REPORT OF EXAMINATION
OF THE
CALIFORNIA FAIR PLAN ASSOCIATION
AS OF
SEPTEMBER 30, 2017

Filed on September 30, 2019

TABLE OF CONTENTS

PAGE

Los Angeles, California
May 31, 2019

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 Association) at its home office located at 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 as of September 30, 2013. This examination covered the period from October 1, 2013 through September 30, 2017.

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 Association’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 Association 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, an adjustment is identified, the impact of such adjustment will be documented separately following the Association's financial statements.

This examination report includes findings of fact and general information about the Association 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 other regulators and/or the Association.

ASSOCIATION HISTORY

The original purpose of the Association was 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 (Division I). Since its formation in 1968, geographic areas eligible for coverage were expanded to include any property in California. In October 1994, the Association began writing Business Owner's Program (BOP or Division II) for small to medium-size business operators who have difficulty obtaining property and liability coverage. The BOP available to eligible risks, includes mandatory property and liability coverage, with an optional burglary and robbery coverage. 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 (participating insurers) holding a certificate of authority from the California Department of Insurance for each class of business.

On May 26, 2017, the California Court of Appeal ruled that the Association was responsible to pay replacement costs to repair an insured's home, even if repair costs exceed the home's market value. On August 9, 2017, the State Supreme Court affirmed the lower court's decision.

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, 2017 follows:

Voting Members

Name	Company	Representing
Cecil Autry	Liberty Mutual Insurance Company	At-large Insurance Companies
Kyle Belvill[a] Vice Chairman	California Casualty Group	Association of California Insurance Companies
Brian Braddock	Farmers Insurance Group	Other Non-stock Insurers
Shirley Gordon[a] Secretary	State Farm Insurance	At-large Insurance Companies
Chad Hourigan	Automobile Club of Southern California	At-large Insurance Companies
Jack McGraw[a] Chairman	Pacific Specialty Insurance Company	At-large Insurance Companies
James Rowland[a]	Allstate Insurance Company	Other Stock Insurers
Tammy Schwartz[b]	TOPA Insurance Group	At-large Insurance Companies

Name	Company	Representing
Vijay Sivakumaran	The Hartford	At-large Insurance Companies

Non-voting Members

Name	Company	Representing
Donna Bacarti	AmWINS Access Insurance Services	Surplus Lines Insurers
Howard King	Modern Corporation	Public
Irene Sabourin	Hub International	Insurance Agents
Javier Rodriguez	RISCO Insurance Services, Inc.	Insurance Brokers

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

Principal Officers

Name	Title
Anneliese Jivan	President
John Boeder[(b)]	Vice President – Underwriting and Operations
Cesar Flores	Vice President – Information Systems
Estee Natale	Vice President - Claims
Jinal Patel	Vice President - Finance

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

(a) Kyle Belvill, Shirley Gordon, and James Rowland were elected as Chairman, Vice Chairman, and Secretary, respectively, for the 2017-2018 fiscal year.

(b) John Boeder, Vice President – Underwriting and Operations, retired on January 3, 2018, and was replaced by Tammy Schwartz, a member of the Governing Committee.

TERRITORY AND PLAN OF OPERATION

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. 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 risk in the regular market.

The Association does not have a certificate of authority, as all its activity is conducted on behalf of its participating insurers. Additionally, the Association does not have a producer's license, as it is composed of participating insurance companies. Producers are not appointed agents of the Association, and are not authorized to bind coverage. All producers licensed in the state of California are eligible to produce business for the Association.

The Association issues policies, collects premiums, pays return premiums, commissions, and various general expenses. The Association contracts with and assigns independent adjusters to adjust claims, after which it then pays 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 within its own 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 policy limit that may be placed through the Association is as follows:

Division	Type of Coverage	Maximum Policy Limit
Division I	Dwelling Coverages	$1.5 million per one location
	Commercial Structures	$3.0 million per one location
	Commercial – All Other Coverages	$1.5 million per one location

Division	Type of Coverage	Maximum Policy Limit
Division II		
Property	Building Coverage	$2 million per one location
	Business Personal Property	$1 million per one location
Liability	Commercial Multi-peril	$300,000 per occurrence
		$600,000 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 following the 1994 Northridge earthquake. The Association participated in the California Earthquake Authority (CEA) and made a capital contribution of $15 million. The participation was designed to limit the Association's earthquake exposure. As of September 30, 2017, the Association has a 0.64% share of the total CEA market, and its maximum exposure to earthquake loss is approximately $11 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 does not assume any reinsurance.

Ceded

Effective February 15, 2017, the Association entered into a one-year Aggregate Property Catastrophe Agreement with various authorized and unauthorized reinsurers. Under the terms of the agreement, the Association's retention is $90 million ultimate net loss in the aggregate, and the reinsurer's maximum limit of liability is $135 million. There have been no ceded losses under the reinsurance agreement during the examination period.

ACCOUNTS AND RECORDS

Information Systems Controls

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

Claims Manual

Pursuant to California Code of Regulations, Title 10, Chapter 5, Subchapter 7.5, Article I, Section 2696.6, the Association's claim manual must contain a copy of the California Fair Claims Settlement Practice Regulations (FCSP). A review of the Association's in-house claims manual and independent adjuster (IA) guidelines noted that neither contained a copy of the regulations. However the IA guidelines did include an internet link, though the link was not active. It is recommended the Association attach the regulations or an active internet link to both the in-house claims manual and the IA guidelines.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Association with the California Department of Insurance and present the financial condition of the Association for the period ending September 30, 2017. The accompanying comments on the financial statements should be considered an integral part of the financial statements. No adjustments were made to the financials as a result of the examination.

Statement of Financial Condition as of September 30, 2017

Statement of Income and Members' Equity for the Year Ended September 30, 2017

Reconciliation of Members' Equity from September 30, 2013
through September 30, 2017

Statement of Financial Condition
as of September 30, 2017

Assets	Ledger and Nonledger Assets	Net Admitted Assets	Notes
Cash and short-term investments	$ 123,634,547	$ 123,634,547	
Premiums receivable	4,550,820	4,550,820	
Assessment receivable	5,876	5,876	
Accrued investment income	347,957	347,957	
Total assets	$ 128,539,200	$ 128,539,200	

Liabilities, Surplus and Members' Equity		
Unpaid losses	$ 12,039,034	(1)
Unpaid loss adjustment expenses	2,447,185	(1)
Unearned premiums	44,031,489	
Advance and unapplied premiums	2,225,025	
Commission payable	709,789	
Accrued expenses	179,804	
Pension and postretirement benefit accrual	5,471,245	(2)
Total liabilities	67,103,571	
Total members' equity	61,435,629	(3)
Total liabilities and members' equity	$ 128,539,200	

Statement of Income and Members' Equity for the Year Ended September 30, 2017

Statement of Income

Underwriting Income		
Premiums earned		$ 75,351,736
Deductions:		
Losses incurred	$ 24,771,455	
Loss adjustment expenses incurred	$ 3,518,270	
Other underwriting expenses incurred	16,488,900	
Total underwriting deductions		44,778,625
Net underwriting gain		30,573,111
Investment Income		
Net investment gain		707,321
Other Income		
Other income		116,472
Net income		$ 31,396,904

Members' Equity

Members' equity, September 30, 2016		$ 61,124,759
Net income	$ 31,396,904	
Change in nonadmitted assets	(279,031)	
Change in pension liability	838,413	
Distributions	(31,645,416)	
Change in equity		310,870
Members' equity, September 30, 2017		$ 61,435,629

Reconciliation of Members' Equity
from September 30, 2013 through September 30, 2017

	Gain in Surplus	Loss in Surplus	
Members' Equity, September 30, 2013			$ 75,820,963
Net income	$ 100,901,092	$	
Change in nonadmitted assets	297,474		
Closure of pool years	21,124		
Change in pension liability		6,749,055	
Distributions		110,845,235	
Cumulative effect of changes in accounting principles	1,989,266		
Total gains and losses	$ 103,208,956	$ 117,594,290	
Net decrease in members' equity			(14,385,334)
Members' equity, September 30, 2017			$ 61,435,629

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 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 the 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, 2017, were found to be reasonably stated and have been accepted for purposes of this examination.

(2) Pension and Postretirement Benefit

On October 1, 2013, the Association adopted Statement of Statutory Accounting Principles (SSAP) No. 92, *Accounting for Postretirement Benefits Other Than Pensions* and SSAP No. 102, *Accounting for Pensions* effective March 2012. In accordance with SSAP Nos. 92 and 102, the Association is to recognize the funded status of a defined benefit plan in the balance sheet. Additionally, pension benefit obligations are required to include all participants, not only vested participants. In addition, elements of plan costs are required to be recognized as either expense components during the current period, or as adjustments to surplus with future amortization into expense. As a result of the adoption of SSAP Nos. 92 and 102, there was a change in accounting principles which resulted in a $1,989,266 cumulative gain to members' equity.

(3) 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.

The following member distributions were approved by the Governing Committee during the examination period:

Fiscal Year	Division Type	Distribution Type	Pool Year(s)	Amount
2014	Division II	Full	2004 - 2009	$ 8,300,000
2015	Division I	Full	2008	7,200,000
			2010	17,500,000
		Partial	2011	10,000,000
			2012	10,000,000
	Division II	Full	2010	1,050,000
2016	Division I	Full	2009	2,800,000
			2012	14,500,000
		Partial	2013	8,000,000
	Division II	Full	2011	441,000
2017	Division I	Full	2013	17,000,000
		Partial	2014	14,000,000
	Division II	Full	2012	667,000
Total Distributions				$111,458,000

SUBSEQUENT EVENTS

The Association placed a moratorium on writing new fire insurance coverage in wildfire-impacted areas throughout California. In accordance to the Association's plan of operation, neighborhood or area location or any hazard beyond control of the property owner shall not be deemed acceptable criteria for declining risk. On December 14, 2017, the California Insurance Commissioner issued a Cease and Desist (C & D) order to the Association. The C & D order prevents the Association from refusing to issue basic property insurance in certain California wildfire zip codes.

On November 8, 2018, two large wildfires ignited in the state of California, the Camp and Woolsey Fires, in northern and southern California, respectively. The Association incurred losses and loss adjustment expenses of approximately $265 million. The maximum reinsurance recoverable available to offset these losses is $135 million.

As a result of the aforementioned wildfires the Association's cost of reinsurance significantly increased. In January 2019, the Governing Committee met and approved a $10 million spending limit to secure the most optimal reinsurance coverage that could be obtained by the Association. The following is a summary of the Company's ceded reinsurance, effective February 15, 2019:

Type of Contract	Reinsurer	Company's Retention	Reinsurer's Limit
Property Catastrophe Aggregate Excess of Loss		$70 million plus	
First Layer	69.00% Various authorized and unauthorized reinsurers	31.00% of $20 million	$20 million x $70 million
Second Layer	70.85% Various authorized and unauthorized reinsurers	29.15% of $135 million	$135 million x $90 million

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records – Information System Controls (Page 7): As the result of the review of the Association's information systems controls, recommendations for improving these controls were presented to the Association. The Association should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems.

Accounts and Records – Claims Manual (Page 7): The Association's in-house claims manual and independent adjuster's 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 is recommended that the Association attach a copy of the regulations or provide an active internet link.

Previous Report of Examination

None.

ACKNOWLEDGMENT

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

Respectfully submitted,

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__/S/__________________________

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