



Date of Notice: Monday, August 15, 2011

PUBLIC NOTICE

A PUBLIC MEETING OF THE GOVERNING BOARD OF THE CALIFORNIA EARTHQUAKE AUTHORITY

NOTICE IS HEREBY GIVEN that the Governing Board of the California Earthquake Authority ("CEA") will meet in Sacramento, California. Pursuant to California Insurance Code §10089.7, subdivision (j), the Bagley-Keene Open Meeting Act applies generally to meetings of the Board, and the meeting is open to the public—public participation, comments, and questions will be welcome for each agenda item. All items are appropriate for action if the Governing Board wishes to take action. Agenda items may be taken out of order.

LOCATION: Cal/EPA Building
Sierra Hearing Room (2nd Floor)
1001 I Street
Sacramento, California

DATE: Thursday, August 25, 2011

TIME: 1:00 p.m.

AGENDA:

1. Call to order and member roll call:
 - Governor
 - Treasurer
 - Insurance Commissioner
 - Speaker of the Assembly
 - Chair of the Senate Rules Committee

Establishment of a quorum

2. Consideration and approval of the minutes of the June 30, 2011, Governing Board meeting.

This CEA Governing Board meeting will be broadcast live on the Internet. Please wait until the official start time of the meeting before clicking on either icon:



Audio



Video (with audio)

If you are unable to log into the meeting please call the CEA directly at (916) 325-3800 for further assistance.

3. Chief Executive Officer Glenn Pomeroy will present his executive report; assisted by CEA executive staff, Mr. Pomeroy's report will include an update for the Board on federal and state legislative activities of interest to the CEA.
4. Chief Financial Officer Tim Richison will present a CEA financial report.
5. Mr. Richison will present and seek Board approval of the proposed CEA Financial Structure for 2012.
6. Mr. Pomeroy will seek Board ratification of the CEA's contract with PricewaterhouseCoopers (PwC) and recommend a related budget augmentation for services in support of a CEA organizational and staffing analysis; the Board authorized the contract in June 2011.
7. CEA Advisory Panel Chair Wayne Coulon will summarize the proceedings at the July 21, 2011, Panel meeting.
8. Chief Communications Officer Chris Nance will present, and seek Board approval of, the proposed 2012 Marketing Value Program.
9. Assistant Chief Financial Officer Mark Dawson will brief the Board on the completed CEA fiscal-year-2010 audit by the CEA's independent auditors, Larson & Rosenberger LLP; representatives of that firm will address the Board to elaborate on the written audit report.
10. Mr. Dawson will present to the Board for its consideration and approval the annual transfer to the CEA Mitigation Fund of a statutory portion of monies attributable to CEA investment income earned.
11. Chief Mitigation Officer Janiele Maffei will provide the Board with an update on the CEA's mitigation programs.
12. Chief Operations Officer Bob Stewart and Earthquake Response Manager Dan Dyce will present for Board consideration and approval proposed changes to the CEA's Claim Manual and seek Board authorization to send the approved Claim Manual to the Insurance Commissioner for review and approval.
13. Senior Counsel Joe Zuber will brief the Board on the renewal of the CEA's Directors and Officers and Employment Practices Liability insurance coverages and request the Board's approval to renew the policy and pay the annual policy premium.
14. Mr. Pomeroy will present the results of the appraisal of Chief Actuary Shawna Ackerman's performance under the CEA executive-performance-evaluation plan.
15. The Board will meet in closed session to discuss personnel matters and litigation matters, as permitted by California Government Code section 11126, subdivisions (a) and (e), respectively.
16. Public comment on items that do not appear on this agenda and public requests that those matters be placed on a future agenda.
17. Adjournment.

For further information about this notice or its contents:

General Information:

Susan Pitton
(916) 325-3800
Toll free (877) 797-4300

California Earthquake Authority
801 K Street, Suite 1000
Sacramento, CA 95814-3518
Toll free (877) 797-4300

Media Contact:

Chris Nance
Chief Communications Officer
(916) 325-3827 (Direct)
nancec@calquake.com

To view this notice on the CEA Web site or to learn more about the CEA, please visit
www.EarthquakeAuthority.com

Persons with disabilities may request special accommodations at this or any future Governing Board meeting or may request the accommodation necessary to receive agendas or materials the CEA prepares for its Board meetings.

Please contact Susan Pitton by telephone, toll free, at (877) 797-4300 or by email at pittons@calquake.com. We would appreciate hearing from you at least five days before the meeting date to best allow us to meet your needs.



Draft Meeting Minutes are not available.

Please see CEA Governing Board Meeting
[Approved Minutes.](#)

Governing Board Memorandum

August 25, 2011

Agenda Item 3: Executive Report by Chief Executive Officer Glenn Pomeroy

Recommended Action: No action required – information only

Chief Executive Officer Glenn Pomeroy will present his Executive Report to the Board; assisted by CEA executive staff, Mr. Pomeroy will update the Board on federal and state legislative activities of interest to the CEA.



FINANCIAL REPORT

**GOVERNING BOARD MEETING
THURSDAY, AUGUST 25, 2011
1:00 P.M.**

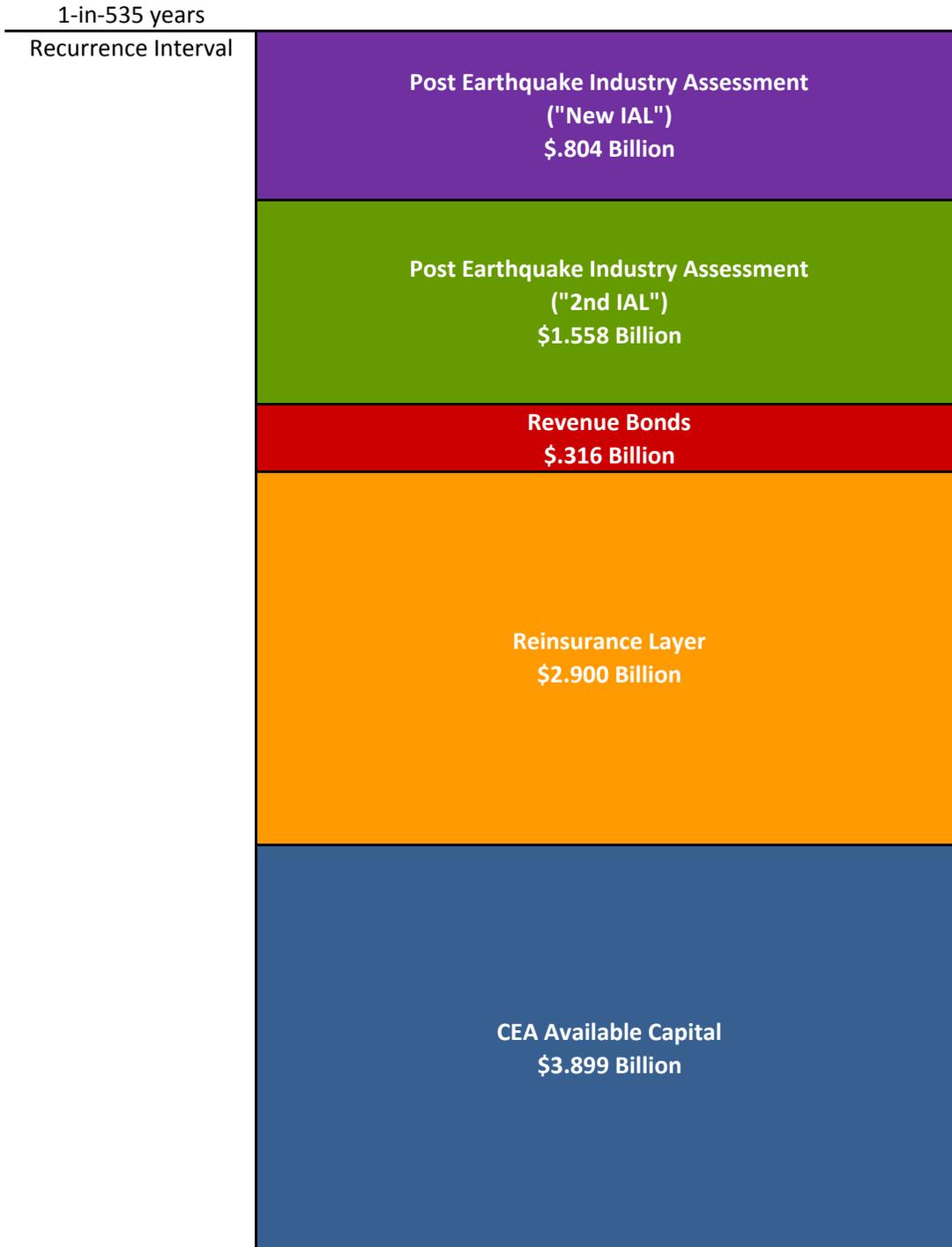
**California Earthquake Authority
Available Capital Report**

Capital as of June 30, 2011

Cash & Investments (includes capital contributions and premiums)	\$ 4,426,624,864 *
Investments from Revenue Bond Proceeds	(315,799,432)
Debt Service (Interest, Principal & Debt Service (Min. Bal.))	(41,170,542)
Interest Receivable	10,906,183
Securities Receivable	0
Premium Receivable	44,350,060
Risk Capital Surcharge Receivable	0
Capital Contributions Receivable	455,826
Other Cash-Related Assets	4,182
Unearned Premium Collected	(225,217,340)
Securities Payable	0
Accounts Payable & Accrued Expenses	(1,379,476)
CEA Available Capital	<u><u>\$ 3,898,774,325</u></u>

* Does not include mitigation cash and investments of \$22,262,068

California Earthquake Authority Claim-paying Capacity as of June 30, 2011



Total \$9.477 Billion

**California Earthquake Authority
Reinsurance Capacity
as of April 1, 2011**

Contract #4a - \$50M 4/1/2011 - 3/31/2012
Contract #4 - \$ 650M 1/1/2011 - 3/31/2012
Contract #3a - \$ 200M 1/1/2011 - 12/31/2011
Contract #3 - \$ 500M 1/1/2011 - 3/31/2012
Contract #2 - \$ 1,300M 1/1/2011 - 12/31/2011
Contract #1 - \$ 200M 1/1/2011 - 12/31/2011

\$3.3B
Reinsurance
Attachment

Total \$2.900 Billion

**California Earthquake Authority
Reinsurance Capacity
as of August 2, 2011**

Reinsurance Contract #4a - \$50M 4/1/2011 - 3/31/2012	5.50% ROL
Reinsurance Contract #4 - \$ 650M 1/1/2011 - 3/31/2012	5.50% ROL
Reinsurance Contract #3a - \$ 200M 1/1/2011 - 12/31/2011	6.00% ROL
Reinsurance Contract #3 - \$ 500M 1/1/2011 - 3/31/2012	6.20% ROL
Reinsurance Contract #2 - \$ 1,300M 1/1/2011 - 12/31/2011	7.50% ROL
Reinsurance Contract #1 - \$ 200M 1/1/2011 - 12/31/2011	8.15% ROL
Transformer Reinsurance Contract A - \$150M 8/2/2011 - 8/1/2014	7.78% ROL

Total \$3.05 Billion

California Earthquake Authority
 Balance Sheet
 As of June 30, 2011

Assets

Cash and investments:	
Cash and cash equivalents	37,707,469
Restricted cash & equivalents	63,551,172
Restricted investments	315,682,014
Investments	<u>4,031,946,277</u>
Total cash and investments	4,448,886,932
Premiums receivable, net of allowance for doubtful accounts of \$10,566,545	44,350,060
Capital contributions receivable	455,826
Risk capital surcharge receivable	-
Interest receivable	10,906,183
Securities receivable	-
Prepaid reinsurance premium	-
Equipment, net	947,895
Deferred policy acquisition costs	41,358,946
Other assets	<u>4,182</u>
Total assets	<u><u>\$ 4,546,910,024</u></u>

Liabilities and Net Assets

Unearned premiums	\$ 307,959,387
Accounts payable and accrued expenses	1,379,476
Claim and claim expense reserves	-
Securities payable	-
Revenue bond payable	189,000,000
Revenue bond interest payable	<u>5,829,705</u>
Total liabilities	<u>504,168,568</u>
Net assets:	
Restricted, expendable	186,120,870
Unrestricted*	<u>3,856,620,586</u>
Total net assets	<u>4,042,741,456</u>
Total liabilities and net assets	<u><u>\$ 4,546,910,024</u></u>

* Includes Cumulative Participating Insurer Contributed Capital of \$756,612,796
 and State of California Contributed Capital of \$161,359,394.

California Earthquake Authority
Statement of Revenues, Expenses and Changes in Net Assets
For the Year-to-Date Ended June 30, 2011

Underwriting income:	
Premiums written	\$ 302,488,318
Less premiums ceded - reinsurance	(96,962,500)
Less risk capital surcharge	-
Net premiums written	<u>205,525,818</u>
Change in unearned premiums	<u>(5,097,165)</u>
Net unearned premiums	<u>(5,097,165)</u>
Net premiums earned	<u>200,428,653</u>
Expenses:	
Claim and claims expense	4,288
Participating Insurer commissions	29,760,880
Participating Insurer operating costs	10,207,169
Reinsurance broker commissions	2,400,000
Pro forma premium taxes	6,755,914
Financing expenses, net	4,086,463
Mitigation Fund expenses	118,209
Other underwriting expenses	<u>8,210,399</u>
Total expenses	<u>61,543,322</u>
Underwriting profit	138,885,331
Net investment income	14,970,927
Other income	190,679
Participating Insurer Contributed Capital	-
State of California premium tax contribution	<u>6,755,914</u>
Increase in net assets	160,802,851
Net assets, beginning of year	<u>3,881,938,605</u>
Net assets, end of year	<u><u>\$ 4,042,741,456</u></u>

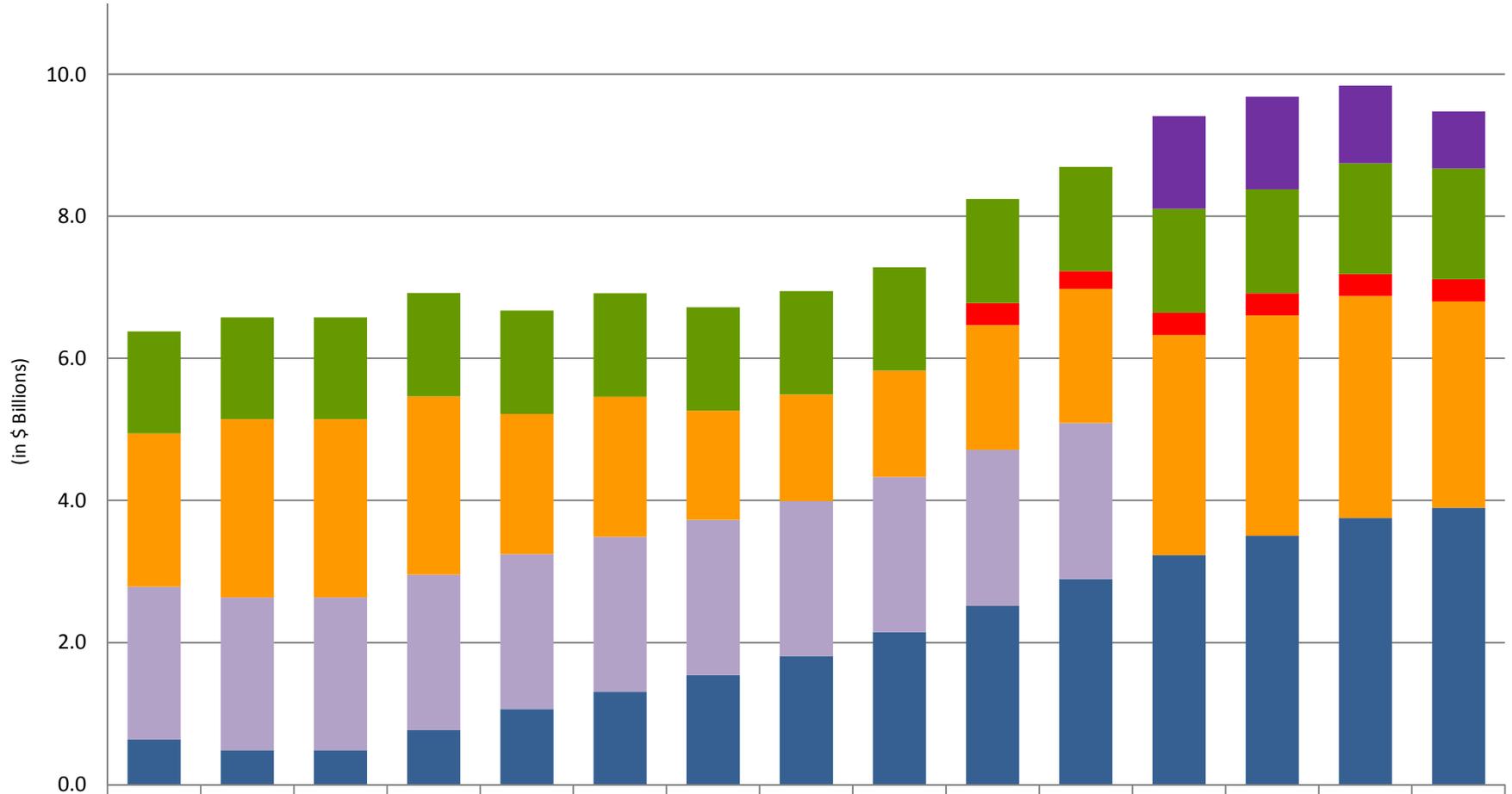
California Earthquake Authority
Insurance Services
Budgeted Expenditures and Actual Expenditures
2011 Budget Year

	(a)	(b)	(c)	(d)	(e)	(f)
	<u>Approved 2011 Budget</u>	<u>Budget Augmentation June 2011</u>	(c=a+b) <u>Augmented Approved 2011 Budget</u>	<u>Actual Expenditures as of 6/30/11</u>	(e=c-d) <u>Remaining Augmented Approved Budget as of 6/30/11</u>	(f=d/c) <u>Percentage of Augmented Approved Budget Used</u>
Salaries & Benefits	\$ 8,383,706	\$ -	\$ 8,383,706	\$ 3,543,347	\$ 4,840,359	42%
Rent	699,880	-	699,880	299,726	400,154	43%
Travel	381,152	-	381,152	119,529	261,623	31%
Non-paid Consultant Travel	842	7,000	7,842	7,566	276	96%
Telecommunications	191,986	-	191,986	99,808	92,178	52%
Training	122,923	-	122,923	92,666	30,257	75%
Insurance	126,362	-	126,362	631	125,731	0%
Board/Panel Services	19,015	-	19,015	10,838	8,177	57%
Administration & Office (Software Maint & Support, Printing & Stationery, Postage)	918,718	-	918,718	457,572	461,146	50%
Administrative Contracted Services						
Data Mgmt Services	778,096	(7,000)	771,096	112,322	658,774	15%
Other Administrative Contracted	40,208	-	40,208	17,682	22,526	44%
Furniture/Equipment						
Under \$500	8,300	-	8,300	(95,645)	103,945	(1152%)
Over \$500	19,000	-	19,000	9,744	9,256	51%
EDP Hardware/Software						
Under \$500	26,238	-	26,238	19,583	6,655	75%
Over \$500	557,400	-	557,400	(86,799)	644,199	(16%)
Capital Lease Obligations	-	-	-	-	-	
Marketing & Outreach	-	-	-	-	-	
Legal Expenses - Intervenor's Fees	-	-	-	-	-	
Dept of Insurance Examination	55,000	-	55,000	24,128	30,872	44%
Total Operating Expenses	12,328,826	-	12,328,826	4,632,698	7,696,128	38%
Consulting Services						
Actuarial	25,000	-	25,000	-	25,000	0%
Claims	10,000	-	10,000	-	10,000	0%
Information Technology	50,000	-	50,000	-	50,000	0%
Information Tech. Security	-	-	-	-	-	0%
Financial Consulting	175,000	-	175,000	98,181	76,819	56%
Marketing Research	-	-	-	-	-	0%
Other Consulting Services	1,387,000	-	1,387,000	436,603	950,397	31%
Total Consulting Services	1,647,000	-	1,647,000	534,784	1,112,216	32%

**California Earthquake Authority
Insurance Services
Budgeted Expenditures and Actual Expenditures
2011 Budget Year**

	(a)	(b)	(c)	(d)	(e)	(f)
	<u>Approved 2011 Budget</u>	<u>Budget Augmentation June 2011</u>	<u>(c=a+b) Augmented Approved 2011 Budget</u>	<u>Actual Expenditures as of 6/30/11</u>	<u>(e=c-d) Remaining Augmented Approved Budget as of 6/30/11</u>	<u>(f=d/c) Percentage of Augmented Approved Budget Used</u>
Research	1,018,000		1,018,000	259,000	759,000	25%
Contracted Services						
Agent Services	50,000	-	50,000	-	50,000	0%
Audit Service	125,000	-	125,000	-	125,000	0%
Brochure/Information Products	25,000	-	25,000	131	24,869	1%
Business System Development	-	-	-	-	-	0%
Communications	110,000	-	110,000	-	110,000	0%
Consumer Services	50,000	-	50,000	-	50,000	0%
Contracted Marketing & Outreach	390,000	-	390,000	84,365	305,635	22%
Dynamic Financial Analysis	-	-	-	-	-	0%
Investment Compliance	-	-	-	-	-	0%
Legal Services-Claims Counsel	200,000	-	200,000	-	200,000	0%
Legal Service - Non-Claims	2,707,690	-	2,707,690	574,539	2,133,151	21%
Modeling Service	1,451,000	-	1,451,000	261,000	1,190,000	18%
Marketing Services	5,288,360	-	5,288,360	1,184,518	4,103,842	22%
Web Development/Maintenance	30,975	-	30,975	-	30,975	0%
Other Contracted Services	1,199,900	-	1,199,900	69,914	1,129,986	6%
Total Contracted Services	11,627,925	-	11,627,925	2,174,467	9,453,458	19%
Investment Expenses	2,455,000	-	2,455,000	920,727	1,534,273	38%
Financing Expenses	10,999,793	-	10,999,793	5,974,654	5,025,139	54%
Catastrophe Bonds	-	-	-	-	-	0%
Reinsurance	225,555,000	-	225,555,000	99,362,500	126,192,500	44%
Total Expenditures	\$ 264,613,544	\$ -	\$ 264,613,544	\$ 113,599,830	\$ 151,013,714	43%

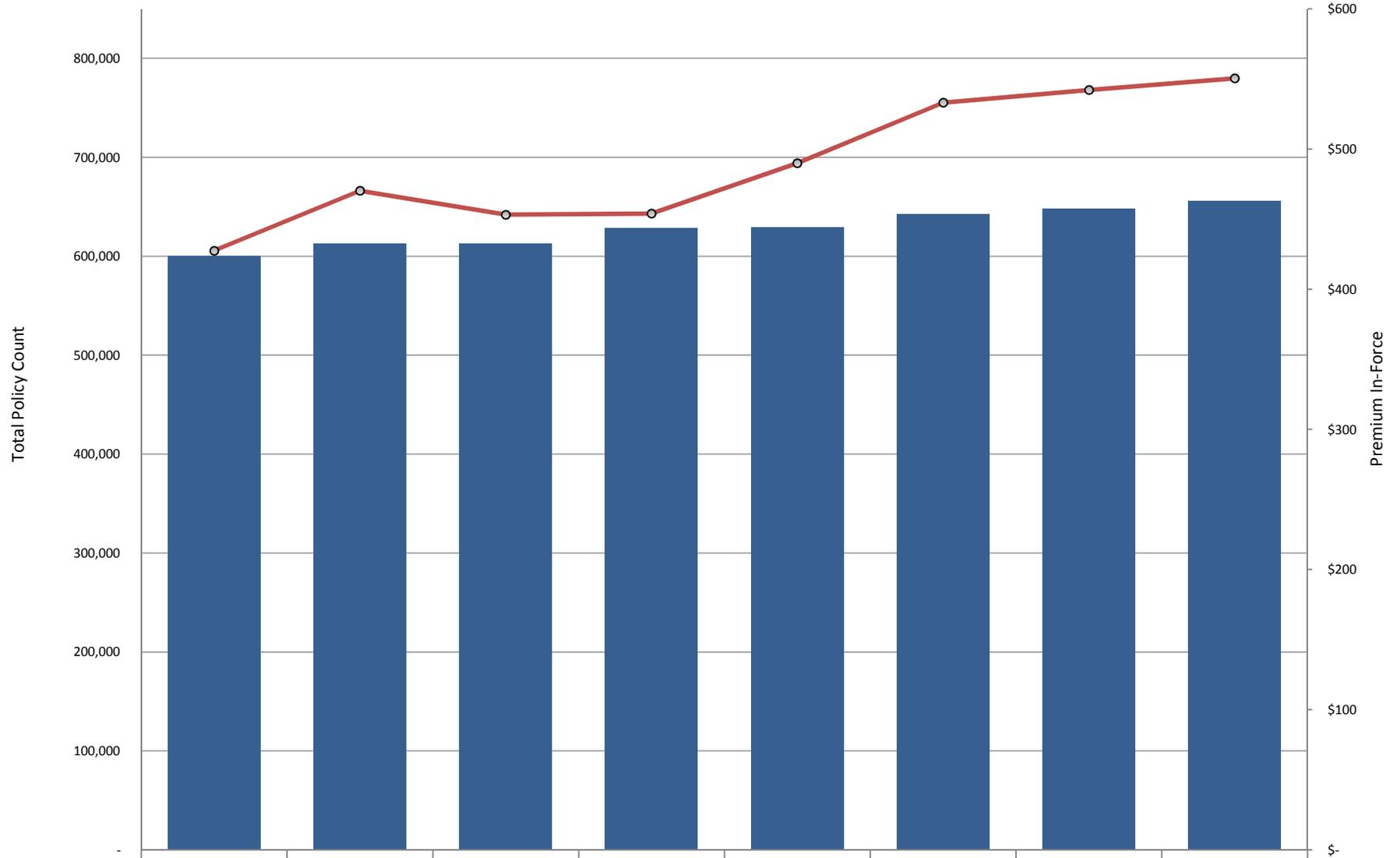
**California Earthquake Authority
Total Claim-paying Capacity (CPC)
as of June 30, 2011**



	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total CPC	\$7.095	\$7.293	\$7.293	\$7.635	\$7.360	\$7.373	\$7.069	\$6.948	\$7.284	\$8.244	\$8.695	\$9.411	\$9.685	\$9.840	\$9.477
New Industry Assessment	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	1.304	1.304	1.095	0.804
2nd Industry Assessment	1.434	1.434	1.434	1.456	1.456	1.456	1.456	1.456	1.456	1.465	1.465	1.465	1.465	1.558	1.558
Revenue Bonds	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.311	0.254	0.311	0.311	0.311	0.316
Reinsurance	2.160	2.509	2.509	2.509	1.971	1.971	1.538	1.500	1.500	1.756	1.885	3.100	3.100	3.123	2.900
1st Industry Assessment	2.150	2.150	2.150	2.183	2.183	2.183	2.183	2.183	2.183	2.197	2.197	0.000	0.000	0.000	0.000
CEA Available Capital	0.635	0.485	0.485	0.772	1.064	1.307	1.544	1.809	2.145	2.515	2.894	3.231	3.505	3.753	3.899

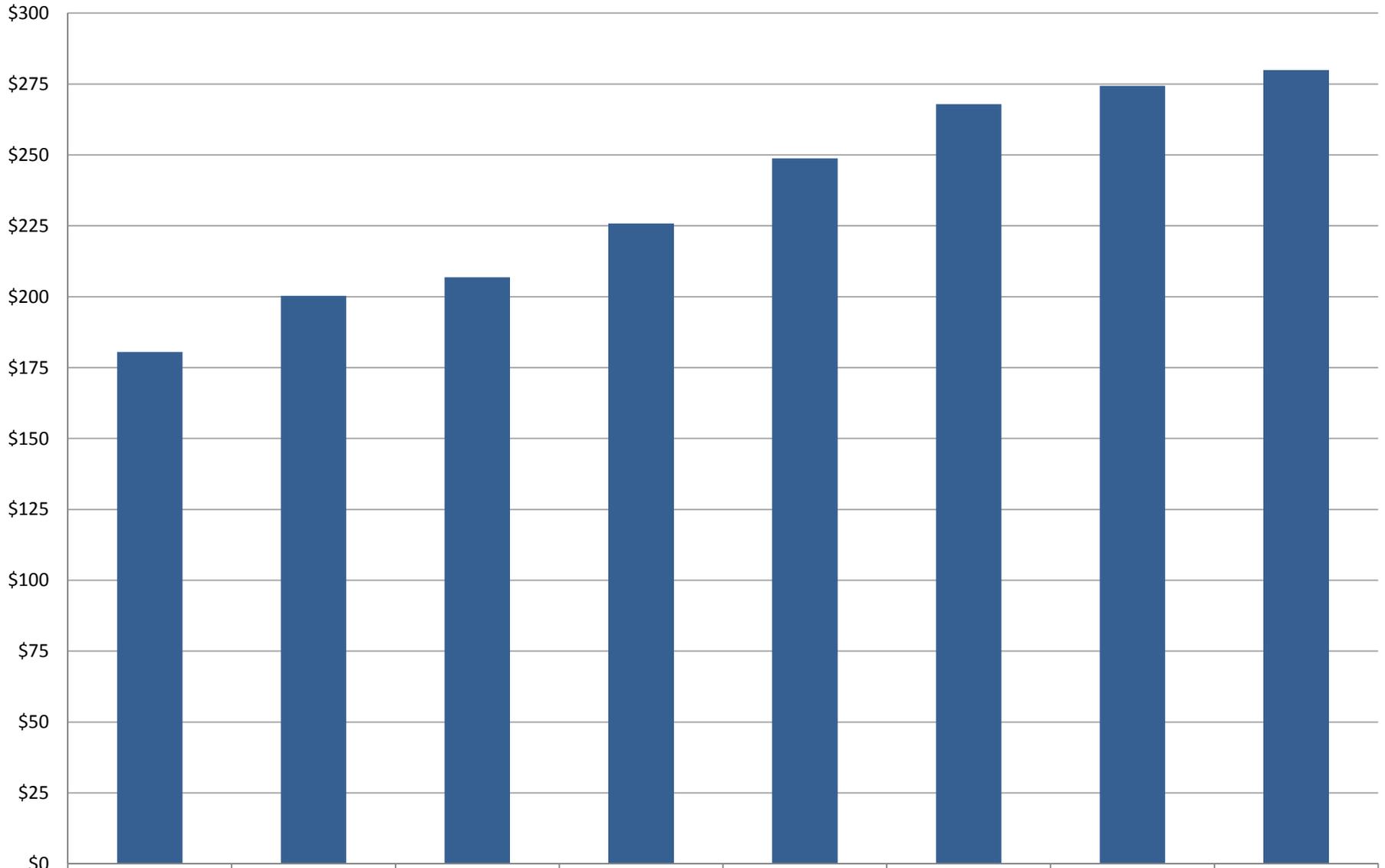
NOTE: In 2007 Revenue Bond proceeds were split between the Base and Supplement programs.

California Earthquake Authority Homeowner Policy Count and Premium In-Force as of June 30, 2011



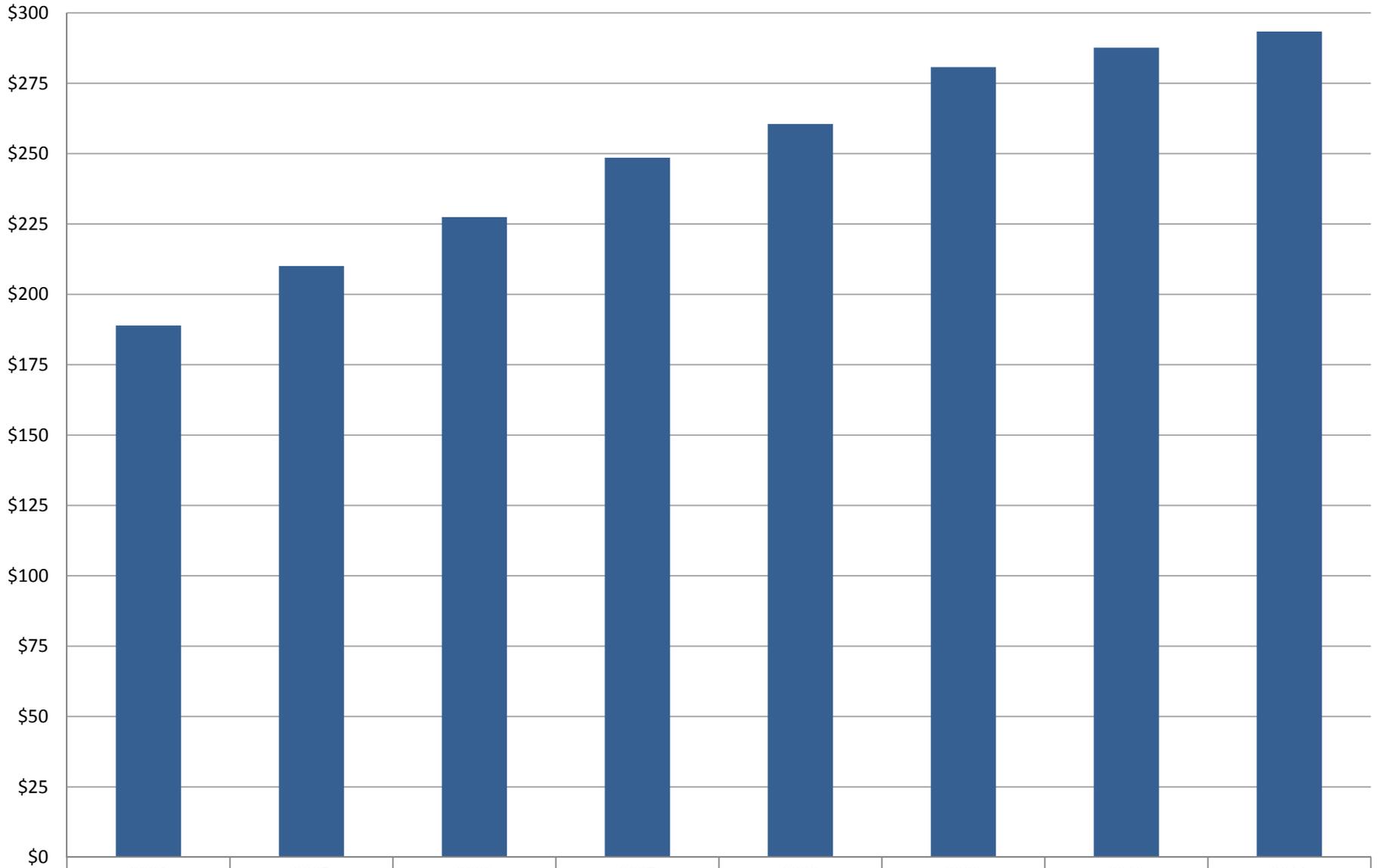
Total Policy Count	600,673	613,266	612,941	628,802	629,138	642,174	647,947	655,592
Total Premium in Force (in \$ Millions)	\$427.5	\$470.2	\$453.2	\$454.0	\$489.9	\$533.1	\$542.1	\$550.4
Annual Change in Policy Count	0.0%	2.1%	-0.1%	2.6%	0.1%	2.1%	0.9%	1.2%
Annual Change in Premium	0.0%	10.0%	-3.6%	0.2%	7.9%	8.8%	1.7%	1.5%

**California Earthquake Authority
Homeowner Policy Total Insured Value (TIV)
as of June 30, 2011**



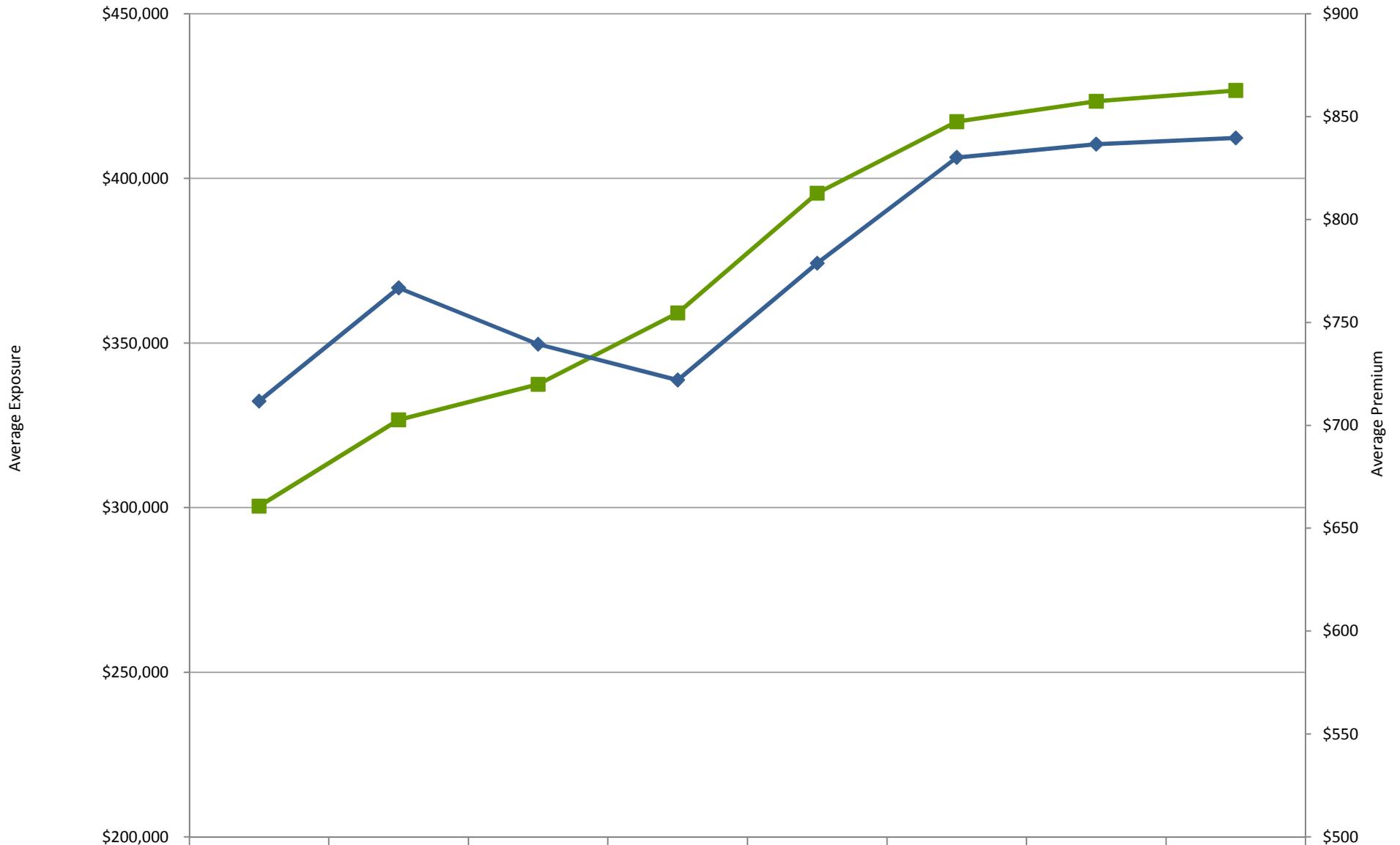
	2004	2005	2006	2007	2008	2009	2010	2011
TIV (in \$ Billions)	\$180.5	\$200.3	\$206.8	\$225.8	\$248.8	\$267.9	\$274.3	\$279.7
Annual Change in TIV	0.00%	11.00%	3.25%	9.17%	10.19%	7.68%	10.26%	1.96%

**California Earthquake Authority
Total Insured Value (TIV)
as of June 30, 2011**



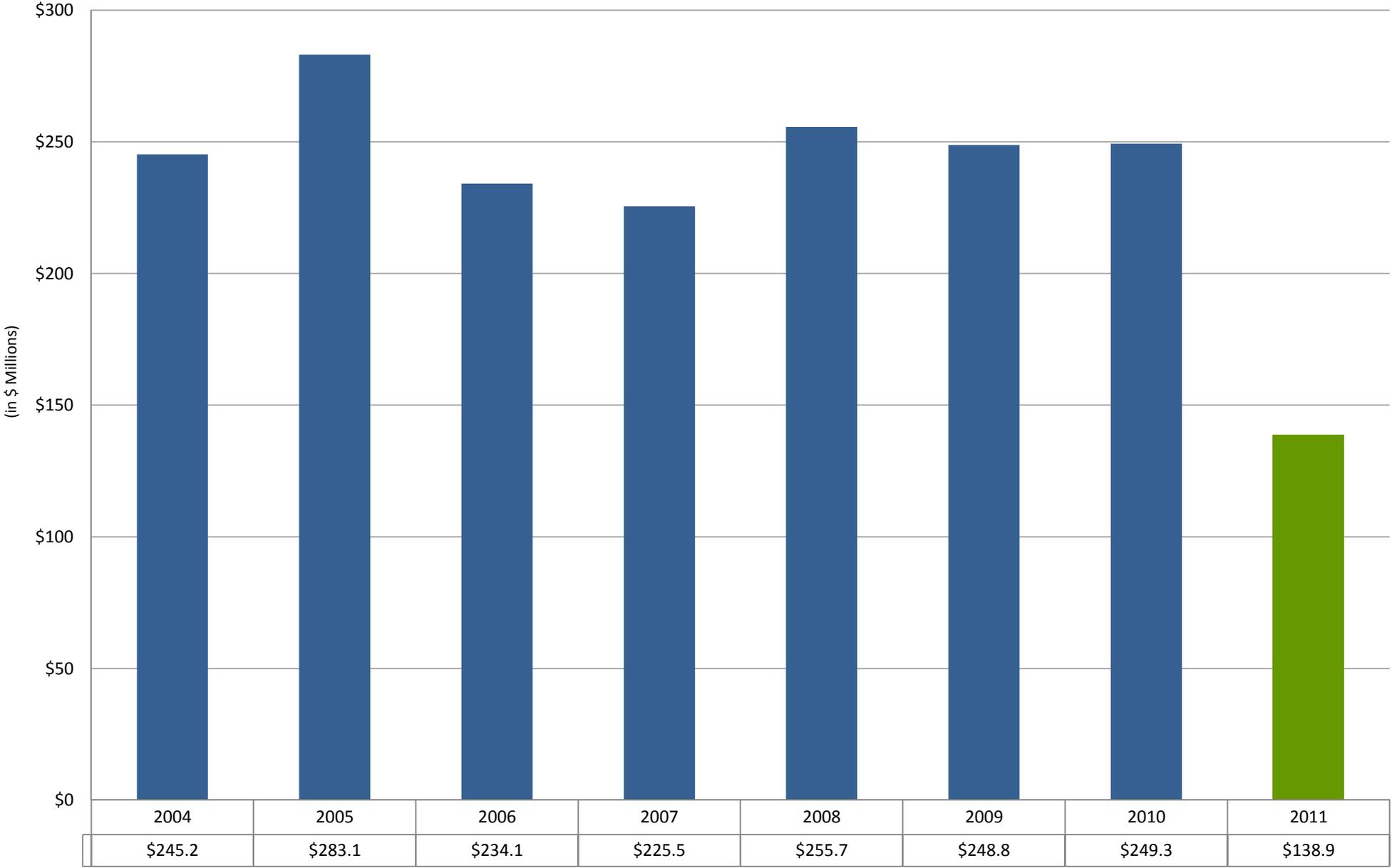
	2004	2005	2006	2007	2008	2009	2010	2011
TIV (in \$ Billions)	\$188.9	\$210.0	\$227.4	\$248.6	\$260.5	\$280.7	\$287.6	\$293.4
Annual Change in TIV	9.6%	11.2%	8.3%	9.3%	4.8%	7.8%	10.4%	4.5%

**California Earthquake Authority
Average Homeowner Policy Premium and Insured Value
as of June 30, 2011**



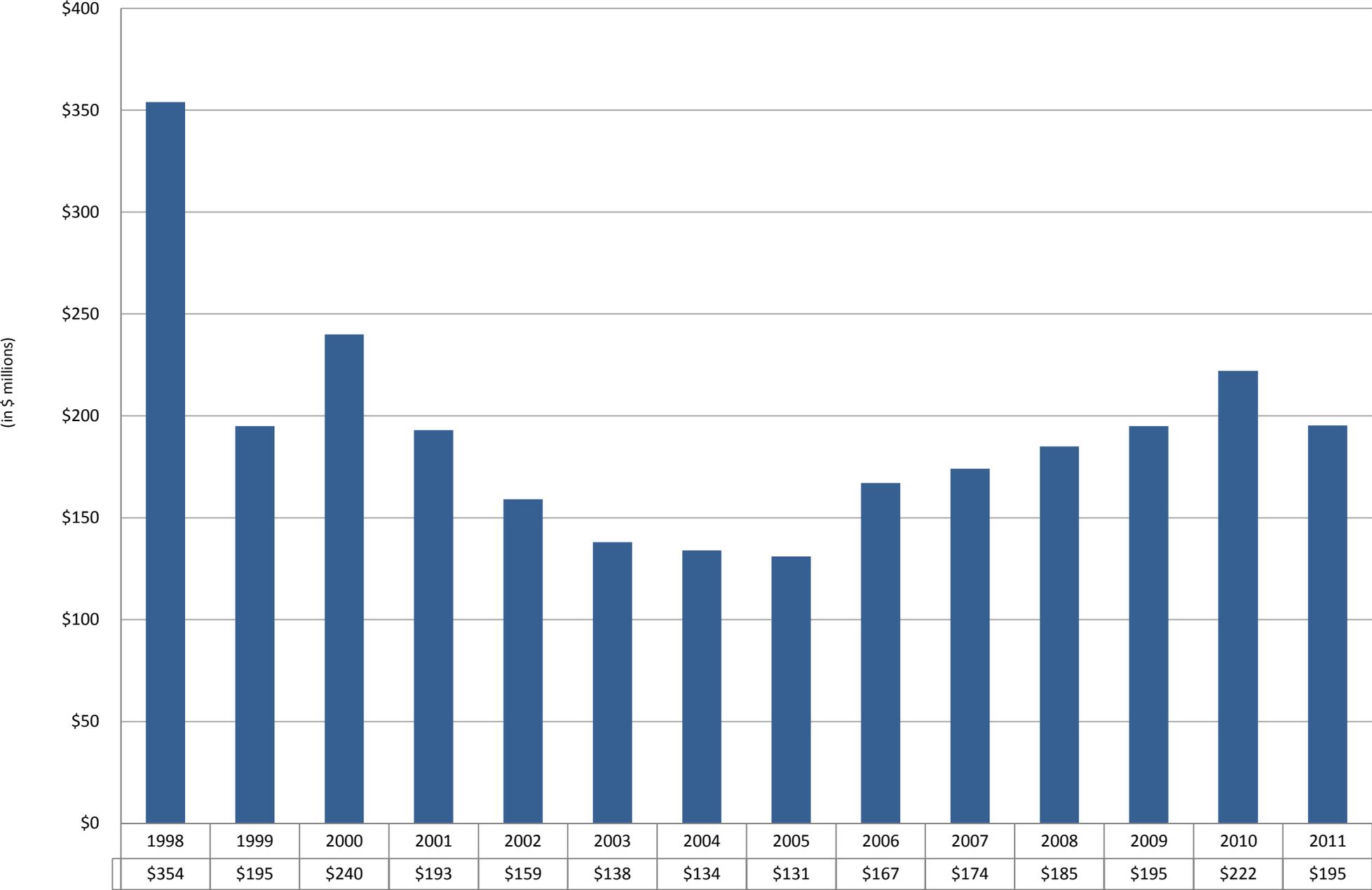
■ Average Insured Value	2004	2005	2006	2007	2008	2009	2010	2011
	\$300,458	\$326,668	\$337,455	\$359,110	\$395,483	\$417,206	\$423,414	\$426,699
◆ Average Premium	\$712	\$767	\$739	\$722	\$779	\$830	\$837	\$840

**California Earthquake Authority
Annual Capital Accumulated from Premium
as of June 30, 2011**

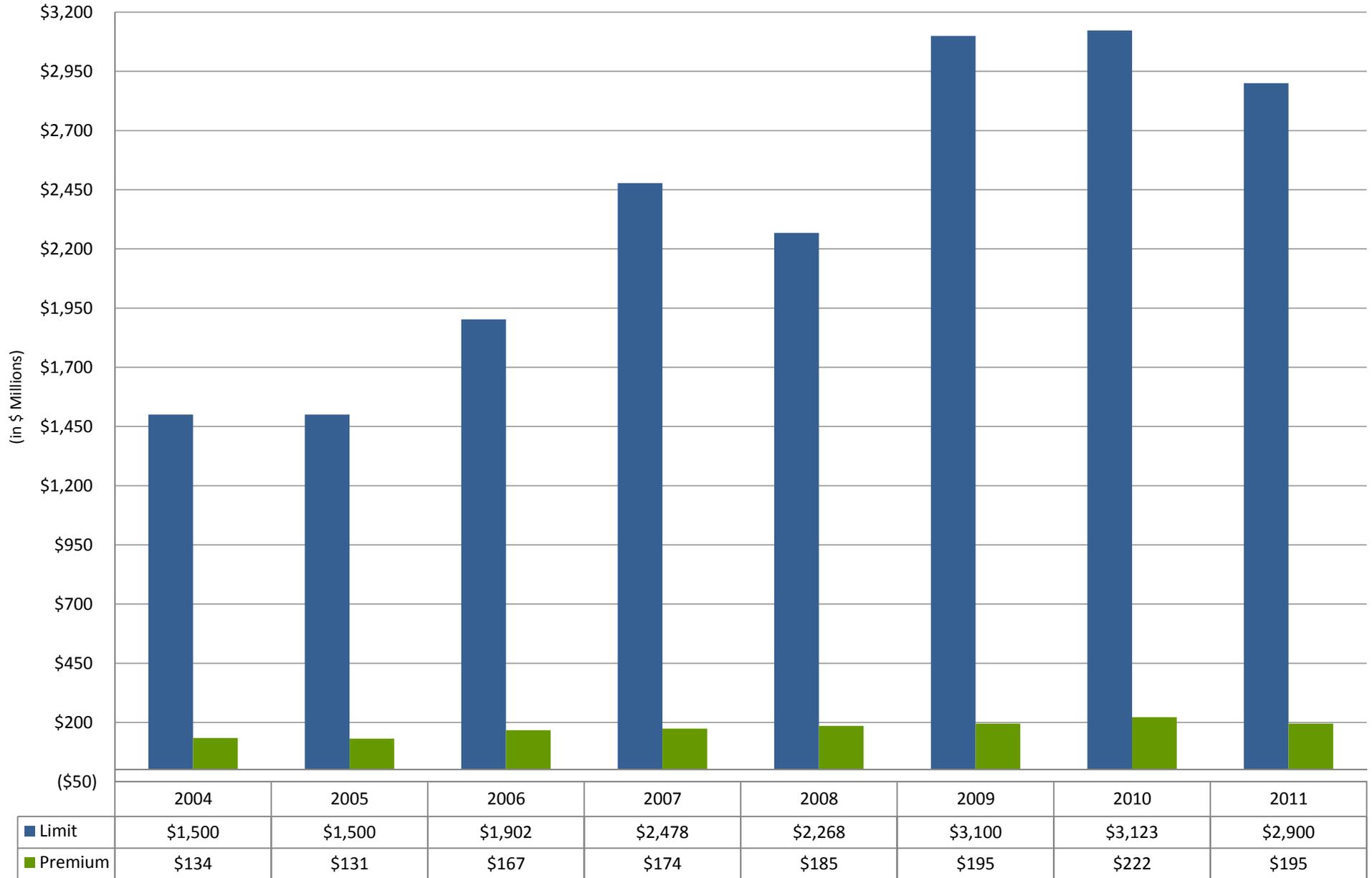


NOTE: From 2010 forward, figure is GASB underwriting profit. Prior to 2010, figure was FASB net premiums written minus total expenses.

**California Earthquake Authority
Annual Reinsurance Premium Expense**

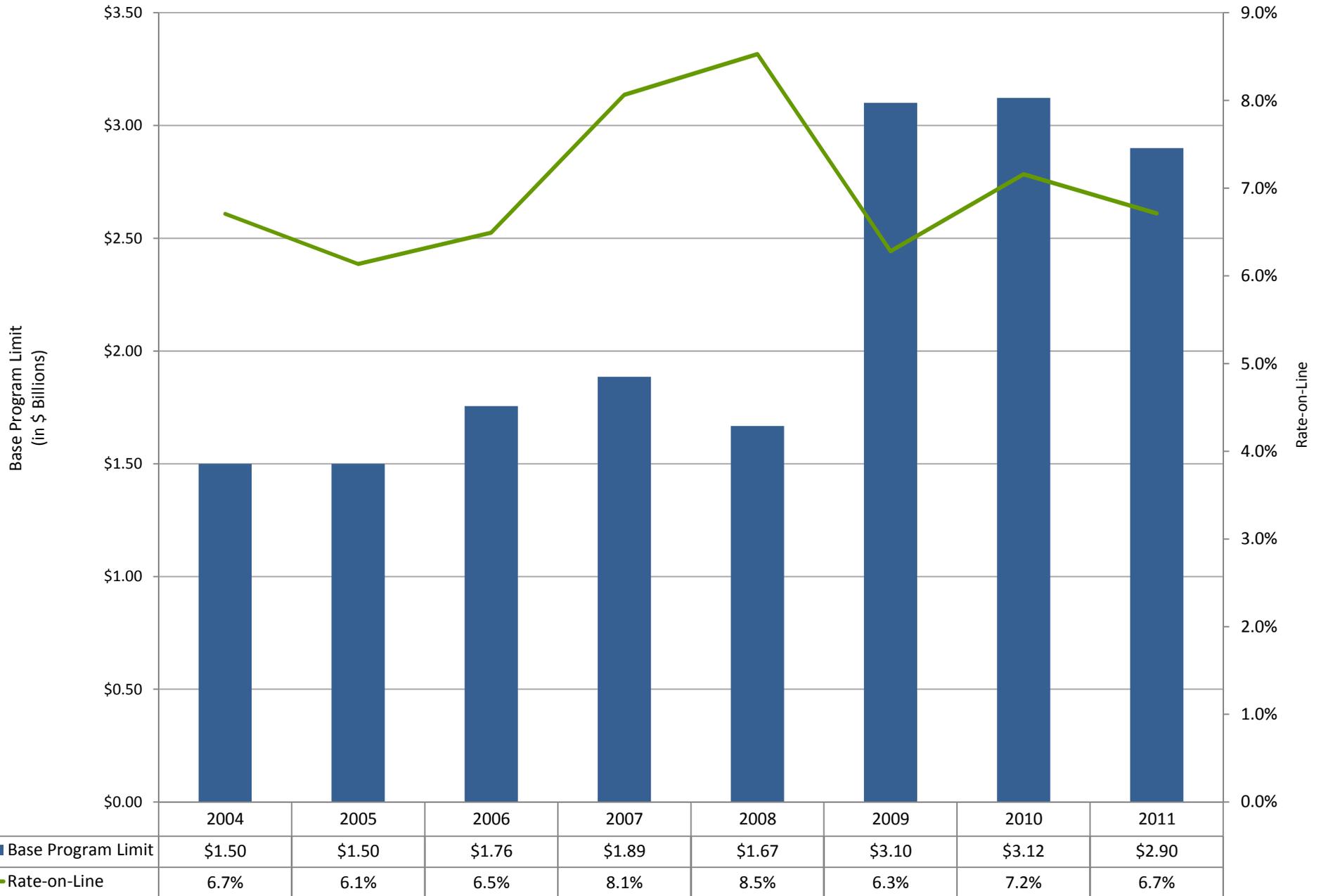


California Earthquake Authority Annual Reinsurance Premium and Limit



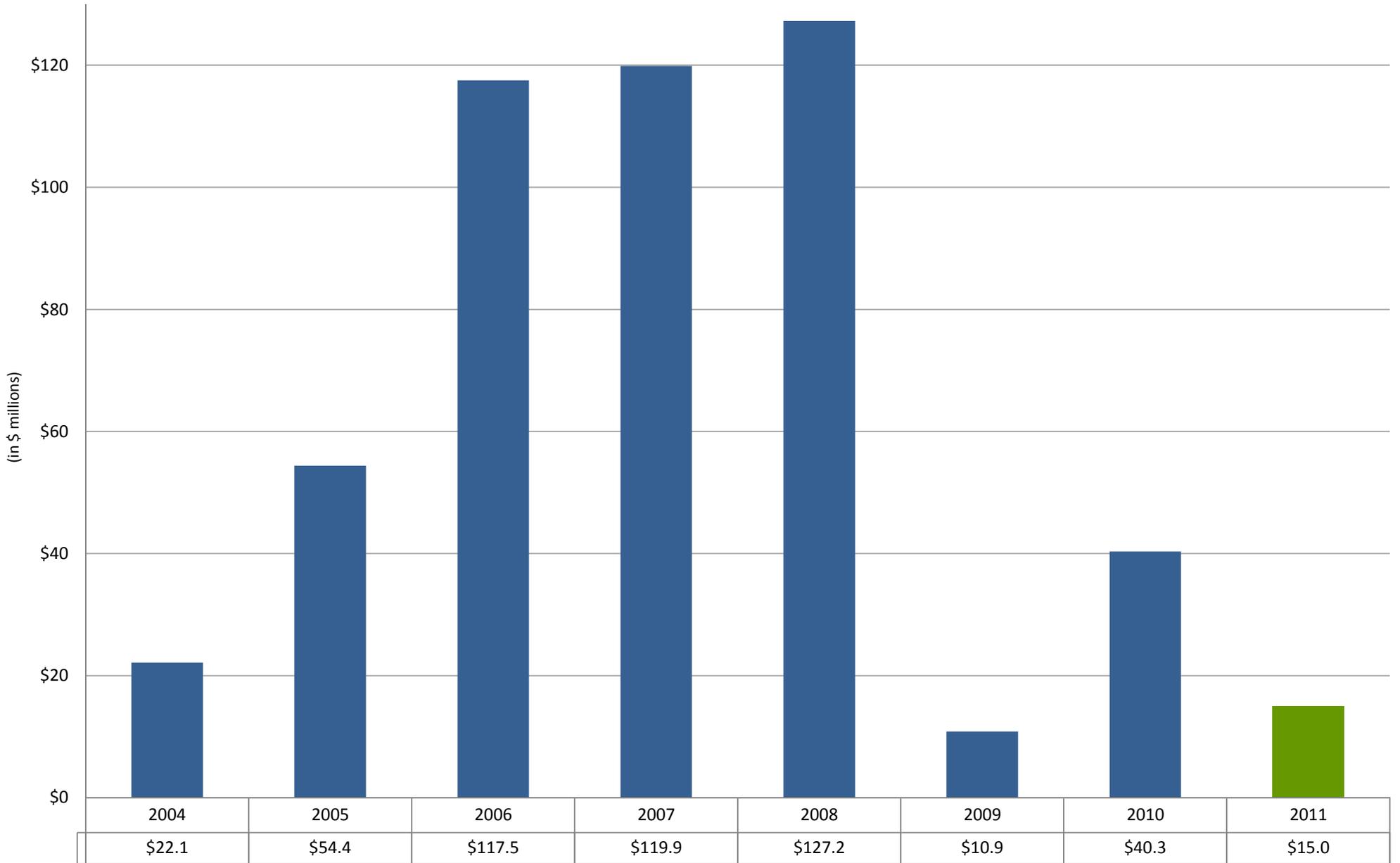
NOTE: Limits through 2005 do not include supplemental coverage while 2006 forward include supplemental coverage.

California Earthquake Authority Reinsurance Base Program Limits and Rate-on-Line



NOTE: The Rate on Line is a weighted average of the individual layers and their respective rates.

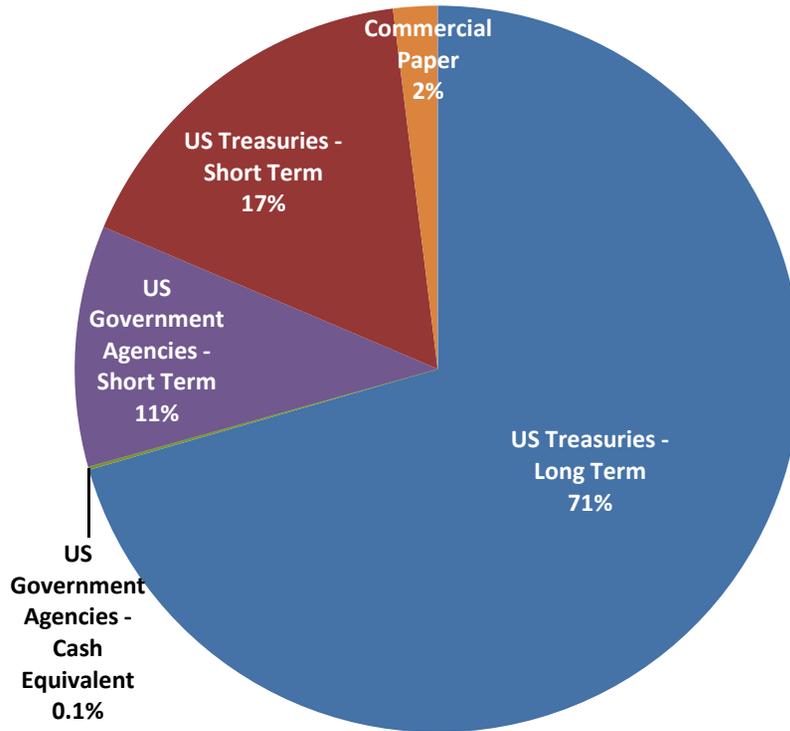
**California Earthquake Authority
Annual Investment Income
as of June 30, 2011**



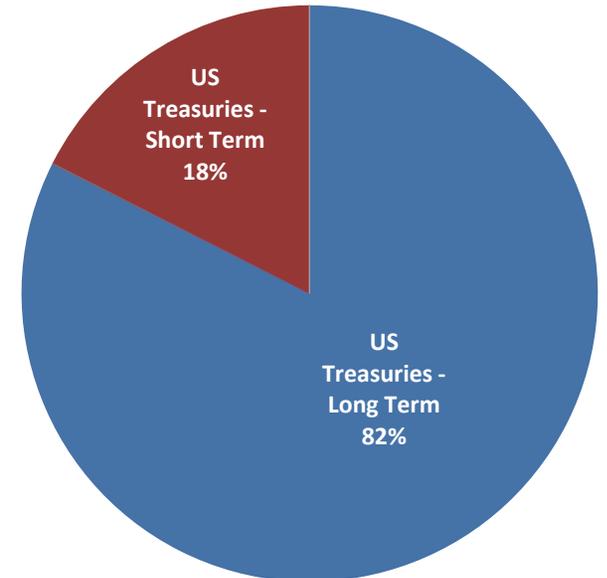
NOTE: Prior to 2011, investment income was reported from FASB financial statements which did not include unrealized gains or losses.

**California Earthquake Authority
Investment Portfolio Distribution
as of June 30, 2011**

CEA Fund
\$ 4,067.9 Million



Claim-Paying Fund
\$ 315.8 Million



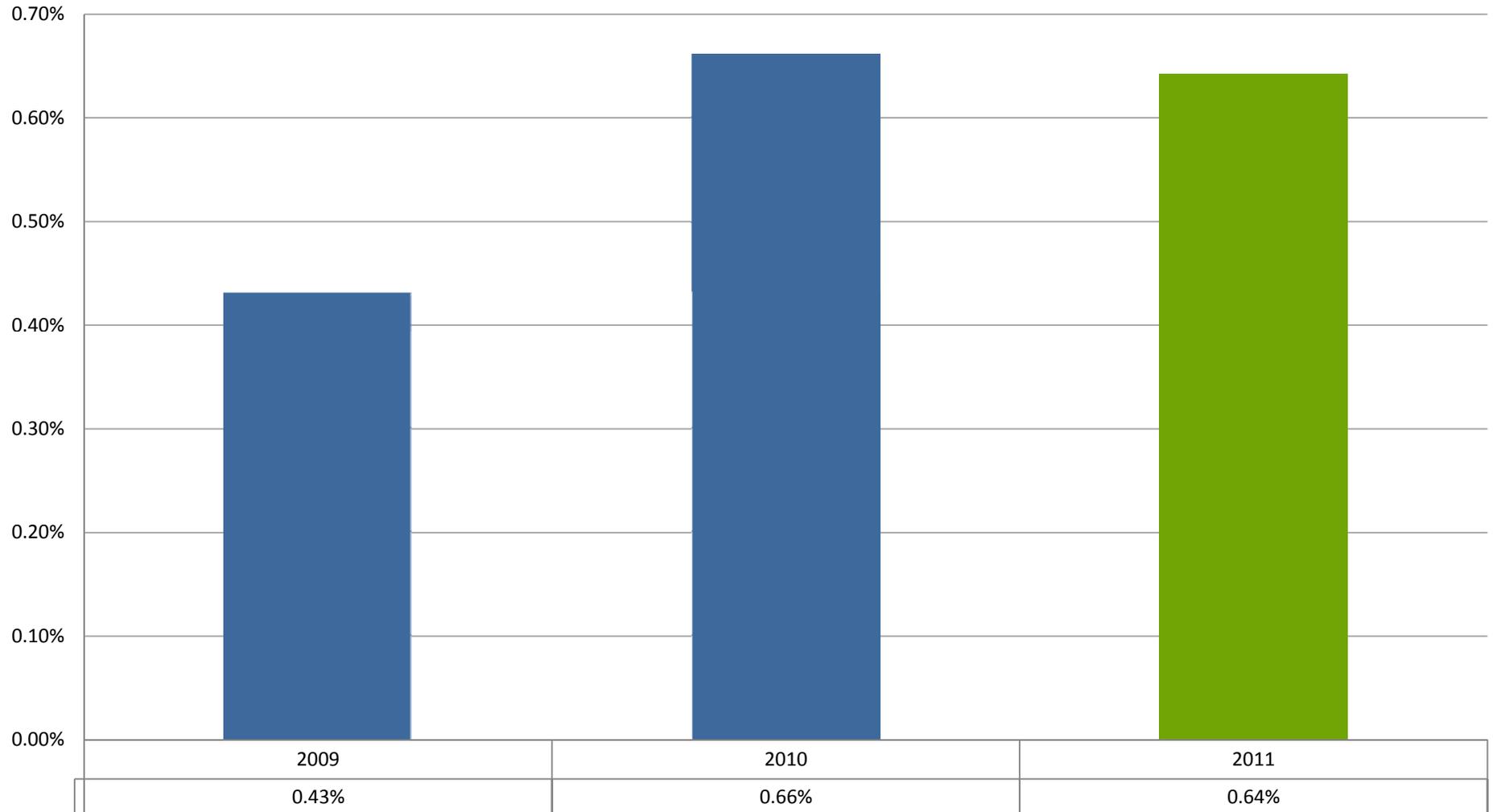
Mitigation Fund
\$ 22.3 Million



Term to Maturity Definitions

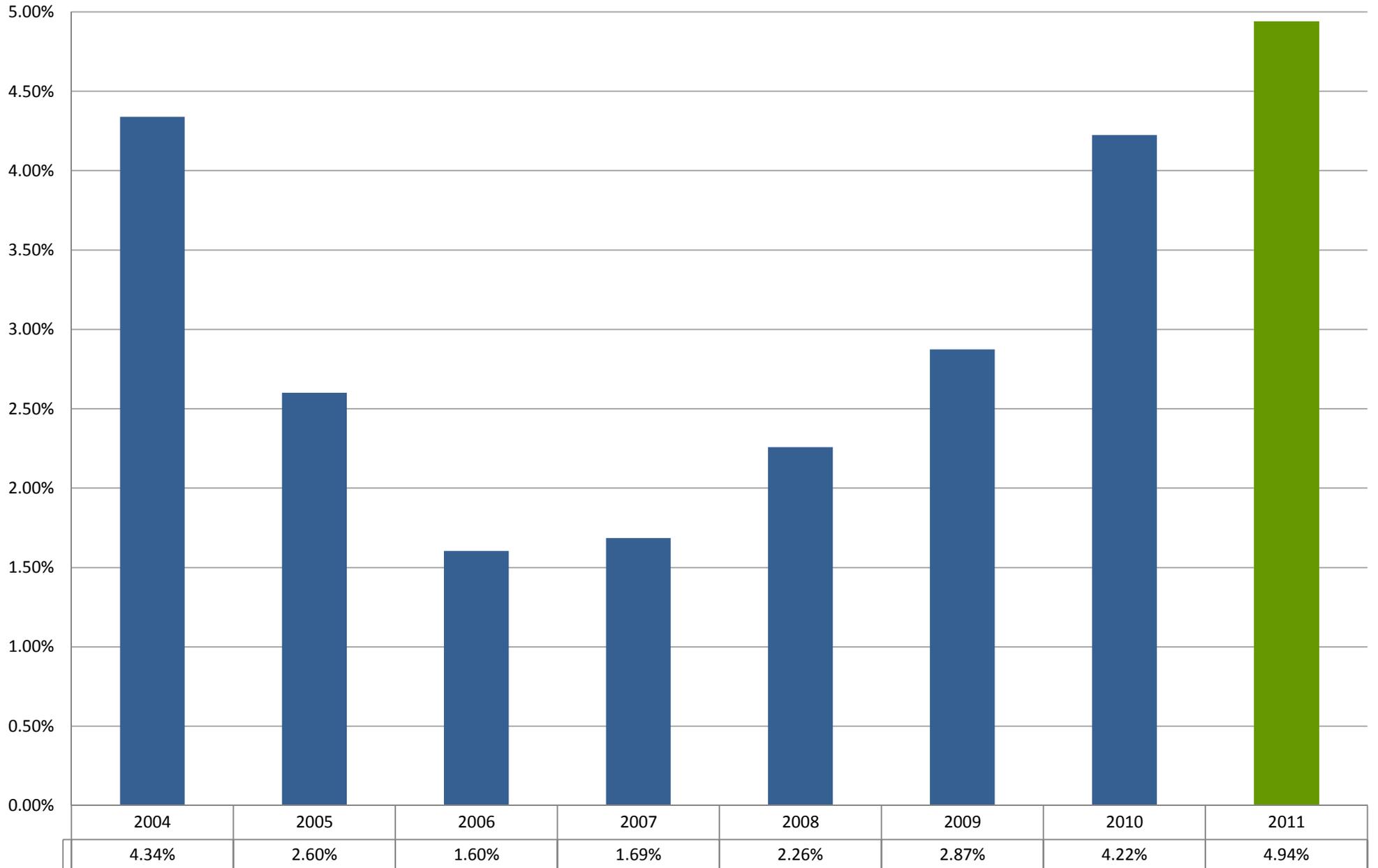
<u>Classification</u>	<u>Trade Date to Maturity</u>
Long Term	≥ 1 year
Short Term	< 1 year and ≥ 90 days
Cash Equivalent	< 90 days

**California Earthquake Authority
12-Month Rolling Investment Return
as of June 30, 2011**



NOTE: Gross of Investment Manager Fees

**California Earthquake Authority
Investment Manager Fees as a Percentage of Investment Income
as of June 30, 2011**



**California Earthquake Authority
Schedule of Outstanding Debt**

DEBT	ISSUANCE AMOUNT	INTEREST RATE	NET PROCEEDS	OUTSTANDING PRINCIPAL	AS OF DATE
Series 2006 Revenue Bonds	\$ 315,000,000	6.169%	\$ 310,829,067	\$ 189,000,000	30-Jun-2011

DEBT SERVICE SCHEDULE

The table below shows the remaining annual debt service requirements for the Series 2006 Bonds.

Period Ending	Outstanding Principal	Principal	Interest	Debt Service	Annual Debt Service
1-Jan-11	\$189,000,000		\$5,829,705	\$5,829,705	
1-Jul-11	\$157,500,000	\$31,500,000	\$5,829,705	\$37,329,705	
2011					\$43,159,410
1-Jan-12	\$157,500,000		\$4,858,088	\$4,858,088	
1-Jul-12	\$126,000,000	\$31,500,000	\$4,858,088	\$36,358,088	
2012					\$41,216,175
1-Jan-13	\$126,000,000		\$3,886,470	\$3,886,470	
1-Jul-13	\$94,500,000	\$31,500,000	\$3,886,470	\$35,386,470	
2013					\$39,272,940
1-Jan-14	\$94,500,000		\$2,914,853	\$2,914,853	
1-Jul-14	\$63,000,000	\$31,500,000	\$2,914,853	\$34,414,853	
2014					\$37,329,705
1-Jan-15	\$63,000,000		\$1,943,235	\$1,943,235	
1-Jul-15	\$31,500,000	\$31,500,000	\$1,943,235	\$33,443,235	
2015					\$35,386,470
1-Jan-16	\$31,500,000		\$971,618	\$971,618	
1-Jul-16		\$31,500,000	\$971,618	\$32,471,618	
2016					\$33,443,235

Governing Board Memorandum

August 25, 2011

Agenda Item 5: Presentation to Governing Board of (Proposed) 2012 CEA
Financial Structure and Capacity

Recommended Action: Approve Proposed 2012 CEA Financial Structure and Capacity

Background:

Each year, staff recommends to the Governing Board a financial structure for the next calendar year of operations. In its search for the optimal sources of claim-paying capacity for 2012, staff has been challenged to balance the following objectives:

1. Remain financially sound, by maintaining claim-paying capacity sufficient for policyholder claims in the event of an earthquake while retaining financial-strength ratings.
2. Provide a more valuable service to consumers, by using a financial structure that makes CEA insurance as affordable as possible and supports the capacity necessary to provide earthquake coverage to more Californians.
3. Generate stability and longevity for the Authority, through a financial structure that ensures the CEA's continuation, and enhances its ability to serve policyholders, after a significant earthquake or series of earthquakes.

The staff analysis and recommendations focus on these priorities.

Analysis:

In arriving at a recommended financial structure, staff thoroughly analyzed claim-paying-capacity sources both used and contemplated in prior years, as well as potential new capacity sources, to determine their viability for the coming year. Given recent, well publicized shifts in financial markets, this exhaustive approach was particularly important, to ensure that all potential resources were evaluated, given current pricing and market-capacity estimates.

The CEA has historically used the three leading earthquake modeling firms – EQECAT, RMS, and AIR – to assist the CEA in analyzing both the nature and the magnitude of risks presented by the CEA's insurance portfolio.

Then, last year the CEA assembled a project team of three actuaries with deep knowledge of catastrophe insurance and the use of models, to recommend how best to use all three models in analyzing the CEA's annual claim-paying capacity. The team's method provided weights of

each model, before application of “demand surge.”¹ The modeling firms have not changed their earthquake models since last year’s analysis, so the use of modeled results has not changed. The following are the weights staff used to recommend the 2012 financial structure:

Modeling Firm	Weight Accorded
EQECAT	50%
AIR	25%
RMS	25%

Proposed CEA claim-paying capacity for 2012 (at 1-in-500 years):	
Modeled losses <i>(1-in-500 level, with no adjustments for demand surge, loss adjustment expense, or exposure growth)</i>	\$6,798,625,501
Exposure adjustment <i>(anticipated growth in 2011)</i>	\$ 382,636,126
Demand-surge adjustment	\$ 1,795,315,407
Loss adjustment expense <i>(Includes loss adjustment expense for participating insurers and CEA)</i>	\$ 852,774,818
Proposed 2012 claim-paying capacity (at 1-in-500 years):	\$ 9,829,351,852

Historically, the CEA has relied heavily on reinsurance — predominantly, traditional reinsurance — for approximately one-third of its total claim-paying capacity. With the recent, highly successful transformer-reinsurance transaction completed, however, the CEA has access to the capital markets for risk transfer, which means an additional strong source of claim-paying capacity and risk transfer, going forward.

- CEA’s risk-transfer purchases (both traditional and transformer reinsurance) that have been required to meet the CEA’s capacity needs is, and has been for years, a significant recurring expense. This major expense requires CEA to charge high premium rates to its policyholders, while a large piece of CEA’s reinsurance premiums paid pass directly to offshore reinsurers.

¹ Demand surge is post-event inflation of the costs of reconstruction and repair, caused by short supplies of both construction material and labor; typically the larger the event, the larger the inflationary effect.

- The nature of catastrophe reinsurance is that the capacity it affords is purchased, but it is rarely used, given the low-frequency, high-damage events that catastrophe insurance is designed to cover — this mirrors the CEA’s experience to date. Through 2011, the CEA will have paid some \$2.9 billion in reinsurance premium for an (average) annual reinsurance capacity of over \$2 billion, but has received just \$267,457 in reinsurance loss recoveries.
- Reinsurance itself is not without uncertainty. Available capacity and price are subject to market conditions, global catastrophes, and other factors beyond CEA’s control. Multi-year reinsurance contracts (such as provided by the recent transformer-reinsurance transaction) relieves some uncertainty, but there remain risks. While staff believes the reinsurance limits CEA is likely to require for 2012 will be obtainable, there is simply no guarantee that the capacity demanded by the CEA in the future will be available at the desired pricing.
- Because CEA has a financial structure that depends heavily on reinsurance, any potential limits on reinsurance-market capacity will constrain the overall claim-paying capacity of the CEA — and that can hinder CEA’s ability to provide affordable earthquake coverage to more Californians.

As a result, staff continues to believe strongly that the ability to reliably access post-event borrowing is absolutely necessary for CEA’s long-term health. Post-event borrowing would partially replace reinsurance (now a major source of CEA claim-paying capacity), and if one or more earthquakes exhaust other (non-debt) claim-paying capacity, CEA would issue post-event bonds, as necessary, to meet its claim obligations.

As currently contemplated, CEA post-event borrowing would use a two-tiered approach to the capital markets:

1. Tier one. As capital-market appetite permits, CEA would first attempt to issue debt secured solely by CEA revenues; if achievable, such debt would be tax-exempt to bondholders and would offer the CEA interest rates more favorable than debt that is taxable to bondholders.
2. Tier two. If CEA’s financing needs exceed what is available through CEA-revenue-only bonds, access to additional investors (including foreign investors) could be achieved through federally guaranteed, post-event borrowing that is taxable to bondholders, explained in further detail below.

Staff firmly believes that the proposed federal legislation, providing committed but limited federal guarantees of CEA’s post-event debt, would benefit CEA’s policyholders by diversifying CEA finances to include post-event borrowing for lower-cost claim-paying capacity. In addition, placing into the capital markets federally guaranteed post-event debt would afford CEA broader capital access (after exhausting tax-exempt potential) by allowing the CEA access to investors seeking taxable, federally guaranteed debt.

That such a federal guarantee can open markets was evidenced in recent years by the TLGP (Temporary Liquidity Guarantee Program) launch, which allowed FDIC-insured banks facing limited or expensive capital-markets access to issue federally guaranteed bonds. This program has been a major success, with over \$334 billion of debt issued since October 2008.

The concept of federally guaranteed bonds is embodied in legislation now pending in Congress—staff has briefed the Board on its status.

Federally guaranteed CEA bonds offer several advantages, any of which informs solutions to CEA capacity issues:

- Placing post-event borrowing in the CEA financial structure maximizes policyholder savings: the cost of post-event borrowing is zero until the debt is incurred. Removing in part the recurring high cost of reinsurance (and other pre-paid risk transfer) minimizes costs—lower costs translate directly to premium-rate reductions for policyholders and maximum capital growth for the CEA.
- Post-event borrowing means significantly lower expenses, making CEA products more affordable, increasing access to CEA earthquake policies and facilitating statewide earthquake take-up.
- Post-event borrowing creates capacity in a financially secure structure, one which can handle the policyholder growth the Board is actively seeking.
- The increased capacity that comes with post-event borrowing would also allow CEA to offer new products, providing consumers with more choices for financial protection.

Conclusions

The proposed 2012 financial structure assumes a risk-transfer program that includes the purchase of both traditional and transformer reinsurance, together providing 30 percent of CEA's 2012 claim-paying-capacity needs.

Details of the Proposed 2012 CEA Financial Structure:

The proposed 2012 CEA financial structure continues a layer of risk-transfer (traditional and transformer reinsurance), which added to other layers provides a total claim-paying capacity of, at a minimum, a least a 1-in-500-year level.

- To provide a claim-paying capacity of 1-in-500 years at January 1, 2012, the proposed 2012 CEA risk-transfer program must provide \$3.120 billion in capacity.
- By law, the CEA's New IAL will be subject to its annual 5% roll-off on April 1, 2012, which is estimated to decrease the New IAL by \$233 million. Additional CEA revenues in the 1st quarter of 2012 are not projected to offset this decrease; staff is providing a proposed claim-paying capacity as of April 1, 2012 that includes an increase in risk-transfer of \$163 million, after the New IAL roll-off.

The 2011 risk transfer program was divided into components.

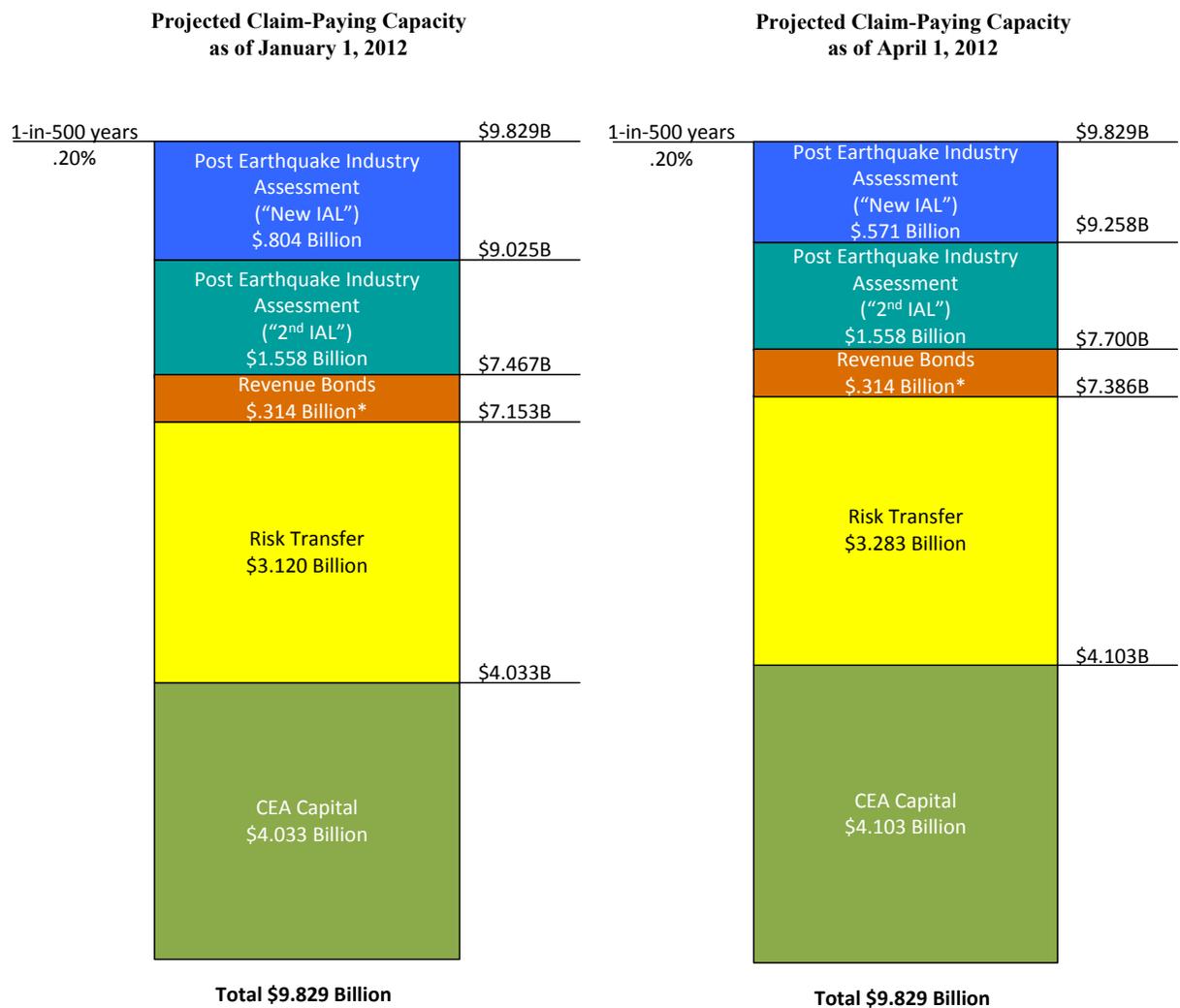
- CEA purchased traditional reinsurance of \$1.700 million for one-year (from January 1, 2011, through December 31, 2011);

- CEA purchased traditional reinsurance of \$1,150 million for 15 months (from January 1, 2011, through March 31, 2012); and
- CEA purchased an additional \$50 million of traditional reinsurance for one year (from April 1, 2011, through March 31, 2012).

With the 2011 risk-transfer program and the recently completed transformer-reinsurance transaction, the proposed 2012 risk transfer program will require the following capacity levels to achieve a 1-in-500-year claim-paying-capacity level.

- \$ 1,770 million of risk-transfer effective on January 1, 2012; and
- \$ 1,363 million of additional risk-transfer effective on April 1, 2012.

The proposed financial structures as of January 1st and April 1st, 2012, are depicted below.



*based on market value

Recommendations:

Staff recommends the Board direct staff to:

1. Proceed with obtaining the proposed 2012 risk-transfer program composed of traditional and transformer reinsurance, as below:
 - \$ 1,770 million of risk-transfer effective on January 1, 2012; and
 - \$ 1,363 million of risk-transfer effective on April 1, 2012.
2. Bring to the Board at its October 2012 meeting a recommendation for the CEA's 2012 risk-transfer program (consisting of traditional and transformer reinsurance).

Governing Board Memorandum

August 25, 2011

Agenda Item 6: Staff request for Board ratification of contract executed with PricewaterhouseCoopers (PwC) for an organization and staffing analysis; approval of a related 2011 budget augmentation

Recommended Action: CEA staff requests the Board ratification of the CEA-PwC contract for an organization and staffing analysis, supported by a related 2011 budget augmentation.

Background:

On June 30, 2011 the Governing Board authorized CEO Glenn Pomeroy to negotiate and execute a contract with PricewaterhouseCoopers (PwC), the consulting firm selected through a competitive-procurement process to complete an organization and staffing analysis of the California Earthquake Authority.

The contract has been negotiated and executed and is presented to the Board for ratification. A copy of the executed contract is provided as *Attachment A*.

In addition, staff recommends that the CEA's 2011 Budget be augmented to support the project, using a new Consulting Services category, "Administration Consulting."

Analysis:

Many aspects of CEA operations and even its overall purpose and prospects have evolved dramatically over the past 15 years. For that reason, CEA executive staff has recommended completion of an independent assessment of various elements of the organization, including overall structure, roles, and staffing levels.

Since its inception, the CEA has been the leading provider of residential earthquake insurance in California and an organization of influence in the global earthquake and finance communities. The CEA is broadly recognized as a worldwide thought leader in developing creative residential-earthquake products and related pricing structures; has set the standard for residential earthquake risk-transfer strategies; is developing leadership roles for the marketing of residential earthquake insurance and loss mitigation products; and has been an influential supporter of earthquake research.

In addition, the CEA is currently expanding its sphere of influence relating to earthquake-loss mitigation and preparedness under the direction of a newly hired Chief Mitigation Officer.

Recent complications in CEA's implementation of new rates, revised policy forms, a new product, and related (and required) systems enhancements have plainly illustrated certain inefficiencies inherent in the current operating structure. That is, some participating insurers' aged computer systems present difficulties that are labor-intensive and costly, inhibiting CEA's ability to effect timely, needed change.

Recognizing the absolute importance and necessity of an organizational paradigm that incorporates smart strategies based on an optimal, mutually beneficial ease-of-doing-business model, CEA executive staff initiated a competitive process to identify a consulting firm specializing in property and casualty insurance operations to complete an independent assessment of various elements of the organization, including structure, roles, and staffing levels.

The CEA released a Request for Qualifications and Proposals – RFQ #02-11 – to invite consultants and consulting firms with demonstrated expertise and success in organizing and optimizing insurance-operations efforts (and ancillary business and business-related activities) of property and casualty insurance organizations to submit qualifications and a proposal to the CEA. *Attachment B* is a copy of RFQ #02-11.

Following a national advertising effort, submission of proposals, and a selection process, PwC was selected as the firm to lead the analysis. PwC is helping CEA assess the effectiveness of current elements of the organization, including structure, roles, and staffing levels, and is consulting with CEA and other interested parties and stakeholders in preparing near- and mid-term future assessments and recommendations of organizational direction, efficiency, and effectiveness.

The services being provided by PwC during the five-phase, 12-week project are described in the contract (*Attachment A*) under Attachment 2 – Engagement Letter.

The project has been successfully launched and has included participation by a broad range of key stakeholders. *Attachment C* provides an overview of the project and includes a status report.

Recommended Actions:

CEA staff requests the Board (1) ratify the contract executed by CEO Glenn Pomeroy, as authorized by the Board on June 30, 2011, with PricewaterhouseCoopers (PwC) and (2) approve a related CEA 2011 budget augmentation to include the project under a new Consulting Services category, Administration Consulting.

AGREEMENT TO PROVIDE CONSULTING SERVICES

This Agreement is entered into in Sacramento, California, by and between the California Earthquake Authority ("CEA"), a public instrumentality of the State of California, and PricewaterhouseCoopers LLP ("PwC"), a limited liability partnership organized under the laws of the State of Delaware. This Agreement is effective July 18, 2011.

In consideration of the mutual promises in this Agreement and the payment of fees for professional services provided for below, the parties make the following agreement:

1. Agreement

The CEA hereby retains PwC to provide consulting services in accordance with the CEA's RFQ #02-11, Request for Qualifications and Proposals, Organization and Staffing Analysis ("the RFQ") and PwC's proposal submitted in response thereto, and to perform the requested services and create and produce requested reports and deliverables stated in the Engagement Letter attached to this Agreement as Attachment 2 and incorporated into this Agreement by this reference, according to the terms and conditions set forth in Attachment 2 and subject to certain additional terms and conditions set forth in this Agreement. In the event of any conflict or inconsistency between any such documents, the following documents will take precedence in the following order: Attachment 2; this Agreement; PwC's response to the RFQ; and the RFQ.

2. Scope of Services

PwC will provide the services requested in the RFQ, in accordance with PwC's written proposal submitted in response to the RFQ. In accordance with the RFQ and PwC's proposal in response to the RFQ, PwC will perform the services described in the Engagement Letter attached to this Agreement as Attachment 2, and will provide the deliverables described in the Engagement Letter attached to this Agreement as Attachment 2.

3. Term of the Agreement

This Agreement will remain in effect for one year, subject to this Agreement's provisions regarding Termination (Section 13). By giving written notice to PwC, the CEA may, at its sole discretion, extend the term of this Agreement for up to two additional six-month periods, on the same pricing basis, and on the same terms and conditions, as the initial contract period.

4. Contractor's Status and Requirements

- a) In any matter arising out of this engagement, PwC will not portray itself as a representative of the CEA unless the CEA expressly so authorizes. PwC's contractors and employees are not, and will not portray themselves as, CEA employees, and no CEA

employee or contractor is considered an employee of PwC. Neither PwC nor its contractors or employees is not entitled to any benefits provided by the CEA, or by the State of California, to its employees.

- b) This Agreement creates a relationship of independent contractor. CEA is interested only in the results to be achieved under this Agreement; the conduct of the work will lie solely with PwC. The work PwC performs under this Agreement, however, must meet the general approval of the CEA, is subject to PwC's professional, legal, and ethical standards, and will be subject to the CEA's general right to secure its satisfactory completion in accordance with the acceptance criteria, as set forth in Section 8.
- c) CEA may during the term of this Agreement engage employees or other independent contractors to perform the same work that PwC performs under this Agreement.
- d) PwC will manage the hours it is to work in performance of its services, and CEA will rely on PwC to work the hours necessary to fulfill the terms of the Agreement. Because the payment arrangements for this engagement are based on hourly fees, however, PwC must keep the CEA apprised of the charges it has incurred and must notify the CEA promptly if any extraordinary fees are anticipated. PwC agrees that its hours and charges will not exceed those stated in the "Fees and Expenses" section of the Engagement Letter attached as Attachment 1 of this Agreement without the CEA's prior written authorization.
- e) PwC must maintain at its expense all necessary insurance for its personnel, including but not limited to workers' compensation, state disability insurance, and unemployment insurance, and a policy or endorsement of comprehensive general liability insurance that names the CEA as an additional insured in a face amount of not less than \$2 million. PwC will promptly provide CEA with certificates of insurance and evidence of insurance coverages on written request.
- f) PwC is and will be responsible for, and indemnify, defend, and hold the CEA and the State of California harmless from and against, any and all liability for or arising out of PwC's obligations for employment taxes, workers' compensation and workers' compensation insurance, state disability or unemployment insurance, and any and all premiums or claims arising out of any of those things, levied on or directly attributable to the services arising out of this Agreement rendered by PwC and PwC's personnel, including PwC's subcontractors. For purposes of this subsection, the term "CEA" means and includes the California Earthquake Authority, its Governing Board and each Board member and designee, the CEA Advisory Panel and each Panel member, and all employees, agents, attorneys, representatives, and contractors of the CEA.
- g) PwC will render its services at any location it determines convenient and reasonable, but PwC acknowledges, however, that the CEA may require it to perform certain work or provide certain reports under this Agreement at the CEA offices or other locations in Sacramento, California, the CEA may designate from time to time.

- h) PwC agrees to use commercially reasonable efforts to meet the delivery schedule set forth in Attachment 2 of this Agreement.

5. Required Personnel and Staffing

- a) PwC agrees to provide all personnel necessary, adjudged by PwC, and acceptable to CEA, as qualified, to perform the services under the Agreement.
- b) The CEA has the right in its sole discretion to reject the assignment of any subcontractors PwC proposes to hire to perform any part of the Services, which right must be exercised in a reasonable manner.

6. Billing Rate—As Specified in Agreement Exhibit

The applicable billing rates for PwC's personnel to be used in this engagement are specified in the in "Fees and Expenses" section of Attachment 2.

7. Travel and Travel-Related Expenses

- a) If requested by CEA or otherwise required by the nature of work under this Agreement and approved by CEA, PwC personnel must travel for project-related tasks.
- b) CEA will reimburse PwC for travel and living expenses at the rates and on the terms noted in the CEA travel expense schedule attached to this Agreement as Attachment 4. If PwC cannot reasonably obtain lodging, airfare, or other travel-related items at the rates established in Attachment 4, then the expenses will be reimbursed in accordance with PwC's travel policies in effect as of the date of travel, which must be furnished to CEA on request; provided, however, that CEA will not reimburse PwC for the cost of first-class air travel or other travel expenses incurred at a deluxe or first-class level under any circumstances.

8. Invoices/Acceptance

- a) Contractor must submit itemized invoices, no more frequently than monthly, in arrears for services already performed. The CEA will make no payments in advance of services rendered. Invoices must include:
 - i. Contractor's name, address and telephone number
 - ii. an itemized description of services, including a detailed cost breakdown;
 - iii. total amount of the invoice.
 - iv. project name

Invoices must be addressed to: California Earthquake Authority
Accounts Payable
801 K Street, Suite 1000
Sacramento, CA 95814

- b) CEA will pay undisputed invoices within 30 days of receipt.
- c) The passage of 30 working days from the date when a project deliverable or output (each, a "Deliverable") is provided to CEA without receipt by PwC of notice of dispute by CEA will constitute acceptance by CEA. Any such notice of dispute provided by CEA must specify in reasonable detail why the Deliverable fails, in material respects, to meet the requirements of this Agreement. As a general matter, CEA agrees that it will accept Deliverables that comply, in all material respects, with the requirements of this Agreement. As used in this paragraph, the term "acceptance" means only that the CEA accepts its obligation to pay for the Deliverable in the amount invoiced by PwC, but the term "acceptance" does not mean or imply that CEA is satisfied with the Deliverable or that CEA acknowledges or admits the Deliverable is free of defects or is otherwise proper.
- d) Unless authorized in advance in writing by the CEA, PwC's aggregate invoices for services rendered pursuant to this Agreement, including both fees and reimbursable costs, must not exceed \$704,342.

9. Contractor's Warranties

- a) PwC warrants that all services it provides under this Agreement and under any related exhibits and schedules will be performed in a professional manner by qualified personnel, in good faith and in accordance with American Institute of Certified Public Accountants ("AICPA") guidelines. PwC DISCLAIMS ALL OTHER WARRANTIES EXPRESS OR IMPLIED, OR WHETHER ARISING BY COURSE OF DEALING OR PERFORMANCE, CUSTOM, USAGE IN THE TRADE OR PROFESSION OR OTHERWISE, INCLUDING BUT NOT LIMITED TO, IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE.
- b) PwC warrants that as of the date of execution of this Agreement, to the best of its knowledge, it is not under any legal obligation that limits or prohibits it from providing to the CEA the services provided for in this Agreement.
- c) **No Conflicts of Interest.** By its signature on this Agreement, PwC warrants to CEA that, to the knowledge of the undersigned, no conflict of interest exists on the part of its employees assigned to perform services under this Agreement, or on the part of any of its key personnel or key subcontractors, that would influence its advice and recommendations to, and activities on behalf of, the CEA. PwC promises to provide CEA with any requested assurances and information concerning any potential, claimed, apparent, or actual conflict of interest that may be brought to PwC's or CEA's attention. PwC will abide in good faith by any protocols developed by CEA to identify, disclose, and address potential, claimed, apparent, and actual conflicts of interest.
- d) **Fair Political Practices Laws and Related Matters.** PwC must not directly or indirectly exploit for its own benefit, or take or receive any benefit, from information PwC obtains from the CEA, provides to the CEA, or receives or provides on behalf of

CEA; provided, however, that PwC may provide services to other persons or entities (including developing materials that are competitive with those produced as a result of the services provided under this Agreement), but only to the extent permitted under both the Fair Political Practices laws of California and the standards of the AICPA and other organizations whose pronouncements regulate PwC's work under this engagement. PwC must disclose to CEA any personal investment or economic interest of PwC personnel that, to the knowledge of any of PwC's Key Personnel, may be deemed to be enhanced by any recommendation made to or activity undertaken on behalf of the CEA. PwC acknowledges that the CEA is subject to the provisions of the Fair Political Practices laws of California (Government Code Section 81000, et seq., and the regulations adopted under that law), and PwC must comply with all requirements of that law and those regulations. If requested by CEA, PwC must obligate its Key Personnel, or their permitted substitutes, to file with CEA Statements of Economic Interests (the State of California's Form 700) in compliance with CEA's conflict of interest code (please see California Code of Regulations, Title 5, Part III, Chapter 1, Section 22000, et seq.), and in that case, the CEA will provide PwC with a copy of the conflict of interest code and the required form.

10. Indemnification

- a) PwC must indemnify, defend, and save harmless the CEA, the CEA Governing Board and Advisory Panel, and all of the officers, agents, and employees of the foregoing, from and against any and all claims or losses for bodily injury, death to persons, tangible property damage and copyrights, patents, or trade secrets infringement, including interest, penalties, and attorney's fees, accruing or resulting to any person, firm, or corporation who is injured or damaged by PwC in the performance of this Agreement.
- b) CEA assumes full and complete responsibility for all its uses and applications of PwC's recommendations and work under this Agreement, and for any failure by CEA to use those recommendations or that work, and agrees to indemnify and hold harmless PwC, its affiliates, officers, directors, employees, agents, and stockholders, against any and all liability, damages, losses, claims, demands, actions, causes of action, and costs, including attorney's fees and expenses, resulting from the death or injury to any person or damage to any property or any other alleged or actual damages resulting from the aforementioned use, application, or non-use of PwC's recommendations or work under this Agreement.
- c) As a condition to the foregoing indemnity obligations under this Section 10, the indemnified party must provide the indemnifying party with prompt notice of any claim for which indemnification may be sought under this provision and must cooperate with the indemnifying party in connection that claim. The indemnifying party will be entitled to control the handling of that claim and to defend or settle that claim, in its sole discretion, with counsel of its own choosing; provided, however, that, in the case of any such settlement, the indemnifying party shall obtain written release of all liability of the indemnified party in form and substance reasonably acceptable to the indemnified party.

- d) The obligations imposed by this Section 10 will remain in effect for three years following any termination of this Agreement.

11. Insurance Requirements

PwC warrants that it carries or is covered under adequate liability, professional errors and omissions, employer's liability, and other necessary policies of insurance and promises to maintain those policies of insurance at limits acceptable to CEA at all times during the term of this Agreement. PwC will furnish satisfactory evidence of insurance coverages to CEA upon request.

12. Excusable Delays in Performance; Termination for Delay

- a) Neither party will be responsible or deemed in default for non-performance or delays in performance of the Agreement due to causes or events beyond its reasonable control and not occasioned by the fault or negligence of the party to be excused, including, but not limited to, civil war, insurrections, enforceable strikes, riots, fires, floods, earthquakes, acts of God, acts of the public enemy, and any statute, order, regulation, proclamation, ordinance, demand, or requirement of any government agency imposed after the effective date of the Agreement. Upon the occurrence of any such cause or event, the party affected must give prompt written notice to the other party, and on giving that notice is excused from performance to the extent of the prevention, restriction, or interference. The affected party must take all reasonable steps to avoid or remove the causes of non-performance.
- b) If performance of a party's obligations is excused in accordance with this section for more than 30 days in any 60-day period, that party can terminate its obligations under this Agreement by giving at least five days' written notice to the other party. If this Agreement is terminated pursuant to this section, PwC must immediately refund to CEA any payments made in excess of the services actually performed by PwC and received by the CEA.

13. Termination of Agreement

- a) **Notice of Termination.** To be effective, any notice of terminations must be sent or delivered according to Section 26 ("Notices").
- b) Contractor is subject to examination and audit by the Bureau of State Audits, the CEA, and CEA's representatives during the term of this Agreement and for three years after the final payment under this Agreement. Any examination or audit would be confined to matters directly connected with the performance of this Agreement, including timesheets and expense reports which support Contractor's invoices provided under this agreement. Contractor must cooperate fully with the Bureau of State Audits, CEA, and CEA's authorized representatives in connection with any examination or audit. The Bureau of State Audits, CEA, and CEA's authorized representatives agree to perform such examination during Contractor's normal business hours and in a non-disruptive manner. All adjustments,

payments, and reimbursements determined necessary through any examination or audit must be made promptly by the appropriate party to this Agreement.

14. Transfer of Title in Developed Materials

On completion or other termination of this Agreement and on payment by CEA of all sums due and owing PwC for its work under this Agreement, PwC must deliver to CEA all copies of any and all CEA owned materials related to this Agreement. Except as otherwise provided in this Agreement, PwC has no right to disclose or use any of the CEA Materials, other than the PwC Portions, for any purpose without the prior written consent of CEA. PwC may retain one copy for its internal records of the CEA owned materials and shall treat such materials as confidential in accordance with Section 16.

15. Compliance with Security Regulations

Each party agrees that it and its personnel will comply with all security regulations in effect from time to time at the premises of the other party.

16. Mutual Agreements of Confidentiality

- a) Each party acknowledges that all material and information which has or will come into its or its employees' possession or knowledge in connection with this Agreement or the performance of this Agreement, and which relates to the past, present, or future research, development, or business activities of the other party (the "Confidential Material"), consists of confidential and proprietary data of the other party, whose disclosure to or use by unauthorized third parties will be damaging. Each party therefore agrees (1) to hold the Confidential Material in confidence, (2) not to make use of it other than for the performance of the Agreement, and (3) not to release or disclose it to any other person. Each party agrees not to release Confidential Material to any employees who have not been officially notified in writing that they are expressly binding themselves not to improperly use or disclose those data.
- b) The obligations of non-disclosure set forth in this Section 16 do not apply to information that has been or from time to time is (i) developed by one party independently of the other and without reference to a party or any Confidential Material of the other party; (ii) rightfully obtained by the other without restriction from a third party who has the right to transfer or disclose it; (iii) publicly available other than through a party's breach of this Agreement; (iv) required to be disclosed by court order or other legal process, or by law, rule or regulation, provided that the party intending to release the Confidential Material must give prior written notice to the other of the order or other legal requirement and of the release; or (v) required to be disclosed by duly promulgated regulatory standards of general application to the party, provided, however, that the party intending to release the information must give prior written notice to the other of the nature of the requirement to release and of the intended release.
- c) PwC understands and agrees that CEA is a public instrumentality of the State of

California and that its records, or some of them, may be subject to public disclosure and production pursuant to law, including but not limited to the California Public Records Act (Chapter 3.5 (commencing with Section 6250) of Division 7 of Title 1 of the California Government Code). The CEA agrees to notify PwC promptly after receiving a request for disclosure of any documents or materials PwC has designated as confidential that are in the CEA's possession, and the CEA agrees to cooperate with PwC, within the statutory framework of and limitations on CEA's duties under the California Public Records Act and all other applicable law, and at PwC's cost and expense, in PwC's efforts to protect any trade secrets and Confidential Material.

- d) PwC must clearly designate and mark all materials it wishes CEA to hold confidential pursuant to this Section 16 and expressly notify the CEA in writing of that designation. Designations and marks may be categorical, so long as the designations are sufficient to describe and place CEA on notice of all material PwC wishes held confidential. CEA will have no obligation of confidentiality unless and until it has received the confidentiality designation.
- e) This Agreement does not restrict the right of PwC to undertake similar work either concurrently or in the future, provided that the CEA's rights of proprietary information and ownership as provided in this Agreement are preserved.
- f) Without limiting the foregoing provisions of this Section 16, should one party receive or have access to non-public material information about the other party, the party must not trade or tip others with respect to that information, even on termination of this Agreement. In the event a prospective customer of PwC requests a reference from the CEA regarding PwC's services under this Agreement, PwC acknowledges and agrees that CEA is entitled to provide an honest, candid response and that PwC is not entitled to claim that any such response is in violation of any confidentiality obligations of this Agreement, its exhibits, or any Schedule.
- g) The obligations imposed by this Section 16 are to be interpreted in light of the terms of Attachment 2 and shall survive termination of this Agreement.

17. Assignment of Agreement

- a) Neither party is permitted to assign this Agreement, nor delegate its duties under this Agreement, in whole or in part, without the prior written consent of the other party. Any purported assignment made without prior written consent is voidable at the option of the party whose consent would have been required by this subsection 17(a).
- b) An authorized assignee of either party has all the rights and obligations of the assigning party that are set forth in this Agreement and any agreement of assignment must expressly so provide.
- c) This Agreement can be amended only by mutual consent of the parties; except as otherwise provided in this Agreement, no change in the terms of this Agreement will be

valid unless it is in writing and executed on behalf of the PwC and the CEA. No oral understanding or agreement that is not expressly a part of this Agreement binds or will bind either party.

18. Invalid Provision of Agreement

Should any part of this Agreement be declared invalid, that declaration will not affect the validity of any remaining part, and the remaining part will remain in effect as if this Agreement had been executed without the invalid part.

19. Section Headings Not Part of Agreement

Section headings are only for convenient reference. They are not to be considered part of, or to be used in interpreting, this Agreement.

20. No Use in Advertising Without Consent

The parties agree that without the other party's written consent, neither party is entitled to use the name, service marks, or trademarks of the other party. PwC must not reveal the existence of this Agreement or its terms or conditions in any written advertising, publicity release, or sales representation without the prior written consent of the CEA unless it is part of the public record. PwC must not characterize its performance under this Agreement in advertising, publicity release, or sales materials without the CEA's prior written permission. PwC may include the CEA in a client list without further advance permission.

21. No Waiver Without Express Consent

No terms or provision of this Agreement will be deemed waived and no breach excused or consented to unless the waiver or consent is in writing and signed by the party claimed to have waived or consented. Any consent by either party to, or waiver of, a breach by the other, whether express or implied, does not constitute a consent to, excuse for, or waiver of any different or subsequent breach.

22. Acknowledgments

- a) Each party acknowledges that it has read this Agreement, understands it, and agrees to be bound by its terms.
- b) The rights and remedies provided in this Agreement are cumulative and are not exclusive of any rights or remedies any party might otherwise have at law or in equity.

23. CEA's Proprietary Interest In Data

The CEA retains at all times during and following performance by PwC under this Agreement all rights in and to the data collected by or on behalf of the CEA and provided to PwC in connection with the work under this Agreement. PwC agrees that it will not use, distribute, sell, or otherwise dispose of those data for any purpose, whether internally for its

own purposes or externally in connection with PwC's services performed on behalf of client or clients other than CEA, without the advance written permission of the CEA.

24. Entire Agreement

This Agreement, which term means and includes all attachments and exhibits to this Agreement, is a fully integrated contract and states the entire agreement between the parties respecting the subject matter of this Agreement; it supersedes and merges any and all prior discussions, representations, demonstrations, negotiations, correspondence, writings, and oral agreements (including, but not limited to, Exhibit 1 of the RFQ, which is replaced by the terms of this Agreement); and it states the entire agreement on which PwC and the CEA rely respecting the subject matter of this Agreement.

25. Additional Obligations of the Parties

a) CEA must use reasonable efforts to comply the following obligations:

- i. Cooperate with PwC by, among other things, making available internal items and information PwC might require to perform its obligations under this Agreement. CEA must use reasonable efforts to provide PwC with the requested items and information with reasonable promptness after a request by PwC.
- ii. Inspect and review all interim and final reports prepared by PwC promptly after receipt.
- iii. Provide PwC with access to CEA's business facilities and business records, including those reasonably available to the CEA on account of its business and contractual relationships, as PwC may reasonably require to perform its services under this Agreement.

b) PwC must use reasonable efforts to comply with the following obligations:

- i. PwC must use reasonable efforts to notify CEA in writing within 15 calendar days: (1) If at any time during the term of this Agreement any of PwC's representations or warranties ceases to be true in all material respects; (2) of any change in PwC's Key Personnel; or (3) of any other material change in PwC's business or partnership organization. All written notices from PwC under this provision must contain enough specific information to permit CEA to evaluate the changes within PwC's personnel or organization under the same criteria used by CEA in its original selection of PwC and approval of original Key Personnel. PwC will provide CEA with any material additional information solely related to these matters that the CEA might reasonably request.
- ii. PwC must use reasonable efforts to notify the CEA in writing of the commencement of any material investigation, examination, or other proceeding

by any government entity (whether legislative, executive, regulatory or judicial), directly involving any Key Personnel and not conducted in the ordinary course of PwC's business, of which any of PwC's Key Personnel either (1) is actually aware or (2) using his or her reasonable efforts to investigate, reasonably should be aware, provided, however, that this provision shall not be interpreted to require the disclosure of any such information that is subject to the attorney-client privilege.

26. Notices

- a) All notices and communications permitted or required by this Agreement must be directed to:

To CEA:	Bob Stewart, CPCU Chief Operations Officer California Earthquake Authority 801 K Street, Suite 1000 Sacramento, CA 95814	Daniel P. Marshall, III General Counsel California Earthquake Authority 801 K Street, Suite 1000 Sacramento, CA 95814
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To PwC: Marc Gullo
PwC
Three Embarcadero Center
San Francisco CA 94111-4004

- b) All notices given under this Agreement must be in writing; oral notices are not effective. Notices directed under this section will be effective as follows: (i) Notices personally delivered to an authorized recipient of a party are effective upon delivery; (ii) Notices deposited with the U.S. Postal Service, first class mail with postage prepaid, are effective five working days after the date of deposit or the date of Postal Service postmark, whichever is later; (iii) Notices deposited with an overnight carrier for any regular business day delivery are effective on that business day of delivery. No notice is effective if delivered solely by facsimile ("fax") or electronic mail ("e-mail").
- c) Any party's address may be changed by providing notice in accordance with this Section 26.

27. Nondiscrimination; Americans With Disabilities Act

- a) During the performance of this Agreement, PwC and its subcontractors, and their agents and employees, promise and agree they will not unlawfully discriminate against or harass or allow harassment of any employee or applicant for employment because of sex, race, color, ancestry, religious creed, national origin, physical disability (including HIV and AIDS), mental disability, medical condition (including health impairments related to or associated with a diagnosis of cancer for which a person has been rehabilitated or cured), age (40 or over), marital status, denial of family and medical care leave, or denial of

pregnancy disability leave. PwC and its subcontractors, and their agents and employees, must ensure that the evaluation and treatment of their employees and applicants for employment are free from those types of discrimination and harassment.

- b) PwC and its subcontractors, and their agents and employees, must comply with the provisions of the Fair Employment and Housing Act (Government Code section 12900 et seq.) and the related regulations (California Code of Regulations, Title 2, Section 7285.0 et seq.). The regulations of the Fair Employment and Housing Commission that implement Government Code section 12990, subdivisions (a) through (f) (Chapter 5 of Division 4 of Title 2 of the California Code of Regulations) are by this reference made a part of this Agreement.
- c) By signing this Agreement, PwC provides its assurance that it complies with the Americans with Disabilities Act of 1990 (42 U.S.C. 12101, et seq. - the "ADA") and all regulations and guidelines issued under the ADA.
- d) PwC and its subcontractors must give written notice of their obligations under this clause to all labor organizations with which they have a collective bargaining or other agreement, if any.
- e) PwC must include the nondiscrimination and compliance provisions of this clause in all permitted subcontracts to perform work under this Agreement.

28. Agreement Does Not Violate Law

- a) PwC represents that the execution of this Agreement, the acts contemplated by this Agreement, and compliance by PwC with any provisions of this Agreement will not violate any provision of any charter document of PwC; knowingly violate any statute or any judgment, decree, order, regulation, or ruling of any court or governmental authority applicable to PwC; or violate, conflict with, constitute a default under, permit the termination of, or require the consent of any person under, any agreement to which PwC may be bound, the occurrence of which in the aggregate would have a material adverse effect on the properties, business, prospects, earnings, assets, liabilities, or financial or other condition of PwC.
- b) PwC represents and warrants that it has the power and authority to enter this Agreement and carry out its obligations under this Agreement. PwC has duly authorized the execution of this Agreement, and no additional act of PwC is necessary to authorize this Agreement. PwC has completed, obtained, and performed all registrations, filings, approvals, authorizations, consents, and examinations any government or governmental authority may require for its acts contemplated by this Agreement.
- c) The person signing the Agreement on behalf of PwC warrants that he or she is duly authorized to enter into the Agreement on behalf of PwC.
- d) PwC must comply with all laws applicable to it, including those laws applicable to it

specifically because of its relationship to the CEA.

29. Choice of Law

This Agreement will be construed and enforced according to California law (without regard to conflict-of-law provisions). A party may sue only in the Superior Court of the State of California, County of Sacramento. Suit includes any action to compel arbitration or enforce an arbitration award. Each party waives any claim that Sacramento is an inconvenient or improper forum or venue. Each party agrees that the court named above will have *in personam* jurisdiction over it..

30. Counterparts

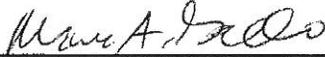
This Agreement may be executed in counterparts. Each counterpart is an original; all counterparts together are one instrument.

Executed in Sacramento, California.

For California Earthquake Authority:

For PricewaterhouseCoopers, LLP


By: Glenn Pomeroy, Chief Executive Officer


By: Marc A. Gallo

7/18/11
Date

July 18, 2011
Date

**ATTACHMENT 1
DRUG FREE WORKPLACE CERTIFICATION**

PwC ("Contractor") hereby certifies its compliance with California Government Code section 8355 to provide a drug-free workplace. The Contractor will:

1. Publish a statement notifying employees that unlawful manufacture, distribution, dispensing, possession, or use of a controlled substance is prohibited and specifying actions to be taken against employees for violations, as required by Government Code section 8355, subdivision (a), paragraph (1).
2. Establish a Drug-Free Awareness Program as required by Government Code section 8355, subdivision (a), paragraph (2).
 - a) The dangers of drug abuse in the workplace;
 - b) The organization's policy of maintaining a drug-free workplace;
 - c) Any available counseling, rehabilitation, and employee assistance programs; and
 - d) The penalties that can be imposed on employees for drug abuse violations.
3. Provide as required by Government Code section 8355, subdivision (a), paragraph (3), that every employee who has duties or responsibilities relating to this Agreement:
 - a) Will receive a copy of the company's drug-free statement; and
 - b) Will agree to abide by the company's statement as a condition of employment on the contract.

CERTIFICATION

I, the official named below, hereby swear that I am duly authorized legally to bind the Contractor to the above described certification. This certification is made under penalty of perjury under the laws of the State of California.

Maria Toledo
Authorized Signature

Principal
Title

July 18, 2011
Date Executed

Sacramento
In the County of:

Federal Identification Number:

ATTACHMENT 2

ENGAGEMENT LETTER

(Engagement letter follows this page)



Mr. Bob Stewart
Chief Operations Officer
California Earthquake Authority
801 K Street, Suite 1000
Sacramento, CA 95814

18 July 2011

Dear Mr. Stewart,

This engagement letter confirms that California Earthquake Authority (CEA) ("you" or "Client") have engaged PricewaterhouseCoopers LLP ("we" or "us" or "PwC") to perform the services described below. This engagement letter supplements the terms of, and is incorporated as a part of, the Agreement for Consulting Services effective July 18, 2011 between the CEA and PwC (the "Agreement").

Scope of Our Services

You are engaging us to provide the following services (the "Services"): Conduct key stakeholder interviews and review internal documents to assess the current-state of CEA's organization structure.

1. Baseline the current-state CEA's organization structure to an industry leading organization and identify potential opportunities for improvement for executive management's consideration.
2. Deliver a written report and related oral presentations to CEA executive management, the CEA Governing Board, and, upon your request, to other key stakeholders you may designate, providing results of the analysis and recommendations that define a multi-functional organizational structure, including:
 - a. identification of required organizational functions;
 - b. resource requirements including staffing roles, size, associated skills and costs; and,
 - c. the role of consultants, contractors, or vendors, or all three, if any, in the proposed organizational structure.
3. Collaborate with CEA staff to develop a strategy and tactical plan to provide services within the next three to five years to CEA's participating insurance companies and public entities, other than CEA, established to provide residential earthquake insurance coverage to consumers and others.



Project Execution Approach

PwC specialists in the Property & Casualty insurance business and organizational assessments will work collaboratively with CEA representatives in the Analysis engagement. Using appropriate Transform techniques, tools and templates especially tailored for the insurance industry, the collaborative team will leverage the Transform Assess and Design stages methodology and assets in five phases specific to the CEA Analysis engagement.

The timeframe is expected to be 12 weeks, as detailed below, commencing on July 18, 2011:

Organization and Staffing Analysis			Week	1	2	3	4	5	6	7	8	9	10	11	12
Phase 1	<i>Create a blended team of PwC and CEA subject matter specialists</i>	PwC's team will be introduced to CEA's project team and will begin to formalize the project plan. The collaborative team will also conduct a kick-off meeting to discuss project objectives, approach, milestones, and deliverables to help establish a blended team.													
Phase 2	<i>Understand and document the current organizational structure</i>	PwC's team will gather information to understand the current organizational environment. PwC will interview key stakeholders in areas such as Policy Services and Claims to understand current processes and key issues currently faced by CEA.													
Phase 3	<i>Analyze alignment and identify recommendations</i>	PwC will deliver the evidence-based functional assessment of CEA's organizational structure based on key findings from Phase 2, which will include gaps between the current structure and industry leading practices. PwC will work collaboratively with CEA executive management to understand their vision for the organization and help determine the optimized, evolving structure for CEA.													
Phase 4	<i>Prioritize recommendations</i>	PwC will work collaboratively with CEA's project team to prioritize the identified opportunities and finalize the list of recommendations.													
Phase 5	<i>Deliver final report and tactical plan roadmap</i>	PwC will deliver the final report to CEA executive management, including the CEA Governing Board. The final report will provide the results of the analysis and recommendations that define the future-state multi-functional organizational structure. PwC will also facilitate the preparation of the strategy and tactical roadmap that will depict releases around major plateaus for the recommended organizational change initiatives.													

PwC will provide working papers during each phase to CEA. Most working papers will become inputs into the two final deliverables: the Interim Report and Final Report. The Interim Report will be completed in Phase 3 and the Final Report will be completed in Phase 5.



Phase 1: Create a blended team of PwC and CEA subject matter specialists

In Phase 1, PwC's team will be introduced to CEA's project team and will begin to formalize the project plan. The collaborative team will also conduct a kick-off meeting to discuss project objectives, approach, milestones, and deliverables to help establish a blended team.

- Activities - The joint team will:
 - Identify key stakeholders and plan interviews
 - Conduct off-site stakeholder meeting with CEA executive team
 - Enable common understanding and alignment of the overall objectives of the project
 - Provide an initial overview of the current organizational structure
 - Understand the vision, goals and objectives for the future
 - Plan the analysis effort
 - Develop interview guides
- Working Paper:
 - **Project Schedule:** (MS Project) The Project Schedule describes the tasks, activities, milestones, and timeline this project will follow to deliver the stated project goals.
 - **Project Kickoff Meeting:** (MS PowerPoint and Oral) The Project Kickoff Meeting is conducted to inform the CEA and PwC project teams of the project, its goals, timeline, work products, and deliverables.
 - **Interview Guide:** (MS Word) The interview guide identifies many of the questions that will be asked during the key stakeholder interviews.

Phase 2: Understand and document the current organizational structure

In Phase 2, PwC's team will gather information to enable them to understand the current organizational environment. PwC will interview key stakeholders in both functional and cross-functional areas to understand current processes and key issues currently faced by CEA. PwC will perform a review of the entire CEA organization.

- Activities - The joint team will:
 - Conduct interviews with key stakeholders to gather information about CEA's current organizational structure
 - Review internal documents regarding the organization, functional areas, departments, core processes, staffing and core technology foundation
- Working Paper:
 - **Observations and Key Findings:** (MS Excel) Observations and Key Findings identified during the key stakeholder interview and upon reviewing the internal documents. Document will include observations and key findings related to resourcing requirements, roles and responsibilities, staffing and staff size, staff skill-sets, and costs.

Phase 3: Analyze alignment and identify recommendations

In Phase 3, PwC will deliver the evidence-based functional assessment of CEA's organizational structure based on key findings from Phase 2, which will include gaps between the current structure and industry leading practices. PwC will work collaboratively with CEA executive management to understand their vision for the organization and help determine the appropriate evolving structure for CEA.

- Activities - The joint team will:
 - Review and analyze the outputs from Phase 2 to identify strengths, weaknesses, and opportunities for improvement within CEA
 - Compare current CEA organization and practices with leading insurance industry practices
- Working Paper:
 - **Gap Analysis:** (MS PowerPoint) Identify strengths, weaknesses, and opportunities for improvement when comparing CEA's organization structure with industry leading practices.



- **Opportunity Alignment:** (MS PowerPoint) Provide the rationale for including the opportunities for improvement in respect to organization goals and objectives.

Phase 4: Prioritize recommendations

In Phase 4, PwC will work collaboratively with CEA's project team to prioritize the identified opportunities and finalize the list of recommendations.

- Activities - The joint team will:
 - Work with CEA management to review, refine, and prioritize the recommendations. Recommendations will consider required organizational functions; high-level resource requirements, including roles, staffing and staff size, associated skill requirements, and related costs; and the role of consultants, contractors, and/or vendors
 - Estimate the effort for major changes and cost / benefit analysis
 - Conduct vendor demonstration as appropriate
- Working Paper:
 - **Recommendation Prioritization:** (MS Excel) Define finalized list of recommendations and determine sequencing of recommendations.
 - **Future-state Organization Design:** (MS PowerPoint) Define the future-state organization structure, including required organizational functions; high-level resource requirements, including roles, staffing and staff size, associated skill requirements, and related costs; and the role of consultants, contractors, and/or vendors.
 - **High-level Business Impact Analysis:** (MS PowerPoint) Develop a high-level impact analysis (high, medium, low impact) of recommendations to CEA-defined strategic drivers.

Phase 5: Deliver final report and tactical plan roadmap

In Phase 5, PwC will deliver the final report to CEA executive management, including the CEA Governing Board. The final report will provide the results of the analysis and recommendations that define the future-state multi-functional organizational structure. PwC will also facilitate the preparation of the strategy and tactical roadmap that will depict releases around major plateaus for the recommended organizational change initiatives.

- Activities - The joint team will:
 - Based on feedback from Phase 4 reports, develop a strategic and tactical plan to attain CEA's vision and objectives within the next 3-5 years
 - Group development of required recommendations into key initiatives
 - Gather cost information, duration, risks and dependencies for each key initiative
 - Prepare final analysis report, recommended strategy and tactical plan roadmap, and executive briefing
- Working Papers:
 - **Key Initiatives:** (MS PowerPoint) Identify key initiatives to be included in the roadmap. Work with CEA to define the cost / benefit analysis, estimated duration, risks and dependencies (if any) for the key initiatives.
 - **Tactical Roadmap:** (MS PowerPoint) The tactical roadmap will identify the key initiatives, phases, and target milestones for deploying the identified recommendations throughout the organization.

Deliverables

We expect to provide you with tangible written material prepared for and delivered to you under this engagement letter ("deliverables") including the following:

- 1) **Interim Report:** (MS PowerPoint) The Interim Report will incorporate the observations and key findings from the key stakeholder interviews and reviewed documents, provide the gap analysis between the current organization structure and an industry leading practice organization, and provide the rationale for the identified opportunities for improvement.



- 2) **Final Report:** (MS PowerPoint) The Final Report will incorporate the analysis from the Interim Report as well as the following elements:
 - a. Recommendation Prioritization
 - b. Future-state Organization Design
 - c. High-level Business Impact Analysis
 - d. Key Initiatives
 - e. Tactical Roadmap
- o Additionally, an executive briefing of the Final Report will be developed.

We may prepare some deliverables in conjunction with you that will be intended to be treated solely as your own, and will not be represented as having been prepared by PwC. You will review such deliverables, revise them as you deem appropriate, approve them prior to your use and take full responsibility for their content.

You will own all deliverables except as follows: we own our working papers, pre-existing materials and any general skills, know-how, processes, or other intellectual property (including a non-client specific version of any deliverables) which we may have discovered or created as a result of the Services. You have a nonexclusive, non-transferable license to use such materials included in the deliverables for your own internal use as part of such deliverables.

In addition to deliverables, we may develop electronic materials (including spreadsheets, documents, databases and other tools) to assist us with an engagement. If we make these available to you, they are provided "as is" and your use of these materials is at your own risk.

Use of Deliverables

PwC is providing the Services and deliverables solely for Client's internal use and benefit pursuant to a client relationship exclusively with you. The Services and deliverables are not for a third party's use, benefit or reliance, and PwC disclaims any contractual or other responsibility or duty of care to others based upon these Services or deliverables or advice we provide. We acknowledge that you are our sole client with respect to the Services, and that we will not take direction from or form a client relationship with any third party (including, but not limited to, your stakeholders) with respect to the Services.

Confidentiality

As used in this engagement letter, "Confidential Information" means non-public information that a party marks as "confidential" or "proprietary" or that otherwise should be understood by a reasonable person to be confidential in nature. Confidential Information does not include any information which (i) is rightfully known to the recipient prior to its disclosure; (ii) is released to any other person or entity (including governmental agencies) without restriction; (iii) is independently developed by the recipient without use of or reliance on Confidential Information; or (iv) is or later becomes publicly available without violation of this engagement letter or may be lawfully obtained by a party from a non-party. Each party will protect the confidentiality of Confidential Information that it receives from the other party in accordance with the terms of this engagement letter and of Section 16 of the Agreement except as required by applicable law, statute, rule, regulation or professional standard, without the other party's prior consent. If disclosure is required by law, statute, rule or regulation (including any subpoena or other similar form of process), or by professional standards, the party to which the request for disclosure is made shall (other than in connection with routine supervisory examinations by regulatory authorities with jurisdiction and without breaching any legal or regulatory requirement) provide the other party with prior prompt written notice thereof and, if practicable under the circumstances, allow the other party to seek a restraining order or other appropriate relief. The parties understand and agree that Client is a public instrumentality of the State of California and that its records, or some of them, may be subject to public disclosure and production pursuant to law, including but not limited to the California Public Records Act (Chapter 3.5 (commencing with Section



6250) of Division 7 of Title 1 of the California Government Code, and that PwC will be notified of requests under the California Public Records for our Confidential Information in accordance with the terms of Section 16(c) of the Agreement.

Our Responsibilities

We will perform the Services in accordance with the Standards for Consulting Services established by the American Institute of Certified Public Accountants. Accordingly, we will not provide an audit or attest opinion or other form of assurance, and we will not verify or audit any information provided to us.

- PwC will perform this engagement as per the tasks and produce the deliverables as defined in the project schedule section.
- PwC will provide the resources with appropriate experience to conduct the work as outlined in the project schedule section.
- PwC will share knowledge with CEA and partner to complete the listed deliverables.

Your Responsibilities

Our role is advisory only. You are responsible for all management functions and decisions relating to this engagement, including evaluating and accepting the adequacy of the scope of the Services in addressing your needs. You are also responsible for the results achieved from using the Services or deliverables, and it is your responsibility to establish and maintain your internal controls. You will designate a competent member of your management to oversee the Services. We expect that you will provide timely, accurate and complete information and reasonable assistance, and we will perform the engagement on that basis.

- CEA will provide access to appropriate business process and application subject matter specialists over the course of the engagement with sufficient and appropriate knowledge, skills, and experience to perform their identified project roles. This includes introductions and access to the key stakeholders for information sharing and support.
- CEA resources will lead the identification of key participants for facilitated sessions.
- Bob Stewart, Chief Operations Officer of CEA will act as CEA change lead.
- CEA functional and technical resources will be made available to assist PwC with data collection, assimilation of existing information and analysis, participation in interviews (as appropriate), validation of results and overall project management and support. Changes in CEA's support may affect PwC's staffing, which would result in a change order.
- Existing information and analysis will be leveraged and relied upon to form the basis of the team's analysis and recommendations. All relevant information and analysis, including those from external parties (e.g. other studies) will be made available to PwC.
- CEA will provide timely decisions and approvals when needed, but in no event later than the weekly schedule provided in this SOW or the project plan.
- PwC will be entitled to rely on CEA's decisions and statements of fact.
- CEA will be primarily responsible for obtaining information pertaining to relevant third party products or services used by CEA, if necessary.
- CEA will order no voluntary project interruptions or stoppages unless called for in the project plan or less than three days in duration (e.g., holiday observance). If non-scheduled voluntary interruptions are ordered by CEA, PwC may not be able to retain its assigned resources during such interruption, and a billable ramp up period for replacement personnel may be required.
- CEA will provide both customer and PwC teams with appropriate workspaces that are co-located in the same area of customer's facilities as agreed upon, which should include workspace, telephone access, local printers, copier and fax access and appropriate meeting space.



Fees and Expenses

The PwC pricing is based on the activities, working papers and deliverables across the work plan. The team anticipates some overlapping activities from one phase to the next and has included a total number of hours for each role in our pricing matrix.

PwC Team	Rates	Anticipated Project Hours	Anticipated Fees
Marc Gallo - Principal	\$600	110	\$ 66,000
Clem Moore - Director	\$484	480	\$ 232,320
Greg Tate - Manager	\$370	480	\$ 177,600
TBD - Senior Associate	\$295	TBD	TBD
PwC Subject Matter Specialists (Principal, Director, Manager)	\$370 - \$600	280*	\$136,422
Total Fees			\$612,342
Total Anticipated Costs (travel, lodging, meals)			\$92,000
Total fees and costs			\$ 704,342

* The average rate of Principal, Director, and Manager was used to determine the Anticipated Project Hours for the PwC Subject Matter Specialists. The actual rate will be applied based on the staff level of the PwC Subject Matter Specialist.

This is a Time and Materials project. Our fee is based on the time required by our professionals to complete the engagement. Individual hourly rates vary according to the experience and skill required. We estimate our fees for this engagement will be \$612,342. PwC also will bill Client for our reasonable out-of-pocket expenses (including, but not limited to, any applicable sales, use or value added tax for booking travel. We estimate that our total anticipated costs (travel, lodging, meals) will be \$92,000. Therefore, total fees and costs are estimated at \$704,342. We will obtain written approval from California Earthquake Authority before accruing any consulting fees or total anticipated costs in excess of this amount. Invoices are due within 30 days of the invoice date.

PwC Team	Staff Level	Project Role	Expected Participation %
Marc Gallo	Principal	Acts as overall advisor and guide to CEA Program Sponsor. Has overall responsibility for the delivery of PwC's services and provides guidance to the project team, aids with the formulation of and drives key workshops and deliverables.	23%



Clem Moore	Director	<p>Manages day-to-day project activities including planning, task assignments, status reporting, and issue identification and resolution.</p> <p>Structures and leads activities related to conducting the current-state organization assessment, performing the gap analysis, identifying recommendations, developing future-state organization environment, and developing tactical roadmap.</p>	100%
Greg Tate	Manager	<p>Acts as lead business analyst. Supports the activities related to conducting the current-state organization assessment, performing the gap analysis, identifying recommendations, developing future-state organization environment, and developing tactical roadmap.</p>	100%
PwC Subject Matter Specialist(s)	All Levels	<p>Contributes as advisor and/or subject matter specialist in the areas of property & casualty insurance, organization design, insurance assessments, industry leading practices, IT, and roadmap development.</p>	As needed

Termination and Dispute Resolution

Either party may terminate the Services by giving notice to that effect in accordance with the Notice provisions of the Agreement.

Any unresolved dispute relating in any way to the Services or this engagement letter shall be resolved by arbitration. The arbitration will be conducted in accordance with the Rules for Non-Administered Arbitration of the International Institute for Conflict Prevention and Resolution then in effect. The arbitration will be conducted before a panel of three arbitrators. The arbitration panel shall have no power to award non-monetary or equitable relief of any sort. It shall also have no power to award damages inconsistent with the Limitations of Liability provisions below. You accept and acknowledge that any demand for arbitration arising from or in connection with the Services must be issued within one year from the date you became aware or should reasonably have become aware of the facts that give rise to our alleged liability and in any event no later than two years after any such cause of action accrued.

This engagement letter and any dispute relating to the Services will be governed by and construed, interpreted and enforced in accordance with the laws of the State of California, without giving effect to any provisions relating to conflict of laws that require the laws of another jurisdiction to apply.



Limitations on Liability

Except as stated in Section 4(f) and Section 10 of the Agreement, and except to the extent finally determined to have resulted from our gross negligence or intentional misconduct, our aggregate liability to pay damages for any losses incurred by you as a result of breach of contract, negligence or other tort committed by us, regardless of the theory of liability asserted, is limited in the aggregate to no more than the total amount of fees paid to us under this engagement letter. In addition, we will not be liable in any event for lost profits, consequential, indirect, punitive, exemplary or special damages. Also, we shall have no liability to you arising from or relating to third-party hardware, software, information or materials selected or supplied by you.

PwC is the U.S. firm of the global network of separate and independent PricewaterhouseCoopers firms (exclusive of PwC, the "Other PwC Firms"). During its performance of the Services, PwC may, in its discretion, draw on the resources of and subcontract to its subsidiaries, the Other PwC Firms and third party subcontractors who perform internal administrative and regulatory compliance functions for PwC (each a "PwC Subcontractor"), in each case within or outside of the United States. Upon request, we will be happy to provide details on the supervision and billing arrangements we use in connection with these professionals. Client agrees that PwC may provide information PwC receives in connection with this engagement letter to each PwC Subcontractor to perform the Services and/or for internal administrative and regulatory compliance purposes. PwC will be solely responsible for the provision of the Services (including those performed by the PwC Subcontractors) and the PwC Subcontractors, their and PwC's respective partners, principals or employees (collectively the "Beneficiaries") shall have no liability or obligations arising out of this engagement letter. Client agrees to: (a) bring any claim or other legal proceeding of any nature arising from the Services against PwC and not against the Beneficiaries; and (b) ensure or procure that Client's consolidated subsidiaries or affiliates receiving services under this engagement letter who Client binds to this engagement letter by its signature ("Client's Subsidiaries") do not assert any such claim or other legal proceeding against PwC or the Beneficiaries. If any of Client's Subsidiaries receive Services under this engagement letter, Client agrees to provide a copy of this engagement letter to such Subsidiaries, and Client will notify them that although PwC Subcontractors may interact with them, the delivery of the Services is governed by the terms of this engagement letter (including the liability limitations herein), and Client's Subsidiaries should notify Client of any disputes or potential claims arising from the Services. PwC disclaims any contractual or other responsibility or duty of care to any other subsidiaries or affiliates. While PwC is entering into this engagement letter on its own behalf, this section also is intended for the benefit of each PwC Subcontractor.

Other Matters

PwC is owned by professionals who hold CPA licenses as well as by professionals who are not licensed CPAs. Depending on the nature of the services we provide, non-CPA owners may be involved in providing services to you now or in the future.

No party to this engagement letter may assign or transfer this engagement letter, or any rights, obligations, claims or proceeds from claims arising under it, without the prior written consent of the other party, and any assignment without such consent shall be void and invalid. If any provision of this engagement letter is found to be unenforceable, the remainder of this engagement letter shall be enforced to the extent permitted by law. If we perform the Services prior to both parties executing this engagement letter, this engagement letter shall be effective as of the date we began the Services. You agree we may use your name in experience citations and recruiting materials. This engagement letter supersedes any prior understandings, proposals or agreements with respect to the Services, and any changes must be agreed to in writing through an amendment to this letter or a change order.

By entering into this engagement letter you are binding your subsidiaries and affiliates to the extent that you have authority to do so. We disclaim any contractual or other responsibility or duty of care to any other subsidiaries or affiliates.



* * * * *

We are pleased to have the opportunity to provide services to California Earthquake Authority (CEA). If you have any questions about this engagement letter, please discuss them with Marc A. Gallo at (510) 219-6609. If the Services and terms outlined in this engagement letter are acceptable, please sign one copy of this engagement letter in the space provided and return it to the undersigned. You may return the signed copy to me by mail or air courier to 3 Embarcadero Center, San Francisco, CA 94111, by facsimile to my attention at 813-329-5531 or attached as a pdf, jpeg or similar file type to an e-mail to me at marc.gallo@us.pwc.com.

Very truly yours,

PricewaterhouseCoopers LLP

By: Marc A. Gallo
Marc A. Gallo
Principal

Date: July 18, 2011

ACKNOWLEDGED AND AGREED:

California Earthquake Authority (CEA)

Signature of client official: Glen Pomeroy

Please print name: Glen Pomeroy

Title: CEO

Date: 7/18/11

ATTACHMENT 3

KEY PERSONNEL

Marc Gallo, Principal

Clem Moore, Director

Greg Tate, Manager

ATTACHMENT 4

CEA TRAVEL REIMBURSEMENT POLICIES

CALIFORNIA EARTHQUAKE AUTHORITY TRAVEL EXPENSE REIMBURSEMENT INFORMATION FOR CONTRACTED PERSONNEL

I. TRAVEL POLICY

It is the CEA's policy to provide reimbursement for the necessary actual expenses incurred by Contracted Personnel due to travel on official CEA business.

II. TRAVEL EXPENSE CLAIMS

The CEA Travel Expense Claim (TEC) Form is used to reimburse Contracted Personnel for travel expenses. No travel expense claim shall be paid unless submitted on this form. All expense claims shall be either typewritten or in ink, properly itemized accompanied by the required receipts and will be approved by the Chief Executive Officer (CEO) or General Counsel.

What Goes On a Travel Claim

- Claimant's name and address
- All appropriate expenses (e.g., per diem, transportation, business expenses)
- All dates and times when expenses occurred
- Location where expenses occurred
- All methods of transportation
- Private vehicle license number if mileage expense is claimed
- Signatures of claimant
- Purpose of business trip
- Any additional justification required

Preparation of an Expense Claim

When completing a TEC form, refer to the "Instructions" on the reverse side of the form and to these procedures. If there are additional questions, contact Bob Stewart, Chief Operations Officer, at (916) 325-3800

Each contractor is responsible for the preparation and contents of his/her travel expense claim even if prepared or typed by someone else. The Contractor's signature is a certification of the validity of his/her statement of expenses. No one may sign for the Contractor unless the Contractor is permanently unable to sign.

Submit the original TEC and supporting documents to contact Bob Stewart, Chief Operations Officer, at 801 K Street, Suite 1000, Sacramento, CA 95814

Receipts Are Required For

- lodging
- long distance business telephone calls and telegraph charges exceeding \$2.50
- airline tickets (travel agency or reservation receipt **and** passenger receipt)
- rental car agreement
- other transportation expenses (including parking fees) exceeding \$10.00
- legal, business or emergency expenses over \$5.00
- gasoline purchased for rental vehicles

Receipts Are **Not** Required For:

- Other Transportation Expenses (including parking fees) less than \$10.
- Business expenses less than \$5.

Acceptable Receipts

Claimants must provide original receipts (if an expense is paid by check, a copy of a canceled check, front and back, is acceptable). Receipts should be printed with the date, business name, and nature and amount of the expense; if these receipt details are not printed on the receipt, Claimant must write the missing details on the receipt.

All odd-sized receipts must be taped to an 8 ½" x 11" sheet of paper; preferably in the chronological order the expenses were incurred. The receipts and papers containing odd-sized receipts must be attached to the TEC before submission..

Lost Receipts

Claimants must furnish original receipts when claiming reimbursement for purchasing lodging, transportation (including airline tickets), and training expenses. In the event of a lost receipt, Claimants are responsible for obtaining a replacement copy of the receipt from the vendor; a faxed replacement copy will suffice with a notation by the Claimant of the reason for the copy, placed in the Lost Receipt Statement which is then attached to the TEC.

If receipts are lost and cannot be replaced, the Claimant must submit a Lost Receipt Statement of the amount of the expense and why the receipt was irreplaceably lost. Regardless of the reason for the absence of a receipt, reimbursement is limited to the amount allowed (without a receipt) for that expense category, and gasoline reimbursement will be limited to \$24.99. In the absence of a satisfactory explanation, no reimbursement will be made.

50-Mile Rule

No per diem expenses (lodging, meals and/or incidentals) shall be allowed at any location within 50 miles of the claimant's business address. In addition, no per diem expenses shall be allowed at any location within 50 miles of a claimant's business or residence address. All claims for travel expense must show the claimant's starting point of travel, either the business address or primary residence address.

Lodging Reimbursement Policy

Lodging may be claimed if travel extends overnight. Contracted Personnel should select accommodations in a moderate price range for the city/town in which they are staying; the CEA will reimburse the actual expense, provided the lodging receipt is attached to the TEC.

Travel Companions

If the Contractor takes a companion, the Contractor should ask the hotel/motel to provide verification of single room cost. Reimbursement shall not exceed the single room rate plus the room tax of the single room rate.

Meal and Incidental Reimbursement Policy

The meal and incidental allowance guidelines are established as a limit to actual expenses. Contracted Personnel on CEA business may claim per diem and incidental expense allowances equal to those determined by the United States government's General Services Administration (GSA) and are available at <http://www.gsa.gov/portal/category/21287#>.

Contracted Personnel may not claim meals when the sole reason for early departure or late arrival is due to stopping for a meal. In addition, when meals are furnished or otherwise paid for, such as meals on airlines, meals included in a conference fee or a free breakfast provided by the hotel, reimbursement for that meal may not be claimed.

Criteria for Claiming Meal Expenses

1. Travel longer than 48 hours:
 - a. First and last travel day will be paid at 75% of the per diem allowance.
2. Travel longer than 25 hours but less than 48 hours:
 - a. Both days will be reimbursed at 75% of the per diem allowance.
3. Travel less than 24 hours:
 - a. 75% of the per diem allowance will be given if the Claimant left their business or residence before 6:00 a.m. and returned before 7:00 p.m.
 - b. 75% of the per diem allowance will be given if the Claimant left their business or residence after 6:00 a.m. and returned after 7:00 p.m.
 - c. 100% of per diem allowance will be given if the Claimant left their business or residence before 6:00 a.m. and returned after 7:00 p.m.
4. Meals not paid for by Claimant:

- a. A sum applicable to a meal furnished without additional cost to the Claimant such as meals on airlines, meals served as part of a conference fee, a breakfast provided by a hotel, will be deducted from that day's per diem allowance. The Claimant should note such no-cost meals in the TEC remarks section.
5. Lunch Allowance:
- a. If Claimant left their business or residence after 10:00 a.m. and returned after 7:00 p.m., they will only receive the per diem allowance for lunch.

III. TRANSPORTATION

Overview

It is CEA policy to claim expense reimbursement for the least expensive mode of transportation available. Determination of the best mode of transportation shall include the consideration of rail, bus and public transportation as well as privately owned or rental vehicles.

Private Vehicle Use

Travel in a Contractor's private vehicle while on CEA out-of-office business is a travel expense and is reimbursable.

Private Vehicle Rates

The CEA's reimbursement rate for the use of privately owned vehicles is \$0.51 per mile.

Transportation to/from Airports

When driving a private vehicle to a common carrier (airplane, train, and bus), mileage may be computed from the Contractor's home, if the Contractor does not start from or go back to the office. If a Contractor drives a private vehicle to the carrier and parks it in the parking lot during travel, \$0.51 per mile may be charged for the round trip mileage. If the Contractor is dropped off and picked up in a private vehicle, the Contractor may claim **twice the round-trip mileage**. The intent of this rule is to allow someone to accompany the claimant to and from the airport, and to retain the vehicle during the Contractor's absence. The mileage is doubled to provide the equivalent of two round trips.

Parking and Toll Charges

Contracted Personnel using privately owned or rental vehicles on official business may be paid for the following:

1. Day parking when on trips away from their headquarters office and residence.
2. Overnight public parking when on trips away from the headquarters city and city of residence.

Submit claims for parking on a TEC; attach a receipt for parking fees exceeding \$10.00 for one continuous period.

Tolls paid on bridges, ferries and toll roads are reimbursable if private car mileage is claimed or

if a rental car is used.

Commercial Car Rental

Rental vehicles are strictly for official business and to obtain meals and lodging while traveling on official CEA business.

Renting a Vehicle

Contracted Personnel may rent an economy (compact) vehicle unless there are reasons for a larger vehicle, such as five or more people and luggage. If a vehicle other than an economy/compact is rented, provide the justification in the "Remarks" section.

Refueling Rental Vehicles

Travelers are encouraged to refuel gas tanks prior to returning the vehicle to the vendor. The vendor's fuel rates are generally higher than self-service pumps. Receipts for the purchase of gasoline must be included in the submission of the TEC for reimbursement.

Personal Use of Rental Vehicles

Travelers on CEA business wishing to extend the rental of a vehicle for personal business must make separate arrangements with the rental company at the time reservations are made and when picking up the vehicle. There must be a separate rental agreement for personal use of a rental car. It is not acceptable to extend rental contracts for official business and pay the difference for those days the vehicle was used on personal business.

Airlines

Contracted Personnel will be reimbursed for travel by aircraft when it is the most efficient and least costly method for conducting official business, and must travel by the least costly class and take advantage of discounts whenever possible.

Meals Served during Air Travel

Meals served on a flight and which the Contractor consumes may not be claimed for reimbursement on a TEC.



Request for Qualifications and Proposals

for

Organization and Staffing Analysis

RFQ #02-11

May 16, 2011

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I. Summary of Key Dates

The following schedule is subject to modification by the California Earthquake Authority (“CEA”). Questions must be submitted in the manner described in Section III.

- | | |
|---|---------------|
| 1. Date of issue | May 16, 2011 |
| 2. Deadline for submitting questions | May 27, 2011 |
| 3. Final date for the CEA to post addenda for which proposers are responsible | June 1, 2011 |
| 4. Final proposal submission date | June 8, 2011 |
| 5. Proposal evaluation | June 9, 2011 |
| 6. Finalists’ presentations (optional) in Sacramento, California | June 15, 2011 |
| 7. Award of opportunity to negotiate contract | June 23, 2011 |
| 8. Commencement date | July 1, 2011 |

II. Background of the California Earthquake Authority and Purpose of the Organization and Staffing Analysis

Following the unprecedented losses from the 1994 Northridge Earthquake, many California insurers either stopped or severely restricted selling new homeowners insurance policies. This was largely due to state law that required insurers to offer earthquake insurance when selling residential property insurance. A California Department of Insurance study released in May 1995 found that insurers representing 93 percent of the voluntary insurance market were either restricting or refusing to sell new policies.

In 1995, the California Legislature approved legislation to create the California Earthquake Authority (CEA). In 1996, the Legislature passed three additional bills that permitted the CEA to become operational when certain conditions were met. These bills were codified in California Insurance Code, sections 10089.5 through 10089.54 and will be referred to as the CEA Act. In November 1996, the Insurance Commissioner certified the conditions had been met. The CEA began writing earthquake policies effective December 1, 1996.

The CEA is administered by a Governing Board composed of five elected public officials. California's Governor, Treasurer, and Insurance Commissioner serve as voting members, while the Speaker of the Assembly and the President Pro-Tempore of the Senate serve as non-voting members. The Governing Board is advised by an 11-member Advisory Panel.

The CEA is currently financed with approximately \$3.8 billion in CEA capital, \$314 million in revenue bond proceeds, \$2.9 billion in third-party reinsurance, and \$2.7 billion in participating-insurer assessments. Operating under a uniform written contract, participating insurers sell and service CEA policies and adjust CEA claims. By law, the State of California has no liability for claims, costs, or liabilities arising from CEA operations.

The CEA's business is residential earthquake insurance and the provision of earthquake-loss-mitigation services and related educational outreach. The CEA offers basic residential earthquake insurance to owners of dwellings, mobilehomes, and condominiums as well as to renters. Policies cover damage to structure and contents and expenses incurred when a home is uninhabitable. CEA rates are actuarially sound, based on the best available science, and approved by the California Insurance Commissioner.

The CEA seeks a consulting firm specializing in property and casualty insurance operations to complete an independent assessment of various elements of the organization, including structure, roles, and staffing levels. The assessment is necessary given the evolution of the organization during its first fifteen years of operation in which it has become the leading provider of residential earthquake insurance in California and an organization of influence in the global earthquake community. Since its inception, the CEA has become a thought leader in development of creative residential earthquake products and related pricing structures; has set the standard for residential earthquake risk transfer strategies; is developing leadership roles for the marketing of residential earthquake insurance and loss mitigation products; and, has been an influential supporter of earthquake research. In addition, the CEA is currently in the process of expanding its sphere of influence relating to earthquake loss mitigation and preparedness under the direction of a new, legislatively created, Chief Mitigation Officer, position.

III. Submitting Questions

Questions are to be submitted by email only, and each proposer is solely responsible for following the timeframes in Section I. Submit all questions to:

RFQ02-11@calquake.com

The CEA will respond to questions as they are received. Answers will be posted on the CEA's Web site, www.EarthquakeAuthority.com, on the *Organization and Staffing Analysis RFQ* page.

IV. Proposer's Responsibilities Regarding Addenda

The CEA reserves the right in its sole discretion to modify any part of this RFQ by issuing a written addendum.

All addenda issued by the CEA after the final submission date for proposals will be posted solely to www.EarthquakeAuthority.com on the *Organization and Staffing Analysis RFQ* page.

Each proposer must continue to check the CEA Web site through the final submission date for further addenda.

Each proposer acknowledges and accepts the affirmative responsibility to inquire regarding, and seek clarification of, any part or provision of this RFQ that the proposer does not understand or believes is reasonably susceptible to more than one interpretation. If a proposer claims any ambiguity, conflict, discrepancy, omission, or other error in the RFQ, the proposer must immediately notify the CEA's RFQ contact person and request clarification. In its sole discretion, the CEA may issue clarifications in the form of written addenda to this RFQ and will post the written addenda to www.EarthquakeAuthority.com on the *Organization and Staffing Analysis RFQ* page.

In its sole discretion, the CEA may disregard any and all claims of ambiguity, conflict, discrepancy, omission, or other error received by the CEA after the final submission date for proposals.

No additional time to meet any deadline will be allowed, due to corrections or clarifications made by the CEA, after the final submission date for proposals.

The provisions of any addendum formally issued by the CEA are automatically incorporated into this RFQ, and in addition and as appropriate, may be made a part of or otherwise reflected in any contract awarded as a result of this RFQ.

Each proposer is required to acknowledge, as part of the proposer's cover letter (see page 12, section IX, subsection 1.g.), that proposer has reviewed the addenda posted one week or more before the final proposal submission date.

V. Submitting Proposal

- Submit the original and four copies of the proposal in a sealed envelope or package.
- The original proposal must bear an original signature of the person who signed the cover letter and be marked "Original."
- The proposer's name and address must appear on the outside of the sealed proposal package/envelope.
- A proposal by a firm must be signed by a person authorized to bind the firm.
- All proposals must be sent or delivered to the following address:

**California Earthquake Authority
801 K Street, Suite 1000
Sacramento, California 95814**

CONFIDENTIAL

Response to Request for Qualifications and Proposals #02-11

- Proposals must be physically received by the CEA no later than 5 p.m. Pacific Time on Wednesday, June 8, 2011.
- Unless expressly and specifically requested by the CEA, proposals are not to be submitted, in whole or in part, by fax or by electronic or magnetic media.

Should a proposal contain information that the proposer considers confidential or proprietary, a statement to that effect must be included in the cover letter, and each and every page containing confidential or proprietary information must be so marked in the upper right-hand corner. The CEA will use reasonable efforts to keep such pages from public disclosure, except to the extent provided in any resulting contract or the extent required by law. The CEA makes no representations or warranties that its efforts will be successful. Proposers are reminded that many of the CEA's records are subject to public disclosure under the California Public Records Act.

No proposal can be considered confidential or proprietary in its entirety.

If, before the submission deadline, a proposer wishes to make any change or augment a proposal it has already submitted to the CEA, the only method of correction or modification is to notify the CEA proposer is withdrawing its proposal and then submit the modified proposal before the proposal-submission deadline. Modification offered in any other manner, or after the proposal-submission deadline, will not be considered.

All proposals become the property of the CEA upon submission.

All costs to develop proposals and attend interviews regarding proposals are the sole responsibility of the proposer and cannot be charged to the CEA.

Please review all addenda posted on the CEA's Web site before submitting proposals.

Record your company name and the RFQ number on each page of the proposal.

VI. Services to be Provided

Introduction

The purpose of this Request for Qualifications and Proposal is to invite consultants and consulting firms with demonstrated expertise and success in organizing and optimizing the insurance-operations efforts, and ancillary business and business-related activities, of property and casualty insurance organizations to submit qualifications and a proposal to the CEA.

The consultant will assist the CEA in assessing the effectiveness of various current elements of the organization, including structure, roles, and staffing levels, and will consult with CEA and other interested parties in preparing near- and mid-term future assessments and recommendations of organizational direction, efficiency and effectiveness.

Term

The contract will have a one-year term. The CEA reserves the right, and the Firm agrees to allow the CEA the option to renew, at the CEA's sole discretion, this Contract for up to two additional six-month periods, at the same pricing basis, and on the same terms and conditions, agreed for the initial contract period.

Scope of Work

The proposing firm will provide the following services, as a minimum:

1. Conduct, complete, and report on an evidence-based functional assessment of the CEA's organizational structure that compares the current structure to an optimized, evolving structure that is to be projected and ultimately defined through collaboration with CEA executive management.
2. Deliver a written report (and make related oral presentations) to CEA executive management, the CEA Governing Board (i.e., board of directors), and certain other key stakeholders, providing results of the analysis and recommendations that define an appropriate multi-functional organizational structure, including:
 - a. identification of required organizational functions;
 - b. resource requirements, including roles, staffing and staff size, associated skill requirements, and related costs; and,
 - c. the role of consultants, contractors, or vendors, or all three, if any, in the proposed organizational structure.
3. Collaborate with CEA staff to develop a strategy and tactical plan to provide services within the next three to five years to CEA's participating insurance companies and public entities, other than CEA, established to provide residential earthquake insurance coverage to consumers and others.
4. The project must be completed no later than November 15, 2011.

VII. Minimum Qualifications

Proposer must meet, to the CEA's satisfaction, all of the following minimum qualifications to be considered for contract award. Proposer must affirmatively attest to each of the minimum qualifications in Proposer's cover letter. Failure to satisfy all minimum qualifications, in the CEA's sole judgment, will result in rejection of the proposal.

1. Have been in business for a minimum of 10 years specializing in business consulting, with demonstrable and successful consulting in the area of U.S. property and casualty insurance operations; if the firm has not been in business for at least 10 years or does not have 10 years' worth of relevant, required experience, the senior principals of the firm must have a least 15 years combined experience with consulting firms that concentrated their practice in the fields noted above; and,
2. Have at least one person assignable to the CEA who has a minimum of seven years of experience in property and casualty insurance-operations consulting.

Note: The CEA's contract form typically prohibits a contractor from replacing key personnel without CEA's prior permission.

VIII. Pricing

Proposal must include a clear and complete fee and expense structure. The CEA will pay negotiated fees and expenses in arrears, as may be agreed. If CEA is asked to accept a minimum periodic fee, proposal must include a clear and complete periodic-fee structure.

IX. Submission Instructions

The proposal and cover letter, exclusive of attachments, must not exceed 18 single-sided pages. Attachments must not exceed 16 single-sided pages. All proposals must include the following elements, in the following order:

1. Cover Letter

The cover letter must be signed by a person authorized to bind the proposer contractually. The CEA will reject any proposal that contains an unsigned cover letter. The cover letter must also contain all of the following:

- a. The proposing firm's name, address, telephone and fax numbers, and Web address.
- b. The name, title or position, telephone number, and email address of the person signing the cover letter and any other persons authorized to make representations for the proposer regarding the RFQ.
- c. A statement that the signature constitutes unrestricted authority to bind the proposer contractually.
- d. A statement that the firm is willing to be bound by contract provisions such as those outlined in Exhibit 1.
- e. A statement that the proposal is a valid, open proposal for at least 90 days after the submission date.
- f. A statement affirming that the proposer satisfies each of the Minimum Qualifications.

- g. A statement that the proposer has reviewed all addenda posted through the final addenda posting date shown on the “Summary of Key Dates.”
- h. A statement that each key professional and each responsible staff member working on the contract is willing to be subject to a background check.

2. Firm Background and History

- a. Location of firm headquarters.
- b. Number of years the firm has been in existence in the same or substantially the same form and under the same trade name.
- c. Total number of offices and employees (provide a breakdown of the number of professional, managerial, and support staff, respectively).
- d. Describe the firm’s ownership and ownership structure.
- e. Identify any affiliated or subsidiary organization(s).
- f. Identify pending or contemplated changes in the firm’s organizational structure.
- g. Identify the proposer’s insurance operations consulting clients and provide contact information from three representative insurance operations consulting clients.
- h. Describe the types of services the firm provides (including, but not limited to, the services described in this RFQ) and reasonable details of the fee arrangements that typically apply.
- i. Describe the firm’s experience providing property and casualty insurance operations consulting services to governmental and non-governmental clients.
- j. Disclose litigation or other legal proceedings in the past three years that your firm, or any officer or principal of your firm, has been involved in related to your firm’s business activities. Explain the nature of each such litigation or legal proceeding, even if the matter has been resolved.
- k. Provide the applicable coverage amounts for the following:
 - i. Errors-and-omissions insurance, if applicable
 - ii. Any other applicable insurance
- l. List every institutional client for which the firm provided any of the services described in Section VI (Services to be Provided) of this RFQ that terminated its relationship with the proposing firm during the past four years. Provide the following information:
 - i. The name of the client
 - ii. A full explanation of the reason(s) for termination of the relationship

3. Work Plan

This should describe how your firm will perform the proposed contract. Be specific and avoid generalizing.

The work plan should address, without limitation, the following components, and should be organized so that it is clear, comprehensive, and concise.

- a. Identify the primary contact for the contract.

- b. Describe your firm's understanding of the work to be performed under this RFQ.
- c. Identify any RFQ requirements which your firm believes are unnecessary.
- d. Propose any alternatives that conform to this RFQ's intent, that would lead to a better result, but which may not satisfy specific RFQ requirements.
- e. Identify any "value-added" services your firm would provide to the CEA.
- f. Detail any conflict of interest, or apparent or potential conflict of interest that would be created by your firm's contracting with the CEA. Propose how to address or resolve these conflicts of interest.
- g. Describe your firm's policy for ensuring the confidentiality of its clients' matters.
- h. Define "client service" as it relates to your firm and describe mechanisms that are in place to solicit and respond to client feedback.
- i. Name the property and casualty insurance operations consulting professionals who would be assigned to the CEA account and their responsibilities. For each member of the team assigned to the CEA account, provide a brief résumé that outlines the person's education and relevant experience; include relevant certifications or credentials, and the length of time each has been held.
- j. If the firm intends to use subcontractors to deliver any of the services outlined in Section VI (Services to be Provided), provide the information in f., g., h., and I regarding the proposed subcontractor(s).

4. Pricing

Price each section of the proposed work plan separately. For each task, for each contract period, specify the expected number of hours, the hourly rates, and the overall cost. If expected number of hours is unknown, provide the hourly rates.

The CEA will use the following information to analyze the reasonableness of the fees. Information is intended for internal CEA use, but certain CEA records are subject to public disclosure under the California Public Records Act and production under the Bagley-Keene Open Meetings Act. The CEA makes no representations or warranties that its efforts to keep records confidential will be successful.

- a. Itemize the direct labor costs using the following categories:
 - i. Staff billing, by title (e.g., partner, project manager, associate, clerical)
 - ii. Rate per hour for each staff member
- b. Itemize consultant and subcontract labor costs.
- c. Itemize maximum costs for travel, lodging, and meals. Costs must be billed in accordance with the CEA's travel policies as provided in Exhibit 2.
- d. State any additional costs not previously covered in this section or state that there are no additional costs.
- e. Total of fees and costs.

5. Equal Employment Opportunity (EEO)

Describe the firm's policies and programs that ensure compliance with state and federal Equal Employment Opportunity requirements.

6. Required Attachments

- a. Proposed fees labeled as "Required Attachment A"
- b. Drug-Free Workplace Certification labeled as "Required Attachment B"
(see Exhibit 3)
- c. References labeled as "Required Attachment C" (see Exhibit 4)

Additional Information

The CEA will not be bound by any oral interpretation of this RFQ by any of its representatives or employees, unless those oral interpretations are subsequently issued as a written addendum to this RFQ.

Each proposer must make those arrangements necessary to become fully informed in advance of commencing work regarding all conditions and matters that, during the contract term, could affect the performance of contracted work. Any failure to fully investigate the scope of work or the foregoing conditions will not relieve the proposer from responsibilities for properly estimating the difficulty or cost to successfully perform the work.

The CEA may request additional clarifying information from any proposer after the initial evaluation of the proposals.

X. Proposal-Evaluation Criteria

The purpose of the proposal-evaluation process is to: 1) determine whether the proposals satisfied the minimum qualifications, content, and format requirements; and 2) identify the proposers most likely to satisfactorily perform the services described. The evaluation process will be conducted in a comprehensive and impartial manner.

Each proposal package will be date-and time-stamped when received. Proposals received after the submission date and time will be returned unopened. Each timely proposal will be reviewed to determine whether it satisfies the minimum qualifications specified in Section VII. Proposals that meet the minimum qualifications will be evaluated and scored. The highest possible score is 100 points.

Finalist Interviews

The CEA may invite finalists to interview at its office in Sacramento, California. All costs and expenses associated with preparing and submitting this RFQ, along with all travel costs related to the interview and contract-negotiation processes, are the sole responsibility of the proposer.

Proposal Evaluation

Criteria and maximum score for the proposal are noted below:

CRITERIA	MAXIMUM POINTS
Work Plan	40
Qualifications, Firm Background, and History	30
Fee	20
Interview	5
References	5
TOTAL SCORE POSSIBLE	100

XI. Award of Opportunity to Contract

If, at any time during or at the conclusion of the RFQ process, the CEA determines that the results or prospects of this RFQ process are unsatisfactory, the CEA reserves the right to discontinue this process and decline to award an opportunity to contract. The final award of the opportunity to contract will be determined by the CEA’s management.

The opportunity to contract will be awarded to the most qualified proposer, after price and other factors have been considered, provided that accepting the proposal is reasonable and in the best interests of the CEA. The CEA reserves the right to reject any or all proposals and to waive any irregularities in the proposals received.

XII. Commencement Date

The commencement date is to be determined.

Certain standard terms of the California Earthquake Authority's (CEA) contract with the Executive Search Services (Contractor) are summarized below:

The contract will include, but will not be limited to, the following provisions:

1. Services to be Performed

The complete description of services is provided in Attachment A: Statement of Work. The CEA's Chief Operations Officer, or a designee of either will manage and direct Contractor's activities.

2. Ambiguities Not Held Against Drafter

Because this Agreement has been freely and voluntarily negotiated by the parties, Contractor and CEA agree that ambiguous contractual provisions will not be construed against the drafter.

3. Amendments

This Agreement can be amended only by mutual consent of the parties. No change in any term will be valid unless the change is in writing and signed by both Contractor and the CEA. No verbal agreement or understanding will bind either party.

4. Assignment; Delegation

Contractor must not assign any of its rights or delegate any of its duties under this Agreement without first obtaining the CEA's written consent. Any purported assignment or delegation by Contractor, in whole or in part, in violation of this section, is voidable at the sole option of the CEA.

5. Attorney Fees and Costs

In the event of litigation between the parties to enforce or interpret this agreement, the non-prevailing party must pay the reasonable attorney fees, costs for in-house counsel services, and actual and taxable costs of the prevailing party. These expenses must be paid in addition to any other relief to which the prevailing party may be entitled.

6. Audits

Contractor is subject to examination and audit by the Bureau of State Audits, the CEA, and CEA's representatives during the term of this Agreement and for three years after the final payment under this Agreement. Any examination or audit would be confined to matters connected with the performance of the required services, including, but not limited to, the costs of administering this Agreement. Contractor must cooperate fully with the Bureau of State Audits, CEA, and CEA's authorized representatives in any examination or audit. All adjustments, payments, and reimbursements determined necessary through any examination or audit must be made promptly by the appropriate party to this Agreement.

7. Changes in Control, Organization or Key Personnel

- 7.1 Contractor must notify CEA in writing within five calendar days:
- A. if any of Contractor's representations or warranties ceases to be true;
 - B. of any change in Contractor's staff who exercise a significant administrative, policy, or consulting role, including the Key Personnel (Attachment ___);
 - C. of any change in the majority ownership, control, or business structure of Contractor;
 - D. of any other material change in Contractor's business organization.
- 7.2 All Contractor's written notices under this provision must contain adequate information to permit CEA to evaluate the changes within Contractor's personnel or organization under the same criteria used by CEA in its original selection of Contractor. Contractor must provide any additional information the CEA might request in connection with such written notices.

8. Choice of Law

This Agreement will be construed and enforced according to California law (without regard to conflict-of-law provisions). A party may sue only in the state court sitting in Sacramento, California. Suit includes any action to compel arbitration or enforce an arbitration award. Each party waives any claim that Sacramento is an inconvenient or improper forum or venue. Each party agrees that the courts named above will have *in personam* jurisdiction over it.

9. Compensation

- 9.1 CEA will compensate the Contractor in accordance with Attachment B (Schedule and Fees). The consideration will compensate Contractor for all expenses Contractor incurs in its performance of services, including travel and per diem.
- 9.2 Contractor guarantees the fees will not increase during the term of this contract.
- 9.3 Correspondence from Contractor to CEA regarding payments or any related compensation matters must be sent to:

California Earthquake Authority
801 K Street, Suite 1000
Sacramento, California 95814
Attn: Bob Stewart, Chief Operations Officer

- 9.4 **Billing and Invoicing.** Contractor must submit itemized monthly invoices in arrears for services already performed. The CEA will make no payments in advance of services rendered. Invoices must include:

- i. Contractor's name, address and telephone number
- ii. an itemized description of services, including a detailed cost breakdown; and
- iii. total amount of the invoice.
- iv. project: "Organization and Staffing Analysis"

Invoices must be addressed to: CEA
Accounts Payable
801 K Street, Suite 1000
Sacramento, CA 95814

9.5 Payment will not be due until the invoiced work is performed, correctly identified on the invoice, and accepted by the CEA. CEA will pay Contractor's invoices as promptly as fiscal procedures permit.

10 Compliance with Laws

10.1 The Contractor must comply with all applicable laws, including those laws specifically applicable because of its relationship to the CEA. Any references to federal or state statutes or regulations are also references to any amendments or successor provisions to those sections.

10.2 **Permits and Licenses.** At its sole expense, Contractor must procure and fully maintain any permits and licenses necessary to accomplish the required services.

10.3 **Additional Documents.** Contractor will execute any additional documents and perform any additional acts as might be reasonable and necessary to carry out the provisions of this Agreement.

11 Confidentiality

11.1 In the course of its duties, the Contractor will gain knowledge of investment, financial, personal, personally-identifiable, technical, accounting, and statistical information pertaining to the CEA, its Governing Board and Advisory Panel and their members, CEA employees, contractors, vendors, agents, and policyholders (collectively, "Restricted Information"). All Restricted Information is *strictly confidential* unless the CEA expressly designates particular Restricted Information as non-confidential. Contractor must not directly or indirectly disclose any Restricted Information, or use it publicly in any way that requires its disclosure, either during or following the term of this Agreement, without the CEA's advance written, specific permission.

11.2 Contractor will not produce, reproduce, publish, or disseminate Restricted Information for its or any other person's personal gain. For purposes of this Section 11, "person" means any person, association, organization, partnership, business trust, limited liability company, or corporation.

11.3 Contractor will only release Restricted Information to its employees, representatives, contractors, or subcontractors, or to any other persons, who have been officially notified in writing that they are expressly binding themselves to maintain confidentiality of the Restricted Information. To the best of its ability, Contractor must affirmatively protect all Restricted Information from unauthorized use or disclosure.

11.4 The Contractor's disclosure of Restricted Information in violation of this provision is a material breach of contract.

11.5 Contractor understands that CEA is a public instrumentality of the State of California and that CEA's and Contractor's records might be subject to public disclosure and production pursuant to various laws, including but not limited to the California Public Records Act (Chapter 3.5, commencing with Section 6250) of Division 7 of Title 1 of the California Government Code) and the Bagley-Keene Open Meeting Act (Article 9, commencing with Section 11120, of Chapter 1 of Part 1 of Division 3 of Title 2 of the California Government Code). The CEA will notify Contractor promptly after receiving a request for disclosure of any documents or materials Contractor has designated as proprietary and confidential in the

CEA's possession. CEA will reasonably cooperate with Contractor, within the statutory framework and limitations on CEA's duties under the applicable law, and at Contractor's sole cost and expense, in Contractor's efforts to protect its trade secrets and confidential information.

12 Conflicts of Interest

12.1 **Contractor's Warranty.** By its signature on this Agreement, Contractor warrants to CEA that no claimed, apparent, or actual conflict of interest exists on its part, or on the part of any principal, employee, contractor, or subcontractor, that would influence its:

- A. advice and recommendations to the CEA;
- B. statements made about the CEA to any person or entity;
- C. activities performed on behalf of the CEA; or
- D. decisions taken or enacted on behalf of the CEA.

12.2 **Contractor's Affirmative Duties to Disclose and Address Conflicts of Interest.** The parties mutually intend and agree that the duty to disclose a claimed, apparent, or actual conflict, is Contractor's sole, affirmative duty. Contractor's failure to identify and disclose such a conflict of interest is a material breach of this Agreement and a default justifying Agreement termination, as the term "default" is used in Subsection (Termination for Contractor's Default). The CEA has sole authority and discretion to determine at any time the import and significance of Contractor's failure to identify and disclose any conflict of interest. Contractor must abide in good faith by any protocols developed by CEA before or during the term of this Agreement to identify, disclose, and address potential, apparent, and actual conflicts of interest. Contractor promises to provide the CEA with any requested information, documentation, and assurances, in writing if so requested, concerning any claimed, apparent, or actual conflict of interest.

12.3 **Fair Political Practices Laws.** Contractor must not directly or indirectly receive any personal benefit from information obtained from the CEA, or received or provided on behalf of CEA. Contractor must disclose to CEA any personal investment or economic interest that may be enhanced or made more valuable by any recommendation made to or activity undertaken on behalf of the CEA. Contractor acknowledges that the CEA is subject to the provisions of the Fair Political Practices laws of California (Government Code Section 81000, et seq., and the regulations adopted under that law), and Contractor must comply with the requirements of that law and those regulations. If requested by CEA, designated Contractor personnel will file with CEA a Statement of Economic Interests in compliance with CEA's Conflict of Interest Code (California Code of Regulations, Title 5, Part III, Chapter 1, Section 22000, et seq.).

12.4 Neither Contractor, nor any of its subsidiaries, officers, or directors, may submit a bid or be awarded a contract to provide services to CEA, procure goods or supplies for CEA, or perform any related action that is an outgrowth of the investment services or advice Contractor provides CEA under this Agreement.

13 Cumulative Remedies

The rights and remedies provided in this Agreement are cumulative and are not exclusive of any rights or remedies any party might otherwise have at law or in equity.

14 Drug-Free Workplace

Contractor will execute and return the certification in Attachment E with the signed Agreement. CEA may terminate the Agreement if the Contractor fails to comply with these drug-free workplace requirements.

15 Force Majeure

Neither party is liable for damages that result from delayed or defective performance when the delays arise from an event that is beyond the control and without the fault or negligence of the offending party. Force majeure events include, but are not restricted to, acts of a public enemy, acts of the State in its sovereign capacity, disabling strikes, epidemics, and quarantine restrictions.

Contractor is not excused for any delays or interruption in performance caused by events such as fires, floods, earthquakes, power failures, or freight embargoes; CEA relies on Contractor's statements and assurances in the Disaster Recovery Plan (Attachment F) and expects continuity of service during such events.

16 Indemnification

16.1 Contractor must indemnify, defend, and save harmless the CEA, the CEA Governing Board and Advisory Panel, and all CEA officers, agents, and employees, from and against any and all losses, costs, liabilities, damages or deficiencies, including interest, penalties and attorney fees, arising from any claims of:

- A. Contractor's breach of its promises, warranties, or other obligations; or
- B. Contractor's acts or omissions constituting bad faith, willful misfeasance, negligence, or reckless disregard of its duties under this Agreement.

16.2 For purposes of this section 20, and in reference to the provisions of section 5 (Assignment; Delegation), a subcontractor's or Contractor's consultant's act or omission to act, whether under Contractor's permitted or unpermitted delegation under this Agreement or unrelated to any delegation, is considered for all purposes the act or omission of Contractor.

17 Insurance

Contractor warrants that it maintains, or will obtain before commencing work under this Agreement, adequate liability and other necessary insurance, including such workers' compensation insurance as required by law, and promises to maintain that insurance at levels acceptable to the CEA at all times during the term of this Agreement. Contractor agrees to:

- A. maintain a liability insurance policy with limits of no less than \$1,000,000 per person / \$3,000,000 per occurrence, providing coverage for all of Contractor's activities;
- B. make CEA an additional named-insured in that policy, with right to notice of nonpayment of premium or cancellation of the policy;
- C. maintain adequate Errors and Omissions insurance, with limits of no less than \$1,000,000; and
- D. provide satisfactory evidence of insurance coverage to the CEA on request.

By its signature on this Agreement, Contractor acknowledges that CEA has no obligation to provide workers' compensation insurance or employee benefits of any nature for Contractor or Contractor's employees or subcontractors.

18 Key Personnel

- 18.1 Attachment D (“Key Personnel”) lists each person exercising a significant administrative, policy, or consulting role under this Agreement. Those personnel are referred to in this Agreement as “Key Personnel.”
- 18.2 Contractor may not substitute, replace, or reassign Key Personnel without CEA’s advance written approval. With CEA approval, the parties may document a change in the Key Personnel, and that writing will then become part of this Agreement. All Key Personnel are expressly subject to the provisions of Sections 7 (Changes in Control, Organization or Key Personnel) and 20 (Notices).
- 18.3 In its sole discretion, CEA can terminate this Agreement immediately, on written notice from CEA to Contractor, if Contractor changes any of its Key Personnel without the CEA’s agreement or if any one or more of the Key Personnel depart Contractor’s staff.

19 Notice of Proceedings

Contractor must promptly notify the CEA in writing of any investigation, examination, or other proceeding commenced by any regulatory agency and involving Contractor, its subcontractors, or any of its Key Personnel that is not conducted in the ordinary course of Contractor’s business.

20 Notices

Any notice required or permitted by this Agreement is deemed given:

- A. on the date of personal delivery;
- B. three days after the mailing date if deposited with the U. S. Postal Service; or
- C. on the date of receipt as shown by written (or, if the record is contained only on a computer storage device, stored) evidence of delivery when delivered by Express Mail or overnight delivery service.

No notice is effective if given only by facsimile machine (fax). Notices are to be directed to all the following representatives:

For CEA:

California Earthquake Authority 801 K Street, Suite 1000 Sacramento, California 95814 Attn: Chief Operations Officer	and	California Earthquake Authority 801 K Street, Suite 1000 Sacramento, California 95814 Attn: General Counsel
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For Contractor:

21 Publicity

Contractor must not release any publicity or announcement concerning this Agreement without the advance written approval of the CEA.

22 Record-keeping; Record Retention

Contractor will keep accurate and appropriate records to accomplish and document the services performed.

22.1 Contractor will use reasonable efforts to ensure that books and records of any permitted subcontractors are accurately maintained; all such books and records must be made available for inspection and copying by CEA or its representatives on reasonable prior notice and during normal business hours. Contractor must maintain its CEA-related records separate and distinct from the records pertaining to other clients.

22.2 All information, data, reports, and records associated with the CEA are the property of CEA and must be returned if requested at any time, and on termination or expiration of the Agreement. Contractor is permitted to keep copies of all such information, data, reports, and records Contractor requires, for three years after final payment on the Agreement.

23 Relationship of the Parties

23.1 This Agreement creates a relationship of independent contractor. CEA is interested only in the results to be achieved under this Agreement; the conduct of the work will lie solely with the Contractor. The work Contractor performs under this Agreement, however, must meet the general approval of the CEA and will be subject to the CEA's general right of inspection and supervision to secure its satisfactory completion.

23.2 Contractor's principals, employees, and contractors are not and will not be considered employees of CEA and are not entitled to any benefits provided by the CEA, or by the State of California, to its employees.

24 Reports

In addition to project deliverables, Contractor must provide other material that the CEA reasonably requests. Contractor will provide oral or written progress reports to:

- A. determine if Contractor is performing satisfactorily and timely;
- B. communicate interim findings; and
- C. facilitate discussion and resolution of issues.

25 Rights in Work

25.1 Neither Contractor, any subcontractor or other consulting staff employed by Contractor, has or will have any rights in any reports, data, documents, systems, or concepts (collectively, "Products") produced by Contractor for CEA. Only CEA has ownership of the Products that result from services provided under this Agreement. CEA reserves the right to give or otherwise release the Products.

25.2. Contractor reserves all rights to its intellectual property (IP) that predates the work performed for CEA, and to coincidental improvements to its IP made during the performance of the work under this Agreement, to the extent that such IP and coincidental improvements are exclusive of the Products.

25.3. CEA may grant Contractor the rights to publish results of its work in professional journals or as presentations at professional conferences, as specified with CEA's written approval for each publication proposed by Contractor.

CEA will not unreasonably withhold or delay approval or non-approval.

25.4 All Products are, and will be considered for all purposes, works-for-hire, including for purposes of interpretation under U.S. Copyright Law, 17 U.S.C. §101, et seq. To the extent that the Products are not construed as works-for-hire, Contractor will assign, and hereby does assign to the CEA, perpetually and without further consideration, all right, title, and interest to the Products. All right, title, and interest in the Products, and any copyright, patent, trade secret, or other proprietary right in the Products, are and shall be the sole property of the CEA.

25.5. Contractor grants to the CEA a perpetual, worldwide, royalty-free license or sublicense to use, copy, maintain, or modify, or to sublicense others to use, copy, maintain, or modify, intellectual property developed by Contractor before the date of the parties' initial agreement to develop the Products (before January 1, 2008) and used by Contractor in connection with the development and production of the Products.

25.6. Contractor will place in a "Source Code Escrow" the source code, object code, and documentation for all software used in connection with the development of the Products, and developed by Contractor for CEA after the date of the parties' initial agreement to develop the Products (after January 1, 2008). The source code, object code, and documentation for that software will be released to the CEA if the Contractor:

- A. is dissolved or adjudged bankrupt;
- B. is acquired by or merged with another business entity;
- C. is in material breach of this Agreement;
- D. is terminated for any reason; or
- E. has completed services for CEA.

26 Subcontractors

26.1 Contractor must perform the work contemplated under this Agreement with resources available within its own organization. Contractor must not subcontract any part of its work under this Agreement without the advance written permission of the CEA. The parties must agree in advance on any subcontractor.

26.2 Contractor must require in writing of any subcontractor that it be bound by all provisions of this Agreement.

27 Taxes

CEA is exempt from Federal excise taxes and will make no payment for or in connection with personal property taxes levied on Contractor or taxes levied on or in connection with Contractor's compensation.

28 Termination

This Agreement can be terminated as follows:

- 28.1 **Termination at the Option of the CEA.** This Agreement may be terminated in whole or in part, for any reason including the convenience of the CEA, and at any time with 30 days written notice by CEA. Despite any termination, and at its sole option, CEA can maintain this Agreement in effect for those transactions pending on the effective date of termination until those transactions are completed. Additionally, Contractor must take all steps specified by CEA to dispose of or otherwise administer any investments entered into under this Agreement. Upon its receipt of a termination notice from CEA, Contractor must promptly discontinue all services affected unless the notice specifies otherwise. If CEA terminates all or any part of this Agreement, CEA will pay Contractor for satisfactory services rendered before the termination, but not more than the maximum amount payable under applicable compensation provisions of this Agreement.
- 28.2 **Termination for Contractor's Default.** In addition to any other termination right, CEA is entitled, with two days written notice to Contractor and without any prejudice to its other remedies, to terminate this Agreement because of Contractor's failure to fulfill any of its Agreement obligations – any such failure is termed Contractor's Default. Upon its receipt of any notice from CEA terminating this Agreement for Contractor's Default, Contractor must immediately discontinue all services affected, unless the notice directs otherwise. Following a two-day notice of termination, CEA will pay Contractor only the reasonable value of its services rendered. In CEA's sole discretion and on any terms it chooses, CEA may offer Contractor an opportunity to address any default or cure any breach.
- 28.3 **Termination for Insolvency.** Contractor must notify CEA in writing immediately if Contractor or any principal of Contractor:
- A. files or is placed under federal bankruptcy laws,
 - B. files or becomes the subject of a state receivership action,
 - C. is adjudged bankrupt,
 - D. has a receiver appointed who qualifies,
 - E. makes an assignment for the benefit of creditors, or
 - F. is the subject of criminal investigation, indictment, or conviction.
- If any of the foregoing events occurs, or if CEA receives notice of any of the foregoing events, or if CEA reasonably determines there is a substantial probability that Contractor will be unable (financially or otherwise) to continue its performance, CEA is entitled to terminate this Agreement and all further rights and obligations immediately upon two days written notice.
- 28.4 **Convenience.** If CEA gives Contractor a notice of termination for failure to fulfill Agreement obligations and it is later determined that Contractor had not so failed, the termination will be considered to have been for the convenience of the CEA.
- 28.5 **Completion.** If CEA terminates this Agreement for Contractor's Default, CEA reserves the right to take over and complete Contractor's work by any means. Contractor will pay the CEA for any additional costs CEA incurs to complete the work, to the extent that those additional costs were incurred due to Contractor's Default.

29 Termination, Effect of

- 29.1 All duties and obligations of CEA and Contractor will cease on termination of this Agreement, except:

- A. Each party will remain liable for any rights, obligations, or liabilities that arose or may arise from its activities under this Agreement before it effectively terminated; and
- B. Those clauses named in Subsection 33.7 (Survival).

29.2 Within 15 days after the effective termination date, Contractor will deliver to the CEA all CEA records and deliverables, whether prepared by Contractor or received by Contractor from a third party. The records and Products include, but are not limited to:

- A. due diligence reports;
- B. reports and data prepared by Contractor, subcontractor or consultants;
- C. financial statements, investment performance data, and related reports and data systems prepared in connection with investment monitoring services;
- D. products, modified software, manuals, custom scripts, code, and processes.

Together, Contractor and CEA will determine an effective method and form to transfer the records and Products, and Contractor will deliver all records and property in usable form. Contractor will cooperate fully to ensure an orderly termination process and orderly transfer of services.

29.3 Upon expiration or termination of this Agreement, Contractor will provide all reasonable assistance to transition CEA's records, accounts, funds, required services to CEAs subsequent service provider, without additional costs to CEA.

29 Time Is of the Essence

Time is of the essence for delivery of services under this Agreement.

30 Waivers

A party's delay in exercising any right or privilege is not a waiver of any Agreement provision. Neither party's waiver, or single or partial exercise of any right or privilege will preclude any other or further exercise of any other right or privilege under this Agreement.

31 Warranties

The Contractor warrants its compliance with the following requirements:

32.1 Employees

- A. Americans with Disabilities Act. Contractor warrants that it complies with the Americans with Disabilities Act of 1990 (42 U.S.C. 12101, et seq. – the "ADA") and all regulations and guidelines issued under the ADA.
- B. Fair Employment and Housing Act. Contractor and subcontractors will comply with the provisions of the Fair Employment and Housing Act (Government Code section 12900 et seq.) and the related regulations (California Code of Regulations, Title 2, Section 7285.0 et seq.). The regulations of the Fair Employment and Housing Commission that implement Government Code section 12990, subdivisions (a) through (f) (Chapter 5 of Division 4 of Title 2 of the California Code of Regulations) are by this reference made a part of this Agreement.
- C. Nondiscrimination. During the performance of this Agreement, Contractor and its subcontractors, and their agents and employees, will not unlawfully discriminate

against, harass or allow harassment of any employee or applicant for employment because of sex, race, color, ancestry, religious creed, national origin, physical disability (including HIV and AIDS), mental disability, medical condition (including health impairments related to a diagnosis of cancer for which a person has been rehabilitated or cured), age (40 or over), marital status, denial of family and medical care leave, or denial of pregnancy disability leave. Contractors and subcontractors, and their agents and employees, must ensure that the evaluation and treatment of their employees and applicants for employment are free from those types of discrimination and harassment.

Contractor must include the nondiscrimination and compliance provisions of this clause in all permitted subcontracts to perform work under this Agreement.

32.2 Labor

- A. **Collective Bargaining.** Contractor and its subcontractors must give written notice of their obligations under this clause to all labor organizations with which they have a collective bargaining or other agreement, if any.
- B. **National Labor Relations Board Certification.** Contractor affirms, under penalty of perjury, that no more than one final, finding of contempt of a Federal Court has been issued against Contractor within the immediately preceding two-year period because of Contractor's failure to comply with a Federal court's order to comply with a National Labor Relations Board order.

32.4 Standard of Care. The personnel or subcontractors responsible for discharging Contractor's duties under this Agreement are experienced in the performance of the duties contemplated and will meet the appropriate standard of care;

32.5 Signature Authorization.

- A. The execution and performance of this Agreement will not:
 - 1. violate any provision of any charter document of the Contractor;
 - 2. violate any statute or any judgment, decree, order, regulation, or rule of any court or governmental authority applicable to Contractor; or
 - 3. violate, conflict with, constitute a default under, permit the termination of, or require the consent of any person under, any agreement to which Contractor may be bound, the occurrence of which would have a material adverse effect on the properties, business, prospects, earnings, assets, liabilities or financial or other condition of Contractor.
- B. The person signing the Agreement warrants that he or she is an agent of the Contractor and is duly authorized to enter into the Agreement on behalf of the Contractor.
- C. Contractor represents and warrants that it has the power and authority to enter this Agreement and carry out its obligations under this Agreement and it has duly authorized the execution of this Agreement, and no additional act of Contractor is necessary to authorize this Agreement. Contractor has completed, obtained, and performed all registrations, filings, approvals, authorizations, consents, and examinations any government or governmental authority may require for its acts contemplated by this Agreement.

32.6 Contractor warrants that it will promptly notify the CEA of any changes in Contractor's compliance with the warranties stated here, and agrees to restore the warranties, as the CEA in its discretion may require, if a lapse occurs. If the Contractor does not provide notice to the CEA to the contrary, the CEA has the absolute right to rely on the ongoing effectiveness of each warranty stated here.

33 Term of Agreement

33.1 This Agreement is effective on Month Date, 2011 and its term expires on Month Date, 2011, unless terminated sooner in accordance with the provisions of Sections 28 (Termination). The CEA may extend this Agreement for the second and third years, without any increase in the fees. The CEA may extend this Agreement for the fourth and fifth years, with the increase in fees provided in Attachment B (Schedule and Fees

33.2 Despite the completion or termination of services, other contractual obligations, including audit, confidentiality, indemnification, record-retention, rights in work, and warranties will continue.

34 Entire Agreement

34.1 This Agreement (A) states all representations of and the entire understanding between the parties with respect to the subject of this Agreement and (B) replaces any prior correspondence, memoranda, or agreements.

34.2 **Binding Effect.** This Agreement, and any instrument or further agreement executed pursuant to this Agreement, will bind the parties, their successors, assignees, and legal representatives.

34.3 **Counterparts.** This Agreement may be executed in counterparts. Each counterpart is an original; all counterparts together are one instrument.

34.4 **Incorporated Documents.** This Agreement consists of the terms of this Agreement and all attached documents that are expressly incorporated. The following schedules and attachments are attached and incorporated into this Agreement:

Attachment A: Scope of Work

Attachment B: Schedule and Fees

Attachment C: Service Expectations

Attachment D: Key Personnel

Attachment E: Drug-Free Workplace Certification

34.5 **Order of Precedence.** For any inconsistencies or ambiguities in the terms of this Agreement and incorporated documents, the following order of precedence will be used:

(i) applicable laws;

(ii) the terms and conditions of this Agreement, including attachments;

(iii) any other provisions, terms, or materials incorporated into this Agreement.

34.6 **Severability.** Should any court hold any provision of this Agreement to be void or unenforceable, the remaining provisions will remain in effect if they are still capable of performance.

34.7 **Survival.** Certain contractual obligations will survive completion of the work or termination of services. These include, but are not limited to: prevailing party's attorney

fees and costs, audit compliance, confidentiality requirements, fiduciary obligations, indemnification, publicity limitation, record retention, rights to work, and warranties.

34.8 **Titles / Section Headings.** Titles and section headings are not part of this Agreement.

California Earthquake Authority

Travel Reimbursement for Contractors¹

1. Policy

The CEA will reimburse for the Contractor's necessary actual expenses incurred by when traveling on official CEA business, if contractually agreed. Contractor's travel must be pre-approved by the CEA department manager.

2. Required Information

All reimbursement requests must be typed, properly itemized, and accompanied by the required receipts. Reimbursement requests must be approved by the appropriate CEA contract manager.

Reimbursement requests must provide the required information:

- CEA department manager's prior approval
- Purpose of business trip
- Claimant's name and address
- All appropriate expenses (airfare, hotel)
- Dates and times when expenses occurred
- Location where expenses occurred
- Signatures of claimant
- Any additional justification required

3. Receipts

Receipts are required for: (a) lodging; and (b) airfare – with travel agency or reservation receipt *and* passenger receipt)

Original receipts must be provided. Receipts must be pre-printed with the name of the business. Lodging receipts must show transaction dates and payment made. Airfare receipts must include agreements, invoices, passenger receipts, and ticket stubs.

4. 50-Mile Rule

No expenses (lodging or airfare) is allowed at any location within 50 miles of the claimant's business address, or within 50 miles of a claimant's primary residence.

All reimbursement requests must document the claimant's starting point of travel - either the business address or primary residence address.

¹ Contractor travel policies are subject to revision.

5. Lodging Reimbursement

Subject to CEA policies for non-employees, the cost of lodging may be claimed if travel is pre-approved.

6. Airfare Reimbursement

The CEA will reimburse for the *least expensive* mode of transportation available. Determination of the least expensive mode of transportation will include consideration of air, rail, and bus travel as well as the

Drug-Free Workplace Certification

The proposer named above hereby certifies that, if awarded a contract, it will comply with Government Code Section 8355 in matters relating to providing a drug-free workplace. The above named proposer will:

1. Publish a statement notifying employees that unlawful manufacture, distribution, dispensation, possession, or use of a controlled substance is prohibited and specifying actions to be taken against employees for violations, by Government Code Section 8355(a).
2. Establish a Drug-Free Awareness Program as required by Government Code Section 8355(b).
 - a) The dangers of drug abuse in the workplace,
 - b) The person’s or organization’s policy of maintaining a drug-free workplace,
 - c) Any available counseling, rehabilitation and employees assistance programs, and
 - d) Penalties that may be imposed upon employees for drug abuse violations.
3. Provide as required by Government code Section 8355(c) that every employee who works on the proposed contract:
 - a) Will receive a copy of the company’s drug-free statement, and
 - b) Will agree to abide by the terms of the company’s statement as a condition of employment on the contract or grant.

CERTIFICATION

I, the official named below, hereby swear that I am duly authorized legally to bind the proposer to the above described certification. I am fully aware that this certification, executed on the date and in the county below, is made under penalty of perjury under the laws of the State of California.

Proposer’s Authorized Signature

Title

Date Executed

In the County of

Federal Identification Number

The proposer must provide at least three references the CEA may contact that have been clients of the proposer within the past three years, including the name, address, and telephone number of the client, the name and title of the contact person, and a general description of the services provided to each client.

Name of Firm: _____

Address: _____

Contact Person: _____

Phone: () _____

Brief Description of Project:

Date and Dollar Value of Project _____

Name of Firm: _____

Address: _____

Contact Person: _____

Phone: () _____

Brief Description of Project:

Date and Dollar Value of Project: _____

Name of Firm: _____

Address: _____

Contact Person: _____

Phone: () _____

Brief Description of Project

Date and Dollar Value of Project: _____

Organization and Staffing Analysis

Status: On Schedule

Phase 1	Phase 2	Phase 3	Phase 4	Phase 5
Create a blended team of PwC and CEA subject matter specialists	Understand and Document the Current Organization Structure	Analyze Alignment and Identify Recommendations	Finalize Recommendations	Identify Key Initiatives from Recommendations
Conduct Project Kick-off Meeting	Identify Key Stakeholders	Conduct Gap Analysis	Prioritize Recommendations	Develop Final Report
Develop the Project Schedule	Review CEA Internal Documentation	Develop Interim Report	Define Future-State Organization Design	Develop Tactical Roadmap
Facilitate CEA Executive Team Meeting	Conduct Key Stakeholder Interviews	★ Deliver Interim Report 9/9/2011	Conduct High-Level Business Impact Analysis	★ Deliver Final Report 10/14/2011
Develop Key Stakeholder Interview Guide	Develop Observations and Key Findings			

Color Key

Completed	In Process	Future Tasks
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Governing Board Memorandum

August 25, 2011

Agenda Item 7: CEA Advisory Panel update—Wayne Coulon

Recommended Action: No action required - information only

CEA Advisory Panel Chair Wayne Coulon will provide a summary of the proceedings from the July 21, 2011, Advisory Panel meeting.

Governing Board Memorandum

August 25, 2011

Agenda Item: 8 Proposed 2012 Marketing Value Program (MVP) budget

Recommended Action: Approve funds to support 2012 MVP implementation

Background:

CEA's marketing has evolved since it opened for business in 1996. Its primary pre-2011 marketing-related activities included:

- 1998 – The SAFER program offered free engineered retrofit-need assessments.
- 2003 – The CEA's CEO mailed a letter describing the benefits of earthquake insurance to each CEA policyholder.
- 2005–06 – CEA joined with the American Red Cross to distribute preparedness kits.
- 2008–09 – CEA sent direct-mail to mobilehome owners to promote a rate decrease.
- 2008–10 – CEA took a leading role in what have become annual *ShakeOut* drills and led promotion through direct mail and paid and earned media.
- CEA provided substantial financial and program support for the USGS publication, *Putting Downs Roots in Earthquake Country*.
- CEA often used paid media, post-event(s), to alert policyholders (and potential policyholders) to important CEA-related claim information.

Analysis:

Key experiences gained from these marketing-related activities before 2011 included:

- Differing forms of CEA new-policy-sales data provided by participating insurers make returns-on-investment for CEA marketing-related activities difficult to quantify.
- Marketing-related activities done on a project-by-project basis present challenges for coordinating with participating-insurer annual marketing plans.
- Previous limited CEA marketing investments (2008–10) demonstrate ability to reverse cyclical policies-in-force downturns and add new policies. (See Attachment A)

In addition to collecting experiences from past marketing activities, the CEA recently completed a comprehensive marketing-research plan designed to produce all information needed to plan and make confident marketing decisions:

- CEA market research – to simulate purchase decisions according to local levels of risk.
- CEA policyholder research – to identify bases for sales after damaging earthquakes.
- CEA branding research – to identify a (marketing) “story” or “promise.”
- Independent social science research – to analyze low levels of earthquake preparedness.
- CEA / CalEMA research – to identify a common message for all stakeholders.

Based on marketing-research results and other, related criteria, the CEA Governing Board on August 26, 2010, approved spending up to \$5 million to support a first-time *annualized* CEA new-policy sales-incentive program for 2011. On October 28, 2010, the Board approved an additional \$550,000 (from unused 2010 *ShakeOut* funds) for a similar 2011 use.

The other, related criteria included:

- Align CEA with industry standards for policyholder acquisition and retention.
- Produce return-on-investment that builds CEA capital.
- Introduce CEA's new brand (*Strength to Rebuild*) to the marketplace.
- Create "CEA relationship" with participating-insurer agents.
- Increase CEA awareness among residential-earthquake-insurance prospects.
- (Further) educate CEA policyholders on CEA claim-paying processes.
- Generate 150 million sales impressions through paid media and direct mail.
 - \$1,750,000 for paid media
 - Plus \$390,000 (*of \$550,000*) to purchase additional TV advertising
 - Plus \$110,000 (*of \$550,000*) to produce a CEA-branded TV ad
 - Plus \$25,000 (*of \$550,000*) to streamline Putting Down Roots publication
 - Plus \$25,000 (*of \$550,000*) to update the CEA logo
 - \$489,000 for direct mail to policyholders (two mailings)
 - \$2,761,000 for direct mail to non-policyholders (three mailings)
- Deliver new-policy-sales incentives for up to 5,000 participating-insurer agents in Flight 1, up to 5,000 CEA-trained agents in Flight 2, and in Flight 3, for up to 5,000 CEA-trained agents who sell three new CEA policies (a flight is a period when paid media and direct mail run concurrently).
- Sell 15,000 new policies.
- Retain more than 800,000 existing policies.

As of August 18th, and although new-policy sales data is not yet final following Flight 1 (June 13–26) and with paid media and direct mail still underway for Flight 2 (August 15-28), data supporting CEA's 2011 Marketing Value Program (MVP) is trending positively:

- All participating insurers are fully engaged or have plans to participate in the MVP.
- Agents trained is up 129 percent compared to same date last year.
- Agents enrolled in the MVP is up 57 percent compared to 2010 ShakeOut.
- New MVP policies sold already is at 54 percent of goal (by agents registered in MVP).
- CEA Web-site-visit analytics show timely marketing impacts.

Key experiences gained from MVP-related activities thus far in 2011 include:

- Agents have informed the CEA of potential confusion associated with, for example, meeting the deadline for Flight 2 registration (July 1) at the same time they're distributing direct mail for Flight 1 (June 13-26); suggest reducing from three flights to two.
- First-time availability of CEA's overall new-policy-sales and existing-policy-retention data — including but not limited to the MVP — support new marketing opportunities; reveals need for greater emphasis on policy/policyholder retention.

- By reducing paid media and direct mail from three flights to two, top-of-mind CEA-brand awareness generated among agents and consumers may erode between flights; propose increasing paid-media budget to support year-round plan and replacing third flight of direct mail with year-long online-marketing strategy.

Digital, mobile, and social media have become dominant forces in how today's consumers make daily purchase decisions. As a result, with CEA's investment in traditional-media materials (TV, radio and newspaper advertising) now ready for multi-year execution, the CEA is prepared to further enhance its media mix with inclusion of an online-marketing component:

- Offers layer of year-round continuity messaging not affordable with other media.
- Provides opportunity to reach statewide audience efficiently and effectively.
- With all appropriate safeguards observed, enhances ability to segment/target new policyholders through their online interests.
- Increases level of data available for real-time analyses and ROI evaluation.
- Provides reliable levels of measurement unmatched by any other medium.
- Offers seamless integration with traditional media planning.

Conclusion:

Clearly the data available thus far demonstrates successful implementation of CEA's 2011 (first-year) MVP. Most important, participating-insurer agents are highly interested in ongoing MVP participation.

Key components of the CEA's 2011 MVP campaign (see *Item 10/Attachments C–H*, presented at the Board meeting on June 30, 2011) are proving to be effective just midway through the first year of implementation.

But ongoing refinements are required in all successful marketing programs. While traditional MVP media materials developed to date — such as TV, radio, and online advertising — are standing the test of time, the CEA may have sought to accomplish too much, too soon, through the number of direct-mail flights through agents. In addition, first-time availability of new-policy-sales and existing-policy-retention data support the need for significant prioritizing adjustments to future CEA marketing-budget numbers.

Like CEA's 2011 planning, CEA's 2012 marketing-budget recommendation remains less than 1 percent of total premium revenue, is based on (industry-standard) policy acquisition and retention percentages, and produces a return-on-investment that increases CEA's capital:

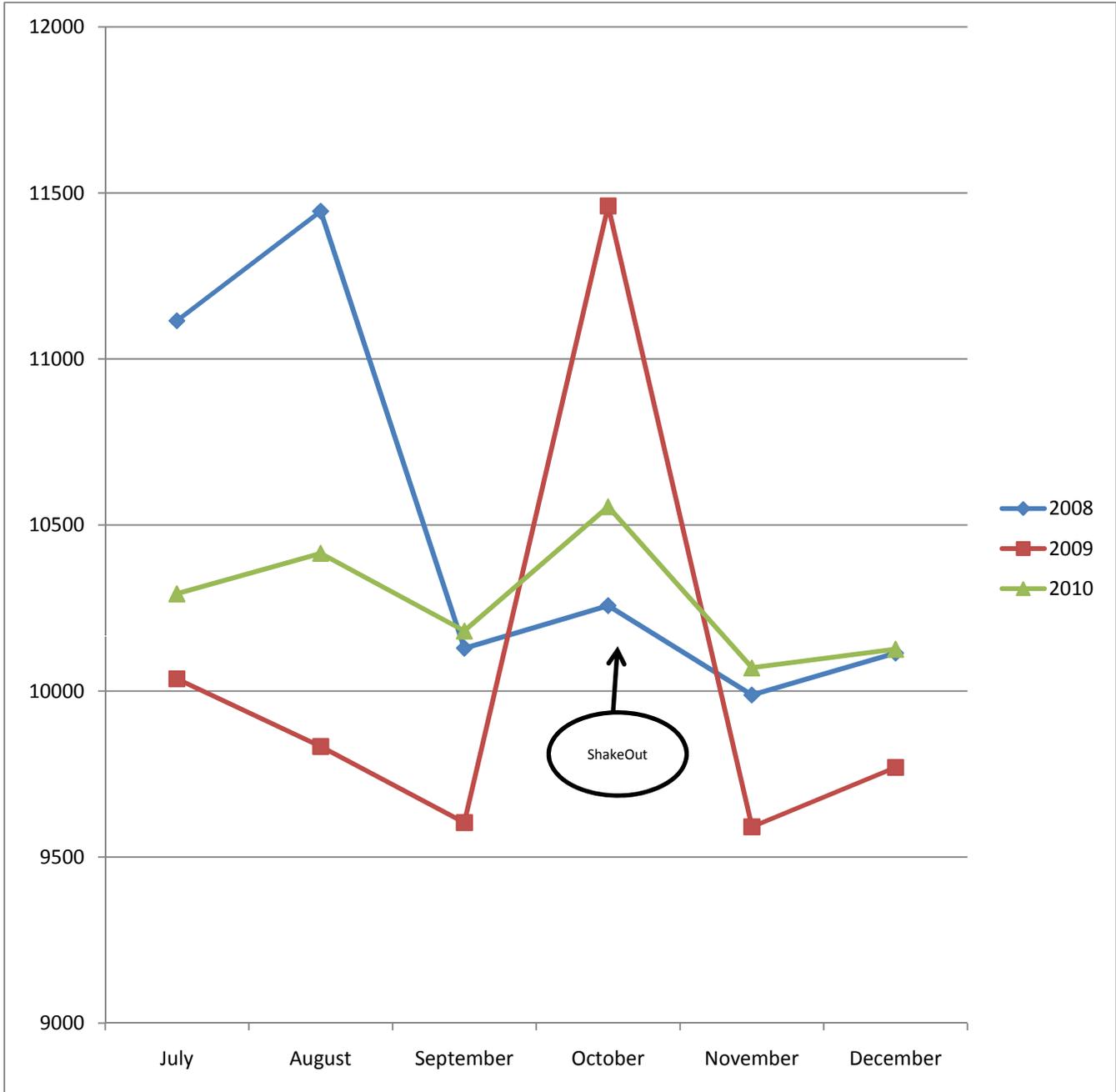
- \$4,775,000 for year-round paid media and online marketing
- \$1,832,000 for direct mail to non-policyholders (two flights/timing to-be-determined)
 - Flight 1 for up to 5,000 participating-insurer agents
 - Flight 2 for up to 5,000 CEA-trained agents who sell three new CEA policies
- \$1,108,000 for direct mail to policyholders (two flights/timing to-be-determined)
- **\$7,715,000 total marketing budget to achieve an overall increase in CEA homeowners policies by 40,000 (through both retention and new-policy sales).**

CEA staff also is proposing to rollover unspent 2011 marketing funds into the 2012 marketing budget, of which no more than \$75,000 in unspent direct-mail funds would be budgeted for near-term creation of 2012 online-marketing plans produced by a subcontractor.

Recommendations:

- Approve a 2012 MVP budget of up to \$7,715,000 to support a second year of annualized strategic-marketing programming.
- Approve the rollover of previously authorized, but unspent, 2011 marketing funds for use in 2012, of which no more than \$75,000 would be paid near term for a subcontractor to develop 2012 online-marketing plans.

July-December 2008-2010 CEA New Policy Sales Data



Previous CEA marketing investments (2008-10) demonstrate ability to reverse cyclical (policies-in-force) downturns and add new policies

Governing Board Memorandum

August 25, 2011

Agenda Item 9: Reports of Audits on CEA Annual Financial Statements (2010)

Recommended Action: No action required – information only

Background:

Larson & Rosenberger, LLP, the California Earthquake Authority's independent auditor, has performed audits of the CEA's financial statements for the year ended December 31, 2010.

- The independent auditor conducted an audit of the CEA's financial statements prepared in accordance with generally accepted accounting principles (GAAP) in the United States of America.
- In addition, and at the CEA's request, the independent auditor also conducted a first-time audit of the CEA's statutory financial statements based on accounting practices prescribed or permitted by the California Department of Insurance.

Reports of Audit for GAAP financial statements are found in *Attachment A* and consist of:

- Independent Auditor's Report
- Management's Discussion and Analysis (MD&A)
- Audited Financial Statements and accompanying notes
- Supplementary Information

Reports of Audit for statutory financial statements are found in *Attachment B* and consist of:

- Independent Auditor's Report
- Audited Statutory Financial Statements and accompanying notes
- Supplementary Information

Analysis:

According to the Independent Auditor's Reports, CEA's 2010 audited GAAP and statutory financial statements present fairly, in all material respects, the financial position of the CEA, in conformity with accounting principles generally accepted in the United States of America and accounting practices prescribed or permitted by the California Department of Insurance, respectively, with the exception of an adjustment to the cumulative pro forma premium tax.

As described in more detail on page 6 of the MD&A (and as observed in Note 2 to the GAAP financial statements), pro forma premium tax of \$11.4 million (and what the CEA law deems a corresponding contribution by the state in the same amount — \$11.4 million) was recognized in the financial statements for the year ended December 31, 2009, because of an error correction in the premium-tax calculation for the prior periods 1997 through 2008.

It is the opinion of the independent auditor that although the cumulative effect of this correction from 1997 forward had a material impact on the 2009 GAAP financial statements, the annual impact of this correction on the stand-alone GAAP financial statements for 2008 was not material, nor (in the judgment of management) was it material to any period back to and including 1997.

A representative of Larson & Rosenberger, LLC, will present to the Board the independent auditor's Management Comment Letter (*Attachment C*).

Recommended Action:

No action required – information only.

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
Assets			
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>
Liabilities and Net Assets			
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 nd 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
Assets		
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
 Liabilities and Net Assets		
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
Cash Flows from Operating Activities:		
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
 Cash Flows from Noncapital Financing Activities:		
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)
 Cash Flows from Capital and Related Financing Activities:		
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
 Cash Flows from Investing Activities:		
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
 Reconciliation to statement of net assets:		
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 2nd 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.

SUPPLEMENTARY INFORMATION

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 ¹	58,992,512
California State Automobile Association Inter-Insurance Bureau ²	39,013,494
Safeco Insurance Company of America ³	46,500,000
California FAIR Plan Association	15,029,487
Interinsurance Exchange of the Automobile Club	14,443,651
CNA/Continental ⁴	13,924,611
Prudential ⁴	11,531,455
Liberty Mutual Fire Insurance Company ⁵	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) ⁴	123,133
Merastar ⁶	-
Homesite Insurance Company of California	-
Pacific National Insurance ⁴	-
Encompass Insurance Company	-
Glen Falls Insurance Company ⁴	-
Commerce West Insurance Company	-
Total	\$ 756,612,796

¹Includes Garrison Insurance Company

²Includes ACA Insurance Company

³Joined the CEA as of December 1, 2008

⁴Not currently writing residential property insurance in California

⁵Includes Golden Eagle Insurance Company

⁶Withdrew 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 ¹	79,572,597	75,655,533
California State Automobile Association Inter-Insurance Bureau ²	25,464,527	21,402,761
Safeco Insurance Company of America ³	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 ⁴	-	-
Prudential ⁴	-	-
Liberty Mutual Fire Insurance Company ⁵	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) ⁴	-	-
Merastar ⁶	-	-
Homesite Insurance Company of California	339,398	321,509
Pacific National Insurance ⁴	-	-
Encompass Insurance Company	4,720,884	3,822,379
Glen Falls Insurance Company ⁴	-	-
Commerce West Insurance Company	11,025	12,763
Total	\$ 603,127,689	\$ 585,520,749

¹Includes Garrison Insurance Company

²Includes ACA Insurance Company

³Joined the CEA as of December 1, 2008

⁴Not currently writing residential property insurance in California

⁵Includes Golden Eagle Insurance Company

⁶Withdrew 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 ¹	39,926,665	38,518,213
California State Automobile Association Inter-Insurance Bureau ²	12,798,895	11,009,533
Safeco Insurance Company of America ³	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 ⁴	-	-
Prudential ⁴	-	-
Liberty Mutual Fire Insurance Company ⁵	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) ⁴	-	-
Merastar ⁶	-	-
Homesite Insurance Company of California	207,392	205,232
Pacific National Insurance ⁴	-	-
Encompass Insurance Company	1,997,526	1,856,652
Glen Falls Insurance Company ⁴	-	-
Commerce West Insurance Company	4,731	5,794
Total	<u>\$ 302,862,221</u>	<u>\$ 298,994,745</u>

¹Includes Garrison Insurance Company

²Includes ACA Insurance Company

³Joined the CEA as of December 1, 2008

⁴Not currently writing residential property insurance in California

⁵Includes Golden Eagle Insurance Company

⁶Withdrew 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

	2010	2009
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 ¹	7,821,373	7,578,732
California State Automobile Association Inter-Insurance Bureau ²	2,369,216	2,136,660
Safeco Insurance Company of America ³	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 ⁴	-	-
Prudential ⁴	-	-
Liberty Mutual Fire Insurance Company ⁵	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) ⁴	-	-
Merastar ⁶	-	125
Homesite Insurance Company of California	33,766	34,309
Pacific National Insurance ⁴	-	-
Encompass Insurance Company	458,143	428,068
Glen Falls Insurance Company ⁴	-	-
Commerce West Insurance Company	1,210	974
Total	\$ 59,970,221	\$ 59,038,013

¹Includes Garrison Insurance Company

²Includes ACA Insurance Company

³Joined the CEA as of December 1, 2008

⁴Not currently writing residential property insurance in California

⁵Includes Golden Eagle Insurance Company

⁶Withdrew 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

	2010	2009
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 ¹	2,681,722	2,659,966
California State Automobile Association Inter-Insurance Bureau ²	812,630	750,321
Safeco Insurance Company of America ³	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 ⁴	-	-
Prudential ⁴	-	-
Liberty Mutual Fire Insurance Company ⁵	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) ⁴	-	-
Merastar ⁶	-	45
Homesite Insurance Company of California	12,127	12,650
Pacific National Insurance ⁴	-	-
Encompass Insurance Company	157,136	148,193
Glen Falls Insurance Company ⁴	-	-
Commerce West Insurance Company	416	341
Total	\$ 20,567,165	\$ 20,695,908

¹Includes Garrison Insurance Company

²Includes ACA Insurance Company

³Joined the CEA as of December 1, 2008

⁴Not currently writing residential property insurance in California

⁵Includes Golden Eagle Insurance Company

⁶Withdrew from the CEA as of May 1, 2009

CALIFORNIA EARTHQUAKE AUTHORITY

Statutory Financial Statements
December 31, 2010 and 2009

With Independent Auditors' Report Thereon

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LARSON & ROSENBERGER LLP
CERTIFIED PUBLIC ACCOUNTANTS

Independent Auditors' Report

To the Board of Governors
California Earthquake Authority

We have audited the accompanying statutory statements of admitted assets, liabilities, and surplus of the California Earthquake Authority (CEA) as of December 31, 2010 and 2009, and the related statutory statements of operations and changes in surplus, and cash flow 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 auditing standards generally accepted 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 described more fully in Note 2 to the financial statements, these financial statements were prepared in conformity with accounting practices prescribed or permitted by the California Department of Insurance, which practices differ from generally accepted accounting principles. The effects on the financial statements of the variances between statutory accounting practices and accounting principles generally accepted in the United States of America are described in Note 2.

In our opinion, because of the matter discussed in the preceding paragraph, the financial statements referred to in the first paragraph do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the California Earthquake Authority as of December 31, 2010 and 2009, or the results of its operations, or its cash flow for the year then ended.

However, in our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the admitted assets, liabilities, and surplus of the California Earthquake Authority as of December 31, 2010 and 2009, and the results of its operations and its cash flow for the year then ended, on the basis of accounting described in Note 2.

Larson & Rosenberger LLP

Glendale, California
July 27, 2011

CALIFORNIA EARTHQUAKE AUTHORITY

Statutory Statements of Admitted Assets, Liabilities, and Surplus As of December 31, 2010 and 2009

	2010	2009
Admitted Assets		
Debt securities, at book/adjusted carrying value	\$ 2,949,805,276	\$ 2,118,616,467
Cash, cash equivalents and short-term investments	1,283,898,970	1,835,406,315
Total cash and invested assets	4,233,704,246	3,954,022,782
Premiums receivable	44,591,137	44,311,612
Investment income receivable	12,350,635	20,543,245
Electronic data processing equipment and software	1,109,954	1,502,899
Other assets	4,904,802	322,878
Total admitted assets	\$ 4,296,660,774	\$ 4,020,703,416
 Liabilities and Surplus		
Liabilities:		
Accounts payable and accrued expenses	\$ 2,378,089	\$ 1,702,036
Collateral loan and interest payable	194,829,705	227,301,323
Unearned premiums	296,557,910	293,406,161
Advance premium	1,900,572	-
Total liabilities	495,666,276	522,409,520
 Surplus:		
Gross paid-in and contributed surplus	756,622,246	751,152,246
Unassigned surplus	3,044,372,252	2,747,141,650
Total surplus	3,800,994,498	3,498,293,896
Total liabilities and surplus	\$ 4,296,660,774	\$ 4,020,703,416

See accompanying notes to statutory financial statements.

CALIFORNIA EARTHQUAKE AUTHORITY

Statutory Statements of Operations and Changes in Surplus For the Years Ended December 31, 2010 and 2009

	2010	2009
Underwriting income:		
Premiums earned, net	\$ 377,472,085	\$ 395,257,060
Losses and loss adjustment expenses	75,036	137,635
Other underwriting expenses	114,252,412	110,750,397
Total underwriting and other deductions	114,327,448	110,888,032
Underwriting income	263,144,637	284,369,028
Investment income and other:		
Net investment income	38,625,285	53,780,427
Net realized capital gain	2,378	10,129
Other income	538,907	395,699
Total investment income and other	39,166,570	54,186,255
Net income	\$ 302,311,207	\$ 338,555,283
Surplus, beginning of year	\$ 3,498,293,896	\$ 3,172,013,470
Net income	302,311,207	338,555,283
Change in nonadmitted assets	(2,308,107)	(8,039,842)
Paid in surplus	5,470,000	-
Mitigation program funding per statute	(2,772,498)	(4,235,015)
Surplus, end of year	\$ 3,800,994,498	\$ 3,498,293,896

See accompanying notes to statutory financial statements.

CALIFORNIA EARTHQUAKE AUTHORITY

Statutory Statements of Cash Flow For the Years Ended December 31, 2010 and 2009

	2010	2009
Cash flow from operating activities:		
Premiums collected, net	\$ 378,748,029	\$ 434,726,595
Losses and loss adjustment expenses paid, net	(75,036)	(137,638)
Underwriting expenses paid	(114,547,976)	(111,305,895)
Net cash provided by underwriting activities	264,125,017	323,283,062
Investment income received, net	71,123,191	83,624,508
Other income	538,908	395,699
Net cash provided by operating activities	335,787,116	407,303,269
Cash flow form investing activities:		
Payments for purchase of bonds	(2,092,676,395)	(1,028,729,006)
Proceeds from sales and maturities of fixed maturities	1,242,121,000	979,525,000
Miscellaneous proceeds (applications)	2,378	(530,924)
Net cash used in investing activities	(850,553,017)	(49,734,930)
Cash flow from financing activities:		
Borrowed funds	(31,500,000)	(31,500,000)
Capital contributions	2,593,189	43,563,244
Other cash applied	(7,834,633)	(3,548,908)
Net cash (used) provided by financing activities	(36,741,444)	8,514,336
Net (decrease) increase in cash, cash equivalents, and short-term investments	(551,507,345)	366,082,675
Beginning cash, cash equivalents, and short-term investments	1,835,406,315	1,469,323,640
Ending cash, cash equivalents, and short-term investments	\$ 1,283,898,970	\$ 1,835,406,315

See accompanying notes to statutory financial statements.

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Statutory Financial Statements
December 31, 2010 and 2009

1. Organization and Description of Business

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 signed 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. As of December 31, 2010, the operating cost reimbursement is 3.43% of written premiums. The producer commission is equal to 10% of written premiums 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 the CEA's written premiums.

The CEA eligibility requirements 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 Congress enacts a natural disaster program, 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.

CALIFORNIA EARTHQUAKE AUTHORITY

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

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying financial statements have been prepared in conformity with statutory accounting practices prescribed or permitted by the California Department of Insurance (SAP) and are not intended to present financial position, results of operations, and cash flow in conformity with accounting principles generally accepted in the United States of America (GAAP). The California Department of Insurance requires all licensed insurers to complete their financial statements in conformance with the *Accounting Practices and Procedures Manual* promulgated by the National Association of Insurance Commissioners (NAIC). The CEA is not a licensed insurer in California but prepares those statutory financial statements on a voluntary basis.

As the CEA meets the definition of a government organization, it also prepares financial statements in accordance with GAAP and all applicable standards issued by Governmental Accounting Standards Board (Governmental GAAP). The more significant variances between SAP and Governmental GAAP are as follows:

- i. The costs of acquiring policies are expensed as incurred, although the related premiums are recognized over the period covered by the policies.
- ii. Nonadmitted assets such as furniture and fixtures, and past-due agents' balances are charged directly against surplus.
- iii. Investments in fixed maturity securities are reported at admitted value (which is amortized cost adjusted for NAIC designations).
- iv. The Earthquake Loss Mitigation Fund, a "sub-account of the CEA" is excluded from these financial statements.
- v. Cash flow is not consistent with Governmental GAAP and a reconciliation from net income to cash provided by operations is not presented.

CALIFORNIA EARTHQUAKE AUTHORITY

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

2. Summary of Significant Accounting Policies (Continued)

Basis of Presentation (Continued)

A reconciliation of net income and surplus as determined in accordance with SAP to amounts determined in accordance with Governmental GAAP as of December 31 is as follows:

	Net Income		Surplus	
	2010	2009	2010	2009
SAP basis	\$ 302,311,207	\$ 331,017,443	\$ 3,800,994,498	\$ 3,498,293,896
Investments	(12,049,809)	(37,644,911)	16,667,387	28,717,723
Nonadmitted assets	-	-	12,698,618	10,390,511
Deferred acquisition costs	519,402	(1,080,866)	40,674,923	40,154,994
Allowance for doubtful accounts	(3,287,177)	2,937,855	(10,533,225)	(7,246,048)
Mitigation fund	(418,641)	(339,296)	22,283,073	19,929,216
Advance premium	(846,669)	-	(846,669)	-
Contributed surplus	5,470,000	-	-	-
Governmental GAAP basis	<u>\$ 291,698,313</u>	<u>\$ 294,890,225</u>	<u>\$ 3,881,938,605</u>	<u>\$ 3,590,240,292</u>

Estimates

The preparation of financial statements in conformity with accounting practices prescribed or permitted by the California Department of Insurance requires management to make estimates and assumptions that affect the reported amounts of admitted assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Investments

Bonds are valued on the basis prescribed by the Purposes and Procedures Manual of the NAIC Securities Valuation Office. Bonds are generally carried at amortized cost using the scientific method of amortization.

Realized gains and losses on sale of investments are determined on the specific identification method. Declines in fair values of investment securities deemed other-than-temporary are recognized as a realized loss in the statement of operations.

Cash, Cash Equivalents, and Short-Term Investments

Included with cash are cash equivalents and short-term investments with maturity dates within one year or less from the acquisition dates. Cash equivalents are highly liquid investments with original maturities of three months or less. Short-term investments are accounted for in the same manner as similar long-term investments.

CALIFORNIA EARTHQUAKE AUTHORITY

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

2. Summary of Significant Accounting Policies (Continued)

Revenue Recognition

Premiums are earned over the terms of the related insurance policies. Unearned premium reserves are established to cover the unexpired portion of premiums written. Such reserves are computed by pro-rata methods for direct business.

Reinsurance premiums, commissions, and reserves related to reinsured business are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Premiums ceded to reinsurers have been reported as a reduction of premiums earned.

Unpaid Losses and Loss Adjustment Expenses

The liability for unpaid losses and loss adjustment expenses is an estimate of payments to be made on individual case estimates for insurance claims that have been incurred and reported or incurred but not yet reported (IBNR) and estimates of expenses for investigating and adjusting all incurred claims. Incurred claims are reduced for estimated reinsurance recoveries. The ultimate costs of claims are dependent on future events, the outcomes of which are affected by many factors. Such factors include the CEA's reserving procedures and settlement philosophy, current and perceived social factors, inflation, current and future court rulings and jury attitudes, and many other economic, scientific, legal, political, and social factors. If a major California earthquake were to occur, there would be a significant increase in the reserve for claims and claim adjustment expense. The CEA does not have any unpaid claims reported as of December 31, 2010 and 2009.

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.

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 CEA worked with the California 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.

CALIFORNIA EARTHQUAKE AUTHORITY

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

2. Summary of Significant Accounting Policies (Continued)

Participating Insurer Capital Contributions (Continued)

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.

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.” As a result, CEA is exempt from remitting state premium tax.

3. Fair Value Disclosures

The following summarizes the estimated fair value of certain financial assets and liabilities at December 31:

	2010		2009	
	Statement value	Fair value	Statement value	Fair value
Debt securities	\$ 2,949,805,276	\$ 2,966,361,848	\$ 2,118,616,467	\$ 2,147,001,167
Collateral loan	189,000,000	206,633,700	220,500,000	218,691,900

The carrying value of cash, cash equivalents, short-term investments, accrued interest, unearned premiums and other liabilities approximate fair value due to the short-term maturity, and low interest rate environment of these items.

CALIFORNIA EARTHQUAKE AUTHORITY

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

4. Investments

Major components of net investment income are derived from the following investments:

	2010	2009
Bonds	\$ 36,793,332	\$ 47,977,331
Short-term investments	3,589,353	7,462,495
Total investment before expenses	40,382,685	55,439,826
Less investment expenses	1,757,400	1,659,399
Net investment income	\$ 38,625,285	\$ 53,780,427

The book/adjusted carrying values and estimated fair values of investments in bonds as of December 31 are as follows:

	Book/Adjusted Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2010				
U.S. treasury securities and obligations of U.S. government corporations and agencies	\$ 2,949,805,276	\$ 18,382,897	\$ (1,826,325)	\$ 2,966,361,848
2009				
U.S. treasury securities and obligations of U.S. government corporations and agencies	\$ 2,118,616,467	\$ 29,243,341	\$ (858,641)	\$ 2,147,001,167

The book/adjusted carrying values and estimated fair values of investments in bonds at December 31, 2010, by contractual maturity, are shown below.

	Book/Adjusted Carrying Value	Fair Value
Due in one year or less	\$ 1,341,210,580	\$ 1,349,001,817
Due in years two through five	1,608,594,696	1,617,360,031
Total	\$ 2,949,805,276	\$ 2,966,361,848

CALIFORNIA EARTHQUAKE AUTHORITY

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

4. Investments (Continued)

Other-than-Temporary Impairment

The following table shows the gross unrealized losses and fair value of the CEA's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous loss position at December 31:

	Less than 12 Months		12 Months or Longer	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
2010				
U.S. treasury securities and obligations of U.S. government corporations and agencies	\$ 394,652,003	\$ (1,806,721)	\$ 99,141,241	\$ (19,604)
2009				
U.S. treasury securities and obligations of U.S. government corporations and agencies	\$ -	\$ -	\$ 302,975,399	\$ (858,641)

5. 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 year ended December 31:

	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

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 on 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 amount of the Claims Paying Account.

CALIFORNIA EARTHQUAKE AUTHORITY

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

5. Long-Term Debt (Continued)

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:

	Principal	Interest	Total
2011	\$ 31,500,000	\$ 10,687,793	\$ 42,187,793
2012	31,500,000	8,744,557	40,244,557
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
Thereafter	31,500,000	971,618	32,471,618
Total	<u>\$ 189,000,000</u>	<u>\$ 34,978,232</u>	<u>\$ 223,978,232</u>

6. 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 a premium adjustment expense against the contract. The CEA continues to cede insurance to reinsurers under catastrophe excess-of-loss reinsurance contracts and reinsurance contracts provided maximum limits of \$3.1 billion at varying attachment points.

CALIFORNIA EARTHQUAKE AUTHORITY

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

6. Reinsurance (Continued)

The effect of reinsurance on premiums is as follows:

	2010		2009	
	Written	Earned	Written	Earned
Direct	\$ 596,107,647	\$ 599,260,213	\$ 607,676,744	\$ 589,954,214
Ceded	221,788,128	221,788,128	194,697,154	194,697,154
Net	\$ 374,319,519	\$ 377,472,085	\$ 412,979,590	\$ 395,257,060

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.

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:

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

8. Mitigation Fund

California Insurance 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 Insurance 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 claims or other claims against the CEA. Accordingly the mitigation fund has been excluded from the determination of statutory net income and surplus in these financial statements. As of December 31, 2010, the potential annual transfer calculated at 5% of investment income was \$2,019,253 which is subject to actuarial review and formal approval of the CEA Governing Board.

CALIFORNIA EARTHQUAKE AUTHORITY

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

9. Unassigned Surplus

Included in unassigned surplus as of December 31 are the following cumulative balances:

	2010	2009
Nonadmitted assets	\$ (12,698,618)	\$ (10,390,511)
Inception to date transfers to mitigation fund	(32,894,073)	(30,121,575)

10. 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.

Defined Contribution Plans

The CEA sponsors a defined contribution savings plan for contract employees. Employees contribute 5% of compensation and the CEA contributes 12.71% of the employee's compensation. 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.

11. Statutory and Regulatory 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.

CALIFORNIA EARTHQUAKE AUTHORITY

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

11. Statutory and Regulatory Compliance (Continued)

In December 1993, the NAIC adopted a risk-based capital formula for property casualty insurance companies, which establishes recommended minimum capital requirements. The formula has been designed to capture the widely varying elements of risks undertaken by writers of different lines of insurance having differing risk characteristics, as well as writers of similar lines where differences in risk may be related to corporate structure, investment policies, reinsurance arrangements, and a number of other factors. The CEA has calculated its risk-based capital requirement as of December 31, 2010 and has capital in excess of any regulatory action or reporting level.

12. Reconciliation to Annual Statement

The following is a reconciliation of amounts reported to the California Department of Insurance in the CEA's annual statement to amounts reported in these statutory statements:

	<u>Net Income</u>	<u>Surplus</u>
2010		
As previously reported in Annual Statement	\$ 297,576,501	\$ 3,800,994,498
Net gain/loss from agents balances	4,734,706	-
As reported herein	<u>\$ 302,311,207</u>	<u>\$ 3,800,994,498</u>
2009		
As previously reported in Annual Statement	\$ 331,017,443	\$ 3,498,293,896
Net gain/loss from agents balances	7,537,840	-
As reported herein	<u>\$ 338,555,283</u>	<u>\$ 3,498,293,896</u>

13. Subsequent Events

Management has evaluated subsequent events through July 27, 2011, which is the date the financial statements were made available to be issued. No events have occurred subsequent to December 31, 2010 requiring recording or disclosure in these financial statements.

SUPPLEMENTARY INFORMATION



LARSON & ROSENBERGER LLP
CERTIFIED PUBLIC ACCOUNTANTS

Independent Auditors' Report on Supplementary Information

To the Board of Governors
California Earthquake Authority

Our report on our audit of the basic financial statements of the California Earthquake Authority for the year ended December 31, 2010 appears on page 1. The audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The summary investment schedule, the supplemental investment risk interrogatories, and the supplemental reinsurance interrogatories on pages 17 to 19 are not a required part of the basic financial statements but are supplementary information required by the National Association of Insurance Commissioners' *Accounting Practices and Procedures Manual*. Such information has been subjected to the auditing procedures applied in the audit 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
July 27, 2011

CALIFORNIA EARTHQUAKE AUTHORITY

Summary Investment Schedule
December 31, 2010

	Gross Investment Holdings		Admitted Assets as Reported in the Annual Statement	
	Amount	%	Amount	%
Bonds:				
U.S. treasury securities	\$ 2,949,805,276	69.67	\$ 2,949,805,276	69.67
Cash, cash equivalents, and short-term investments	1,283,898,970	30.33	1,283,898,970	30.33
Total invested assets	<u>\$ 4,233,704,246</u>	<u>100.00</u>	<u>\$ 4,233,704,246</u>	<u>100.00</u>

CALIFORNIA EARTHQUAKE AUTHORITY

Supplemental Investment Risk Interrogatories December 31, 2010

1. The total admitted assets as reported on page 2 of the CEA's annual statement are \$4,296,660,774.
2. The following are the CEA's largest exposures to a single issuer, borrower, and/or investment excluding U.S. government, U.S. government agency securities, and those U.S. government money market funds listed in the Appendix to the SVO Purposes and Procedure Manual as exempt, property occupied by the CEA, and policy loans:

Issuer	Investment Category	Amount	% of Total Admitted Assets
General Electric	Short-Term Bond	\$ 24,985,622	0.6%
JP Morgan Chase & Co.	Short-Term Bond	24,985,789	0.6

3. The total admitted assets held in bonds by NAIC rating are:

Bonds	Amount	% of Total Admitted Assets
NAIC-1	\$ 4,231,466,093	98%

4. The CEA does not have any assets held in foreign investments.
5. The CEA does not have any assets held in Canadian investments.
6. The CEA does not have any assets held in investments with contractual sales commitments
7. The CEA does not have any assets held in nonaffiliated, privately placed equities (included in other equity securities) excluding securities eligible for sale under Securities Exchange Commission (SEC) Rule 144a or SEC Rule 144 without restrictions.
8. The CEA does not have any assets held in general partnership interests.
9. The CEA does not have any assets held in mortgage loans.
10. The CEA does not have any interests held in real estate.
11. The CEA does not have any investments held in mezzanine real estate loans.
12. The CEA does not have any admitted assets subject to the following types of agreements: securities lending, repurchase agreements, reverse repurchase agreements, dollar repurchase agreements, and dollar reverse repurchase agreements.
13. The CEA does not hold warrants not attached to other financial instruments, options, caps, or floors.
14. The CEA does not hold assets as potential exposure for collars, swaps, and forwards.
15. The CEA does not hold assets as potential exposure for futures contracts.

CALIFORNIA EARTHQUAKE AUTHORITY

Supplemental Reinsurance Interrogatories December 31, 2010

1. The CEA has not reinsured risk under a quota share reinsurance contract that includes a provision that would limit the reinsurer's losses below the stated quota share percentage.
2. The CEA ceded risk under reinsurance contracts for which during the year ended December 31, 2010: (i) total ceded written premiums were greater than 5% of prior year-end surplus; (ii) it accounted for those contracts as reinsurance and not as a deposit; and (iii) the contracts contain aggregate stop loss reinsurance coverage:
 - The CEA cedes risk to reinsurers under catastrophe excess-of-loss reinsurance contracts for purposes of limiting its maximum exposure. In 2010, the CEA entered into reinsurance contracts that provided a maximum limit of \$3.1 billion, which resulted in an aggregate financial impact of \$222 million in ceded written premiums. The contracts were annual contracts.
3. The CEA has not ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates), excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the CEA, or (ii) an association of which one or more unaffiliated policyholders of the CEA is a member where:
 - The written premium ceded to the reinsurer by the CEA or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or
 - Twenty-five Percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the CEA or its affiliates.
4. Except for transactions meeting the requirements of paragraph 30 of SSAP No. 62R, *Property and Casualty Reinsurance*, the CEA has not ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:
 - Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles (SAP) and as a deposit under generally accepted accounting principles (GAAP); or
 - Accounted for that contract as reinsurance under GAAP and as a deposit under SAP.



LARSON & ROSENBERGER LLP
CERTIFIED PUBLIC ACCOUNTANTS

To the Governing Board
California Earthquake Authority

In planning and performing our audit of the financial statements of the California Earthquake Authority (CEA) as of and for the year ended December 31, 2010, in accordance with auditing standards generally accepted in the United States of America, we considered its internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the CEA's internal control. Accordingly, we do not express an opinion on the effectiveness of the CEA's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. Additionally, this report is being prepared consistent with the guidance in the NAIC/AICPA Working Group letter to regulators on the interpretation of Section 11 of the NAIC Model Audit Rule dated March 9, 2005. However, as discussed below, we identified certain deficiencies in internal control that we consider to be a material weakness as of December 31, 2010.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the following deficiencies in the CEA's internal control to be material weaknesses:

Review of Participating Insurers' Policy Records and Procedures

The CEA engages in various internal and external audit activities such as investment compliance, contract reviews and review of participating insurers' policy records. We noted that the scope of audit activities as it pertained to the policy records of participating insurers would not timely identify potential errors in policy data and the resulting premiums. We also noted a lack of communication between the internal audit and finance departments in planning and determining the scope of audit procedures. During our audit, we became aware of instances with one participating insurer where the data provided the CEA did not match the participating insurer's homeowners' policy data, resulting in incorrectly rated premiums on CEA policies. Such errors might have been detected and addressed by more in-depth audit procedures.

We recommend the CEA establish an audit program incorporating procedures for reviewing and validating policy data with participating insurers' source documents and develop a schedule that includes regular audits of policy records maintained by the participating insurer. We recommend communication among finance and internal audit team members to ensure risks in internal control over financial reporting are properly addressed.

Organization of Information Technology (IT) Processes and Procedures

As we noted in our prior year's audit, weakness in IT controls resulted in policies and procedures that did not adequately address the following: security, systems development and life cycle, backup and recovery, business continuity planning, physical access to servers, and security incident response.

The CEA has entered into a contract with Protiviti and commenced a project to remediate this weakness in IT controls and as of December 31, 2010, the project was ongoing and thus it remained unremediated. The project is scheduled to be complete prior to December 31, 2011. We recommend the CEA continue with the remediation project.

This communication is intended solely for the information and use of management, the governing board, others within the organization, and state insurance departments to whose jurisdiction the CEA is subject and is not intended to be and should not be used by anyone other than these specified parties.

Larson & Rosenberger LLP

Glendale, California
August 17, 2011

Governing Board Memorandum

August 25, 2011

Agenda Item 10: Request for Annual Set-Aside for the CEA Loss Mitigation Fund

Recommended Action: Approve the Annual Set-Aside for the CEA Loss Mitigation Fund

Background:

California Insurance Code section 10089.37 states, in pertinent part:

The board shall set aside in each calendar year an amount equal to 5 percent of investment income accruing on the authority's invested funds, or five million dollars (\$5,000,000), whichever is less, if deemed actuarially sound by a consulting actuary employed or hired by the authority, to be maintained as a subaccount in the California Earthquake Authority Fund. The authority shall use those funds to fund the establishment and operation of an earthquake Loss Mitigation Fund....

The Governing Board last approved set-aside funding for the CEA Loss Mitigation Fund in August 2010 after its receipt of the 2009 audited financial statements. The Board authorized a set-aside amount of \$2,772,498.

Analysis:

The CEA Loss Mitigation Fund is established by law to hold the money to be used for the CEA mitigation activities' operational and program expenses. The Board, however, must approve the mitigation programs before CEA Loss Mitigation Fund money can be expended on program activities.

The Insurance Code also requires that the set-aside of monies for the CEA Loss Mitigation Fund be reviewed "by a consulting actuary employed or hired by the authority" to determine if it will impair the CEA's actuarial soundness—the CEA's Chief Actuary has reviewed the staff proposal to transfer funds and has determined that the requested transfer will not impair the CEA's actuarial soundness, as stated in *Attachment A*.

Staff requests Board authorization and approval to set aside \$2,019,253 for the CEA Loss Mitigation Fund, as calculated and shown on *Attachment B*.

Recommendation:

Staff recommends the Board authorize a set-aside of \$2,019,253 for the CEA Loss Mitigation Fund.



Memorandum

DATE: August 17, 2011

TO: Tim Richison, Chief Financial Officer

FROM:  Shawna Ackerman, Chief Actuary

CC: Mark Dawson, Assistant Chief Financial Officer

RE: 2010 Earthquake Loss Mitigation Fund

Pursuant to California Insurance Code §10089.37, the California Earthquake Authority (CEA) shall set aside an amount equal to the lesser of 5% of its annual investment income or \$5,000,000 for the Earthquake Loss Mitigation Fund, if deemed actuarially sound. The amount under review for calendar year 2010 is \$2,019,253.

The term “actuarially sound” is often applied to rates. The current rate structure considers and provides for a sufficient provision for the mitigation fund.

In the context of the statute for the mitigation fund, the term may also apply to the CEA’s solvency. I have reviewed the financial data provided to me including the provision for the mitigation fund. The CEA available capital at June 30, 2011 is \$3.899 billion and the total claims paying capacity is \$9.477 billion. The mitigation funds available to set aside are approximately 0.05% of the CEA’s available capital and 0.02% of the CEA’s total claims paying capacity. Because the mitigation fund represents a small percentage of the CEA’s total claims paying capacity, the absence of the funds for claims paying will not impair the CEA’s solvency. Additionally, the mitigation funds can increase the CEA’s ability to pay 100% of claims liabilities to the extent that the funds are used to support activities that reduce the CEA’s losses in the event of a damaging earthquake. Therefore, I conclude that the mitigation fund amount as proposed is actuarially sound as contemplated in the statute.

California Earthquake Authority
Calculation of Available Set-Aside Amount for Loss Mitigation Fund
For the Years Ended December 31

Year	Investment Income	5% of Investment Income	A	B	C	(A + B + C)
			Beginning-of-Year Remaining Funds Available for Set Aside	Lesser of 5% of Investment Income or \$5 million **	Funds Set Aside by the Governing Board	End-of-Year Remaining Funds Available for Set Aside
Balance as of December 31, 2000						\$ -
2001	\$ 44,184,990.04	\$ 2,209,249.50	\$ -	\$ 2,209,249.50	\$ (309,275.55)	\$ 1,899,973.95
2002	\$ 24,782,830.64	\$ 1,239,141.53	\$ 1,899,973.95	\$ 1,239,141.53	\$ (2,509,232.25)	\$ 629,883.23
2003	\$ 25,562,896.69	\$ 1,278,144.83	\$ 629,883.23	\$ 1,278,144.83	\$ -	\$ 1,908,028.07
2004	\$ 35,851,094.85	\$ 1,792,554.74	\$ 1,908,028.07	\$ 1,792,554.74	\$ -	\$ 3,700,582.81
2005	\$ 64,786,415.96	\$ 3,239,320.80	\$ 3,700,582.81	\$ 3,239,320.80	\$ (3,700,582.81)	\$ 3,239,320.80
2006	\$ 118,647,844.32	\$ 5,932,392.22	\$ 3,239,320.80	\$ 5,000,000.00	\$ (3,239,320.80)	\$ 5,000,000.00
2007	\$ 125,616,215.18	\$ 6,280,810.76	\$ 5,000,000.00	\$ 5,000,000.00	\$ (5,000,000.00)	\$ 5,000,000.00
2008	\$ 84,700,308.00	\$ 4,235,015.40	\$ 5,000,000.00	\$ 4,235,015.40	\$ (5,000,000.00)	\$ 4,235,015.40
2009	\$ 55,449,955.00	\$ 2,772,497.75	\$ 4,235,015.40	\$ 2,772,497.75	\$ (4,235,015.40)	\$ 2,772,497.75
2010	\$ 40,385,063.00	\$ 2,019,253.15	\$ 2,772,497.75	\$ 2,019,253.15	\$ (2,772,497.75)	\$ 2,019,253.15
Balance as of December 31, 2010						\$ 2,019,253.15

** By law, "(t)he board shall set aside in each calendar year an amount equal to 5 percent of investment income accruing on the authority's invested funds, or five million dollars (\$5,000,000), whichever is less..."
Insurance Code section 10089.37.

Governing Board Memorandum

August 25, 2011

Agenda Item 11: Update on the CEA Mitigation Program

Recommended Action: No action required

Background and Analysis:

Important steps to implement the California Residential Mitigation Program (“CRMP”) have been completed:

- Hiring the CEA Chief Mitigation Officer (“CMO”), a position authorized by recent amendment to the CEA statute — CEA hired structural engineer Janiele Maffei effective May 9, 2011.
- Forming a Joint Powers Authority (“JPA”) with the California Emergency Management Agency — Cal EMA Secretary Mike Dayton and CEA CEO Glenn Pomeroy signed the Joint Exercise of Powers Agreement on August 16, 2011.
- Identifying JPA board members — CEA has selected CEO Glenn Pomeroy and CCO Chris Nance as board members representing CEA, and two members will be selected by Cal EMA.
- Scheduling the first JPA-board meeting — The CEA and Cal-EMA are finalizing matters for the agenda and the date of the first JPA-board meeting; a public notice and agenda will be prepared and publicized, in accordance with law.

Each of these steps was critical to launch and situate the Residential Brace and Bolt Program, which staff has referred to as R2B2.

In addition to the steps above, activities specific to R2B2 have been completed:

- Finalizing contractor-training details — The Federal Emergency Management Agency has authorized its contractor to create a training module for work required by the California Building Code to seismically strengthen cripple walls and anchor sill-plates of light, woodframe, residential buildings.¹
- Identifying potential retrofit pilot-program locations, to be presented to the JPA board. Staff has tentatively designated communities in high-seismicity areas in both Northern and Southern California — the communities have a number of owner-occupied houses built before residential seismic-code development.

¹ This training will supplement FEMA’s **Seismic Rehabilitation Training for One- and Two-Family Residential Wood-frame Dwellings, P-593**.

Staff has identified five remaining steps — the steps either require JPA-board approval or hinge on a JPA-board decision:

- Establish and implement JPA's back-office requirements (bank accounts, insurance, etc.);
- Facilitate JPA's execution of contract between the JPA and a CRMP administrator;
- Finalize cash-incentive-program structure;
- Develop retrofit-program-related marketing recommendations;
- Propose to the CEA Governing Board a mitigation fund budget that includes expenditures for various retrofit programming, including expanded JPA involvement.

Recommendation:

No action – information only.

Governing Board Memorandum

August 25, 2011

Agenda Item 12: Update the CEA Claim Manual (April 2009 revision)

Recommended Action: Approve updated CEA Claim Manual (to be sent for review to the California Department of Insurance)

Background:

CEA participating insurers are using the CEA Claim Manual approved by the Governing Board in February 2009 and the Insurance Commissioner in April 2009.

CEA staff has now updated the current Manual anticipating the CEA policy forms, rate application, and Department of Insurance regulations proposed for January 1, 2012.

Analysis:

Since CEA implemented the April 2009 revision of the Manual, several important events have occurred that have potential impact on the current Claim Manual, including:

- The CEA will introduce new editions of the policy forms for its Basic Earthquake Policy – Homeowners, Renters, and Common Interest Development, effective January 1, 2012.
- The CEA will introduce a Homeowners Choice product later in 2012.

Because of those events, CEA staff has updated the Manual. The attached updated Manual reflects the events noted above and incorporates general improvements of CEA insurance-claim policies and procedures. The revised Claim-Handling Guidelines have been given thorough operational and legal review.

The Claim Manual is part of the CEA's Plan of Operations. As such, before this newly revised Claim Manual can take effect it first must be approved by the Board; following Board approval, it must be submitted to and approved by the Insurance Commissioner.

Staff seeks Board approval of the attached, updated Claim Manual. Assuming the Board and the Commissioner approve the updated Manual, CEA will provide it to all CEA participating insurers for immediate implementation and use.

There are three attachments to this memorandum to assist the review of the updated Manual:

- *Attachment A* is a draft copy of the (proposed) updated Manual.
- *Attachment B* summarizes major changes to the April 2009 Manual.
- *Attachment C* is the (April 2009) Manual, now in use.

Recommendation:

Staff recommends the Board approve the updated CEA Claim Manual and that the Board authorize Staff to send the updated Manual to the California Department of Insurance for the Commissioner's review and approval.



CLAIM MANUAL

CALIFORNIA EARTHQUAKE AUTHORITY

APPROVED BY THE GOVERNING BOARD, xxx 20xx
APPROVED BY THE INSURANCE COMMISSIONER, xxx, 20xx

Note: This Manual includes several references to a Basic Earthquake Policy – Homeowners Choice. At the time of the approval of this Manual, the CEA has not yet introduced the Homeowners Choice policy into the insurance market place. As always, it is the claim representative’s responsibility to determine what CEA policy coverage a claim is being handled under. If and when the CEA Homeowners Choice becomes available to consumers, and the claim representative is handling a claim for a policyholder with a Homeowners Choice policy, the claim representative should follow the procedures contained in this Manual that are specific to Basic Earthquake Policy – Homeowners Choice.

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INTRODUCTION

The purpose of this Manual is to assist experienced property claim representatives and managers in the evaluation and supervision of California Earthquake Authority earthquake insurance claims.

The CEA is committed to making sure all of its claims are handled in a fair, timely, and consistent manner. The CEA audits and re-inspects claims to make sure that claims are properly investigated and that appropriate procedures have been followed.

The Participating Insurer, its claim representatives and other personnel whom it may retain, are all required to strictly conform to all applicable laws and regulations. Nothing contained in this Claim Manual is intended to change the requirements placed upon insurers and their claim representatives by the California Insurance Code, other applicable statutes, applicable regulations, or any case law interpreting any applicable statute or regulation. In the event that an item or procedure specified in this Manual seems to conflict with any applicable statute, regulation, or case law, the Participating Insurer is to conform strictly to the statute, regulation, or case law.

This Manual does not create coverage when none is provided by the CEA policy of insurance in force at the time of the loss. If there are any conflicts or inconsistencies between this Claims Manual and the language of the CEA's insurance policy, the policy language will take precedence.

BACKGROUND OF THE CEA

Under the California Insurance Code, insurers that sell residential property insurance in California are required to offer earthquake insurance to their residential property policyholders. As a result of the many claims from the 1994 Northridge earthquake, insurers became concerned that another earthquake could exhaust their available resources. As a result, many companies stopped selling homeowners insurance in California, which created an insurance availability crisis.

In an attempt to resolve this crisis in insurance availability, the California Legislature established the California Earthquake Authority (CEA). Companies that did not wish to have the catastrophic exposure of residential earthquake insurance could become CEA Participating Insurers. Membership in the CEA allowed Participating Insurers to offer earthquake coverage to their residential insureds through the CEA.

The CEA is a publicly-managed, privately-financed entity, operating much like an insurance company, though with some significant differences. Funds to pay earthquake claims come from premiums collected and investment income, Participating Insurer contributions and assessments, reinsurance purchased by the CEA, and other CEA risk transfer mechanisms. No funds from the public or from the State of California's General Fund are pledged to cover losses incurred by CEA policyholders.

THE ROLE OF THE PARTICIPATING INSURANCE COMPANY

When an earthquake results in a claim against a CEA policy sold by a Participating Insurer, the claim representative for that insurer handles the claim on behalf of the CEA. The CEA reimburses the Participating Insurer for the indemnity dollars paid, and pays the Participating Insurer a loss adjustment fee to cover claims-adjusting expenses.

Every Participating Insurer has executed a uniform Insurer Participation Agreement, which sets forth that insurer's relationship with the CEA. As the claims agents for the CEA, Participating Insurers are responsible for investigating and adjusting claims made under CEA policies. Section 3.2 of Article III of the Insurer Participation Agreement reads in part: "The Participating Insurer may perform Authority services on behalf of the Authority in any reasonable manner that is in compliance with the statutory, regulatory, and case law regarding claims handling practices; provided, however, where the Authority has promulgated specific procedures to govern its operations, the Participating Insurer shall conform its practices to those procedures."

Participating Insurers and their representatives should handle all CEA claims in an expeditious and thorough manner, with at least as much care or diligence as they use in handling their own non-CEA business.

It is important to understand that CEA policies do not provide the same types of coverages property claim representatives may be accustomed to seeing under a traditional residential fire policy. Each policy issued by the CEA should be carefully reviewed.

1. GENERAL CEA CLAIMS INFORMATION

1-1. Types of CEA Policies

The CEA provides earthquake coverage in the State of California through several different earthquake insurance policies. They are:

A. Basic Earthquake Policy – Homeowners (Form BEQ-3B)

In this Manual, this policy is also referred to as an HO Basic policy. This policy insures owners of dwellings, manufactured homes and mobilehomes. Coverage for dwelling, personal property, and loss of use are included in this policy. This policy provides coverage as follows:

1. Dwelling: The limit of insurance for Coverage A Dwelling and Coverage B Extensions to Dwelling have a combined single limit (CSL) in the CEA policy that will be the same as the Coverage A limit of insurance listed on the declarations page of the Participating Insurer's companion homeowner fire policy.
2. Coverage C: Personal Property

Coverage C limits will be selected by the policyholder in one of the following amounts:

- \$5,000, \$25,000, \$50,000, \$75,000 or \$100,000

3. Coverage D: Loss of Use

Coverage D limits will be selected in one of the following amounts:

- \$1,500, \$10,000, \$15,000, or \$25,000

The policy includes \$10,000 of Building Code Upgrade Coverage as additional insurance. This is in addition to the Coverage A & B CSL. For an additional premium, Building Code Upgrade Coverage may be increased from \$10,000 to \$20,000 for dwelling owners. This \$20,000 increased limit option is not available for Manufactured Homes/Mobilehomes. Note: Building code upgrade limits are shown on the declarations page on the January 1, 2012 edition of the policy. Prior to that, the increased limits for building code upgrade were added to a CEA policy by endorsement.

B. Basic Earthquake Policy – Homeowners Choice (BEQ-3C)

In this Manual, this policy is also referred to as a HO Choice policy. This policy insures owners of dwellings, manufactured homes or mobilehomes. Coverage for dwelling is mandatory in a HO Choice policy. The consumer may select to add personal property,

loss of use coverage, or both. They may also have a HO Choice policy without including personal property and or loss of use coverage.

The limit of insurance for the Coverage A & B is a combined single limit (CSL) and will be the same as the Coverage A limit of insurance listed on the declarations page of the Participating Insurer's companion homeowner fire policy.

The following coverage options may be purchased separately or in combination by the HO Choice policyholder. The coverage options are as follows:

1. The consumer may choose to add Coverage C: Personal Property

Coverage C limits are available in the following amounts:

- \$5,000, \$25,000, \$50,000, \$75,000 or \$100,000

2. The consumer may choose to add Coverage D: Loss of Use

Coverage D limits are available in the following amounts:

- \$1,500, \$10,000, \$15,000, or \$25,000

The HO Choice policy includes \$10,000 of Building Code Upgrade Coverage as additional insurance. This is in addition to the Coverage A and B CSL. For an additional premium, Building Code Upgrade Coverage may be increased to \$20,000 for dwelling owners. This \$20,000 increased limit option is not available for Manufactured Homes/Mobilehomes.

C. Basic Earthquake Policy - Renters (Form BEQ-4B)

This policy insures tenants of dwellings, manufactured homes (mobilehomes), apartments or condominiums. The CEA participating insurer's companion policy will be similar to or a Renters (HO-4), Manufactured Home/ Mobilehome (tenant policy), Dwelling Fire (contents only), or Landlord (contents only) policy.

This policy provides Coverage C: Personal Property and Coverage D: Loss of Use

Coverage C and D limits are available in the following amounts:

- Coverage C: \$5,000, \$25,000, \$50,000, \$75,000 or \$100,000
- Coverage D: \$1,500, \$10,000, \$15,000, or \$25,000

D. Basic Earthquake Policy - Common Interest Development (Form BEQ-6B)

In California, a “common interest development” can be a community apartment project, a condominium project, a planned development, or a stock cooperative, all as further defined in California Civil Code section 1351. Since most people equate “common interest development” with a “condominium,” throughout the remainder of this Manual we will use the term “condominium” interchangeably with “common interest development.”

This policy insures owners of condominium or cooperative units or other common interest development units. Coverage for building property, personal property with loss-of-use, and loss assessment are sold separately. The CEA participating insurer's companion policy will be similar to or a Condominium Unit Owners (HO-6) or equivalent policy.

This policy provides the availability of three coverage options that may be purchased separately or in combination, at the policyholder's option. The coverages are as follows:

1. Option One – Coverage A: Building Property – \$25,000 limit.

Coverage includes Building Code Upgrade Coverage of \$10,000 as additional insurance.

2. Option Two – Coverage C: Personal Property *and* Coverage D: Loss of Use.

When this option is purchased, the policyholder will have coverage for both Coverage C and D which are available in the following amounts:

- Coverage C: \$5,000, \$25,000, \$50,000, \$75,000 or \$100,000
- Coverage D: \$1,500, \$10,000, \$15,000, or \$25,000

3. Option Three – Coverage E: Loss Assessment

When this coverage is purchased, the limit of insurance can be \$25,000, \$50,000 or \$75,000.

1-2. Deductibles - Differences Between Homeowners and Homeowners Choice

Basic Earthquake Policy – Homeowners Form BEQ-3B
 Basic Earthquake Policy – Homeowners Choice Form BEQ-3C

POLICY TYPE	DEDUCTIBLE
<p>Homeowners Homeowners / Manufactured Home (Mobilehome) (BEQ-3B)</p> <p>Dwelling and real property (Coverage A and Coverage B)</p> <p>Personal Property (Coverage C)</p> <p>Loss of Use (Coverage D)</p>	<p>Adjuster must first determine if the pertinent CEA policy is on the Basic form.</p> <p>The deductible is 10 % or 15 % of the Coverage A & B Combined Single Limit (CSL) of insurance. The first \$1,500 of emergency repairs is paid with no deductible. (Section 4-24)</p> <p>Nothing will be paid for personal property damage until the dwelling deductible is met by covered damage to Coverage A and B property.</p> <p>No deductible – Loss of Use can be paid if it was caused by a covered cause of loss.</p>
<p>Homeowners Choice Homeowners/Manufactured Home (Mobilehome) (BEQ-3C)</p> <p>Dwelling and real property (Coverage A and Coverage B)</p> <p>Personal Property (Coverage C) Optional coverage in a Choice policy</p> <p>Loss of Use (Coverage D) Optional coverage in a Choice policy</p>	<p>The adjuster must first determine if the pertinent CEA policy is on the Choice form.</p> <p>The deductible is 10 % or 15 % of the Coverage A & B CSL of insurance. The first \$1,500 of emergency repairs is paid with no deductible. (See Section 4-24)</p> <p>The deductible for personal property is 10 % or 15 % of the personal property coverage limit. This deductible is waived if the Coverage A deductible is met. (If coverage purchased.)</p> <p>No deductible – Loss of Use can be paid if it was caused by a covered cause of loss. (If purchased.)</p>

If you are handling a claim under a CEA HO Choice form, it is very important to remember that the personal property deductible is waived when the Coverage A & B CSL deductible is met.

Please note that with the CEA HO Choice form, it is possible that the covered damage to items covered by A & B, might not exceed the A & B deductible. However, if Coverage C personal property damages exceed the coverage C deductible, apply the coverage C deductible and pay for the covered personal property up to the policy limit. If the Coverage A and B deductible is met after a Coverage C payment has been made, a payment to the policyholder for the amount of the Coverage C deductible previously held back will need to be made.

1-3. Companion Policy Required

CEA policies are sold and issued through Participating Insurers.

By law (California Insurance Code section 10089.20), a CEA earthquake policy is valid only if an underlying residential fire insurance policy is in force covering the same property. The CEA policy is legally void if no residential fire policy issued by the same Participating Insurer is in force at the time of the loss, regardless of whether a formal notice of cancellation of the CEA policy has been sent or received at the time of loss.

1-4. Reporting Claims to the CEA

Participating Insurers are to report to the CEA all claims from CEA policyholders, whether or not the Participating Insurer expects the claim to exceed the deductible.

1-5. Claim Reserving

The aggregated reserve on reported claims provides the CEA's first estimate of severity of an earthquake and ultimate exposure for the event. Claim representatives must quickly set reserves that represent the best estimate of a claim's ultimate cost. Reserves should be adjusted as soon as new information is learned that would affect the ultimate cost.

When there is a legitimate question of coverage, set the reserve at the estimated amount of damages (minus the deductible amount) until the coverage issue is resolved.

If the claim is expected to be under the deductible, it should be reported with a zero (\$0) reserve or the lowest reserve amount allowed by the Participating Insurer's claims processing system.

1-6. CEA Earthquake Response Manager – Duties and Responsibilities

The CEA has a Claim Manager, referred to within the CEA as an Earthquake Response Manager (ERM). The duties of the ERM include:

- a. Maintaining and communicating CEA procedures for handling of CEA claims
- b. Assisting Participating Insurers with earthquake claims training
- c. Monitoring Participating Insurers' earthquake claims response procedures
- d. Maintaining an on-site presence after an earthquake
- e. Coordinating claims activity with the Participating Insurers after an earthquake
- f. Chairing the CEA Claims Coverage Committee (See section 1-9.)
- g. Initiating and coordinating reinspections and claim file reviews after an earthquake (See section 1-11.)

1-7. Participating Insurer Claims Liaison – Duties and Responsibilities

Each Participating Insurer must designate a CEA Claims Liaison (and a backup) to work closely with the ERM in coordinating all activities prior to and after an earthquake. The individual selected should be a property claims professional with the knowledge and the authority within the Participating Insurer's company to resolve CEA claim issues in a timely manner.

- The CEA Claim Liaison must be California Earthquake Claims Accredited. The earthquake accreditation process is detailed at: California Code of Regulations, Title 10, Chapter 5, Subchapter 7.5.1 - Insurance Adjuster Training for Evaluating Earthquake Damage, <http://www20.insurance.ca.gov/pdf/REG/33849.PDF>.
- CEA Claims Liaisons must be familiar with this CEA Claim Manual. A copy can be retrieved from the CEA Web site at: www.earthquakeauthority.com - Agent and Adjuster Information Center - Adjuster Information.
- CEA Claims Liaisons must understand CEA coverage. A good way to get training on CEA coverage is to take the CEA's on-line coverage training found on the CEA Web site.
- CEA Claims Liaisons must understand how to calculate and teach others about CEA deductibles. Take the CEA deductible calculation training that is found on the CEA Web site under the Adjuster link.
- Payment Authority - CEA Claims Liaisons have the authority to pay a CEA earthquake claim up to the CEA policy limit.

Following are some matters that must be referred to the CEA:

- **Any legal action filed on a CEA claim, notice or knowledge of any lawsuit against a Participating Insurer on a CEA claim, and any legal action where the name California Earthquake Authority or CEA appears:** Participating Insurers must immediately notify the CEA's Legal Department if they obtain formal or informal knowledge of the initiation of any such legal actions. Participating Insurers must immediately provide copies of all legal papers and pleadings received by the Participating Insurer to the CEA's Legal Department by e-mail attachment or by fax: (916) 327-8270, and follow up with a telephone call to (916) 325-3800 to make sure that the papers were received. Participating Insurers are not authorized to accept service of legal process on the CEA's behalf, and if a Participating Insurer does happen to come into possession of any such legal papers, the papers must immediately be provided to the CEA's Legal Department.

- Department of Insurance complaints or requests for assistance:** If a Participating Insurer receives notice of any policyholder or consumer complaint, or policyholder or consumer request for assistance made to the California Department of Insurance (CDI) concerning the Participating Insurer's handling of or involvement in any CEA-related matter, the Participating Insurer must immediately send or fax a copy of the Department of Insurance complaint to the CEA's Consumer Services Unit Fax: (916) 327-3411, and follow up with a telephone call to (916) 325-3800 to make sure that the document was received. The Participating Insurer may provide the appropriate response to the CDI without the CEA's prior approval of the response, but the Participating Insurer must send the CEA's Consumer Services Unit a copy of the response that was sent to the policyholder and the CDI. Until the issue is resolved, the Participating Insurer must mail or fax to the CEA's Consumer Services Unit a copy of all further correspondence with the CDI on the issue.
- Taking claims to appraisal or Department of Insurance mediation:** Participating Insurers must consult with the CEA and obtain the CEA's prior approval before demanding appraisal or mediation (including mediation under the CDI's earthquake claim mediation program), and must provide the CEA with the details on the claim made, settlement demands, offers made, and the reasoning for the position taken by the Participating Insurer.
- Examination under oath (EUO):** Participating Insurers must notify and consult with the CEA, and obtain the CEA's prior approval, before giving notice to an insured that the Participating Insurer wishes to take his or her EUO. The Participating Insurer must provide the CEA with the details on the claim, settlement demands, and the reasons why the Participating Insurer believes an EUO would be appropriate. In the event an examination under oath is set, it must be handled in accordance with California Insurance Code section 2071.1.
- Claims where the damages are not covered by the earthquake policy in force:** When an insured makes a claim and a Participating Insurer makes no payment because the loss is not covered by the CEA policy in force, the Participating Insurer must inform the policyholder in writing that the claim is being denied and the letter must quote the policy provisions on which the decision is based. The CEA has not provided a sample letter for this situation, but some of the wording found in the under-deductible sample letter (Attachment 6 in the CEA Claim Manual) may be useful. Participating Insurers must send a copy (by e-mail) of the denial letter to the CEA's Earthquake Response Manager for review and approval as to form before sending the letter to the insured. See Section 7-22 for more guidance on denial letters and the CEA required under deductible letter.

In addition, CEA Claim Liaisons are required to:

- Attend annual CEA claims manager conference.
- Prepare and submit annual CEA claims response plan (cat plan).
- Know about the CUREE Guidelines and how your company will use the Guidelines after an earthquake. (www.curee.org)
- Prepare and keep updated a list of engineers that can be used after an earthquake catastrophe.
- Maintain relationships with catastrophe adjusting companies and make sure their adjusters are California earthquake accredited.
- Sign up for earthquake notification to your cell phone – www.cisn.org.
- Immediately after an earthquake where the CEA requires it, report nightly claim numbers via e-mail to the CEA until the data systems are in sync. Usually 15 days. See Section 3.2 for details on what to report.

1-8. Adjuster Training Requirements

Consistent claims handling by its Participating Insurers is a top priority of the CEA. Excellence and consistency in claims handling can best be accomplished by regular and comprehensive training.

The CEA does not specify the claim handling forms that a Participating Insurance company is required to use. Each company may use the property claims handling forms that it uses for other types of property claims. The only required CEA form is the under deductible denial letter which is addressed in Section 7-21.

The Participating Insurers are responsible for ensuring that their claim representatives and any independent adjusters that they use are properly trained to handle earthquake claims. This Manual can be used as a resource to train claim representatives on the handling of CEA claims.

a. Training on the CEA Policy

On an ongoing basis, but not less than every three years and within one year after the approval by the CEA Governing Board and the Insurance Commissioner of any revised version of this Claims Manual, Participating Insurers must provide detailed training to their claim representatives who will be handling claims for the CEA on the CEA coverages and on this Claims Manual. Participating Insurers must also require those claim representatives to complete the on-line training offered by the CEA prior to being dispatched to handle any CEA claim. This on-line training is available at the CEA Web site at www.earthquakeauthority.com, under the “Agent and Adjuster Information Center” tab on the CEA Web site.

b. Fair Claims Practices Training

It is the responsibility of Participating Insurers to make sure their claim representatives, including any independent claim representatives they may employ,

are trained on California Fair Claims Settlement Practices found in the California Code of Regulation, Title 10, Chapter 5, Subchapter 7.5.

Any apparent conflict between this Claims Manual and the regulations is to be resolved through strict compliance with the regulations.

As defined in the regulations, Participating Insurers are considered claims agents for the California Earthquake Authority. The CEA requires that Participating Insurers follow the time and notice provisions in the Regulations, as provided for in the regulations under Section 2695.7, Standards for Prompt, Fair and Equitable Settlements.

All requirements under Section 2695.3 of the regulations, File and Record Documentation, are to be fulfilled by the Participating Insurers. The CEA does not keep a physical file for individual claims, and requires the Participating Insurers to retain the physical claim file in compliance with Section 2695.3.

All requirements under Sections 2695.4 and 2695.5 of the regulations, Representation of Policy Provisions and Benefits and Duties upon Receipt of Communications respectively, are the responsibility of the Participating Insurers as claims agents for the CEA. Should the CEA receive any written or oral inquiry per Section 2695.5 (a) (such as a Department of Insurance complaint), it will forward any such inquiry to the Participating Insurer for response directly to the party that generated the inquiry. The CEA is to be provided a copy of all such responses, directed to the attention of the CEA Earthquake Response Manager.

Section 2695.6 of the regulations requires annual certification of written claim-handling standards and training of all Claims Agents used by the Participating Insurers. In this context, independent adjusting individuals and companies are by definition “Claims Agents.” The CEA intends to use the Participating Insurers’ Certifications as its own. These Annual Certifications are subject to audit by the CEA.

In order to meet the requirements of these regulations, Participating Insurers are to note in the claim file and/or in their computer systems each instance where a claim or coverage is declined in whole or in part with respect to the party making the claim.

The complete California Department of Insurance Regulations can be viewed online at <http://www.insurance.ca.gov>.

c. Insurance Adjuster Training For Evaluating Earthquake Damage

The CEA requires that Participating Insurance companies handling claims on behalf of the CEA comply with the California Department of Insurance regulations that set forth standards governing the training of insurance adjusters in evaluating damage caused by earthquakes and the procedures for reporting unaccredited adjusting.

These regulations can be found in the CALIFORNIA CODE OF REGULATIONS, Title 10, Chapter 5, Subchapter 7.5.1 *Insurance Adjuster Training For Evaluating Earthquake Damage*, or on the Web at:

<http://www20.insurance.ca.gov/epubacc/REG/33849.htm>.

d. Unique Issues when Handling Earthquake Damage – CUREE Guidelines

Participating Insurers are encouraged to use the CUREE Guidelines EDA2 (a free download at www.curee.org) as one source of training material that can be used to train claims representatives on the unique issues involved in evaluating damage to residential structures caused by an earthquake. Some examples of the information available are:

- Where to get and how to use an earthquake shaking intensity map – ShakeMap.
- Archive of all earthquake ShakeMaps. [www.earthquake.usgs.gov ShakeMaps, Archive](http://www.earthquake.usgs.gov/ShakeMaps/Archive)
- When evaluating a home, what to look for, where to look, when to call an engineer, and suggested repair guidelines.
- What a complete engineer’s report should include. See Chapter 9.
- Glossary and acronyms of common earthquake technical terms.

1-9. Policy and Coverage Interpretations

The CEA has established the following process for answering and resolving CEA policy coverage questions.

- a. Participating Insurers should first attempt to resolve policy and claim coverage questions by consulting this Manual and by using the expertise of their senior claims professionals and claims management.
- b. Remaining unresolved policy coverage questions should be referred to the CEA on the CEA Coverage Review Form with a narrative report under each of the applicable headings. An example of a completed form and a blank Coverage Review Form are included as “Attachment 3” to this Manual.
- c. The Coverage Review Form should be submitted to the CEA ERM along with a copy of all claim file materials necessary for the proper review of the issue. Participating Insurers must use overnight mail or e-mail attachments of electronic copies when sending a file to the CEA for consideration.
- d. If relevant to the question, the file should include photographs of the damage, documentation regarding the amount of the loss, transcribed statements of interested

parties, a declarations page, endorsements, correspondence, and copies of the electronic notes. All other information pertinent to the coverage question under review should also be provided.

- e. Upon receiving a coverage question from a Participating Insurer, the CEA Claims Coverage Committee reviews the question and the CEA ERM notifies the Participating Insurer of its coverage decision.

It will be the responsibility of the Participating Insurer to communicate the coverage decision to the policyholder and, when appropriate, to other interested parties.

The CEA ERM will endeavor to respond as quickly as possible, given the constraints associated with resource allocation in response to larger earthquake events. The Participating Insurer should notify the CEA ERM if there are circumstances requiring a specific turnaround time (other than the response times required by the California Fair Claim Settlement Practices Regulations). If you do not receive a response from the CEA in 15 days, please follow up with the ERM. During the period of time used for a coverage review, the Participating Insurer's claim representative must keep the claimant informed in writing, as provided in the Fair Claim Settlement Practices Regulations section 2695.7(c)(1).

In order to help achieve the CEA's goal of claim-handling consistency, Participating Insurers must not send a question regarding coverage for a CEA claim or CEA policy interpretation to counsel for a legal opinion before submitting the question to the CEA and obtaining the CEA's written consent for the Participating Insurer to seek a legal opinion on that question. In some circumstances, the CEA may have already obtained a coverage opinion on the general or specific topic in question, and may be able to share the conclusions of that opinion with the Participating Insurer.

1-10. Mediation – Department of Insurance Earthquake Mediation Program

The California Department of Insurance Web site reads in part:

One of the responsibilities of the California Department of Insurance (Department), is to help consumers who are having difficulty getting their residential property or earthquake insurance claims resolved. California Insurance Code Chapter 8.9 was enacted in October 1995 as a result of Senate Bill No. 882. This law made it possible to establish a program for the mediation of certain disputes over residential earthquake damage claims arising out of the Northridge earthquake of 1994 and any subsequent earthquakes. In 2004, Senate Bill No. 64 was enacted as an urgency measure to expand the mediation program to include residential property insurance losses other than earthquake. The program will be available for those losses that occurred after September 30, 2003, and for which the Governor declared an emergency. This program uses mediation to bring you and your insurance company together in an informal meeting with a qualified mediator. www.insurance.ca.gov

The CEA realizes that during an earthquake catastrophe response, there will be a small number of claims where the claims representative and the policyholder disagree on the scope of and the amount of repair costs for the covered damage.

Participating Insurers are strongly encouraged to incorporate the requirements of the Earthquake Mediation program into their CEA claims handling procedures. Upon notice of a demand for mediation by any party, the Participating Insurer must provide a detailed report to the CEA's ERM, describing the claim made, settlement demands, offers made and the full reasoning for the position taken by the Participating Insurer.

All mediation dates must be immediately communicated to the ERM. Participating Insurers will handle all communications directly with the CDI, and will immediately provide copies of all written materials to the CEA's ERM. The Participating Insurer will provide the most knowledgeable member of its staff to attend the mediation. Notice of the mediation must be given to the CEA's ERM sufficiently in advance of the mediation to enable the CEA to make an informed decision about whether to attend.

1-11. Reinspections and Claim File Reviews

The CEA uses both physical claim reinspections and claim file reviews to monitor whether CEA claims are handled in a prompt, consistent, and fair manner. A physical claim reinspection involves actually visiting and evaluating the earthquake-damaged home, while a claim-file review is generally accomplished in an office by looking at the claim file and all supporting electronic records.

a. Reinspections and Claim File Reviews Performed by the Participating Insurer

The CEA expects that Participating Insurers will have their own claims quality assurance programs, including a program for field reinspections of open claims, as well as reviews or audits of claim files. These plans should be documented in the earthquake response plan each Participating Insurer submits to the CEA every year. (See section 2-2.)

- **Reinspections:** It is important to conduct reinspections on open claims early in the claim-handling process so that the damage can be viewed before repairs are completed. Of course, the policyholder's permission must always be obtained. The reinspection program should look at a statistically-valid sample of all claims from a specific earthquake. The ERM or the ERM's designee may be available to join Participating Insurer inspectors when they are conducting CEA earthquake claim reinspections. Requests to participate in the reinspections should be made through the ERM, who will try to accommodate these requests according to the available resources. Copies of results should be retained, since the CEA may request copies of any review at a later date.
- **Claim file reviews:** In addition to physical claim reinspections, Participating Insurers are required to have a regular claim file quality review program. The Participating Insurer should apply the same quality of review and look at the same

number of claim files as it would for its own claims. Copies of results should be retained, since the CEA may request copies of any review at a later date.

b. Reinspections and Claim File Reviews Performed by the CEA

The CEA may conduct field reinspections of open claims and/or reviews of claim files after an earthquake. While field reinspections are generally performed on open claims, claim file reviews may be performed on open or closed claim files. The purpose of these reinspections and claim file reviews is to:

1. Monitor and promote adherence to the CEA Claim Manual
 2. Verify the accuracy of claims settlements, and
 3. Determine whether claims are being handled in accordance with the California Fair Claims Settlement Practices Regulations and other applicable regulations and statutes.
- Reinspections: All CEA claim reinspections will be conducted separately and in addition to any Participating Insurer reinspections. Before the claim reinspection process begins, the CEA will ask for a complete copy of the claim file for each claim it wishes to reinspect. The CEA re-inspector may be either a CEA employee or an independently-contracted individual or company. The CEA will endeavor to reinspect a representative sample from each Participating Insurer and to look at claims under each type of CEA earthquake policy.
 - Claim file reviews: The CEA may also elect to conduct claim file reviews on open or closed claim files. These may be done at the Participating Insurer's office or the CEA may request that copies of the claims files be sent to the CEA office for review.

In either case, the CEA will endeavor to give sufficient notice to the Participating Insurer so as not to disrupt the Participating Insurer's ongoing claims-handling process.

It is the CEA's intent to communicate any issues discovered by the reinspections or claim file reviews to the relevant Participating Insurer.

c. Claim File Review Elements

CEA claim reviews may include, in addition to other elements, an evaluation of some or all of the following elements, depending on what may be appropriate to the facts and circumstances of the particular claim being reviewed:

1. Promptness of first contact
2. Development of initial information
3. Timely and thorough completion of the scope of damage (listing of damage)
4. Repair estimate of damages
5. Statements from the policyholder, if warranted
6. Reserve calculations and adequacy of reserves

7. Coverage information and how it applies to the claim
8. Effective use of a diary that results in timely claims handling
9. Timeliness of communication with insured regarding claim status
10. Alertness to fraud and prompt notice given to appropriate parties
11. Appropriate use of engineers or other experts
12. Completeness of documentation of the amount of loss – Statement of loss
13. Timeliness of claim payments
14. Quality of written adjuster communications to the policyholder
15. Compliance with the CEA Claims Manual
16. Compliance with California Fair Claims Practices Regulations
17. Was adjuster (independent or company) earthquake claim handling accredited
18. Periodic guidance on open files by Claims Management
19. Effectiveness of Participating Insurer's reinspection program and claim file reviews

d. Timing of CEA Claim Reviews

Field reinspections: The CEA will typically begin conducting physical reinspections of claims around 30 to 45 days after an earthquake; however they can begin at any time.

Office claim file reviews: Claim file reviews can begin at any time after an earthquake, but most likely will begin after a majority of the claims have been completed and closed.

1-12. Overlapping or Coexistent Insurance Coverage

To help resolve issues of overlapping insurance or coexistent insurance coverage, the claim representative should follow the Other Insurance provisions in the CEA policy. Further help can be found in the *Guiding Principles for Overlapping Insurance Coverage* published in 1963 by a consortium of underwriting organizations. This document should be available from your claim manager.

When dealing with condominium policies, pay particular attention to the Other Insurance wording in the policy. This is discussed in more detail in sections 5-2 and 5-3 of this Manual.

1-13. ISO ClaimSearch® (PILR)

The CEA requires that every CEA earthquake claim be entered into ISO Claim Search.

The ISO ClaimSearch system is a national repository where claims can be reported. When a newly reported earthquake claim matches up with a previously reported earthquake claim on the same property address, a report is generated.

CEA claims are handled by many different Participating Insurance companies and policyholders sometimes move from company to company. The CEA regularly receives earthquake claims from small earthquakes and upon investigation, it is not uncommon for these claims to be denied when the damage being claimed is determined to be caused by something other than an earthquake.

By having CEA claims in ISO Claims Search, our participating Insurers will be notified of prior earthquake claims and the claims representative can evaluate if any unrepaired prior damage is being claimed in the new CEA earthquake claim.

1-14. Claim Representatives Should Handle Claim to Conclusion

The Participating Insurer must make every effort to assure that the original claim representative assigned to a claim will handle the claim to conclusion. If reassignment of claims to another claim representative is necessary, the Participating Insurer must have procedures in place to facilitate a proper transfer of the files, including instructions in each file on what remains to be done to complete the handling on each claim.

California Insurance Code section 10082.3 addresses this issue where it reads, in part:

“Adjusters: If, within a six-month period, the company assigns a third or subsequent adjuster to be primarily responsible for a claim, the insurer, in a timely manner, shall provide the insured with a written status report. For purposes of this section, a written status report shall include a summary of any decisions or actions that are substantially related to the disposition of a claim, including, but not limited to, the amount of losses to structures or contents, the retention or consultation of design or construction professionals, the amount of coverage for losses to structures or contents and all items of dispute.”

2. PRE-EARTHQUAKE DISASTER RESPONSE PREPARATION

2-1. Pre-Earthquake Planning - General

Response planning before an earthquake occurs is very important. The ERM is available to the Participating Insurer claim liaison to assist with pre-earthquake training and planning.

2-2. Participating Insurer Earthquake Response Plan

Each Participating Insurer is responsible for its own earthquake catastrophe response planning. By the end of each calendar year, an updated claims-oriented response plan specific to earthquake claims is to be filed with the CEA. It must address, at a minimum, the following aspects of catastrophe planning:

- a. Processes to make sure staff and independent adjusters are trained before they are needed for earthquake catastrophe claims handling duty. It is the Participating Insurer's responsibility to make sure that every claim representative working on a CEA claim meets the following criteria:
 - Is trained on the California Department of Insurance Fair Claims Settlement Practice Regulations
 - Is trained and accredited on the CALIFORNIA CODE OF REGULATIONS, TITLE 10, CHAPTER 5, SUBCHAPTER 7.5.1: INSURANCE ADJUSTER TRAINING FOR EVALUATING EARTHQUAKE DAMAGE
 - Is trained on Department of Insurance standards for evaluating damage caused by earthquakes
 - Has received training in the handling of CEA claims and at a minimum, has recently taken the CEA on-line claims coverage and deductible calculation courses
 - If using any independent adjusters, plans to confirm that all such adjusters are properly licensed to investigate and adjust claims in California
- b. Procedures for the initial (first 48 hours) earthquake catastrophe response:
 - Processes for accepting new earthquake claims
 - Plans for properly trained and accredited initial response adjusters
 - Plans for claims management including the ability to determine affected policies-in-force
 - Resources available - buildings, cars, computers, etc.
 - Logistical details on how response activities will be coordinated
- c. Procedures for full term earthquake catastrophe response:
 - Plans for a sufficient number of properly trained and accredited earthquake adjusters
 - Plans for the longer term management of CEA earthquake claims
 - Resources available – buildings, cars, computers, independent adjusters, etc.

- Logistics - details on how response activities will be coordinated
- d. Procedures for how experts, including engineers, will be used and details on pre-earthquake arrangements for these services.
- e. Procedures for handling first reports of CEA claims and other phone-related support programs, such as the availability of national catastrophe call centers, etc.

3. POST-EARTHQUAKE RESPONSE

3-1. CEA Earthquake Response Manager

Following the occurrence of an earthquake from which a significant number of CEA claims is expected to be presented, the CEA Earthquake Response Manager most likely will travel to the general area of the earthquake and make efforts to be available to consult with the Participating Insurers' CEA Claims Liaisons.

3-2 Claims Counts

The CEA does not know about a claim until the Participating Insurer opens a new claim and that claim record is transmitted to the CEA data system. Due to this delay, after an earthquake that is expected to generate a significant number of claims, or when notified by the CEA ERM, participating insurers need to manually report claim counts to the CEA. This daily claim count reporting will continue until such time as the CEA's data systems sync up with the actual amount of CEA claims. This generally takes about three weeks.

When notified by the CEA ERM, please report the following information by e-mail to ceaclaims@calquake.com, with a copy to the ERM, by the end of every working day.

Date of the report:

Name of company:

Name of contact person at company:

Contact person e-mail and phone number:

Total Number of claims, open & closed (not suffixes/coverages) received so far from the earthquake:

Out of the total # of claims, how many are now closed:

What is the current total dollar amount of all open reserves:

What is the current total dollar amount of all paid CEA claims to date:

3-3. Media Communications Following an Earthquake

After an earthquake, the CEA will endeavor to maintain communications with the Participating Insurers in order to provide the public with helpful, accurate, and timely information. Participating Insurers must work with the CEA's Director of Communications on communications with the media or outreach to the general public. 916-325-3800

The CEA maintains specific guidelines on how the CEA name, logo, and trademarks should be used. All advertising that a Participating Insurer might do must be consistent with CEA directives that have been provided to each Participating Insurer. Copies of these directives are available from the CEA's Director of Communications.

3-4. Participating Insurer Catastrophe Claim Managers

Participating Insurers' key on-site personnel should be determined by the insurer at the outset of the catastrophe, and a list containing their names should be forwarded via e-mail to the ERM within 24 hours of the earthquake.

The ERM will endeavor to meet with the Participating Insurer claims liaisons near the earthquake site on an as-needed basis. The meetings between the ERM and the Participating Insurer representatives can serve as a forum to resolve issues, such as:

- a. Updating the ERM with the progress each Participating Insurer has made in establishing its catastrophe office(s)
- b. Identifying and sharing information about specific problems encountered by the Participating Insurers
- c. Informing the Participating Insurer representatives of the current status of the CEA's coordination with governmental agencies
- d. Discussing general policy coverage issues
- e. Discussing particular structural elements being encountered on claims in the area

3-5. Catastrophe Offices

Although Participating Insurers must provide adequate staffing and operations, the establishment, number, and location of catastrophe response offices is left to the discretion of the Participating Insurers. Participating Insurers should provide the CEA with the address and telephone number of their catastrophe offices as they are established.

Participating Insurers must make it reasonably easy for new CEA claims to be reported by policyholders. This may include the use of agents, the Internet, and/or prominently publicized toll-free telephone numbers.

3-6. CEA Event Code

Immediately following an earthquake where the CEA expects to receive claims against CEA policies, the CEA will assign an Event Code. Specific Event Codes have the form YYNNN, where YY is the last two digits of the year in which the earthquake event occurs and NNN numbers events sequentially in 10-unit increments. While the first two digits of the event code change with the New Year, the next three digits are sequential over the years. For example, if the last Event Code issued in 2012 had been 12410, the first Event Code issued in 2013 would have been 13420.

For claims where the CEA has not provided an Event Code, use YY999, where YY is the last two digits of the year for the claimed date of loss, and 999 designates that this is a miscellaneous earthquake claim for that year.

The CEA will communicate the Event Code to all Participating Insurers as soon as possible following the earthquake's initial seismic activity. All claim-related data transmissions to the CEA must include an event code.

3-7. New Claims Reported to the CEA

Presentation of claims directly to the Participating Insurer will result in the most timely claims service, and most claims will be reported directly to the Participating Insurers. However, the CEA may receive calls in which the policyholder or another interested party wishes to report a claim under a CEA policy to the CEA, rather than to the Participating Insurer. Callers will be encouraged to report the claim directly to the appropriate Participating Insurer and will be given the toll-free claim reporting telephone number for the responsible Participating Insurer.

If the caller cannot or will not make the report of a claim to the responsible Participating Insurer, the CEA representative will complete a property loss notice form and fax it to the appropriate Participating Insurer's claims department. (See Attachment 7.)

3-8 EARLE (Earthquake Loss Estimation System)

The CEA has developed a proprietary software system called "EARLE" (Earthquake Loss Estimation System), which is used to provide a rapid estimate of the CEA's total insured losses arising from a major earthquake, and enables the CEA to provide a prompt report of that estimate to the CEA Governing Board as required by law.

Participating Insurer CEA Claims Liaisons will be notified when the EARLE process is to be used by the CEA. Once the EARLE process is initiated, the EARLE system computer statistically selects a pool of CEA insured properties for immediate inspection and damage estimation. The CEA will use independent adjusters to inspect 200 homes. To distinguish these home inspections from claim adjusting work, this work is called an "EARLE Inspection" and the independent adjusters who conduct these inspections for the CEA are called "EARLE inspectors".

The inspectors will make it clear to the property owners that they are not their insurance claim representative, and if the homeowner has new earthquake damage, they need to report their damage to their Participating Insurance Company who will establish a CEA claim and send out a claim representative to handle their claim. The CEA is not allowing an EARLE inspector to handle the claim for the Participating Insurance Company on the property they inspected.

An electronic copy of the scope, estimate of damage, and any photographs that were taken to support the estimate, will be provided to the appropriate Participating Insurance Company.

The CEA uses these EARLE estimates by integrating them into modeled estimates of loss to come up with a more accurate estimate of potential total loss to the CEA.

3-9. Pro Rata or Installment Claims Payments

If an earthquake or series of earthquakes threatens to exhaust the CEA's claims-paying capacity, statute provides that the Insurance Commissioner may authorize the CEA to pay policyholder claims on a *pro rata* basis. Once an earthquake occurs, the CEA estimates probable losses based on in-force coverages and damage models. The CEA will then compare its preliminary overall loss reserve estimate of the earthquake to the claims-paying capacity of the CEA.

In case of a severe earthquake, or several significant earthquakes over a relatively short period of time, it is possible that the CEA could declare a Claims Payment Ratio (CPR) of less than 100%. If a CPR is declared, the CPR is used to determine what percentage of the claim is to be paid to the insured by the Participating Insurer. Participating Insurers can assume the CPR is 100% unless the CEA announces otherwise.

The CPR may be adjusted during the handling of claims arising out of an earthquake based upon actual paid claim amounts and the resources available to the CEA for payment of claims. If the CPR is adjusted, paid claims will need to be recalculated and additional payments forwarded to the insured.

This discussion about the CPR does not change the way Participating Insurers are to handle, report, or seek reimbursement from the CEA for claims payments. Claims reimbursement procedures are found in the CEA Participating Insurer Operating Procedures Manual.

4. BASIC EARTHQUAKE POLICY - HOMEOWNERS

- This Manual does not create coverage where none is provided by the policy of insurance in force at the time of the loss.
- Items in italics below are quoted directly from the policy.
- The CEA homeowner policy is used to insure one to four unit residential dwelling structures and manufactured home and mobilehomes.

The CEA has two forms for its homeowner / manufactured home / mobilehome policies:

1. Basic Earthquake Policy – Homeowners, form BEQ-3B
(In this Manual this policy is referred to as the HO Basic policy.)
2. Basic Earthquake Policy – Homeowners Choice, form BEQ-3C
(In this Manual this policy is referred to as the HO Choice policy.)

The main difference between these two policies is how the policy is structured and as a result how the deductible is applied. All other policy provisions, coverage, sublimits, etc. are the same. See Section 1-2 for an overview of deductibles in these two policies.

In contrast to the CEA HO Basic policy, the CEA HO Choice policy provides for three coverage options that can be purchased together in any combination or separately. They are:

Coverage A & B CSL: DWELLING
Coverage C: PERSONAL PROPERTY
Coverage D: LOSS OF USE

Coverage A & B CSL: DWELLING is required on a Homeowners Choice policy.

Coverage C: PERSONAL PROPERTY is an optional coverage that a policyholder may elect to add to a Choice policy. If selected, the insured may choose limits ranging from \$5,000 to \$100,000. This coverage has its own 10% or 15% deductible that is waived if the damage to coverage A & B CSL exceeds the coverage A & B CSL deductible.

See the chart in Section 1-2 for information on how deductibles are applied in a Choice policy.

Coverage D: LOSS OF USE is an optional coverage that a policyholder may elect to add to a Choice policy. If selected, the insured may choose limits ranging from \$1,500 to \$25,000.

The fact that these coverages can be purchased separately and with different coverage limits requires the claim representative to be vigilant in confirming coverage, limits, and deductible amounts.

4-1. Introduction to the CEA Homeowners Policy

The CEA Homeowners earthquake policy has a combined single limit for Coverage A: DWELLING and Coverage B: EXTENSIONS TO DWELLING that will match the amount of the Coverage A: limit in the companion fire policy. Adjusters may need to explain this to the insured since this is different from the way most fire policies are structured.

The policy has a table of contents, which makes it easy to read and follow. All claim representatives must thoroughly read the specific policy in force at the time of the loss to determine the appropriate coverages, limits, and exclusions. Reviewing this Claim Manual is not a substitute for reading the policy.

4-2. Covered Losses

The CEA policy is a specified peril policy. It insures against only one peril, specifically: *...accidental, direct physical loss from an **earthquake** that commences during the policy period as part of a **seismic event** that commences during the policy period...*

*“Seismic event” means one or more **earthquakes** that occur within a 360-hour period. The **seismic event** commences upon the initial **earthquake**, and all **earthquakes** or **aftershocks** that occur within the 360 hours immediately following the initial **earthquake** are considered for purposes of this policy to be part of the same **seismic event**. (360 hours equals 15 days.) Read the complete policy definitions for “earthquake,” “seismic event,” and “tectonic processes.”*

In order for a claim to be covered, the earthquake and the seismic event (i.e., the first in time of any series of related earthquakes) both must have commenced during the CEA policy period.

4-3. Losses Excluded

As mentioned above, the CEA policy covers only the peril of an earthquake that occurs during the policy period as part of a seismic event that commences during the policy period. Losses caused by any peril other than an earthquake commencing during the policy period, do not fall within the insuring agreement of the policy. The policy also contains a list of excluded perils. Losses caused by these perils are excluded even if an earthquake contributes to the loss. The exclusions should be read carefully as there are exceptions. For example:

- Under Losses Excluded, number 2, water damage, the policy reads:

*This water damage exclusion, (however) does not exclude loss that results from water damage to covered property as a result of an **earthquake**, which causes:*

- the release of water from water heaters, refrigerators, or water supply pipes within the **dwelling**;*
- the displacement of water from a swimming pool, decorative pool, spa, or hot tub; or*

- (iii) *the release of water from municipal or other water supply lines on or off the **residence premises** or the release of water or sewage from sewers or drains on or off the **residence premises**.*
- Under Losses Excluded, number 5, non-earthquake earth movement is excluded, but there are exceptions: That exclusion reads in part:
 - 5. *Earth movement, settling of land, land sliding, subsidence, mudflows, or earth sinking, rising or shifting, unless the earth movement, settling of land, land sliding, subsidence, mudflow, or earth sinking, rising or shifting:*
 - a. *is induced by, and would not have occurred in the absence of, an earthquake that commences during the policy period as part of a **seismic event** that commences during the policy period; and*
 - b. *causes loss that manifests within one year after the **earthquake** that caused the loss.*

The above are merely illustrative examples of excluded perils. There are several other excluded perils listed in the policy—carefully read the policy for the complete list.

4-4. Loss Settlement is at Replacement Cost

The BASIC EARTHQUAKE POLICY – HOMEOWNERS is a replacement cost policy both for real property and for most personal property.

The real property Loss Settlement condition of the policy (Condition 5) specifies that, once losses on building property exceed the deductible, settlement . . . *will not exceed the smallest of the following:*

- (i) *the **replacement cost** at the time of loss;*
- (ii) *if the damaged property has been actually repaired or replaced, the amount actually and necessarily spent to repair or replace the damaged property; or*
- (iii) *the applicable **limit of insurance** or any applicable **sublimit(s)**.*

Personal property is also settled at replacement cost, except for certain limited categories of personal property that are settled at actual cash value. These categories are described in Condition 6 of the policy:

*We will settle losses to covered property described under Coverage C: PERSONAL PROPERTY at **replacement cost**, except that we will settle losses to property in items (i), (ii), and (iii) of this paragraph, below, at **actual cash value** only.*

- (i) *Property which by its inherent nature cannot be replaced;*
- (ii) *Property not maintained in good or workable condition; or*
- (iii) *Property that is outdated or obsolete, or property not useful for its intended purpose.*

Unlike some Participating Insurers' underlying policies, actual repair or replacement is not required to collect the replacement cost with regard to Coverage A Dwelling, Coverage B Extensions to Dwelling or Coverage C Personal Property. (Remember that there are certain limited categories of personal property which are payable at actual cash value only. See Conditions, Loss Settlement, Coverage C.)

However, if the property has already been repaired or replaced at the time payment is made, the amount payable is limited to the amount spent. The exception to this rule is losses covered under "Other Coverages for Building Code Upgrades." This cost is paid only if the property is actually repaired and the cost is incurred. The CEA permits the pre-payment of code upgrades if it is clear, in the claim representative's professional judgment, that property is going to be repaired, the code upgrade cost is known (or it is known that code upgrade costs will exceed the Building Code Upgrades coverage limit), and making this payment would complete the claim process.

4-5. Types of Building Property Insured – Dwelling is Defined

Business and commercial buildings are never insured by the CEA policy.

The CEA homeowners policy covers the residence premises, which can be a one, two, three, or four unit dwelling or a manufactured / mobilehome located at the address shown in the declarations. "Dwelling" is specifically defined in the DEFINITIONS found in the policy. It provides:

"Dwelling," means the residential structure or mobile home at the location described in the DECLARATIONS. Dwelling does not include land, whether or not beneath the residential structure or mobile home, even if required for support. Dwelling does not include any structure other than the residential structure or mobile home unless the structure (1) shares a common wall or a continuous roof line with the residential structure or mobile home or (2) is attached to the residential structure or mobile home by a foundation that is continuous with or contiguous to the foundation of the residential structure.

4-6. Chimneys – Coverage A: \$5,000 Sublimit of Insurance

Chimneys are covered up to a \$5,000 sublimit regardless of the number of chimneys covered. For purposes of applying the sublimit: "**Chimney**" means the flue or vent and the building code-required structure that surrounds the flue or vent, including exterior chimney facings, from the firebox to the outside of that structure. **Chimney** does not include a hearth, a mantel, or the firebox where combustion takes place. The hearth, mantel and firebox are not subject to this \$5,000 sublimit and damage to them is covered under the dwelling limit.

The homeowners policy condition 5(g), reads:

*To repair or replace a **chimney**, we will not pay more than the least of the following amounts:*

- (i) *the sublimit of \$5,000 that applies to chimneys;*
- (ii) *the cost of replacement of a masonry **chimney** or **chimneys** with a non-masonry, earthquake-resistant **chimney** or **chimneys**; or*
- (iii) *the necessary amount actually spent to repair the damaged **chimney** or **chimneys**.*

There are three things to remember when working with chimneys.

1. Follow the chimney definition and don't include the hearth, mantel, and firebox in the estimate of chimney damage.
2. The CEA policy has a \$5,000 chimney sublimit, no matter how many chimneys there are on the property. This is not \$5,000 per chimney, but \$5,000 total for all chimneys.
3. The settlement provisions provide for the least of three different options, one being that chimneys are replaced with a non-masonry, earthquake resistant chimney.

4-7. Equipment and Utility Service Structures - Coverage B

The policy covers equipment and utility service structures for electric, telephone, natural or bottled gas, heating, oil, water, septic, and sanitary sewage systems. To be covered, these items must be owned by the insured, must be on the residence premises, and must affect the habitability of the dwelling.

In order to determine whether any such item is covered, the claim representative must determine the answer to the following four questions:

1. Does the insured own the item?
2. Is the item that was damaged one of the types of items listed in the policy?
3. Is the item physically located on the insured's premises?
4. Does the item affect the habitability of the dwelling?

There is coverage under a CEA homeowners policy only when the answer to all four questions is "yes."

4-8. Walkways, Driveways, Decks, Patio Slabs - Coverage B

The policy reads in part as follows: ... *we cover... 2. That portion of any walkway, driveway, deck, or patio that is necessary for regular pedestrian ingress to or egress from the **dwelling** and for the regular ingress to and egress from the **dwelling** by any non-ambulatory insured.* The scope of this coverage is to allow for safe pedestrian passage to and from the dwelling for the insureds. The scope is best appreciated by breaking down the coverage language as follows:

- *That portion* – This language obviously states that only the relevant *portion* of the property is covered. Use the local city or county building codes, where the codes speak to this issue, to determine what “that portion” necessary for safe ingress and egress is.
- *Any* should be interpreted to mean *all* walking surfaces that are used for regular pedestrian ingress or egress.
- *Pedestrian* - Means that ingress and egress necessary for vehicles is not covered. (An exception could be made for a non-ambulatory insured.)
- *To or from the dwelling* - This means that the policy covers regular pedestrian ingress and egress from the home to a public sidewalk or to the private or public street next to the home.

Questions about what portion of the walkway, driveway or patio should be repaired or replaced must be addressed on an individual basis according to the facts of the loss and the coverage available. The claim file should have a detailed drawing of what ingress and egress was allowed, and the file should contain documentation as to how and why the dimensions and amounts paid were arrived at. This coverage is for replacement cost with materials of like kind and quality and for the same use. (See the definition of “replacement cost” in the policy.)

4-9. Bulkheads, Piers, and Retaining Walls - Coverage B

The policy covers *those bulkheads, piers, and retaining walls on the **residence premises** that are integral to the stability of the **dwelling**.* Except as provided for in “OTHER COVERAGES,” item 4, the cost of repairing, replacing or stabilizing the land under or around these devices is not covered.

The policy applies only to property located on the residence premises and in which the named insured holds an insurable interest. Therefore, to the extent that bulkheads, piers, and retaining walls are not entirely located on the residence premises, the insurable interest must be fully investigated and coverage based on the extent of the policyholder’s insurable interest.

4-10. Property Not Covered: Coverage A and Coverage B

The CEA BASIC EARTHQUAKE POLICY – HOMEOWNERS does not cover certain items of real property. For example, the following are not covered:

- Detached garages, outbuildings, pools, spas, fences, and other structures not set forth in Coverage B: EXTENSIONS TO DWELLING.
- Exterior water supply systems including, but not limited to, irrigation systems, sprinkler systems, and water reclamation systems.
- Underground structures or equipment located outside the foundation wall of the structure (except equipment and utility services which affect habitability of the dwelling).
- Land, other than that portion of land stabilization expenses covered under OTHER COVERAGES, item 4. (See section 4-27.)

These are only a few examples. It is important to read the policy for a complete list of property that is not covered.

4-11. Property Not Covered: Exterior Masonry Veneer

The CEA policy does not cover: *Exterior masonry veneer. For purposes of this exclusion, stucco and exterior chimney facings are not exterior masonry veneers.*

The terms “masonry” and “veneer” are common terms, and definitions for them can be found in the dictionary. The common understanding in a construction context is that the term “veneer” refers to a *nonstructural* facing of brick, concrete, stone, tile, or other similar material attached to a backing for the purpose of ornamentation.

The question sometimes arises about what can be allowed (paid for) under the CEA policy coverage if the masonry veneer falls off a home. The answer is nothing can be paid for any such loss. Masonry veneer is not covered and there is no policy provision or requirement to pay for replacing it with something else.

Also, take note that the brick on a home may not be masonry veneer. If the structure is a masonry structure, then any part of that masonry structure that is not veneer may be covered under the CEA policy.

4-12. Property Not Covered: Exterior and Underground Systems and Structures

Except as provided under Coverage B: EXTENSIONS TO DWELLING, the policy does not cover exterior water supply systems including, but not limited to irrigation systems, sprinkler systems, and water reclamation systems; underground structures or equipment located outside the perimeter of the dwelling foundation, including but not limited to underground pipes, cables, flues, drains, electrical supply systems and electrical lighting systems. (This is found in the policy, under Property Not Covered, Coverage A and Coverage B, Item 10.)

4-13. Property Not Covered: Antennas and Satellite Dishes

The policy does not cover antennas, satellite dishes and any towers, brackets, or attachments that support or secure them.

4-14. Property Not Covered: Decorative or Artistic Features of the Dwelling

The policy does not cover: *Any decorative or artistic features of the property, including but not limited to works of art; items such as murals; stained or leaded glass; mirrors; chandeliers; mosaics; statuary or sculpture; carvings, inlays, and reliefs or bas reliefs; and fountains, aquariums, and their systems. If at the time of loss a decorative or artistic feature is serving a utilitarian purpose, the cost to repair or replace the decorative or artistic feature is not covered to the extent the cost of repair or replacement exceeds the cost of replacing it with a non-decorative, non-artistic functional replacement.*

In applying this policy provision, the CEA recommends the following approach. If an item on the above list is damaged by the earthquake, it is not covered and if an item is not listed, it probably is covered. If a claim representative is unsure if an item rises to the level of being a decorative or artistic feature of the property, they should e-mail a picture to his or her company CEA Liaison, who can consult with the CEA if necessary.

For purposes of illustration, the following lists the common meaning of the words used in this section of the policy. These definitions were taken from a standard dictionary.

Murals – a painting that is applied to a wall, ceiling, or floor surface

Stained glass – glass that has been colored in some way

Leaded glass – pieces of glass held together by lead, can be clear, stained, or etched glass

Mirrors – a polished or smooth surface (as of glass) that forms images by reflection

Chandeliers –light fixture, hangs from the ceiling, branched, often ornate

Mosaics – design made of small pieces of colored stone or glass

Statuary – statues collectively

Statue – a sculpture representing a human or animal

Sculpture – a three-dimensional work of art

Carvings – an object created by carving (as wood or ivory or stone)

Inlays – decorate the surface by inserting wood, stone, or metal

Reliefs and bas reliefs – Decorative features in which figures or designs are raised above (or indented into) the surrounding flat surface

Fountains - a structure from which an artificially produced jet of water arises

Aquariums - tank with water for keeping fish and underwater animals, or a tank for reptiles

The claim representative should identify the listed decorative or artistic features of the home during the initial assessment of the scope of the damage and discuss any excluded items with the insured. The claim representative should also discuss any items with a utilitarian purpose and what the reasonable non-decorative, functional replacement, should be. (e.g., chandelier verses a non-decorative replacement light fixture of equivalent quality of other light fixtures in the home)

4-15. Property Not Covered: Awnings and Patio Coverings

The policy does not cover *awnings and patio coverings, or their support structures*. All structures comprising the patio covering, including posts supporting the covering, are excluded. Awnings and patio coverings are not covered even if permanently attached to the dwelling.

A patio slab is not part of a covered loss, except for any portion of it that is necessary for ingress or egress as described in the policy. (See section 4-8.)

4-16. Property Not Covered: Landscaping

Damage to *Landscaping, trees, shrubs, lawns, or plants, even if damaged by necessary repairs to covered property*, are not covered. If it is necessary to remove a landscape element in order to access the structure for repairs, an allowance for removal may be considered, but policy coverage does not allow for replacement of the landscaping element.

4-17. Property Not Covered: Swimming Pools, Spas, and Hot Tubs

The policy does not cover swimming pools, spas, or hot tubs, whether they are personal property or part of the dwelling. Tile or other material linking or attaching the pool, spa, or hot tub to a deck or to the dwelling is not covered. The policy reads as follows:

*Property Not Covered—Coverage A and Coverage B We do not cover: Swimming pools, spas, and hot tubs, whether part of the **dwelling** or not, including the tile or other material linking or attaching the pool, spa or hot tub to a deck or to the **dwelling**.*

4-18. Garages and Outbuildings

Detached garages and outbuildings are not covered. However, the definition of “dwelling” includes structures that share a common wall or continuous roof line with the residential structure or mobilehome or are attached by a foundation that is continuous or contiguous to the foundation of the dwelling. If a garage or outbuilding meets this definition then it would be covered under the structure policy limit.

4-19. Plaster - Limited to the Cost of Sheetrock or Drywall

The policy does not cover plaster, to the extent that the cost to repair or replace it exceeds the value of its replacement with Sheetrock or drywall. The claim representative should consider whether minor repairs with plaster may be less costly and more beneficial to the insured than repair or replacement with Sheetrock or drywall.

4-20. Dwelling Glass - Loss Settlement

Conditions:

5. *Loss Settlement: Coverages A and B.*

f. We will replace covered glass with safety glazing material when required by ordinance or law.

This applies when you are paying for broken building window glass, and building codes require that it be replaced with safety glass. This increased cost falls under the policy building code upgrade coverage.

The companion homeowner's policy may have coverage for broken dwelling glass. If there is double coverage, see the provisions in the policy regarding Other Insurance.

4-21. Coverage C - Personal Property Not Covered or Subject to a Sublimit

Certain types of personal property are not covered. Other categories of personal property are covered, but only up to a sublimit. Read the policy for a complete list of not covered and sublimited personal property. Here are some examples:

- Glassware, crystal, china, and porcelain are not covered. (Structural glass found in windows and doors is covered under Coverage A.) Food products packaged in glass are not considered glassware and may be covered. For example, bottles of wine, and the replacement cost of the product at today's prices (including the glass container) can be considered as covered personal property.
- The policy does not cover: *artwork, including but not limited to paintings, drawings, framing, sculpture, photographs, handmade tapestries and rugs, pottery, and ceramics.*
- Motor vehicles, watercraft, *and trailers are not covered.*
- *Business property: Coverage C has a sublimit of \$1,000 on business property. There is a separate sublimit of \$3000 on computers and other electronic data processing equipment, whether or not it is business property. Therefore, a computer used for business is not limited by the \$1,000 business property sublimit.*
- Personal Property owned by others: Property owned by roomers, boarders, or renters not related to an insured is not covered. For property owned by all other persons other than an insured, there is a sublimit of \$2,500 on covered personal property, regardless of the Coverage C limit of insurance.

4-22. Coverage D: Loss of Use

Coverage D: Loss of Use coverage can be purchased up to a maximum of \$25,000. If a covered loss makes the dwelling unfit to live in, and the insured vacates the dwelling, the necessary increase in living expenses actually incurred is covered. The claim file should contain documentation to support all loss of use expenses that were paid for.

If any part of the dwelling was rented to others or held for rental, and a covered loss makes it unfit to live in, the fair rental value (less any expenses that do not continue) is covered.

If a civil authority prohibits you from occupying your dwelling because of direct damage to the residence premises or other premises, caused by an earthquake ... we cover the resulting Additional Living Expense or Loss of Rent, subject to the "COVERAGE D: LOSS OF USE" limits of insurance. Other premises include roads and bridges.

This coverage is not subject to any deductible. Even if their property losses are under the policy deductible, there is coverage for policyholders whose dwellings are temporarily unfit to live in while they repair damage to the dwelling caused by a covered earthquake.

There is no maximum period of time after the occurrence of an earthquake for covered Loss of Use expenses to be incurred. Loss of Use coverage applies even if the insured is not required to vacate the insured premises until months after the earthquake (such as, for example, when repairs to the property cannot be started until a substantial period of time after the earthquake due to a shortage of contractors available to perform the work).

If there is a question of coverage, use Attachment 5 with any advance payment.

4-23. Protection of Property - Emergency Repairs – No deductible on first \$1,500

In the Homeowners and Homeowners Choice policies, it is important to note that the first \$1,500 of emergency repairs does not have a deductible. This provision is not available in a renter or condo policy. The specific policy coverage in the CEA homeowners policy reads in part:

OTHER COVERAGES

The following other coverages are provided subject to all terms and conditions of this policy. Except for the first \$1,500 of losses covered under Item 1, "Emergency Repairs," the coverages are provided subject to the application of the DEDUCTIBLE CLAUSE.

- 1. Emergency Repairs. If covered damage occurs to covered property and such emergency measures are made necessary as the result of an **earthquake** that commences during the policy period as part of a **seismic event** that commences during the policy period, **we** will pay the following portion of the cost **you** incur for reasonable and necessary emergency measures **you** take (1) to protect against further damage to covered property, (2) to remove from covered property in the **dwelling** the residue of broken glass if the **dwelling** is otherwise habitable, or (3) to repair or replace covered broken windows in the **dwelling** or other covered structural glass that is part of the **dwelling** if the **dwelling** is otherwise habitable. This Emergency Repairs coverage provides coverage up to a **sublimit** of 5% of the policy **limit of insurance** for the type of property being protected.*

*The applicable total **limit of insurance** for the type of property being protected will be reduced by any amount **we** pay for this coverage, but **we** will never pay more for emergency repairs than 5% of the policy **limit of insurance** for the type of property being protected.*

- a. *The first \$1,500 of covered costs **you** incur for such reasonable and necessary emergency measures is not subject to the application of the **DEDUCTIBLE CLAUSE**. Costs **you** incur for such emergency measures in excess of \$1,500 are subject to the application of the **DEDUCTIBLE CLAUSE**, which means that until **you** satisfy the deductible amount, you will not be paid for any such costs **you** incur above \$1,500.*

This means that the claim representative should pay for covered emergency repairs up to \$1,500 without applying a deductible.

In addition, the representative must keep track of all covered emergency repairs because they are subject to the policy sublimit of 5% of coverage A & B CSL.

Use the following mathematical steps to calculate how much you should pay on a claim.

- Step 1: Pay all the dwelling emergency repairs up to \$1,500 with no deductible
- Step 2: Add up the total covered dwelling damage, including emergency repair expenses paid in step 1, and subtract the dwelling policy deductible to see how much is owed. Remember that dwelling emergency repairs are subject to a 5% policy sublimit of the Coverage A and B CSL.
- Step 3: If step 2 produces an amount owed to the policyholder, subtract the amount paid in step 1 and pay the difference.

Regardless of whether or not the claim exceeds the dwelling policy deductible, the policyholder is still entitled to the first \$1,500 of any covered Coverage A & B emergency repairs with no deductible.

4-24. Other Coverages: Debris Removal

The policy reads in part: ***We will pay the reasonable expense you incur in removing from the **residence premises** the debris of covered property that is damaged by an **earthquake** This coverage provides up to 5% of the combined single **limit of insurance** for “**COVERAGE A: DWELLING**” and “**COVERAGE B: EXTENSIONS TO DWELLING**” as additional insurance.***

No coverage for debris removal is provided until and unless losses covered under Coverages A or B have exceeded the policy deductible.

This is similar to the provision found in most HO fire policies and is used when you have a total loss that exceeds the policy limits and when there has been extra expenses for debris removal over and above the policy limit. In cases where you can document this extra debris removal expense, you can pay up to an additional 5% of coverage A.

4-25. Other Coverages: Building Code Upgrade

Building code upgrade coverage in the amount of \$10,000 is provided as additional insurance in a CEA homeowners policy. For dwellings other than mobilehomes, the policyholder can select a limit of \$10,000 or \$20,000.

Some things to remember about this coverage are:

- The covered property must actually be repaired before payment may be made for Building Code Upgrade coverage. The CEA permits the pre-payment of code upgrades if it is clear, in the claim representative's professional judgment, that property is going to be repaired, the code upgrade cost is known (or it is known that code upgrade costs will exceed the Building Code Upgrades coverage limit), and making this payment would complete the claim process.
- This coverage is additional insurance to the Coverages A and B combined single limit.
- This coverage is to bring the covered property up to local residential building code standards that were in effect *on the date of the earthquake* that caused the loss.
- The coverage pays only for the *Building Code Upgrade costs necessary to secure a reconstruction permit for repair of the covered property.*
- Building code upgrade is not one of the four items that are included in the HO deductible calculation. See the HO policy deductible section where it reads in part:

2. *Only the following will be applied to meet the deductible:*

- a. *The reasonable and necessary **replacement cost** of the covered damage to property covered under "COVERAGE A: DWELLING," but only up to the amount of the applicable **sublimit** for property for which there is a **sublimit** under "COVERAGE A: DWELLING," and*
- b. *The reasonable and necessary **replacement cost** of the covered damage to property covered under "COVERAGE B: EXTENSIONS TO DWELLING," but only up to the amount of the applicable **sublimit** for property for which there is a **sublimit** under "COVERAGE B: EXTENSIONS TO DWELLING," and*
- c. *The reasonable and necessary cost of emergency measures in excess of \$1,500 covered under "OTHER COVERAGES," item 1, that **you** actually take to protect property that is covered under "COVERAGE A: DWELLING" and "COVERAGE B: EXTENSIONS TO DWELLING" against further damage or secure the **dwelling**, but only up to the **sublimit** of 5% of the combined single **limit of insurance** for "COVERAGE A: DWELLING" and "COVERAGE B:*

EXTENSIONS TO DWELLING,” and

- d. The reasonable and necessary cost to replace, rebuild, stabilize or otherwise restore the land that is covered under “OTHER COVERAGES,” item 4, but only up to the **sublimit** of \$10,000.*
- 3. The cost to repair or replace personal property, or any other cost not set forth in 2.a through 2.d, above, will not be applied to meet the deductible.*

As you can see, building code upgrade is not mentioned in a. through d. above and therefore is not one of the four items you can use in the deductible calculation.

4-26. Other Coverages: Land Stabilization

The policy covers up to \$10,000 for the cost to replace, rebuild, stabilize, or otherwise restore land owned by the insured necessary to support the dwelling, if the need for stabilization is caused directly by a covered earthquake and is necessary for the habitability of the dwelling. This coverage is provided as a \$10,000 sublimit of the Coverages A and B combined single limit. Other than this, there is no coverage for land. Note: Land is excluded in the definition of “Dwelling.” The cost of engineering work done to determine the need for land stabilization is included in this \$10,000 limit.

Minor movement of land (not land stabilization) to accommodate a foundation repair covered under the policy is properly placed under Coverage A, and is not subject to the land stabilization sublimit of \$10,000.

4-27. Losses Excluded

The CEA policy covers only one peril, earthquake. The LOSSES EXCLUDED section of the policy provides as follows: ***We do not insure for any loss that is not directly caused by an **earthquake** that commences during the policy period as part of a **seismic event** that commences during the policy period. Without limiting the above, even if a loss directly or indirectly is caused by, is contributed to by, results from, or is aggravated by an **earthquake**, we do not insure for any loss that is caused directly or indirectly by, or that in any way results from, is contributed to by, or is aggravated by, any of the following:*** The policy then lists a number of specifically-excluded perils. The most significant of these are discussed below, but claim representatives must read the policy and familiarize themselves with the complete list.

4-28. Losses Excluded: Fire and Explosion

The policy does not cover losses resulting from fire or explosion. This includes fires resulting from such things as broken gas lines, exposed wiring, or other factors directly resulting from an earthquake. Any losses resulting from fire must be handled under the policyholder’s fire insurance policy, not under the CEA policy.

In situations where part of the home is damaged by a covered earthquake and part of the home is damaged by a fire, the claim representative working on each claim will need to properly allocate the damage to either the fire or earthquake policy.

NOTE: The CEA must be immediately notified, by e-mail to the Earthquake Response Manager, about any CEA claim opened up on a fire-damaged home where the CEA claim has a claim reserve of greater than zero (or whichever other minimum reserve amount that Participating Insurer uses to open up a CEA claim). The CEA intends to inspect these claims to make sure the damages are appropriately allocated.

4-29. Losses Excluded: Asbestos and Other Pollutants

The policy contains a detailed pollution and pollutants exclusion that applies to groundwater, land, and personal property.

Because this exclusion applies to personal property, the policy will not cover asbestos removal, including the cost of testing, when the expense is necessary to repair or replace damaged items under Coverage C. Damage to any personal property, including furniture, furnishings, and clothing that are contaminated by asbestos is not covered.

The policy would, however, cover asbestos removal (including the cost of testing) or other earthquake-caused pollution damage to the dwelling when the expense is necessary to repair or replace damaged items or real property covered under Coverages A or B. Where the claim representative suspects that asbestos may be present, an expert should be consulted.

4-30. Losses Excluded: Non-Earthquake Earth Movement and Land Sliding

The policy does not cover any loss caused directly or indirectly by non-earthquake earth movement: *Earth movement, settling of land, land sliding, subsidence, mudflows, or earth sinking, rising or shifting . . .* There is an exception to this exclusion, however—the policy *does* cover the loss if such earth movement, settling of land, land sliding, subsidence, mudflow, or earth sinking, rising, or shifting satisfies both of the following requirements:

- a. is induced by, and would not have occurred in the absence of, an **earthquake** that commences during the policy period as part of a **seismic event** that commences during the policy period; and*
- b. causes loss that manifests within one year after the **earthquake** that caused the loss.*

For example, if an earthquake is determined to have caused a landslide that occurred six months after the earthquake, the damage caused to the dwelling may be covered. However, if the landslide occurs or the loss manifests anytime after the first anniversary of the earthquake, the damage is not covered under the CEA policy.

4-31. Losses Excluded: Theft or Vandalism

Theft, vandalism, or other human conduct causing loss following an earthquake is excluded. The policy provides that it does not cover any loss that is caused directly or indirectly by . . . *Theft, vandalism or other human conduct causing loss following an earthquake.*

5. BASIC EARTHQUAKE POLICY - COMMON INTEREST DEVELOPMENT

In California, a “common interest development” can be a community apartment project, a condominium project, a planned development, or a stock cooperative, all as further defined in California Civil Code section 1351. Since the term “common interest development” is most typically applied to condominiums, for ease of reference the term “condominium” will be used throughout the remainder of this Manual.

Following is a brief summary of the coverages, exclusions, and limitations provided by the condominium policy. This policy has many of the same provisions found in the BASIC EARTHQUAKE POLICY – HOMEOWNERS. The purpose of the following is to point out some of the unique features of the condominium policy.

Read the specific policy in force at the time of the claim to determine the appropriate coverages, limits, and exclusions. This summary is not a substitute for reading the policy. You will also need to review the association master policy and the association governing documents in order to adjust a condominium loss.

5-1. Policy Definitions

The vast majority of the key definitions found in the BASIC EARTHQUAKE POLICY – HOMEOWNERS are also found in the BASIC EARTHQUAKE POLICY – COMMON INTEREST DEVELOPMENT. There are, however, some additional definitions that are unique to this policy. Read the definitions for the following terms, none of which is contained in the other policies: “association governing documents,” “association master policy,” “association of owners,” “common interest development,” and “dwelling unit.”

5-2. Adjusting Condominium Claims – Coordination

The greater the number of units in a complex, the greater the need for coordination. Participating Insurers should identify the number of policies they have issued within a given condominium complex. To the extent possible, claims assignments should be given to the same claim representative and supervised by the same individual.

5-3. Other Earthquake Coverage

If a loss to property that would otherwise be covered under Coverage A: BUILDING PROPERTY is covered under an association master policy, refer to the “other insurance” clause in the CEA policy:

8. Other Insurance.

- a. *If you have other insurance, not including the **association master policy**, that covers **earthquake** loss to the **dwelling unit** or other property covered under this policy, we will pay **our** share of the covered loss or damage. **Our** share is the proportion that the applicable **limit of insurance** under this policy bears to the combined **limits of insurance** of all policies that cover the same property.*
- b. *If there is other insurance that covers the same loss or damage, other than as described in 8.a above, we will pay only for the amount of covered loss or damage in excess of the amount due from that other insurance, but we will not pay more than the applicable **limit of insurance**.*

Part b. above makes it clear that the association earthquake coverage is primary.

5-4. Duties after a Loss

While the insured's duties after a loss are basically the same as the BASIC EARTHQUAKE POLICY - HOMEOWNERS, the following is unique to the condominium policy:

*If requested, provide the **participating insurer** with copies of all **association governing documents**.*

5-5. Overview of the Declarations Page and Coverage Options

In contrast to the CEA homeowner's policy, the common interest development policy provides for three coverage groups that can be purchased together in any combination or separately. They are:

Coverage A: BUILDING PROPERTY

Coverage C: PERSONAL PROPERTY together with Coverage D: LOSS OF USE

Coverage E: LOSS ASSESSMENT

Coverage A: BUILDING PROPERTY can be purchased alone or in combination with other coverages. If Coverage A is selected, the limit is always \$25,000. Building code upgrade coverage of \$10,000 additional insurance comes with Coverage A.

Coverage C: PERSONAL PROPERTY is sold together with Coverage D: LOSS OF USE. The base-limits policy carries \$5,000 in Coverage C and \$1,500 in Coverage D. The insured may select higher limits up to \$100,000 for Coverage C and up to \$25,000 for Coverage D. Coverage C and Coverage D can be purchased in combination with other coverages, or as the only coverages under the policy.

Coverage E: LOSS ASSESSMENT can be purchased alone or in combination with other coverages. Depending on the value of the condominium, the limit will be either \$25,000, \$50,000 or \$75,000.

The fact that these coverages can be purchased separately and with different coverage limits of insurance, each coverage with its own deductible provisions, requires the claim representative to be vigilant in confirming coverage, limits, and deductible amounts. Always check the declarations page for the coverage, limits, and deductible.

5-6. Losses Excluded

Losses excluded are the same as those found in the BASIC EARTHQUAKE POLICY - HOMEOWNERS policy.

5-7. Deductibles

One difference between the condominium policy and the homeowners policy is how deductibles are handled. Unlike the homeowners policy, in the condominium policy each coverage has its own separate deductible, and only loss to property covered under that coverage counts against the deductible. In the condominium policy, there is:

- A separate deductible for Coverage A: BUILDING PROPERTY. The deductible is always \$3,750 (15% of the Coverage A limit). Only losses subject to coverage under Coverage A can be used to meet the Coverage A deductible.
- A separate deductible for Coverage C: PERSONAL PROPERTY. The deductible is always \$750, regardless of the Coverage C limit of insurance. Only losses subject to coverage under Coverage C can be used to meet the Coverage C deductible.
- No deductible for Coverage D: LOSS OF USE.
- A separate deductible for Coverage E: LOSS ASSESSMENT. The deductible is 15% of the Coverage E limit (i.e., \$3,750 for \$25,000 limit policies, \$7,500 for \$50,000 limit, and \$11,250 for the \$75,000 limit policies). Only losses subject to coverage under Coverage E can be used to meet the Coverage E deductible.

Since Coverages A, C, and E can be purchased independently and each has its own separate deductible, it is best to refer to the Declarations page to determine the correct deductible to apply.

5-8. Building Property - Coverage A

Coverage A is optional in the BASIC EARTHQUAKE POLICY – COMMON INTEREST DEVELOPMENT, so it is important to carefully review the Declarations page to determine whether the policyholder purchased Coverage A. A single-family residence usually has one owner and stands separate from other structures. In contrast, a condominium project is a collection of separate dwelling units together with property owned jointly by many owners. Property owned jointly may include the structure in which the individual units are located, common walkways, pools, and other common

property. Often, the association of owners has obtained a policy of insurance, referred to as an “association master policy” in the CEA policy, which may insure against the perils of fire, earthquake, or both.

The first step to be taken in order to determine whether the property is covered under Coverage A: BUILDING PROPERTY is to review:

- The association governing documents to determine whether the insured has the obligation to repair or maintain the property, and
- The association master policy to determine whether the property is covered for the risk of earthquake under the association master policy.

There are two basic categories of property covered under Coverage A: BUILDING PROPERTY. The first category is covered regardless of what the policyholder’s individual maintenance obligations are under the association governing documents. That category consists of the following property:

We cover:

1. The following property:

- a. Built-in appliances, fixtures, alterations, and improvements that are part of the structure in which the **dwelling unit** is located and are contained within the **dwelling unit**;*
- b. Wall-to-wall interior carpeting attached to the **dwelling unit**;*
- c. Items of real property, other than **chimneys**, that pertain exclusively to the **dwelling unit**.*

In addition to the above items, the policy covers the following second category of property, which is only covered if the insured has an obligation to maintain the property under the association governing documents. Therefore, the claim representative will need to review those governing documents to determine whether any of the following property is covered:

- 2. The following property, but **only** to the extent that **you** are obligated to repair or maintain the property under the terms of the **association governing documents**:*
 - a. Plumbing pipes and utility service structures and equipment that are enclosed within the walls, ceiling, or floor of the **dwelling unit**, extending to the exterior surface of the perimeter walls of the **dwelling unit**;*
 - b. Equipment and utility service structures for electric, telephone, natural or bottled gas, heating, oil, water, septic, and sanitary sewage systems that (1) are located outside of the perimeter walls of the **dwelling unit** but within the **common interest development** and (2) directly affect the habitability of the **dwelling unit**;*
 - c. **Chimneys** that are attached to or part of the **dwelling unit**, up to a **sublimit** of \$5,000, regardless of the number of **chimneys** covered.*

5-9. Emergency Repairs – Coverage A

Emergency repairs to protect Coverage A: BUILDING PROPERTY will only be paid if damage exceeds the Coverage A deductible. The emergency repairs coverage provides coverage up to a sublimit of \$1,500 of the policy limit for Coverage A: BUILDING PROPERTY.

5-10. Debris Removal – Coverage A

The policy allows for an additional 5% of Coverage A to be paid in cases of a total loss.

Debris Removal. We will pay the reasonable expense you incur in removing from the common interest development the debris of property covered under “COVERAGE A: BUILDING PROPERTY” that is damaged by an earthquake that commences during the policy period as part of a seismic event that commences during the policy period. This coverage provides up to 5% of the limit of insurance for “COVERAGE A: BUILDING PROPERTY” as additional insurance.

Removal of debris is included when handling a claim. For claims where the Coverage A policy limit is reached, and the claim included debris removal, up to an additional 5% of Coverage A can be paid as additional insurance.

5-11. Loss Settlement – Coverage A

Loss settlement under Coverage A: BUILDING PROPERTY is basically the same as loss settlement under Coverages A and B of the BASIC EARTHQUAKE POLICY - HOMEOWNERS.

However, considering the nature of common ownership versus individual ownership of property found in common interest developments, it is particularly important to remember to determine whether the insured has an insurable interest and a responsibility to insure the property. Also, determine whether the CEA policyholder's loss may be covered or collectible under an association master policy in which case you should refer to the “Other Insurance” provision of the policy.

5-12. Personal Property – Coverage C

The adjusting is the same under the homeowners, renters, and condominium policy, except for the application of the deductible. Coverage C is an optional coverage in the BASIC EARTHQUAKE POLICY – COMMON INTEREST DEVELOPMENT, so it is important to carefully review the Declarations page to determine whether the policyholder has purchased Coverage C, and if so, in what coverage amount.

The deductible under Coverage C of the BASIC EARTHQUAKE POLICY – COMMON INTEREST DEVELOPMENT is \$750. This is 15% of the \$5,000 base limits offered for

Coverage C. The deductible amount of \$750 remains the same even if the policyholder purchases higher Coverage C limits.

Under the BASIC EARTHQUAKE POLICY – COMMON INTEREST DEVELOPMENT, a claim can be paid as soon as the loss to personal property exceeds the \$750 Coverage C: PERSONAL PROPERTY deductible. This is different from the structure of the BASIC EARTHQUAKE POLICY – HOMEOWNERS, where regardless of the amount of loss to personal property, there is no payment for any loss to personal property until after the loss to dwelling and extensions to dwelling exceeds the amount of the dwelling deductible.

5-13. Emergency Repairs – Coverage C

The cost of emergency measures undertaken to protect damaged personal property from further damage is part of the Coverage C limit and will only be paid if damage to personal property exceeds the Coverage C deductible. The coverage reads, in part, as follows:

*This Emergency Repairs coverage provides coverage up to a sublimit of the lesser of (i) 5% of the policy **limit of insurance** for “COVERAGE C: PERSONAL PROPERTY” or (ii) \$1,000. The applicable total **limit of insurance** for the “COVERAGE C: PERSONAL PROPERTY” will be reduced by any amount we pay for this coverage.*

5-14. Debris Removal – Coverage C

Coverage C of the policy provides for removal of the debris of damaged personal property as follows:

*Debris Removal. We will pay the reasonable expense you incur in removing from the **common interest development** the debris of property covered under “COVERAGE C: PERSONAL PROPERTY” that is damaged by an **earthquake** that commences during the policy period as part of a **seismic event** that commences during the policy period. This coverage provides, as additional insurance, up to the lesser of (i) 5% of the **limit of insurance** for “COVERAGE C: PERSONAL PROPERTY” or (ii) \$1,000.*

If the Coverage C limit has been exhausted, there is still additional coverage for debris removal (up to the lesser of 5% of the Coverage C limit or \$1,000). This is additional insurance.

5-15. Loss of Use – Coverage D

Coverage D: Loss of Use is an optional coverage in the BASIC EARTHQUAKE POLICY – COMMON INTEREST DEVELOPMENT, so it is important to carefully review the Declarations page to determine whether the policyholder has purchased Coverage D, and if so, in what coverage amount. If the policyholder purchased Coverage

D, the calculation for Loss of Use or Loss of Rents is functionally the same as under the homeowners policy.

In order to collect Loss of Use or Loss of Rents, under the BASIC EARTHQUAKE POLICY - HOMEOWNERS, the dwelling must be unfit to live in. Under the condominium policy, even if the dwelling unit is undamaged or not unfit to live in at the time of the earthquake, but the insured is forced to vacate because of repairs to other units, Loss of Use or Loss of Rents may be paid. Check the specific policy provision for the exact terms and conditions for Loss of Use coverage.

5-16. Loss Assessment - Coverage E

A loss assessment is a demand by an association of owners, telling the dwelling unit owner that he or she has to pay for damage to common property. That loss assessment is covered, but only to the extent that the assessment relates to the repair or replacement of damaged association property that is the kind of property that is covered under Coverage E. For example, swimming pools are listed as “Losses Not Covered” under Coverage E, so if the association assesses a CEA policyholder for a share of the damaged pool, the CEA policy cannot pay for any part of loss assessment attributable to the repair of the damaged pool.

Coverage E: LOSS ASSESSMENT is an optional coverage in the BASIC EARTHQUAKE POLICY – COMMON INTEREST DEVELOPMENT, so it is important to carefully review the Declarations page to determine whether the policyholder has purchased Coverage E, and if so, in what coverage amount.

If the policyholder purchased Coverage E, the policy covers the insured’s share of an assessment charged by the association against all property owners in the common interest development, if all of the following three requirements are satisfied:

- a. ***Requirement One:** You have a legal obligation to pay the amounts assessed against you by the association of owners, and the assessment is properly and legally made as a result of a loss that is directly caused by an **earthquake** that commences during the policy period as part of a **seismic event** that commences during the policy period;*
- b. ***Requirement Two:** The assessment is not made as a result of a loss specified in “Losses Not Covered—Coverage E”; and*
- c. ***Requirement Three:** The assessment is made as a result of a loss that is to property owned by one or any combination of the following three categories: (i) all members of the **association of owners collectively**, (ii) the **association of owners**, or (iii) **you**.*

An assessment against the insured must be fully investigated, since there may be portions that are not covered.

The claim representative must obtain sufficient documentation and records to understand the basis for the assessment. For example, suppose there is no association master policy that covers earthquake damage, and suppose each owner is assessed \$10,000 to fix the roof of the complex. Assuming the deductible has been met, this could be a covered loss.

However, assume the loss assessment for \$10,000 was to repair landscaping. This would not be covered. To determine the covered portion of the claim, the claim representative should reduce the loss assessment sought by the association of owners by that portion of the loss assessment attributable to any of the categories of property not covered as set forth in Coverage E: LOSS ASSESSMENT or to causes excluded in any of the policy exclusions.

Also, there is a sublimit of \$10,000 for that portion of any assessment relating to building code upgrades. Unlike the case with Coverage A losses for building code upgrades, this is not additional insurance, but rather, is a sublimit of the Coverage E limit of insurance.

Check the declarations page for the applicable deductible for Coverage E: Loss Assessment.

5-17. Reduction of Value - Property not Repaired or Replaced - Coverage E

In rare situations, the association of owners may elect not to repair or replace damaged property, or they may be permanently prevented from repairing or replacing the property. The resulting reduction in the fair market value of the insured's ownership interest is covered if both of the following requirements are satisfied.

- i. *As a result of the unrepaired damage, the **dwelling unit** either is unfit to live in or cannot legally be occupied; and*
- ii. *The reduction in the value of **your** ownership interest in the **dwelling unit** is not the result of a loss to property specified in "Losses Not Covered—Coverage E."*

The way to calculate the proper amount to be paid for this type of claim is specified in detail in the policy language. It is essential that the policy language be carefully reviewed if such a claim is presented.

5-18. Compliance with Ordinance and Law – Coverage A and Coverage E

The policy provides that losses relating to the following are not covered:

7. *Required compliance with any ordinance, law, or residential building code that regulates the use, construction, repair, or demolition of a building or other structure, except as specifically provided under this policy, under the following provisions:*
 - a. *"Other Coverages—Coverage A," Item 3, "Building Code Upgrades," subject to the applicable \$10,000 **limit of insurance**, or*
 - b. *"Losses Covered—Coverage E," Item 1, "Assessment By Association of Owners," subject to the applicable \$10,000 **sublimit.***

5-19. Ingress and Egress

The condominium policy specifies, under Losses Not Covered, Coverage A, Building Property and Coverage E, Loss Assessment, that losses to walkways, driveways, decks, and patios are not covered, except for those walkways, driveways, decks, and patios necessary to provide ingress to and egress from the insured's dwelling unit.

The ingress and egress exception to Losses Not Covered under Coverages A and E both apply only to ingress to and egress "*from the dwelling unit*". Dwelling unit is defined as "*your individual unit*." Thus, payments under these exceptions are limited to damage to ingress to and egress from the insured's dwelling unit.

In cases of loss to ingress and egress that might potentially be covered under the CEA policy, claim representatives should pay particular attention to the possibility that such losses are covered under an association master policy or other insurance, and apply the "Other Insurance" clause of the CEA policy.

6. BASIC EARTHQUAKE POLICY – RENTERS

The BASIC EARTHQUAKE POLICY – RENTERS does not provide coverage for loss to real property, it provides only Coverage C: PERSONAL PROPERTY and Coverage D: LOSS OF USE.

The scope of these two coverages is basically the same under the RENTERS policy as it is in the HOMEOWNERS and CONDO policy.

6-1. Personal Property – Deductible

The deductible under the BASIC EARTHQUAKE POLICY – RENTERS is \$750. This is 15% of the \$5,000 base limits offered for Coverage C. The deductible amount of \$750 remains the same even if the policyholder purchases higher Coverage C limits.

Under the BASIC EARTHQUAKE POLICY – RENTERS, a claim can be paid as soon as the loss to personal property exceeds the \$750 Coverage C: PERSONAL PROPERTY deductible. This is different from the CEA HO earthquake policy.

6-2. Loss of Use

As with the other CEA policies, there is no deductible for Coverage D: LOSS OF USE. The adjustment of a Loss of Use claim is the same as it is under the homeowners policy. The policy reads in part:

*If the part of the **rental unit** that **you** occupy becomes unfit to live in and **you** are forced to vacate the **rental unit** as a result of either (1) damage to the **rental unit** caused by an **earthquake** that commences during the policy period as part of a **seismic event** that commences during the policy period or (2) the process of repairing damage to the **rental unit** caused by an **earthquake** that commences during the policy period as part of a **seismic event** that commences during the policy period, then **we** cover the necessary increase in living expenses **you** actually incur to maintain **your** normal standard of living. **We** will pay Additional Living Expenses for the shortest time reasonably needed (a) to repair or replace the parts of the **rental unit** **you** occupy that are unfit to live in, or (b) for **you** to permanently relocate elsewhere if the owner of the **rental unit** does not elect to repair or replace the **rental unit**.*

If the insured sublets a portion of the rental unit to a subtenant and actually loses rental income due to earthquake damage, the insured may also collect under Coverage D for that loss of rent.

6-3. Policy Exclusions – Renters Policy

The items that are not covered and the exclusions that apply to a renters policy are the same as those found in the homeowners policy, under personal property coverage.

7. CLAIMS INVESTIGATION PROCEDURES

These investigation procedures are designed to provide basic claim-handling information. They are intended to augment what an experienced property claim representative already knows about properly handling property claims, and to highlight certain unique aspects of CEA policies. They have been developed to promote consistency among claim representatives and fairness to policyholders in the handling of CEA claims. They will not cover all situations.

7-1. A Companion Policy Must Be in Force

If at the time of loss no companion policy is in effect, the CEA policy is void and no payment can be made. At the outset of the investigation, confirm that the underlying companion policy is in force.

7-2. California Fair Claims Settlement Practices Regulations and Other Laws

All claim representatives handling claims in California must abide by the California Fair Claims Settlement Practices Regulations and other applicable codes or regulations.

Claim representatives are expected to be familiar with the California Insurance Code section 790.03(h), setting forth certain specified unfair claim-handling practices; and the California Fair Claims Settlement Practices found in the California Code of Regulation, Title 10, Chapter 5, Subchapter 7.5.

Insurers and their representatives must not knowingly engage in any of the unfair claims handling practices listed in these statutes.

7-3. Claim File Documentation

Participating Insurers are expected to handle claims on behalf of the CEA in a manner consistent with this Manual, their company claim lines, and the California Fair Claims Settlement Practices Regulations. Specific requirements (for example, the number of photographs required) will not be dictated by the CEA beyond the statement that all claims files must be clearly documented, with sufficient detail in the file, that a person reading the file is able to understand how and why all decisions were made on the claim.

The documentation to support claims decisions is to be kept in the Participating Insurer claim file. Files are subject to review and audit by the CEA.

7-4. Keep the Policyholder Informed

Good claim-handling practices, as well as applicable regulations, require that policyholders be kept informed during the claim process. Keep the insured up-to-date about the claim and the progress of the investigation as decisions and information become available and in every case no less than every 30 days. Estimates and expert

reports should be shared with the insured as soon as possible. Keep the insured informed when key decisions will be made on their claim. When a report from an expert is relied on to form an opinion regarding damage, provide a copy of that report to the insured. Give the insured a copy of the claim representative's scope and estimate as soon as possible.

The CEA values the privacy of its insureds; therefore the CEA insists that no one discuss a claim with the media. Furthermore, California law, including California Insurance Code sections 791 through 791.21, protects the confidentiality of private policyholder-related information. Refer all media inquiries you receive to your company media spokesperson, your team leader, or to the CEA at (916) 325-3800.

Claim representatives must be trained on the current law regarding the obligation of the insurer to fully investigate earthquake damage that is discovered or reported after the earthquake damage claim is initially submitted to or closed by the Participating Insurer. The Participating Insurer must investigate reports of hidden or later-discovered damages before invoking any policy provisions regarding the time limit for submitting claims. Even if a new claim is received more than one year after the date of loss, the Participating Insurer should open a new claim and investigate the facts of the claim before it invokes any policy provisions. All such investigations should be made subject to a written reservation of rights.

All claims should be concluded with a final closing letter even if payment is being made. This letter should: (1) explain in writing any previous decision not explained in writing, and (2) quote the "Legal Action" condition of the policy.

7-5. Timely Adjusting - SBA and FEMA Requirements

In light of the policy deductible, policyholders generally will not receive payment for the total amount of the damage, and will be required to bear some portion of the financial costs of the earthquake themselves. As a result they may be looking to the Small Business Administration (SBA) for low-interest loans or to the Federal Emergency Management Agency (FEMA) for grants. In order to receive SBA and FEMA assistance, the insured will need documentation from the claim representative. Usually these agencies require a statement of loss or a denial letter. The SBA and FEMA have loan-submission deadlines, so the insureds will need this documentation as quickly as possible. It is important that the handling of the claim and final paperwork be timely.

More information about FEMA and the SBA can be found at their Web sites at: <http://www.fema.gov> and <http://www.sba.gov>.

7-6. Destructive and Other Tests to Determine Extent or Cause of Loss

In some situations, the insured may be solely responsible for the cost of performing tests. The CEA policy provides as follows:

*At **our** option, **we** may select and retain adjusters, consultants, contractors, engineers, or other experts to inspect **your** property or to perform tests, including destructive tests, to determine the extent or cause of loss with respect to any claim **you** make under this policy. **We** will bear the cost of performing any tests (including the cost of repair of damage necessitated by any destructive tests) that **we** elect to perform to determine the extent or cause of loss.*

*If, however, it is the opinion of the CEA that **your** property (or some particular part of **your** property) has not sustained covered **earthquake** damage over the deductible amount of this policy, and despite **our** opinion you request additional testing of **your** property or that part of your property, then if additional testing is performed, you are solely responsible for the costs of performing the additional testing and of repairing the damage to **your** property that was caused by any additional destructive testing, unless the additional testing establishes the existence of covered **earthquake** damage that, either alone or combined with other covered **earthquake** damage, exceeds the deductible amount of this policy.*

When necessary, complete a “testing agreement,” a copy of which is included in this Manual as Attachment 4.

7-7. Use of Engineers or Experts

Where the causation is obvious and damage is non-structural, a claim representative can assess the damage.

However, earthquake damage can manifest itself in a variety of forms, from minor cracking of interior Sheetrock to major failure of the foundation system. An engineer should be used when the damage appears to be structural in nature. The services of an expert will assist in the analysis of the cause and extent of loss and the proper way to repair the damage. It is important that the claim representative understand the distinctions between the various expert fields and how they can be best used during the claim investigation. One source of earthquake engineering information is the CUREE *General lines for the Assessment and Repair of Earthquake Damage in Residential Woodframe Buildings*. (www.curee.org) Look for the EDA2 document.

a. When to Retain an Engineer or Expert

Participating Insurers will determine the need for engineers or other experts as soon as possible in the claim adjustment process. It is not necessary to request approval from the CEA.

Some of the conditions you should consider when retaining an engineer to inspect the properties are:

- Building has collapsed or partially collapsed,
- Building superstructure has shifted relative to or off its foundation,
- Building as a whole, any story, any walls, any cripple walls, or columns are visibly out of plumb,
- Shifting or movement of interior walls and partitions relative to the floor,
- A pattern of broken windows or a pattern of sticking or inoperable hinged doors,
- For hillside houses, at the downhill edge: damage to vertical supports; posts visibly out of plumb; broken, slack, or buckled diagonal bracing; or damage to connection between foundation and superstructure,
- Visible distortion of the roofline or significant fresh damage to attic framing,
- Damage to the structure in the vicinity of the chimney,
- A pattern of splitting of framing members (sill plate, hold down locations, floor joists, etc.), and
- Evidence of fresh settlement of floors.

b. What Kind of Engineer to Select

Generally, a claim representative should start with a structural specialist (a Civil Engineer specializing in structural engineering or a Structural Engineer). A structural specialist can evaluate all components of a building, including the foundation, for structural damage. The structural specialist should be consulted regarding the need for a soils specialist or other technical consultants.

For purposes of claims adjusting, the primary technical issues for the engineer to address are:

- Identification of all structurally significant earthquake damage, especially those damage patterns that might not be obvious to owners and adjusters,
- Causation (i.e. distinguishing between damage caused by the earthquake and conditions/damage attributable to other causes),
- Scope of work necessary to repair the damage caused by the earthquake in accordance with the terms of the policy, and
- Any building code upgrades that may be required as a part of the repair of the earthquake damages.

c. Locating Qualified Engineers

Ideally, carriers should maintain a list of pre-qualified engineers who can be called upon in the immediate aftermath of an earthquake. When that is not the case, one source of contact information for potentially qualified engineers is the regional Structural Engineers Association of California (see www.seaoc.org for links to regional association) or the local chapter of the American Society of Civil Engineers (see www.asce.org/inside/sec_brnch.cfm for links to local chapters).

Prior to retaining an engineer, check credentials, by obtaining a copy of the engineer's curriculum vitae (résumé) or statement of qualifications that should include information on education, work experience, technical expertise, and professional registration (or engineering license) numbers.

The status of an engineer licensed in California can be verified at the California Department of Consumer Affairs Web site. www.dca.ca.gov Look for the link titled: "License Search for Professional Engineers..."

d. Written Contract Specifying the Scope of Services

Assuming that the engineer's credentials are acceptable, the next step is executing a written agreement or contract with the engineer. California Business and Professions Code section 6749 requires, with some exceptions, that engineers provide their clients with a written contract specifying at a minimum:

1. A description of the services to be provided to the client by the professional engineer.
2. A description of any basis of compensation applicable to the contract, and the method of payment agreed upon by the parties.
3. The name, address, and license or certificate number of the professional engineer, and the name and address of the client.
4. A description of the procedure that the professional engineer and the client will use to accommodate additional services.
5. A description of the procedure to be used by any party to terminate the contract.

Following a major earthquake, qualified engineers in an area may be overwhelmed or in short supply. Claim representatives should ask for and agree to the delivery time for any written reports before authorizing the work.

e. Payment of Expert Fees

Claim representatives should ask for and agree to a budget before authorizing the work.

Expert fees necessary to investigate a claim or determine the cause of loss are paid for by Participating Insurers. The Participating Insurers receive a loss-adjusting fee on all paid claims, which when averaged out over all claims handled, is designed to reimburse them for these fees.

Expenses that are part of the repair process (i.e. permits, architectural, etc.) are part of the indemnity payment that is made under the policy coverage limits after the deductible and any other policy provisions are met.

7-8. Costs to Rebuild or Repair – Prices of Building Materials

The CEA is committed to providing fair and reasonable local cost reimbursements for covered earthquake damage. Claim representatives may use automated damage estimating programs or qualified contractors to estimate the dollar value of damage. The CEA does not provide cost of labor and or cost of materials information after an earthquake. Determining appropriate labor and materials costs is part of the Participating Insurers' loss adjustment duties. Participating Insurers should make sure their estimating programs have been updated with appropriate local post-disaster labor and material costs.

California law regulates price increases for goods and services after a state of emergency has been declared. Section 396 of the California Penal Code is intended to prevent post-disaster "price gouging," and that statute provides that persons selling specified goods and services at a price more than 10% above the price charged prior to an emergency are guilty of a misdemeanor and are subject to criminal prosecution.

7-9. Overhead and Profit

It is appropriate to allow for overhead and profit (O&P) in cases where the repair involves multiple trades requiring the use of a general contractor to control the job. It is not appropriate to allow for O&P when you are dealing with individual trades and individual tradesmen are doing the work. On a one-trade repair, do not allow for O&P even if a general contractor is doing the work.

If it is appropriate to allow for O&P on an estimate, add the overhead percentage and the profit percent together and then apply the total percentage to the estimate. Do not apply the percentages individually since this approach results in a higher cumulative O&P amount. The CEA allows O&P amounts that follow the customary practice of contractors in a given area. The reasons for any exceptions to these O&P lines should be documented in the claim file.

7-10. Claim Payment Ratio

If there is a very large earthquake or a series of earthquakes, such that the CEA's claims paying ability might be exceeded, there is a provision in the CEA policy that provides for the payment of claims on a pro-rata bases. If this were ever to be needed, the CEA would declare a "claim payment ratio". This would mean that the adjuster would determine the total amount payable on a claim and then pay the insured a percentage of that total amount based on the CEA's declared claim payment ratio.

If a ratio other than 100% is to be used, it will be communicated to the Participating Insurers as soon as possible and will apply to all loss settlements from the date of notification onward.

7-11. Double Coverage

To help resolve issues of overlapping insurance or coexistent insurance coverage, the claim representative should follow the Other Insurance provisions in the policy involved. Further help can be found in the *Guiding Principles for Overlapping Insurance Coverage* published in 1963 by a consortium of underwriting organizations. This document should be available from your claim manager.

7-12. Suspected Fraudulent Claims

Often discrepancies in claims handling can be resolved by open communication with the insured. It is important that claim representatives keep an open mind and treat the policyholder with respect at all times.

Refer suspected fraudulent claims to the Participating Insurer's Special Investigation Unit (SIU). Request a Proof of Loss as stated in the policy conditions. It is expected that claim representatives be trained to recognize insurance fraud. The claim file should have evidence of teamwork between SIU and the claims handler in resolving the issues in question.

Unless the true amount of covered loss and damage has been determined before the referral to SIU, determination of the actual covered loss and damage, if any, should be continued by the claim representative during the SIU investigation. A general reservation of rights letter should be sent to the insured indicating that investigation is not a commitment as to payment.

7-13. Emergency Repairs

The policyholder is always responsible for taking the necessary steps to protect property from further damage under the "Your duties After Loss" condition found in every CEA policy.

Different CEA policies pay for emergency repairs in different ways so you need to read the policy language carefully. Here is a summary of how the various CEA policies provide for handling emergency repairs.

Homeowners and Homeowners Choice – Emergency repairs to Coverage A and B

- The first \$1,500 of emergency repair is paid without a deductible
- The claim representative must keep track of all covered emergency repairs because they are subject to the policy sublimit of 5% of coverage A & B CSL.
- All emergency repairs up to the 5% emergency repairs sublimit are used in the deductible calculation. (See Section 4-24 for more details)

Condo – Emergency repairs

- Cov A: Covered up to \$1,500 as sublimit of Coverage A

- Cov C: Covered for the lesser of 5% or \$1,000 sublimit of C if Coverage C purchased
- Subject to the policy deductible

Renter – Emergency repairs

- Cov C: Covered for lesser of 5% or \$1,000 sublimit of Coverage C
- Subject to the policy deductible

7-14. Scope of Loss and Estimates

In most cases, the claim representative should complete a sufficiently thorough examination of the home to enable him or her to list all recent earthquake damage, complete a diagram of areas to be repaired, and obtain needed measurements. The claim representative should then complete an itemized scope of loss.

Claim representatives should create or obtain an accurate estimate of the cost to repair all covered earthquake damage. Participating Insurers may use any software generally accepted by the insurance industry in the preparation of building and structure repair estimates. The file must contain the documentation necessary to support the estimate. The measurement of areas, room sizes and other dimensions on which quantities of material and labor are based must be shown in the estimate. A diagram should be prepared and attached to the estimate. Document the damages with photographs as appropriate.

Claim representatives may need to reevaluate an estimate if notified that the actual costs of repairs differ from the costs that were listed on the original estimate. Any additional earthquake damage found after repairs have begun should also be evaluated for coverage.

Engineers or experts should be used when appropriate. (See section 7-7.)

The insured should be given a copy of the scope and estimate as soon as possible. If the policyholder wants to get their own estimate, make sure they understand the importance of using the claim representative's scope of covered damage.

7-15. Cracks in Concrete Surfaces Such as Garage Floors and Foundations

Most concrete work, especially house and garage floor slabs, develop small cracks over time. This is considered normal and generally does not impair the structural function of the concrete. The cost to repair old cracks that were in the concrete prior to the earthquake is not covered; however, new damage due to the earthquake, which may include expansions of old cracks, is covered.

The claim representative, with the advice of an appropriate expert, will need to determine whether concrete needs to be replaced or whether it can be repaired with injected epoxy or other methods. In cases where the cracks do not cause structural impairment, strong consideration should be given to a repair with properly injected epoxy. This will be

decided on a case-by-case basis and the CEA generally allows for repair or replacement, whichever is most appropriate.

In claims where exacerbation of cracks is being claimed, one approach to valuing the damage is to establish what it would have cost to repair the crack before the earthquake. Then value the cost to repair the crack after the earthquake. The difference in those two numbers is the value of the damage caused by the exacerbation.

7-16. Subrogation

While there is less likelihood that there is third-party liability for the damages suffered by an insured from an earthquake than from most other perils, the claim representative should still be aware of subrogation potential. For example, defects in construction can cause additional damage during an earthquake, or the earthquake damage may be increased by recent work in the surrounding area by a public entity or contractor. It is the claim representative's responsibility to thoroughly investigate any subrogation potential.

The Participating Insurer is responsible for the subrogation process.

If the claim representative discovers that the loss may have occurred as a result of negligence of a third party, proper documentation must be gathered so that a successful subrogation claim can be pursued. Proper investigation of a claim with subrogation potential should include at least the following:

- a. Take a recorded statement of persons likely to have information about the contributing cause of damage if possible;
- b. Obtain and preserve any evidence;
- c. Notify the insured of the intention to pursue subrogation rights and of the "Subrogation" provision of the CEA policy requiring an assignment of rights and cooperation in the pursuit of subrogation;
- d. Take photographs of the damage and other items material to the case; and
- e. Notify the responsible party and their insurance carrier as soon as it appears that a subrogation claim may be presented.

7-17. Salvage

As in any other claim, consideration should be given as to whether any damaged items have salvage value. The CEA's position is that the policyholder should be made whole, including the deductible, before any salvage is taken. If there are salvageable items that need to be dealt with, follow your company procedures for dealing with salvage in the claim handling process.

7-18. Proof of Loss

The CEA does not require a Proof of Loss on every claim. However, the CEA has a right to one where necessary. The policy provides that, upon the Participating Insurer's request, a Proof of Loss must be provided within 60 days.

In cases where the insured and the insurer do not agree on the amount of loss, it is sometimes valuable to get the insured's input as to the loss by requesting the insured to file a Proof of Loss. This decision should be made on a case-by-case basis.

7-19. Loss Settlement Disputes

Generally, loss settlement disputes involve questions concerning scope of damage, the proper repair method, and the actual cost of the repairs. Keep an open mind and solicit input from the insured's contractor or representative to resolve discrepancies in scope, repair method, and pricing. Personal meetings can be helpful.

Disputes can often be efficiently resolved through the California Earthquake Claims Mediation Program with the California Department of Insurance (CDI) at (800) 927-4357. The CEA supports using the CDI mediation program to resolve issues of scope of loss, mandated building code upgrades, pre-existing damage, additional living expense, asbestos abatement, earthquake vs. aftershocks, hidden damages, and personal property valuation issues. (CDI form 526, EQMED 12/99)

Another dispute resolution option is the appraisal provision in the policy. If CDI mediation does not resolve the dispute, the appraisal process is still available. Please note that in the event of a government-declared disaster, appraisal may be requested but may not be compelled. (Insurance Code Section 2071)

7-20. Coverage Disputes

Unlike loss settlement disputes, coverage disputes concerning the interpretations of policy coverage or policy language cannot be handled through the CDI mediation program or resolved in appraisal. When investigating a claim where coverage is an issue, consider a reservation-of-rights letter. Procedures to resolve coverage disputes are explained in section 1-9.

7-21. Denying Damages Not Covered and Claims Under the Deductible

There are three main types of denial letters that may need to be sent to a policyholder.

1. Claims under the deductible:

Where an insured makes a claim and a Participating Insurer makes no payment because the damage is below the deductible, the Participating Insurer must inform the policyholder in writing that the claim is being denied. Section 2695.7(b) (1) of title 10 of

the California Code of Regulations requires that “when an Insurer denies or rejects a first party claim, in whole or in part, it shall do so in writing...” Attachment 6 is a sample under-deductible denial letter. The CEA does not need to approve these letters before they are sent.

2. Claims where the damages are not covered by the earthquake policy in force

Where an insured makes a claim and a Participating Insurer makes no payment because the damage is not covered by the policy in force, the Participating Insurer must inform the policyholder in writing that the claim is being denied and the letter must quote the policy provisions on which the decision is based. The CEA has not provided a sample letter for this situation, but some of the wording found in Attachment 6 may be useful. Participating Insurers must send a copy by e-mail, of the denial letter to the CEA’s ERM for review and approval as to form before mailing it to the insured. (See Section 1-7.)

3. Claims with a combination of both of the above situations

Where an insured makes a claim and a portion of it is subject to denial but other parts will be paid, the Participating Insurers must inform the policyholder in writing about the specifics of what is being paid, and what is not being paid and why. The CEA does not need to approve these letters before they are sent.

With regard to homeowner claims, a denial letter must:

- Deny payment for damage for Coverage A and Coverage B if it is under the deductible.
- Deny any claim made under Coverage C (a) under a HO Basic policy, on the ground that damage to property covered under Coverage A and Coverage B is insufficient to meet the policy deductible, or (b) under a HO Choice policy, on the ground that the damage to property covered under Coverage C is insufficient to meet the policy deductible.

Denial letters under all policies should:

- Inform the insured of his or her right to obtain further inspections and to obtain new estimates, if necessary.
- Explain to the insured that Loss of Use coverage has no deductible and the insured may apply for Loss of Use payments later if a covered loss makes the dwelling unfit to live in and it needs to be vacated during repairs. This is true even if the Coverage A and B damages are under the deductible.
- Invite the insured to submit any documents showing that the loss exceeds the deductible.
- Advise the insured of the one-year requirement to bring legal action and quote the language from the policy.
- Include the required wording on how to contact the California Department of Insurance.

Always include any expert's reports that you used to make your decision with the denial letter.

All denial letters should be completed as soon as practical since policyholders may need these letters to apply for FEMA or SBA assistance.

7-22. Usage of the Name "California Earthquake Authority" in Letters

It is important to properly use the name "California Earthquake Authority" or the acronym "CEA" in claims correspondence when adjusting a claim for the CEA. (Questions about the approval process to use the CEA mark (logo) are found in CEA Circular #OPS-00-06.)

Whenever the words "California Earthquake Authority" are used they may be in title case (first letter of each word capitalized) or in all capital letters. It is not appropriate to use these words in all lower case. The acronym "CEA" is always used in upper case with no periods.

Letterhead: You should use your company letterhead or name and you should include the words "A Participating Insurer of the California Earthquake Authority."

The salutation: It is best to personalize claims correspondence whenever possible. It is generally not appropriate to use the words "California Earthquake Authority" or "CEA" in the salutation. If you do not know the name of the policyholder, however, you may use "Dear CEA Policyholder."

The body of a letter: It is acceptable to use the name "California Earthquake Authority" or the abbreviation "CEA" when referring to the CEA as an entity or to CEA policy language.

For example, "Please refer to your BASIC EARTHQUAKE POLICY – HOMEOWNERS, issued by the California Earthquake Authority, where it reads in part ..."

Or, "The XXX insurance company, a Participating Insurer of the California Earthquake Authority (CEA), wishes to inform you ..."

Signature block: You may use your normal signature block, and while not required, you may add "A Participating Insurer of the California Earthquake Authority."

For example: Sincerely,

John Q. Adams
Senior Claim Representative
XXX Insurance Company,

A Participating Insurer of the California Earthquake Authority

The return address in a letter: You may use “A Participating Insurer of the California Earthquake Authority” as part of your return address shown in a letter.

Claims settlement checks: If you have a field on your check to name the company on whose behalf the payment is being issued, you may use “California Earthquake Authority.”

CEA return address: It is not appropriate to use the CEA home office address or phone number in any correspondence. Do not use the CEA name or address as the return address on an outgoing or return envelope. In other words, the return address should never be shown as: “California Earthquake Authority, [Participating Insurer’s Address].”

7-23. When to Name a Mortgagee as a Joint Payee on a Claims Settlement Check

It is important to protect both the interest of the policyholder and any mortgagee or lender that may have a legal right of recovery to an earthquake claim payment. In some cases, it is not appropriate to name the mortgagee on a CEA earthquake policy claim payment, because the mortgagee may not have the legal right to share control of CEA insurance policy proceeds. Therefore, it is important that the relevant loan documents be examined to determine whether the lender has any right to recovery of earthquake insurance proceeds.

It is the claim representative’s responsibility to determine whether a mortgagee is to be named on a claim payment check. This is accomplished by reviewing the applicable mortgage documents to determine if the mortgagee required earthquake insurance as an express condition for making the loan or if the loan documents contain wording requiring that the mortgagee be named on proceeds from an earthquake claim. In these cases the claim representative must name the mortgagee as an additional payee on the claims indemnity payment.

Under longstanding informal lines, when the total indemnity payment will be \$10,000 or less, the payment may be made to the policyholder(s) only. However, you may need to follow any specific requirements that are found in a mortgage contract.

The lender is not entitled to any control over payments for ALE.

In summary, it falls to the claim representative to determine whether a mortgagee needs to be named on a claim payment check. The claim file must be documented to support the decision made by the claim representative.

7-24. Complete Investigation

In addition to documenting new earthquake damage in a home, it is important to take pictures of rooms without damage and to document the claim file about rooms that do not have damage. This is important if and when the claim file reopens at a later date with an allegation that the claim representative missed finding some earthquake damage or did not conduct a complete investigation.

All CEA claim files are expected to include the CUREE Guidelines General Damage Earthquake Inspection Checklist found in the CUREE EDA2 document available for free from the CUREE Web site at www.curee.org. This checklist is to be used by a claim representative on the initial inspection of the home. The purpose of requiring this inspection checklist is to work towards consistent and complete inspections by all the CEA participating insurance companies. This checklist is to be used by company as well as independent adjusters.

When a claim representative is investigating a claim and there is evidence that there may be damage in the attic or crawlspace, or the home has suffered structural earthquake damage, the CEA expects that the claim representative will inspect the home's attic and crawlspace (if they exist and they are accessible). In these cases it is recommended that the claim representative use the attic or crawlspace inspection checklist found in the CUREE Guidelines at www.curee.org. You can download a free copy of these checklists from this Web site. These checklists are contained within document EDA2. (Earthquake Damage Assessment) These inspection checklists can also be requested from the CEA's ERM.

While most inspections will be done by a claim representative, it is understood that the claim representative may have an engineer or a contractor, etc. do an inspection for them. The claim file should reflect the results of these inspections. Appropriate personal safety measures should be taken during these inspections.

7-25. Reasonably Uniform Appearance of Repairs

The California Fair Claim Settlement Practices Regulations, section 2695.9(a)(2), reads in part: "When a loss requires replacement of items and the replaced items do not match in quality, color or size, the insurer shall replace all items in the damaged area so as to conform to a reasonably uniform appearance."

Carpet and floor coverings: When dealing with replacement of carpet and other floor coverings, good judgment must prevail, but generally if a match cannot be found, doorways with doors that can close (swinging or pocket) can be used as the dividing line between rooms where there will be replacement of floor covering damaged by this loss and adjoining rooms where the floor covering was not damaged and need not be replaced. (This concept does not apply to closets with doors. For purposes of floor covering replacement, such closets should be considered part of the room.)

Roofs: Bear in mind that the regulations do not require an exact color match, but rather that all items in the damaged area “conform to a reasonably uniform appearance.” It is expected that the claim representative use his or her good judgment to determine how much of the damaged area needs to be repaired or replaced to comply with the “reasonably uniform appearance” standard.

It will generally not be necessary to replace the whole slope unless materials of the same size and quality cannot be found or the condition of the roof makes a repair impossible. Repairs most likely will be made with new materials of like kind and quality, which generally fade to match the existing materials.

When a claim representative recommends a repair rather than a replacement, the CEA requires that the representative explain the “reasonably uniform appearance” concept to the insured and advise how the claim representative determined the area to be repaired.

Attachment 1. Coverage Chart – Homeowners vs. Homeowners Choice

	HOMEOWNERS Includes Mfg. homes and Mobilehomes	HOMEOWNERS - Choice Includes Mfg. homes and Mobilehomes
COVERAGE A		
Dwelling	Companion Policy Limit	Companion Policy Limit
Deductible	10% or 15% of A & B Combined Single Limit	10% or 15% of A & B Combined Single Limit
COVERAGE B Other Structures	Limited coverage included in CSL Limit for Coverages A & B.	Limited coverage included in CSL Limit for Coverages A & B.
COVERAGE C	\$5,000 Included	Optional Coverage – insured can buy or not buy this coverage
Contents – Coverage amounts selected by Insured	Higher limits that can be purchased \$25,000 \$50,000 \$75,000 \$100,000	\$5,000 \$25,000 \$50,000 \$75,000 \$100,000
Deductible	Deductible on A must be exceeded before C can be paid.	Separate 10% or 15% deductible for C. Deductible waived if A deductible met
COVERAGE D	\$1,500 included	Optional Coverage - Insured can buy or not buy this coverage
Loss of Use—Coverage Amounts selected by Insured (No deductible)	Higher limits that can be purchased \$10,000 \$15,000 \$25,000	\$1,500 \$10,000 \$15,000 \$25,000
OTHER COVERAGES	Included	Included
Debris Removal	5% of A & B CSL as additional insurance on total losses	5% of A & B CSL as additional insurance on total losses
Emergency Repairs	No deductible on first \$1,500, rest subject to 5% policy sublimit and included in deductible calculation	No deductible on first \$1,500, rest subject to 5% policy sublimit and included in deductible calculation
Land Stabilization	\$10,000 Sublimit of A & B CSL	\$10,000 Sublimit of A & B CSL
Building Code Upgrade	This is additional insurance, Dwelling: \$10,000 or \$20,000, Mobilehome: \$10,000 only	This is additional insurance, Dwelling: \$10,000 or \$20,000, Mobilehome: \$10,000 only

Attachment 2. Coverage Chart – Common Interest Development, Renters

	COMMON INTEREST DEVELOPMENT (Condo)	RENTERS
COVERAGE A	Optional Coverage in condo policy	No Coverage
Dwelling	\$25,000 Real Property	No Coverage
Policy Deductibles	Real prop. Cov. A: \$3,750 Pers. Prop. Cov. C: \$750 Loss Assessment Cov. E: \$3,750, \$7,500, or \$11,250	Pers. Prop. Cov. C: \$750
Emergency Repairs	Cov. A: \$1,500 Cov. C: Lesser of 5% or \$1,000	Cov. C: Lesser of 5% or \$1,000
COVERAGE B Other Structures	No Coverage	No Coverage
COVERAGE C	Optional Coverage in condo policy	Always included in renter policy
Contents Coverage amounts are selected by Insured	\$5,000 \$25,000 \$50,000 \$75,000 \$100,000	\$5,000 \$25,000 \$50,000 \$75,000 \$100,000
COVERAGE D	Optional Coverage in condo policy	Always included in renter policy
Loss of Use—Coverage Amounts selected by Insured (No deductible)	\$1,500 \$10,000 \$15,000 \$25,000	\$1,500 \$10,000 \$15,000 \$25,000
COVERAGE E	Optional Coverage in condo policy	No Coverage
Loss Assessments	Condo value \$135,000 or less \$75,000, \$50,000 or \$25,000 is available; Condo value greater than \$135,001, limit can be \$50,000 or \$75,000	No Coverage
OTHER COVERAGES		
Debris Removal	Additional insurance, Cov. A: 5% of A, if A is purchased Cov. C: Lesser of 5% of C or \$1,000 if C is purchased	Cov. C: Lesser of 5% of C or \$1,000 as additional insurance
Emergency Repairs	Cov. A: \$1,500 as sublimit of Cov A Cov. C: Lesser of 5% or \$1,000 sublimit of C if Cov. C purchased	Cov. C: Lesser of 5% or \$1,000 sublimit of Cov. C
Land Stabilization	No Coverage	No Coverage
Building Code Upgrade	Additional insurance, \$10,000 (if Coverage A is purchased)	No Coverage

Attachment 3. Example of CEA Coverage Review Form

Your Name:: Jane Claims Manager		Contact phone number: 916-236-3698	
XXX Insurance Company			
Your claim representatives Name:	<u>Date of Loss:</u>	<u>Coverage</u>	<u>Coverage</u>
John Q. Adjuster	9/03/06	<u>Limit:</u>	<u>Deductibles:</u>
Policy #:	Policy Period:	A	A
123-456-789	02/07/06 – 02/07/07	200,000	15% 30,000
Insured:		C	C
David and Liz Insured		5000	N/A
Property Address:		D	
123 Main Street		1500	N/A
City, St, Zip		Code:	
Any town, CA 90210		10,000	
Coverages Reserves and Paid	Reserves	\$ Paid to Date	
A-Dwelling	10,000	0	
C-Contents	0	0	
D-Loss of Use	0	0	
Code Upgrade	0	0	
Land Stabilization	0	0	
Loss Assessment	0	0	
	0	0	
<p>Description of loss: The Insured's home was damaged by an earthquake on 9/03/2006. The house is of two-story woodframe construction with a perimeter concrete foundation. There is also a guesthouse (one story) of similar construction that includes a bedroom, bath, kitchen, and a two-car garage. The two structures are built end-to-end, north to south, with a breezeway connecting the north-end of the house and the south end of the guesthouse. The breezeway shares a roofline with the guesthouse. The roof is connected to the north-end wall of the house. A wall on the west side of the breezeway connects to both the house and guesthouse, enclosing the west side of the breezeway. The breezeway is of woodframe construction on its own perimeter foundation. The foundation abuts the foundations of the house on the south side and the guesthouse on the north.</p> <p>Coverage question: Is the guesthouse a dwelling as defined by the policy and if so can it be considered under <u>COVERAGE A: 'DWELLING'</u>? The guesthouse is a residential structure of not more than four units and is at the location described in the DECLARATIONS. The DECLARATIONS page makes no mention of, or distinction between, the two structures.</p> <p>Our research: Webster's defines "contiguous" as "1. in physical contact; touching along all or most of one side. 2. near, next, adjacent". By this definition the breezeway's foundation is contiguous with both of the other structures' foundations. However, the breezeway <i>must</i> be considered part of the guesthouse in any case because of the roofline they share. It would appear that the guesthouse meets the definition of a dwelling on all criteria except the roofline. The definition only requires one criterion to be met.</p> <p>Our recommendation: As such, the guesthouse would appear to fall under "<u>COVERAGE A: 'DWELLING'</u>" since it requires that the building be defined as a dwelling and be identified on the DECLARATIONS page. The page gives only the address, and doesn't identify or exclude any specific structures. Based upon the above points it is our recommendation that coverage be extended to the guesthouse. For your reference we have attached diagrams and photos as well as a copy of the Earthquake Declarations Page. Please contact Team Leader John Q. Manager at (800) 555-1234 if you have any questions.</p>			
Submitted by: Jane Q. Manager		Date: 10/03/06	

Coverage Review Form - California Earthquake Authority

Your Name:		Contact phone number:	
Insurance Company:			
Your claim representatives Name:	<u>Date of Loss:</u>	<u>Coverage</u> <u>Limit:</u>	<u>Coverage</u> <u>Deductibles:</u>
Policy #:	Policy Period:	A	A
Insured:		C	C
Property Address:		D	
City, St, Zip		Code:	
Coverages Reserves and Paid	Reserves	\$ Paid to Date	
A-Dwelling			
C-Contents			
D-Loss of Use			
Code Upgrade			
Land Stabilization			
Loss Assessment			
Description of loss:			
 Coverage question:			
 Our research:			
 Our recommendation:			
Submitted by:		Date: xx/xx/xxxx	

Attachment 4. Testing Authorization Agreement

Testing Authorization Agreement

Claim Number: _____ Date of Loss: _____

Name: _____ Date of Agreement: _____
(Policyholder)

Address: _____

City: _____ State: _____ Zip: _____

I [we], _____ [Name(s) of policyholder(s)], acknowledge and agree to the following:

1. _____ [Name of Participating Insurer] (“the Insurer”), a Participating Insurer of the California Earthquake Authority (“the CEA”), and I [we] disagree (i) as to whether my [our] home has sustained covered earthquake damage over the deductible amount of my [our] insurance policy issued by the CEA, and (ii) as to the need for further testing to determine the extent or cause of damage to my [our] home. The Insurer contends that additional testing will not establish the existence of covered earthquake damage over the amount of the deductible, and I [we] believe that additional testing will establish that my [our] home sustained covered earthquake damage over the amount of the deductible.
2. The Insurer has advised me [us] that, pursuant to the terms of my [our] insurance policy, the Insurer will not authorize any additional testing as part of the claims adjusting process unless I [we] agree that, in the event additional testing is performed and that testing fails to establish the existence of covered earthquake damage over the amount of the deductible of the insurance policy issued by the CEA, I [we] will pay for the cost of conducting that testing, including the cost of repairing any damage to my [our] property caused by any destructive testing that is conducted.
3. I [we] therefore request the Insurer to authorize the following testing:

[DESCRIPTION OF TESTING REQUESTED BY POLICYHOLDER]

I [we] agree that, in the event the testing described above fails to establish the existence of earthquake damage that is covered under my [our] CEA policy and that it is over the deductible amount of that policy, I [we] will pay for all costs associated with conducting that testing, including, but not limited to, the cost of repairing any damage to my [our] property caused by any destructive testing. I [we] understand that, in the event the testing described above establishes that my [our] property has sustained covered earthquake damage over the amount of the deductible of the CEA policy, I [we] will not be required to pay for any of the costs of that testing.

Policyholder(s): _____ Date: _____
(Signature of policyholder)

Claim Representative _____ Date: _____

CEA Participating Insurer: _____

Attachment 5. Advanced Payment Agreement

Advanced Payment Agreement

Name
Address
City, State

Re: Claim No.:
Policy No.:
Policyholder(s):
Address of Insured Property:
Date of Damage:

Dear _____,

There is a question as to whether there is coverage under the policy for the damages, which have occurred. We are investigating the claim. We are under no legal obligation to make any payments until the coverage investigation is complete.

However, to prevent any undue hardship which this loss may cause, we advance the sum of \$_____ under the following terms and conditions:

- 1) This advance shall not be considered as any admission that payment is due under any portion of the policy;
- 2) If we determine that payment is not required under the terms and conditions of the policy, you will repay the advance;
- 3) In making this advance, we reserve all rights and do not waive any terms, conditions or requirements under the policy, nor any rights we have; and
- 4) Other than as agreed in this letter, you reserve your rights as well.

You will cooperate in the coverage investigation, and comply with the policy conditions regarding the presentation of any claim. We may need a Proof of Loss or an examination under oath.

If we determine that your claim is payable, we will apply the advance against any benefit due under the policy. If you have any questions, please let us know.

Sincerely,

XXXXXXXXXXXX

I have read this letter, and agree to its terms:

[Insured]

Attachment 6. CEA Under-Deductible Letter

Sample Wording for Under Deductible Denial Letter on a Homeowners Policy

Dear XXXXXX,

Thank you for your courtesy and cooperation during the investigation of your claim [or other opening greeting].

As we discussed, your California Earthquake Authority policy provides coverage for earthquake damage, subject to a deductible of \$ _____. Our investigation and estimate of damage has determined that the cost to repair any covered damage to your [dwelling, extensions to dwelling– as appropriate] is less than your deductible. For this reason, we will be unable to make any payment under the terms and conditions of your policy, and your claim is therefore denied. [Optional when there is a personal property loss also: Please note that no payment can be made for loss to any personal property until the deductible for the dwelling or extensions to dwelling is met.]

The attached estimate represents our evaluation of your covered damages. If you believe we have missed any damage, please let us know. Also, you may wish to obtain your own estimate of the cost of repairs. If you obtain your own repair estimate (or if you have already obtained one), and the amount is above your policy deductible, please contact us immediately and send us a detailed estimate.

While the covered damage to your property did not exceed the deductible, expenses incurred for Loss of Use while the home is uninhabitable could be considered for payment under Coverage D – Loss of Use. This coverage is subject to the applicable limit of insurance. Please let us know if your home becomes uninhabitable during the repair process and you incur Loss of Use expenses.

California law requires us to notify you of a time limit that applies to your claim. The time limit pertains to Condition 10, which is found on page ___ of your policy. This condition is required by law and is contained in all residential property insurance policies issued in the State of California. The condition states the following:

CONDITIONS

10. Legal Action. No action can be brought under this policy by any person unless the policy provisions have been fully complied with and the action is started within one year after the date of inception of the loss.

This condition limits your time to commence legal action for recovery of damages sustained in your loss. Please note that we do not mean to suggest that you file a legal action. We only seek to advise you of the time limitation set forth within this condition of your policy.

We are also required to let you know that, if you believe that this claim has been wrongfully denied or rejected or that there is a dispute as to damages, you have the right to have the matter reviewed by the California Department of Insurance at 300 South Spring Street, 11th Floor, Los Angeles, CA 90013 (213) 897-8921, (800) 927-4357.

Please contact me if you have any questions regarding your damages, your coverage, or the contents of this letter. I can be reached at 1.800.xxx.xxxx.

Sincerely, John/Jane Q. Adjuster Senior Claim Representative XXX Insurance Company
A Participating Insurer of the California Earthquake Authority

cc: Agent

Attachment 7. Sample Property Loss Notice

Property Loss Notice – Report of New Earthquake Claim

To: _____ Fax # _____
(Name of Insurance Company) (Insurance company claim reporting Fax telephone number)
From: California Earthquake Authority - Sacramento CA,
Toll Free 877.797.4300 # Pages _____

Print large, bold and neat.

Today's Date: _____ Time this claim report was taken: _____ AM PM
(Circle one)

Caller's Name: _____

Your phone number in case we get disconnected: (____) _____ - _____ ext. _____

The name of your insurance company: _____

Your policy number: _____ Effective Date: _____

Policy Type: HO Condo Renter Mobilehome - Date damage occurred: _____
(Circle one)

Your Agent's Name: _____ Agent's Phone # (____) _____

Are you the Insured: Yes No a. If not, what is your relationship to the insured: _____
(Circle one) If Yes, go to c. If No, answer a & b.)

b. If the caller is not the insured, what is the insured's name: _____

c. Name of person who can show the damage to a claim rep: _____

Home phone # for this person: (____) _____ - _____ Work phone #: (____) _____ - _____

Cell Phone : (____) _____ - _____ E-mail _____

What times are best to call: _____ Language preference: _____
(It is important that you verify the insured's name, telephone # & policy number.) (Complete only if they request, i.e. Spanish)

Location of the damaged property: City: _____

Street address: _____ Zip _____

Are there any issues prohibiting access to property? Yes No Describe damage below:

Do you have an estimate or guess on the \$ amount of damage: \$ _____

CEA Representative's Name: _____ Phone Number: _____

CALIFORNIA EARTHQUAKE AUTHORITY

Side-by-Side Comparison:

CEA Claim Manual (April 2009) to proposed, updated CEA Claim Manual (August 2011)

Some Manual provisions have changed or have been moved, and the Manual has been reorganized.

PROPOSED JANUARY 2012 CLAIM MANUAL	APRIL 2009 CLAIM MANUAL
<p>Page 2: The following note is new in this Manual: <i>Note: This Manual includes several references to a Basic Earthquake Policy - Homeowners Choice. At the time of the approval of this Manual, the CEA has not yet introduced Homeowners Choice into the insurance market place. As always, it is the claim representative's responsibility to determine what CEA policy coverage a claim is being handled under. If and when the CEA Homeowners Choice policy becomes available to consumers, and the claim representative is handling a claim for a policyholder with a Homeowners Choice policy, the claim representative should follow the procedures contained in this Manual that are specific to Basic Earthquake Policy - Homeowner Choice.</i></p>	<p>No equivalent wording. This note makes clear that the Manual includes information on the CEA earthquake insurance policy, <i>Basic Earthquake Policy – Homeowners Choice</i>.</p>
<p>Page 7. INTRODUCTION Background and introduction are separated in the updated Manual. INTRODUCTION is now solely an introduction and includes wording from other sections of the 2009 Manual revision.</p>	<p>Page 6. BACKGROUND AND INTRODUCTION These are separated into two paragraphs in the updated Manual.</p>
<p>Page 7. BACKGROUND OF THE CEA Minor edits.</p>	
<p>Page 8. THE ROLE OF THE PARTICIPATING INSURANCE COMPANY New and expanded in the updated Manual.</p>	<p>No equivalent wording.</p>

PROPOSED JANUARY 2012 CLAIM MANUAL	APRIL 2009 CLAIM MANUAL
1. GENERAL CEA CLAIMS INFORMATION	1. GENERAL CEA CLAIMS INFORMATION
1-1. Types of CEA Policies Section is expanded to provide details on 2012 CEA policy forms.	1-1. Types of Policies Issued
1-2 Deductibles - Differences Between Homeowners and Homeowners Choice This is a new section.	1-2. Companion Policy Required Moved to Section 1-3 in updated Manual.
1-3. Companion Policy Required No change in wording but moved here from Manual Section 1-2.	1-3. Relationship and Duties of Participating Insurers Moved to page 8 of the updated Manual.
1-4. Reporting claims to the CEA Minor edits	1-4. CEA Earthquake Response Manager Duties and Responsibilities Moved to Section 1-6 of the updated Manual.
1-5. Claim Reserving Moved here from section 1-11 in 2009 Manual revision.	1-5. Participating Insurer Claims Liaison Duties and Responsibilities Moved to Section 1-7 of the updated Manual.
1-6. CEA Earthquake Response Manager – Duties and Responsibilities No change.	1-6. Adjuster Training Requirements Moved to Section 1-8 of the updated Manual.
1-7. Participating Insurer Claims Liaison – Duties and Responsibilities Moved here from Section 7-2 of the 2009 Manual revision. Expanded description of participating-insurer duties.	1-7. Policy and Coverage Interpretations Moved to Section 1-9 of the updated Manual.
1-8. Adjuster Training Requirements Minor edits.	1-8. Mediation – Department of Insurance Earthquake Mediation Program Moved to Section 1-10 of the updated Manual.
1-9. Policy and Coverage Interpretations Minor edits.	1-9. Reinspections and Claim File Reviews Moved to Section 1-11 of the updated Manual.

PROPOSED JANUARY 2012 CLAIM MANUAL	APRIL 2009 CLAIM MANUAL
1-10. Mediation – Department of Insurance Earthquake Mediation Program No change; moved from Section 1-8 in 2009 Manual revision.	1-10. Overlapping or Coexistent Insurance Coverage Moved to Section 1-12.
1-11. Reinspections and Claim File Reviews Minor edits.	1-11. Claim Reserving Moved to Section 1-5.
1-12. Overlapping or Coexistent Insurance Coverage Moved from Section 7-12. Includes major edits.	This discussion was moved from Section 7-12 of the 2009 Manual revision to Section 1-12 of the updated Manual.
1-13. ISO ClaimSearch® (PILR) New in this Manual.	No equivalent wording.
1-14. Claim Representatives Should Handle Claim to Conclusion No change. Moved here from section 2-3 in 2009 Manual revision.	Moved from Section 2-3 in 2009 Manual revision to Section 1-14 in the updated Manual.
2. PRE-EARTHQUAKE DISASTER RESPONSE PREPARATION	2. PRE-EARTHQUAKE DISASTER RESPONSE PREPARATION
2-1. Pre-Earthquake Planning - General No change.	2-1. Pre-Earthquake Planning - General
2-2. Participating Insurer Earthquake Response Plan Minor edits.	2-2. Participating Insurer Earthquake Response Plan
	2-3. Claim Representatives Should Handle Claim to Conclusion Moved to section 1-14 in updated Manual.
3. POST-EARTHQUAKE RESPONSE	3. POST-EARTHQUAKE RESPONSE
3-1. CEA Earthquake Response Manager No change.	3-1. CEA Earthquake Response Manager
3-2 Claims Counts Procedure added to this Manual.	No equivalent wording.

PROPOSED JANUARY 2012 CLAIM MANUAL	APRIL 2009 CLAIM MANUAL
3-3. Media Communications Following an Earthquake No change.	3-2. Media Communications Following an Earthquake Section 3-2 of the 2009 Manual revision is moved to Section 3-3 in the updated Manual.
3-4. Participating Insurer Catastrophe Claim Managers No change.	3-3 Participating Insurer Claims Liaison Section 3-3 of the 2009 Manual revision moved to 3-4 in the updated Manual. Change in title.
3-5. Catastrophe Offices No change.	3-4. Catastrophe Offices Section 3-4 in 2009 Manual revision moved to Section 3-5 in the updated Manual.
3-6. CEA Event Code Minor edits.	3-5. CEA Event Code Section 3-5 of the 2009 Manual revision moved to Section 3-6 in the updated Manual.
3-7. New Claims Reported to the CEA No change.	3-6. New Claims Reported to the CEA Section 3-6 of the 2009 Manual revision moved to Section 3-7 in the updated Manual.
3-8 EARLE (Earthquake Loss Estimation System) Procedure added to this Manual.	No equivalent wording.
3-9. Pro Rata or Installment Claims Payments Minor edits.	3-7. Pro Rata or Installment Claims Payments Section 3-7 of the 2009 Manual revision moved to Section 3-9 in the updated Manual.
4. BASIC EARTHQUAKE POLICY - HOMEOWNERS	4. BASIC EARTHQUAKE POLICY - HOMEOWNERS
4-1 Introduction to the CEA homeowner policy Minor edits.	4-1. Overview of Covered Losses Section 4-1 of the 2009 Manual revision moved to Section 4-2 in the updated Manual.
4-2. Covered Losses Minor edits.	4-2. Losses Excluded Section 4-2 of the 2009 Manual revision moved to Section 4-3 in the updated Manual.
4-3. Losses Excluded Minor edits.	4-3. Deductible Deductible examples in this section are removed and will be shown in CEA's on-line training

PROPOSED JANUARY 2012 CLAIM MANUAL	APRIL 2009 CLAIM MANUAL
	modules. Participating insurers responsibilities regarding deductibles are made clear in Section 1-7 of the updated Manual.
4-4. Loss Settlement is at Replacement Cost No change.	4-4. Loss Settlement is at Replacement Cost
4-5. Types of Building Property Insured – Dwelling is Defined Edited for clarity.	4-5. Types of Building Property Insured
4-6. Chimneys – Coverage A: \$5,000 Sublimit of Insurance Edited due to policy change eliminating need to include all chimney damage in the deductible.	4-6. Chimneys – Coverage A: \$5,000 Sublimit of Insurance
4-7. Equipment and Utility Service Structures - Coverage B Minor edits.	4-7. Equipment and Utility Service Structures - Coverage B:
4-8. Walkways, Driveways, Decks, Patio Slabs - Coverage B Minor edits.	4-8. Walkways, Driveways, Decks, Patio Slabs - Coverage B:
4-9. Bulkheads, Piers, and Retaining Walls - Coverage B No change.	4-9. Bulkheads, Piers, and Retaining Walls - Coverage B:
4-10. Property Not Covered: Coverage A and Coverage B No change.	4-10. Property Not Covered: Coverage A: and Coverage B:
4-11. Property Not Covered: Exterior Masonry Veneer No change.	4-11. Property Not Covered: Exterior Masonry Veneer
4-12. Property Not Covered: Exterior and Underground Systems and Structures No change.	4-12. Property Not Covered: Exterior and Underground Systems and Structures
4-13. Property Not Covered: Antennas and Satellite Dishes No change.	4-13. Property Not Covered: Antennas and Satellite Dishes

PROPOSED JANUARY 2012 CLAIM MANUAL	APRIL 2009 CLAIM MANUAL
4-14. Property Not Covered: Decorative or Artistic Features of the Dwelling Edits for clarity.	4-14. Property Not Covered: Decorative or Artistic Features of the Dwelling
4-15. Property Not Covered: Awnings and Patio Coverings Minor edits.	4-15. Property Not Covered: Awnings and Patio Coverings
4-16. Property Not Covered: Landscaping No change.	4-16. Property Not Covered: Landscaping
4-17. Property Not Covered: Swimming Pools, Spas, and Hot Tubs No change.	4-17. Property Not Covered: Swimming Pools, Spas, and Hot Tubs
4-18. Garages and Outbuildings No change.	4-18. Garages and Outbuildings
4-19. Plaster - Limited to the Cost of Sheetrock or Drywall No change.	4-19. Plaster - Limited to the Cost of Sheetrock or Drywall
4-20. Dwelling Glass - Loss Settlement Edits for clarity.	4-20. Dwelling Glass - Loss Settlement
4-21. Coverage C - Personal Property Not Covered or Subject to a Sublimit Updated policy sublimits. Combined 4-21 and 4-22 from 2009 Manual revision into section 4-1 in revised Manual.	4-21. Coverage C - Personal Property Covered
4-22. Coverage D: Loss of Use Minor edits.	4-22. Coverage C - Personal Property Not Covered or Subject to a Sublimit Included in 4-21 in the updated Manual.
4-23. Protection of Property - Emergency Repairs – No deductible on first \$1,500 Expanded to explain that first \$1,500 of emergency repairs incurs no deductible and how to calculate that policy feature.	4-23. Coverage D: Loss of Use Moved to section 4-22 of updated Manual.
4-24. Other Coverages: Debris Removal Edits for clarity.	4-24. Other Coverages: Emergency Repairs Moved to 4-23 in the updated Manual.

PROPOSED JANUARY 2012 CLAIM MANUAL	APRIL 2009 CLAIM MANUAL
4-25. Other Coverages: Building Code Upgrade Expanded to make handling of this policy feature clearer.	4-25. Other Coverages: Debris Removal Moved to 4-24 in the updated Manual.
4-26. Other Coverages: Land Stabilization No change.	4-26. Other Coverages: Building Code Upgrade Moved to 4-25 in updated Manual.
4-27. Losses Excluded No change.	4-27. Other Coverages: Land Stabilization Moved to 4-26 in the updated Manual.
4-28. Losses Excluded: Fire and Explosion No change.	4-28. Losses Excluded Moved to 4-27 in the updated Manual
4-29. Losses Excluded: Asbestos and Other Pollutants No change.	4-29. Losses Excluded: Fire and Explosion Moved to 4-28 in the updated Manual.
4-30. Losses Excluded: Non-Earthquake Earth Movement and Land Sliding No change.	4-30. Losses Excluded: Asbestos and Other Pollutants Moved to 4-29 in the updated Manual.
4-31. Losses Excluded: Theft or Vandalism No change.	4-31. Losses Excluded: Non-Earthquake Earth Movement and Land Sliding Moved to 4-30 in the updated Manual.
	4-32. Losses Excluded: Theft or Vandalism Moved to 4-31 in the updated Manual.
5. BASIC EARTHQUAKE POLICY - COMMON INTEREST DEVELOPMENT	5. BASIC EARTHQUAKE POLICY - COMMON INTEREST DEVELOPMENT
5-1. Policy Definitions No change.	5-1. Policy Definitions
5-2. Adjusting Condominium Claims – Coordination No change.	5-2. Adjusting Condominium Claims – Coordination
5-3. Other Earthquake Coverage No change.	5-3. Other Earthquake Coverage
5-4. Duties after a Loss No change.	5-4. Duties after a Loss

PROPOSED JANUARY 2012 CLAIM MANUAL	APRIL 2009 CLAIM MANUAL
5-5. Overview of the Declarations Page and Coverage Options Minor edits.	5-5. Overview of the Declarations Page and Coverage Options
5-6. Losses Excluded Minor edits.	5-6. Losses Excluded
5-7. Deductibles No change.	5-7. Deductibles
5-8. Building Property - Coverage A Expanded to include updated sublimit.	5-8. Building Property - Coverage A
5-9. Emergency Repairs – Coverage A No change.	5-9. Emergency Repairs – Coverage A
5-10. Debris Removal – Coverage A Minor edits.	5-10. Debris Removal – Coverage A
5-11. Loss Settlement – Coverage A No change.	5-11. Loss Settlement – Coverage A
5-12. Personal Property – Coverage C No change.	5-12. Personal Property – Coverage C
5-13. Emergency Repairs – Coverage C No change.	5-13. Emergency Repairs – Coverage C
5-14. Debris Removal – Coverage C No change.	5-14. Debris Removal – Coverage C
5-15. Loss of Use – Coverage D No change.	5-15. Loss of Use – Coverage D
5-16. Loss Assessment - Coverage E No change.	5-16. Loss Assessment - Coverage E
5-17. Reduction of Value - Property not Repaired or Replaced - Coverage E Minor edit.	5-17. Reduction of Value - Property not Repaired or Replaced - Coverage E

PROPOSED JANUARY 2012 CLAIM MANUAL	APRIL 2009 CLAIM MANUAL
5-18. Compliance with Ordinance and Law – Coverage A and Coverage E Minor edit.	5-18. Compliance with Ordinance and Law – Coverage A and Coverage E
5-19. Ingress and Egress No change.	5-19. Ingress and Egress
6. BASIC EARTHQUAKE POLICY – RENTERS	6. BASIC EARTHQUAKE POLICY – RENTERS
6-1. Personal Property – Deductible Minor edit.	6-1. Personal Property – Deductible
6-2. Loss of Use Minor edit.	6-2. Loss of Use
6-3. Policy Exclusions – Renters Policy New section addressing renter’s exclusions.	No equivalent section in 2009 Manual revision.
7. CLAIMS INVESTIGATION PROCEDURES	7. CLAIMS INVESTIGATION PROCEDURES
7-1. A Companion Policy Must Be in Force No change.	7-1. A Companion Policy Must Be in Force
Section 7-2 in the 2009 Manual revision included in 1-7 of the updated Manual.	7-2. Policy Interpretation – When to Consult With the CEA Moved to section 1-7 of the updated Manual.
7-2. California Fair Claims Settlement Practices Regulations and Other Laws Minor edits.	7-3. California Fair Claims Settlement Practices Regulations and Other Laws
7-3. Claim File Documentation Minor edits.	7-4 Claim File Documentation
7-4. Keep the Policyholder Informed No change.	7-5. Keep the Policyholder Informed
7-5. Timely Adjusting - SBA and FEMA Requirements No change.	7-6. Timely Adjusting - SBA and FEMA Requirements

PROPOSED JANUARY 2012 CLAIM MANUAL	APRIL 2009 CLAIM MANUAL
7-6. Destructive and Other Tests to Determine Extent or Cause of Loss No change.	7-7. Destructive and Other Tests to Determine Extent or Cause of Loss
7-7. Use of Engineers or Experts No change.	7-8. Use of Engineers or Experts
7-8. Costs to Rebuild or Repair – Prices of Building Materials No change.	7-9. Costs to Rebuild or Repair – Prices of Building Materials
7-9. Overhead and Profit No change.	7-10. Overhead and Profit
7-10. Claim Payment Ratio No change.	7-11. Claim Payment Ratio
7-11. Double Coverage No change.	7-12. Double Coverage
7-12. Suspected Fraudulent Claims No change.	7-13. Suspected Fraudulent Claims
7-13. Emergency Repairs Title changed and updated for changes in updated policies (the first \$1,500 of emergency repairs incurs no deductible).	7-14. Protection of Property - Emergency Repairs
7-14. Scope of Loss and Estimates No change.	7-15. Scope of Loss and Estimates
7-15. Cracks in Concrete Surfaces Such as Garage Floors and Foundations Added information about exacerbation of concrete cracks by earthquake-event.	7-16. Cracks in Concrete Surfaces Such as Garage Floors and Foundations
7-16. Subrogation No change.	7-17. Subrogation
7-17. Salvage No change.	7-18. Salvage
7-18. Proof of Loss No change.	7-19. Proof of Loss

PROPOSED JANUARY 2012 CLAIM MANUAL	APRIL 2009 CLAIM MANUAL
7-19. Loss Settlement Disputes No change.	7-20. Loss Settlement Disputes
7-20. Coverage Disputes No change.	7-21. Coverage Disputes
7-21. Denying Damages Not Covered and Claims Under the Deductible No change.	7-22. Denying Damages Not Covered and Claims Under the Deductible
7-22. Usage of the Name “California Earthquake Authority” in Letters No change.	7-23. Usage of the Name “California Earthquake Authority” in Letters
7-23. When to Name a Mortgagee as a Joint Payee on a Claims Settlement Check Minor edits.	7-24. When to Name a Mortgagee as a Joint Payee on a Claims Settlement Check
7-24. Complete Investigation Major edits, including pointing out availability of CUREE Guidelines.	7-25. Complete Investigation
7-25. Reasonably Uniform Appearance of Repairs No change.	7-26. Reasonably Uniform Appearance of Repairs
Attachment 1. Coverage Chart – Homeowners vs. Homeowners Choice Edited to include Homeowners and Homeowners Choice policies.	Attachment 1. Coverage Comparison Chart – Homeowners, Common Interest Development, Renters
Attachment 2. Coverage Chart – Common Interest Development, Renters Includes condo and renters coverage that did not fit on chart in Attachment 1.	Attachment 2. Example of How to Calculate the CEA Policy Deductible This section has been eliminated from the Claim Manual, because it was not comprehensive enough to cover all situations. The subject will be covered in detail in the CEA’s on-line training modules. Section 1-7 of the updated Claim Manual makes clear that participating insurers’ claims liaisons must use the CEA’s on-line training courses for CEA-policy-deductible training.

PROPOSED JANUARY 2012 CLAIM MANUAL	APRIL 2009 CLAIM MANUAL
Attachment 3. Example of CEA Coverage Review Form No change.	Attachment 3. Example of CEA Coverage Review Form
Attachment 4. Testing Authorization Agreement No change.	Attachment 4. Testing Authorization Agreement
Attachment 5. Advanced Payment Agreement No change.	Attachment 5. Advanced Payment Agreement
Attachment 6. CEA Under Deductible Letter No change.	Attachment 6. CEA Under Deductible Letter
Attachment 7. Sample Property Loss Notice No change.	Attachment 7. Sample Property Loss Notice



CLAIM MANUAL

CALIFORNIA EARTHQUAKE AUTHORITY

APPROVED BY THE GOVERNING BOARD, February, 2009
APPROVED BY THE INSURANCE COMMISSIONER, April, 2009

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BACKGROUND AND INTRODUCTION

The purpose of this manual is to assist experienced property claim representatives in the investigation and settlement of California Earthquake Authority earthquake insurance claims.

Under the California Insurance Code, insurers that sell residential property insurance in California are required to offer earthquake insurance to their residential property policyholders. As a result of the many claims from the 1994 Northridge earthquake, insurers became concerned that another earthquake would exhaust their available resources. As a result, many companies stopped selling homeowners insurance in California, which created an insurance availability crisis.

In an attempt to resolve this crisis in insurance availability, the California Legislature established the California Earthquake Authority (CEA). Companies that did not wish to have the catastrophic exposure of earthquake insurance could become CEA Participating Insurers by contributing capital to the CEA. Membership in the CEA allowed Participating Insurers to offer earthquake coverage to their residential insureds through the CEA.

The CEA is a publicly-managed, privately-financed entity, operating much like an insurance company, though with some significant differences. Funds to pay earthquake claims come from premiums collected and investment income, Participating Insurer contributions and assessments, reinsurance purchased by the CEA, and other CEA risk transfer mechanisms. No funds from the public or from the State of California's General Fund are pledged to cover losses incurred by CEA policyholders.

When an earthquake results in a claim against a CEA policy sold by a Participating Insurer, the claim representative for that insurer handles the claim on behalf of the CEA. The CEA reimburses the Participating Insurer for the indemnity dollars paid, and pays the Participating Insurer a loss adjustment fee to cover claims-adjusting expenses.

The CEA is committed to making sure all of its claims are handled fairly, timely, and consistently. To accomplish that goal, all Participating Insurers and their claim representatives, whether employees or independent contractors, are required to follow the claim-handling guidelines in this manual. The CEA audits and re-inspects claims to make sure that claims are properly investigated and that appropriate procedures have been followed.

It is important to understand that CEA policies do not provide the same types of coverages property claim representatives may be accustomed to seeing under a traditional residential policy. Each policy issued by the CEA should be carefully reviewed.

Nothing contained in this manual is intended to change the responsibilities placed upon insurers by the California Fair Claims Settlement Practices Regulations, the California Insurance Code, or any other statute or regulation. The claim representative, independent adjuster, and Participating Insurer are required to strictly conform to the applicable laws and regulations.

1. GENERAL CEA CLAIMS INFORMATION

1-1. Types of Policies Issued

The CEA provides earthquake coverage in the State of California through three distinct policies. They are:

- **Basic Earthquake Policy – Homeowner**
This is the most frequently-sold policy and the one a claim representative should review first. It would be expected that the majority of the claims would be made under this policy. In addition to traditional single-family homes, mobilehomes are also insured using this policy.
- **Basic Earthquake Policy – Renters**
This policy provides personal property and additional living expense coverages similar to that in the homeowners policy, although the deductibles work differently from a homeowners policy. It does not cover the dwelling or extensions to dwelling.
- **Basic Earthquake Policy – Common Interest Development**
In California, a “common interest development” can be a community apartment project, a condominium project, a planned development, or a stock cooperative, all as further defined in California Civil Code section 1351. Since most people equate “common interest development” with a “condominium,” throughout the remainder of this manual we will use the term “condominium” interchangeably with “common interest development.”

These guidelines do not create coverage when none is provided by the CEA policy of insurance in force at the time of the loss. If there are any conflicts or inconsistencies between this Claims Manual and the language of the CEA’s insurance policy, the policy language will take precedence.

Nothing contained in this Claims Manual is intended to change the requirements placed upon insurers and their claim representatives by the California Insurance Code, other applicable statutes, applicable regulations, or any case law interpreting any applicable statute or regulation. In the event that an item or procedure specified in these guidelines seems to conflict with any applicable statute, regulation, or case law, the claim representative is to conform strictly to the statute, regulation, or case law.

1-2. Companion Policy Required

CEA policies are sold and issued through Participating Insurers.

By law (California Insurance Code section 10089.20), a CEA earthquake policy is valid only if an underlying residential fire insurance policy is in force covering the same property. The CEA policy is legally void if no residential fire policy issued by the same Participating Insurer is in force at the time of the loss, regardless of whether a formal notice of cancellation of the CEA policy has been sent or received at the time of loss.

1-3. Relationship and Duties of Participating Insurers

Every Participating Insurer has executed a uniform Insurer Participation Agreement, which sets forth that insurer's relationship with, and responsibilities to, the CEA. The procedures contained in this Claims Manual are in addition to the "Procedures and Accounting Manual" and the "Participating Insurer Operating Procedures Manual," which serve as guides to Participating Insurers in completing their contractual obligations to handle claims arising under CEA policies.

As the claims agents for the CEA, Participating Insurers are responsible for investigating and adjusting claims made under CEA policies. Section 3.2 of Article III of the Insurer Participation Agreement reads in part: "The Participating Insurer may perform Authority services on behalf of the Authority in any reasonable manner that is in compliance with the statutory, regulatory, and case law regarding claims handling practices; provided, however, where the Authority has promulgated specific procedures to govern its operations, the Participating Insurer shall conform its practices to those procedures."

Participating Insurers and their representatives should handle all CEA claims in an expeditious and thorough manner, with at least as much care or diligence as they use in handling their own non-CEA business.

Participating Insurers are to report to the CEA all claims from CEA policyholders, whether or not the Participating Insurer expects the claim to exceed the deductible. If the claim is expected to be under the deductible, it should be reported with a zero dollars reserve (or the lowest reserve amount allowed by the Participating Insurer's claims system).

1-4. CEA Earthquake Response Manager – Duties and Responsibilities

The CEA has an Earthquake Response Manager (ERM). The duties of the ERM include:

- a. Maintaining and communicating CEA guidelines for adjustment and payment of claims
- b. Assisting Participating Insurers with earthquake claims training
- c. Monitoring Participating Insurers' disaster response procedures
- d. Maintaining an on-site presence after an earthquake
- e. Coordinating claims activity with the Participating Insurers after an earthquake
- f. Chairing and participating in the CEA Claims Coverage Committee (See section 1-7.)
- g. Initiating and coordinating reinspections and claim file reviews after an earthquake (See section 1-9.)

1-5. Participating Insurer Claims Liaison – Duties and Responsibilities

Each Participating Insurer must designate a single claims liaison to work closely with the ERM in coordinating all activities prior to and after an earthquake. The individual selected should be a property claims professional with the knowledge and the authority within the Participating Insurer's company to resolve issues in a timely manner.

1-6. Adjuster Training Requirements

Consistent claims handling by its Participating Insurers is a top priority of the CEA. Excellence and consistency in claims handling can best be accomplished by regular and comprehensive training. The Participating Insurers are responsible for ensuring that their claim representatives and any independent adjusters that they use are properly trained to handle earthquake claims. This manual can be used as a resource to train claim representatives on the handling of CEA claims.

a. Training on the CEA Policy and Adjusting Guidelines

On an ongoing basis, but not less than every three years and within one year after the approval by the CEA Governing Board and the Insurance Commissioner of any revised version of this Claims Manual, Participating Insurers must provide detailed training to their claim representatives on the CEA coverages and on this Claims Manual. Participating Insurers must also require that their claim representatives complete the on-line training offered by the CEA prior to being dispatched to handle any CEA claim. This on-line training is available at the CEA Web site at www.earthquakeauthority.com, under the “Helping Adjusters” section of the CEA Web site.

b. Fair Claims Practices Training

It is the responsibility of Participating Insurers to make sure their claim representatives, including any independent claim representatives they may employ, are certified on California Fair Claims Settlement Practices found in the California Code of Regulation, Title 10, Chapter 5, Subchapter 7.5.

Any apparent conflict between this Claims Manual and the regulations is to be resolved through strict compliance with the regulations.

As defined in the regulations, Participating Insurers are considered claims agents for the California Earthquake Authority. The CEA requires that Participating Insurers follow the time and notice provisions in the Regulations, as provided for in the regulations under Section 2695.70, Standards for Prompt, Fair and Equitable Settlements.

All requirements under Section 2695.3 of the regulations, File and Record Documentation, are to be fulfilled by the Participating Insurers. The CEA does not keep a physical file for individual claims, and requires the Participating Insurers to retain the physical claim file in compliance with Section 2695.3.

All requirements under Sections 2695.4 and 2695.5 of the regulations, Representation of Policy Provisions and Benefits and Duties upon Receipt of Communications respectively, are the responsibility of the Participating Insurers as claims agents for the CEA. Should the CEA receive any written or oral inquiry per Section 2695.5 (a) (such as a Department of Insurance complaint), it will forward any such inquiry to the Participating Insurer for response directly to the party that generated the inquiry. The CEA is to be provided a copy of all such responses, directed to the attention of the CEA Earthquake Response Manager.

Section 2695.6 of the regulations requires annual certification of written claim-handling standards and training of all Claims Agents used by the Participating Insurers. In this context, independent adjusting individuals and companies are by definition “Claims Agents.” The CEA intends to use the Participating Insurers’ Certifications as its own. These Annual Certifications are subject to audit by the CEA.

In order to meet the requirements of these regulations, Participating Insurers are to note in the claim file and/or in their computer systems each instance where a claim or coverage is declined in whole or in part with respect to the party making the claim.

The complete California Department of Insurance Regulations can be viewed online at <http://www.insurance.ca.gov>.

c. Insurance Adjuster Training For Evaluating Earthquake Damage

The CEA requires that Participating Insurance companies handling claims on behalf of the CEA comply with the California Department of Insurance regulations that set forth standards governing the training of insurance adjusters in evaluating damage caused by earthquakes and the procedures for reporting unaccredited adjusting.

These regulations can be found in the CALIFORNIA CODE OF REGULATIONS, Title 10, Chapter 5, Subchapter 7.5.1 *Insurance Adjuster Training For Evaluating Earthquake Damage*, or on the Web at: <http://www20.insurance.ca.gov/epubacc/REG/33849.htm>.

1-7. Policy and Coverage Interpretations

The CEA has established the following process for answering and resolving CEA policy coverage questions.

- a. Participating Insurers should first attempt to resolve policy and claim coverage questions by consulting this manual and by using the expertise of their senior claims professionals and claims management.
- b. Remaining unresolved claim questions should be referred to the CEA on the CEA Coverage Review Form with a narrative report under each of the applicable headings. An example of a completed form and a blank Coverage Review Form are included as Attachment 3 to this manual.
- c. The Coverage Review Form should be submitted to the CEA ERM along with a copy of the claim file and all other materials necessary for the proper review of the issue. Participating Insurers must use overnight mail when sending a file to the CEA for consideration.
- d. If relevant to the question, the file should include photographs of the damage, documentation regarding the amount of the loss, transcribed statements of interested parties, a declarations page, endorsements, correspondence, and copies of the electronic notes. All other information pertinent to the coverage question under review should also be provided.

- e. Upon receiving a coverage question from a Participating Insurer, the CEA Claims Coverage Committee reviews the question and the CEA ERM notifies the Participating Insurer of its coverage decision.

It will be the responsibility of the Participating Insurer to communicate the coverage decision to the policyholder and, when appropriate, to other interested parties.

The CEA ERM will endeavor to respond as quickly as possible, given the constraints associated with resource allocation in response to larger earthquake events. The Participating Insurer should notify the CEA ERM if there are circumstances requiring a specific turnaround time (other than the response times required by the California Fair Claim Settlement Practices Regulations). If you do not receive a response from the CEA in 15 days, please follow up with the ERM. During the period of time used for a coverage review, the Participating Insurer's claim representative must keep the claimant informed in writing, as provided in the Fair Claim Settlement Practices Regulations section 2695.7(c)(1).

In order to help achieve the CEA's goal of claim-handling consistency, Participating Insurers must not send a question regarding coverage for a CEA claim or CEA policy interpretation to counsel for a legal opinion before submitting the question to the CEA and obtaining the CEA's written consent for the Participating Insurer to seek a legal opinion on that question. In some circumstances, the CEA may have already obtained a coverage opinion on the general or specific topic in question, and may be able to share the conclusions of that opinion with the Participating Insurer.

1-8. Mediation – Department of Insurance Earthquake Mediation Program

In the event there is a dispute with an insured about the amount of settlement, Participating Insurers are to fully disclose the insured's right to pursue resolution of the claim by way of the California Earthquake Mediation Program (Title 10 of the California Code of Regulations, sections 2696.1 through 2696.10 and California Insurance Code sections 10089.70 through 10089.84).

Participating Insurers are strongly encouraged to incorporate the requirements of the Earthquake Mediation program into their CEA claims handling guidelines and manuals. Every claim supervisor responsible for CEA claims should be provided with CDI Mediation form 526 EQMED 12/99. These can be ordered from the CDI at 1-800-927-4357.

Upon notice of a demand for mediation by any party, the Participating Insurer must provide a detailed report to the CEA's ERM, describing the claim made, settlement demands, offers made and the full reasoning for the position taken by the Participating Insurer.

All mediation dates must be immediately communicated to the ERM. Participating Insurers will handle all communications directly with the CDI, and will immediately provide copies of all written materials to the CEA's ERM. The Participating Insurer will provide the most knowledgeable member of its staff to attend the mediation. Notice of the mediation must be given

to the CEA's ERM sufficiently in advance of the mediation to enable the CEA to make an informed decision about whether to attend.

1-9. Reinspections and Claim File Reviews

The CEA uses both physical claim reinspections and claim file reviews to monitor whether CEA claims are handled in a prompt, consistent, and fair manner. A physical claim reinspection involves actually visiting and evaluating the earthquake-damaged home, while a claim-file review is generally accomplished in an office by looking at the claim file and all supporting electronic records.

a. Reinspections and Claim File Reviews Performed by the Participating Insurer

The CEA expects that Participating Insurers will have their own claims quality assurance programs, including a program for field reinspections of open claims, as well as reviews or audits of claim files. These plans should be documented in the earthquake response plan each Participating Insurer submits to the CEA every year. (See section 2-2.)

- **Reinspections:** It is important to conduct reinspections on open claims early in the claim-handling process so that the damage can be viewed before repairs are completed. Of course, the policyholder's permission must always be obtained. The reinspection program should look at a statistically-valid sample of all claims from a specific earthquake. The ERM or the ERM's designee may be available to join Participating Insurer inspectors when they are conducting CEA earthquake claim reinspections. Requests to participate in the reinspections should be made through the ERM, who will try to accommodate these requests according to the available resources.
- **Claim file reviews:** In addition to physical claim reinspections, Participating Insurers are required to have a regular claim file quality review program. The Participating Insurer should apply the same quality of review and look at the same number of claim files as it would for its own claims. Copies of results should be retained, since the CEA may request copies of any review at a later date.

b. Reinspections and Claim File Reviews Performed by the CEA

The CEA may conduct field reinspections of open claims and/or reviews of claim files after an earthquake. While field reinspections are generally performed on open claims, claim file reviews may be performed on open or closed claim files. The purpose of these reinspections and claim file reviews is to:

1. Monitor and promote adherence to the CEA claim guidelines, policies, and procedures,
 2. Verify the accuracy of claims settlements, and
 3. Determine whether claims are being handled in accordance with the California Fair Claims Settlement Practices Regulations and other applicable regulations and statutes.
- **Reinspections:** All CEA claim reinspections will be conducted separately and in addition to any Participating Insurer reinspections. Before the claim reinspection process begins, the CEA will ask for a complete copy of the claim file for each claim it wishes to reinspect.

The CEA reinspector may be either a CEA employee or an independently-contracted individual or company. The CEA will endeavor to reinspect a representative sample from each Participating Insurer and to look at claims under each type of CEA earthquake policy.

- Claim file reviews: The CEA may also elect to conduct claim file reviews on open or closed claim files. These may be done at the Participating Insurer's office or the CEA may request that copies of the claims files be sent to the CEA office for review.

In either case, the CEA will endeavor to give sufficient notice to the Participating Insurer so as not to disrupt the Participating Insurer's ongoing claims-handling process.

It is the CEA's intent to communicate any issues discovered by the reinspections or claim file reviews to the relevant Participating Insurer.

c. Claim File Review Elements

CEA claim reviews may include, in addition to other elements, an evaluation of some or all of the following elements, depending on what may be appropriate to the facts and circumstances of the particular claim being reviewed:

1. Promptness of first contact
2. Development of initial information
3. Timely and thorough completion of the scope of damage (listing of damage)
4. Repair estimate of damages
5. Statements, if warranted
6. Reserve calculations and adequacy of reserves
7. Full coverage information and how it applies to the claim
8. Effective use of a diary that results in timely claims handling
9. Timeliness of communication with insured regarding claim status
10. Alertness to fraud and prompt notice given to appropriate parties
11. Appropriate use of engineers or other experts
12. Completeness of documentation of the amount of loss – Statement of loss
13. Timeliness of claim payments
14. Quality of written adjuster communications, including log notes and claims memos
15. Compliance with the CEA Claims Manual
16. Compliance with California Fair Claims Practices Regulations
17. Periodic guidance on open files by Claims Management
18. Effectiveness of Participating Insurer's reinspection program and claim file reviews

d. Timing of CEA Claim Reviews

Field reinspections: The CEA will typically begin conducting physical reinspections of claims around 30 to 45 days after an earthquake; however they can begin at any time.

Office claim file reviews: Claim file reviews can begin at any time after an earthquake, but most likely will begin after a majority of the claims have been completed and closed.

1-10. Overlapping or Coexistent Insurance Coverage

To help resolve issues of overlapping insurance or coexistent insurance coverage, the claim representative should follow the Other Insurance provisions in the CEA policy. Further help can be found in the *Guiding Principles for Overlapping Insurance Coverage* published in 1963 by a consortium of underwriting organizations. This document should be available from your claim manager.

When dealing with condominium policies, pay particular attention to the Other Insurance wording in the policy. This is discussed in more detail in sections 5-2 and 5-3 of this manual.

1-11. Claim Reserving

The aggregated reserve on reported claims provides the CEA's first estimate of severity of an earthquake and ultimate exposure for the event. Claim representatives must quickly set reserves that represent the best estimate of a claim's ultimate cost. Reserves should be adjusted as soon as new information is learned that would affect the ultimate cost.

When there is a legitimate question of coverage, set the reserve at the estimated amount of damages (minus the deductible amount) until the coverage issue is resolved.

If the claim is expected to be under the deductible, it should be reported with a zero (\$0) reserve or the lowest reserve amount allowed by the Participating Insurer's claims processing system.

2. PRE-EARTHQUAKE DISASTER RESPONSE PREPARATION

2-1. Pre-Earthquake Planning - General

Response planning before an earthquake occurs is very important. The ERM is available to the Participating Insurer claim liaison to assist with pre-earthquake training and planning.

2-2. Participating Insurer Earthquake Response Plan

Each Participating Insurer is responsible for its own earthquake catastrophe response planning.

By the end of each calendar year, an updated claims-oriented response plan specific to earthquake claims is to be filed with the CEA. It must address, at a minimum, the following aspects of catastrophe planning:

- a. Processes to make sure staff are trained before they are needed for earthquake catastrophe claims handling duty. It is the Participating Insurer's responsibility to make sure that every adjuster working on a CEA claim meets the following criteria:
 - Is trained on the California Department of Insurance Fair Claims Settlement Practice Regulations
 - Is accredited on the 1-1-2005 Department of Insurance standards for evaluating damage caused by earthquakes
 - Has received training in the handling of CEA claims and at a minimum, has recently taken the CEA on-line claims coverage and deductible calculation courses
 - If using any independent adjusters, plans to confirm that all such adjusters are properly licensed to investigate and adjust claims in California
- b. Procedures for the initial (first 48 hours) earthquake catastrophe response:
 - Processes for accepting new earthquake claims
 - Plans for properly trained and accredited initial response adjusters
 - Plans for claims management including the ability to determine affected policies-in-force
 - Resources available - buildings, cars, computers, etc.
 - Logistical details on how response activities will be coordinated
- c. Procedures for longer term earthquake catastrophe response:
 - Plans for a sufficient number of properly trained and accredited earthquake adjusters
 - Plans for the longer term management of CEA earthquake claims
 - Resources available – buildings, cars, computers, independent adjusters, etc.
 - Logistics - details on how response activities will be coordinated
- d. Procedures for how experts, including engineers, will be used, and details on pre-earthquake arrangements for these services.
- e. Procedures for handling first reports of CEA claims and other phone-related support programs, such as the availability of national catastrophe call centers, etc.

2-3. Claim Representatives Should Handle Claim to Conclusion

The Participating Insurer must make every effort to assure that the original claim representative assigned to a claim will handle the claim to conclusion. If reassignment of claims to another claim representative is necessary, the Participating Insurer must have procedures in place to facilitate a proper transfer of the files, including instructions in each file on what remains to be done to complete the handling on each claim.

California Insurance Code section 10082.3 addresses this issue where it reads, in part:

“Adjusters: If, within a six-month period, the company assigns a third or subsequent adjuster to be primarily responsible for a claim, the insurer, in a timely manner, shall provide the insured with a written status report. For purposes of this section, a written status report shall include a summary of any decisions or actions that are substantially related to the disposition of a claim, including, but not limited to, the amount of losses to structures or contents, the retention or consultation of design or construction professionals, the amount of coverage for losses to structures or contents and all items of dispute.”

3. POST-EARTHQUAKE RESPONSE

3-1. CEA Earthquake Response Manager

Following the occurrence of an earthquake from which a significant number of CEA claims is expected to be presented, the CEA Earthquake Response Manager most likely will travel to the general area of the earthquake and make efforts to be available to consult with the Participating Insurers' CEA Claims Liaisons.

3-2. Media Communications Following an Earthquake

After an earthquake, the CEA will endeavor to maintain communications with the Participating Insurers in order to provide the public with helpful, accurate, and timely information. Participating Insurer representatives are not authorized to communicate with the media on the CEA's behalf.

The CEA maintains specific guidelines on how the CEA name, logo, and trademarks can be used. All advertising that a Participating Insurer might do must be consistent with CEA directives that have been provided to each Participating Insurer. Copies of these directives are available from the CEA's Director of Communications.

3-3. Participating Insurer Claims Liaison

Participating Insurers' key on-site personnel should be determined by the insurer at the outset of the catastrophe, and a list containing their names should be forwarded via e-mail to the ERM within 24 hours of the earthquake.

The ERM will endeavor to meet with the Participating Insurer claims liaisons near the earthquake site on an as-needed basis. The meetings between the ERM and the Participating Insurer representatives can serve as a forum to resolve issues, such as:

- a. Updating the ERM with the progress each Participating Insurer has made in establishing its catastrophe office(s)
- b. Identifying and sharing information about specific problems encountered by the Participating Insurers
- c. Informing the Participating Insurer representatives of the current status of the CEA's coordination with governmental agencies
- d. Discussing general policy coverage issues
- e. Discussing particular structural elements being encountered on claims in the area

3-4. Catastrophe Offices

Although Participating Insurers must provide adequate staffing and operations, the establishment, number, and location of catastrophe response offices is left to the discretion of the Participating Insurers. Participating Insurers should provide the CEA with the address and telephone number of their catastrophe offices as they are established.

Participating Insurers must make it reasonably easy for new CEA claims to be reported by policyholders. This may include the use of agents and/or prominently publicized toll-free telephone numbers.

3-5. CEA Event Code

Immediately following an earthquake of a Richter magnitude of 5.0 or higher, or any event that results in significant claims against CEA policies, the CEA will assign an Event Code. Specific Event Codes have the form YYNNN, where YY is the last two digits of the year in which the earthquake event occurs and NNN numbers events sequentially in 10-unit increments. While the first two digits of the event code change with the new year, the next three digits are sequential over the years. For example, if the last Event Code issued in 2005 had been 05070, the first Event Code issued in 2006 would have been 06080.

The CEA will communicate the Event Code to all Participating Insurers as soon as possible following the earthquake event's initial seismic activity. All claim-related data transmissions to the CEA data repository must include the event code.

3-6. New Claims Reported to the CEA

Presentation of claims directly to the Participating Insurer will result in the most timely claims service, and most claims will be reported directly to the Participating Insurers. However, the CEA may receive calls in which the policyholder or another interested party wishes to report a claim under a CEA policy to the CEA, rather than to the Participating Insurer. Callers will be encouraged to report the claim directly to the appropriate Participating Insurer and will be given the toll-free claim reporting telephone number for the responsible Participating Insurer.

If the caller cannot or will not make the report of a claim to the responsible Participating Insurer, the CEA representative will complete a property loss notice form and fax it to the appropriate Participating Insurer's claims department. (See Attachment 7.)

3-7. Pro Rata or Installment Claims Payments

If an earthquake or series of earthquakes threatens to exhaust the CEA's claims-paying capacity, statute provides that the Insurance Commissioner may authorize the CEA to pay policyholder claims on a *pro rata* basis. Once an earthquake occurs, the CEA estimates probable losses based on in-force coverages and damage models. The CEA will then compare its preliminary overall loss reserve estimate of the earthquake to the claims-paying capacity of the CEA.

In case of a severe earthquake, or several significant earthquakes over a relatively short period of time, it is possible that the CEA could declare a Claims Payment Ratio (CPR) of less than 100%. If a CPR is declared, the CPR determines what percentage of the claim is to be paid to the insured by the Participating Insurer. Participating Insurers can assume the CPR is 100% unless the CEA announces otherwise.

The CPR may be adjusted during the handling of claims arising out of an earthquake based upon actual paid claim amounts and the resources available to the CEA for payment of claims. If the CPR is adjusted upward, paid claims will need to be recalculated and additional payments forwarded to the insured.

This discussion about the CPR does not change the way Participating Insurers are to adjust, report, or seek reimbursement from the CEA for claims payments. Claims reimbursement procedures are found in the CEA Participating Insurer Operating Procedures Manual.

4. BASIC EARTHQUAKE POLICY – HOMEOWNERS

These guidelines do not create coverage where none is provided by the policy of insurance in force at the time of the loss. Items in italics below are quoted directly from the policy. The CEA homeowners policy is used to insure residential dwelling structures, including mobilehomes.

The declarations page provides an overview of the dwelling policy, which is structured as follows:

- Coverage A: DWELLING and Coverage B: EXTENSIONS TO DWELLING have a combined single limit of coverage
- There is a separate limit for Coverage C: PERSONAL PROPERTY
- There is a separate limit for Coverage D: LOSS OF USE

The CEA Homeowners earthquake policy has a combined single limit for Coverage A: DWELLING and Coverage B: EXTENSIONS TO DWELLING that will match the amount of the Coverage A: limit in the companion fire policy. Adjusters may need to explain this to the insured since this is different than the way most fire policies are structured.

In addition to these limits, claims personnel need to be aware that the policy has various sublimits, including, but not limited to, sublimits for chimneys, emergency repairs, land stabilization, and certain types of personal property. (Look at Section 4-5 for further details on this topic) The policy has a table of contents, which makes it easy to read and follow.

Following is a brief summary of the coverages, exclusions, and limitations provided by the BASIC EARTHQUAKE POLICY – HOMEOWNERS.

The BASIC EARTHQUAKE POLICY – RENTERS, and BASIC EARTHQUAKE POLICY - COMMON INTEREST DEVELOPMENT have many of the same provisions; the areas in which they vary from the standard homeowner’s policy are discussed in sections 5 and 6.

All claim representatives must thoroughly read the specific policy in force at the time of the loss to determine the appropriate coverages, limits, and exclusions. Reviewing this Claim Manual is not a substitute for reading the policy.

4-1. Overview of Covered Losses

The CEA policy is a specified peril policy. It insures against only one peril, specifically: *...accidental, direct physical loss from an **earthquake** that commences during the policy period as part of a **seismic event** that commences during the policy period...*

*“**Seismic event**” means one or more **earthquakes** that occur within a 360-hour period. The **seismic event** commences upon the initial **earthquake**, and all **earthquakes** or aftershocks that occur within the 360 hours immediately following the initial **earthquake** are considered for purposes of this policy to be part of the same **seismic event**. (360 hours equals 15 days.) Read the complete policy definitions for “earthquake,” “seismic event,” and “tectonic processes.”*

In order for a claim to be covered, the earthquake and the seismic event (i.e., the first in time of any series of related earthquakes) both must have commenced during the CEA policy period.

4-2. Losses Excluded

As mentioned above, the CEA policy covers only the peril of an earthquake that occurs during the policy period as part of a seismic event that commences during the policy period. Losses caused by any peril other than an earthquake commencing during the policy period do not fall within the insuring agreement of the policy. The policy also contains a list of excluded perils—losses caused by these perils are excluded even if an earthquake contributes to the loss. The exclusions should be read carefully as there are exceptions. For example:

- Under Losses Excluded, number 2, water damage, the policy reads:

*This water damage exclusion, however, does not exclude loss that results from water damage to covered property as a result of an **earthquake**, which causes:*

- the release of water from water heaters, refrigerators, or water supply pipes within the **dwelling**;*
- the displacement of water from a swimming pool, decorative pool, spa, or hot tub; or*
- the release of water from municipal or other water supply lines on or off the **residence premises** or the release of water or sewage from sewers or drains on or off the **residence premises**.*

- Under Losses Excluded, number 5, non-earthquake earth movement is excluded, but there are exceptions: That exclusion reads in part:

We do not insure for any loss that is caused by... 5. Earth movement, settling of land, land sliding, subsidence, mudflows, or earth sinking, rising or shifting, unless the earth movement, settling of land, land sliding, subsidence, mudflow, or earth sinking, rising or shifting:

- is induced by, and would not have occurred in the absence of, an earthquake that commences during the policy period as part of a **seismic event** that commences during the policy period; and*
- causes loss that manifests within one year after the **earthquake** that caused the loss.*

The above are merely illustrative examples of excluded perils. There are several other excluded perils listed in the policy—carefully read the policy for the complete list.

4-3. Deductible

The CEA BASIC EARTHQUAKE POLICY – HOMEOWNERS provides for a deductible option of 10% or 15% of the Coverage A and Coverage B combined single limit of insurance. Check the declarations page to see which deductible percentage applies to the particular policy under which the claim is submitted.

For losses covered under Coverage A: DWELLING or Coverage B: EXTENSIONS TO DWELLING, there is a combined single limit of coverage and a combined deductible. For example, if the combined single limit for Coverages A and B is \$200,000 and the deductible percentage is 15%, the deductible is \$30,000.

Losses to personal property are not taken into account when calculating the deductible! Only covered loss to real property is counted against the deductible. No payment will be made for any personal property loss until the amount of covered loss to property that is covered under Coverage A: DWELLING or Coverage B: EXTENSIONS TO DWELLING exceeds the deductible shown on the declarations page. Regardless of the amount of loss to personal property, there will be no payment for any loss unless the loss to dwelling and extensions to dwelling exceeds the amount of the deductible.

Following are two homeowners policy examples:

Example 1: How to calculate proper payment after applying the deductible.

Coverages A and B combined single limit = \$200,000
Covered damage to dwelling and extensions (Coverages A and B property) = \$234,000
Deductible = 15% x \$200,000 = \$30,000

The following illustration shows that the deductible is applied first, and then covered claims are paid up to the combined single limit, leaving amounts in excess of \$230,000 as uninsured losses:

\$234,000 Total loss to covered items under Coverages A and B
- \$30,000 Less the deductible
\$204,000 Remaining loss to covered items
\$200,000 Coverage Limit and the amount that can be paid on this claim
\$ 4,000 Loss not paid since coverage limits already paid in full

Further, in the above example, the Coverages A and B deductible was exceeded so Coverage C can be paid up to the Coverage C limit without further deductible.

Example 2: Here is an example showing significant personal property damage, but no CEA payout since the Coverages A and B damage did not exceed the Coverages A and B deductible.

Coverages A and B combined single limit = \$200,000
Personal Property limit = \$75,000
Damage to dwelling and extensions (Coverages A and B property) = \$5,000
Damage to personal property = \$20,000
Deductible = 15% x \$200,000 = \$30,000

\$ 5,000 Loss to covered items under Coverages A and B property
\$30,000 Deductible on Coverages A and B

\$	0	Payment under Coverages A and B since loss did not exceed the deductible
\$20,000		Personal property loss
	<u>20,000</u>	<u>Personal property loss not covered since Coverages A and B deductible not met</u>
\$	0	Total amount paid on this claim for personal property

Read the deductible clause in the policy to determine what will be applied to meet the deductible. It reads in part:

2. *Only the following will be applied to meet the deductible:*

- a. *The reasonable and necessary **replacement cost** of the covered damage to property covered under “COVERAGES A: DWELLING,” and*
- b. *The reasonable and necessary **replacement cost** of the covered damage to property covered under “COVERAGES B: EXTENSIONS TO DWELLING,” but only up to the amount of the applicable **sublimit** for property for which there is a **sublimit** under “COVERAGES B: EXTENSIONS TO DWELLING,” and*
- c. *The reasonable and necessary cost of emergency measures covered under “OTHER COVERAGES,” item 1, that **you** actually take to protect property that is covered under “COVERAGES A: DWELLING” and “COVERAGES B: EXTENSIONS TO DWELLING” against further damage, but only up to the **sublimit** of 5% of the combined single **limit of insurance** for “COVERAGES A: DWELLING” and “COVERAGES B: EXTENSIONS TO DWELLING,” and*
- d. *The reasonable and necessary cost to replace, rebuild, stabilize or otherwise restore the land that is covered under “OTHER COVERAGES,” item 4, but only up to the **sublimit** of \$10,000.*

3. *The cost to repair or replace personal property, or any other cost not set forth in 2a. through 2d. above, will not be applied to meet the deductible.*

4. *The deductible will be applied one time for each **seismic event**.*

Important! There is no deductible for Coverage D: LOSS OF USE. Please note that even if the insured does not have a real property loss in excess of the policy deductible, the insured can still claim the Loss of Use coverage at a later date if forced to move out of the dwelling while covered earthquake-related repairs are being made to the property. (See section 4-23.)

See Section 4.6 for information on how chimneys are handled in the CEA Homeowner policy deductible calculations.

For another example of how to calculate a deductible, see Attachment 2.

4-4. Loss Settlement is at Replacement Cost

The BASIC EARTHQUAKE POLICY – HOMEOWNERS is a replacement cost policy both for real property and for most personal property.

The real property Loss Settlement condition of the policy (Condition 5) specifies that, once losses on building property exceed the deductible, settlement ...*will not exceed the smallest of the following:*

- (i) *the **replacement cost** at the time of loss;*
- (ii) *if the damaged property has been actually repaired or replaced, the amount actually and necessarily spent to repair or replace the damaged property; or*
- (iii) *the applicable **limit of insurance** or any applicable **sublimit(s)**.*

Personal property is also settled at replacement cost, except for certain limited categories of personal property that are settled at actual cash value. These categories are described in Condition 6 of the policy:

*We will settle losses to covered property described under Coverage C: PERSONAL PROPERTY ... at **replacement cost**, except that we will settle losses to property in items (i), (ii), and (iii) of this paragraph, below, at **actual cash value** only.*

- (i) *Property which by its inherent nature cannot be replaced;*
- (ii) *Property not maintained in good or workable condition; or*
- (iii) *Property that is outdated or obsolete, or property not useful for its intended purpose.*

Unlike many Participating Insurers' underlying policies, actual repair or replacement is not required to collect the replacement cost with regard to Coverage A Dwelling, Coverage B Extensions to Dwelling or Coverage C Personal Property (except for certain limited categories of personal property which are payable at actual cash value only). However, if the property has already been repaired or replaced at the time payment is made, that amount payable is limited to the amount spent. The exception to this rule is losses covered under "Other Coverages for Building Code Upgrades." This cost is paid only if the property is actually repaired and the cost is incurred. The CEA permits the pre-payment of code upgrades if it is clear, in the claim representative's professional judgment, that property is going to be repaired, the code upgrade cost is known (or it is known that code upgrade costs will exceed the Building Code Upgrades coverage limit), and making this payment would complete the claim process.

4-5. Types of Building Property Insured

Business and commercial buildings are never insured by the CEA policy.

Under COVERAGE A: DWELLING, the policy covers the residence premises, which can be a one, two, three, or four unit dwelling at the address shown in the declarations. "Dwelling" is specifically defined in the DEFINITIONS found in the policy. It provides:

*"**Dwelling**," means the residential structure or mobile home at the location described in the DECLARATIONS. **Dwelling** does not include land, whether or not beneath the residential structure or mobile home, even if required for support. **Dwelling** does not include any structure other than the residential structure or mobile home unless the structure (1) shares a common wall*

or a continuous roof line with the residential structure or mobile home or (2) is attached to the residential structure or mobile home by a foundation that is continuous with or contiguous to the foundation of the residential structure.

Under COVERAGE B: EXTENSIONS TO DWELLING, you will find a list of the non-dwelling other structures covered by the policy.

Besides the residence premises, some of the items covered under the Coverages A and B combined single limit are certain types of the following categories of property:

- On-premises equipment and utility service structures that affect the habitability of dwelling. (See section 4-7.)
- Walkways, driveways, decks, and patios are covered to the extent necessary to restore regular pedestrian ingress to and egress from the dwelling. (See section 4-8.)
- Bulkheads, piers, and retaining walls that are integral to the stability of the dwelling are covered. (See section 4-9.)

The “OTHER COVERAGES” section of the policy contains the following additional property building property coverages:

- Emergency repairs *up to a 5% sublimit* of the Coverages A and B combined single limit. (See section 4-24.)
- Debris removal up to 5% of the Coverages A and B combined single limit *as additional insurance*. (See section 4-25.)
- Building code upgrade coverage in the amount of \$10,000 or \$20,000 (depending on the coverage option selected by the policyholder) *as additional insurance*. (See section 4-26.)
- Land stabilization, necessary to support the dwelling is covered up to \$10,000 *as a sublimit of Coverage A*. (See section 4-27.)

4-6. Chimneys – Coverage A: \$5,000 Sublimit of Insurance

Chimneys are covered up to a \$5,000 sublimit regardless of the number of chimneys covered. For purposes of applying the sublimit: “**Chimney**” *means the flue or vent and the building code-required structure that surrounds the flue or vent, including exterior chimney facings, from the firebox to the outside of that structure. Chimney does not include a hearth, a mantel, or the firebox where combustion takes place.* The hearth, mantel and firebox are not subject to this \$5,000 sublimit and damage to them is covered under the dwelling limit. Also, please note that payment for the replacement of masonry chimneys is made at the cost of a non-masonry chimney.

The non-masonry provision is found in the homeowner policy condition 5(g), which reads: *To repair or replace a **chimney**, we will not pay more than the least of the following amounts:*

- the **sublimit** of \$5,000 that applies to chimneys;*
- the cost of replacement of a masonry **chimney** or **chimneys** with a non-masonry, earthquake-resistant **chimney** or **chimneys**; or*

(iii) *the necessary amount actually spent to repair the damaged **chimney** or **chimneys**.*

There are four things to remember when working with chimneys.

1. Follow the chimney definition and don't include the hearth, mantel, and firebox in the estimate of chimney damage.
2. The CEA policy has a \$5,000 chimney sublimit, no matter how many chimneys there are on the property.
3. The CEA will allow all the covered chimney damage in the deductible calculation (Special limits of insurance - Coverage A) but in no case can the claim payment be more than \$5,000 for all chimney damage.
4. Chimneys are covered at a non-masonry replacement cost. (See Policy Conditions 5-g i, ii, iii.) Scope and estimate all chimney damage at its non-masonry replacement cost.

See Attachment 2 for an example in which \$14,000 of chimney damage is included in the deductible calculation, but only \$5,000 is paid for chimney loss in the final claim payment.

4-7. Equipment and Utility Service Structures - Coverage B:

The policy covers equipment and utility service structures for electric, telephone, natural or bottled gas, heating, oil, water, septic, and sanitary sewage systems. To be covered, these items must be owned by the insured, must be on the residence premises, and must affect the habitability of the dwelling.

Exterior water supply systems, including irrigation systems, sprinkler systems, and water reclamation systems are excluded. (See section 4-12.)

In order to determine whether any such item is covered, the claim representative must determine the answer to the following three questions:

1. Does the insured own the item?
2. Is the item physically located on the insured's premises?
3. Does the item affect the habitability of the dwelling?

There is coverage under a CEA homeowners policy only when the answer to all three questions is "yes."

4-8. Walkways, Driveways, Decks, Patio Slabs - Coverage B:

The policy reads in part as follows: ... *we cover...* 2. *That portion of any walkway, driveway, deck, or patio that is necessary for regular pedestrian ingress to or egress from the **dwelling** and for the regular ingress to and egress from the **dwelling** by any non-ambulatory **insured**.* The scope of this coverage is to establish safe pedestrian passage to and from the dwelling for the insureds. The scope is best appreciated by breaking down the coverage language as follows:

- *That portion* – This language obviously states that only the relevant *portion* of the property is covered. Use the local city or county building codes, where the codes speak to this issue, to determine what “that portion” necessary for safe ingress and egress is.
- *Any* should be interpreted to mean *all* such items that are used for regular pedestrian ingress or egress.
- *Pedestrian* - Means that ingress and egress necessary for vehicles is not covered. (An exception could be made for a non-ambulatory insured.)
- *To or from the dwelling* - This means that the policy covers regular pedestrian ingress and egress from the home to a public sidewalk or to the private or public street next to the home.

Questions about what portion of the walkway, driveway or patio should be repaired or replaced must be addressed on an individual basis according to the facts of the loss and the coverage available. The claim file should have a detailed drawing of what ingress and egress was allowed, and the file should contain documentation as to how and why the dimensions and amounts paid were arrived at. This coverage is for replacement cost with materials of like kind and quality and for the same use. (See the definition of “replacement cost” in the policy.)

4-9. Bulkheads, Piers, and Retaining Walls - Coverage B:

The policy covers *those bulkheads, piers, and retaining walls on the residence premises that are integral to the stability of the dwelling*. Except as provided for in “OTHER COVERAGES,” item 4, the cost of repairing, replacing or stabilizing the land under or around these devices is not covered.

The policy applies only to property located on the residence premises and in which the named insured holds an insurable interest. Therefore, to the extent that bulkheads, piers, and retaining walls are not entirely located on the residence premises, the insurable interest must be fully investigated and coverage based on the extent of the policyholder’s insurable interest.

4-10. Property Not Covered: Coverage A: and Coverage B:

The CEA BASIC EARTHQUAKE POLICY – HOMEOWNERS does not cover certain items of real property. For example, the following are not covered:

- Detached garages, outbuildings, pools, spas, fences, and other structures not set forth in Coverage B: EXTENSIONS TO DWELLING.
- Exterior water supply systems including, but not limited to, irrigation systems, sprinkler systems, and water reclamation systems.
- Underground structures or equipment located outside the foundation wall of the structure (except equipment and utility services which affect habitability of the dwelling).
- Land, other than that portion of land stabilization expenses covered under OTHER COVERAGES, item 4. (See section 4-27.)

These are only a few examples. It is important to read the policy for a complete list of property that is not covered.

4-11. Property Not Covered: Exterior Masonry Veneer

The CEA policy does not cover: *Exterior masonry veneer. For purposes of this exclusion, stucco and exterior chimney facings are not exterior masonry veneers.*

The terms “masonry” and “veneer” are common terms, and definitions for them can be found in the dictionary. The common understanding in a construction context is that the term “veneer” refers to a *nonstructural* facing of brick, concrete, stone, tile, or other similar material attached to a backing for the purpose of ornamentation.

The question sometimes arises about what can be allowed (paid for) under the CEA policy coverage if the masonry veneer falls off a home. The answer is nothing can be paid for any such loss. Masonry veneer is not covered and there is no policy provision or requirement to pay for replacing it with something else.

Also, take note that the brick on a home may not be masonry veneer. If the structure is a masonry structure, then any part of that masonry structure that is not veneer may be covered under the CEA policy.

4-12. Property Not Covered: Exterior and Underground Systems and Structures

Except as provided under Coverage B - EXTENSIONS TO DWELLING, the policy does not cover exterior water supply systems including, but not limited to irrigation systems, sprinkler systems, and water reclamation systems; underground structures or equipment located outside the perimeter of the dwelling foundation, including but not limited to underground pipes, cables, flues, drains, electrical supply systems and electrical lighting systems. (This is found in the policy, under Property Not Covered, Coverage A and Coverage B, Item 10.)

4-13. Property Not Covered: Antennas and Satellite Dishes

The policy does not cover antennas, satellite dishes and any towers, brackets, or attachments that support or secure them.

4-14. Property Not Covered: Decorative or Artistic Features of the Dwelling

The policy does not cover: *Any decorative or artistic features of the property, including but not limited to works of art; items such as murals; stained or leaded glass; mirrors; chandeliers; mosaics; statuary or sculpture; carvings, inlays, and reliefs or bas reliefs; and fountains, aquariums, and their systems. If at the time of loss a decorative or artistic feature is serving a utilitarian purpose, the cost to repair or replace the decorative or artistic feature is not covered to the extent the cost of repair or replacement exceeds the cost of replacing it with a non-decorative, non-artistic functional replacement.*

Please note that the list of items contained in the exclusion is not exhaustive; any component of the dwelling that is “decorative or artistic” in nature may be excluded. If an adjuster is unsure, the adjuster should ask his or her company’s CEA Liaison, who can consult with the CEA if necessary.

The claim representative should identify the decorative or artistic features of the home during the initial assessment of the scope of the damage and discuss any excluded items with the insured. The claim representative should also discuss any items with a utilitarian purpose (e.g., chandelier verses a non-decorative light fixture) and what the reasonable non-decorative, functional replacement should be.

The following lists the common meaning of the words used in this section of the policy. For purposes of illustration, these definitions were taken from a standard dictionary.

Murals – a painting that is applied to a wall, ceiling, or floor surface

Stained glass – glass that has been colored in some way

Leaded glass – pieces of glass held together by lead, can be clear, stained, or etched glass

Mirrors – a polished or smooth surface (as of glass) that forms images by reflection

Chandeliers – light fixture, hangs from the ceiling, branched, often ornate

Mosaics – design made of small pieces of colored stone or glass

Statuary – statues collectively

Statue – a sculpture representing a human or animal

Sculpture – a three-dimensional work of art

Carvings – an object created by carving (as wood or ivory or stone)

Inlays – decorate the surface by inserting wood, stone, or metal

Reliefs and bas reliefs – Decorative features in which figures or designs are raised above (or indented into) the surrounding flat surface

Fountains - a structure from which an artificially produced jet of water arises

Aquariums - tank with water for keeping fish and underwater animals, or a tank for reptiles

If at the time of loss a decorative or artistic feature is serving a utilitarian purpose, (e.g., a chandelier, etc.) the item can be considered in the repair estimate at the cost of repair or replacement with a non-decorative, non-artistic functional replacement consistent with the quality of materials generally found in the home. For example, in the case of the chandelier, the adjuster should allow for a replacement light fixture of equivalent quality of other light fixtures in the home, but should not pay for the replacement of the damaged chandelier.

4-15. Property Not Covered: Awnings and Patio Coverings

The policy does not cover *awnings and patio coverings, or their support structures*. All structures comprising the patio covering, including posts supporting the covering, are excluded. Awnings and patio coverings are not covered even if permanently attached to the dwelling.

Depending on the construction, a porch or patio can become part of the dwelling if it (1) *shares a common wall or a continuous roof line with the residential structure or mobile home or (2) is attached to the residential structure or mobile home by a foundation that is continuous with or contiguous to the foundation of the residential structure.*

A patio slab is not part of a covered loss, except for any portion of it that is necessary for ingress or egress as described in the policy. (See section 4-8.)

4-16. Property Not Covered: Landscaping

Damage to *Landscaping, trees, shrubs, lawns, or plants, even if damaged by necessary repairs to covered property*, are not covered. If it is necessary to remove a landscape element in order to access the structure for repairs, an allowance for removal may be considered, but policy coverage does not allow for replacement of the landscaping element.

4-17. Property Not Covered: Swimming Pools, Spas, and Hot Tubs

The policy does not cover swimming pools, spas, or hot tubs, whether they are personal property or part of the dwelling. Tile or other material linking or attaching the pool, spa, or hot tub to a deck or to the dwelling is not covered. The policy reads as follows:

Property Not Covered—Coverage A and Coverage B

We do not cover:

*Swimming pools, spas, and hot tubs, whether part of the **dwelling** or not, including the tile or other material linking or attaching the pool, spa or hot tub to a deck or to the **dwelling**.*

4-18. Garages and Outbuildings

Detached garages and outbuildings are not covered. However, the definition of “dwelling” includes structures that share a common wall or continuous roof line with the residential structure or mobilehome or are attached by a foundation that is continuous or contiguous to the foundation of the dwelling. If a garage or outbuilding meets this definition then it would be covered under the structure policy limit.

4-19. Plaster - Limited to the Cost of Sheetrock or Drywall

The policy does not cover plaster, to the extent that the cost to repair or replace it exceeds the value of its replacement with Sheetrock or drywall. The claim representative should consider whether minor repairs with plaster may be less costly and more beneficial to the insured than repair or replacement with Sheetrock or drywall.

4-20. Dwelling Glass - Loss Settlement

Decorative or artistic glass features of a dwelling are excluded. (See section 4-14.) Other glass that is part of a dwelling, such as ordinary window glass, is covered. In addition, the policy allows for replacement of covered glass with safety glazing material when required by ordinance or law. (See Policy Conditions 5, Loss Settlement: Coverages A and B, f.)

The companion homeowner’s policy may have earthquake coverage for glass used in the dwelling. If there is double coverage, see the provisions in the policy regarding Other Insurance.

4-21. Coverage C - Personal Property Covered

After the dwelling deductible is met by damage to covered real property, personal property is covered without further deductible, subject to the total limit of insurance set forth in the Declarations page for Coverage C.

The policy provides a minimum limit of \$5,000 for personal property coverage, and additional coverage up to \$100,000 can be purchased. See the Declarations page for the policyholder's limits.

4-22. Coverage C - Personal Property Not Covered or Subject to a Sublimit

Certain types of personal property are not covered. Other categories of personal property are covered, but only up to a sublimit. Read the policy for a complete list of not covered and sublimited personal property. Here are some examples:

- Glassware, (including crystal) china, and porcelain are not covered. (Structural glass found in windows and doors is covered under Coverage A.) Food products packaged in glass are not considered glassware and may be covered. For example, bottles of wine, and the replacement cost of the product at today's prices (including the glass container) can be considered as covered personal property.
- The policy does not cover: *artwork, including but not limited to paintings, drawings, framing, sculpture, photographs, handmade tapestries and rugs, pottery, and ceramics.* For purposes of this coverage, clay and stoneware dishes are not pottery and are covered.
- Motor vehicles, watercraft, and trailers are not covered.
- Business property: Coverage C has a sublimit of \$300 on business property. There is a separate sublimit of \$1,000 on computers and other electronic data processing equipment, whether or not it is business property. Therefore, a computer used for business is not limited by the \$300 business property sublimit.
- Personal Property owned by others: Property owned by roomers, boarders, or renters not related to an insured is not covered. For property owned by all other persons other than an insured, there is a sublimit of \$2,500 on covered personal property, regardless of the Coverage C limit of insurance.

4-23. Coverage D: Loss of Use

Coverage D: Loss of Use coverage can be purchased up to a maximum of \$15,000. The policy includes a minimum of \$1,500 Loss of Use coverage. If a covered loss makes the dwelling unfit to live in, and the insured vacates the dwelling, the necessary increase in living expenses actually incurred is covered.

If any part of the dwelling was rented to others or held for rental, and a covered loss makes it unfit to live in, the fair rental value (less any expenses that do not continue) is covered.

If a civil authority prohibits the insured from occupying the dwelling because of direct damage to neighboring premises caused by an earthquake we cover the resulting Additional Living Expense or Loss of Rent, subject to the limit of insurance. Neighboring premises includes roads and

bridges. Even if an insured has no damage to their home, if they are kept away by civil authorities, adjusters should quickly evaluate if they qualify for this coverage.

This coverage is not subject to any deductible. There is coverage for policyholders whose dwellings are temporarily unfit to live in while they repair damage to the dwelling caused by a covered earthquake, even if their property losses are under the deductible.

There is no maximum period of time after the occurrence of an earthquake for covered Loss of Use expenses to be incurred. Loss of Use coverage applies even if the insured is not required to vacate the insured premises until months after the earthquake (such as, for example, when repairs to the property cannot be started until a substantial period of time after the earthquake due to a shortage of contractors available to perform the work).

If there is a question of coverage, use Attachment 5 with any advance payment.

4-24. Other Coverages: Emergency Repairs

The cost of necessary and reasonable emergency measures taken to protect against further earthquake damage is covered up to a sublimit of 5% of the limit of insurance for the type of property being protected. Amounts paid for emergency measures reduce the available limit of insurance for the category of property being protected. This is not additional coverage. No coverage is provided until and unless losses covered under Coverages A or B have exceeded the policy deductible.

This sublimit applies to emergency measures that are temporary only. Permanent repairs done on an emergency basis are to be treated as all other permanent repairs. The insured has a duty to perform emergency repairs, and the claim representative should provide full disclosure to the policyholder of the applicable policy coverage, limits, deductible, and possible claim payment ratio, any of which might limit the payment under their coverage.

4-25. Other Coverages: Debris Removal

The policy reads in part: *We will pay the reasonable expense you incur in removing from the residence premises the debris of covered property that is damaged by an earthquake This coverage provides up to 5% of the combined single limit of insurance for “COVERAGE A: DWELLING” and “COVERAGE B: EXTENSIONS TO DWELLING” as additional insurance.* No coverage is provided until and unless losses covered under Coverages A or B have exceeded the policy deductible.

4-26. Other Coverages: Building Code Upgrade

Building code upgrade coverage in the amount of \$10,000 or \$20,000 is provided as additional insurance. Some things to remember about this coverage are:

- The covered property must actually be repaired before payment may be made for Building Code Upgrade coverage. (See section 4-4 for further guidance on when payment can be made.)
- This coverage is additional insurance to the Coverages A and B combined single limit.
- This coverage is to bring the covered property up to local residential building code standards that were in effect *on the date of the earthquake* that caused the loss.
- The coverage pays only for the Building Code Upgrade costs necessary to secure a reconstruction permit for repair of the *covered* property.

Note: The base-limits CEA homeowner policy includes \$10,000 of Building Code Upgrade coverage as additional insurance. This applies to all dwellings, including mobilehomes.

For dwellings other than mobilehomes, the policyholder can increase this limit by endorsement from a \$10,000 limit to a \$20,000 limit of additional insurance.

4-27. Other Coverages: Land Stabilization

The policy covers up to \$10,000 for the cost to replace, rebuild, stabilize, or otherwise restore land owned by the insured necessary to support the dwelling, if the need for stabilization is caused directly by a covered earthquake and is necessary for the habitability of the dwelling. This coverage is provided as a \$10,000 sublimit of the Coverages A and B combined single limit. Other than this, there is no coverage for land. Note: Land is excluded in the definition of “Dwelling.” The cost of engineering work done to determine the need for land stabilization is included in this \$10,000 limit.

Minor movement of land (not land stabilization) to accommodate a foundation repair covered under the policy is properly placed under Coverage A, and is not subject to the land stabilization sublimit of \$10,000.

4-28. Losses Excluded

The CEA policy covers only one peril, earthquake. The LOSSES EXCLUDED section of the policy provides as follows: *We do not insure for any loss that is not directly caused by an **earthquake** that commences during the policy period as part of a **seismic event** that commences during the policy period. Without limiting the above, even if a loss directly or indirectly is caused by, is contributed to by, results from, or is aggravated by an **earthquake**, we do not insure for any loss that is caused directly or indirectly by, or that in any way results from, is contributed to by, or is aggravated by, any of the following:* The policy then lists a number of specifically-excluded perils. The most significant of these are discussed below, but claim representatives must read the policy and familiarize themselves with the complete list.

4-29. Losses Excluded: Fire and Explosion

The policy does not cover losses resulting from fire or explosion. This includes fires resulting from such things as broken gas lines, exposed wiring, or other factors directly resulting from an earthquake. Any losses resulting from fire must be adjusted under the policyholder’s fire insurance policy, not under the CEA policy.

In situations where part of the home is damaged by a covered earthquake and part of the home is damaged by a fire, the claim representative working on each claim will need to properly allocate the damage to either the fire or earthquake policy.

NOTE: The CEA must be immediately notified, by e-mail to the Earthquake Response Manager, about any CEA claim opened up on a fire-damaged home where the CEA claim has a claim reserve of greater than zero (or whichever other minimum reserve amount that Participating Insurer uses to open up a CEA claim). The CEA intends to inspect these claims to make sure the damages are appropriately allocated.

4-30. Losses Excluded: Asbestos and Other Pollutants

The policy contains a detailed pollution and pollutants exclusion that applies to groundwater, land, and personal property.

Because this exclusion applies to personal property, the policy will not cover asbestos removal, including the cost of testing, when the expense is necessary to repair or replace damaged items under Coverage C. Damage to any personal property, including furniture, furnishings, and clothing that are contaminated by asbestos is not covered.

The policy would, however, cover asbestos removal (including the cost of testing) or other earthquake-caused pollution damage to the dwelling when the expense is necessary to repair or replace damaged items or real property covered under Coverages A or B. Where the claim representative suspects that asbestos may be present, an expert should be consulted.

4-31. Losses Excluded: Non-Earthquake Earth Movement and Land Sliding

The policy does not cover any loss caused directly or indirectly by non-earthquake earth movement: *Earth movement, settling of land, land sliding, subsidence, mudflows, or earth sinking, rising or shifting . . .* There is an exception to this exclusion, however—the policy *does* cover the loss if such earth movement, settling of land, land sliding, subsidence, mudflow, or earth sinking, rising, or shifting satisfies both of the following requirements:

- a. *is induced by, and would not have occurred in the absence of, an **earthquake** that commences during the policy period as part of a **seismic event** that commences during the policy period; and*
- b. *causes loss that manifests within one year after the **earthquake** that caused the loss.*

For example, if an earthquake causes a landslide to occur six months after the earthquake, the damage caused to the dwelling may be covered. However, if the landslide occurs or the loss manifests anytime after the first anniversary of the earthquake, the damage is not covered under the CEA policy.

4-32. Losses Excluded: Theft or Vandalism

Theft, vandalism, or other human conduct causing loss following an earthquake is excluded. The policy provides that it does not cover any loss that is caused directly or indirectly by . . . *Theft, vandalism or other human conduct causing loss following an **earthquake**.*

5. BASIC EARTHQUAKE POLICY - COMMON INTEREST DEVELOPMENT

In California, a “common interest development” can be a community apartment project, a condominium project, a planned development, or a stock cooperative, all as further defined in California Civil Code section 1351. Since the term “common interest development” is most typically applied to condominiums, for ease of reference the term “condominium” will be used throughout the remainder of this manual.

Following is a brief summary of the coverages, exclusions, and limitations provided by the condominium policy. This policy has many of the same provisions found in the BASIC EARTHQUAKE POLICY – HOMEOWNERS. The purpose of the following is to point out some of the unique features of the condominium policy.

Read the specific policy in force at the time of the claim to determine the appropriate coverages, limits, and exclusions. This summary is not a substitute for reading the policy. You will also need to review the association master policy and the association governing documents in order to adjust a condominium loss.

5-1. Policy Definitions

The vast majority of the key definitions found in the BASIC EARTHQUAKE POLICY – HOMEOWNERS are also found in the BASIC EARTHQUAKE POLICY – COMMON INTEREST DEVELOPMENT. There are, however, some additional definitions that are unique to this policy. Read the definitions for the following terms, none of which is contained in the other policies: “association governing documents,” “association master policy,” “association of owners,” “common interest development,” and “dwelling unit.”

5-2. Adjusting Condominium Claims – Coordination

The greater the number of units in a complex, the greater the need for coordination. Participating Insurers should identify the number of policies they have issued within a given condominium complex. To the extent possible, claims assignments should be given to the same claim representative and supervised by the same individual.

5-3. Other Earthquake Coverage

If a loss to property that would otherwise be covered under Coverage A: BUILDING PROPERTY is covered under an association master policy, refer to the “other insurance” clause in the CEA policy:

Other Insurance.

- a. *If you have other insurance, not including the **association master policy**, that covers **earthquake** loss to the **dwelling unit** or other property covered under this policy, we will pay **our** share of the covered loss or damage. **Our** share is the proportion that the applicable **limit of insurance** under this policy bears to the combined **limits of insurance** of all policies that cover the same property.*

b. *If there is other insurance that covers the same loss or damage, other than as described in 8.a above, we will pay only for the amount of covered loss or damage in excess of the amount due from that other insurance, but we will not pay more than the applicable **limit of insurance**.*

5-4. Duties after a Loss

While the insured's duties after a loss are basically the same as the BASIC EARTHQUAKE POLICY - HOMEOWNERS, the following is unique to the condominium policy:

*If requested, provide the **participating insurer** with copies of all **association governing documents**.*

5-5. Overview of the Declarations Page and Coverage Options

In contrast to the BASIC EARTHQUAKE POLICY – HOMEOWNERS, the BASIC EARTHQUAKE POLICY - COMMON INTEREST DEVELOPMENT provides for three coverage groups that can be purchased together in any combination or separately. They are:

Coverage A: BUILDING PROPERTY

Coverage C: PERSONAL PROPERTY together with Coverage D: LOSS OF USE

Coverage E: LOSS ASSESSMENT

Coverage A: BUILDING PROPERTY can be purchased alone or in combination with other coverages. If Coverage A is selected, the limit is always \$25,000. Building code upgrade coverage of \$10,000 additional insurance comes with Coverage A.

Coverage C: PERSONAL PROPERTY is sold together with Coverage D: LOSS OF USE. The base-limits policy carries \$5,000 in Coverage C and \$1,500 in Coverage D. The insured may select higher limits ranging between \$5,000 and \$100,000 for Coverage C and between \$1,500 and \$15,000 for Coverage D. Coverage C and Coverage D can be purchased in combination with other coverages, or as the only coverages under the policy.

Coverage E: LOSS ASSESSMENT can be purchased alone or in combination with other coverages. Depending on the value of the condominium, the limit will be either \$25,000, \$50,000 or \$75,000.

The fact that these coverages can be purchased separately and with different coverage limits of insurance, each coverage with its own deductible requirements, requires the claim representative to be vigilant in confirming coverage, limits, and deductible amounts. Always check the declarations page for the coverage, limits, and deductible.

5-6. Losses Excluded

Losses excluded are identical to the BASIC EARTHQUAKE POLICY - HOMEOWNERS policy.

5-7. Deductibles

One difference between the condominium policy and the homeowners policy is how deductibles are handled. Unlike the homeowners policy, in the condominium policy each coverage has its own separate deductible, and only loss to property covered under that coverage counts against the deductible. In the condominium policy, there is:

- A separate deductible for Coverage A: BUILDING PROPERTY. The deductible is always \$3,750 (15% of the Coverage A limit). Only losses subject to coverage under Coverage A can be used to meet the Coverage A deductible.
- A separate deductible for Coverage C: PERSONAL PROPERTY. The deductible is always \$750, regardless of the Coverage C limit of insurance. Only losses subject to coverage under Coverage C can be used to meet the Coverage C deductible.
- No deductible for Coverage D: LOSS OF USE.
- A separate deductible for Coverage E: LOSS ASSESSMENT. The deductible is 15% of the Coverage E limit (i.e., \$3,750 for \$25,000 limit policies, \$7,500 for \$50,000 limit, and \$11,250 for the \$75,000 limit policies). Only losses subject to coverage under Coverage E can be used to meet the Coverage E deductible.

Since Coverages A, C, and E can be purchased independently and each has its own separate deductible, it is best to refer to the Declarations page to determine the correct deductible to apply.

5-8. Building Property - Coverage A

Coverage A is optional in the BASIC EARTHQUAKE POLICY – COMMON INTEREST DEVELOPMENT, so it is important to carefully review the Declarations page to determine whether the policyholder purchased Coverage A. A single-family residence usually has one owner and stands separate from other structures. In contrast, a condominium project is a collection of separate dwelling units together with property owned jointly by many owners. Property owned jointly may include the structure in which the individual units are located, common walkways, pools, and other common property. Often, the association of owners has obtained a policy of insurance, referred to as an “association master policy” in the CEA policy, which may insure against the perils of fire, earthquake, or both.

The first step to be taken in order to determine whether the property is covered under Coverage A: BUILDING PROPERTY is to review:

- The association governing documents, to determine whether the insured has the obligation to repair or maintain the property, and
- The association master policy to determine whether the property is covered for the risk of earthquake under the association master policy.

There are two basic categories of property covered under Coverage A: BUILDING PROPERTY. The first category is covered regardless of what the policyholder’s individual maintenance obligations are under the association governing documents. That category consists of the following property:

We cover:

1. The following property:
 - a. Built-in appliances, fixtures, alterations, and improvements that are part of the structure in which the **dwelling unit** is located and are contained within the **dwelling unit**;
 - b. Wall-to-wall interior carpeting attached to the **dwelling unit**;
 - c. Items of real property, other than **chimneys**, that pertain exclusively to the **dwelling unit**;
 - d. **Chimneys** that are attached to or part of the **dwelling unit**, up to a **sublimit** of \$5,000, regardless of the number of **chimneys** covered.

In addition to the above items, the policy covers the following second category of property, which is only covered if the insured has an obligation to maintain the property under the association governing documents. Therefore, the claim representative will need to review those governing documents to determine whether any of the following property is covered:

2. The following property, but only to the extent that **you** are obligated to repair or maintain the property under the terms of the **association governing documents**:
 - a. Plumbing pipes and utility service structures and equipment that are enclosed within the walls, ceiling, or floor of the **dwelling unit**, extending to the exterior surface of the perimeter walls of the **dwelling unit**;
 - b. Equipment and utility service structures for electric, telephone, natural or bottled gas, heating, oil, water, septic, and sanitary sewage systems that (1) are located outside of the perimeter walls of the **dwelling unit** but within the **common interest development** and (2) directly affect the habitability of the **dwelling unit**.

5-9. Emergency Repairs – Coverage A

Emergency repairs to protect Coverage A: BUILDING PROPERTY will only be paid if damage exceeds the Coverage A deductible. The emergency repairs coverage provides coverage up to a sublimit of 5% of the policy limit for Coverage A: BUILDING PROPERTY.

5-10. Debris Removal – Coverage A

The policy provides for debris removal of building property as follows:

***Debris Removal.** We will pay the reasonable expense you incur in removing from the **common interest development** the debris of property covered under “COVERAGE A: BUILDING PROPERTY” that is damaged by an **earthquake** that commences during the policy period as part of a **seismic event** that commences during the policy period. This coverage provides up to 5% of the **limit of insurance** for “COVERAGE A: BUILDING PROPERTY” as additional insurance.*

Debris removal is part of Coverage A and will only be paid if all Coverage A loss exceeds the deductible.

5-11. Loss Settlement – Coverage A

Loss settlement under Coverage A: BUILDING PROPERTY is basically the same as loss settlement under Coverages A and B of the BASIC EARTHQUAKE POLICY - HOMEOWNERS.

However, considering the nature of common ownership versus individual ownership of property found in common interest developments, it is particularly important to remember to determine whether the insured has an insurable interest and a responsibility to insure the property. Also, determine whether the CEA policyholder's loss may be covered or collectible under an association master policy in which case you should refer to the "Other Insurance" provision of the policy.

5-12. Personal Property – Coverage C

The adjusting is the same under the homeowners, the renters, and condominium policy, except for the application of the deductible. Coverage C is an optional coverage in the BASIC EARTHQUAKE POLICY – COMMON INTEREST DEVELOPMENT, so it is important to carefully review the Declarations page to determine whether the policyholder has purchased Coverage C, and if so, in what coverage amount.

The deductible under Coverage C of the BASIC EARTHQUAKE POLICY – COMMON INTEREST DEVELOPMENT is \$750. This is 15% of the \$5,000 base limits offered for Coverage C. The deductible amount of \$750 remains the same even if the policyholder purchases higher Coverage C limits.

Under the BASIC EARTHQUAKE POLICY – COMMON INTEREST DEVELOPMENT, a claim can be paid as soon as the loss to personal property exceeds the \$750 Coverage C: PERSONAL PROPERTY deductible. This is different from the structure of the BASIC EARTHQUAKE POLICY – HOMEOWNERS, where regardless of the amount of loss to personal property, there is no payment for any loss to personal property until after the loss to dwelling and extensions to dwelling exceeds the amount of the dwelling deductible.

5-13. Emergency Repairs – Coverage C

The cost of emergency measures undertaken to protect damaged personal property from further damage is part of the Coverage C limit and will only be paid if damage to personal property exceeds the Coverage C deductible. The coverage reads, in part, as follows:

*This Emergency Repairs coverage provides coverage up to a sublimit of the lesser of (i) 5% of the policy **limit of insurance** for "COVERAGE C: PERSONAL PROPERTY" or (ii) \$1,000. The applicable total **limit of insurance** for the "COVERAGE C: PERSONAL PROPERTY" will be reduced by any amount **we** pay for this coverage.*

5-14. Debris Removal – Coverage C

Coverage C of the policy provides for removal of the debris of damaged personal property as follows:

Debris Removal. We will pay the reasonable expense you incur in removing from the common interest development the debris of property covered under “COVERAGE C: PERSONAL PROPERTY” that is damaged by an earthquake that commences during the policy period as part of a seismic event that commences during the policy period. This coverage provides, as additional insurance, up to the lesser of (i) 5% of the limit of insurance for “COVERAGE C: PERSONAL PROPERTY” or (ii) \$1,000.

If the Coverage C limit has been exhausted, there is still additional coverage for debris removal (up to the lesser of 5% of the Coverage C limit or \$1,000).

5-15. Loss of Use – Coverage D

Coverage D: Loss of Use is an optional coverage in the BASIC EARTHQUAKE POLICY – COMMON INTEREST DEVELOPMENT, so it is important to carefully review the Declarations page to determine whether the policyholder has purchased Coverage D, and if so, in what coverage amount. If the policyholder purchased Coverage D, the calculation for Loss of Use or Loss of Rents is functionally the same as under the homeowners policy.

In order to collect Loss of Use or Loss of Rents, under the BASIC EARTHQUAKE POLICY - HOMEOWNERS, the dwelling must be unfit to live in. Under the condominium policy, even if the dwelling unit is undamaged or not unfit to live in at the time of the earthquake, but the insured is forced to vacate because of repairs to other units, Loss of Use or Loss of Rents may be paid. Check the specific policy provision for the exact terms and conditions for Loss of Use coverage.

5-16. Loss Assessment - Coverage E

A loss assessment is a demand by an association of owners, telling the dwelling unit owner that he or she has to pay for damage to common property. That loss assessment is covered, but only to the extent that the assessment relates to the repair or replacement of damaged association property that is the kind of property that is covered under Coverage E. For example, swimming pools are listed as “Losses Not Covered” under Coverage E, so if the association assesses a CEA policyholder for a share of the damaged pool, the CEA policy cannot pay for any part of loss assessment attributable to the repair of the damaged pool.

Coverage E: LOSS ASSESSMENT is an optional coverage in the BASIC EARTHQUAKE POLICY – COMMON INTEREST DEVELOPMENT, so it is important to carefully review the Declarations page to determine whether the policyholder has purchased Coverage E, and if so, in what coverage amount.

If the policyholder purchased Coverage E, the policy covers the insured’s share of an assessment charged by the association against all property owners in the common interest development, if all of the following three requirements are satisfied:

- a. *Requirement One: You have a legal obligation to pay the amounts assessed against you by the **association of owners**, and the assessment is properly and legally made as a result of a loss that is directly caused by an **earthquake** that commences during the policy period as part of a **seismic event** that commences during the policy period;*
- b. *Requirement Two: The assessment is not made as a result of a loss specified in “Losses Not Covered—Coverage E”; and*
- c. *Requirement Three: The assessment is made as a result of a loss that is to property owned by one or any combination of the following three categories: (i) all members of the **association of owners collectively**, (ii) the **association of owners**, or (iii) **you**.*

An assessment against the insured must be fully investigated, since there may be portions that are not covered.

The claim representative must obtain sufficient documentation and records to understand the basis for the assessment. For example, suppose there is no association master policy that covers earthquake damage, and suppose each owner is assessed \$10,000 to fix the roof of the complex. Assuming the deductible has been met, this could be a covered loss. However, assume the loss assessment for \$10,000 was to repair landscaping. This would not be covered. To determine the covered portion of the claim, the claim representative should reduce the loss assessment sought by the association of owners by that portion of the loss assessment attributable to any of the 17 categories of property not covered as set forth in Coverage E: LOSS ASSESSMENT or to causes excluded in any of the policy exclusions.

Also, there is a sublimit of \$10,000 for that portion of any assessment relating to building code upgrades. Unlike the case with Coverage A losses for building code upgrades, this is not additional insurance, but rather, is a sublimit of the Coverage E limit of insurance.

Check the declarations page for the applicable deductible for Coverage E: Loss Assessment.

5-17. Reduction of Value - Property not Repaired or Replaced - Coverage E

In rare situations, the association of owners may elect not to repair or replace damaged property, or it may be permanently prevented from repairing or replacing the property. The resulting reduction in the fair market value of the insured’s ownership interest is covered if both of the following requirements are satisfied.

- i. *As a result of the unrepaired damage, the **dwelling unit** either is unfit to live in or cannot legally be occupied; and*
- ii. *The reduction in the value of **your** ownership interest in the **dwelling unit** is not the result of a loss to property specified in “Losses Not Covered—Coverage E.”*

The method of calculation of the proper amount a claim presented under this unique form of coverage is specified in detail in the policy language. It is essential that the policy language be carefully reviewed if such a claim is presented.

5-18. Compliance with Ordinance and Law – Coverage A and Coverage E

The policy provides that losses relating to the following are not covered:

7. *Required compliance with any ordinance, law, or residential building code that regulates the use, construction, repair, or demolition of a building or other structure, except as specifically provided under this policy, under the following provisions:*
 - a. *“Additional Coverages—Coverage A,” Item 3, “Building Code Upgrades,” subject to the applicable \$10,000 **sublimit**, and*
 - a. *“Losses Covered—Coverage E,” Item 1, “Assessment By Association of Owners,” subject to the applicable \$10,000 **sublimit**.*

5-19. Ingress and Egress

The condominium policy specifies, under Losses Not Covered, Coverage A, Building Property and Coverage E, Loss Assessment, that losses to walkways, driveways, decks, and patios are not covered, except for those walkways, driveways, decks, and patios necessary to provide ingress to and egress from the insured’s dwelling unit.

The ingress and egress exception to Losses Not Covered under Coverages A and E both apply only to ingress to and egress “*from the **dwelling unit***”. Dwelling unit is defined as “***your individual unit***.” Thus, payments under these exceptions are limited to damage to ingress to and egress from the insured’s dwelling unit.

In cases of loss to ingress and egress that might potentially be covered under the CEA policy, claim representatives should pay particular attention to the possibility that such losses are covered under an association master policy or other insurance, and apply the “Other Insurance” clause of the CEA policy.

6. BASIC EARTHQUAKE POLICY – RENTERS

The BASIC EARTHQUAKE POLICY – RENTERS does not provide coverage for loss to real property, it provides only Coverage C: PERSONAL PROPERTY and Coverage D: LOSS OF USE.

The scope of these two coverages is basically the same under the BASIC EARTHQUAKE POLICY – RENTERS as it is in the BASIC EARTHQUAKE POLICY – HOMEOWNERS. However, the calculation of the deductible for Coverage C: PERSONAL PROPERTY is significantly different from the method of calculating the deductible found in the BASIC EARTHQUAKE POLICY – HOMEOWNERS, and instead is calculated in the same manner as the BASIC EARTHQUAKE POLICY – COMMON INTEREST DEVELOPMENT.

6-1. Personal Property – Deductible

The deductible under the BASIC EARTHQUAKE POLICY – RENTERS is \$750. This is 15% of the \$5,000 base limits offered for Coverage C. The deductible amount of \$750 remains the same even if the policyholder purchases higher Coverage C limits.

Under the BASIC EARTHQUAKE POLICY – RENTERS, a claim can be paid as soon as the loss to personal property exceeds the \$750 Coverage C: PERSONAL PROPERTY deductible. This is different from what is under the BASIC EARTHQUAKE POLICY – HOMEOWNERS, where regardless of the amount of loss to personal property, there is no payment for any loss to personal property until after the loss to dwelling and extensions to dwelling exceeds the amount of the dwelling deductible.

6-2. Loss of Use

As with the other CEA policies, there is no deductible for Coverage D: LOSS OF USE. The adjustment of a Loss of Use claim is the same as it is under the homeowners policy. Even if the insured did not receive payment under the other coverages in the policy, the policyholder may be able to collect Loss of Use at a later date when repairs are made. The policy reads in part:

*If the part of the **rental unit** that **you** occupy becomes unfit to live in and **you** are forced to vacate the **rental unit** as a result of either (1) damage to the **rental unit** caused by an **earthquake** that commences during the policy period as part of a **seismic event** that commences during the policy period or (2) the process of repairing damage to the **rental unit** caused by an **earthquake** that commences during the policy period as part of a **seismic event** that commences during the policy period, then **we** cover the necessary increase in living expenses **you** actually incur to maintain **your** normal standard of living. **We** will pay Additional Living Expenses for the shortest time reasonably needed (a) to repair or replace the parts of the **rental unit** **you** occupy that are unfit to live in, or (b) for **you** to permanently relocate elsewhere if the owner of the **rental unit** does not elect to repair or replace the **rental unit**.*

If the insured sublets a portion of the rental unit to a subtenant and actually loses rental income due to earthquake damage, the insured may also collect under Coverage D for that loss of rent.

7. CLAIMS INVESTIGATION PROCEDURES

These investigation procedures are designed to provide basic claim-handling information. They are intended to augment what an experienced property claim representative already knows about adjusting property claims, and to highlight certain unique aspects of CEA policies. They have been developed to promote consistency among claim representatives and fairness to policyholders in the adjusting of CEA claims. They will not cover all situations.

7-1. A Companion Policy Must Be in Force

If at the time of loss no companion policy is in effect, the CEA policy is void and no payment can be made. At the outset of the investigation, confirm that the underlying companion policy is in force.

7-2. Policy Interpretation – When to Consult With the CEA

As claims agents for the California Earthquake Authority, Participating Insurers are responsible for investigating and adjusting claims made under CEA policies in a fair, prompt, and consistent manner. Section 3.2 of Article III of the Insurer Participation Agreement reads in part: “The Participating Insurer may perform Authority services on behalf of the Authority in any reasonable manner that is in compliance with the statutory, regulatory, and case law regarding claims handling practices; provided, however, where the Authority has promulgated specific procedures to govern its operations, the Participating Insurer shall conform its practices to those procedures.”

Participating Insurers are reminded to follow all CEA procedures on claims matters and that some matters must be referred to the CEA. Matters that must be referred to the CEA include the following:

- **Any legal action filed on a CEA claim, notice, or knowledge of any lawsuit against a Participating Insurer on a CEA claim, and any legal action where the name California Earthquake Authority or CEA appears:**
Participating Insurers must immediately notify the CEA’s Legal Department if they obtain formal or informal knowledge of the initiation of any such legal actions. Participating Insurers must immediately provide copies of all legal papers and pleadings received by the Participating Insurer to the CEA’s Legal Department Fax: (916) 327-8270), and follow up with a telephone call to (916) 325-3800 to make sure that the papers were received. *Participating Insurers are not authorized to accept service of legal process on the CEA’s behalf*, and if a Participating Insurer does happen to come into possession of any such legal papers, the papers must immediately be provided to the CEA’s Legal Department.
- **Department of Insurance complaints or requests for assistance:**
If a Participating Insurer receives notice of any policyholder or consumer complaint, or policyholder or consumer request for assistance made to the California Department of Insurance (CDI) concerning the Participating Insurer’s handling of or involvement in any

CEA-related matter, the Participating Insurer must immediately send or fax a copy of the Department of Insurance complaint to the CEA's Consumer Services Unit Fax: (916) 327-8270, and follow up with a telephone call to (916) 325-3800 to make sure that the document was received. The Participating Insurer may provide the appropriate response to the CDI without the CEA's prior approval of the response, but the Participating Insurer must send the CEA's Consumer Services Unit a copy of the response that was sent to the policyholder and the CDI. Until the issue is resolved, the Participating Insurer must mail or fax to the CEA's Consumer Services Unit a copy of all future correspondence with the CDI on the issue.

- **Taking claims to appraisal or Department of Insurance mediation:**
Participating Insurers must consult with the CEA and obtain the CEA's prior approval before demanding appraisal or mediation (including mediation under the CDI's earthquake claim mediation program), and must provide the CEA with the details on the claim made, settlement demands, offers made, and the reasoning for the position taken by the Participating Insurer.
- **Examination under oath (EUO):**
Participating Insurers must notify and consult with the CEA, and obtain the CEA's prior approval, before giving notice to an insured that the Participating Insurer wishes to take his or her EUO. The Participating Insurer must provide the CEA with the details on the claim, settlement demands, and the reasons why the Participating Insurer believes an EUO would be appropriate. In the event an examination under oath is set, it must be handled in accordance with California Insurance Code section 2071.1.
- **Claims where the damages are not covered by the earthquake policy in force:**
When an insured makes a claim and a Participating Insurer makes no payment because the loss is not covered by the CEA policy in force, the Participating Insurer must inform the policyholder in writing that the claim is being denied and the letter must quote the policy provisions on which the decision is based. The CEA has not provided a sample letter for this situation, but much of the wording found in the under-deductible sample letter (Attachment 6) will be useful. Participating Insurers must send a copy by e-mail, of the denial letter to the CEA's ERM for review and approval as to form before sending the letter to the insured. (See section 7-22.)
- **Loss settlement disputes:** (See section 7-20.)
- **Coverage questions:** (See section 1-7.)

7-3. California Fair Claims Settlement Practices Regulations and Other Laws

All claim representatives handling claims in California must abide by the California Fair Claims Settlement Practices Regulations and other applicable codes or regulations.

Claim representatives are expected to be familiar with the California Insurance Code section 790.03(h), setting forth certain specified unfair claims-handling practices. Insurers and their representatives must not knowingly engage in any of the practices listed in that statute.

7-4 Claim File Documentation

Participating Insurers are expected to handle claims on behalf of the CEA in a manner consistent with this manual, their company claim guidelines, and the California Fair Claims Settlement Practices Regulations. Specific requirements (for example, the number of photographs required) will not be dictated by the CEA beyond the statement that all claims files must be clearly documented, with sufficient detail in the file, that a person reading the file is able to understand how and why all decisions were made on the claim.

The documentation to support claims decisions is to be kept in the Participating Insurer claim file. Files are subject to review and audit by the CEA.

7-5. Keep the Policyholder Informed

Good claim-handling practices, as well as applicable regulations, require that policyholders be kept informed during the claim process. Keep the insured up-to-date about the claim and the progress of the investigation as decisions and information become available, and in every case no less than every 30 days. Estimates and expert reports should be shared with the insured as soon as possible. Keep the insured informed when key decisions will be made on their claim. When a report from an expert is relied on to form an opinion regarding damage, provide a copy of that report to the insured. Give the insured a copy of the claim representative's scope and estimate as soon as possible.

The CEA values the privacy of its insureds; therefore the CEA insists that no one discuss a claim with the media. Furthermore, California law, including California Insurance Code sections 791 through 791.21, protects the confidentiality of private policyholder-related information. Refer all media inquiries you receive to your company media spokesperson, your team leader, or to the CEA at (916) 325-3800.

Claim representatives must be trained on the current law regarding the obligation of the insurer to fully investigate earthquake damage that is discovered or reported after the earthquake damage claim is initially submitted to or closed by the Participating Insurer. The Participating Insurer must investigate reports of hidden or later-discovered damages before invoking any policy provisions regarding the time limit for submitting claims. Even if a new claim is received more than one year after the date of loss, the Participating Insurer should open a new claim and investigate the facts of the claim before it invokes any policy provisions. All such investigations should be made subject to a written reservation of rights.

All claims should be concluded with a final closing letter even if payment is being made. This letter should: (1) explain in writing any previous decision not explained in writing, and (2) quote the "Legal Action" condition of the policy, and advise the insured of the tolling of that provision from the date that the claim was reported to the date of the final letter.

7-6. Timely Adjusting - SBA and FEMA Requirements

In light of the policy deductible, policyholders generally will not receive payment for the total amount of the damage, and will be required to bear some portion of the financial costs of the earthquake themselves. As a result they may be looking to the Small Business Administration (SBA) for low-interest loans or to the Federal Emergency Management Agency (FEMA) for grants. In order to receive SBA and FEMA assistance, the insured will need documentation from the claim representative. Usually these agencies require a statement of loss or a denial letter. The SBA and FEMA have loan-submission deadlines, so the insureds will need this documentation as quickly as possible. It is important that the handling of the claim and final paperwork be timely.

More information about FEMA and the SBA can be found at their Web sites at: <http://www.fema.gov> and <http://www.sba.gov>.

7-7. Destructive and Other Tests to Determine Extent or Cause of Loss

In some situations, the insured may be solely responsible for the cost of performing tests. The policy provides as follows:

*At our option, we may select and retain adjusters, consultants, contractors, engineers, or other experts to inspect **your** property or to perform tests, including destructive tests, to determine the extent or cause of loss with respect to any claim **you** make under this policy. We will bear the cost of performing any tests (including the cost of repair of damage necessitated by any destructive tests) that we elect to perform to determine the extent or cause of loss.*

*If, however, it is the opinion of the CEA that **your** property (or some particular part of **your** property) has not sustained covered **earthquake** damage over the deductible amount of this policy, and despite our opinion you request additional testing of **your** property or that part of your property, then if additional testing is performed, you are solely responsible for the costs of performing the additional testing and of repairing the damage to **your** property that was caused by any additional destructive testing, unless the additional testing establishes the existence of covered **earthquake** damage that, either alone or combined with other covered **earthquake** damage, exceeds the deductible amount of this policy.*

When necessary, complete a “testing agreement,” a copy of which is included in this manual as Attachment 4.

7-8. Use of Engineers or Experts

Where the causation is obvious and damage is non-structural, a claim representative can assess the damage.

However, earthquake damage can manifest itself in a variety of forms, from minor cracking of interior Sheetrock to major failure of the foundation system. An engineer should be used when the damage appears to be structural in nature. The services of an expert will assist in the analysis of the cause and extent of loss and the proper way to repair the damage. It is important that the claim

representative understand the distinctions between the various expert fields and how they can be best used during the claim investigation. One source of earthquake engineering information is the CUREE *General Guidelines for the Assessment and Repair of Earthquake Damage in Residential Woodframe Buildings*. (www.curee.org)

a. When to Retain an Engineer or Expert

Participating Insurers will determine the need for engineers or other experts as soon as possible in the claim adjustment process. It is not necessary to request approval from the CEA.

Some of the conditions you should consider when retaining an engineer to inspect the property are:

- Building has collapsed or partially collapsed,
- Building superstructure has shifted relative to or off its foundation,
- Building as a whole, any story, any walls, any cripple walls, or columns are visibly out of plumb,
- Shifting or movement of interior walls and partitions relative to the floor,
- A pattern of broken windows or a pattern of sticking or inoperable hinged doors,
- For hillside houses, at the downhill edge; damage to vertical supports; posts visibly out of plumb; broken, slack, or buckled diagonal bracing; or damage to connection between foundation and superstructure,
- Visible distortion of the roofline or significant fresh damage to attic framing,
- Damage to the structure in the vicinity of the chimney,
- A pattern of splitting of framing members (sill plate, hold down locations, floor joists, etc.), and
- Evidence of fresh settlement of floors.

b. What Kind of Engineer to Select

For purposes of claims adjusting, the primary technical issues for the engineer to address are:

- Identification of all structurally significant earthquake damage, especially those damage patterns that might not be obvious to owners and adjusters,
- Causation (i.e. distinguishing between damage caused by the earthquake and conditions/damage attributable to other causes),
- Scope of work necessary to repair the damage caused by the earthquake in accordance with the terms of the policy, and
- Any building code upgrades that may be required as a part of the repair of the earthquake damages.

Generally, a claim representative should start with a structural specialist (a Civil Engineer specializing in structural engineering or a Structural Engineer). A structural specialist can evaluate all components of a building, including the foundation, for structural damage. The structural specialist should be consulted regarding the need for a soils specialist or other technical consultants.

c. Locating Qualified Engineers

Ideally, carriers should maintain a list of pre-qualified engineers who can be called upon in the immediate aftermath of an earthquake. When that is not the case, one source of contact information for potentially qualified engineers is the regional Structural Engineers Association of California (see www.seaoc.org for links to regional association) or the local chapter of the American Society of Civil Engineers (see www.asce.org/inside/sec_brnch.cfm for links to local chapters).

Prior to retaining an engineer, check credentials, by obtaining a copy of the engineer’s curriculum vitae (résumé) or statement of qualifications that should include information on education, work experience, technical expertise, and professional registration (or engineering license) numbers.

The status of an engineer licensed in California can be verified at:
http://www.dca.ca.gov/pels/l_lookup.htm

d. Written Contract Specifying the Scope of Services

Assuming that the engineer’s credentials are acceptable, the next step is executing a written agreement or contract with the engineer. California Business and Professions Code section 6749 requires, with some exceptions, that engineers provide their clients with a written contract specifying at a minimum:

1. A description of the services to be provided to the client by the professional engineer.
2. A description of any basis of compensation applicable to the contract, and the method of payment agreed upon by the parties.
3. The name, address, and license or certificate number of the professional engineer, and the name and address of the client.
4. A description of the procedure that the professional engineer and the client will use to accommodate additional services.
5. A description of the procedure to be used by any party to terminate the contract.

Following a major earthquake, qualified engineers in an area may be overwhelmed or in short supply. Claim representatives should ask for and agree to the delivery time for any written reports before authorizing the work.

e. Payment of Expert Fees

Claim representatives should ask for and agree to a budget before authorizing the work.

Expert fees necessary to investigate a claim or determine the cause of loss are paid for by Participating Insurers. There could be an exception when dealing with testing. (See section 7-7.) The Participating Insurers receive a loss-adjusting fee on all paid claims, which when averaged out over all claims handled, is designed to reimburse them for these fees.

Fees necessary to determine the cause of loss should not be included as part of the claim payment—they are loss adjustment expenses. Fees necessary to determine the appropriate

repair or replacement are part of the claim payment under the policy coverage limits after the deductible and any other policy provisions are met.

7-9. Costs to Rebuild or Repair – Prices of Building Materials

The CEA is committed to providing fair and reasonable local cost reimbursements for covered earthquake damage. Claim representatives may use automated damage estimating programs or qualified contractors to estimate the dollar value of damage. The CEA does not provide cost of labor and or cost of materials information after an earthquake. Determining appropriate labor and materials costs is part of the Participating Insurers' loss adjustment duties. Participating Insurers should make sure their estimating programs have been updated with appropriate local post-disaster labor and material costs.

California law regulates price increases for goods and services after a state of emergency has been declared. Section 396 of the California Penal Code is intended to prevent post-disaster "price gouging," and that statute provides that persons selling specified goods and services at a price more than 10% above the price charged prior to an emergency are guilty of a misdemeanor and are subject to criminal prosecution.

7-10. Overhead and Profit

It is appropriate to allow for overhead and profit (O&P) in cases where the repair involves multiple trades requiring the use of a general contractor to control the job. It is not appropriate to allow for O&P when you are dealing with individual trades and individual tradesmen are doing the work. On a one-trade repair, do not allow for O&P even if a general contractor is doing the work.

If it is appropriate to allow for O&P on an estimate, add the overhead percentage and the profit percent together and then apply the total percentage to the estimate. Do not apply the percentages individually since this approach results in a higher cumulative O&P amount. The CEA allows O&P amounts that follow the customary practice of contractors in a given area. The reasons for any exceptions to these O&P guidelines should be documented in the claim file.

7-11. Claim Payment Ratio

If there is a very large earthquake or a series of earthquakes, such that the CEA's claims paying ability might be exceeded, there is a provision in the CEA policy that provides for the payment of claims on a pro-rata bases. If this were ever to be needed, the CEA would declare a "claim payment ratio". This would mean that the adjuster would determine the total amount payable on a claim and then pay the insured a percentage of that total amount based on the CEA's declared claim payment ratio.

If a ratio other than 100% is to be used, it will be communicated to the Participating Insurers as soon as possible and will apply to all loss settlements from the date of notification onward.

7-12. Double Coverage

To help resolve issues of overlapping insurance or coexistent insurance coverage, the claim representative should follow the Other Insurance provisions in the policy involved. Further help can be found in the *Guiding Principles for Overlapping Insurance Coverage* published in 1963 by a consortium of underwriting organizations. This document should be available from your claim manager.

7-13. Suspected Fraudulent Claims

Often discrepancies in claims handling can be resolved by open communication with the insured. It is important that claim representatives keep an open mind and treat the policyholder with respect at all times.

Refer suspected fraudulent claims to the Participating Insurer's Special Investigation Unit (SIU). Request a Proof of Loss as stated in the policy conditions. It is expected that claim representatives be trained to recognize insurance fraud. The claim file should have evidence of teamwork between SIU and the claims handler in resolving the issues in question.

Unless the true amount of covered loss and damage has been determined before the referral to SIU, determination of the actual covered loss and damage, if any, should be continued by the claim representative during the SIU investigation. A general reservation of rights letter should be sent to the insured indicating that investigation is not a commitment as to payment.

7-14. Protection of Property - Emergency Repairs

Emergency repairs coverage is available to protect a dwelling and extensions to a dwelling to the extent these items are covered by the particular policy form. However, in each instance, the cost of the emergency repairs is payable only if damage exceeds the applicable deductible. This does not apply to the renters policy since the renters policy does not provide coverage for real property.

Emergency repairs coverage also applies to protect personal property as part of Coverage C. Check the deductible. This applies to the homeowner, condominium, and renters policy.

The emergency repairs coverage provides coverage up to a sublimit of 5% of the policy limit of insurance for the type of property being protected.

7-15. Scope of Loss and Estimates

In most cases, the claim representative should complete a sufficiently thorough examination of the home to enable him or her to list all recent earthquake damage, complete a diagram of areas to be repaired, and obtain needed measurements. The claim representative should then complete an itemized scope of loss.

Claim representatives should create or obtain an accurate estimate of the cost to repair all covered earthquake damage. Participating Insurers may use any software generally accepted by the

insurance industry in the preparation of building and structure repair estimates. The file must contain the documentation necessary to support the estimate. The measurement of areas, room sizes and other dimensions on which quantities of material and labor are based must be shown in the estimate. A diagram should be prepared and attached to the estimate. Document the damages with photographs as appropriate.

Claim representatives may need to reevaluate an estimate if notified that the actual costs of repairs differ from the costs that were listed on the original estimate. Any additional earthquake damage found after repairs have begun should also be evaluated for coverage.

Engineers or experts should be used when appropriate. (See section 7-8.)

The insured should be given a copy of the scope and estimate as soon as possible.

7-16. Cracks in Concrete Surfaces Such as Garage Floors and Foundations

Most concrete work, especially house and garage floor slabs, develop small cracks over time. This is considered normal and generally does not impair the structural function of the concrete. The cost to repair old cracks that were in the concrete prior to the earthquake is not covered; however, new damage due to the earthquake, which may include expansions of old cracks, is covered.

The claim representative, with the advice of an appropriate expert, will need to determine whether concrete needs to be replaced or whether it can be repaired with injected epoxy or other methods. In cases where the cracks do not cause structural impairment, strong consideration should be given to a repair with properly injected epoxy. This will be decided on a case-by-case basis and the CEA generally allows for repair or replacement, whichever is most appropriate.

7-17. Subrogation

While there is less likelihood that there is third-party liability for the damages suffered by an insured from an earthquake than from most other perils, the claim representative should still be aware of subrogation potential. For example, defects in construction can cause additional damage during an earthquake, or the earthquake damage may be increased by recent work in the surrounding area by a public entity or contractor. It is the claim representative's responsibility to thoroughly investigate any subrogation potential.

The Participating Insurer is responsible for the subrogation process.

If the claim representative discovers that the loss may have occurred as a result of negligence of a third party, proper documentation must be gathered so that a successful subrogation claim can be pursued. Proper investigation of a claim with subrogation potential should include at least the following:

- a. Take a recorded statement of persons likely to have information about the contributing cause of damage if possible;
- b. Obtain and preserve any evidence;

- c. Notify the insured of the intention to pursue subrogation rights and of the “Subrogation” provision of the CEA policy requiring an assignment of rights and cooperation in the pursuit of subrogation;
- d. Take photographs of the damage and other items material to the case; and
- e. Notify the responsible party and their insurance carrier as soon as it appears that a subrogation claim may be presented.

7-18. Salvage

As in any other claim, consideration should be given as to whether any damaged items have salvage value. The CEA’s position is that the policyholder should be made whole, including the deductible, before any salvage is taken. If there are salvageable items that need to be dealt with, follow your company procedures for dealing with salvage in the claim handling process.

7-19. Proof of Loss

The CEA does not require a Proof of Loss on every claim. However, the CEA has a right to one where necessary. The policy provides that, upon the Participating Insurer’s request, a Proof of Loss must be provided within 60 days.

In cases where the insured and the insurer do not agree on the amount of loss, it is sometimes valuable to get the insured’s input as to the loss by requesting the insured to file a Proof of Loss. This decision should be made on a case-by-case basis.

7-20. Loss Settlement Disputes

Generally, loss settlement disputes involve questions concerning scope of damage, the proper repair method, and the actual cost of the repairs. Keep an open mind and solicit input from the insured’s contractor or representative to resolve discrepancies in scope, repair method, and pricing. Personal meetings can be helpful.

Disputes can often be efficiently resolved through the California Earthquake Claims Mediation Program with the California Department of Insurance (CDI) at (800) 927-4357. The CEA supports using the CDI mediation program to resolve issues of scope of loss, mandated building code upgrades, pre-existing damage, additional living expense, asbestos abatement, earthquake vs. aftershocks, hidden damages, and personal property valuation issues. (CDI form 526, EQMED 12/99)

Another dispute resolution option is the appraisal provision in the policy. If CDI mediation does not resolve the dispute, the appraisal process is still available.

7-21. Coverage Disputes

Unlike loss settlement disputes, coverage disputes concerning the interpretations of policy coverage or policy language cannot be handled through the CDI mediation program or resolved in appraisal.

When investigating a claim where coverage is an issue, consider a reservation-of-rights letter. Procedures to resolve coverage disputes are explained in section 1-8.

7-22. Denying Damages Not Covered and Claims Under the Deductible

There are three main types of denial letters that may need to be sent to a policyholder.

1. Claims under the deductible:

Where an insured makes a claim and a Participating Insurer makes no payment because the damage is below the deductible, the Participating Insurer must inform the policyholder in writing that the claim is being denied. Section 2695.7(b) (1) of title 10 of the California Code of Regulations requires that “when an Insurer denies or rejects a first party claim, in whole or in part, it shall do so in writing...” Attachment 6 is a sample under-deductible denial letter. The CEA does not need to approve these letters before they are sent.

2. Claims where the damages are not covered by the earthquake policy in force

Where an insured makes a claim and a Participating Insurer makes no payment because the damage is not covered by the policy in force, the Participating Insurer must inform the policyholder in writing that the claim is being denied and the letter must quote the policy provisions on which the decision is based. The CEA has not provided a sample letter for this situation, but much of the wording found in Attachment 6 will be useful. Participating Insurers must send a copy by e-mail, of the denial letter to the CEA’s ERM for review and approval before mailing it to the insured.

3. Claims with a combination of both of the above situations

Where an insured makes a claim and a portion of it is subject to denial but other parts will be paid, the Participating Insurers must inform the policyholder in writing about the specifics of what is being paid, and what is not being paid and why. The CEA does not need to approve these letters before they are sent.

With regard to homeowner claims, a denial letter must:

- Deny payment for damage for Coverage A and Coverage B if it is under the deductible.
- Deny any claim made under Coverage C, on the ground that damage to property covered under Coverage A and Coverage B is insufficient to meet the policy deductible.

Denial letters under all policies should:

- Inform the insured of his or her right to obtain further inspections and to obtain new estimates, if necessary.
- Explain to the insured that Loss of Use coverage has no deductible and the insured may apply for Loss of Use payments later if a covered loss makes the dwelling unfit to live in and it needs

to be vacated during repairs. This is true even if the Coverage A and B damages are under the deductible.

- Invite the insured to submit any documents showing that the loss exceeds the deductible.
- Advise the insured of the one-year requirement to bring legal action and quote the language from the policy, and explain that the time limit has been tolled during the handling of the claim.
- Include the required wording on how to contact the California Department of Insurance.

Always include any expert's reports that you used to make your decision with the denial letter.

All denial letters should be completed as soon as practical since policyholders may need these letters to apply for FEMA or SBA assistance.

7-23. Usage of the Name "California Earthquake Authority" in Letters

It is important to properly use the name "California Earthquake Authority" or the acronym "CEA" in claims correspondence when adjusting a claim for the CEA. (Questions about the approval process to use the CEA mark (logo) are found in CEA Circular #OPS-00-06.)

Whenever the words "California Earthquake Authority" are used they may be in title case (first letter of each word capitalized) or in all capital letters. It is not appropriate to use these words in all lower case. The acronym "CEA" is always used in upper case with no periods.

Letterhead: You should use your company letterhead or name and you should include the words "A Participating Insurer of the California Earthquake Authority."

The salutation: It is best to personalize claims correspondence whenever possible. It is generally not appropriate to use the words "California Earthquake Authority" or "CEA" in the salutation. If you do not know the name of the policyholder, however, you may use "Dear CEA Policyholder."

The body of a letter: It is acceptable to use the name "California Earthquake Authority" or the abbreviation "CEA" when referring to the CEA as an entity or to CEA policy language.

For example, "Please refer to your BASIC EARTHQUAKE POLICY – HOMEOWNERS, issued by the California Earthquake Authority, where it reads in part ..."

Or, "The XXX insurance company, a Participating Insurer of the California Earthquake Authority (CEA), wishes to inform you ..."

Signature block: You may use your normal signature block, and while not required, you may add "A Participating Insurer of the California Earthquake Authority."

For example: Sincerely,

John Q. Adams
Senior Claim Representative
XXX Insurance Company,
A Participating Insurer of the California Earthquake Authority

The return address in a letter: You may use “A Participating Insurer of the California Earthquake Authority” as part of your return address shown in a letter.

Claims settlement checks: If you have a field on your check to name the company on whose behalf the payment is being issued, you may use “California Earthquake Authority.”

CEA return address: It is not appropriate to use the CEA home office address or phone number in any correspondence. Do not use the CEA name or address as the return address on an outgoing or return envelope. In other words, the return address should never be shown as: “California Earthquake Authority, [Participating Insurer’s Address].”

7-24. When to Name a Mortgagee as a Joint Payee on a Claims Settlement Check

It is important to protect both the interest of the policyholder and any mortgagee or lender that may have a legal right of recovery to an earthquake claim payment. In some cases, it is not appropriate to name the mortgagee on a CEA earthquake policy claim payment, because the mortgagee may not have the legal right to share control of CEA insurance policy proceeds. Therefore, it is important that the relevant loan documents be examined to determine whether the lender has any right to recovery of earthquake insurance proceeds.

It is the claim representative’s responsibility to determine whether a mortgagee is to be named on a claim payment check. This is accomplished by reviewing the applicable mortgage documents to determine if the mortgagee required earthquake insurance as an express condition for making the loan or if the loan documents contain wording requiring that the mortgagee be named on proceeds from an earthquake claim. In these cases the claim representative must name the mortgagee as an additional payee on the claims indemnity payment.

Under longstanding informal guidelines, when the total indemnity payment will be \$10,000 or less, the payment may be made to the policyholder(s) only. The lender is not entitled to any control over payments for ALE.

In summary, it falls to the claim representative to determine whether a mortgagee needs to be named on a claim payment check. The claim file must be documented to support the decision made by the claim representative.

CEA Claims Bulletin 98-4, “Conditions under which a mortgagee can be named as a joint payee on a CEA claims check or draft” lays out the CEA’s position on this subject and includes some letters a claim representative can choose to use when dealing with a non-responsive policyholder.

7-25. Complete Investigation

Attic and crawlspace inspections are an important part of most complete investigations of earthquake damage. When a claim representative is investigating a claim and discovers that the home has suffered or may have suffered any amount of earthquake damage, the CEA expects that the claim representative will inspect the home's attic and crawlspace (if they exist and they are accessible).

This applies even when, although there may be other damage, there is no external evidence that there is damage in an attic or crawlspace. It is understood that the claim representative may have an engineer or a contractor, etc. do this inspection for them. The claim file should reflect the results of these inspections. Appropriate personal safety measures should be taken during these inspections.

7-26. Reasonably Uniform Appearance of Repairs

The California Fair Claim Settlement Practices Regulations, section 2695.9(a)(2), reads in part: "When a loss requires replacement of items and the replaced items do not match in quality, color or size, the insurer shall replace all items in the damaged area so as to conform to a reasonably uniform appearance."

Carpet and floor coverings: When dealing with replacement of carpet and other floor coverings, good judgment must prevail, but generally if a match cannot be found, doorways with doors that can close (swinging or pocket) can be used as the dividing line between rooms where there will be replacement of floor covering damaged by this loss and adjoining rooms where the floor covering was not damaged and need not be replaced. (This concept does not apply to closets with doors. For purposes of floor covering replacement, such closets should be considered part of the room.)

Roofs: Bear in mind that the regulations do not require an exact color match, but rather that all items in the damaged area "conform to a reasonably uniform appearance." It is expected that the claim representative use his or her good judgment to determine how much of the damaged area needs to be repaired or replaced to comply with the "reasonably uniform appearance" standard.

It will generally not be necessary to replace the whole slope unless materials of the same size and quality cannot be found or the condition of the roof makes a repair impossible. Repairs most likely will be made with new materials of like kind and quality, which generally fade to match the existing materials.

When a claim representative recommends a repair rather than a replacement, the CEA requires that the representative explain the "reasonably uniform appearance" concept to the insured and advise how the claim representative determined the area to be repaired.

Attachment 1

Coverage Comparison Chart – Homeowners, Common Interest Development, Renters

	HOMEOWNERS Includes Mobilehomes	COMMON INTEREST DEVELOPMENT (Condo)	RENTERS
COVERAGE A		(Optional Coverage)	
Dwelling	Companion Policy Limit	\$25,000 Real Property	No Coverage
Deductible	10% or 15% of A & B Combined Single Limit	Real prop. Cov. A: \$3,750 Pers. Prop. Cov. C: \$750 L. Assess. E: \$3,750, \$7,500, or \$11,250	Cov. C: \$750
COVERAGE B Other Building Structures	Limited coverage included in CSL Limit for Coverages A & B.	No Coverage	No Coverage
COVERAGE C		(Optional Coverage)	
Contents – Coverage amounts selected by Insured	\$5,000 \$25,000 \$50,000 \$75,000 \$100,000	\$5,000 \$25,000 \$50,000 \$75,000 \$100,000	\$5,000 \$25,000 \$50,000 \$75,000 \$100,000
Specific Limitations Money, Banknotes	\$250	\$250	\$250
Electronic Data Processing Equipment	\$1,000	\$1,000	\$1,000
Business Property	\$300	\$300	\$300
COVERAGE D		(Optional Coverage)	
Loss of Use—Coverage Amounts selected by Insured	\$1,500 \$10,000 \$15,000 (No deductible)	\$1,500 \$10,000 \$15,000 (No deductible)	\$1,500 \$10,000 \$15,000 (No deductible)
COVERAGE E		(Optional Coverage)	
Loss Assessments	No Coverage	Condo value \$135,000 or less \$75,000, \$50,000 or \$25,000 is available; Condo value greater than \$135,001, limit can be \$50,000 or \$75,000	No Coverage
OTHER COVERAGES			
Debris Removal	Additional insurance, 5% of A & B CSL (combined single limit)	Additional insurance, 5% of A (if A is purchased) 5 % of C (if C is purchased)	Additional insurance, 5% of C
Emergency Repairs	5% of applicable coverage (A or C), payments reduce limits	5% of applicable coverage (A or C), payments reduce limits	5% of C, payments reduce limits
Land Stabilization	\$10,000 (Sublimit of A & B CSL, payments reduce limits)	No Coverage	No Coverage
Building Code Upgrade	Additional insurance, Dwelling: \$10,000 or \$20,000, Mobilehome: \$10,000 only	Additional insurance, \$10,000 (if Coverage A is purchased)	No Coverage

Attachment 2

Example of How to Calculate the CEA Policy Deductible

BASIC EARTHQUAKE POLICY – HOMEOWNERS DEDUCTIBLE EXAMPLE

ASSUMPTIONS:

Dwelling amount on Declarations Page: \$200,000 - Contents limit is \$5,000

Deductible amount on Declarations Page: \$ 30,000 (15%)

Assume dwelling unfit to live in during repairs. Loss of use coverage is \$1,500.

<u>Coverage</u>	<u>Damage Amount</u>	<u>Amount used in the deductible calculation</u>
Dwelling	\$20,000	\$20,000
Contents	\$10,000	Not applied to meet deductible
Emergency repairs	\$12,000	\$10,000
Necessary walkways	\$ 2,000	\$ 2,000
2 Chimneys	\$14,000	\$14,000
Land Stabilization	<u>\$12,000</u>	<u>\$10,000</u>
Total	\$70,000	\$56,000

EXPLANATION:

Dwelling: The full amount of dwelling loss under Coverages A & B can be used to meet the deductible.

Contents: The cost to repair or replace personal property will not be applied to meet the deductible.

Temporary: Emergency measures to protect from further damage: This “Other Coverage” has a sublimit of 5% of the Coverages A & B amount. In this example, only \$10,000 (5% of \$200,000) will be applied to meet the deductible.

Chimney: Damage to chimneys is included in Coverage A and the full non-masonry value of the damage is included in the deductible calculation. However, payments for chimneys are subject to a sublimit of \$5,000. See Special Limits of Insurance, Coverage A.

Necessary walkways: (Needed for pedestrian ingress and egress) is Coverage B and will be applied to meet deductible.

Land Stabilization: This coverage is provided as a \$10,000 sublimit of the combined single limit for Coverages A & B.

TO COMPUTE THE CLAIMS PAYMENT:

- The \$56,000 of covered dwelling damage exceeds the deductible amount of \$30,000 so a claims payment will be made.
- The payment for the chimneys must be limited to \$5,000.
- Because the loss exceeded the Coverages A & B deductible, a contents payout will be made for \$5,000. (The contents loss is held to the policy limit.)
- Loss of Use coverage of up to \$1,500 can be made if incurred. This is not subject to a deductible.

TOTAL PAYMENT:

Coverages A, B & Emergency Repairs (20+10+2+5+10-30)	\$17,000
Coverage C	5,000
<u>Coverage D (must be incurred to collect)</u>	<u>1,500</u>
Total Payment	\$23,500

Attachment 3

Example of Coverage Review Form - California Earthquake Authority

Your Name: Jane Claims Manager		Contact phone number: 916-236-3698	
XXX Insurance Company			
Your claim representatives Name:	<u>Date of Loss:</u>	<u>Coverage</u>	<u>Coverage</u>
John Q. Adjuster	9/03/06	<u>Limit:</u>	<u>Deductibles:</u>
Policy #:	Policy Period:	A	A
123-456-789	02/07/06 – 02/07/07	200,000	15% 30,000
Insured:		C	C
David and Liz Insured		5000	N/A
Property Address:		D	
123 Main Street		1500	N/A
City, St, Zip		Code:	
Any town, CA 90210		10,000	
	<u>Coverages Reserves and Paid</u>	<u>Reserves</u>	<u>\$ Paid to Date</u>
A-Dwelling		10,000	0
C-Contents		0	0
D-Loss of Use		0	0
Code Upgrade		0	0
Land Stabilization		0	0
Loss Assessment		0	0
		0	0
<p>Description of loss: The Insured's home was damaged by an earthquake on 9/03/2006. The house is of two-story woodframe construction with a perimeter concrete foundation. There is also a guesthouse (one story) of similar construction that includes a bedroom, bath, kitchen, and a two-car garage. The two structures are built end-to-end, north to south, with a breezeway connecting the north-end of the house and the south end of the guesthouse. The breezeway shares a roofline with the guesthouse. The roof is connected to the north-end wall of the house. A wall on the west side of the breezeway connects to both the house and guesthouse, enclosing the west side of the breezeway. The breezeway is of woodframe construction on its own perimeter foundation. The foundation abuts the foundations of the house on the south side and the guesthouse on the north.</p> <p>Coverage question: Is the guesthouse a dwelling as defined by the policy and if so can it be considered under <u>COVERAGE A: 'DWELLING'?</u> The guesthouse is a residential structure of not more than four units and is at the location described in the DECLARATIONS. The DECLARATIONS page makes no mention of, or distinction between, the two structures.</p> <p>Our research: Webster's defines "contiguous" as "1. in physical contact; touching along all or most of one side. 2. near, next, adjacent". By this definition the breezeway's foundation is contiguous with both of the other structures' foundations. However, the breezeway <i>must</i> be considered part of the guesthouse in any case because of the roofline they share. It would appear that the guesthouse meets the definition of a dwelling on all criteria except the roofline. The definition only requires one criterion to be met.</p> <p>Our recommendation: As such, the guesthouse would appear to fall under "<u>COVERAGE A: 'DWELLING'</u>" since it requires that the building be defined as a dwelling and be identified on the DECLARATIONS page. The page gives only the address, and doesn't identify or exclude any specific structures. Based upon the above points it is our recommendation that coverage be extended to the guesthouse.</p> <p>For your reference we have attached diagrams and photos as well as a copy of the Earthquake Declarations Page.</p> <p>Please contact Team Leader John Q. Manager at (800) 555-1234 if you have any questions.</p>			
Submitted by: Jane Q. Manager		Date: 10/03/06	

Coverage Review Form - California Earthquake Authority

Your Name:		Contact phone number:	
Insurance Company:			
Your claim representatives Name:	<u>Date of Loss:</u>	<u>Coverage</u> <u>Limit:</u>	<u>Coverage</u> <u>Deductibles:</u>
Policy #:	Policy Period:	A	A
Insured:		C	C
Property Address:		D	
City, St, Zip		Code:	
Coverages Reserves and Paid	Reserves	\$ Paid to Date	
A-Dwelling			
C-Contents			
D-Loss of Use			
Code Upgrade			
Land Stabilization			
Loss Assessment			
Description of loss:			
Coverage question:			
Our research:			
Our recommendation:			
Submitted by:	Date: xx/xx/xxxx		

Attachment 4

Testing Authorization Agreement

Claim Number: _____ Date of Loss: _____

Name: _____ Date of Agreement: _____
(Policyholder)

Address: _____

City: _____ State: _____ Zip: _____

I [we], _____ [Name(s) of policyholder(s)] _____, acknowledge and agree to the following:

1. _____ [Name of Participating Insurer] _____ (“the Insurer”), a Participating Insurer of the California Earthquake Authority (“the CEA”), and I [we] disagree (i) as to whether my [our] home has sustained covered earthquake damage over the deductible amount of my [our] insurance policy issued by the CEA, and (ii) as to the need for further testing to determine the extent or cause of damage to my [our] home. The Insurer contends that additional testing will not establish the existence of covered earthquake damage over the amount of the deductible, and I [we] believe that additional testing will establish that my [our] home sustained covered earthquake damage over the amount of the deductible.
2. The Insurer has advised me [us] that, pursuant to the terms of my [our] insurance policy, the Insurer will not authorize any additional testing as part of the claims adjusting process unless I [we] agree that, in the event additional testing is performed and that testing fails to establish the existence of covered earthquake damage over the amount of the deductible of the insurance policy issued by the CEA, I [we] will pay for the cost of conducting that testing, including the cost of repairing any damage to my [our] property caused by any destructive testing that is conducted.
3. I [we] therefore request the Insurer to authorize the following testing: _____

[DESCRIPTION OF TESTING REQUESTED BY POLICYHOLDER] _____

I [we] agree that, in the event the testing described above fails to establish the existence of earthquake damage that is covered under my [our] CEA policy and that it is over the deductible amount of that policy, I [we] will pay for all costs associated with conducting that testing, including, but not limited to, the cost of repairing any damage to my [our] property caused by any destructive testing. I [we] understand that, in the event the testing described above establishes that my [our] property has sustained covered earthquake damage over the amount of the deductible of the CEA policy, I [we] will not be required to pay for any of the costs of that testing.

Policyholder(s): _____ Date: _____
(Signature of policyholder)

(Signature of policyholder) Date: _____

Claim Representative _____ Date: _____

CEA Participating Insurer: _____

Attachment 5

Advanced Payment Agreement

Name
Address
City, State

Re: Claim No.:
Policy No.:
Policyholder(s):
Address of Insured Property:
Date of Damage:

Dear _____,

There is a question as to whether there is coverage under the policy for the damages, which have occurred. We are investigating the claim. We are under no legal obligation to make any payments until the coverage investigation is complete.

However, to prevent any undue hardship which this loss may cause, we advance the sum of \$_____ under the following terms and conditions:

- 1) This advance shall not be considered as any admission that payment is due under any portion of the policy;
- 2) If we determine that payment is not required under the terms and conditions of the policy, you will repay the advance;
- 3) In making this advance, we reserve all rights and do not waive any terms, conditions or requirements under the policy, nor any rights we have; and
- 4) Other than as agreed in this letter, you reserve your rights as well.

You will cooperate in the coverage investigation, and comply with the policy conditions regarding the presentation of any claim. We may need a Proof of Loss or an examination under oath.

If we determine that your claim is payable, we will apply the advance against any benefit due under the policy. If you have any questions, please let us know.

Sincerely,

XXXXXXXXXXXX

I have read this letter, and agree to its terms:

[Insured]

Attachment 6

Sample Wording for Under Deductible Denial Letter on a Homeowners Policy

Dear XXXXXX,

Thank you for your courtesy and cooperation during the investigation of your claim [or other opening greeting].

As we discussed, your California Earthquake Authority policy provides coverage for earthquake damage, subject to a deductible of \$_____. Our investigation and estimate of damage has determined that the cost to repair any covered damage to your [dwelling, extensions to dwelling– as appropriate] is less than your deductible. For this reason, we will be unable to make any payment under the terms and conditions of your policy, and your claim is therefore denied. [Optional when there is a personal property loss also: Please note that no payment can be made for loss to any personal property until the deductible for the dwelling or extensions to dwelling is met.]

The attached estimate represents our evaluation of your covered damages. If you believe we have missed any damage, let us know. Also, you may wish to obtain your own estimate of the cost of repairs. If you obtain your own repair estimate (or if you have already obtained one), and the amount is above your policy deductible, please contact us immediately and send us a detailed estimate.

While the covered damage to your property did not exceed the deductible, expenses incurred for Loss of Use while the home is uninhabitable could be considered for payment under Coverage D – Loss of Use. This coverage is subject to the applicable limit of insurance. Please let us know if your home becomes uninhabitable during the repair process and you incur Loss of Use expenses.

California law requires us to notify you of a time limit that applies to your claim. The time limit pertains to Condition 10, which is found on page ___ of your policy. This condition is required by law and is contained in all residential property insurance policies issued in the State of California. The condition states the following:

CONDITIONS

10. Legal Action. No action can be brought under this policy by any person unless the policy provisions have been fully complied with and the action is started within one year after the date of inception of the loss.

This condition limits your time to commence legal action for recovery of damages sustained in your loss. Please note that we do not mean to suggest that you file a legal action. We only seek to advise you of the time limitation set forth within this condition of your policy.

California case law provides that the one-year time period for commencing legal action is tolled from the date you notified us of the claim until the date of this letter. Tolled means that this time period does not count towards the calculation of the one-year time period to begin legal action.

We are also required to let you know that, if you believe that this claim has been wrongfully denied or rejected or that there is a dispute as to damages, you have the right to have the matter reviewed by the California Department of Insurance at 300 South Spring Street, 11th Floor, Los Angeles, CA 90013 (213) 897-8921, (800) 927-4357.

Please contact me if you have any questions regarding your damages, your coverage, or the contents of this letter. I can be reached at 1.800.xxx.xxxx.

Sincerely, John/Jane Q. Adjuster Senior Claim Representative XXX Insurance Company
A Participating Insurer of the California Earthquake Authority

cc: Agent

Attachment 7

Property Loss Notice – Report of New Earthquake Claim

To: _____ Fax # _____
(Name of Insurance Company) (Insurance company claim reporting Fax telephone number)

From: California Earthquake Authority - Sacramento CA,
Toll Free 877.797.4300

Pages _____

Print large, bold and neat.

Today's Date: _____ Time this claim report was taken: _____ AM PM
(Circle one)

Caller's Name: _____

Your phone number in case we get disconnected: (_____) _____ - _____ ext. _____

The name of your insurance company: _____

Your policy number: _____ Effective Date: _____

Policy Type: HO Condo Renter Mobilehome - Date damage occurred: _____
(Circle one)

Your Agent's Name: _____ Agent's Phone # (_____) _____

Are you the Insured: Yes No a. If not, what is your relationship to the insured: _____
(Circle one) If Yes, go to c. If No, answer a & b.)

b. If the caller is not the insured, what is the insured's name: _____

c. Name of person who can show the damage to a claim rep: _____

Home phone # for this person: (____) _____ - _____ Work phone #: (____) _____ - _____

Cell Phone : (_____) _____ - _____ E-mail _____

What times are best to call: _____ Language preference: _____
(It is important that you verify the insured's name, telephone # & policy number.) (Complete only if they request, i.e. Spanish)

Location of the damaged property: City: _____

Street address: _____ Zip _____

Are there any issues prohibiting access to property? Yes No Describe damage below:

Do you have an estimate or guess on the \$ amount of damage: \$ _____

CEA Representative's Name: _____ Phone Number: _____

Governing Board Memorandum

August 25, 2011

Agenda Item 13: Renewal of the CEA's D&O and EPLI insurance policy

Recommended Action: Approve renewal premium for D&O and EPLI policy.

Background:

Each year, the CEA purchases Directors and Officers ("D&O") and Employment Practices Liability Insurance ("EPLI") coverage for its business operations, covering not only acts of the CEA as an organization but also acts of the CEA's employees, contract executives, and Governing Board members.

Before 2005, the CEA was only offered D&O/EPLI on a standard corporate-form policy that was less suited to the CEA's unique form of organization. In 2005, the CEA began purchasing D&O/EPLI coverage from RSUI Indemnity Company, a specialty carrier that offers a D&O/EPLI policy form tailored to not-for-profit public organizations such as the CEA. The appropriate coverage was renewed in 2006 and has been renewed annually ever since.

Analysis:

RSUI has offered to renew the existing coverage for an additional year—from August 31, 2011, through August 31, 2012. The CEA's broker-team has negotiated a slight decrease in the premium charged since 2006, and confirms there are no decreases in coverage; in fact, a few enhancements have been incorporated. The renewal premium is \$113,180.

The broker-team advises that it could not find another carrier that would offer coverage to the CEA on more favorable terms or at more favorable rates.

Based on the above, CEA staff is satisfied with the terms of the current and offered coverages and recommends accepting the carrier's renewal offer.

Recommendation:

Authorize the necessary expenditure and delegate signature authority to the chief executive officer so that staff may:

1. Renew the CEA's existing D&O/EPLI coverage, currently quoted at a premium of \$113,180, and;
2. Bind the coverage at or before the expiration of CEA's existing coverage on August 31, 2011.

California Earthquake Authority

Losses & Loss Adjustment Expenses (LAE) Paid - Cumulative to June 30, 2011

Event Code	Event Name	Date of Event	Magnitude	Location	# of Paid Claims	Losses Paid	LAE Paid	Total Paid Losses & LAE
98010	Chino	1/5/1998	4.3	3 mi. W of Chino	1	\$1,385.72	\$124.71	\$1,510.43
98050	San Juan Bautista	8/12/1998	5.3	7 mi. SSE of San Juan Bautista	1	161,204.93	13,643.13	\$174,848.06
98070	Redding	11/26/1998	5.2	3 mi. NNW of Redding	1	4,029.72	362.67	\$4,392.39
	1998 Minor Quakes				2	4,199.20	377.93	\$4,577.13
99050	Hector Mine	11/16/1999	7.0	28 mi. N of Joshua Tree (near Palm Springs)	25	137,361.81	12,362.47	\$149,724.28
	1999 Minor Quakes				1	4,037.26	363.35	\$4,400.61
00030	Napa	9/3/2000	5.2	17 mi. ESE of Santa Rosa; 6 mi. NNE of Sonoma; 3 mi. WSW of Yountville	15	278,130.07	25,031.71	\$303,161.78
01010	Ferndale	1/13/2001	5.4	53 mi. WNW of Ferndale	1	34,764.54	3,128.79	\$37,893.33
	2001 Minor Quakes				1	52,896.82	4,760.70	\$57,657.52
01040	West Hollywood	9/9/2001	4.2	West Hollywood	10	67,044.15	6,033.94	\$73,078.09
	2002 Minor Quakes				1	8,361.24	752.51	\$9,113.75
03090	San Simeon	12/22/2003	6.4	7 mi. NE of San Simeon	84	2,692,628.02	242,339.74	\$2,934,967.76
04120	Parkfield	9/28/2004	6.0	7 mi SSE of Parkfield	1	7,032.59	632.93	\$7,665.52
07240	Chatsworth	8/9/2007	4.5	4 mi NNW of Chatsworth	1	7,813.88	703.24	\$8,517.12
07250	Alum Rock	10/30/2007	5.6	5 mi NNE of Alum Rock	1	6,149.20	553.42	\$6,702.62
08280	Chino Hills	7/29/2008	5.4	5.5 mi SE of Diamond Bar	8	156,781.38	14,110.29	\$170,891.67
09320	Calexico	12/30/2009	5.9	22.7 mi SE of Calexico	1	275.88	24.83	\$300.71
	2009 Minor Quakes				1	4,839.51	435.56	\$5,275.07
10330	Ferndale	1/9/2010	6.5	27 mi W of Ferndale	2	22,153.62	1,993.83	\$24,147.45
10360	Baja California Mexico	4/4/2010	7.2	16 mi SW from Guadalupe Victoria, Mexico	15	46,166.44	4,109.25	\$50,275.69
	Total				173	\$3,697,255.98	\$331,845.00	\$4,029,100.98

Claims History Report Glossary

Event Code: A 5 digit code that the CEA assigns to all earthquakes expected to produce paid losses. This code is used to track statistics for a particular earthquake.

Event Name: This is generally the name given to the earthquake by the USGS (United States Geological Survey).

Date of Event: Date that the earthquake occurred.

Magnitude: Richter scale magnitude assigned by USGS.

Location: This is assigned by USGS and is usually a city close to the earthquake.

of Paid Claims: A numeric count of the claims that received a payment for damage caused by a particular earthquake.

Losses Paid: Total dollar amount of all claims paid to the policyholders for a particular earthquake.

LAE Paid: "LAE" stands for Loss Adjustment Expense which is always 9% of paid losses. This is the amount paid to the Participating Insurers for handling the claim.

Total Paid Losses and ALE: The sum of Losses Paid and LAE Paid.

Minor Quakes: Losses paid for damage from minor earthquakes that were initially not expected to generate a claim and therefore were not issued a CEA event code.

California Earthquake Authority

Operations - Governing Board Report

All Companies - As Of 7/23/2011 - Policies in Force on: 6/30/2011

TOTALS	Policies In Force	% Total	Exposure	% Total	Written Premium	% Total	Avg Written Premium
Homeowner							
15% Total	594,468	72.3 %	251,116,557,023	85.6 %	486,420,879	80.9 %	818
10% Total	61,124	7.4 %	28,623,593,607	9.8 %	64,018,238	10.7 %	1,047
Homeowner Total	655,592	79.7 %	279,740,150,630	95.4 %	550,439,117	91.6 %	840
Manufactured Homes (Mobilehomes)							
15% Total	20,636	2.5 %	2,122,152,272	0.7 %	2,071,143	0.3 %	100
10% Total	3,817	0.5 %	558,851,184	0.2 %	482,915	0.1 %	127
Manufactured Homes (Mobilehomes) Total	24,453	3.0 %	2,681,003,456	0.9 %	2,554,058	0.4 %	104
Condo Total	102,374	12.4 %	9,503,807,500	3.2 %	41,018,181	6.8 %	401
Renter Total	40,048	4.9 %	1,449,464,500	0.5 %	6,962,111	1.2 %	174
Grand Total	822,467	100.0 %	293,374,426,086	100.0 %	600,973,466	100.0 %	731

California Earthquake Authority

Operations - Governing Board Report

All Companies - As Of 7/23/2011 - Policies in Force on: 6/30/2011

HOMEOWNER	Policies In Force	% Total	Exposure	% Total	Written Premium	% Total	Avg Written Premium
Deductible - 15%							
CovA/C5k/D1.5k/BCU10k	594,469	90.7 %	243,692,071,523	87.1 %	449,558,650	81.7 %	756
BCU 20k	59,227	9.0 %	592,270,000	0.2 %	1,577,731	0.3 %	27
Coverage C 25k	30,746	4.7 %	614,920,000	0.2 %	5,289,474	1.0 %	172
Coverage C 50k	21,063	3.2 %	947,835,000	0.3 %	5,230,080	1.0 %	248
Coverage C 75k	10,422	1.6 %	729,540,000	0.3 %	3,265,665	0.6 %	313
Coverage C 100k	33,219	5.1 %	3,155,805,000	1.1 %	13,214,094	2.4 %	398
Coverage D 10k	38,950	5.9 %	331,075,000	0.1 %	2,020,713	0.4 %	52
Coverage D 15k	78,003	11.9 %	1,053,040,500	0.4 %	6,264,472	1.1 %	80
15% Total	594,468	90.7 %	251,116,557,023	89.8 %	486,420,879	88.4 %	818
Deductible - 10%							
CovA/C5k/D1.5k/BCU10k	61,124	9.3 %	25,513,387,107	9.1 %	51,167,557	9.3 %	837
BCU 20k	12,961	2.0 %	129,610,000	0.0 %	321,251	0.1 %	25
Coverage C 25k	10,007	1.5 %	200,140,000	0.1 %	1,648,644	0.3 %	165
Coverage C 50k	7,518	1.1 %	338,310,000	0.1 %	1,556,155	0.3 %	207
Coverage C 75k	4,348	0.7 %	304,360,000	0.1 %	1,101,001	0.2 %	253
Coverage C 100k	17,247	2.6 %	1,638,465,000	0.6 %	5,959,251	1.1 %	346
Coverage D 10k	13,614	2.1 %	115,719,000	0.0 %	542,977	0.1 %	40
Coverage D 15k	28,415	4.3 %	383,602,500	0.1 %	1,721,403	0.3 %	61
10% Total	61,124	9.3 %	28,623,593,607	10.2 %	64,018,238	11.6 %	1,047
Homeowner Total	655,592	100.0 %	279,740,150,630	100.0 %	550,439,117	100.0 %	840

California Earthquake Authority

Operations - Governing Board Report

All Companies - As Of 7/23/2011 - Policies in Force on: 6/30/2011

MANUFACTURED HOMES (MOBILEHOMES)	Policies In Force	% Total	Exposure	% Total	Written Premium	% Total	Avg Written Premium
Deductible - 15%							
CovA/C5k/D1.5k/BCU10k	20,636	84.4 %	1,935,142,772	72.2 %	1,960,570	76.8 %	95
Coverage C 25k	1,642	6.7 %	32,840,000	1.2 %	22,153	0.9 %	13
Coverage C 50k	1,115	4.6 %	50,175,000	1.9 %	18,438	0.7 %	17
Coverage C 75k	341	1.4 %	23,870,000	0.9 %	6,566	0.3 %	19
Coverage C 100k	456	1.9 %	43,320,000	1.6 %	10,290	0.4 %	23
Coverage D 10k	1,757	7.2 %	14,934,500	0.6 %	23,524	0.9 %	13
Coverage D 15k	1,620	6.6 %	21,870,000	0.8 %	29,602	1.2 %	18
15% Total	20,636	84.4 %	2,122,152,272	79.2 %	2,071,143	81.1 %	100
Deductible - 10%							
CovA/C5k/D1.5k/BCU10k	3,817	15.6 %	400,634,684	14.9 %	418,950	16.4 %	110
Coverage C 25k	1,130	4.6 %	22,600,000	0.8 %	10,946	0.4 %	10
Coverage C 50k	952	3.9 %	42,840,000	1.6 %	11,789	0.5 %	12
Coverage C 75k	324	1.3 %	22,680,000	0.8 %	4,474	0.2 %	14
Coverage C 100k	413	1.7 %	39,235,000	1.5 %	7,030	0.3 %	17
Coverage D 10k	1,250	5.1 %	10,625,000	0.4 %	11,102	0.4 %	9
Coverage D 15k	1,499	6.1 %	20,236,500	0.8 %	18,625	0.7 %	12
10% Total	3,817	15.6 %	558,851,184	20.8 %	482,915	18.9 %	127
Manufactured Homes (Mobilehomes) Total	24,453	100.0 %	2,681,003,456	100.0 %	2,554,058	100.0 %	104

California Earthquake Authority

Operations - Governing Board Report

All Companies - As Of 7/23/2011 - Policies in Force on: 6/30/2011

CONDO	Policies In Force	% Total	Exposure	% Total	Written Premium	% Total	Avg Written Premium
Coverage A/BCU 10k	71,995	70.3 %	2,519,825,000	26.5 %	6,367,074	15.5 %	88
Coverage C 5k/D 1.5k	36,372	35.5 %	236,418,000	2.5 %	3,300,389	8.0 %	91
Coverage C 5k ¹	7,452	7.3 %	37,260,000	0.4 %	701,424	1.7 %	94
Coverage C 25k	13,829	13.5 %	345,725,000	3.6 %	2,701,042	6.6 %	195
Coverage C 50k	12,048	11.8 %	602,400,000	6.3 %	2,672,880	6.5 %	222
Coverage C 75k	5,983	5.8 %	448,725,000	4.7 %	1,465,553	3.6 %	245
Coverage C 100k	11,581	11.3 %	1,158,100,000	12.2 %	2,915,078	7.1 %	252
Coverage D 1.5k ²	7,423	7.3 %	11,134,500	0.1 %	3	0.0 %	0
Coverage D 10k	15,146	14.8 %	151,460,000	1.6 %	200,028	0.5 %	13
Coverage D 15k	28,324	27.7 %	424,860,000	4.5 %	449,913	1.1 %	16
Coverage E 25k	2,922	2.9 %	73,050,000	0.8 %	711,502	1.7 %	243
Coverage E 50k	62,697	61.2 %	3,134,850,000	33.0 %	17,685,755	43.1 %	282
Coverage E 75k	4,800	4.7 %	360,000,000	3.8 %	1,847,539	4.5 %	385
Condo Total	102,374	100.0 %	9,503,807,500	100.0 %	41,018,181	100.0 %	401

¹Policies that have a Coverage C limit of 5k and a Coverage D limit >1.5k

²Policies that have a Coverage D limit of 1.5k and a Coverage C limit >5k

California Earthquake Authority

Operations - Governing Board Report

All Companies - As Of 7/23/2011 - Policies in Force on: 6/30/2011

RENTER	Policies In Force	% Total	Exposure	% Total	Written Premium	% Total	Avg Written Premium
Coverage C 5k/D 1.5k	15,699	39.2 %	102,043,500	7.0 %	1,514,566	21.8 %	96
Coverage C 5k ¹	3,070	7.7 %	15,350,000	1.1 %	305,166	4.4 %	99
Coverage C 25k	9,221	23.0 %	230,525,000	15.9 %	1,903,141	27.3 %	206
Coverage C 50k	6,343	15.8 %	317,150,000	21.9 %	1,483,034	21.3 %	234
Coverage C 75k	2,046	5.1 %	153,450,000	10.6 %	529,520	7.6 %	259
Coverage C 100k	3,669	9.2 %	366,900,000	25.3 %	923,423	13.3 %	252
Coverage D 1.5k ²	4,874	12.2 %	7,311,000	0.5 %	0	0.0 %	0
Coverage D 10k	7,078	17.7 %	70,780,000	4.9 %	100,841	1.4 %	14
Coverage D 15k	12,397	31.0 %	185,955,000	12.8 %	202,421	2.9 %	16
Renter Total	40,048	100.0 %	1,449,464,500	100.0 %	6,962,111	100.0 %	174

¹Policies that have a Coverage C limit of 5k and a Coverage D limit >1.5k

²Policies that have a Coverage D limit of 1.5k and a Coverage C limit >5k

California Earthquake Authority

Historical Reinsurance Costs

Base & Supplemental Limits

Contract Year	Contract	Limit	Retention	Rate On Line (ROL)	Premium
2011	Contract #1	\$200,000,000 xs	\$3,300,000,000	8.1500%	\$16,300,000
	Contract #2	\$1,300,000,000 xs	\$3,500,000,000	7.5000%	\$97,500,000
	Contract #3	\$500,000,000 xs	\$4,500,000,000	6.2000%	\$31,000,000
	Contract #3a	\$200,000,000 xs	\$4,500,000,000	6.0000%	\$12,000,000
	Contract #4 (65% placed)	\$650,000,000 xs	\$5,000,000,000	5.5000%	\$35,750,000
	Contract #4a (5% placed)	\$50,000,000 xs	\$5,000,000,000	5.5000%	\$2,062,500
Total		\$2,900,000,000 xs	\$3,300,000,000	6.7108%	\$194,612,500
Percent Change from Previous Year		-7.13%		-6.24%	-12.92%
2010	Contract #1	\$202,500,000 xs	\$3,300,000,000	9.2500%	\$18,731,250
	Contract #2	\$1,000,000,000 xs	\$3,500,000,000	8.5500%	\$85,500,000
	Contract #3	\$275,000,000 xs	\$4,250,000,000	7.7000%	\$21,175,000
	Contract #4	\$300,000,000 xs	\$4,500,000,000	6.8000%	\$20,400,000
	Contract #5 (97.10% placed)	\$200,000,000 xs	\$4,800,000,000	6.5000%	\$12,623,000
	Contract #6 (94.05% placed)	\$250,000,000 xs	\$5,000,000,000	6.2500%	\$14,695,313
	Contract #7 (79.62619% placed)	\$1,150,000,000 xs	\$5,250,000,000	5.5000%	\$50,363,565
Total		\$3,122,526,185 xs	\$3,300,000,000	7.1573%	\$223,488,128
Percent Change from Previous Year		0.73%		13.96%	14.79%
2009	Contract #1	\$500,000,000 xs	\$3,500,000,000	7.7500%	\$38,749,846
	Contract #2	\$500,000,000 xs	\$4,000,000,000	6.9999%	\$34,999,384
	Contract #3	\$200,000,000 xs	\$4,500,000,000	5.9600%	\$11,920,000
	Contract #4	\$100,000,000 xs	\$4,700,000,000	5.8000%	\$5,800,000
	Contract #5	\$200,000,000 xs	\$4,800,000,000	5.5400%	\$11,080,000
	Contract #6	\$200,000,000 xs	\$5,000,000,000	5.3100%	\$10,620,000
	Contract #7 Backup Reinsurance for Transformer	\$250,000,000 xs	\$5,160,000,000	6.9900%	\$17,475,000
	Contract #8	\$650,000,000 xs	\$5,410,000,000	4.9938%	\$32,460,000
	Contract #9 Backup Reinsurance for Transformer	\$400,000,000 xs	\$6,000,000,000	6.6500%	\$26,600,000
	Contract #10	\$100,000,000 xs	\$6,060,000,000	4.9938%	\$4,993,846
Total		\$3,100,000,000 xs	\$3,500,000,000	6.2806%	\$194,698,076
Percent Change from Previous Year		85.96%		-26.36%	5.71%

(Combined base & Supplemental)

**California Earthquake Authority
Historical Reinsurance Costs**

Contract Year	Contract	Limit	Retention	Rate On Line (ROL)	Premium	
Base-Limits						
2008	Combined Reinsurance Contract #1	\$300,000,000	xs	\$3,600,000,000	9.8000%	\$29,400,000
	Combined Reinsurance Contract #2	\$1,367,000,000	xs	\$3,900,000,000	8.2500%	\$112,777,500
	Total	\$1,667,000,000	xs	\$3,600,000,000	8.5289%	\$142,177,500
	Percent Change from Previous Year	-11.58%			5.77%	-6.48%
2007	Collateralized Reinsurance Contract (2006-2007)	\$350,000,000	xs	\$3,600,000,000	6.9500%	\$24,325,000
	Reinsurance Layer 1	\$150,000,000	xs	\$3,950,000,000	15.0000%	\$22,500,000
	Reinsurance Layer 2	\$50,000,000	xs	\$4,100,000,000	12.5000%	\$6,250,000
	Collateralized Reinsurance Contract (2007)	\$125,000,000	xs	\$4,150,000,000	11.5000%	\$14,375,000
	Reinsurance Layer 3	\$20,000,000	xs	\$4,275,000,000	11.0000%	\$2,200,000
	Reinsurance Layer 4 (79.45953% placed)	\$1,200,000,000	xs	\$4,300,000,000	7.1000%	\$0
	Reinsurance Layer 5 (79.47738% placed)	\$298,000,000	xs	\$5,500,000,000	6.2000%	\$0
	Total	\$1,885,356,952	xs	\$3,600,000,000	8.0639%	\$152,033,760
	Percent Change from Previous Year	7.37%			24.19%	33.33%
2006	Collateralized Reinsurance Contract (2005-2006)	\$300,000,000	xs	\$3,300,000,000	7.0000%	\$21,000,000
	Collateralized Reinsurance Contract (2006-2007)	\$350,000,000	xs	\$3,600,000,000	6.9500%	\$24,325,000
	Collateralized Reinsurance Contract	\$30,000,000	xs	\$3,950,000,000	6.8000%	\$2,040,000
		\$680,000,000	xs	\$3,300,000,000	6.9654%	\$47,365,000
	Base-Limit Coverage Reinsurance Contract Insurance In Force Adjustment	\$1,076,000,000	xs	\$4,006,000,000	6.0000%	\$64,560,000 \$2,100,000
	Total	\$1,756,000,000	xs	\$3,300,000,000	6.4935%	\$114,025,000
	Percent Change from Previous Year	17.07%			5.83%	23.89%

**California Earthquake Authority
Historical Reinsurance Costs**

Contract Year	Contract	Limit	Retention	Rate On Line (ROL)	Premium		
2005	Collateralized Reinsurance Contract (2005-2006)	\$300,000,000	xs	\$3,300,000,000	7.0000%	\$21,000,000	
	First Transformer Layer (2004-2005)	\$150,000,000	xs	\$3,600,000,000	7.2500%	\$10,875,000	
	MLCRC First Reinsurance Layer	\$550,000,000	xs	\$3,750,000,000	5.7500%	\$31,625,000	
		\$1,000,000,000	xs	\$3,300,000,000	6.3500%	\$63,500,000	
	Second Transformer Layer (2004-2005)	\$200,000,000	xs	\$4,617,000,000	5.5000%	\$11,000,000	
	MLCRC Second Reinsurance Layer	\$300,000,000	xs	\$4,817,000,000	4.3500%	\$13,050,000	
		\$500,000,000	xs	\$4,617,000,000	4.8100%	\$24,050,000	
	Insurance In Force Adjustment ¹					\$4,484,662	
	Total		\$1,500,000,000	xs	\$3,300,000,000	6.1356%	\$92,034,662
	Percent Change from Previous Year		0.00%		-8.51%	-8.51%	
2004	MLCRC First Reinsurance Layer	\$700,000,000	xs	\$2,900,000,000	7.8500%	\$54,950,000	
	First Transformer Layer (2004-2005)	\$150,000,000	xs	\$3,600,000,000	7.2500%	\$10,875,000	
	MLCRC Second Reinsurance Layer	\$150,000,000	xs	\$3,750,000,000	6.3500%	\$9,525,000	
		\$1,000,000,000	xs	\$2,900,000,000	7.5350%	\$75,350,000	
	Second Transformer Layer (2004-2005)	\$200,000,000	xs	\$4,617,000,000	5.5000%	\$11,000,000	
	MLCRC Third Reinsurance Layer	\$300,000,000	xs	\$4,817,000,000	4.7500%	\$14,250,000	
		\$500,000,000	xs	\$4,617,000,000	5.0500%	\$25,250,000	
	Total		\$1,500,000,000	xs	\$2,900,000,000	6.7067%	\$100,600,000
	Percent Change from Previous Year		-2.47%		-6.40%	-8.72%	
	2003	MLCRC Coverage A	\$600,000,000	xs	\$2,900,000,000	8.8000%	\$52,800,000
MLCRC Coverage B		\$400,000,000	xs	\$3,500,000,000	7.2500%	\$29,000,000	
		\$1,000,000,000	xs	\$2,900,000,000	8.1800%	\$81,800,000	
Transformer Layer		\$200,000,000	xs	\$4,617,000,000	5.5000%	\$11,000,000	
MLCRC Coverage C		\$338,000,000	xs	\$4,817,000,000	5.1500%	\$17,407,000	
		\$538,000,000	xs	\$4,617,000,000	5.2801%	\$28,407,000	
Total			\$1,538,000,000	xs	\$2,900,000,000	7.1656%	\$110,207,000
Percent Change from Previous Year			-21.98%		6.99%	-16.53%	

**California Earthquake Authority
Historical Reinsurance Costs**

Contract Year	Contract	Limit	Retention	Rate On Line (ROL)	Premium
2002	First Aggregate	\$1,433,620,000 xs	\$3,436,000,000	7.2500%	\$82,187,450
	First Aggregate (\$200M part of)	\$1,433,620,000 xs	\$3,436,000,000	7.1400%	\$14,280,000
	First Aggregate (\$100M part of)	\$1,433,620,000 xs	\$3,436,000,000	5.9900%	\$5,990,000
		\$1,433,620,000 xs	\$3,436,000,000	7.1468%	\$102,457,450
	Second Aggregate	\$537,607,500 xs	\$5,326,000,000	5.5000%	\$29,568,413 ²
	Total	\$1,971,227,500 xs	\$3,436,000,000	6.6976%	\$132,025,863
	Percent Change from Previous Year	0.00%		-13.69%	-13.69%
2001	First Aggregate	\$1,433,620,000 xs	\$3,130,000,000	8.5000%	\$96,357,700
	First Aggregate (\$200M part of)	\$1,433,620,000 xs	\$3,130,000,000	7.5000%	\$15,000,000
	First Aggregate (\$100M part of)	\$1,433,620,000 xs	\$3,130,000,000	5.9900%	\$5,990,000
		\$1,433,620,000 xs	\$3,130,000,000	8.1854%	\$117,347,700
	Second Aggregate	\$537,607,500 xs	\$5,281,000,000	6.6250%	\$35,616,497
	Total	\$1,971,227,500 xs	\$3,130,000,000	7.7598%	\$152,964,197
	Percent Change from Previous Year	-21.43%		-17.31%	-35.03%
2000	First Aggregate	\$1,433,620,000 xs	\$2,843,000,000	8.5000%	\$104,857,697
	First Aggregate (\$200M part of)	\$1,433,620,000 xs	\$2,843,000,000	7.5000%	\$15,000,002
		\$1,433,620,000 xs	\$2,843,000,000	8.3605%	\$119,857,699
	Second Aggregate	\$1,075,215,000 xs	\$4,993,000,000	10.7500%	\$115,585,613
		Total	\$2,508,835,000 xs	\$2,843,000,000	9.3846%
	Percent Change from Previous Year	0.00%		3.02%	3.02%
1999	First Aggregate	\$1,433,620,000 xs	\$2,602,000,000	11.0000%	\$157,698,200
	No Claims Bonus Paid to CEA				(\$28,970,456)
	Exposure Adjustment				(\$15,769,820)
	Revised ROL and Premium	\$1,433,620,000 xs	\$2,602,000,000	7.8792%	\$112,957,924
	Second Aggregate	\$1,075,215,000 xs	\$4,753,000,000	10.7500%	\$115,585,613
	Total	\$2,508,835,000 xs	\$2,602,000,000	9.1095%	\$228,543,537
	Percent Change from Previous Year	0.00%		-23.56%	-23.56%

**California Earthquake Authority
Historical Reinsurance Costs**

Contract Year	Contract	Limit	Retention	Rate On Line (ROL)	Premium	
1998	First Aggregate	\$1,433,620,000	xs	\$2,726,000,000	14.3750%	\$206,082,875
	No Claims Bonus Paid to CEA					(\$22,687,734)
	Revised ROL and Premium	\$1,433,620,000	xs	\$2,726,000,000	12.7925%	\$183,395,141
	Second Aggregate	\$1,075,215,000	xs	\$4,877,000,000	10.7500%	\$115,585,613
	Total	\$2,508,835,000	xs	\$2,726,000,000	11.9171%	\$298,980,754
Percent Change from Previous Year		16.13%		-4.19%	11.27%	
1997	First Aggregate	\$1,433,620,000	xs	\$2,850,000,000	14.3750%	\$206,082,875
	No Claims Bonus Paid to CEA					(\$14,430,600)
	Revised ROL and Premium	\$1,433,620,000	xs	\$2,850,000,000	13.3684%	\$191,652,275
	Second Aggregate (1/1/98 - 3/31/98)	\$1,075,215,000	xs	\$4,877,000,000	10.7500%	\$28,896,403
	Second Aggregate (7/1/97 - 12/31/97)	\$716,810,000	xs	\$4,815,000,000	10.7500%	\$38,528,538
	Second Aggregate (4/1/97 - 6/30/97)	\$358,405,000	xs	\$5,001,000,000	10.7500%	\$9,632,134
	Total	\$2,160,430,000³	xs	\$2,850,000,000	12.4378%	\$268,709,350

¹ Based on IIF of \$198,926,424,765 at 12/31/05

² Twelve month annualized amount

³ Includes average limit for Second Aggregate of \$716.810M

Note: Retentions based on CEA Capital and retained earnings calculated at the beginning of the calendar year
Retentions were variable between 1997 - 2002

California Earthquake Authority Historical Reinsurance Costs

Supplemental-Limits

Contract Year	Contract	Limit	Retention	Rate On Line (ROL)	Premium
2008	Combined Reinsurance Contract #1	\$150,000,000 xs	\$50,000,000	10.8500%	\$16,275,000
	Combined Reinsurance Contract #2	\$451,300,000 xs	\$200,000,000	5.7000%	\$25,725,000
Total		\$601,300,000 xs	\$50,000,000	6.9849%	\$42,000,000
Percent Change from Previous Year		1.45%		-1.43%	0.00%
2007	Supplemental-Limits Excess (1st Layer)	\$50,000,000 xs	\$50,000,000	14.2500%	\$7,125,000
	Supplemental-Limits Excess (2nd Layer)	\$200,000,000 xs	\$100,000,000	8.7375%	\$17,475,000
	Supplemental-Limits Excess (3rd Layer)	\$342,715,221 xs	\$300,000,000	5.0771%	\$17,400,000
Total		\$592,715,221 xs	\$50,000,000	7.0860%	\$42,000,000
Percent Change from Previous Year		306.36%		66.73%	577.53%
2006 ¹	Supplemental-Limits Excess	\$145,858,362 xs	\$450,000,000	4.2500%	\$6,198,980
Total		\$145,858,362 xs	\$450,000,000	4.2500%	\$6,198,980

¹ 2006 included quota share limit of \$450M

Supplemental Quota Share

Contract Period		Written Premium	Ceding Commission	Ceded Premium	Losses
Begin	End				
1/1/2005	12/31/2006	\$102,946,945	\$18,181,382	\$84,765,563	
7/1/2004	12/31/2004	\$16,102,397	\$2,232,406	\$13,869,991	
7/1/2003	6/30/2004	\$22,980,920	\$4,599,044	\$18,381,876	\$186,801
1/1/2003	6/30/2003	\$18,538,621	\$3,707,724	\$14,830,897	\$50,817
7/1/2002	12/31/2002	\$12,510,357	\$2,502,071	\$10,008,286	
3/1/2001	6/30/2002	\$27,527,388	\$5,505,478	\$22,021,910	
7/1/1999	2/28/2002	\$15,448,110	\$3,089,622	\$12,358,488	
Unearned Premium @ 12/31/2006		-\$24,138,678	-\$4,224,269	-\$19,914,409	
Total		\$191,916,060	\$35,593,458	\$156,322,602	\$237,618