

REPORT OF EXAMINATION  
OF THE  
CALIFORNIA EARTHQUAKE AUTHORITY  
AS OF  
DECEMBER 31, 2022

A handwritten signature in blue ink, appearing to read 'D. DeLa...' with a stylized flourish at the end.

Filed on March 7 , 2024

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Sacramento, California  
February 15, 2024

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

### CALIFORNIA EARTHQUAKE AUTHORITY

(hereinafter also referred to as the CEA), which has its home office located at 801 K Street, Suite 1000, Sacramento, California 95814.

#### SCOPE OF EXAMINATION

We have performed our single-state examination of the CEA. The previous examination of the CEA was made as of December 31, 2017. This examination covers the period from January 1, 2018 through December 31, 2022.

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 CEA's financial condition, assess corporate governance, identify current and prospective risks, and evaluate system controls and procedures used to mitigate those risks. The examination also includes identifying and evaluating significant risks that could cause the CEA's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the CEA were considered in accordance with the risk-focused examination process. This includes 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 an adjustment was identified during the course of the

examination, the impact of such adjustment will be documented separately following the CEA's financial statements.

This examination report includes findings of fact and general information about the CEA and its financial condition. There might 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 CEA.

### CEA HISTORY

The CEA was created in 1996 pursuant to California Insurance Code (CIC) Section 10089.6 to transact insurance in California as necessary to sell residential earthquake insurance in the manner set forth in CIC Section 10089.26 through 10089.28, and commenced operations in December 1996.

### MANAGEMENT AND CONTROL

Pursuant to California Insurance Code (CIC) Section 10089.7(a), the CEA is governed by a three-member Governing Board consisting of the Governor, the State Treasurer, and the Insurance Commissioner, each of whom may name designees to serve as board members in their place. The Speaker of the Assembly and the Chairperson of the Senate Committee on Rules serve as nonvoting, ex officio members of the Governing Board, and may name designees to serve in their place.

CIC Section 10089.7(c) provides that the Governing Board shall have the power to conduct the affairs of the CEA, and may perform all acts necessary or convenient in the exercise of that power.

The members of the Governing Board and principal officers serving as of December 31, 2022 are as follows:

## Board of Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Gavin Newsom Fair Oaks, California	Governor State of California
Fiona Ma San Francisco, California	Treasurer State of California
Ricardo Lara Los Angeles, California	Insurance Commissioner State of California
Robert Rivas* Salinas, California	Speaker of the Assembly State of California
Toni Atkins* San Diego, California	Chair of the Senate Rules Committee State of California

*\*Non-voting members*

## Principal Officers

<u>Name</u>	<u>Title</u>
Glenn Pomeroy <sup>(A)</sup>	Chief Executive Officer
Thomas Hanzel	Chief Financial Officer
Thomas Welsh	Chief Legal and Compliance Officer
Shawna Ackerman	Chief Risk and Actuarial Officer
Laurie Johnson <sup>(B)</sup>	Chief Catastrophe Response and Resilience Officer
Janiele Maffei	Chief Mitigation Officer
Charlotte Fadipe	Chief Communications Officer

The following changes in management occurred subsequent to the examination date:

- (A) Effectively January 17, 2024, Thomas Welsh was appointed as Interim Chief Executive Officer following Glenn Pomeroy's decision to step down.
- (B) Effectively October 31, 2023, Laurie Johnson resigned. Effective July 31, 2023, George Sittner was hired to fill the position vacated by Laurie Johnson and the position was renamed to Chief Insurance and Claims Officer.

## Insurer Participation Agreements

Services are performed on behalf of the CEA by the participating insurers pursuant to the terms of the Insurer Participation Agreements signed by the CEA and each participating insurer. These services include policy administration and claims settlement. Refer to the

“Territory and Plan of Operation” section for more information on the participating insurers.

### CLAIM-PAYING CAPACITY

As of December 31, 2022, the CEA reported a total claim-paying capacity of \$19.731 billion. The CEA’s claim-paying capacity comes from CEA’s available capital (\$6.062 billion), reinsurance/risk transfer (\$8.918 billion), revenue bonds (\$2.088 billion), policyholder surcharge (\$1.00 billion), and post-earthquake industry assessments (\$1.663 billion).

#### Revenue Bonds

California Insurance Code (CIC) Section 10089.10(b) authorizes the CEA, through the Treasurer, to enter into capital market contracts for the purpose of expanding CEA’s capacity and achieving maximum capacity for writing earthquake coverage.

On March 17, 2020, the CEA issued Series 2020A revenue bonds totaling \$400 million. The issuance is comprised of one Serial Bond issued at \$400 million at 1.3% interest rate which matured in 2020.

On November 24, 2020, the CEA issued Series 2020B revenue bonds totaling \$300 million. The issuance is comprised of four Serial Bonds issued at \$50 million with a 1.127% interest rate, \$50 million with a 1.227% interest rate, \$100 million with a 1.327% interest rate, and \$100 million with a 1.477% interest rate, which matured in 2021, 2021, 2022, and 2023, respectively. At December 31, 2022, the sinking fund balance was \$51,188,841.

On October 28, 2021, the CEA issued 2021A revenue bonds totaling \$225 million. The issuance is comprised of one Serial Bond issued at \$225 million at 0.2% interest rate which matured in 2021.

On October 13, 2022, the CEA issued 2022A revenue bonds totaling \$500 million. The issuance is comprised of five Serial Bonds issued at \$50 million with a 5.393% interest rate, \$110 million with a 5.493% interest rate, \$110 million with a 5.603% interest rate,

\$110 million with a 5.603% interest rate, and \$120 million with a 5.603 interest rate, maturing in 2023, 2024, 2025, 2026, and 2027, respectively. At December 31, 2022, the sinking fund balance was \$22,740,671.

### Post-Earthquake CEA Policyholder Surcharge

Since its creation in 1995, the CEA has had the ability to impose a \$1 billion Post-Earthquake Surcharge on its policyholders, if needed to pay claims. Assembly Bill No. 2927 (AB 2927), which the California Legislature adopted and the Governor signed on September 27, 2018, and became effective on January 1, 2019 clarified the provisions in state law concerning this claims-paying capacity layer. AB 2927 amended CIC Sections 10089.23 and 10089.29 by simplifying the mechanism for the CEA to more readily access \$1 billion of claim-paying capacity from CEA-policyholder surcharge debt. CIC Section 10089.29 authorizes the CEA to issue and sell investment grade revenue bonds or secure other debt financing, or both, in amounts not to exceed \$1 billion plus related costs if claims and claim expenses incurred by the Authority from an earthquake event exhaust the total of the following: (A) The CEA's available capital; (B) The maximum amount of all contributions of initial operating capital made by participating insurers pursuant to CIC Section 10089.15, and assessments levied and paid pursuant to CIC Section 10089.23; (C) All reinsurance actually available and under contract to the CEA; and (D) All risk transfer provided and any other capital committed through capital market contracts that is actually under contract to the CEA from private capital markets. The CEA is authorized to surcharge annually all CEA policyholders up to 20 percent of each policyholder's annual earthquake insurance policy premium to repay the bonded indebtedness or other debt incurred by the CEA pursuant to CIC Section 10089.29.

### Post-Earthquake Industry Assessments

The CEA is authorized to levy assessments on participating insurers if claims and claims expenses paid by the CEA due to earthquake events exhaust the total of the available capital, reinsurance, policyholder assessments, and proceeds from debt financing. These assessments are authorized pursuant to CIC Sections 10089.30. Assessments levied shall not exceed \$2 billion. The amounts available for assessment are subject to periodic

reduction as described in CIC Section 10089.30. At December 31, 2022, the amount available for assessment was \$1.663 billion.

### EARTHQUAKE LOSS MITIGATION FUND

Pursuant to California Insurance Code (CIC) Section 10089.37, the CEA is permitted to set aside in each calendar year an amount equal to 5 percent of investment income accruing on the CEA's invested funds, or \$5 million, whichever is less, if deemed actuarially sound by a consulting actuary employed for, or hired by the CEA, to be maintained as a sub-account in the California Earthquake Authority Fund. The CEA shall use those funds to fund the establishment and operation of an Earthquake Loss Mitigation Fund. CIC Section 10089.38 states that the Earthquake Loss Mitigation Fund may be applied to supply grants and loans or loan guarantees to dwelling owners who wish to retrofit their homes to protect against earthquake damage.

The following table illustrates the amounts set aside pursuant to CIC Section 10089.37 during the examination period:

<u>Year</u>	<u>Loss Mitigation Fund</u>
2018	\$ 4,088,500
2019	5,000,000
2020	5,000,000
2021	5,000,000
2022	5,000,000

### CALIFORNIA WILDFIRE FUND

On July 12, 2019, Governor Gavin Newsom signed Assembly Bill (AB) 1054 and AB 111 (collectively, the "2019 Wildfire Legislation"). The 2019 Wildfire Legislation enacts a broad set of reforms and programs related to utility-caused wildfires in California, including establishing the California Wildfire Fund (Wildfire Fund), a catastrophe insurance fund that provides up to \$21 billion in claim-paying capacity for claims arising from a wildfire caused by California's three largest electrical utility companies: Pacific Gas & Electric Company, San Diego Gas & Electric Company, and Southern California Edison



Company. Since 2019, the CEA has acted as the Administrator of the Wildfire Fund. Assets in the CEA and the Wildfire Fund are segregated and separately managed and maintained. All costs and expenses incurred by the CEA to administer the Wildfire Fund are allocated to and paid from the Wildfire.

### TERRITORY AND PLAN OF OPERATION

The CEA is authorized to write residential earthquake insurance in the State of California pursuant to California Insurance Code (CIC) Section 10089.6(a). Earthquake insurance policies are available for homeowners, condominium owners, mobile homeowners, and renters in California.

The CEA offers two earthquake products for both homeowners and mobile homeowners: Standard Homeowners and Homeowners Choice. Standard Homeowners bundles all the coverages into one package: home (dwelling), personal property, loss of use, building code upgrade, and emergency repairs. Coverages, except for loss of use, and the first \$1,500 of emergency repairs, are subject to the dwelling deductible. Homeowners Choice covers dwelling, building code upgrade and emergency repairs, and also provides two optional coverages: personal property and loss of use which has no deductible. The deductibles available on the homeowner policies are between 5% to 25% on the home (dwelling) and personal property coverage.

For the condominium unit owners, the CEA provides the following coverages: building property, personal property, loss of use, loss assessment, building code upgrade, and emergency repair. The renter policy covers personal property, loss of use, and emergency repairs.

The CEA's earthquake business is placed through its participating insurers. Pursuant to CIC Section 10089.9, each insurer participating in the CEA shall execute a contract with the California Insurance Commissioner that sets forth its rights and responsibilities as a CEA participant, and such contract shall be part of the CEA's plan of operations and shall be uniform for every participating insurer. By selling its policies exclusively through its participating insurers, CEA provides two-thirds of the residential earthquake insurance

policies sold in California. As of the examination date, there were 21 insurers who have signed Insurer Participation Agreements with the CEA.

According to the Insurer Participation Agreements, participating insurers act as independent contractor agents on behalf of the CEA by performing policy and claims services which include underwriting, policy issuance, premium collection, and claims adjustment. Participating insurers receive a producer commission equal to 10 percent of written premium for all new and renewal CEA policies and a non-claims related operating cost reimbursement equal to 6 percent of net written premiums. Participating insurers also are reimbursed for claims expenses associated with the CEA's earthquake claims equal to 9 percent of the total amount of the claim paid out.

The CEA imposes an eligibility requirement for earthquake policies as follows: (1) The risk must be a qualified residential property; (2) The risk must be insured by a companion policy issued by a CEA participating insurer that will act as the servicing carrier for the earthquake policy; (3) The risk must be insured to the value of the companion policy; and (4) All prior earthquake structural damage must be repaired before an application for coverage is accepted.

The following table illustrates the direct premiums written during the examination period:

<u>Year</u>	<u>Written Premiums</u>
2018	\$ 774,296,157
2019	820,924,237
2020	843,756,374
2021	901,285,346
2022	956,388,110

#### REINSURANCE

##### Assumed

The CEA has no assumed reinsurance.

## Ceded

As of December 31, 2022, the CEA had 47 catastrophe one-year and multi-year aggregate excess of loss reinsurance and transformer reinsurance treaties with various reinsurers. Most of the multi-year treaties have a single limit over a two-, three- or four-year term. There are also multi-year contracts that have the option of two limits available for two events. In addition, the retention is adjusted based on the contracted probability of loss on an annual basis.

Certain contracts allow for an adjustment of premium, based on the average aggregate insurance in-force and the exposure adjustment limit. There was no premium adjustment expense against the contracts as of December 31, 2022, in accordance with contract terms.

As of December 31, 2022, the ceded reinsurance provided maximum limits of \$8.918 billion.

## FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the CEA with the California Department of Insurance and present the financial condition of the CEA for the period ending December 31, 2022. The accompanying comments to the amounts reported in the financial statements should be considered an integral part of the financial statements. No adjustments were made to the financial statements as a result of the examination.

Statement of Financial Condition as of December 31, 2022

Underwriting and Investment Exhibit for the Year Ended December 31, 2022

Reconciliation of Surplus as Regards Policyholders from December 31, 2017  
through December 31, 2022

Statement of Financial Condition  
as of December 31, 2022

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 7,125,978,271	\$	\$ 7,125,978,271	
Cash, cash equivalents, and short-term investments	1,448,470,946		1,448,470,946	
Receivables for securities	80,859,507		80,859,507	
Investment income due and accrued	33,336,441		33,336,441	
Uncollected premiums and agents' balances in course of collection	73,072,864	6,533,138	66,539,726	
Furniture and equipment	13,151	13,151	0	
Aggregate write-ins for other than invested assets	<u>7,995,514</u>	<u>3,953,398</u>	<u>4,042,116</u>	
Total assets	<u>\$ 8,769,726,694</u>	<u>\$ 10,499,687</u>	<u>\$ 8,759,227,007</u>	
<u>Liabilities, Surplus, and Other Funds</u>				<u>Notes</u>
Losses			\$ 3,362,001	(1)
Loss adjustment expenses			302,580	(1)
Other expenses			8,962,238	
Borrowed money and interest thereon			606,759,450	
Unearned premiums			483,283,096	
Advance premiums			3,200,076	
Ceded reinsurance premiums payable			(26,581,000)	
Provision for reinsurance			14,367,000	
Payable for securities			57,653,832	
Aggregate write-ins for liabilities			<u>14,723,714</u>	
Total liabilities			1,166,032,987	
Aggregate write-ins for special surplus fund		\$ (71,298,581)		
Gross paid-in and contributed surplus		790,666,246		
Unassigned funds (surplus)		<u>6,873,826,355</u>		
Surplus as regards policyholders			<u>\$ 7,593,194,020</u>	
Total liabilities, surplus, and other funds			<u>\$ 8,759,227,007</u>	

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2022

Underwriting Income

Premiums earned		\$ 428,998,109
Deductions:		
Losses and loss adjustment expenses incurred	\$ 3,587,483	
Other underwriting expenses incurred	194,971,522	
Aggregate write-ins for underwriting deductions	<u>22,704</u>	
Total underwriting deductions		<u>198,581,709</u>
Net underwriting gain		230,416,400

Investment Income

Net investment income earned	\$ 108,988,727	
Net realized capital losses	<u>(67,123)</u>	
Net investment loss		108,921,604

Other Income

Net loss from agents' or premium balances charged off (amount recovered \$(86,107) amount charged off \$0)	\$ (86,107)	
Finance and service charges not included in premiums	429,983	
Aggregate write-ins for miscellaneous income	<u>29,880</u>	
Total other income		<u>373,756</u>
Net income		<u>\$ 339,711,760</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2021		\$ 7,208,904,969
Net income	\$ 339,711,760	
Change in nonadmitted assets	(1,328,428)	
Change in provision for reinsurance	29,308,000	
Aggregate write-ins for gains in surplus	<u>16,597,719</u>	
Change in surplus as regards policyholders for the year		<u>384,289,051</u>
Surplus as regards policyholders, December 31, 2022		<u>\$ 7,593,194,020</u>

Reconciliation of Surplus as Regards to Policyholders  
from December 31, 2017 through December 31, 2022

Surplus as regards policyholders, December 31, 2017			\$ 5,942,012,357
	Gain in Surplus	Loss in Surplus	
Net income	<u>\$ 1,586,784,411</u>	<u>\$</u>	
Change in nonadmitted assets		2,029,624	
Change in provision for reinsurance		14,367,000	
Surplus adjustments: Paid-in	13,272,000		
Aggregate write-ins for gains and losses in surplus	<u>67,521,876</u>	<u></u>	
Total gains and losses	<u>\$ 1,667,578,287</u>	<u>\$ 16,396,624</u>	
Net increase in surplus as regards policyholders			<u>1,651,181,663</u>
Surplus as regards policyholders, December 31, 2022			<u>\$ 7,593,194,020</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Loss and Loss Adjustment Expenses

Since the CEA's inception, there has not been a major earthquake. The CEA had approximately \$3.66 million in loss and loss adjustment expense reserves as of December 31, 2022. Based on an analysis by a Senior Casualty Actuary from the California Department of Insurance, the CEA's loss and loss adjustment expense reserves as of December 31, 2022 were found to be reasonably stated and have been accepted for the purpose of this examination.

## SUBSEQUENT EVENTS

In January 2024, Glenn Pomeroy, the CEA's Chief Executive Officer (CEO) stepped down and the CEA's Governing Board appointed Thomas Welsh to serve as interim CEO while the Board conducts a search for a permanent CEO. The interim CEO will maintain his role as the CEA's Chief Legal & Compliance Officer.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

None.

### Previous Report of Examination

None.



ACKNOWLEDGMENT

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

Respectfully submitted,

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Allen Lau, CFE  
Examiner-In-Charge  
Senior Insurance Examiner (Specialist)  
Department of Insurance  
State of California

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Kyo Chu, CFE  
Senior Insurance Examiner, Supervisor  
Department of Insurance  
State of California