

## FITCH AFFIRMS CALIFORNIA EARTHQUAKE AUTHORITY AT 'A'

Fitch Ratings-Chicago-17 May 2013: Fitch Ratings has affirmed the California Earthquake Authority's (CEA) outstanding fixed-rate revenue bonds at 'A'. The bonds mature on July 1, 2016. Fitch has also affirmed the CEA's Issuer Default Rating (IDR) at 'A'. The Rating Outlook is Stable.

### KEY RATING DRIVERS

The ratings reflect the CEA's maintenance of claims-paying resources targeted to cover losses for at least a one-in-500-year earthquake. The CEA had \$10.35 billion in sources of funds to pay claims at Feb. 28, 2013. Included was \$4.2 billion in available capital, as well as the proceeds from the revenue bonds, reinsurance and other risk transfer, and prospective post-earthquake assessments of 'participating insurers'.

The CEA's principal risk is a catastrophic earthquake large enough to exhaust its claims-paying resources and requiring it to access the capital markets or other sources in order to pay claims. The total claims-paying resources are estimated to cover losses for a one-in-605-year earthquake, or a probability of (resource) exhaustion of 0.17% at Feb. 28, 2013.

The CEA's capital quality is adequate based primarily on Fitch's approach to capital analysis. Fitch stressed the reported probability of exhaustion considering that the models used may understate the true probability and that some portion of the CEA's claims-paying resources may be uncollectible under stress or in an extreme event. The stress-adjusted probability of exhaustion aligns with a 'BBB' rating on the insurance-linked security (ILS) calibration matrix.

While the assessment of capital is lower relative to the ratings of similar companies that insure catastrophe risk, Fitch believes the CEA's financial flexibility is much stronger than similarly-rated private insurers. The state of California, the insurance industry in California, and policyholders in California all have an interest in the CEA's continuance as an organization in Fitch's view.

In addition, Fitch believes there are potential public policy or industry initiatives that would contribute to the CEA's ability to recapitalize following a large earthquake that exhausted its claims-paying resources. Also contributing to the CEA's financial flexibility is its strong capital formation rate, the ability to access capital markets to issue additional revenue bonds, or in the event of a large earthquake, the ability to issue post-event bonds and/or bonds payable from surcharges on CEA policyholders.

Additional ratings strengths include the CEA's strong, stable pledged revenues and performance on debt service covenants, which result in part from its highly profitable operations, and significant market share. The quality of the CEA's investment portfolio is very high, consisting solely of U.S. government and agency securities, commercial paper, and cash and equivalents.

The ratings assume the maintenance of claims-paying resources to cover losses for approximately a one-in-500-year event over the foreseeable future.

### RATING SENSITIVITIES

Key ratings triggers that could lead to a downgrade include changes in claims-paying resources that reduce covered losses to a one-in-400-year event. However, a timely demonstration of the CEA's ability to access capital markets or recapitalize by other means, following a reduction in claims-paying capacity, could mitigate downgrade pressure. Fitch may also downgrade the ratings if the quality of its investment portfolio or the financial strength of its industry members or reinsurers declined materially.

The key rating trigger that could lead to an upgrade is an increase in claims-paying resources to a one-in-1,000-year event.

The CEA is a privately financed, publicly managed entity that offers basic residential earthquake insurance in California. The CEA was created by the California Legislature in 1996 to assure availability of earthquake coverage for homeowners following the Northridge Earthquake.

Fitch affirms the following ratings with a Stable Outlook:

The California Earthquake Authority

--Fixed-rate revenue bonds due 2016 at 'A';

--IDR at 'A'.

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Additional information is available at '[www.fitchratings.com](http://www.fitchratings.com)'.

Applicable Criteria and Related Research:

--'Insurance Rating Methodology' (Jan. 11, 2013);

--'Insurance-Linked Securities' (Aug. 8, 2012).

Applicable Criteria and Related Research

Insurance Rating Methodology — Amended

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=698731](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=698731)

Insurance-Linked Securities

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=684430](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=684430)

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