



Date of Notice: Friday, May 31, 2019

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: California Earthquake Authority
Main Conference Room
801K Street, Suite 1000
Sacramento, California

DATE: Wednesday, June 12, 2019

TIME: 12:00 p.m. Call to Order followed by
Closed Session
1:00 p.m. Public Session

AGENDA:

Preliminary Matters

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

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 this icon:



[Video \(with audio\)](#)

If you are unable to view and hear the meeting, please call CEA directly at (916) 661-5001 for assistance.

2. The Board will meet in closed session to discuss personnel matters, as permitted by California Government Code section 11126, subdivision (a).
3. Consideration and approval of the minutes of the March 20, 2019 Governing Board meeting.
4. Consideration and approval of the minutes of the April 12, 2019 Governing Board meeting.

CEA Enterprise – Executive and Operations Reports

5. Executive Report by Chief Executive Officer Glenn Pomeroy, which will include an update for the Board on legislative activities of interest to the CEA.
6. Chief Operations Officer Kellie Schneider will update the Board on the quantitative business metrics report.
7. Enterprise & Strategic Risk Advisor Laurie Johnson will update the Board on CEA enterprise-risk-management-program planning and progress.
8. Mr. Pomeroy will seek Board approval to permit CEA to contract to hire a Chief Information Security Officer.

Insure – Matters Related to CEA’s Insurance Business

9. Chief Financial Officer Tom Hanzel will present to the Board the quarterly CEA financial report.
10. Mr. Hanzel will seek Board approval for the annual set-aside of a statutory portion of CEA investment income for transfer into the CEA Earthquake Loss Mitigation Fund.
11. Mr. Hanzel will provide a brief overview of CEA’s need to retain a consulting firm to assist CEA in a comprehensive assessment of its readiness to efficiently and effectively administer a high volume of claims following a major earthquake, and will seek Board approval to contract with a consulting firm to assist CEA in this process.
12. CEA independent financial auditor Plante Moran PLLC will present to the Board the results of its most recent audit of CEA, conducted pursuant to the standards of the Governmental Accounting Standards Board (GASB).

Mitigate – Matters Related to CEA’s Mitigation Mission

13. Mr. Pomeroy will report on the continued development of a 501(c)(3) Non-Profit Public Benefit Corporation.
14. Chief Mitigation Officer Janiele Maffei will update the Board on CEA-mitigation-program projects including the California Residential Mitigation Program incentive program (CRMP Earthquake Brace + Bolt), CEA’s financial-incentive and mitigation program (CEA Brace + Bolt), and ongoing mitigation-related research projects.

Educate – Matters Related to CEA’s Earthquake Preparation & Education Mission

- 15. Mr. Pomeroy will report on CEA’s launch of the statewide multi-agency earthquake preparedness and recovery “TV News Station Initiative.”
- 16. Ms. Maffei will update the Board on the CEA Research Program.

Conclusion

- 17. Public comment on matters that do not appear on this agenda and requests by the public that those matters be placed on a future agenda.
- 18. Closing remarks by Mr. Pomeroy.
- 19. Adjournment.

For further information about this notice or its contents:

General Information:

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To view this notice on the CEA website or to learn more about CEA, please visit www.EarthquakeAuthority.com.
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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 CEA prepares for its Board meetings. Please contact Colby Tunick by telephone, toll free, at (877) 797-4300 or by email at CEABoardLiaison@calquake.com. We would appreciate hearing from you at least five days before the meeting date to best allow us to meet your needs.
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NOTE: If in the future you do not wish to receive public notices pertaining to CEA, please send your request by email to CEABoardLiaison@calquake.com.

DRAFT

CALIFORNIA EARTHQUAKE AUTHORITY GOVERNING BOARD MEETING MINUTES

Wednesday, March 20, 2019
1:00 p.m.

Location: CalSTRS Headquarters Building
Board Room – Lobby, E-124
100 Waterfront Place
West Sacramento, California

Members of the Governing Board in attendance:

Mark Ghilarducci, designee of Governor Gavin Newsom, Board Chair
Fiona Ma, State Treasurer
Michael Martinez, designee of Insurance Commissioner Ricardo Lara
Jeffrey Wood, designee of Speaker of the Assembly Anthony Rendon
Craig Fry, designee of Chair of the Senate Rules Committee Toni Atkins

Members of the CEA Staff in attendance:

Glenn Pomeroy, Chief Executive Officer
Shawna Ackerman, Chief Actuary
Sheri Aguirre, Strategic Advisor
Tom Hanzel, Chief Financial Officer
Laurie Johnson, PhD, Enterprise & Strategic Risk Advisor
Janiele Maffei, Chief Mitigation Officer
Michael Melavic, Acting Chief Information Officer
Chris Nance, Chief Communications Officer
Kellie Schneider, Chief Operations Officer
Colby Tunick, Acting Governing Board Liaison
Tom Welsh, General Counsel

Also present:

Kapil Bhatia, Director of Public Finance, Raymond James & Associates, Inc.
Kasey O'Connor, Legislative Director, Office of the State Treasurer

1. Call to order and member roll call.

Chair Mark Ghilarducci called the meeting to order at 1:01 p.m. A quorum was achieved.

2. Consideration and approval of the minutes of the December 12, 2018, CEA Governing Board meeting.

MOTION: Chair Ghilarducci moved approval of the December 12, 2018, California Earthquake Authority Governing Board Meeting Minutes as presented. Ms. Ma seconded. Motion carried unanimously.

3. Executive Report by Chief Executive Officer Glenn Pomeroy, which will include an update for the Board on legislative activities of interest to the CEA.

Glenn Pomeroy, Chief Executive Officer, welcomed new CEA Governing Board members Fiona Ma, State Treasurer, and Michael Martinez, designee of Insurance Commissioner Ricardo Lara.

Mr. Pomeroy welcomed new staff members Tom Welsh, General Counsel, Tom Hanzel, Chief Financial Officer, and Michael Melavic, Acting Chief Information Officer. He noted that the Insurance Operations role was moved back under the Chief Financial Officer responsibilities.

Mr. Pomeroy provided a summary, with a slide presentation, of the CEA policies in force, policy growth, mitigation retrofits, claim-paying capacity, restructuring of the financial tower to create sustainability, federal legislation, and community outreach efforts.

Questions and Discussion

Ms. Ma asked if there will be an opportunity for the Board to weigh in on legislation. Mr. Pomeroy stated the next Board meeting is scheduled for June 12th but Board members may ask for an additional Board meeting at any time for issues such as taking positions on legislation.

Ms. Ma stated supporting legislation would help bills move forward. She asked about meeting times for the Listening Sessions in Los Angeles, San Francisco, and Sacramento. Sheri Aguirre, CEA Strategic Advisor, stated the meeting times will be 11:30 a.m. to 1:30 p.m.

Chair Ghilarducci asked about the venues for the Listening Session events.

Ms. Aguirre stated the Listening Sessions will be held at the City Hall in Los Angeles and the City Hall in San Francisco. The venue for the Sacramento Listening Session has yet to be determined.

Mr. Wood stated the City Hall in downtown Los Angeles is not convenient for the other 87 cities in Los Angeles County. He asked if Listening Sessions will be planned in additional cities. Mr. Pomeroy stated the idea is to learn the level of interest by holding Listening Sessions in three parts of the state.

4. Chief Financial Officer Tom Hanzel will present to the Board the quarterly CEA Financial Report.

Tom Hanzel, Chief Financial Officer, provided an overview, with a slide presentation, of the CEA financial information as of December 31, 2018. He stated the Mitigation budget is over budget due to the Engineering line item but this is money well spent. He stated the importance of working with engineers to

better understand what happens to housing at different earthquake magnitudes to ensure that mitigation programs will work properly during an event.

5. Mr. Hanzel will seek Board authorization to set the CEA participating insurers' respective maximum earthquake loss funding assessment levels, effective April 1, 2019.

Mr. Hanzel provided an overview of the background and analysis of the annual CEA Participating Insurer maximum earthquake loss funding assessment levels and showed slides of Attachment A: 2019 Maximum Earthquake Loss Funding Assessment Levels.

Staff recommendations:

- Adopt the CEA market-share percentages shown in Attachment A, which are to be used to determine the maximum earthquake loss funding assessment levels for CEA participating insurers, effective April 30, 2019.
- Authorize CEA staff to notify each participating insurer of its respective April 30, 2019, maximum earthquake loss funding assessment level responsibility.

MOTION: Mr. Martinez moved approval of the staff recommendations as presented. Ms. Ma seconded. Motion carried unanimously.

6. Mr. Hanzel will seek Board approval to contract with additional investment managers.

Mr. Hanzel stated the CEA went through a Request for Qualifications (RFQ) process during the third and fourth quarters of last year for investment management companies that manage \$10 billion or more and \$10 billion or less. The management limits are \$1.25 billion maximum CEA assets for the larger managers and \$250 million for the smaller managers. Seven responses were received – five from large managers and two from small managers.

Staff recommendations:

- Approval of the investment firms listed below to provide investment management services for the CEA Fund:
 - Small Manager
 - Emergent Financial Services, LLC
 - Miles Capital, Inc.
 - Large Manager
 - American Beacon Advisors, Inc.
 - Chandler Asset Management
 - Goldman Sachs Asset Management

- Longfellow Investment Management Co.
- RBC Global Asset Management (U.S.) Inc.
- Authorize CEO Glenn Pomeroy to negotiate and execute the contracts on behalf of CEA.

Questions and Discussion

Ms. Ma asked if additional contracts would have been approved if more responses were received and passed the selection panel process. Mr. Hanzel stated he would be willing to consider more than ten managers for increased distribution, although there can be too many managers based on infrastructure.

Mr. Martinez stated the need for a robust and competitive process that attracts as many individuals as possible. He questioned that the RFQ was only published on the CEA website and advertised in one periodical and that the seven respondents are the current investment managers. Individuals may not have known about the existence of the RFQ. He stated he appreciated that Mr. Hanzel will be looking into this to improve the RFQ process in the future.

Chair Ghilarducci agreed with the need to reach a greater audience during the RFQ process. He asked about the length of the contracts. Mr. Hanzel stated they are five-year contracts with an option to extend them by two years.

MOTION: Ms. Ma moved approval of the staff recommendations as presented. Mr. Martinez seconded. Motion carried unanimously.

7. Kapil Bhatia, Managing Director of Public Finance for Raymond James & Associates, Inc. – the CEA’s independent financial advisor – will present to the Board the annual report on the state of the economy.

Kapil Bhatia, Managing Director of Public Finance for Raymond James & Associates, Inc., provided an overview, with a slide presentation, of the economic, financial, investment, and risk-transfer market in his annual report on the state of the economy. He concluded the following:

- Interest rates are low.
- Economic growth is slow with lower productivity.
- Capital is cheap.
- Financial markets are strong.
- Reinsurance markets are stable.
- The CEA portfolio is strong and stable.

Questions and Discussion

Mr. Martinez asked when the Board last reviewed the investment policy strategy. Mr. Bhatia stated the Board made minor changes last year and it is currently under review. He anticipated presenting updates at the June or September Board meeting.

Chair Ghilarducci asked that Mr. Bhatia include an in-depth discussion on the strategies during his future presentation. He referred to Slide 63, which lists the total estimated loss, insured losses, and uninsured losses for the 2018 wildfires. He asked about government costs. Mr. Bhatia stated government losses are difficult to estimate and are not included in the estimates.

Ms. Ma asked about the market for catastrophe bonds and what California should be doing to protect against further unexpected losses. Mr. Bhatia stated the catastrophe bond market is strong if it is structured right. It is a non-collateralized market that is expected to continue to grow. He stated investors are looking for diversified perils.

8. Mr. Pomeroy will propose, for Board approval, a routine update to CEA's Governing Board resolutions pertaining to certain CEA bank accounts.

Mr. Pomeroy stated the need to update the list of signatories on the banking documents. Mr. Hanzel's name will replace Todd Coombes' name, who recently resigned from the CEA, on the list of CEA executives with the authority to perform routine banking transactions on behalf of the CEA.

Staff recommendation:

- Adopt the resolutions in substantially the forms attached as Attachment A and Attachment B.

MOTION: Mr. Martinez moved approval of the staff recommendation as presented. Ms. Ma seconded. Motion carried unanimously.

9. Enterprise & Strategic Risk Advisor Laurie Johnson will update the Board on CEA enterprise-risk-management-program planning and progress.

Laurie Johnson, Enterprise and Strategic Risk Advisor, provided an overview, with a slide presentation, of the progress to date, framework, priority risks, quarterly report, and 2019 program plan of the Enterprise Risk Management program.

10. Chief Communications Officer Chris Nance will present, and seek Board approval of, the 2020 CEA advertising budget.

Chris Nance, the Chief Communications Officer, provided an overview, with a slide presentation, of the background, current programming, outreach and media marketing expansion, and barriers and challenges of CEA marketing. He stated the plan to change from spring and fall advertising to quarterly advertising with a regional emphasis – Los Angeles, Bay Area, San Diego, and statewide. He showed videos of the new product advertisement theme and a news talent educational vignette PSA. He stated the proposed modest 8 percent increase in the advertising budget is to support greater sophistication and further extension of the program.

Staff recommendation:

- Approve proposed advertising budget up to \$13,200,000 to implement CEA's 2020 advertising plan.

Questions and Discussion

Mr. Martinez asked about high-level metrics for advertising such as market penetration and the increase of policies in force. Mr. Nance offered to meet offline to discuss the CEA marketing strategies and metrics in detail. He stated the CEA has never gone over the marketing budget.

Mr. Pomeroy welcomed the Insurance Commissioner's input in the marketing program and on meaningful metrics.

Mr. Fry complimented Mr. Nance and his team that the advertising does not scare individuals into buying earthquake policies but instead makes them think. It is a better way to get the message through. Mr. Pomeroy stated social scientists agree that people cannot be scared into action but must be informed of the consequences of not acting and educated on what they can do to feel safer. This is the underlying effort behind all of CEA advertising.

Ms. Ma asked about the Out-of-Home and Trade categories of the budget. Mr. Nance stated Out-of-Home is billboard and transit shelter advertising. The Trade category is the Business-to-Business (B2B) side as opposed to the Business-to-Consumer (B2C) side. The B2B side is a very important area to further explore. It enables the CEA to work with agents who are eager to sell CEA policies and attracts interest from more agents who currently may not have an interest in selling CEA policies. The marketing to reach agents is different from the marketing to reach consumers. The advertising budget is separated accordingly.

Ms. Ma noted that the Trade category has increased. Mr. Nance stated the CEA has worked exclusively with agents in the past. He stated that investment has been increased because efforts will be expanded to include realtors, mortgage bankers, and financial planners.

Chair Ghilarducci asked if Mr. Nance has assessed how advertising correlates to an increase in policies. Mr. Nance stated the monthly website analytics in web traffic and A/B testing of digital advertising are informative.

Ms. Ma asked why agents are not incentivized to sell the product. Mr. Nance stated it is prohibited in statute.

MOTION: Mr. Martinez moved approval of the staff recommendation as presented. Ms. Ma seconded. Motion carried unanimously.

11. Chief Operations Officer Kellie Schneider will seek Board approval for CEA to contract for and purchase Enterprise Resource Planning software in 2019.

(Item Withdrawn)

12. Chief Mitigation Officer Janiele Maffei will update the Board on CEA mitigation-program projects, including the California Residential Mitigation Program incentive program (CRMP Earthquake Brace + Bolt), CEA’s financial-incentive and mitigation program (CEA Brace + Bolt), and ongoing mitigation-related research projects.

Mr. Pomeroy presented this agenda item for Janiele Maffei, Chief Mitigation Officer, who was out of the office on jury duty. He provided an overview, with a slide presentation, of the goals and status of the CRMP Earthquake Brace + Bolt and 2019 CEA Brace + Bolt programs. He stated the CRMP has several applications in for additional Federal Emergency Management Agency (FEMA) grants for proactive risk-reduction mitigation work.

13. Ms. Maffei will update the Board on the CEA Research Program.

Mr. Pomeroy provided an overview, with a slide presentation, of the current status of the CEA research projects.

14. Acting Chief Information Officer Michael Melavic will report to the Board on CEA insurance and information-technology initiatives.

Michael Melavic, Acting Chief Information Officer, deferred to Mr. Hanzel to present the first two presentation slides. Mr. Hanzel gave an overview of the insurance education and sales support activities and insurance operations of the CEA. He stated the natural catastrophe team will meet next week in Sacramento for a few days and do a Camp Fire site visit.

Mr. Melavic continued the slide presentation and discussed the status of the information-technology initiative. He stated the IT portion of the Department of Insurance financial audit that is done every three years was successfully completed, the results of which will be published in one month.

Questions and Discussion

Chair Ghilarducci asked if the insurance operations team makes projections on potential growth or looks at policy growth in arrears. Mr. Pomeroy stated the previous month's activity is captured by the 24th of the following month.

Mr. Melavic stated there are metrics from prior years to use as a comparison.

15. Ms. Schneider will update the Board on the quantitative business metrics report.

Kellie Schneider, Chief Operations Officer, provided an overview, with a slide presentation, of the four strategic goals and the performance metrics to accomplish this year.

Questions and Discussion

Mr. Martinez suggested that this agenda item be presented at the beginning of each Board meeting to help provide context for subsequent conversations and approvals.

16. 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.

There was no closed session.

17. Public comment on items that do not appear on this agenda and requests by the public that those matters be placed on a future agenda.

There was no public comment.

18. Adjournment.

There being no further business, the meeting was adjourned at 3:16 p.m.

DRAFT

CALIFORNIA EARTHQUAKE AUTHORITY GOVERNING BOARD MEETING MINUTES

Friday, April 12, 2019
1:30 p.m.

Location: California Earthquake Authority
801 K Street, Suite 1000
Main Conference Room
Sacramento, California

Members of the Governing Board in attendance:

State Treasurer Fiona Ma
Michael Martinez, designee of Insurance Commissioner Ricardo Lara
Jeffrey Wood, designee of Speaker of the Assembly Anthony Rendon
(via teleconference)

Members of the CEA Staff in attendance:

Glenn Pomeroy, Chief Executive Officer
Sheri Aguirre, Strategic Advisor
Tom Hanzel, Chief Financial Officer
Susie Hernandez, Legislative Director
Chris Nance, Chief Communications Officer
Colby Tunick, Acting Governing Board Liaison
Tom Welsh, General Counsel

Also present:

Alex Barnett, Policy Consultant, Office of California Senator Robert Hertzberg
John Norwood, Norwood Associates (via teleconference)
Kasey O'Connor, Legislative Director, Office of the State Treasurer

1. Call to order and member roll call.

Acting Chair Fiona Ma called the meeting to order at 1:30 p.m. A quorum was achieved.

- 2. Chief Executive Officer Glenn Pomeroy will ask that the Governing Board adopt a resolution or resolutions authorizing CEA to sponsor and/or actively support the passage and adoption of certain state and federal legislation related to the business of CEA and CEA's seismic mitigation efforts, including California Senate Bill 254 (Hertzberg), California Assembly Bill 548 (Rodriguez), and any federal legislation providing federal**

tax exemptions for any grants or other seismic mitigation benefits funded through or by CEA.

• Senate Bill 254

Glenn Pomeroy, Chief Executive Officer, provided a summary, with a slide presentation, of Senate Bill (SB) 254 (Hertzberg), the Resilient Homes Initiative. He stated SB 254 will dramatically increase funds available for residential earthquake mitigation programs and will enhance the long-term sustainability of the CEA.

Questions and Discussion

Acting Chair Ma asked about the difference that has caused entities that opposed the last iteration to now be in support of this current version of the bill. Tom Welsh, General Counsel, stated the reason for the robust and diverse list of supporters is due to the CEA's efforts during the last few years to educate individuals on how to take steps to enhance the CEA's ability to be more meaningfully involved in its core mission of mitigating and helping California prepare. This bill represents sound public policy and is the product of a deeper amount of stakeholder communication.

Acting Chair Ma suggested contacting the resiliency officer in San Francisco. Mr. Pomeroy stated staff has had ongoing discussions with Brian Strong, Chief Resilience Officer for San Francisco. Their official position on the bill is not yet known since the bill only became available last week.

Acting Chair Ma offered her assistance. Mr. Pomeroy stated he would appreciate her help.

Mr. Martinez stated Insurance Commissioner Lara feels that this proposal benefits everyone – it strengthens homes and provides sustainability to the CEA. Mr. Martinez referred to the second point on the resolution, which was included in the meeting packet, and stated the need for the Department of Insurance to promulgate regulations to ensure clarity on the part of insurers and the CEA – the collection of the assessment, the enforcement, and the logistics between the insured and the insurer.

Public Comment

John Norwood, Norwood Associates, stated a number of clients have concerns about this bill, including independent insurance agents, the California Insurance Wholesalers Association, First American Corporation, the Independent Insurance Agents and Brokers of California, and Zenith Insurance Company. He stated the amendments to this bill just became available last week and have yet to be digested by the public or the industry. He stated the Legislature should not be looking at competing assessments on non-participating insurers and their policyholders at this time. He suggested that SB 254 be a two-year bill to give time for additional workshops on this issue. He suggested that the CEA bring in experts to come up with a report detailing other possibilities. He stated the

concern that it falls to agents and surplus lines brokers to collect assessments but they do not receive anything in return. He questioned their authority to collect assessments from clients.

Mr. Pomeroy stated he would connect with Mr. Norwood offline to discuss his concerns. He stated he disagreed that the bill should become a two-year bill because of the need to retrofit as many homes as possible as soon as possible.

Acting Chair Ma agreed that there is a great need to retrofit as many homes as possible. She stated the CEA will have an opportunity to work together on concerns because this is just the beginning of the process. She moved to support the resolution to sponsor SB 254 and to continue to bring experts together to continue the dialogue and insure against unintended consequences to the best of the CEA's ability. Mr. Martinez seconded.

MOTION: Ms. Ma moved adoption of the resolution of sponsorship of and support for Senate Bill 254 by Senator Herzberg as presented by staff. Mr. Martinez seconded. Motion carried and approved by a roll call vote.

• **Assembly Bill 548**

Mr. Pomeroy continued the slide presentation and discussed Assembly Bill (AB) 548 (Rodriguez). He stated the goal of AB 548 is to encourage the CEA to find a way to make the Earthquake Brace + Bolt program more meaningful to individuals of low-income and vulnerable communities.

MOTION: Mr. Martinez moved to authorize the CEA to actively support Assembly Bill 548 by Assemblyman Rodriguez as presented by staff and to authorize CEA staff to work with legislative leaders and members of the Senate, Assembly, and stakeholders to see passage of this bill. Ms. Ma seconded. Motion carried and approved by a roll call vote.

• **H.R. 2053 and Senate Bill 1058**

Mr. Pomeroy continued the slide presentation and discussed H.R. 2053 and SB 1058 to eliminate the tax penalty on grants at the federal level.

MOTION: Mr. Martinez moved to authorize the CEA to actively support H.R. 2053 and Senate Bill 1058 in the United States Congress and authorize CEA staff to work with Congressional leaders and members of the United States House and Senate to see passage of these measures. Ms. Ma seconded. Motion carried and approved by a roll call vote.

3. Adjournment.

There being no further business, the meeting was adjourned at 2:58 p.m.

Governing Board Memorandum

June 12, 2019

Agenda Item 5: 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.

Governing Board Memorandum

June 12, 2019

Agenda Item 6: Quantitative Business Metrics Report Update

Recommended Actions: No action required—information only

Chief Operations Officer Kellie Schneider will present to the Board the periodic CEA Operations Business Metrics Report.

Governing Board Memorandum

May 29, 2019

Agenda Item 7: CEA Enterprise Risk Management Program update

Recommended Action: No action required—information only

The CEA Enterprise Risk Management (ERM) Program is focused on monitoring and managing 12 priority risks:

Financial Risks	Insurance Risks	Operational Risks	Strategic Risks
<ul style="list-style-type: none"> • Risk Transfer • Financial Management – Investments and Accounting 	<ul style="list-style-type: none"> • Policy Contracting and Servicing • Claim Handling • Earthquake Science and Modeling • CEA Residential Mitigation programs 	<ul style="list-style-type: none"> • Business Continuity • IT Systems and Data Security • Legal – Compliance and Litigation • Workforce 	<ul style="list-style-type: none"> • Legislative/Regulatory • Reputation

For each priority risk, risk drivers have been identified, each with corresponding risk checkpoints and limits that are regularly monitored by priority-risk owners, the CEA Enterprise and Strategic Risk Advisor, and the CEA ERM Committee. Also, since a major, damaging earthquake occurring in California would constitute an overarching risk consideration, each priority risk is assessed from both a “steady-state” perspective and a post-earthquake perspective.

The following scorecard represents CEA ERM risk-reporting for 2nd quarter 2019 and includes all activity since the immediately past CEA Governing Board meeting.

- The column “Q2 2019” indicates risk status and whether a risk escalation occurred during the preceding three months.
- The column named Outlook indicates the potential future direction of the risk status—as either positive, negative, or stable—until the CEA Governing Board next meets.
- The final column is a brief summary of actions taken and risk-escalation status.

Since March 2019, one new risk checkpoint was reached. ERM-based risk response and controls have been applied and the priority-risk has a positive outlook for Q3 2019. There are also two continuing issues from prior reports: The IT Systems and Data Security priority-risk remains at “red” status while CEA continues to work to complete a contracting-related matter, and the Legislative-Regulatory priority-risk remains at “yellow” status while CEA is engaged in a legislative process that could affect key CEA features. Both have a positive outlook for Q3 2019.

ERM Quarterly Report	Status		29-May-19
Priority Risk	Q2 2019	Outlook	Activity Last Quarter / Comments
Risk Transfer		Stable	
Financial Management - Investments and Accounting		Stable	
Policy Sales and Servicing		Stable	
Business Continuity		Positive	A business continuity matter triggered a risk-checkpoint control response. Risk responses and controls are being reviewed.
IT Systems and Data Security		Positive	A required contracting matter is in progress, but was not completed within the intended time frame. Work continues to resolve this matter.
Legislative/Regulatory		Positive	CEA is actively engaged in the legislative process, seeking to enhance its claim-paying capacity and ensure the availability of future additional capacity to meet growth needs and accomplish other program goals. That process, because it could affect key CEA features, has triggered ERM-related monitoring, outreach, and documentation controls.
Claim Handling		Stable	
Legal - Compliance and Litigation		Stable	
Reputation		Stable	
Earthquake Science and Modeling		Stable	
Workforce		Stable	
Residential Mitigation Programs		Stable	

Legend	
	No risk checkpoints or limits reached.
	Approaching or reached a risk checkpoint.
	Approaching or reached a risk limit.

The Enterprise & Strategic Risk Advisor and support staff are continuing their work with the ERM Committee to advance the risk culture and ERM awareness within CEA and build out the enterprise-wide risk-management framework, in accordance with principles of the Own Risk and Solvency Assessment (“ORSA”) guidance of the National Association of Insurance Commissioners.

The 2019 ERM Program Plan includes regular reviews of each priority-risk and corresponding risk control summary and consideration of potential emerging risks, enhancing the ERM program management, staffing and suite of risk assessment and monitoring tools and approaches, and addressing post-earthquake response-planning priorities revealed through the ERM efforts.

Recommendations: None—information only.

CEA Governing Board Memorandum

June 12, 2019

Agenda Item 8: Approval for CEA process to contract to hire employee for upper-management and unique, high-skill position

Recommended Action: Approve recommended process and accept CEO Glenn Pomeroy's recommendation to direct-hire a contract Chief Information Security Officer

Background:

When the CEA opened for business in 1996, the CEA statute provided a 25-person limit on how many CEA employees could be hired "subject to civil service positions." However, the CEA statute also broadly authorized the Governing Board to fill positions outside of civil service as necessary to allow CEA to conduct its business. Because a staff of 25 civil servants was not sufficient to carry out the Governing Board's directives to fulfill its publicly adopted mission, CEA has always relied upon a diversified workforce consisting of civil servants, contract employees, and supplemental staff hired through employment agencies.

The CEA statute was amended in 2013 to eliminate the 25-person cap on CEA's civil service employee base. As a result, CEA's civil service workforce has grown steadily. Nonetheless, CEA has needed to retain a material portion of its workforce through employment agencies, particularly to fill upper-level management and a variety of high-skill/unique-skill positions.

Because of the complex nature of the CEA's insurance and related business activities and its position in a competitive retail insurance marketplace and as a major, world-leading participant in the multi-billion dollar global risk-transfer marketplace, both upper-management and executive positions within CEA require candidates who have unique knowledge, skills, and abilities associated with the high-level work they are hired to perform.

Over the past several years CEA's insurance business has grown significantly. During that same period, CEA has also undertaken new initiatives that have increased the complexity of the business, most notably the launch of robust earthquake mitigation programs and development of a sophisticated insurance policy administration system for the benefit of participating insurers (the "Central Policy Processing" or "CPP" system). As CEA's business has become larger and more complex, there has been a corresponding growth in the level of business risks faced by CEA, particularly around data security. Examples of this increased complexity and risk include:

- CEA’s obligation to maintain highly confidential personally identifiable information (PII) for more than 2.5 million current and former policyholders;
- The additional obligation to maintain the confidentiality of PII for almost 500,000 California residential homeowners policyholders of PIs who elect to use CEA to distribute statutorily mandated “mandatory marketing documents” (MMD). As more PIs elect use CEA for this MMD distribution process, CEA’s custody of PII for individual households could jump to more than 11 million confidential household records.
- The annual onboarding of new (and larger) PIs onto CEA CPP system will exponentially increase CEA’s custodial obligations for PII.
- Cyber security risks have significantly increased over the last five years, both in general and particularly within the insurance industry. This is evidenced by CEA PIs requiring the CEA to have cyber insurance to cover the financial impact that post-breach remediation would be require.
- The reputational risk to the CEA in the event of an information breach, if not handled per current industry standards and best practices (which includes a certified CISO at the helm), has the potential to significantly lower the number of current CEA policyholders and could be devastating with regards to obtaining new policyholders.

A strong bench of uniquely qualified upper-level staff available to fill CEA’s numerous critical roles is both available to the CEA, and the only workable way to effectively execute these significant strategic objectives and manage the risks associated with the CEA’s continued successful operation. In particular, the cyber and data risks faced by CEA requires the engagement of a highly sophisticated and qualified Chief Information Security Officer.

In order to spur growth as the leading earthquake-insurance enterprise in the country and one of the largest in the world, CEA must recruit and retain qualified, skilled professionals—leaders, managers, and uniquely skilled staff who have insurance-industry experience in leadership roles, as well as private-sector technical and business acumen.

Analysis:

When creating CEA, the Legislature recognized the unique nature of CEA’s business and the resulting complexity of meeting those needs. The Legislature gave CEA and the Governing Board extremely broad statutory authority to decide how best to staff CEA’s unique operations.

California Insurance Code sections 10089.5–10089.54 authorize the Board to conduct CEA business operations in several different ways, including by contracting with officers and employees to administer the Authority.

While a significant and growing number of CEA employees are and will remain subject to civil service provisions, Insurance Code section 10089.7 provides the Governing Board a plenary authority and power to “employ or contract with that staff and those professionals the board deems necessary for its efficient administration.” Further, the Governing Board is empowered “without limitation” to perform “all acts that relate to the function and purpose of the authority, whether or not specifically designated in” the CEA statute.

In the September 20, 2017, Governing Board meeting, the CEA requested approval to fill four positions using the authority noted above:

- Insurance Marketing Director
- Mitigation Director
- Reinsurance and Risk Transfer Director
- Chief Information Security Officer

The Governing Board approved two of the positions, Insurance Marketing Director and Reinsurance and Risk Transfer Director, and recommended that the CEA attempt to recruit candidates for the remaining two positions, Mitigation Director and Chief Information Security Officer (CISO), within the California civil service process.

The CEA was successful recruiting a candidate for the Mitigation Director position; however, despite working with the State’s Chief Information Officer to develop a civil service position for the CISO position, and conducting two robust recruiting efforts for the CISO position in 2018, the CEA has been unsuccessful in recruiting a candidate to fill the CISO position as a civil service appointment.

A recap of CEA’s recruitment attempts are displayed below:

PROCESS/STEPS	TIMELINE
<ul style="list-style-type: none"> • Developed a Career Executive Assignment (C.E.A.) concept for the CISO position with assistance from State’s CIO 	March - April, 2018
<ul style="list-style-type: none"> • C.E.A. Concept Submitted to CalHR 	May 10, 2018
<ul style="list-style-type: none"> • C.E.A. Concept Approved by CalHR 	June 12, 2018
<ul style="list-style-type: none"> • First Posting 	August 7 - October 25, 2018

PROCESS/STEPS	TIMELINE
Posting Period: 8/7/2018 - 8/22/2018 <ul style="list-style-type: none"> - # of Applications received: - 18 # of Eligible applications : 5 - # of Candidates Interviewed: 2 - (Both interviews scheduled on October 25, 2018) - No candidate selected - 	
<ul style="list-style-type: none"> • Second Posting 	January 25 - May 20, 2019
Posting Period: 1/25/2019 - 2/24/2019 <ul style="list-style-type: none"> - # of Applications received: 6 - # of Eligible applications : 2 - # of Candidates Interviewed: 2 - (Both 1st round interviews scheduled on April 26,2019) - # of Candidates selected for 2nd Interview: 1 - (2nd-round interview scheduled on May 7, 2019) - No candidate selected 	

In sum, despite multiple attempts, the civil service process has not provided a candidate pool that meets the requirements of the CEA’s unique information security environment—especially as our security landscape becomes more complex.

Recommendation

Based on the analysis provided and the authority cited above, staff recommends that the Governing Board delegate to the chief executive officer authority to hire a Chief Information Security Officer who possesses a specialized and required skillset as a contract or at-will employee of CEA.



FINANCIAL REPORT

March 31, 2019

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Note: See Fact Sheets for Policies In Force, Written Premiums, and Exposures.

Financial Statements & Budgets

California Earthquake Authority
Balance Sheet
as of March 31, 2019

Assets	2019	2018
Cash and investments:		
Cash and cash equivalents	\$ 97,598,779	\$ 183,014,304
Restricted cash and equivalents	7,715,106	17,964,538
Restricted investments	448,142,072	435,084,441
Investments	6,157,289,646	5,747,636,534
Total cash and investments	<u>6,710,745,603</u>	<u>6,383,699,817</u>
Premiums receivable, net of allowance for doubtful accounts of \$5,467,667	91,292,569	72,479,326
Capital contributions receivable	4,424,000	-
Interest receivable	24,828,701	22,223,118
Securities receivable	62,469,637	46,193,066
Restricted securities receivable	3,122,537	3,179,686
Prepaid reinsurance premium	19,919,025	18,891,043
Prepaid transformer maintenance premium	770,407	2,757,306
Equipment, net	194,115	251,495
Other assets	95,642	20,277
Total assets	<u>\$ 6,917,862,236</u>	<u>\$ 6,549,695,134</u>
Liabilities and Net Position		
Unearned premiums	\$ 411,674,924	\$ 373,351,453
Accounts payable and accrued expenses	5,037,561	4,567,706
Loss and loss adjustment expense reserves	131,243	42,079
Securities payable	56,899,921	33,494,714
Revenue bond payable	105,000,000	210,000,000
Revenue bond interest payable	736,313	1,472,625
Total liabilities	<u>579,479,962</u>	<u>622,928,577</u>
Net position:		
Restricted, expendable	361,783,637	251,751,393
Unrestricted, participating insurer contributed capital	790,656,796	777,384,796
Unrestricted, State of California contributed capital	279,199,255	260,449,846
Unrestricted, all other remaining	4,906,742,586	4,637,180,522
Total net position	<u>6,338,382,274</u>	<u>5,926,766,557</u>
Total liabilities and net position	<u>\$ 6,917,862,236</u>	<u>\$ 6,549,695,134</u>

California Earthquake Authority
Statement of Revenues, Expenses and Changes in Net Position
Year-to-Date Ended March 31, 2019

	2019	2018
Underwriting income:		
Premiums written	\$ 195,878,310	\$ 176,846,653
Less premiums ceded - reinsurance	(92,511,828)	(90,189,728)
	<hr/>	<hr/>
Net premiums written	103,366,482	86,656,925
	<hr/>	<hr/>
Change in unearned premiums	5,773,277	104,563
	<hr/>	<hr/>
Net premiums earned	109,139,759	86,761,488
	<hr/>	<hr/>
Expenses:		
Losses and loss adjustment expenses	16,129	(21,877)
Participating Insurer commissions	19,589,566	17,685,697
Participating Insurer operating costs	6,362,247	5,743,589
Reinsurance broker commissions	700,000	700,000
Pro forma premium taxes equivalent	4,606,086	4,158,630
Other underwriting expenses	10,569,978	8,987,617
	<hr/>	<hr/>
Total expenses	41,844,006	37,253,656
	<hr/>	<hr/>
Underwriting profit	67,295,753	49,507,832
Net investment income	71,152,877	(21,268,470)
Other income	125,366	119,024
Grant revenue	62,980	4,050
Financing expenses, net	(695,146)	(137,225)
Earthquake Loss Mitigation Fund expenses	(3,744,854)	(388,783)
State of California premium tax contribution equivalent	4,606,086	4,158,630
	<hr/>	<hr/>
Increase in net position	138,803,062	31,995,058
Net position, beginning of year	6,199,579,212	5,894,771,499
	<hr/>	<hr/>
Net position, end of year to date	<u>\$ 6,338,382,274</u>	<u>\$ 5,926,766,557</u>

CALIFORNIA EARTHQUAKE AUTHORITY
Insurance Services
Budgeted and Actual Expenditures
As of March 31, 2019

	(a)	(b)	(c)	(d) (d=a+b+c)	(e)	(f) (f=d-e)	(g) (g=e/d)
	<u>Approved 2019 Budget 1/1/2019</u>	<u>Adjustments</u>	<u>Augmentations</u>	<u>2019 Budget after Augmentations and Adjustments</u>	<u>Actual Expenditures</u>	<u>Augmented & Adjusted Approved Budget (d) vs. Actual Expenditures (e)</u>	<u>Percentage used of Augmented & Adjusted 2019 Budget</u>
Human Resources:							
Compensation and Benefits	\$ 29,283,828	\$ -	\$ -	\$ 29,283,828	\$ 6,450,673	\$ 22,833,155	22.03%
Travel	685,314	-	-	685,314	75,642	609,672	11.04%
Other	469,030	-	-	469,030	76,999	392,031	16.42%
Board Meeting	24,800	-	-	24,800	2,065	22,735	8.33%
Administration & Office	1,023,627	-	-	1,023,627	67,256	956,371	6.57%
EDP Hardware	1,694,063	-	-	1,694,063	58,126	1,635,937	3.43%
EDP Software	1,765,873	-	-	1,765,873	189,053	1,576,820	10.71%
Information Technology	3,072,201	-	-	3,072,201	268,381	2,803,820	8.74%
Telecommunications	371,980	-	-	371,980	67,243	304,737	18.08%
Rent/Lease	1,419,718	-	-	1,419,718	348,208	1,071,510	24.53%
Compliance	30,000	-	-	30,000	-	30,000	0.00%
Government Affairs	2,256,000	-	-	2,256,000	167,612	2,088,388	7.43%
Insurance	268,336	-	-	268,336	-	268,336	0.00%
Internal Audit	30,000	-	-	30,000	-	30,000	0.00%
Other	75,450	-	-	75,450	4,575	70,875	6.06%
Regulatory Expenses	354,500	-	-	354,500	78,315	276,185	22.09%
Risk Management	69,600	-	-	69,600	14,656	54,944	21.06%
Total Statutory Expenditures¹	\$ 42,894,320	\$ -	\$ -	\$ 42,894,320	\$ 7,868,803	\$ 35,025,517	18.34%
Audit Services	139,500	-	-	139,500	10,000	129,500	7.17%
Capital Market	1,924,105	-	-	1,924,105	774,957	1,149,148	40.28%
Claims	134,000	-	-	134,000	1,200	132,800	0.90%
Grants	100,000	-	-	100,000	18,787	81,213	18.79%
Investment Services	3,426,928	-	-	3,426,928	844,254	2,582,674	24.64%
Legal Services	4,303,600	-	-	4,303,600	90,817	4,212,783	2.11%
Loss-Modeling	1,085,700	-	-	1,085,700	386,602	699,098	35.61%
Marketing Services	16,810,515	-	-	16,810,515	685,088	16,125,427	4.08%
Producer Compensation	80,000,000	-	-	80,000,000	19,353,308	60,646,692	24.19%
Participating Insurer Operating Costs	35,206,400	-	-	35,206,400	7,348,106	27,858,294	20.87%
Seismic Related Research	380,000	-	-	380,000	-	380,000	0.00%
Engineering Related Research	3,910,000	-	-	3,910,000	204,814	3,705,186	5.24%
Risk Transfer	353,013,800	-	-	353,013,800	93,232,828	259,780,972	26.41%
Total Non-Statutory Expenditures	\$ 500,434,548	\$ -	\$ -	\$ 500,434,548	\$ 122,950,762	\$ 377,483,786	24.57%
Total Budget Expenditures	\$ 543,328,868	\$ -	\$ -	\$ 543,328,868	\$ 130,819,566	\$ 412,509,302	24.08%

¹Total 2019 Statutory Expenditures of \$7.8 million were 4.02% of written premium. This is in compliance with the maximum permitted ratio of 6.0%.

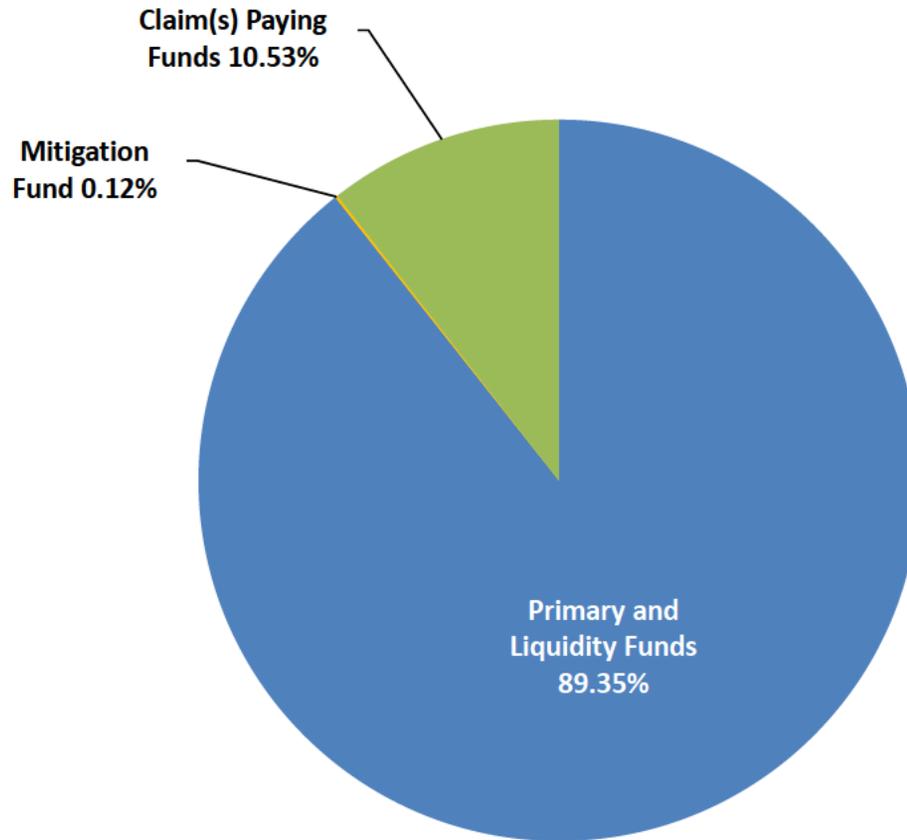
CALIFORNIA EARTHQUAKE AUTHORITY
Mitigation
Budgeted Expenditures and Actual Expenditures
As of March 31, 2019

	(a)	(b)	(c)	(d) (d=a+b+c)	(e)	(f) (f=d-e)	(g) (g=e/d)
	Approved 2019 Budget 1/1/2019	Adjustments	Augmentations	2019 Budget after Augmentations and Adjustments	Actual Expenditures	Augmented & Adjusted Approved Budget (d) vs. Actual Expenditures (e)	Percentage used of Augmented & Adjusted 2019 Budget
Human Resources:							
Compensation and Benefits	\$ 1,232,992	\$ -	\$ -	\$ 1,232,992	\$ 333,240	\$ 899,752	27.03%
Travel	50,544	-	-	50,544	-	50,544	0.00%
Other	24,565	-	-	24,565	10,300	14,265	41.93%
Administration & Office	64,649	-	-	64,649	2,143	62,506	3.31%
Information Technology	840	-	-	840	140	700	16.67%
Telecommunications	32,400	-	-	32,400	3,921	28,479	12.10%
Rent/Lease	111,900	-	-	111,900	27,850	84,050	24.89%
Other	200,000	-	-	200,000	-	200,000	0.00%
Total Operating Expenditures	\$ 1,717,890	\$ -	\$ -	\$ 1,717,890	\$ 377,594	\$ 1,340,296	21.98%
CRMP Contribution	6,300,000	-	-	6,300,000	3,300,000	3,000,000	52.38%
Investment Services	12,400	-	-	12,400	1,125	11,275	9.07%
Marketing	4,500	-	-	4,500	1,731	2,769	38.46%
Engineering - Related	400,000	-	-	400,000	-	400,000	0.00%
Total Other Expenditures	\$ 6,716,900	\$ -	\$ -	\$ 6,716,900	\$ 3,302,855	\$ 3,414,045	49.17%
Total Expenditures	\$ 8,434,790	\$ -	\$ -	\$ 8,434,790	\$ 3,680,449	\$ 4,754,341	43.63%

Investments

**California Earthquake Authority
Investment Distribution at Market Value
as of March 31, 2019**

Market Value	\$6,670,210,790
Primary and Liquidity Funds	89.35%
Mitigation Fund	0.12%
Claim(s) Paying Funds	10.53%
Total:	100.00%



Debt

**California Earthquake Authority
Schedule of Outstanding Debt**

DEBT	ISSUANCE AMOUNT	INTEREST RATE	NET PROCEEDS	OUTSTANDING PRINCIPAL	AS OF DATE	MOODY'S RATING*	FITCH RATING**
Series 2014 Revenue Bonds 5 year bond CUSIP 13017HAE6	\$ 250,000,000	2.805%	\$ 247,910,261	\$ 105,000,000	31-Mar-2019	A3 Outlook Stable	A Outlook Stable

DEBT-SERVICE SCHEDULE

Debt	Payment Date	Outstanding Principal	Principal	Interest	Debt Service	Annual Debt Service
Series 2014 Revenue Bonds	1-Jan-17	\$250,000,000	\$0	\$3,506,250	\$3,506,250	
5 year bond	1-Jul-17	\$210,000,000	\$40,000,000	\$3,506,250	\$43,506,250	
	2017- Paid					\$47,012,500
	1-Jan-18	\$210,000,000	\$0	\$2,945,250	\$2,945,250	
	1-Jul-18	\$105,000,000	\$105,000,000	\$2,945,250	\$107,945,250	
	2018- Paid					\$110,890,500
	1-Jan-19	\$105,000,000	\$0	\$1,472,625	\$1,472,625	
	1-Jul-19	\$0	\$105,000,000	\$1,472,625	\$106,472,625	
	2019- Outstanding					\$107,945,250

*Moody's rating since November 2018.

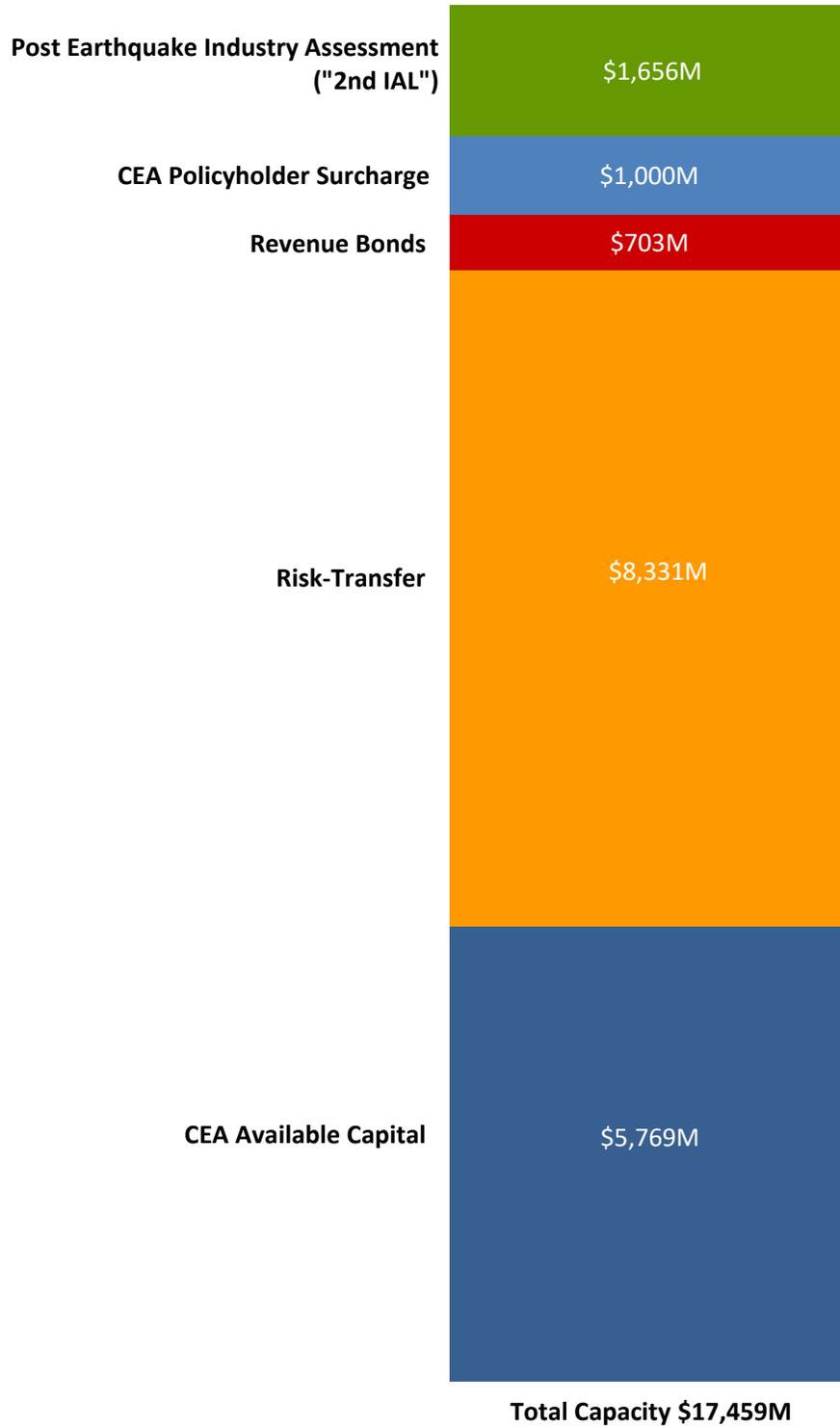
**Fitch rating affirmed December 2018.

Claim-Paying Capacity

**California Earthquake Authority
Available Capital Report
as of March 31, 2019**

Cash & Investments (includes capital contributions and premiums)	\$	6,710,745,603
Earthquake Loss Mitigation Fund Cash and Investments	\$	(4,037,109)
Interest & Securities Receivable	\$	87,298,338
Premium Receivable	\$	91,292,569
Risk Capital Surcharge & Capital Contributions Receivable	\$	4,424,000
Other Assets	\$	95,642
Revenue Bonds	\$	(702,576,809)
Debt Service (Interest, Principal & Debt Service (Min. Bal.))	\$	(79,486,314)
Unearned Premium Collected	\$	(276,407,700)
Accrued Reinsurance Premium Expense	\$	-
Accounts and Securities Payable, and Accrued Expenses	\$	(61,937,482)
Loss Reserves	\$	(131,243)
CEA Available Capital	\$	5,769,279,495

**California Earthquake Authority
Claim-Paying Capacity
as of March 31, 2019**



Note: Not drawn to scale

Risk-Transfer Programs

**California Earthquake Authority
Current Risk-Transfer Program Summary
as of March 31, 2019**

Traditional Reinsurance Contracts	Contract Period	Reinsurance Limit
2019 January Program Contract 1	January 1, 2019 - December 31, 2019	1,047,774,800
2019 January Program Contract 2	January 1, 2019 - December 31, 2019	316,100,000
2019 January Program Contract 3	January 1, 2019 - December 31, 2019	75,000,000
2019 January Program Contract 4	January 1, 2019 - December 31, 2019	40,000,000
2019-2020 January Program Contract 1	January 1, 2019 - December 31, 2020	333,800,000
2019-2020 January Program Contract 2	January 1, 2019 - December 31, 2020	92,550,000
2019-2020 January Program Contract 3	January 1, 2019 - December 31, 2020	125,000,000
2019-2020 January Program Contract 4	January 1, 2019 - December 31, 2020	300,000,000
2018-2019 January Program Contract 1 (21 Month)	January 1, 2018 - September 30, 2019	207,709,560
2018-2019 January Program Contract 2 (21 Month)	January 1, 2018 - September 30, 2019	42,300,000
2018-2019 January Program Contract 1	January 1, 2018 - December 31, 2019	165,337,440
2018-2019 January Program Contract 2	January 1, 2018 - December 31, 2019	74,623,680
2018-2019 January Program Contract 3	January 1, 2018 - December 31, 2019	120,004,990
2018-2019 January Program Contract 4	January 1, 2018 - December 31, 2019	50,000,000
2018-2019 April Program Contract 1	April 1, 2018 - March 31, 2019	820,323,400
2018-2019 April Program Contract 1 (18 Month)	April 1, 2018 - September 30, 2019	280,130,000
2017-2019 April Program Contract 1	April 1, 2017 - March 31, 2019	186,780,000
2016-2019 August Program Contract 1	August 1, 2016 - July 31, 2019	200,000,000
2017-2020 August Program Contract 2	August 1, 2017 - July 31, 2020	200,000,000
2015-2020 August Program Contract 1	August 1, 2015 - July 31, 2020	139,000,000
2018-2019 December Program Contract 1	December 1, 2018 - November 30, 2019	60,000,000
2018-2019 December Program Contract 2	December 1, 2018 - November 30, 2019	80,000,000
2019 January Program Contract 5	January 1, 2019 - December 31, 2019	140,000,000
2018-2019 January Program Contract 5	January 1, 2018 - December 31, 2019	164,999,800
2018-2019 January Program Contract 6	January 1, 2018 - December 31, 2019	279,999,840
2018-2020 June Program Contract 1	June 1, 2018 - May 31, 2020	69,999,990
2017-2020 August Program Contract 1	August 1, 2017 - July 31, 2020	93,750,000
2017-2019 December Program Contract 1	December 1, 2017 - November 30, 2019	124,999,994
2018-2019 December Program Contract 3	December 1, 2018 - November 30, 2019	49,999,950
2016-2019 August Program Contract 2	August 1, 2016 - July 31, 2019	93,750,000
2018-2019 August Program Contract 1	August 1, 2018 - July 31, 2019	118,750,000
2018-2021 August Program Contract 1	August 1, 2018 - July 31, 2021	93,750,000
2017-2019 July Program Contract 1	July 1, 2017 - June 30, 2019	70,000,000
Total Traditional Reinsurance		6,256,433,444
Transformer Reinsurance Contracts	Contract Period	Reinsurance Limit
2016-2019 Transformer Reinsurance Contract 1	December 1, 2016 - November 30, 2019	500,000,000
2017-2020 Transformer Reinsurance Contract 1	May 16, 2017- May 15, 2020	500,000,000
2017-2020 Transformer Reinsurance Contract 2	May 16, 2017- May 15, 2020	425,000,000
2017-2020 Transformer Reinsurance Contract 3	December 1, 2017 - November 30, 2020	200,000,000
2017-2020 Transformer Reinsurance Contract 4	December 1, 2017 - November 30, 2020	200,000,000
2018-2021 Transformer Reinsurance Contract 1	September 14, 2018 - September 13, 2021	250,000,000
Total Transformer Reinsurance		2,075,000,000
Total Risk-Transfer Program		\$ 8,331,433,444

Governing Board Memorandum

June 12, 2019

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 July 2018. The Governing Board authorized a set-aside amount of \$4,088,500.

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 Governing 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 \$5,000,000 for the CEA Loss Mitigation Fund, as calculated and shown in *Attachment B*.

Recommendation:

Staff recommends the Board authorize a set-aside of \$5,000,000 for the CEA Loss Mitigation Fund.

MEMORANDUM

DATE: May 22, 2019
TO: Tom Hanzel, Chief Financial Officer
FROM: Shawna Ackerman, Chief Actuary *SA*
RE: 2018 Earthquake Loss Mitigation Fund

Pursuant to California Insurance Code §10089.37, the California Earthquake Authority (CEA) shall set aside in each calendar year 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 2018 is \$5,000,000.

The term “actuarially sound” is often applied to rates. When used in this context “actuarially sound” means that the rate covers the expected future costs for the transfer of risk. In this context, 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. As of December 31, 2018, CEA available capital is \$5.658 billion and total claims paying capacity is \$16.136 billion. The mitigation funds available to set aside are approximately 0.09% of the CEA’s available capital and 0.03% 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
2011	\$ 31,693,442.00	\$ 1,584,672.10	\$ 2,019,253.15	\$ 1,584,672.10	\$ (2,019,253.15)	\$ 1,584,672.10
2012	\$ 24,766,000.00	\$ 1,238,300.00	\$ 1,584,672.10	\$ 1,238,300.00	\$ (1,584,672.10)	\$ 1,238,300.00
2013	\$ 21,291,499.16	\$ 1,064,574.96	\$ 1,238,300.00	\$ 1,064,574.96	\$ (1,238,300.00)	\$ 1,064,574.96
2014	\$ 25,375,330.26	\$ 1,268,766.51	\$ 1,064,574.96	\$ 1,268,766.51	\$ (1,064,574.96)	\$ 1,268,766.51
2015	\$ 42,808,825.00	\$ 2,140,441.25	\$ 1,268,766.51	\$ 2,140,441.25	\$ -	\$ 3,409,207.76 *
2016	\$ 110,719,225.00	\$ 5,535,961.25	\$ 3,409,207.76	\$ 5,000,000.00	\$ (3,409,207.76)	\$ 5,000,000.00
2017	\$ 81,770,000.00	\$ 4,088,500.00	\$ 5,000,000.00	\$ 4,088,500.00	\$ (5,000,000.00)	\$ 4,088,500.00
2018	\$ 105,539,322.00	\$ 5,276,966.10	\$ 4,088,500.00	\$ 5,000,000.00	\$ (4,088,500.00)	\$ 5,000,000.00
Balance as of December 31, 2018						\$ 5,000,000.00

***Note: The 2014 set-aside amount \$1,268,766.51 was transferred March 2016.**

**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

June 12, 2019

Agenda Item 11: Request authorization to retain a consulting firm to provide a comprehensive assessment of CEA's claim readiness

Recommended Action: Approve retaining a consulting firm to provide a comprehensive assessment of CEA's claim readiness

Background:

CEA, with assistance from its participating insurers (PIs), is charged with efficiently and effectively adjusting claims following a damaging earthquake. Since its inception, CEA's statutory business model has provided for CEA to utilize the claim staff of its participating insurers to perform all claim adjustment/settlement activities, under CEA's supervision. In short, the PIs act as CEA's third-party administrators for all claims, and the PIs are reimbursed for claim administration expenses.

Although CEA has delegated claim administration responsibilities to its PIs, CEA has developed internal capabilities so that CEA can manage and monitor claim administration activities after an event. Internal CEA claims staff (CEA Claim Team) is responsible for planning, developing, implementing and maintaining all aspects of CEA's overarching earthquake response and claim handling program. This claim program includes, among other things:

- Preparation: Training and directing CEA's individual PIs as necessary to ensure that each PI is prepared to handle all earthquake claims in a manner consistent with applicable California law and CEA's policy terms. CEA's preparation includes conducting an annual day-long claim handling seminar with senior claims staff from substantially all of CEA's PIs, at which the PIs are briefed on CEA's expectations and best practices for CEA claims.
- Monitoring & Supervision: Following an event, CEA's program includes active monitoring of PIs' claim administration to ensure continuing compliance with California law and the rights of policyholders under CEA policies.
- Data Management: Also following an event, CEA's claim program provides for managing and consolidating all claim-related data through CEA's EPICenter data warehouse. The CEA Claim Team's data-related responsibilities include the development of reports as needed to monitor and manage claims, ensuring follow-up and timely closure of older claims; reporting claim information to CEA's senior management and Governing Board; and generating any reports required for purposes of reinsurance billings and collections.

CEA is committed to ensuring all claims are handled in a fair, timely, and consistent manner. While CEA's claim administration program is fully developed and implemented, CEA believes that the program should be "stress tested" to assess CEA's true readiness for a major earthquake, and to identify any underlying limitations or areas of improvement.

Analysis

California is fortunate in that we have not experienced a major damaging earthquake in several decades. The moderate earthquakes that have occurred during the past twenty years have generated relatively modest numbers of claims for CEA, and none of those moderate earthquakes have truly stress tested CEA's claim administration program. A major damaging earthquake, however, will give rise to an extraordinary level of claim activity, well beyond what has been experienced by any similarly sized, quasi-public natural catastrophe insurer.

CEA staff recommends that CEA evaluate and test its readiness to handle a high volume of claims through a third-party review of CEA's current claims program. The review should include each element of the claim program—preparation and training, claim procedures following an event, adequacy of CEA's and PIs' claims administration systems and technology, and data management and integrity. A third-party review by a sophisticated consulting firm will fully evaluate and provide opportunities to improve, in advance, the efficiency and effectiveness of CEA's claims program, which protects CEA policyholders.

The benefits of retaining an independent consulting firm to evaluate CEA's claim readiness is that it will be a relatively short-term project that will allow CEA to contain and control the expense of the review. CEA staff believes that there are multiple nationally and internationally recognized consultancies that would be eager to compete for the right to assist CEA on a cost-effective and timely basis.

Finally, the most important beneficiary of a diligent assessment of CEA's claims readiness *prior to the next damaging earthquake* will be CEA's policyholders. The better prepared CEA and PIs are to handle the high volume of claims that will arise from a major damaging earthquake, the more rapidly, accurately, and fairly CEA can honor its commitment to policyholders.

Recommendation:

Based on the foregoing background and analysis, staff recommends the Board authorize CEA to procure the services of a consultant to provide a comprehensive assessment of CEA's claim readiness at an expense not to exceed \$250,000.

Governing Board Memorandum

June 12, 2019

Agenda Item 12: Report of Audit on CEA Annual Financial Statements (2018)

Recommended Action: No action required—information only

Background:

Plante Moran, PLLC, California Earthquake Authority's independent auditor, has performed an audit of CEA's financial statements for the year ended December 31, 2018.

- The independent auditor conducted an audit of CEA's financial statements prepared in accordance with generally accepted accounting principles (GAAP) in the United States of America.

Report 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

Analysis:

According to the Independent Auditor's Reports, CEA's 2018 audited GAAP financial statements present fairly, in all material respects, the financial position of CEA, in conformity with accounting principles generally accepted in the United States of America.

Recommended Action: No action required—information only.

CALIFORNIA EARTHQUAKE AUTHORITY

Financial Statements
December 31, 2018 and 2017

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Independent Auditor's Report

To the Governing Board
California Earthquake Authority

Report on the Financial Statements

We have audited the accompanying financial statements of California Earthquake Authority (the "CEA") as of and for the years ended December 31, 2018 and 2017 and the related notes to the financial statements, which collectively comprise the CEA's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these basic financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of basic financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these basic 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 basic financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the basic financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the basic financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the basic financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the basic financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of California Earthquake Authority as of December 31, 2018 and 2017 and the changes in its financial position and its cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

To the Governing Board
California Earthquake Authority

Other Matters

Required Supplemental Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, the schedule of CEA's proportionate share of the net pension liability and the schedule of CEA's contributions: pension plan, as identified in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplemental information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on California Earthquake Authority's basic financial statements. The accompanying schedules of participating insurer capital contributions, participating insurer premiums written, participating insurer unearned premiums, participating insurer commissions, and participating insurer operating costs are presented for the purpose of additional analysis and are not a required part of the basic financial statements.

The schedules of participating insurer capital contributions, participating insurer premiums written, participating insurer unearned premiums, participating insurer commissions, and participating insurer operating costs are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedules of participating insurer capital contributions, participating insurer premiums written, participating insurer unearned premiums, participating insurer commissions, and participating insurer operating costs are fairly stated in all material respects in relation to the basic financial statements as a whole.

Plante & Moran, PLLC

May 29, 2019

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 position, 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 available capital (net position) to leverage approximately \$16.1 billion in claims-paying capacity at December 31, 2018. The CEA's claims-paying capacity is determined from the CEA's available capital, risk-transfer coverage, debt, and post-event prospective participating insurance company assessments. The CEA derives its capital from participating insurer capital contributions and from increases in net position 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 had 1,050,835 policyholders at December 31, 2018, most of whom insure single-family dwellings through the CEA. The CEA offers a basic 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. The CEA policy deductible ranges from 5 percent to 25 percent, which is determined by the homeowner, and will affect the premium amount paid.

The CEA employs contract employees, employees subject to civil-service provisions, and an extensive network of contract vendors to perform functions on behalf of the CEA. The CEA is continuing to transition to more employees subject to civil service provisions to handle these functions, which over time will reduce the number of contract vendors necessary to handle these internal functions.

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, 2018 and 2017 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 position of the CEA. The statements of revenues, expenses, and changes in net position, also prepared on the accrual basis, consider 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.

Condensed Balance Sheets

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

	2018	2017	2016
Assets			
Current			
Cash and investments	\$ 6,610,077,544	\$ 6,317,362,817	\$ 6,220,262,441
Premiums receivable, net	69,456,437	64,475,336	44,074,808
Prepaid reinsurance premium	19,854,113	17,291,299	15,251,226
Securities receivable	-	98,223,089	17,043,971
Other current assets	34,651,019	27,925,371	22,537,240
Total current assets	6,734,039,113	6,525,277,912	6,319,169,686
Noncurrent			
Capital assets	208,044	269,494	115,381
Total assets	6,734,247,157	6,525,547,406	6,319,285,067
Deferred Outflows of Resources	4,462,640	-	-
Total assets and deferred outflows of resources	6,738,709,797	6,525,547,406	6,319,285,067
Liabilities			
Current			
Unearned premiums	417,448,201	373,456,016	317,465,364
Revenue bonds payable, current portion	105,000,000	105,000,000	100,000,000
Other current liabilities	12,623,686	47,627,416	24,206,369
Total current liabilities	535,071,887	526,083,432	441,671,733
Noncurrent			
Revenue bonds payable, noncurrent portion	-	105,000,000	210,000,000
Other noncurrent liabilities	12,745,149	485,589	718,484
Total liabilities	547,817,036	631,569,021	652,390,217
Deferred Inflows of Resources	103,316	-	-
Total liabilities and deferred inflows of resources	547,920,352	631,569,021	652,390,217

CALIFORNIA EARTHQUAKE AUTHORITY

Management's Discussion and Analysis (Continued)

Condensed Balance Sheets (Continued)

	2018	2017	2016
Net Position			
Net investment in capital assets	208,044	269,494	115,381
Restricted, expendable	327,622,508	225,507,185	118,507,816
Unrestricted	5,862,958,893	5,668,201,706	5,548,271,653
Total net position	6,190,789,445	5,893,978,385	5,666,894,850
Total liabilities, deferred inflows of resources, and net position	\$ 6,738,709,797	\$ 6,525,547,406	\$ 6,319,285,067

Assets

Total assets grew \$208.7 million (3%) in 2018. The increase was primarily due to cash and investments, which grew \$292.7 million (5%). This was offset by a decrease in the securities receivable, as it had a balance of zero compared to \$98.2 million in 2017.

In 2017, total assets grew \$206.2 million (3%). The increase was primarily due to cash and investments, which grew \$97.1 million (2%), and an increase in securities receivable which grew \$81.2 million compared to 2016. 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.

Deferred Outflows of Resources/Deferred Inflows of Resources

Deferred outflows and inflows of resources increased by \$4,462,640 and \$103,316, respectively, in 2018. Deferred outflows represent amounts that will be recognized in pension expense in future periods. Deferred outflows of resources in 2018 included employer contributions made during 2018 subsequent to the June 30, 2017 measurement date used for the defined benefit pension plan. These balances are associated with the recording of the CEA's proportionate share of net pension liability as reported to the CEA by the State Controller in accordance with Governmental Accounting Standards Board (GASB) Statement No. 68. See Note 9 in the financial statements for further discussion of these balances.

Liabilities

Total liabilities decreased \$83.8 million (13%) in 2018. A decrease of \$105.0 million in revenue bonds payable was due to debt repayments. See Note 3 in the notes to financial statements for further discussion of the bonds. The securities payable also had a balance of zero compared to \$32.7 million in 2017.

These decreases were offset by an increase in unearned premiums of \$44.0 million and noncurrent liabilities of \$12.2 million. The increase in unearned premiums was driven by the increase in written premiums in 2018. The increase in other noncurrent liabilities relates to the increase in the CEA's proportionate share of net pension liability during December 31, 2018. See Note 9 in the financial statements for further discussion of the pension liability.

Total liabilities decreased \$20.8 million (3%) in 2017. A decrease of \$100.0 million in revenue bonds payable from debt repayments was offset by an increase in unearned premiums of \$56.0 million and securities payable of \$27.5 million. The increase in unearned premiums in 2017 is consistent with the increase in written premiums for 2017.

CALIFORNIA EARTHQUAKE AUTHORITY

Management's Discussion and Analysis (Continued)

Condensed Balance Sheets (Continued)

Net Position

The CEA classifies its net position into three components, invested in capital assets, net of related debt; restricted-expendable, and unrestricted. Invested in capital assets, net of related debt consists of equipment and leasehold improvements, and there is no debt related to the purchase of these assets. Restricted net position includes the net position 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 loss mitigation programs. The remaining net position of the CEA is classified as unrestricted. The CEA's net position grew \$296.8 million (5%) and \$227.1 million (4%) in 2018 and 2017, respectively.

The 2018 increase was primarily comprised of the underwriting profit of \$182.1 million, premium tax contributions from the State of California of \$18.3 million, and net investment income of \$92.7 million. The 2017 increase was primarily comprised of the underwriting profit of \$182.1 million, premium tax contributions from the State of California of \$16.6 million, and net investment income of \$38.1 million.

Condensed Statements of Revenue, Expenses, and Changes in Net Position

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

	<u>2018</u>		<u>2017</u>		<u>2016</u>
Underwriting income:					
Premiums written	\$ 778,340,984		\$ 706,550,318		\$ 619,134,034
Less premiums ceded - reinsurance	<u>(366,630,729)</u>		<u>(315,744,745)</u>		<u>(202,192,413)</u>
Net premiums written	<u>411,710,255</u>	53%	<u>390,805,573</u>	55%	<u>416,941,621</u>
Change in net unearned premiums	<u>(43,992,185)</u>		<u>(55,990,652)</u>		<u>9,247,565</u>
Net premiums earned	<u>367,718,070</u>	47%	<u>334,814,921</u>	47%	<u>426,189,186</u>
Expenses:					
Loss and loss adjustment expenses	148,833		(84,914)		125
Other underwriting expenses	<u>185,518,102</u>		<u>152,767,591</u>		<u>148,391,478</u>
Total expenses	<u>185,666,935</u>	24%	<u>152,682,677</u>	22%	<u>148,391,603</u>
Underwriting profit	182,051,135	23%	182,132,244	26%	277,797,583

CALIFORNIA EARTHQUAKE AUTHORITY

Management's Discussion and Analysis (Continued)

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

	2018		2017		2016
Non-operating income and expenses:					
Net investment income	92,745,186		38,062,720		85,290,988
Other non-operating income	18,774,366		20,319,770		14,960,627
Other non-operating expenses	(10,031,627)		(13,431,199)		(10,858,541)
Total non-operating income and expenses	101,487,925	13%	44,951,291	6%	89,393,074
Capital contributions	13,272,000		-		-
Increase in net position	296,811,060	38%	227,083,535	32%	367,190,657
Net position, beginning of year	5,893,978,385		5,666,894,850		5,299,704,193
Net position, end of year	\$ 6,190,789,445		\$ 5,893,978,385		\$ 5,666,894,850

The increase in net position was \$296.8 million in 2018, which resulted in a net profit margin of 38%, and was a \$76.4 million (34%) increase compared to 2017. The increase in 2018 compared to 2017 was driven by net investment income increasing \$54.7 million and capital contributions increase of \$13.3 million.

The investment income increase was driven by a \$24.4 million increase in interest income, and a positive change in unrealized gains/losses of \$31.7 million. The capital contribution increase was due to a new participating insurer joining the CEA in 2018. The underwriting profit increase was primarily driven by an increase in premiums written of \$71.8 million and an increase in the change in unearned premiums of \$12.0 million. This was offset by an increase in premiums ceded of \$50.9 million due to the increase policy exposure.

The increase in net position was \$227.1 million in 2017, which resulted in a net profit margin of 32%, and was a decrease of \$140.1 million compared to 2016. The decrease in 2017 compared to 2016 was driven by net investment income decreasing \$47.2 million and underwriting profit decrease of \$95.7 million.

The net investment income decrease was largely due to 2016 having a one-time realized gain of \$47.5 million on a settlement. The decrease in net premiums written is due to a \$87.4 million increase in written premiums being offset by an increase in premiums ceded of \$113.6 million due to the increased policy exposure and the change in unearned premiums decreased \$65.2. The variance results from the change in premiums written in both years that includes a portion that relates to coverage in future periods.

CALIFORNIA EARTHQUAKE AUTHORITY

Management's Discussion and Analysis (Continued)

Condensed Statements of Cash Flows

Primary sources of cash included cash flows from operations and proceeds from maturities of investments. The primary uses 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:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Net cash provided by operating activities	\$ 237,095,275	\$ 218,810,113	\$ 278,319,341
Net cash used in noncapital financing activities	(104,756,546)	(103,330,015)	(44,784,037)
Net cash provided by (used in) capital and related financing activities	5,530,000	(223,584)	(100,018)
Net cash (used in) provided by investing activities	<u>(303,410,981)</u>	<u>235,817,328</u>	<u>(334,589,403)</u>
Net (decrease) increase in cash and cash equivalents	(165,542,252)	351,073,842	(101,154,117)
Cash and cash equivalents, beginning of year	<u>389,813,362</u>	<u>38,739,520</u>	<u>139,893,637</u>
Cash and cash equivalents, end of year	<u>\$ 224,271,110</u>	<u>\$ 389,813,362</u>	<u>\$ 38,739,520</u>

Cash from operating activities increased \$18.3 million (8%) and decreased \$59.5 million (21%) in 2018 and 2017, respectively. The 2018 increase resulted primarily from an increase in cash received from premiums of \$87.2 million, offset by an increase in payments for reinsurance of \$44.4 million and an increase in payments for other operating expenses of \$19.3 million. The 2017 decrease resulted primarily from an increase in cash received from premiums of \$63.2 million, offset by an increase in payments for reinsurance of \$111.6 million and an increase in payments to employees for services of \$9.4 million.

For the remaining cash flow activities, the biggest change from 2018 compared to 2017 is a \$5.8 million increase in capital and related financing activities and a decrease of \$539.2 million in cash provided by investing activities. The \$5.8 million increase for financing activities was primarily due to contributed capital payments of a new participating insurer of \$5.5 million. The \$539.2 million decrease in investing activities is driven by the net effect of proceeds of the maturities of investments compared to the purchases of investments.

For 2017 compared to 2016, the biggest change in the remaining cash flow activities was \$58.5 million increase in cash used in noncapital financing activities and increase in cash provided by investing activities of \$570.4 million. The \$58.5 million change in financing activities for 2017 is primarily due to \$100.0 million principal bond payment in 2017, compared to \$40.0 million in 2016. The \$570.4 million change in investing activities was driven by the net effect of proceeds of the maturities of investments compared to the purchases of investments.

Liquidity

The CEA maintains a liquid investment portfolio in order to be able to pay claims in the event of a large earthquake. As of December 31, 2018, 8.5% of the portfolio was scheduled to mature in 90 days or less, securities maturing between 91 days and one year accounted for 9.9% of the portfolio, while securities maturing between one to five years accounted for the remaining 81.6% of the portfolio, with a total portfolio modified duration of approximately 2.2 years. 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 CEA pays policyholder claims from its claims-paying capacity.

CALIFORNIA EARTHQUAKE AUTHORITY

Management's Discussion and Analysis (Continued)

Liquidity (Continued)

The following depicts the CEA's claims-paying capacity in effect as of December 31, 2018, in millions of dollars:

CEA capital available for claims	\$	5,658
Risk transfer financial products		8,132
Revenue bonds		690
Post-earthquake industry assessments (2 nd Layer)		1,656
Total	\$	<u>16,136</u>

Capital Assets and Debt Activity

Capital Assets

The CEA's investment in capital assets as of December 31, 2018 was \$208,044 (net of accumulated depreciation). No major capital asset purchases were made in the current year.

Debt Administration

At December 31, 2018, the CEA had total short-term debt obligations of \$105,000,000 in the form of revenue bonds, and short-term debt obligations of \$164,497 and long-term debt obligations of \$926,503 associated with Senate Bill 84 loan payable. Additional information on the CEA's long-term debt can be found in Note 3 in the Notes to the Financial Statements.

Current Economic Factors and Conditions

The California economy has been improving at a hastening pace. The unemployment rate in California went from 4.4% at the end of December 2017 to 4.1% at the end of December 2018. This was a record low for the State of California since they started tracking this data in 1976. The CEA continues to experience year over year growth in policy counts. As of December 31, 2018, CEA policyholders increased 2.92% from December 31, 2017. The growth in 2018 was most likely a result of increased awareness of earthquake risk and recent catastrophic events in North America, including hurricanes on the East Coast and elsewhere in the world and major wildfires in California; along with the improved California economy.

Requests for Information

This financial report is designed to provide a general overview of the CEA's finances for all those interested. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to California Earthquake Authority, 801 K Street, Suite 1000, Sacramento, CA 95814.

CALIFORNIA EARTHQUAKE AUTHORITY

Balance Sheets
As of December 31, 2018 and 2017

	2018	2017
Assets and Deferred Outflows of Resources		
Current assets:		
Cash and investments:		
Cash and cash equivalents	\$ 157,085,080	\$ 371,218,759
Restricted cash and equivalents	67,186,030	18,594,603
Restricted investments	360,913,199	355,668,723
Investments	6,024,893,235	5,571,880,732
Total cash and investments	6,610,077,544	6,317,362,817
Premiums receivable, net of allowance for doubtful accounts of \$ 5,346,462 and \$ 4,579,468	69,456,437	64,475,336
Capital contributions receivable	7,742,000	-
Interest receivable	25,314,888	21,920,430
Securities receivable	-	39,172,684
Restricted securities receivable	-	59,050,405
Prepaid reinsurance premium	19,854,113	17,291,299
Prepaid transformer maintenance premium	1,268,123	5,639,851
Other current assets	326,008	365,090
Total current assets	6,734,039,113	6,525,277,912
Noncurrent assets:		
Capital assets, net	208,044	269,494
Total assets	6,734,247,157	6,525,547,406
Deferred Outflows of Resources		
Related to pensions	4,462,640	-
Total assets and deferred outflows of resources	\$ 6,738,709,797	\$ 6,525,547,406

CALIFORNIA EARTHQUAKE AUTHORITY

Balance Sheets
As of December 31, 2018 and 2017 (Continued)

	2018	2017
Liabilities and Deferred Inflows of Resources		
Current liabilities:		
Unearned premiums	417,448,201	373,456,016
Accounts payable and accrued expenses	10,420,749	11,362,754
Loss and loss expense reserves	115,114	94,974
Compensated absences - current portion	450,701	496,620
Securities payable	-	32,727,818
SB 84 loan payable - current portion	164,497	-
Revenue bond payable - current portion	105,000,000	105,000,000
Revenue bond interest payable	1,472,625	2,945,250
Total current liabilities	535,071,887	526,083,432
Noncurrent liabilities:		
Revenue bond payable	-	105,000,000
SB 84 loan payable	926,503	-
Net pension liability	11,070,484	-
Compensated absences	748,162	485,589
Total liabilities	547,817,036	631,569,021
Deferred Inflows of Resources		
Related to pensions	103,316	-
Total liabilities and deferred inflows of resources	547,920,352	631,569,021
Net Position		
Net investment in capital assets	208,044	269,494
Restricted, expendable	327,622,508	225,507,185
Unrestricted	5,862,958,893	5,668,201,706
Total net position	6,190,789,445	5,893,978,385
Total liabilities and deferred inflows of resources, and net position	\$ 6,738,709,797	\$ 6,525,547,406

CALIFORNIA EARTHQUAKE AUTHORITY

Statements of Revenues, Expenses, and Changes in Net Position For the Years Ended December 31, 2018 and 2017

	2018	2017
Underwriting income:		
Premiums written	\$ 778,340,984	\$ 706,550,318
Less premiums ceded - reinsurance	(366,630,729)	(315,744,745)
Net premiums written	411,710,255	390,805,573
Change in unearned premiums	(43,992,185)	(55,990,652)
Net premiums earned	367,718,070	334,814,921
Operating expenses:		
Loss and loss adjustment expenses	148,833	(84,914)
Participating insurer commissions	77,838,382	70,657,732
Participating insurer operating costs	25,280,833	22,945,402
Reinsurance broker commissions	2,800,000	2,800,000
Pro forma premium taxes	18,301,952	16,613,830
Other underwriting expenses	61,296,935	39,750,627
Total operating expenses	185,666,935	152,682,677
Underwriting profit	182,051,135	182,132,244
Non-operating income and expenses:		
Net investment income	92,745,186	38,062,720
Other income	468,364	472,970
Grant revenue	4,050	3,232,970
Grant expenses	(18,626)	(3,218,394)
Investment income on bond proceeds, net of related expenses	1,262,291	(2,709,361)
Mitigation Fund expenses	(2,375,292)	(2,103,444)
California Residential Mitigation Program contribution	(8,900,000)	(5,400,000)
State of California premium tax contribution	18,301,952	16,613,830
Total of non-operating income and expenses	101,487,925	44,951,291
Contributed capital	13,272,000	-
Increase in net position	296,811,060	227,083,535
Net position, beginning of year	5,893,978,385	5,666,894,850
Net position, end of year	\$ 6,190,789,445	\$ 5,893,978,385

CALIFORNIA EARTHQUAKE AUTHORITY

Statements of Cash Flows For the Years Ended December 31, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Cash received from premiums	\$ 773,359,883	\$ 686,149,790
Cash payments for premiums ceded - reinsurance	(364,821,815)	(320,445,634)
Cash payments for operating expenses	(144,150,355)	(124,846,970)
Cash payments to employees for services	(27,292,438)	(22,047,073)
Net cash provided by operating activities	237,095,275	218,810,113
Cash flows from noncapital financing activities:		
Repayment of revenue bonds	(105,000,000)	(100,000,000)
Interest paid on revenue bonds	(6,148,039)	(8,393,496)
Interest income on revenue bonds proceeds	5,937,705	4,575,935
Grant revenue	4,050	3,232,970
Grant expense	(18,626)	(3,218,394)
Other income	468,364	472,970
Net cash used in noncapital financing activities	(104,756,546)	(103,330,015)
Cash flows from capital and related financing activities:		
Contributed capital receipts	5,530,000	-
Acquisition of equipment	-	(223,584)
Net cash provided by (used in) capital and related financing activities	5,530,000	(223,584)
Cash flows from investing activities:		
Proceeds from maturities of investments	1,849,553,785	2,175,342,645
Purchases of investments	(2,288,599,749)	(1,996,952,835)
Investment income	138,296,797	60,027,883
Investment expense	(2,661,814)	(2,600,365)
Net cash (used in) provided by investing activities	(303,410,981)	235,817,328
Net (decrease) increase in cash and cash equivalents	(165,542,252)	351,073,842
Cash and cash equivalents, beginning of year	389,813,362	38,739,520
Cash and cash equivalents, end of year	\$ 224,271,110	\$ 389,813,362

CALIFORNIA EARTHQUAKE AUTHORITY

Statements of Cash Flows (Continued) For the Years Ended December 31, 2018 and 2017

	2018	2017
Reconciliation of operating income to net cash provided by operating activities:		
Underwriting profit	\$ 182,051,135	\$ 182,132,244
Adjustments to reconcile underwriting profit to net cash provided by operating activities:		
Depreciation on equipment	61,451	69,471
Pro forma premium tax expense	18,301,952	16,613,830
Contribution to California Residential Mitigation Program	(8,900,000)	(5,400,000)
Mitigation Fund expenses	(2,375,292)	(2,103,444)
Net periodic pension expense	7,802,160	-
Changes in operating assets and liabilities:		
Premiums receivable	(4,981,101)	(20,400,528)
Unearned premiums	43,992,185	55,990,652
Other assets	39,082	(152,810)
Prepaid reinsurance premium	(2,562,814)	(2,040,073)
Prepaid transformer maintenance premium	4,371,728	(2,660,816)
Claim and claim expense reserves	20,140	(93,055)
Change in CRMP payable	-	(3,000,000)
Accounts payable and accrued expenses	(942,005)	(48,226)
Compensated absences payable	216,654	(97,132)
Net cash provided by operating activities	\$ 237,095,275	\$ 218,810,113

Non-cash Investing, Capital and Financing Activities

The change 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 Position, was a decrease of \$5.4 million and \$37.1 million in 2018 and 2017, 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 Position was \$18.3 million and \$16.6 million in 2018 and 2017, respectively.

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements
December 31, 2018 and 2017

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 elect 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 3.25%. 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, 2018, there are 24 participating insurers of which 19 insurers are writing CEA policies. Four participating insurers account for 69% 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, 2018 and 2017

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

Operating revenues are those revenues that are generated from providing earthquake insurance policies. All other revenues are reported as non-operating revenues. Operating expenses are those costs related to providing those earthquake insurance policies. All other expenses are reported as non-operating expenses.

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. Prepaid insurance premiums are the pro rata portion of premiums ceded applicable to the unexpired period of reinsurance coverage.

Use of Restricted/Unrestricted Net Position

When an expense is incurred for purposes for which both restricted and unrestricted net position is available, the CEA's policy is to apply unrestricted net position before applying any restricted net position available.

CEA's policy could change if California experiences a major earthquake event.

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, 2018 and 2017

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

Investments

Investments consist primarily of certificates of deposit, U.S. treasuries, U.S. agencies, commercial paper, and corporate bonds, 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. The CEA intends to hold the majority of investments to maturity.

Capital Assets

Capital assets are stated at historical cost. The capitalization threshold for assets with a useful life beyond one year is \$5,000. Depreciation is computed using the straight-line method over the useful lives as follows:

Leasehold improvements	Shorter of useful life or remaining lease term
Computer equipment and software	3 years
Furniture and other equipment	5 years
Capital leases	Shorter of useful life or remaining lease term

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. There were no such risk-capital surcharges during 2018 and 2017.

Policy Acquisition Costs

Acquisition costs, consisting of participating insurer commissions and operating costs, vary with and are primarily related to the issuance of new and renewal insurance policies. These costs are expensed as incurred.

Losses and Loss Adjustment Expenses

Reserves for insurance losses and loss 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. The CEA had \$115,114 and \$94,974 in unpaid claims reported as of December 31, 2018 and 2017, respectively.

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued)
December 31, 2018 and 2017

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

If the CEA's Governing Board determines that the CEA's net position, 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. Amica Mutual Insurance Company joined the CEA in August 2018 and is required to make a capital contribution of \$13,272,000 over a 12-month period. As of December 31, 2018, participating insurer capital contributions totaled \$791 million and were 99% 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.

As of December 31, 2017, participating insurers have a cumulative residential property insurance market share of approximately 75.5% of the total residential property insurance market in California based on written premium. The market share as of December 31, 2018 was unavailable as of the date the financial statements were issued. 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 Position

The CEA classifies its net position into three components, net position invested in capital assets, net of related debt; restricted-expendable and unrestricted net position. There is no debt related to capital assets, so the balance of net position invested in capital assets consists only of the capital assets balance. Restricted net position includes the net position 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.

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.

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued)
December 31, 2018 and 2017

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

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. State premium tax contributions were \$18,301,952 and \$16,613,830 for the years ended December 31, 2018 and 2017, respectively.

Compensated Absences

Employees accrue vacation, holiday and sick leave benefits. However, unused sick leave is not included in compensated absences because they do not vest to employees. CEA contract employees are paid at the time of termination from CEA employment. CEA civil-service employees are paid at the time of termination only for employees that have left civil service employment. CEA civil-service employees that retain employment within civil service are removed as a liability for CEA, without a payout, as CEA is no longer responsible for the vested balance of these employees.

Pension Liability

All CEA civil-service employees participate in the California Public Employees' Retirement System (CalPERS), which is included in the State of California's Comprehensive Annual Financial Report as a fiduciary component unit. The portion of the present value of projected benefit payments to be provided to civil-service employees attributable to past periods of service less CEA's fiduciary net position is recorded as a liability. The CEA is using the measurement date as of June 30, 2017, which is the most recent information available.

Deferred Outflows and Inflows of Resources

In addition to assets and liabilities, the Balance Sheets will sometimes report a separate section for deferred outflows and inflows of resources. Deferred outflows of resources represent a consumption of net position that applies to a future period and will not be recognized as an outflow of resources (expense) until a future period. Deferred inflows of resources represent an acquisition of net position that will be recognized as an inflow of resources (revenue) in a future period. Deferred outflows and inflows of resources as of December 31, 2018 related to pension results from the actuarially determined liability and pension contributions made after the measurement date.

Upcoming Accounting Pronouncements

In June 2017, the GASB issued GASB Statement No. 87, *Leases*. This Statement will increase the usefulness of governments' financial statements by requiring reporting of certain lease asset and liabilities that currently are not reported. It will enhance comparability of financial statements among governments by requiring lessees and lessors to report leases under a single model. This Statement also will enhance the decision-usefulness of the information provided to financial statement users by requiring notes to financial statements related to the timing, significance, and purpose of a government's leasing arrangements. GASB Statement No. 87 is required to be adopted for years beginning after December 15, 2019.

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued) December 31, 2018 and 2017

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

The CEA is currently evaluating the impact this standard will have on the financial statements when adopted, during the CEA's 2020 fiscal year, but does not expect this standard to have a significant impact on the financial statements.

In April 2018, the GASB issued GASB Statement No. 88, *Certain disclosures related to debt, including direct borrowing and direct placements*. The requirements of this Statement will improve financial reporting by providing users of financial statements with essential information that currently is not consistently provided. In addition, information about resources to liquidate debt and the risks associated with changes in terms associated with debt will be disclosed. As a result, users will have better information to understand the effects of debt on a government's future resource flows. GASB Statement No. 88 is required to be adopted for years beginning after June 15, 2018. The CEA has determined that the impact would be enhanced footnote disclosures within the financial statements. As of December 31, 2018, the CEA had no debt that would still be outstanding when these additional disclosures are required to be adopted.

2. Cash and Investments

As of December 31, 2018 and 2017, the CEA had the following cash and investments:

December 31, 2018						
Investment Maturities (in Years)						
	Less Than 1	1-2	2-3	3-4	4-5	Total
U. S. Treasuries	\$1,033,542,131	\$1,774,746,453	\$1,401,712,564	\$1,244,727,646	\$929,153,462	\$ 6,383,882,256
U. S. Agencies	134,426,745	-	-	-	-	134,426,745
Commerical Paper	30,701,596	-	-	-	-	30,701,596
Cash	61,066,947	-	-	-	-	61,066,947
Total	<u>1,259,737,419</u>	<u>1,774,746,453</u>	<u>1,401,712,564</u>	<u>1,244,727,646</u>	<u>929,153,462</u>	<u>6,610,077,544</u>
December 31, 2017						
Investment Maturities (in Years)						
	Less Than 1	1-2	2-3	3-4	4-5	Total
U. S. Treasuries	\$1,424,952,696	\$ 719,047,301	\$1,706,073,241	\$1,369,232,981	\$995,409,675	\$ 6,214,715,894
U. S. Agencies	46,780,280	-	-	-	-	46,780,280
Commerical Paper	47,618,115	-	-	-	-	47,618,115
Cash	8,248,528	-	-	-	-	8,248,528
Total	<u>1,527,599,619</u>	<u>719,047,301</u>	<u>1,706,073,241</u>	<u>1,369,232,981</u>	<u>995,409,675</u>	<u>6,317,362,817</u>

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued) December 31, 2018 and 2017

2. Cash and Investments (Continued)

The table below identifies the investment types that are authorized for the CEA by the California Government Code or CEA's investment policy, where more restrictive. The table also identifies certain provisions of the CEA's investment policy that address interest rate risk, credit risk, and concentration risk.

Liquidity Fund:

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment In One Issuer
U.S. Treasury Securities	180 days	None	None
Federal Agency Securities	180 days	50%	25%
Bankers Acceptances (BA)	180 days	25%	5%
Certificates of Deposit	180 days	25%	5%
Commercial Paper	180 days	25%	5%
Corporate Bonds/Notes	180 days	25%	5%

Primary Reserve Fund:

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment In One Issuer
U.S. Treasury Securities	5 years	None	None
Federal Agency Securities	N/A	None	None
Bankers Acceptances (BA)	N/A	None	None
Certificates of Deposit	N/A	None	None
Commercial Paper	N/A	None	None
Corporate Bonds/Notes	N/A	None	None

Mitigation Fund:

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment In One Issuer
U.S. Treasury Securities	90 days	None	None
Federal Agency Securities	90 days	50%	25%
Bankers Acceptances (BA)	90 days	25%	5%
Certificates of Deposit	90 days	25%	5%
Commercial Paper	90 days	25%	5%
Corporate Bonds/Notes	90 days	25%	5%

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued) December 31, 2018 and 2017

2. Cash and Investments (Continued)

Claims Paying Fund:

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment In One Issuer
U.S. Treasury Securities	5 years	None	None
Federal Agency Securities	180 days	50%	25%
Bankers Acceptances (BA)	180 days	25%	5%
Certificates of Deposit	180 days	25%	5%
Commercial Paper	180 days	25%	5%
Corporate Bonds/Notes	180 days	25%	5%

Cash Deposits

With the issuance of the series 2014 revenue bonds, the CEA is required to deposit 1/12th of the annual interest payment by the 15th of each month into a trust account. Starting on July 1, 2015, the CEA also was required to deposit 1/12th of the annual principal payment by the 15th of each month into a trust account. Such amounts are held in restricted cash, cash equivalents and investments.

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 180 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 3 years. As of December 31, 2018, the CEA's combined portfolio had a maximum modified duration of 2.2 years.

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, 2018, 97% of the portfolio consisted of U.S. Treasuries and 3% of the portfolio consisted of U.S. Agencies, commercial paper and cash.

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued) December 31, 2018 and 2017

2. Cash and Investments (Continued)

CEA's cash equivalents and investments are rated as follows:

Security Type	Moody's*	Standard & Poor's*
US Treasury	Aaa	AA+
Federal Home Loan Mortgage Corporation	Aaa	AA+
Fannie Mae	Aaa	AA+
Chevron Corporation	Aa2	AA
Coca Cola	A1	A+
Pfizer Inc.	A1	AA
Toyota Motor Credit Corporation	Aa3	AA-

*Although U.S. Treasury is the only security type that can be held long term, the long-term rating is used as the short-term rating equivalent is too broad to show much difference between security type.

Concentration of Credit Risk

There is no concentration of investments in any one non-U.S. Governmental issuer, which is not explicitly guaranteed, that represents 5% or more of total investments.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of failure of a depository financial institution, CEA will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. CEA has no policy that would limit the exposure to custodial credit risk for deposits. At December 31, 2018 and 2017 approximately \$60.8 million and \$8.2 million, respectively, of CEA deposits were not covered by FDIC insurance.

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 statements of revenues, expenses, and changes in net position.

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued) December 31, 2018 and 2017

2. Cash and Investments (Continued)

Investment income for the years ended December 31, 2018 and 2017 are as follows:

	2018	2017
U.S. agency securities	\$ 1,651,416	\$ 1,191,546
Commercial paper	1,069,967	514,213
U.S. treasuries	104,035,916	80,616,259
Interest income	106,757,299	82,322,018
Change in fair value of investments	(5,412,594)	(37,082,998)
Less investment expenses	(2,661,814)	(2,600,365)
Net investment income	\$ 98,682,891	\$ 42,638,655

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

	2018	2017
Investment income on bond proceeds, net of related expenses	\$ 5,937,705	4,575,935
Net investment income	92,745,186	38,062,720
	\$ 98,682,891	\$ 42,638,655

The change in fair value of investments for the years ended December 31, 2018 and 2017 are calculated as follows:

	2018	2017
Fair value of investments at the end of year	\$ 6,385,806,434	\$ 5,927,549,455
Add: Proceeds of investments matured	1,786,063,785	2,226,975,645
Add: Amortization of discounts/premium	5,759,014	14,416,809
Less: Chg in realized gain/loss	379,558	(14,386)
Less: Cost of investments purchased	(2,255,871,930)	(2,024,487,600)
Less: Fair value of investments at the beginning of year	(5,927,549,455)	(6,181,522,921)
Change in fair value of investments	\$ (5,412,594)	\$ (37,082,998)

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued)
December 31, 2018 and 2017

2. Cash and Investments (Continued)

Fair Value Measurement

The CEA categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is divided into 3 levels with each level based on the source used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. The asset's level within the hierarchy is based on the lowest level of input that is significant to the fair value measurement. The CEA's assessment of the significance of particular inputs to these fair value measurements requires judgement and considers factors specific to each asset or liability.

U.S. treasury securities and U.S. agency securities classified in Level 1 are valued using prices quoted in active markets for those securities.

The fair value of commercial paper was determined to be amortized cost due to the short-term duration of the security.

As of December 31, 2018, and 2017, the CEA had the following recurring fair value measurements:

December 31, 2018

	Fair Value Measurement Using			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Bonds:				
U.S. Treasuries	\$ 6,324,469,706	\$ -	\$ -	\$ 6,324,469,706
U.S. Agencies	49,022,445	-	-	49,022,445
Commercial Paper	-	12,314,283	-	12,314,283
Subtotal	6,373,492,151	12,314,283	-	6,385,806,434
Cash and cash equivalents:				
U.S. Treasuries	59,412,550	-	-	59,412,550
U.S. Agencies	85,404,300	-	-	85,404,300
Commercial Paper	-	18,387,313	-	18,387,313
Cash	61,066,947	-	-	61,066,947
Subtotal	205,883,797	18,387,313	-	224,271,110
Total	\$ 6,579,375,948	\$ 30,701,596	\$ -	\$ 6,610,077,544

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued)
December 31, 2018 and 2017

2. Cash and Investments (Continued)

December 31, 2017

	Fair Value Measurement Using			Total
	Quoted Prices in	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
	Active Markets			
	for Identical Assets (Level 1)			
Bonds:				
U.S. Treasuries	\$ 5,923,859,336	\$ -	\$ -	\$ 5,923,859,336
U.S. Agencies	3,690,119	-	-	3,690,119
Subtotal	5,927,549,455	-	-	5,927,549,455
Cash and cash equivalents:				
U.S. Treasuries	290,856,558	-	-	290,856,558
U.S. Agencies	43,090,161	-	-	43,090,161
Commercial Paper	-	47,618,115	-	47,618,115
Cash	8,248,528	-	-	8,248,528
Subtotal	342,195,247	47,618,115	-	389,813,362
Total	\$ 6,269,744,702	\$ 47,618,115	\$ -	\$ 6,317,362,817

Fair Value of Other 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.

3. Long-Term Liabilities

The following is a summary of long-term liabilities, excluding the net pension liability (see footnote 9) as of December 31, 2018:

	Balance 1-Jan-18	Additions	Retirements	Balance 31-Dec-18	Due within One Year
Revenue Bonds	\$210,000,000	\$ -	(\$105,000,000)	\$105,000,000	\$105,000,000
SB 84 Loan	-	1,091,000	-	1,091,000	164,497
Compensated Absences	982,209	667,355	(450,701)	1,198,863	450,701
Total	\$210,982,209	\$1,758,355	(\$105,450,701)	\$107,289,863	\$105,615,198

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued) December 31, 2018 and 2017

3. Long-Term Liabilities (Continued)

On November 6, 2014 CEA issued Series 2014 revenue bonds totaling \$350,000,000, summarized as follows:

<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Price or Yield</u>	<u>Maturity Date</u>
\$40,000,000	1.194 %	1.194 %	July 1, 2016
60,000,000	1.824	1.824	July 1, 2017
40,000,000	2.805	2.805	July 1, 2017
105,000,000	2.805	2.805	July 1, 2018
105,000,000	2.805	2.805	July 1, 2019

The bonds will bear interest from their date of delivery at the rates shown above, payable semiannually on January 1 and July 1, commencing on January 1, 2015. The series 2014 bonds are not subject to optional redemption prior to maturity and are payable from future pledged policyholder premiums.

The series 2014 revenue bonds are used to enhance claims paying capacity. The net proceeds from the revenue bonds were deposited into their respective Claims Paying Account and were used to purchase investments according to CEA's investment policy. The proceeds will only be used for future payments of earthquake policyholder claims and related loss adjustment expenses and may not be used to repay principal and interest of the debt. Revenue bond proceeds may be used for payment of claims after the CEA exhausts its capital available for claims and any capacity made available by reinsurance contracts. Repayment of debt does not affect the level of the Claims Paying Account.

The table below is the future scheduled debt service payments for the CEA's long-term debt as of December 31, 2018:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	\$ 105,000,000	\$ 1,472,625	\$ 106,472,625
Total requirements	\$ 105,000,000	\$ 1,472,625	\$ 106,472,625

This schedule includes the mandatory sinking-fund payment of \$105 million due July 1, 2019. The sinking fund balance was \$55.4 million and \$55.8 million as of December 31, 2018 and 2017 respectively. Interest paid during the year was \$5,890,500 and \$8,106,900 for 2018 and 2017, respectively.

SB 84 Loan

Senate Bill 84 (SB 84), authorized a one-time \$6 billion supplemental pension payment in 2017-18 to the California Public Employees' Retirement System (CalPERS), in addition to the actuarially determined annual contribution, which is to be apportioned to the five state retirement plans based on their share of the aggregate unfunded liability. The supplemental pension payment was funded through a cash loan from the Surplus Money Investment Fund and other state funds that accrue interest to the General Fund, which will be paid back by June 30, 2030, through the General Fund and other funds responsible for retirement contributions for the state's plans.

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued) December 31, 2018 and 2017

3. Long-Term Liabilities (Continued)

The total amount the CEA is responsible for paying is \$1,273,000, which includes principal of \$1,091,000 and interest of \$182,000. The interest rate is valued at the quarter-to-date yield at the two-year constant maturity U.S. Treasury rate and will be payable in July of each year subsequent to 2018.

Annual debt service requirements to maturity for the note payable at December 31, 2018 are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	\$ 164,497	\$ 37,503	\$ 202,000
2020	167,835	34,165	202,000
2021	173,948	28,052	202,000
2022	181,111	20,889	202,000
2023	188,429	13,571	202,000
Thereafter	215,180	47,820	263,000
Total requirements	<u>\$ 1,091,000</u>	<u>\$ 182,000</u>	<u>\$ 1,273,000</u>

4. Net Position

As described in Note 1, net position includes restricted and unrestricted portions. The following table details the components of net position as it relates to restricted and unrestricted:

	<u>2018</u>	<u>2017</u>
Restricted:		
Mitigation fund	\$ 16,092,656	\$ 22,115,006
Claims paying account	311,529,852	203,392,179
Total restricted net position	<u>\$ 327,622,508</u>	<u>\$ 225,507,185</u>
Unrestricted:		
Contributed capital	\$ 790,656,796	\$ 777,384,796
Additional paid-in capital	274,593,169	256,291,216
Other unrestricted	4,797,708,928	4,634,525,694
Total unrestricted net position	<u>\$ 5,862,958,893</u>	<u>\$ 5,668,201,706</u>

5. Risk Transfer

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 CEA from its primary responsibility to its policyholders, the reinsurance company that assumes the coverage assumes responsibility to reimburse 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 coverage 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.

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued) December 31, 2018 and 2017

5. Risk Transfer (Continued)

Certain 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, 2018, and 2017 in accordance with these terms, CEA did not have a premium adjustment expense against the contracts.

In addition to single year contracts, CEA contracts with reinsurers on multi-year contracts with a single limit over a two, three or a five-year term. The first-year premium for the reinsurance limit is calculated on the full limit, while subsequent premiums would be calculated on the remaining limit, if there were a recoverable from the reinsurance contract. An annual adjustment to the retention is based on the contracted probability of loss.

At the end of 2018, CEA had a total of four multi-year term contracts with the option of two limits available for two events. Similar to other CEA multi-year contracts, the first-year premium for the reinsurance limit is calculated on the full limit, while subsequent year's premium will be calculated on the remaining limit, if there is a recoverable from the reinsurance contract. An annual adjustment to the retention is based on the contracted probability of loss.

As of December 31, 2018, CEA ceded insurance to reinsurers under catastrophe excess-of-loss reinsurance contracts and provided maximum limits of \$8.132 billion at varying attachment points, and 34% of the limit balance is fully collateralized.

6. Statutory Compliance

State of California Insurance Code limits the CEA's "operating expenses" to a percentage of its "premium income." In calculating this limitation, the CEA determined that its premium income is its reported premiums written.

Effective January 1, 2015, statutory provisions pertaining to CEA operating expenses were amended by legislation, and items to be excluded from CEA operating expenses were spelled out in the new law, which (in effect) changed certain items of operating-expense inclusion, when compared to past practices of the CEA. The operating-expense cap was moved to 6% as defined in California Insurance Code section 10089.6, subdivisions (c) and (d), as amended by AB 2064. Operating expenses underneath this legislation totaled \$32.1 million and \$26.6 million for the years ended December 31, 2018 and 2017, respectively, and did not exceed 6% of premiums written in either year.

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, 2018 and 2017

7. Commitments and Contingencies (Continued)

The CEA leases office facilities and equipment under various non-cancelable operating lease agreements that expire through June 2024. Rental expense associated with the lease agreements was \$1,175,631 and \$1,167,533 for the years ended December 31, 2018 and 2017, respectively. Future minimum rental payments under these agreements are as follows:

<u>Year</u>	<u>Amount</u>
2019	\$ 1,304,342
2020	1,324,472
2021	1,358,791
2022	1,369,882
2023	1,357,747
Thereafter	690,671
Total	<u>\$ 7,405,905</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, 2018, and 2017, the balance sheets include expendable restricted net position related to the Mitigation Fund totaling \$16,092,656 and \$22,115,006 respectively. The expendable restricted net position of the Mitigation Fund as of December 31, 2018 includes the potential annual transfer amount of \$5,000,000, which is subject to actuarial review and formal approval of the CEA’s Governing Board as discussed in the previous paragraph.

9. Defined Benefit Pension Plan

Plan Description

All CEA civil-service employees participate in the California Public Employees’ Retirement System (CalPERS), which is included in the State of California’s (State) Comprehensive Annual Financial Report as a fiduciary component unit. CalPERS administers the Public Employees’ Retirement Fund (PERF). PERF is an agent multiple-employer defined benefit pension plan. CEA participates in the State Miscellaneous Plan (the Plan) in a cost-sharing arrangement in which all risks and costs are shared proportionately by participating State agencies.

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued) December 31, 2018 and 2017

9. Defined Benefit Pension Plan (Continued)

CalPERS issues a publicly available comprehensive annual financial report that may be obtained by writing to the California Public Employees' Retirement System, Fiscal Services Division, P.O. Box 942703, Sacramento, California 94229 or by visiting the CalPERS website at www.CalPERS.ca.gov under Forms and Publications.

Benefits Provided

The PERF provides service retirement and disability benefits, survivor benefits, annual cost of living adjustments and death benefits to plan members, who must be public employees and beneficiaries. CEA has civil service employees that are members of the following bargaining units: Professional Administrative, Financial and Staff Service (Bargaining Unit 1); Attorneys and Hearing Officer (Bargaining Unit 2) and Professional Scientific (Bargaining Unit 10), all of CEA's civil service employees are classified as members of the State Miscellaneous Plan. Vesting occurs after five years, or after ten years for second-tier employees. The benefit provisions are established by the Public Employees' Retirement Law (PERL) and the Public Employees' Pension Reform Act of 2013 (PEPRA). Benefits are based on a formula using a member's years of service credit, age at retirement, and final compensation (average salary for a defined period of employment). Retirement formulas vary based on:

- Classification (e.g. miscellaneous, peace officers and firefighters, or judges);
- Membership category (pre-PEPRA and post-PEPRA); and
- Specific provisions in employees' contracts.

The Plans provisions and benefits in effect at December 31, 2018 are summarized as follows:

	<u>State Miscellaneous Tier 1</u>			<u>State Miscellaneous Tier 2</u>	
	Prior to January 15, 2011	On or after January 15, 2011	On or after January 1, 2013	Prior to January 1, 2013	On or after January 1, 2013
Hire date					
Benefit formula	2% @ 55	2% @ 60	2% @ 62	1.25% @ 65	1.25% @ 67
Benefit vesting schedule	5 years of service	5 years of service	5 years of service	10 years of service	10 years of service
Benefit payments	monthly for life	monthly for life	monthly for life	monthly for life	monthly for life
Retirement age	50-63	50-63	52-67	50-65	52-67
Monthly benefits, as a % of eligible compensation	1.1% - 2.5%	1.092% - 2.418%	1% - 2.5%	0.5% - 1.25%	0.65% - 1.25%

Contributions

Section 20814(a) of the California Public Employees' Retirement Law (PERL) requires that employer contribution rates for all public employers to be determined on an annual basis by the actuary and shall be effective on the July 1st following notice of a change in the rate. The total plan contributions are determined through CalPERS annual actuarial valuation process. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. CEA is required to contribute the difference between the actuarially determined rate and the contribution rate of employees.

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued)
December 31, 2018 and 2017

9. Defined Benefit Pension Plan (Continued)

For the measurement period ended June 30, 2017 (the measurement date), the average active employee contribution rate and the employer’s actuarially determined contribution rate, expressed as a percentage of payroll were:

	Average Active Employee Contribution Rate	Employer Contribution Rate
State Miscellaneous Plan	6.737%	26.734%

For the fiscal year ended December 31, 2018, the contributions recognized as part of pension expense were \$1,219,273.

Senate Bill 84 (SB 84), approved by the Governor on July 10, 2017, directed the State to contribute an additional \$6 billion to the State Plans during fiscal year 2017-18 to pay down the unfunded accrued liability. Payments were made in three equal installments on or around October 31, 2017, January 16, 2018 and April 17, 2018. These payments are in addition to the actuarially required contributions for fiscal year 2017-18. The CEA’s portion of the \$6 billion loan is \$1,273,000, which includes both principal and interest. See Note 3 for further information.

Pension Liabilities, Pension Expense and Deferred Outflows/Inflows of Resources Related to Pensions

As of December 31, 2018, CEA reported net pension liabilities for its proportionate share of the Plan’s net pension liabilities in the amount of \$11,070,484.

CEA’s net pension liability is measured as the proportionate share of the net pension liability of the Plan. The net pension liabilities of the Plan as of December 31, 2018 are measured as of June 30, 2017, and the total pension liabilities for the Plan used to calculate the net pension liabilities were determined by an actuarial valuation as of June 30, 2016 rolled forward to June 30, 2017 using standard update procedures. CEA’s proportionate share of the net pension liability of the Plan was based on the State Controller’s Office (SCO) projection for CEA based on its pensionable compensation (covered payroll). The SCO calculated and provided CEA with their allocated pensionable compensation percentages by Plan. CEA’s proportionate share of the net pension liabilities for the Plan as of June 30, 2017 was .030301%.

For the year ended December 31, 2018, CEA recognized pension expense of \$7,802,160.

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued) December 31, 2018 and 2017

9. Defined Benefit Pension Plan (Continued)

At December 31, 2018, CEA reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	State Miscellaneous Plan	
	Deferred Outflows of Resources	Deferred Inflows of Resources
CEA's contributions subsequent to the measurement date	\$ 1,721,132	\$ -
Change in assumptions	1,287,979	-
Net differences between expected and actual experience	48,503	103,316
SB 84 Supplemental Contribution	1,091,000	-
Difference between projected and actual earnings on pension plan investments	314,026	-
	\$ 4,462,640	\$ 103,316

The amounts reported as deferred outflows of resources related to contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending December 31, 2019. Other amounts reported as deferred inflows of resources related to pensions will be amortized into pension expense in future years.

Actuarial Assumptions

For the measurement period ended June 30, 2017 (measurement date), the total pension liability was determined by rolling forward the June 30, 2016 total pension liability using standard update procedures. The June 30, 2016 and the June 30, 2017 total pension liabilities of all Plans were based on the following actuarial method and assumptions:

Actuarial Cost Method	Entry Age Normal
Actuarial Assumptions	
Discount Rate	7.15%
Inflation	2.75%
Salary Inflation	Varies by Entry Age and Service
Mortality Rate Table ⁽¹⁾	Derived using CalPERS' Membership Data for all Funds Contract COLA up to 2.75% until Purchasing Power Protection Allowance
Post Retirement Benefit Increase	Floor on Purchasing Power applies, 2.75% thereafter

The mortality table used was developed based on CalPERS' specific data. The table includes 20 years of mortality improvements using Society of Actuaries Scale BB. For more details on this table, please refer to the 2014 experience study report.

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued) December 31, 2018 and 2017

9. Defined Benefit Pension Plan (Continued)

All other actuarial assumptions used in the June 30, 2016 valuation were based on the results of an actuarial experience study for the period from 1997 to 2011, including updates to salary increase, mortality and retirement rates. The Experience Study report may be accessed on the CalPERS website at www.calpers.ca.gov under Forms and Publications.

Discount Rate

The discount rate used to measure the total pension liability was 7.15% as of June 30, 2016. To determine whether the municipal bond rate should be used in the calculation of the discount rate for each plan, CalPERS stress tested plans that would most likely result in a discount rate that would be different from the actuarially assumed discount rate. The tests revealed the assets would not run out. Therefore, the current 7.15% discount rate is appropriate, and the use of the municipal bond rate calculation is not deemed necessary. The long-term expected discount rate of 7.15% is applied to all plans in the Public Employees' Retirement Fund (PERF). The cash flows used in the testing were developed assuming that both members and employers will make their required contributions on time and as scheduled in all future years. The stress test results are presented in a detailed report called "GASB Crossover Testing Report" that can be obtained at CalPERS website under the GASB 68 section.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class.

In determining the long-term expected rate of return, staff took into account both short-term and long-term market return expectations as well as the expected pension fund (PERF) cash flows. Taking into account historical returns of all the Public Employees Retirement Funds' asset classes (which includes the agent plan and two cost-sharing plans or PERF A, B, and C funds), expected compound (geometric) returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each PERF fund. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equal to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

The table below reflects long-term expected real rate of return by asset class. The rate of return was calculated using the capital market assumptions applied to determine the discount rate and asset allocation. The target allocation shown was adopted by the Board effective on July 1, 2014.

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued)
December 31, 2018 and 2017

9. Defined Benefit Pension Plan (Continued)

<u>Asset Class</u>	<u>Current Target Allocation</u>	<u>Real Return Years 1 - 10 ¹</u>	<u>Real Return Years 11+ ²</u>
Global Equity	47.00%	4.90%	5.38%
Global Fixed Income	19.00%	0.80%	2.27%
Inflation Sensitive	6.00%	0.60%	1.39%
Private Equity	12.00%	6.60%	6.63%
Real Estate	11.00%	2.80%	5.21%
Infrastructure and Forestland	3.00%	3.90%	5.36%
Liquidity	2.00%	-0.40%	-0.90%

- (1) An expected inflation of 2.5% used for this period
- (2) An expected inflation of 3.0% used for this period

Sensitivity of the Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following presents CEA’s proportionate share of the net pension liabilities of the Plan as of June 30, 2017 (measurement date), calculated using the discount rate of 7.15% as well as what CEA’s proportionate share of the net pension liabilities would be if it were calculated using a discount rate 1 percentage point lower (6.15%) or 1 percentage point higher (8.15%) than the current discount rate:

	<u>State Miscellaneous</u>		
	<u>Discount Rate - 1% (6.15%)</u>	<u>Current Discount Rate (7.15%)</u>	<u>Discount Rate +1% (8.15%)</u>
CEA's proportionate share of plan's net pension liability	\$15,145,766	\$11,070,484	\$7,660,109

Pension Plan Fiduciary Net Position

Detailed information about the State of California Miscellaneous Plan’s fiduciary net position is available in the separately issued CalPERS financial reports.

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued) December 31, 2018 and 2017

10. Defined Contribution Plan

The CEA sponsors the California Earthquake Authority Retirement Plan (Plan), a 401(A) defined contribution savings plan for contract employees. The Plan is administered by UBS Financial Services. Employees contribute 5% of base compensation. The CEA contributes 12.71% of the employee's base compensation. The maximum base compensation for 2018 and 2017 was \$275,000 and \$270,000. The contributions are funded semi-annually and allocated to the CEA based on employee contributions.

Employees are fully vested in their account from the beginning of their employment. The CEA has no legal obligation for benefits under this Plan. Only the CEA Board has the authority to amend the Plan provisions. Employee contributions in 2018 and 2017 were \$90,738 and \$85,334 respectively. CEA's contributions in 2018 and 2017 were \$230,857 and \$217,107, respectively.

11. Risk Management

The CEA is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The CEA has insurance policies with private insurance companies for the following policies:

<u>Policy Type</u>	<u>Policy Limits</u>
Workers Compensation	\$ 1,000,000
Financial Institution Bond	\$ 1,500,000
Business Liability	\$ 5,000,000
Director and Officers Liability	\$ 5,000,000

Management believes such coverage is sufficient to preclude any significant uninsured losses to the CEA. Claim amounts have not exceeded policy limits in the last three years.

12. California Residential Mitigation Program

On August 16, 2011, the CEA entered into a Joint Powers Agreement (JPA) with the California Emergency Management Agency (Cal EMA) to create the California Residential Mitigation Program (CRMP) for the purpose of supplying grants, loans, and loan guarantees (and related assistance and incentives) to owners of dwellings in California. Since the inception of the agreement, CalEMA, the name of the organization, has changed to California Emergency Office of Emergency Services (Cal OES). The CRMP Governing Board is comprised of two representatives of each the CEA and Cal OES. Transfers approved by the CEA governing board from the CEA Mitigation Fund to the CRMP totaled \$8,900,000 and \$5,400,000 in 2018 and 2017, respectively.

In addition to the CEA governing board approved transfers, in 2018, the CEA Mitigation Fund (Mitigation) transferred to CRMP \$18,626 in Federal Emergency Management Agency (FEMA) funds for the CRMP Earthquake Brace + Bolt program (CRMP EBB) which offers up to \$3,000 for homeowners to seismically retrofit their houses. In 2017, Mitigation transferred to CRMP \$3,000,000 in California Department of Insurance (CDI) funds and \$218,394 in FEMA funds for the CRMP EBB.

Requests for CRMP financial information should be addressed to California Residential Mitigation Program, 801 K Street, Suite 1000, Sacramento, CA 95814.

CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued) December 31, 2018 and 2017

13. Subsequent Events

Management has evaluated subsequent events up through and including June 2, 2019, which is the date the financial statements were made available to be issued. No events, other than those disclosed below and elsewhere in these financial statements, have occurred subsequent to December 31, 2018 requiring recording or disclosure in these financial statements.

The CEA's most recent rate form filing was approved by the Department of Insurance in 2018 for new and renewal business on and after July 1, 2019. The form filing was made to introduce new rating factors, apply an enhanced hazard mitigation discount to qualifying CEA homeowners' policies, and changes some rating territories. The net result in the filing is a decrease in the CEA's statewide average rates.

On September 27, 2018, the California Legislature adopted, and the Governor signed, Assembly Bill No. 2927. This legislation took effect on January 1, 2019 and provided a mechanism for the CEA to more readily access \$1 billion of claim-paying capacity from standby CEA-policyholder surcharge debt.

REQUIRED SUPPLEMENTARY INFORMATION

CALIFORNIA EARTHQUAKE AUTHORITY

Schedule of CEA's Proportionate Share of the Net Pension Liability As of December 31, 2018 Last 10 Years *

	<u>2018 **</u>
State Miscellaneous Plan	
CEA's proportion of the net pension liability	0.030301%
CEA's proportionate share of the net pension liability	\$11,070,484
CEA's covered-employee payroll	\$3,512,318
CEA's proportionate share of the net pension liability as percentage of their covered-employee payroll	315.19%
Plan fiduciary net position as a percentage of the total pension liability	66.42%

Notes to Schedule:

* - 2018 was the 1st year of implementation of GASB 68, therefore only one year is presented

** - Information is as of the June 30, 2017 measurement date.

CALIFORNIA EARTHQUAKE AUTHORITY

Schedule of CEA's Contributions: Pension Plan
As of December 31, 2018
Last 10 Years *

	<u>2018</u>
State Miscellaneous Plan	
Contractually required contribution	\$1,219,273
Contributions in relation to the contractually required contribution	(1,219,273)
Contribution deficiency (excess)	<u>\$0</u>
CEA's covered-employee payroll	\$3,512,318
Contributions as a percentage of covered-employee payroll	34.71%

Notes to Schedule:

* - 2018 was the 1st year of implementation of GASB 68, therefore only one year is presented

SUPPLEMENTARY INFORMATION

CALIFORNIA EARTHQUAKE AUTHORITY

Schedule of Participating Insurer Capital Contributions From Inception Through December 31, 2018

1 State Farm General Insurance Company	\$ 254,658,275
2 Allstate Insurance Company	145,612,517
3 The Fire Insurance Exchange (Farmers)	143,280,000
4 United Services Automobile Association ¹	58,992,512
5 Safeco Insurance Company of America ³	46,500,000
6 California State Automobile Association Inter-Insurance Bureau ²	39,013,494
7 Nationwide Insurance Company ⁷	20,772,000
8 California FAIR Plan Association	15,029,487
9 Interinsurance Exchange of the Automobile Club	14,443,651
10 CNA/Continental ^{4,6,12}	13,924,611
11 Amica ¹¹	13,272,000
12 Prudential ⁴	11,531,455
13 Liberty Mutual Fire Insurance Company ⁵	6,699,434
14 Foremost Property and Casualty Insurance Company	4,614,304
15 Mercury Casualty Company	1,406,238
16 Armed Forces Insurance Exchange	783,685
17 GuideOne (formerly Preferred Risk) ⁴	123,133
18 Homesite Insurance Company of California	-
19 Pacific National Insurance ⁴	-
20 Encompass Insurance Company	-
21 Glen Falls Insurance Company ⁴	-
22 Commerce West Insurance Company ⁸	-
23 Hyundai ⁹	-
24 Progressive ¹⁰	-
	-
Total	\$ 790,656,796

¹ Includes Garrison Insurance Company

² Includes ACA Insurance Company

³ Joined the CEA as of December 1, 2008

⁴ Not currently writing residential property insurance in California

⁵ Includes Golden Eagle Insurance Company

⁶ Withdrew from the CEA as of May 2011

⁷ Joined the CEA as of November 2011

⁸ Includes MAPFRE Insurance Company

⁹ Joined the CEA as of August 2014

¹⁰ Joined the CEA as of May 2015

¹¹ Joined the CEA as of August 2018

¹² Allstate bought CNA in 1999 and is writing underneath Encompass.

CALIFORNIA EARTHQUAKE AUTHORITY

Schedules of Participating Insurer Premiums Written For the Years Ended December 31, 2018 and 2017

	2018	2017
1 State Farm General Insurance Company	\$ 258,911,457	\$ 230,602,026
2 Allstate Insurance Company	72,258,079	68,332,452
3 The Fire Insurance Exchange (Farmers)	102,130,047	92,830,553
4 United Services Automobile Association ¹	102,821,271	102,499,324
5 Safeco Insurance Company of America ³	46,636,149	42,064,383
6 California State Automobile Association Inter-Insurance Bureau ²	43,669,924	35,341,935
7 Nationwide Insurance Company ⁷	21,693,400	20,650,109
8 California FAIR Plan Association	4,222,771	4,119,320
9 Interinsurance Exchange of the Automobile Club	57,282,769	51,541,539
10 CNA/Continental ^{4,6,12}	-	-
11 Amica ¹¹	1,448,137	-
12 Prudential ⁴	-	-
13 Liberty Mutual Fire Insurance Company ⁵	18,897,890	17,641,652
14 Foremost Property and Casualty Insurance Company	5,571,993	4,679,900
15 Mercury Casualty Company	34,633,993	29,168,944
16 Armed Forces Insurance Exchange	532,881	506,211
17 GuideOne (formerly Preferred Risk) ⁴	-	-
18 Homesite Insurance Company of California	2,689,790	2,204,112
19 Pacific National Insurance ⁴	-	-
20 Encompass Insurance Company	3,856,512	3,838,222
21 Glen Falls Insurance Company ⁴	-	-
22 Commerce West Insurance Company ⁸	161,625	170,971
23 Hyundai ⁹	2,503	1,198
24 Progressive ¹⁰	919,793	357,467
	\$ 778,340,984	\$ 706,550,318
Total		

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CALIFORNIA EARTHQUAKE AUTHORITY

Schedule of Participating Insurer Unearned Premium For the Years Ended December 31, 2018 and 2017

	2018	2017
1 State Farm General Insurance Company	\$ 130,041,112	\$ 114,537,537
2 Allstate Insurance Company	37,642,185	36,000,455
3 The Fire Insurance Exchange (Farmers)	52,246,052	48,141,073
4 United Services Automobile Association ¹	66,424,578	58,761,700
5 Safeco Insurance Company of America ³	29,524,621	26,440,382
6 California State Automobile Association Inter-Insurance Bureau	22,103,517	18,834,601
7 Nationwide Insurance Company ⁷	11,083,312	10,915,339
8 California FAIR Plan Association	2,150,515	2,091,604
9 Interinsurance Exchange of the Automobile Club	28,803,785	25,585,712
10 CNA/Continental ^{4,6,12}	-	-
11 Amica ¹¹	1,404,946	-
12 Prudential ⁴	-	-
13 Liberty Mutual Fire Insurance Company ⁵	11,462,452	10,899,959
14 Foremost Property and Casualty Insurance Company	2,893,315	2,553,698
15 Mercury Casualty Company	17,414,318	15,184,261
16 Armed Forces Insurance Exchange	286,970	251,045
17 GuideOne (formerly Preferred Risk) ⁴	-	-
18 Homesite Insurance Company of California	1,411,291	1,089,117
19 Pacific National Insurance ⁴	-	-
20 Encompass Insurance Company	1,891,804	1,837,913
21 Glen Falls Insurance Company ⁴	-	-
22 Commerce West Insurance Company ⁸	79,479	88,511
23 Hyundai ⁹	1,433	589
24 Progressive ¹⁰	582,516	242,520
Total	\$ 417,448,201	\$ 373,456,016

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CALIFORNIA EARTHQUAKE AUTHORITY

Schedule of Participating Insurer Commissions For the Years Ended December 31, 2018 and 2017

	2018	2017
1 State Farm General Insurance Company	\$ 25,889,777	\$ 23,058,906
2 Allstate Insurance Company	7,225,527	6,832,474
3 The Fire Insurance Exchange (Farmers)	10,213,230	9,282,908
4 United Services Automobile Association ¹	10,281,946	10,249,795
5 Safeco Insurance Company of America ³	4,664,433	4,207,068
6 California State Automobile Association Inter-Insurance Burea	4,367,029	3,534,320
7 Nationwide Insurance Company ⁷	2,169,214	2,064,903
8 California FAIR Plan Association	422,289	411,931
9 Interinsurance Exchange of the Automobile Club	5,734,389	5,160,093
10 CNA/Continental ^{4,6,12}	-	-
11 Amica ¹¹	144,815	-
12 Prudential ⁴	-	-
13 Liberty Mutual Fire Insurance Company ⁵	1,890,562	1,764,731
14 Foremost Property and Casualty Insurance Company	555,458	466,022
15 Mercury Casualty Company	3,463,200	2,916,616
16 Armed Forces Insurance Exchange	53,291	50,604
17 GuideOne (formerly Preferred Risk) ⁴	-	-
18 Homesite Insurance Company of California	269,202	220,617
19 Pacific National Insurance ⁴	-	-
20 Encompass Insurance Company	385,637	383,760
21 Glen Falls Insurance Company ⁴	-	-
22 Commerce West Insurance Company ⁸	16,163	17,114
23 Hyundai ⁹	250	120
24 Progressive ¹⁰	91,970	35,750
	\$ 77,838,382	\$ 70,657,732
Total		

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⁷ Joined the CEA as of November 2011

⁸ Includes MAPFRE Insurance Company

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¹⁰ Joined the CEA as of May 2015

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CALIFORNIA EARTHQUAKE AUTHORITY

Schedule of Participating Insurer Operating Costs For the Years Ended December 31, 2018 and 2017

	2018	2017
1 State Farm General Insurance Company	\$ 8,410,994	\$ 7,489,800
2 Allstate Insurance Company	2,346,983	2,219,376
3 The Fire Insurance Exchange (Farmers)	3,317,137	3,014,498
4 United Services Automobile Association ¹	3,339,490	3,328,570
5 Safeco Insurance Company of America ³	1,515,022	1,366,859
6 California State Automobile Association Inter-Insurance Bureau	1,419,132	1,148,475
7 Nationwide Insurance Company ⁷	704,491	670,645
8 California FAIR Plan Association	137,217	133,868
9 Interinsurance Exchange of the Automobile Club	1,859,626	1,673,150
10 CNA/Continental ^{4,6,12}	-	-
11 Amica ¹¹	47,058	-
12 Prudential ⁴	-	-
13 Liberty Mutual Fire Insurance Company ⁵	613,790	572,959
14 Foremost Property and Casualty Insurance Company	179,435	150,362
15 Mercury Casualty Company	1,125,290	947,013
16 Armed Forces Insurance Exchange	17,292	16,434
17 GuideOne (formerly Preferred Risk) ⁴	-	-
18 Homesite Insurance Company of California	87,362	71,519
19 Pacific National Insurance ⁴	-	-
20 Encompass Insurance Company	125,315	124,673
21 Glen Falls Insurance Company ⁴	-	-
22 Commerce West Insurance Company ⁸	5,251	5,550
23 Hyundai ⁹	81	39
24 Progressive ¹⁰	29,867	11,612
	\$ 25,280,833	\$ 22,945,402
Total		

¹ Includes Garrison Insurance Company

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Governing Board Memorandum

June 12, 2019

Agenda Item 13: Ongoing consideration of launching a CEA-established nonprofit public benefit (501(c)(3)) corporation to raise funds to support seismic retrofit programs and mitigation activities

Recommended Actions: No action required—information only

Background

California faces a daunting residential resilience challenge with 29 of California's 58 counties considered to be in high-seismic areas and in which 83 percent of the population lives. It is estimated that more than 5 million residences were built to "Moderate Code" design level or below and are, therefore, buildings likely constructed prior to the adoption of modern seismic code provisions in 1980.

Established by law, CEA's Earthquake Loss Mitigation Fund holds monies CEA uses to carry out mitigation programs for all Californians, including, at present:

- Funding Earthquake Brace + Bolt (EBB) grants paid by the California Residential Mitigation Program ("CRMP").
- Paying personnel and administrative costs to support EBB-grant programming.
- Funding research on retrofit performance of single-family houses.
- Paying to support and develop new "pre-engineered standards" to enable cost-effective retrofits of more types of seismically vulnerable houses.

The EBB's unique and innovative program has a solid track record over the past five years, having completed more than 7,800 seismic retrofits. CEA estimates more than 1 million older houses in the Los Angeles and Bay Area could benefit from this specific type of retrofit.

These older houses are not bolted to their foundations, and the crawl spaces between the foundation and the first floor are connected by short, unbraced "cripple walls" that are vulnerable to collapse during a strong earthquake. The collapse of these cripple walls causes the house to drop to the ground or slide off its foundation.

This resulting damage can be extremely costly to the homeowner. For example, because of the moderate (M6.0) 2014 South Napa earthquake, owners of houses that suffered this type of damage received construction estimates of up to \$300,000 for repairs, including the extensive and expensive work involved in lifting the house while the foundation is rebuilt beneath it.

Basic code-compliant retrofits of pre-1979 houses—that is, completing the steps highlighted in the California Insurance Code to support favorable earthquake insurance pricing (bolting frame to foundation, bracing cripple walls with plywood or equivalent)—can greatly reduce the likelihood of this expensive and dangerous damage to single-family homes.

Typically, retrofits are both quick to accomplish and reasonable in cost. And if the homeowner of the retrofitted house is a CEA customer, the price of their CEA earthquake insurance policy is reduced by up to 25 percent (effective July 1, 2019).

Proposal

A CEA-established nonprofit public benefit corporation (tax exempt under Internal Revenue Code section 501(c)(3)) has the potential to create an additional source of mitigation funding through charitable donations, providing individuals and corporations the ability to claim state and federal charitable deductions for their contributions. In addition, the public benefit corporation could have strategic relationships with other nonprofits to expand its potential reach. California enjoys one of the largest economies in the world and these accumulated private donations could be a critical source of funding for residents, which will not come at the expense of CEA policyholders.

The specific purposes of this corporation would be to seek donations that can be deployed to:

- Encourage, fund, and conduct activities and research regarding
 - the seismic strengthening of residential buildings and related infrastructures, including securing building contents,
 - the science and engineering principles under which the effects of seismic activity are examined, studied, understood, and addressed, and
 - the development and promulgation of best practices for post-earthquake recovery methods and pre- and post-earthquake resiliency techniques;
- Develop educational materials for, and promote the education of, California residents and others about best practices for mitigating the damaging effects of earthquakes on residential structures and related infrastructures;
- Support the development and promulgation of best-practice recovery efforts and resiliency techniques within California and elsewhere; and
- Conduct other charitable and educational activities associated with these purposes, as allowed by law.

The nonprofit corporation's operations would be completely transparent. Its functions would include receiving tax-favored contributions from a variety of sources, maintaining these funds in separate, insured accounts, and then disbursing from accumulated funds sums earmarked for clearly defined grant programs and other appropriate mitigation-related purposes, such as relevant, productive research.

The CEA Governing Board will approve each key step of the formation of the nonprofit and the foregoing mitigation activities would be conducted under the supervision of a board of trustees selected by the CEA Governing Board.

Current Status and Next Steps

On September 20, 2017, the CEA Governing Board approved the basic steps to begin to establish a nonprofit public benefit corporation. CEA staff was authorized to file Articles of Incorporation to incorporate a nonprofit charitable foundation under California law.

The Articles of Incorporation were filed with the California Secretary of State on November 29, 2017, to establish the legal existence of the nonprofit.

The next steps are to gain CEA Governing Board approval of:

- Adoption of a detailed business plan,
- Applying for a tax identification number for the nonprofit, and
- Adoption of a set of bylaws, which will provide the rules and regulations that will govern the nonprofit organization and its directors and officers.

CEA staff and its legal counsel are in the process of finalizing the bylaws, which will include provisions and controls to ensure that the nonprofit corporation remains transparent and accountable to CEA's Governing Board. The proposed bylaws and recommendations will be presented for consideration at the September CEA Governing Board meeting.

Recommendation

No action required—information only.

Governing Board Memorandum

June 12, 2019

Agenda Item 14: Chief Mitigation Officer Janiele Maffei will update the Board on the following earthquake mitigation projects:

- The California Residential Mitigation Program (CRMP Earthquake Brace + Bolt)
- CEA’s financial incentive and mitigation program (CEA Brace + Bolt)
- Ongoing mitigation-related research projects
- CEA Seismic Retrofit Verification Program

Recommended Actions: No action required—information only

A. CRMP Earthquake Brace + Bolt Programs

1. 2019 EBB Program

As of May 20, the Earthquake Brace + Bolt Program has completed 7,813 retrofits.

Registration for the 2019 EBB program closed on November 13, 2018, with 8,688 registered homeowners in 255 ZIP Codes applying for the program. It was funded initially with a \$3 million FEMA grant and \$3 million from the CRMP. It was later determined that additional FEMA grant funding may become available so that all grant incentives for the 2019 EBB program could be funded with FEMA grants.

CRMP continues to await FEMA approval before initiating(?) Phase 2 activities for the 2019 EBB program, which allows homeowners to begin work. This unanticipated delay is due to environmental and historical preservation concerns. No timeframe for resolution has been provided.

In response to the significant delay, a special meeting of the CRMP Governing Board was held on April 22, 2019, requesting approval to utilize \$3 million of the approved 2019 CRMP budget to create a CRMP-funded EBB Program. The request was approved, and homeowners were given the option to move from the FEMA-funded program to the 2019 CRMP-funded EBB Program, which launched April 23, 2019.

As of May 20, the 2019 CRMP-funded EBB Program has transferred 984 homeowners from the 2019 FEMA-funded EBB Program, with 5 retrofits completed and 19 retrofits currently in process.

2. 2018 EBB Program

The 2018 EBB Program is slated to close on June 1, 2019, with approximately 3,350 retrofits completed, which represents 99% of the forecasted number of seismic retrofits to be completed for the program year.

3. Future Funding Opportunities

CEA is awaiting determination of its \$20 million DR 4344 HMGP grant application and will be submitting two grant applications under DR 4407.

- DR 4407 0104 - \$20M – (EBB Soft Story, 3 counties) – application submitted by 7/5/2019
- DR 4407 0105 - \$20M – (EBB 23 counties) -application submitted by 7/5/2019

CEA also is awaiting determination of its **Pre-Disaster Mitigation (PDM)** \$10M - Multi-Family Dwellings grant application.

B. CEA Brace + Bolt Program (CEA BB)

CEA BB opened in February 2019, with an invitation sent to 4,000 policyholders. Sixty policyholders initially accepted the invitation. In light of the disappointing results obtained by our policyholder mailing, additional outreach measures are being pilot tested including different types of mailings, phone calls and emails, when available, and encouraging agents to contact their policyholders directly. Results will be reported at the next board meeting.

C. Ongoing Research Projects

1. Guidelines Development:

The ATC 110 earthquake-guidelines-development project, first phase, completed on June 20, 2018. Now called FEMA P-1100, *Vulnerability-Based Seismic Assessment and Retrofit of One- and Two-Family Dwellings*, the document is currently under review by FEMA. The bulk publication consists of three volumes:

- Volume 1, prestandard publication (available online (estimated) September 2018 and softcover (estimated) December 2018)
- Volume 2, FEMA plan set
- Volume 3, background documents

ATC managed the project budget so as to permit a contract extension for 12 months at no additional cost. The additional work and remaining funds are to be used to develop training materials for the guidelines and archive data used in developing the guidelines. This work is underway and is expected to be completed by September 2019.

CEA is working with FEMA and the International Code Council (ICC) to adopt the guidelines as industry standards, which paves the way for adoption into California's building code. Additionally, by creating a uniform seismic-retrofit-design method for homeowners, contractors, and engineers, the new guidelines will help CEA and others (1) establish and expand incentive programs to encourage seismic retrofits, such as that of the California Residential Mitigation Program, and (2) enhance CEA's ability to develop and provide suitable mitigation discounts for CEA-insured homeowners. The ICC Standard will be proposed for adoption into the IBC 2024 by Fall 2020.

CEA provided the funding for this project, which is jointly managed by CEA's CMO Janiele Maffei and FEMA's Mike Mahoney.

D. CEA Seismic Retrofit Verification Program

The fundamental goal of CEA's Seismic Retrofit Verification Program (SRVP) is to inform California homeowners (existing and potential) about geologic and structural risks and vulnerabilities that could impact their house.

Based primarily on FEMA P-50 *Simplified Seismic Assessment of Detached, Single-Family, Wood-Frame Dwellings* and P-50-1 *Retrofit Guidelines of Detached, Single-Family, Wood-Frame Dwellings*, SRVP ultimately seeks to provide and promote training in conducting risk assessments, develop tools for conducting assessments, and build an inspection workforce. The workforce will be useful to CEA policyholders seeking to complete the CEA Earthquake Insurance - Dwelling Retrofit Verification Form (DRV) in order to obtain their Hazard Reduction Discount.

In 2019, SRVP is achieving this through multiple components:

1. Simplified Seismic Assessment Certification (coordinated through CREIA);
2. Incorporation of CEA's Hazard Reduction Discount (HRD) DRV form into QuakeGrade®;
3. Development and implementation of Authorized Inspection Professional (AIP) services;
 - a. Searchable database of California-licensed general contractors, civil engineers, and structural engineers willing to provide HRD inspections,
 - b. Webinar and training for AIPs on conducting HRD inspection and completing DRV forms;
4. Planned submission of an application to FEMA (due July 5, 2019) for Hazard Mitigation Grant Program funds (a 36-month grant) to:
 - a. update FEMA P-50 to reflect current science and correct data links, including incorporation of FEMA P-1100 assessment and retrofit guidelines;
 - b. update FEMA P-50 training to incorporate upgrades;
 - c. update QuakeGrade® to incorporate P-50 updates; and,
 - d. build an all inclusive AIP portal for registration, online training with testing in use of the DRV, P-50 and QuakeGrade®, auto-registration into QuakeGrade®, and
 - e. develop and implement an outreach and marketing campaign to California inspection professionals, homeowners, policyholders, and community stakeholders on the services and benefits of utilizing an AIP for inspections prior to a home purchase, to verify quality of a retrofit, and to complete CEA's DRV form.

Recommendation: No recommendation—information only.

Governing Board Memorandum

June 12, 2019

Agenda Item 15:

TV News Station Initiative

Recommended Action:

Information only

Along with greater emphasis on regional media planning for 2019, CEA encouraged its television news partners to demonstrate a shared commitment to helping their viewers prepare to survive and recover from California’s next damaging earthquake. Participating separately from advertising inventory, CEA’s TV news partners were encouraged to produce news-reporter PSAs, feature a shared landing page produced by CEA for their station’s website, and participate in newsroom briefings with select earthquake preparedness experts.

This memo focuses on results from recent news briefings in Los Angeles and San Francisco. News briefings for San Diego will be scheduled for August.

Background: TV news-reporter PSAs¹

By the fall of 2019, CEA’s PSA script will have been read by 17 different TV news reporters in three markets—to date, twelve PSAs have been completed for Los Angeles and San Francisco. For development, each of the TV stations necessarily control production of their PSA however they deem appropriate. The PSAs are or will be rotated at 10 percent of CEA’s advertising plan for each of the 17 TV stations and are additionally utilized at the stations’ discretion when open inventory is available.



“ Scientists say that a damaging earthquake is inevitable.

So it’s important to get prepared.

Here’s what you can do right now:

- Practice how to drop, cover, and hold on during an earthquake.
- Make sure your family has an emergency plan and supplies in place.
- Check whether your older house should be bolted to its foundation.
- And call your agent to discuss earthquake insurance options.
- For tips on earthquake recovery, go to [station website].

We’re here to help. ”

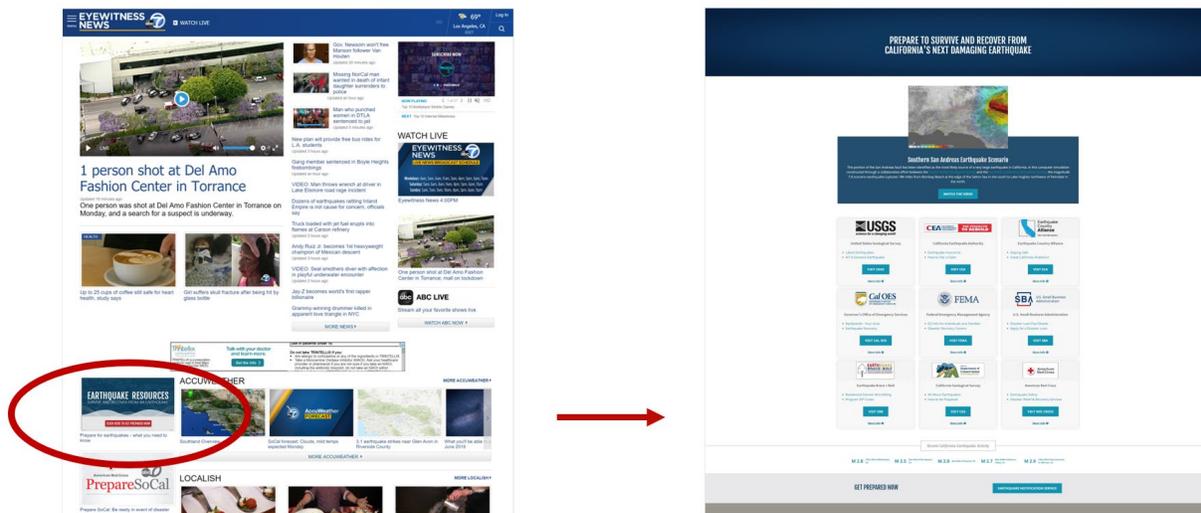
Background: Shared website landing page

As a resource for TV news-reporter PSAs to direct viewers to more information, CEA has produced a shared landing page accessed through each station’s website that provides earthquake preparedness, survival, and recovery information from a variety of earthquake experts:

¹ The strategy of utilizing local news talent for earthquake preparedness PSAs aligns with results from the California Earthquake Preparedness Survey conducted by the UCLA School of Public Health and Survey Research Center for the State of California in 2010, which reported that “over 80 percent of California residents have gotten information about earthquake preparedness from television anchors and reporters.” Numerous research studies conducted by CEA since that date generally have further reinforced those results.

- U.S. Geological Survey – Latest Earthquakes and a Regional Earthquake Scenario
- California Earthquake Authority – Earthquake Insurance and How to File a Claim
- Earthquake Country Alliance – Seven Steps to EQ Safety and Great California ShakeOut
- Governor’s Office of Emergency Services – MyHazards and Earthquake Recovery
- FEMA – EQ Information for Individuals and Families and Disaster Recovery Centers
- SBA – Disaster Loan Fact Sheets and Apply for a Disaster Loan
- Earthquake Brace + Bolt – Residential Seismic Retrofitting and Program ZIP Codes
- California Geological Survey – All About Earthquakes and How to Be Prepared
- American Red Cross – Earthquake Safety and Disaster Relief & Recovery Services

CEA’s goals for the shared landing page are to disseminate it most efficiently across numerous news outlets, and to prompt news sources to offer the shared landing page year-round. While the goal to share efficiently has been achieved, CEA still is working with news sources through the rest of this year to secure year-round availability.



Update: In-person TV news station briefings

CEA has gathered spokespersons with earthquake expertise—from organizations represented on the landing page—to annually educate TV newsroom personnel on earthquake information, and to be a contact for more information when needed. To date, CEA has facilitated six news briefings in Los Angeles, and five news briefings in San Francisco. Key newsroom personnel from each of the 11 stations actively participated in these briefings.



KABC – LA



KCBS – LA



KGO – SF



KRON – SF

Though the news briefings are focused on providing high-level information about earthquake preparedness, survival, and recovery, news stations occasionally may decide to produce a related news story on the topic.

Such was the case in Los Angeles recently, when—immediately following a briefing—FOX LA produced a 30-minute news feature that included seven landing-page spokespersons. The special aired on two different local Fox channels in the Los Angeles area in April and was promoted on Twitter before, during, and after the air date: once by Fox LA (to their 224,000 followers), five times by host Hal Eisner (nearly 10,000 followers), and seven times by Managing Editor Pete Wilgoren (nearly 5,000 followers). The special also resulted in CEA and the rest of the earthquake experts participating in Eisner’s podcast show “What the Hal.”



FOX – LA

Based on the level of news-team participation in TV station briefings thus far in Los Angeles and San Francisco, CEA is optimistic that TV news stations in San Diego will similarly participate.

Recommendation:

Information only.

Governing Board Memorandum

June 12, 2019

Agenda Item 16: CEA Research Program: Projects

Recommended Actions: No action required—information only

Background:

With Governing Board support and approval, CEA launched a new research program in 2017. The program provides for three tiers of funding for multiple disciplines of research, all relevant to CEA’s mission to provide affordable, accessible earthquake insurance for those who own or rent residences in California.

1. Grant Program

Grants for professional and academic development comprise two of the tiers of the grant program. Projects must be related to earthquake studies, regardless of discipline, and meet program specifications for focus areas. The grant recipients will most likely be research specialists, possibly private sector but more likely faculty employed in public and private universities, within and outside California. In addition to generating research to inform CEA in its mission and inform the earthquake community in general, the grants are intended to support and build a new generation of earthquake-science specialists from many disciplines, including graduate students and professionals establishing themselves in the field.

Grant contracts would be made with the university, which distributes grant funds to the ultimate recipient. NOTE: Universities often add substantial overhead costs, reducing net funds to the researcher—this may have impacts on the grant awards.

CEA Research and Legal Department staff have collaborated on (draft) program policies and procedures, including best options for contracting with university faculty who may be awarded a CEA grant, and are finding the goal more complex than anticipated.

In addition to the CEA Legal Department, input from CEA Finance and Accounting will ensure funding requests and distribution meet audit requirements. As well, clear contracting criteria and a process to administer the contracts and distribute funds must be set before program launch. As a result, the grant program will not launch until mid-2019.

2. Research Projects

Cripple-Wall Performance Effects

CEA contracted with the Pacific Earthquake Engineering Research (PEER) Center in September 2016 to lead the CEA’s research project, “Quantifying the Performance of Retrofit of Cripple Walls and Sill Anchorage in Single Family Wood-frame Buildings.”

Progress to date on the seven project tasks:

1. Literature Review. *Completed*
2. Analysis of Building Inventory and Defining Representative “Index Buildings.” *Completed*
3. Selecting Ground-Motion Records and Developing Loading Protocols. *Completed*
4. Experimental Program. *Completed*
5. Analytical Modeling. *In Progress*
6. Loss Model Calibration Framework. *In Progress*
7. Reporting, including regular progress reports: three reports have been received, and the project is on track.

With this project, CEA will have refined scientific data to inform CEA rate levels and premium discounts.

CEA Damage-Assessment Guidelines

In 2007 CEA provided major funding for the Consortium of Universities for Research in Earthquake Engineering (CUREE), whose work produced the “Assessment and Repair of Earthquake Damage” project—a set of guidelines for “...a sound technical basis for use by engineers, contractors, owners, the insurance industry, building officials, and others in the post-earthquake context. Based on experimental and analytical research and a broad discussion of the issues involved, the guidelines... ..facilitate improved consistency in the evaluation of building damage and the associated need for repairs.”

The Guidelines were last updated in 2010. As part of CEA’s funding agreement with CUREE, the Guidelines were made available for free PDF download and have been widely distributed as part of the California Department of Insurance-required earthquake training for adjusters.

CUREE disbanded in December 2016, leaving a void in maintaining and updating the Guidelines. To ensure Guidelines continuity, CEA contracted with Applied Technology Council in May 2018 to update the existing CUREE Guidelines (renaming them to the “CEA Damage Assessment Guidelines”) and to develop companion engineering guidelines.

Drafting the General Guidelines and Engineering Guidelines is currently underway and is expected to be completed October 2019.

UCERF 3 Analysis

The UCERF3 model represents a substantial advancement in science. It is also complex, yielding more than 250,000 fault-based ruptures—25 times more than the UCERF2 model.

To deal with the complexity, work is required to identify which of the UCERF3 model’s “branches” most influence modeled results.

Although CEA is not legally obligated to advance the scientific understanding of seismic risk in California, staff continues to believe that it is in CEA’s best interests to do so, on a voluntary basis. Seismic research underpins many of CEA’s actions, such as:

- Developing the structure and cost of innovative insurance products, using the best available science.
- Understanding the amounts of risk-transfer CEA requires to ensure coverage needs and policyholder claims.
- Measuring the effects of risk-reduction features on expected policyholder losses (e.g., to support a more robust hazard-reduction discount).
- Effectively communicating risk to CEA policyholders and other stakeholders.
- Quantifying the anticipated total cost of a damaging earthquake, using CEA’s proprietary EARLE process.

The Governing Board agreed to and approved an earlier request that CEA contract with the Southern California Earthquake Center (SCEC) to manage and carry out with the further efforts and collaboration of the UCERF3 research participants. USGS and SCEC will have leading roles in the development, progress, and quality control of the project, with oversight and appropriate management to be provided by the CEA Research Department.

CEA staff is currently working with SCEC to finalize the contract; however, this project has been delayed slightly due to personnel changes within SCEC. This project is expected to begin in Q3 2019.

Recommendation:

No action required—information only