REPORT OF EXAMINATION

OF THE

CALIFORNIA FAIR PLAN ASSOCIATION

AS OF

SEPTEMBER 30, 2020

Insurance Commissioner

FILED on July 29, 2022

TABLE OF CONTENTS

Los Angeles, California
June 15, 2022

Honorable Ricardo Lara
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

CALIFORNIA FAIR PLAN ASSOCIATION

(hereinafter also referred to as the FAIR Plan) with its home office located at 725 South Figueroa Street, Suite 3900, Los Angeles, California 90017.

SCOPE OF EXAMINATION

We have performed our single-state examination of the FAIR Plan. The previous examination of the FAIR Plan was as of September 30, 2017. This examination covered the period from October 1, 2017 through September 30, 2020, and subsequent events.

The examination was conducted in accordance with the National Association of Insurance Commissioners *Financial Condition Examiners Handbook ("Handbook")*. The Handbook requires the planning and performance of the examination to evaluate the FAIR Plan's financial condition, assess corporate governance, identify current and prospective risks, and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the FAIR Plan were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with Statutory Accounting

Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination, a material adjustment is identified, the impact of such an adjustment will be reflected in the FAIR Plan's financial statements.

This examination report includes findings of fact, and general information about the FAIR Plan and its financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), were not included within the examination report but separately communicated to the FAIR Plan.

MANAGEMENT AND CONTROL

California Insurance Code §10094 and the Plan of Operation ("Plan") as referenced in California Insurance Code §10095 require that the Governing Committee of the FAIR Plan be comprised of nine voting members, who are elected annually from member companies, and who will serve for one year, or until successors are elected. Not more than one participating insurer within a holding company may serve on the Governing Committee. Additionally, four non-voting members are to be appointed by the Governor for an indefinite term including one representative of insurance agents, one representative of insurance brokers, one representative of surplus line brokers, and one representative of the public.

The Governing Committee members serving as of September 30, 2020 are as follows:

Voting Members

Name	Company	Representing
Cecil Autry, Chairperson	Liberty Mutual Insurance Company	At-large insurance companies
Kyle Belvill	California Casualty Group	Association of California Insurance Companies

Name	Company	Representing
Meggan Conner	The Hartford	At-large insurance companies
Nicole Forziati	State Farm Insurance	At-large insurance companies
Michael Mohamed	Interinsurance Exchange of the Automobile Club	Other Non-Stock Insurers
Denise Pavlov	TOPA Insurance Group	At-large insurance companies
Jeff Sauls	Farmers Insurance Group	Other Non-Stock Insurers
Michael Schalk	Allstate Insurance Company	Other Stock Insurers
Cedric Snow	CSAA Insurance Group	At-large insurance companies

Non-voting Members

Name	Company	Representing
Vacant[1]	Vacant	Public via the Department
Irene Sabourin	Hub International	Insurance Agents
Donna Bacarti	AmWINS Access Insurance Services	Surplus Lines Insurers
Javier Rodriguez	RISCO Insurance Services, Inc.	Insurance Brokers

1 Mark Buell was appointed by Governor Gavin Newsom on November 13, 2020

Principal Officers

Name	Title
Anneliese Jivan	President[2]
Victoria Roach	Vice President – Underwriting, Product, and Human Resources[3]
Cesar Flores	Vice President – Information Systems
Kornel Heard	Vice President – Operations
Estee Natale	Vice President – Claims
Jinal Patel	Vice President – Finance

Designated liaisons for the California Insurance Department for attendance at Governing Committee meetings are as follows:

Name	Title	Branch
Edward Cimini	Senior Casualty Actuary	Rate Regulation Branch
Risa Salat-Kolm	Senior Staff Counsel	Legal Branch Enforcement Bureau
Daniel Wade	Senior Staff Counsel	Legal Branch, Rate Enforcement Bureau

TERRITORY AND PLAN OF OPERATION

The FAIR Plan was organized by the insurance industry in accordance with the establishing statute enacted by the California State Legislature to make property insurance for homes and businesses available in two areas of the state: (1) specified brush/wildfire areas; and (2) specific urban areas (Division I) designated by the Commissioner of Insurance ("Commissioner") of the California Insurance Department. A Business Owner's Program ("BOP") (Division II) has been offered by the FAIR Plan since October 1, 1994. BOP offers coverage to small and medium-sized business operators, who have difficulty obtaining property and liability insurance in the voluntary insurance market. The FAIR Plan is a syndicated property insurance pool established to provide insurance coverage to those insurable risks that would otherwise not be able to obtain coverage through voluntary markets. Effective May 30, 2001, the Commissioner

2 Resigned February 28, 2022
3 President effective March 1, 2022

expanded the FAIR Plan's area of operation state-wide.

In accordance with California insurance statutes, all private insurance companies licensed to write fire, allied lines, homeowners, commercial multi-peril, and earthquake coverages are required to participate in the FAIR Plan and share in any profits and losses as a condition of their authority to transact insurance in California. It is a mechanism to spread risk, premiums, losses, and expenses among the participating insurers. Participating percentages are reduced proportionately by the amount that the participating insurers voluntarily write in the designated lines of business. Accounting activity is allocated to pool years, which remain open until closure is approved by the Governing Committee, and either a distribution, assessment, or capital contribution of equity (re-application to other pool years) of funds may be made. A distribution or assessment requires the approval of the Commissioner.

All activity conducted by the FAIR Plan is on behalf of its participating insurers. For this reason, the FAIR Plan does not have a certificate of authority. Licensed producers are not appointed agents of the FAIR Plan; however, all property and casualty producers licensed by the California Insurance Department are eligible to submit applications to the FAIR Plan on behalf of their insurance clients. Consumers may also seek coverage directly from the FAIR Plan without the use of a licensed producer.

The FAIR Plan writes its own policies, collects premiums, pays return premiums, commissions, and incurs general expenses. One-year policies are issued, and premium rates are based upon the FAIR Plan's loss experience, as approved by the California Insurance Department. While the FAIR Plan does not verify if applicants attempted to place a risk in the voluntary market, it does require that producers e-sign an acknowledgement that they have conducted a diligent search, as required by California Insurance Code ("CIC") §10093.

The maximum policy limits that may be placed through the FAIR Plan as of September 30, 2020 are as follows:

Division	Type of Coverage	Maximum Policy Limit
Division I	Dwelling Fire-Buildings and Contents	$3.0 million per one location
Property	Commercial Structures	$3.0 million per one location
	Commercial-All Other Coverages	$1.5 million per one location
Division II	Building Coverage	$3.0 million per one location
Property	Business Personal Property	$1.5 million per one location
Liability	Commercial Multi-peril	$300,000 per occurrence $600,000 in aggregate

Effective February 1, 2022, the Commissioner approved the FAIR Plan to issue commercial policies to farmowners, wineries, and other outdoor businesses.

On March 10, 2022, the Commissioner directed the FAIR Plan to increase policy limits by May 1, 2022 as follows:

Division	Type of Coverage	Maximum Policy Limit
Division I	Commercial Structures	$5.6 million per one location
Property	Commercial-All Other Coverages	$2.8 million per one location
Division II	Building Coverage	$4.0 million per one location
Property	Business Personal Property	$2.0 million per one location
Liability	Commercial Multi-peril	$600,000 per occurrence $1.2 million in aggregate

In December 1996, the California Earthquake Authority ("CEA") was created by the California State Legislature to help resolve the insurance availability crisis in California, and accordingly, the FAIR Plan made a capital contribution of $15.0 million to the CEA. Pursuant to CIC §10091(c), the FAIR Plan continues to participate in the CEA. The participation is designed to limit the FAIR Plan's earthquake exposure. As of September 30, 2020, the FAIR Plan has a 0.48% share of the total CEA market, and its maximum exposure to earthquake loss is approximately $8.0 million. Future assessments in the event of a catastrophe are dependent upon the FAIR Plan's CEA earthquake market share, the magnitude of the earthquake losses, and the financial position of the CEA.

REINSURANCE

Assumed

The FAIR Plan does not assume any reinsurance.

Ceded

The FAIR Plan maintains certain reinsurance coverages that limit the FAIR Plan's liability with respect to cumulative losses under all policies issued by the FAIR Plan. The FAIR Plan remains contingently liable with respect to reinsurance ceded to the extent that any reinsurer is unable to meet its contractual obligation.

Effective February 15, 2020 to March 1, 2021, the FAIR Plan had a reinsurance property catastrophe aggregate excess of loss contract in place that covers catastrophic fire and earthquake losses up to 100.00% of $100 million in excess of $250 million ultimate net loss first aggregate, 100.00% of $200 million in excess of $350 million ultimate net loss second aggregate and 96.90% of $300 million in excess of $550 million ultimate net loss third aggregate. The FAIR Plan must meet or exceed a deductible of $10 million to the aggregate ultimate net loss from any loss occurrence before applying the full amount of ultimate net loss to the aggregate ultimate net loss under the treaty. The FAIR Plan's reinsurers are rated A- or better by A.M. Best.

For the year ended September 30, 2020, the FAIR Plan ceded $58,693,000 of premiums and recovered no losses or loss adjustment expenses under the reinsurance agreement. For the year ended September 30, 2019, the FAIR Plan ceded $8,531,000 of premiums and recovered $135.0 million in losses and loss adjustment expenses through reinsurance,

ACCOUNTS AND RECORDS

Information Systems Controls

During the examination, an assessment was made of the FAIR Plan's general controls over its information systems. As a result of this review, some findings were noted and were presented to the FAIR Plan along with recommendations to strengthen its controls. The FAIR Plan should evaluate the recommendations and make appropriate changes to strengthen its information systems controls.

Operational Processes and Controls

During the examination, an assessment was made of the FAIR Plan's operational processes and controls. All operational activities supporting the FAIR Plan's scope of administrative, underwriting, claims, and policyholder service functions were considered in the review, including its budgeting, financial reporting, and liquidity and capital management. As a result of this assessment, certain findings were noted and were presented to the FAIR Plan, along with recommendations to strengthen its operational processes and controls. The FAIR Plan should evaluate the recommendations and make appropriate changes to operational processes and controls.

Premium Deficiency Reserves

It was determined that the FAIR Plan did not calculate a premium deficiency reserve (PDR), in its statutory financial statement as of September 30, 2020, in accordance to Statutory Statement of Accounting Principle (SSAP) No. 53, Paragraph 17. During the examination, a PDR calculation was performed and it was determined a PDR of $526,000 was necessary as of the examination date. Due to the PDR amount being immaterial, no exam adjustment was made. The FAIR Plan did perform a PDR calculation and reported a $19.2 million in its statutory financial statement as of September 30, 2021. It is recommended that FAIR Plan implement procedures to ensure PDR calculations be performed on a quarterly basis to determine whether the PDR should be recorded or adjusted in its quarterly statutory financial statements in accordance to SSAP No. 53, Paragraph 17.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the FAIR Plan with the California Insurance Department and present the financial condition of the FAIR Plan for the year ended September 30, 2020. The accompanying comments should be considered an integral part of the financial statements. There were no adjustments made to the financial statements as a result of the examination.

Statement of Financial Condition as of September 30, 2020

Statement of Income and Members' Deficit for the Year Ended September 30, 2020

Reconciliation of Members' Equity (Deficit) from September 30, 2017 through September 30, 2020

Statement of Financial Condition
as of September 30, 2020

Assets	Ledger and Non-ledger Assets	Net Admitted Assets	Notes
Cash and short-term investments	$ 214,782,946	$ 214,782,946	
Premiums receivable	23,239,322	23,239,322	
Accrued investment income	75,788	75,788	
Other assets	256,529	256,529	
Total assets	$ 238,354,585	$ 238,354,585	

Liabilities and Members' Deficit		Notes
Unpaid losses	$ 227,750,447	(1)
Unpaid loss adjustment expenses	17,265,404	(1)
Unearned premiums	173,360,742	
Advance and unapplied premiums	9,672,482	
Commissions payable	4,323,207	
Pension and postretirement benefit accrual	6,554,567	
Escheatment payable	3,142,240	
Accrued expenses	1,594,297	
Total liabilities	443,663,386	
Total members' deficit	(205,308,801)	(2)
Total liabilities and members' deficit	$ 238,354,585	

Statement of Income and Members' Deficit for the Year Ended September 30, 2020

Statement of Income

Underwriting Income		
Premium earned		$ 182,876,486
Deductions:		
Losses incurred		271,593,401
Loss adjustment expenses incurred		21,807,412
Other underwriting expenses incurred		44,962,868
Total underwriting deductions		338,363,681
Net underwriting loss		(155,487,195)
Investment Income		
Net investment gain		897,608
Other Income		
Other income		304,209
Net loss		$ (154,285,378)

Members' Deficit

Members' deficit, September 30, 2019		$ (37,507,402)
Net loss	$ (154,285,378)	
Change in nonadmitted assets	(11,606,823)	
Change in pension liability	(1,914,235)	
Other	5,037	
Change in members' deficit for the year		(167,801,399)
Members' deficit, September 30, 2020		$ (205,308,801)

Reconciliation of Members' Equity (Deficit)
from September 30, 2017 through September 30, 2020

	Gain in Surplus	Loss in Surplus	
Members' equity, September 30, 2017			$ 61,435,629
Net losses	$	$ (251,178,859)	
Changes in nonadmitted assets		(12,286,141)	
Changes in pension liability		(3,281,386)	
Other gains	1,956		
Total gains and losses	$ 1,956	$ (266,746,386)	
Net decrease in members' equity			(266,744,430)
Members' deficit, September 30, 2020			$ (205,308,801)

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The liabilities for unpaid losses and unpaid loss adjustment expenses include an amount determined from individual case estimates and loss reports and estimates, based on past experience, for losses incurred but not reported. Losses incurred are directly allocated to pool years based upon the effective date of the policy. Allocated loss adjustment expenses are allocated to pools directly, and unallocated loss adjustment expenses are allocated to pools in proportion to claims paid. Beginning in the second quarter of the fiscal year ended September 30, 2020, the FAIR Plan retained Milliman, Inc. ("Milliman") to prepare quarterly estimates of loss and loss adjustment expense reserves, including incurred but not reported reserves.

Pursuant to California Insurance Code §10094, the FAIR Plan may assess member companies their proportional shares of losses incurred in a pool year. The FAIR Plan's Governing Committee must approve all assessments. There have been no such assessments to member companies since fiscal year 1994.

A Senior Casualty Actuary with the California Insurance Department reviewed the work of Milliman, and performed additional analysis as deemed appropriate. Based on this review, the FAIR Plan's unpaid losses and unpaid loss adjustment expenses as of September 30, 2020, were found to be reasonably stated and have been accepted for purposes of this examination.

(2) Members' Deficit

The FAIR Plan reviews pool years annually to determine if a distribution of members' equity is appropriate. The Governing Committee approves the closure of the pool years and the members' equity distribution. Distribution of members' equity is made subject to the financial condition of the FAIR Plan. In making a distribution, the Governing Committee may reduce the distribution by deficits incurred in other pool years. There have been no distributions approved by the Governing Committee during the examination period.

SUBSEQUENT EVENTS

There have been a series of Orders issued by the Commissioner since 2019, which require changes to the Plan to effect certain aspects in its business operations. On November 14, 2019, the Commissioner issued Order 2019-2 requiring the FAIR Plan to offer consumers the ability to purchase a policy with coverages similar to those contained in an HO-3 policy, increasing policy limits to $3.3 million for all personal lines homeowners risks, including the right to pay premiums in monthly installments without fees, and requiring the right to pay premiums by credit card or electronic funds transfer without fees. The FAIR Plan did not agree with some or parts of the Commissioner's Orders, and consequently, the FAIR Plan initiated litigation challenging the Commissioner's Order.

On July 12, 2021, the Superior Court issued an Order, which limited the coverages that the FAIR Plan would be required to provide consumers, but upheld the Commissioner's authority to order additional property-related coverage options not provided by the FAIR Plan. Subsequently, on September 20, 2021, the Commissioner issued Order 2021-2, as amended on November 19, 2021, again requiring the FAIR Plan to provide consumers access to additional coverages. The FAIR Plan filed suit challenging that Order. On February 10, 2022, the Superior Court denied the FAIR Plan's request for a preliminary injunction barring enforcement of Order 2021-2, as amended, and, on March 21, 2022, the FAIR Plan filed a notice of appeal. The FAIR Plan continues to pursue litigation challenging Order 2021-2, which requires the FAIR Plan to offer personal lines coverage related to the insured property for accidental discharge or overflow of water or steam, premises liability, incidental workers' compensation, theft, falling objects, weight of ice, snow, or sleet, freezing, and loss of use, including coverage for additional living expenses.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records – Information System Controls (Page 8): As the result of the assessment of the FAIR Plan's information systems controls, recommendations for improving these controls were presented to the FAIR Plan. It is recommended that the FAIR Plan evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems.

Accounts and Records – Operational Processes and Controls (Page 8). An assessment was made of the FAIR Plan's operational processes and controls. All operational activities supporting the FAIR Plan's scope of administrative, underwriting, claims, and policyholder service functions were considered in the review, including its budgeting, financial reporting, and liquidity and capital management. As a result of this assessment, certain significant findings were noted and were presented to the FAIR Plan, along with recommendations and best practices to strengthen its operational processes and controls. It is recommended that the FAIR Plan evaluate the significant findings and recommendations, and best practices, and make appropriate changes to operational processes and controls.

Accounts and Records – Premium Deficiency Reserves (Page 8). FAIR Plan did not calculate a premium deficiency reserve (PDR), to determine if it needed to record a PDR in its statutory financial statement as of September 30, 2020, in accordance to Statutory Statement of Accounting Principle (SSAP) No. 53, Paragraph 17. It is recommended that the FAIR Plan implement procedures to ensure PDR calculations be performed on a quarterly basis to determine whether the PDR should be recorded or adjusted in its quarterly statutory financial statements in accordance to SSAP No. 53, Paragraph 17.

Previous Report of Examination

Accounts and Records – Information System Controls: As the result of the assessment of the FAIR Plan's information systems controls, recommendations for improving these controls were presented to the FAIR Plan. It was recommended that the FAIR Plan should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems. The FAIR Plan has complied with these recommendations.

Accounts and Records – Claims Manual: The FAIR Plan's in-house claims manual and independent adjusters guidelines did not contain a copy of the California Fair Claims Settlement Practices, as required by California Code of Regulations, Title 10, Chapter 5, Subchapter 7.5, Article I, Section 2695.6. It was recommended that the FAIR Plan attach a copy of the regulations or provide an active internet link. The FAIR Plan has complied with this recommendation.

<u>ACKNOWLEDGMENT</u>

Acknowledgment is made of the cooperation and assistance extended by the FAIR Plan's officers and employees during the course of this examination.

Respectfully submitted,

Mark G. Noller Digitally signed by Mark G. Noller
Date: 2022.07.29 17:27:00 -04'00'

Mark G. Noller, CPA ret., CIE, AIRC
Contracted Examiner-In-Charge
Rudmose & Noller Advisors, LLC

Briggs, Anjanette Digitally signed by Briggs, Anjanette
Date: 2022.07.29 14:44:44 -07'00'

Anjanette Briggs, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California