

REPORT OF EXAMINATION  
OF THE  
CALIFORNIA FAIR PLAN ASSOCIATION  
AS OF  
SEPTEMBER 30, 2013

Filed September 30, 2014

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Los Angeles, California  
September 5, 2014

Honorable Dave Jones  
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 Association) at the primary location of its books and records, 3435 Wilshire Boulevard, Los Angeles, California 90010.

**SCOPE OF EXAMINATION**

We have performed our single-state examination of the Association. The previous examination of the Association was made as of September 30, 2009. This examination covers the period from October 1, 2009 through September 30, 2013. The examination was conducted in accordance with the National Association of Insurance Commissioners' Financial Condition Examiners Handbook. The Handbook requires the planning and performance of the examination to evaluate the Association's financial condition, to identify prospective risks, and to obtain information about the Association, including corporate governance, identification and assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, and management's compliance with Statutory Accounting Principles and Plan of Operations. All accounts and activities of the Association were considered in accordance with the risk-focused examination process.

In addition to those items specifically commented upon in this report, other phases of the Association's operations were reviewed including the following areas that require no further comment: association history; corporate records; fidelity bonds and other insurance; employees' pensions, and insurance plans; loss experience; growth of association; and accounts and records.

### SUBSEQUENT EVENTS

The reinsurer's maximum limit of liability increased to \$125 million for the Association ceded property catastrophe aggregate excess of loss reinsurance agreement with Lloyd's of London, the largest participant (22.75%), along with other participants, effective February 15, 2014. The Association's retention remains at \$100 million.

The Association made Members' Equity distributions of \$8.3 million to member companies in July 2014.

Section III B of the Association's Plan of Operation was amended and the composition of the nine voting Governing Members was changed to include one member from the American Insurance Association, one member from the Association of California Insurance Companies, one member from all other stock insurers, one member from all other non-stock insurers, and five members from at-large insurers. This change was approved by the California Insurance Commissioner on October 23, 2013.

### MANAGEMENT AND CONTROL

A thirteen-member Governing Committee manages the Association. Nine members are elected annually from member companies and are voting members. Four members are appointed by the Governor for an indefinite term and are non-voting members. The representation on the Governing Committee is specified in California Insurance Code Section 10094 and in the Association's Plan of Operations. A listing of the Governing Committee members serving as of September 30, 2013 follows:

### Voting Members

<u>Name</u>	<u>Company</u>	<u>Representing</u>
Brian Braddock Chairman	Farmers Insurance Group	Other non-stock insurers
Stephen Hylka	Liberty Mutual Group	The Alliance of American Insurers
Shirley Gordon	State Farm Insurance	At-large insurance companies
William W. Martin(a) Vice Chairman	The Hartford	American Insurance Association
Jack McGraw <sup>(a)</sup> Secretary	Pacific Specialty Insurance Company	At-large insurance companies
James McMasters <sup>(a)</sup>	Fireman's Fund Insurance Companies	At-large insurance companies
Chuck Muenzen	California Casualty Group	The National Association of Independent Insurers
Fred Strauss	Allstate Insurance Company	Other Stock Insurers
Raj Varma	Automobile Club of Southern California	At-large insurance companies

### Nonvoting Members

<u>Name</u>	<u>Company</u>	<u>Representing</u>
Donna Bacarti	Burns & Wilcox Insurance Services	Insurance Brokers
Howard King	Modern Corporation	Public
Javier Rodriquez	RISCO Insurance Services, Inc.	Surplus Lines

<u>Name</u>	<u>Company</u>	<u>Representing</u>
Irene M. Sabourin	John O. Bronson Company	Insurance Agents

George Yen, Chief, Rate Specialist Bureau, is the designated liaison of the California Department of Insurance.

Principal Officers

<u>Name</u>	<u>Title</u>
Anneliese Jivan	President
Victor R. Natividad	Vice President - Finance
Estee Natale	Vice President – Claims
John Boeder	Vice President – Underwriting/Operations
Michael Harris <sup>(b)</sup>	Vice President – Public Affairs
Cesar Flores	Vice President – Information Systems

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

- (a) William M. Martin, Jack McGraw, and James McMasters were elected as Chairman, Vice Chairman, and Secretary, respectively for the 2013 – 2015 fiscal years
- (b) Michael Harris retired on August 1, 2014, his position was eliminated

TERRITORY AND PLAN OF OPERATION

The original purpose of the Association is to provide coverage in areas where applicants have been unable to obtain coverage in the regular markets. The Association writes fire, extended coverage, vandalism and malicious mischief, and commercial sprinkler leakage on risks in urban areas designated by the California Insurance Commissioner. Since its formation in 1968 geographic areas eligible for coverage were expanded to include any property in California. One-year policies are issued and premium rates are based upon the Association’s experience. The Association does not verify if applicants have attempted to place the risk in the regular market.

The Association is not an insurer, but a mechanism to spread the risk, premiums, losses

and expenses among the participating insurers. The Association is a separate joint venture of all insurance companies (participants or participating insurers) holding certificates of authority from the California Department of Insurance for each class of business. The Association's Plan of Operations provides that the policies of insurance written and issued by them are on behalf of its participating insurers and that the respective liabilities of the insurers are several and not joint, and each such insurer is considered to be a direct insurer for its share in such writing.

All activity conducted by the Association is on behalf of its participating insurers. For this reason, it does not have a certificate of authority as an insurance company. Likewise it does not have a producer's license as it is composed of its participating insurance companies. Therefore, producers are not appointed agents of the Association, and they cannot bind coverage. All producers licensed by the State of California are eligible to produce business for the Association.

The Association writes its own policies and collects premiums, pays return premiums, commissions, and various general expenses. The Association contracts with and assigns independent adjusters to adjust claims filed and pay claims and related loss adjustment expenses. Unallocated general expenses are apportioned between claims and underwriting. Each participating insurer includes its portion of the Association's written premiums with its direct business and pays the associated premium tax.

Member insurers' participation percentages are reduced proportionately by the amount that they voluntarily write in designated brush areas and certain urban areas.

The maximum limit of liability that may be placed through the Association is as follows:

Description of Coverage	Maximum Limit Amount
Dwelling Buildings and Contents	\$1.5 million per one location
Commercial Buildings	\$3 million
Commercial Building Contents	\$1.5 million maximum for each tenant
<p>The maximum cumulative coverage for all tenants' contents, which can be insured in a single commercial building, will be \$3 million, unless the following conditions are met:</p>	
<p>1. \$3 million up to \$5 million contents coverage if the building is protected by a 24 hour guard service on the premises.</p>	
<p>2. \$5 million to \$10 million contents coverage if the building is protected by a 24 hour guard service on the premises and an automatic sprinkler</p>	

Business Owners' Policy (BOP) is available to certain commercial property owners and small to medium sized business operators. The BOP provides a package of coverages for eligible risks, which includes mandatory property and liability coverages, with burglary and robbery offered as optional coverage. The maximum limit of liability of BOP building coverage and business personal property coverage is \$2 million and \$1 million, respectively. The BOP comprises approximately 1.5% of the total Association's writings at the examination date.

In December 1996, the California Earthquake Authority (CEA) was created by the California State Legislature to help resolve the insurance availability crisis in California following the 1994 Northridge earthquake. The Association participated in the CEA and made a \$15 million capital contribution. The participation was designed to limit the Association's earthquake exposure. As of September 30, 2013, the Association has a 0.80% share of the total CEA market and has a maximum exposure to earthquake loss

of approximately \$16 million. Future assessments in the event of a catastrophe are dependent upon the Association's CEA earthquake market share, the amount of the earthquake losses and the financial status of the CEA.

## REINSURANCE

### Assumed

The Association did not assume reinsurance during the examination period.

### Ceded

The Association maintains a ceded property catastrophe aggregate excess of loss reinsurance agreement. This agreement is renegotiated annually through an intermediary, Aon Benfield. This agreement was first effective on February 15, 2010.

As of September 30, 2013, this ceded reinsurance agreement is with Lloyd's of London, the largest participant (22.75%), along with other participants where the Association will be indemnified at the net aggregate liability as a result of one or more loss occurrences during the term of this agreement. The Association's retention is the initial \$100 million ultimate net loss in the aggregate and the reinsurer's maximum limit of liability is \$100 million. There have been no ceded losses under the reinsurance agreement during the examination period.

## FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of September 30, 2013

Statement of Income and Members' Equity for the Year Ended  
September 30, 2013

Reconciliation of Members' Equity from September 30, 2009  
through September 3, 2013

Statement of Financial Condition  
as of September 30, 2013

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Cash and short-term investments	\$ 128,468,361	\$ 128,468,361	
Premiums receivable	4,217,852	4,217,852	
Accrued investment income	<u>25,478</u>	<u>25,478</u>	
 Total assets	 <u>\$ 132,711,691</u>	 <u>\$ 132,711,691</u>	
 <u>Liabilities and Members' Equity</u>			
Unpaid losses		\$ 8,982,973	(1)
Unpaid loss adjustment expenses		2,229,350	(1)
Unearned premiums		37,003,330	
Advance and unapplied premiums		1,845,792	
Commissions payable		670,821	
Accrued expenses		340,627	
Pension and postretirement benefit accrual		5,449,723	
Distribution due to members		<u>368,112</u>	
 Total liabilities		 56,890,728	
 Total members' equity		 <u>75,820,963</u>	 (2)
 Total liabilities and members' equity		 <u>\$ 132,711,691</u>	

Statement of Income and Members' Equity  
for the Year Ended September 30, 2013

Statement of Income

Underwriting Income

Premiums earned		\$ 62,090,969
Deductions:		
Losses and loss expenses incurred	\$ 21,733,662	
Other underwriting expenses incurred	<u>15,520,668</u>	
Total underwriting deductions		<u>37,254,330</u>
Net underwriting gain		24,836,639

Investment Income

Net investment loss		(92,038)
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Other Income

Total other income		<u>114,518</u>
Net income		<u>\$ 24,859,119</u>

Members' Equity

Members' equity, September 30, 2012		\$ 48,254,572
Net income	\$ 24,859,119	
Change in nonadmitted assets	(201,100)	
Closure of pool years	(213,984)	
Change in minimum pension liability	<u>3,122,356</u>	
Change in equity		<u>27,566,391</u>
Members' equity, September 30, 2013		<u>\$ 75,820,963</u>

Reconciliation of Members' Equity  
from September 30, 2009 through September 30, 2013

Members' deficit, September 30, 2009, per Examination			\$ (14,033,899)
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 87,366,390	\$	
Change in nonadmitted assets		917,069	
Retention of Equity	2,227,078		
Aggregate write-ins for gains in Members' Equity	<u>1,178,463</u>		
Total gains and losses	<u>\$ 90,771,931</u>	<u>\$ 917,069</u>	
Net increase in members' equity for the examination period			<u>89,854,862</u>
Members' equity, September 30, 2013, per Examination			<u>\$ 75,820,963</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Unpaid Losses and Unpaid 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 an amount, 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 by a ratio of claims paid.

Pursuant to California Insurance Code Section 10094, the Association is empowered to assess member companies their proportional share of losses incurred in a pool year. The Association's Governing Committee must approve all assessments. There have been no cash assessments made to member companies since fiscal year 1994.

The Association is not required to prepare an Analysis of Losses and Loss Expenses (Schedule P), or to provide an actuarial opinion.

Based on an analysis by a Casualty Actuary for the California Department of Insurance, the Association's unpaid losses and unpaid loss adjustment expenses as of September 30, 2013 were found to be reasonably stated and have been accepted for purposes of this examination.

### (2) Members' Equity

The Association 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 Association. In making a

distribution, the Governing Committee is empowered to reduce the distribution by deficits incurred in other pool years.

In fiscal year 2013, the Governing Committee decided to leave the 2008, 2009, and 2010 pool years open and approved the closure of 2009 pool year for Business Owners' Policy (BOP). No significant members' equity distribution was made during the examination period in order to improve the financial condition of the Association which was severely affected by a series of wildfires between 2007 and 2009. During the four-year examination period, the Association distributed a total of \$411,000 to those companies who are no longer members of the Association.

### 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 Company's officers and employees during the course of this examination.

Respectfully submitted,

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Examiner-In-Charge  
Associate Insurance Examiner  
Department of Insurance  
State of California