SENATE COMMITTEE ON APPROPRIATIONS
Senator Anthony Portantino, Chair
2019 - 2020 Regular Session

SB 254 (Hertzberg) - California Earthquake Authority

Version: April 1, 2019
Urgency: Yes
Hearing Date: May 13, 2019

Policy Vote: INS. 7 - 3
Mandate: No
Consultant: Debra Cooper

Bill Summary: SB 254 the California Resilient Homes Initiative, would make a number of changes to restructure the California Earthquake Authority's (CEA) financial structure to expand mitigation programs.

Fiscal Impact: The California Department of Insurance (CDI) would not incur additional costs to implement this bill.

Background: The CEA was created in 1996 following the 1994 Northridge earthquake that caused an estimated $20 billion in residential damages, only half of which was insured. In response, the Legislature created the California Earthquake Authority (CEA), a publicly managed, privately funded nonprofit tasked with protecting homeowners from the financial risks associated with regular seismic events.

The CEA offers residential coverage to a little over 1 million policyholders, about two-thirds of the residential earthquake insurance policies sold in California. In recent years, the CEA's role has expanded to include more proactive mitigation efforts, such as the Brace-and-Bolt Program, which has provided over 7,000 retrofit grants since 2014.

Different sized insurers play different roles in a healthy market. Non-CEA insurers tend to be much smaller with only a few exceeding 1% of the market share. Non-CEA insurers are also subject to federal taxes and California's gross premium tax. Additionally, non-CEA insurers are subject to assessments by the California Insurance Guarantee Association (CIGA) for non-CEA earthquake claims (CEA insurers are not).

The CEA has made extensive efforts to facilitate earthquake mitigation. In August 2011, the California Residential Mitigation Program was established as a joint-exercise-of-powers entity by the CEA and the Governor's Office of Emergency Services, to carry out mitigation programs to assist California homeowners who wish to seismically retrofit their houses.

Proposed Law: This bill would:

- Revise the elements of the CEA's tiered system supporting its claims-paying capacity and add new sources:
  - *Reinsurance:* Expands the purpose for purchasing reinsurance and issuing bonds to include "conducting other authority operations."
  - *Bonds:* Revises the bond debt limit to issue up to $1 billion "excluding costs of issuance and sale."
  - *CEA-Insurer Assessment:* Splits the $2 billion assessment into two pots, repeals the $1.7 billion assessment on CEA insurers and replaces it with the contingent

tax on many other types of property and casualty policies issued by CEA and non-CEA insurers, and prohibits the CEA from reinstating any assessment obligation it has reduced after the CEA's capital exceeds $6 billion.
  - *Contingent Capital*. Authorizes the CEA Board to impose a tax on many types of property and casualty insurance policies, to be paid by the consumer, for the purpose of paying CEA claims in the event that all other existing resources are depleted.

- Create the Mitigation and Contingent Capital Expense Reserve Fund.
  - Require the CEA to deposit 2% of the amount of contingent capital into that fund and suspend payments if the CEA determines that it is necessary to use subsequent event funding.
  - Directs those funds to the Earthquake Loss Mitigation Fund, the High Seismic Risk Zone Mitigation Fund, and to be used for the purpose of funding a new claims-paying capacity layer that must be used before the CEA imposes a surcharge on CEA policies.
- Authorize the CEA to establish a "subsequent event" claim-paying fund after a major earthquake in order to ensure that CEA can continue to write policies and have resources to pay claims arising from a subsequent major earthquake.
- Create the Subsequent Event Segregated Account and require the CEA to set aside $500 million in protected operating capital in that account. This bill would reallocate the remaining contingent capital capacity and suspend collection of the tax until all other subsequent event funding is exhausted.
- Eliminate the prohibition of writing coverage if Fannie Mae and Freddie Mac require earthquake insurance for single family residential structures.
- Make many technical changes to the laws applicable to the CEA.
- Declares the act to be an urgency statute to take effect immediately.

Related Legislation:

AB 548 (Rodriguez, 2019) would require the California Residential Mitigation Program (CRMP) to promote its Earthquake Brace & Bolt mitigation program to low-income homeowners. The measure is pending in the Assembly Appropriations Committee.

AB 2927 (Nazarian, Chapter 828, Statutes of 2018) revised and recast the CEA's authority to sell revenue bonds or secure other debt financing of no more than $1 billion if claims and claim expenses incurred following an earthquake exhaust its available capital, the maximum amount of any insurer contributions or assessments, all reinsurance actually available and under contract, and any other risk transfer provided through capital market contracts, and specifies that the costs of issuance and sale of those revenue bonds are in addition to the $1 billion, and not deducted from the proceeds, as specified.

SB 602 (Monning, 2015) would have authorized the CEA to enter into voluntary contractual assessments with property owners to finance the instillation of seismic strengthening improvements. The measure was never heard in the Assembly Appropriations Committee.

AB 1429 (Nazarian, 2015) would have authorized CRMP to provide grants to residential homeowners for the purpose of defraying the cost of seismic retrofitting, among other purposes and would have required, if the Legislature appropriated the funds, the CRMP to implement a grant program and, on or after July 1, 2017, make grants that assist a qualifying owner of a multiunit residential structure defray the owner's cost of seismic retrofitting of the structure. The measure was never heard in the Senate Insurance Committee.

AB 2064 (Cooley, Chapter 419, Statutes of 2014) revised the offer of earthquake insurance noticed; increased the cap on CEA operating expenses from 3% to 6% to include all expenses in that cap except those expenditures specifically excluded; changed the loss assessment coverage for condominiums from mandatory to optional; and required CEA participating insurers to send CEA marketing materials to homeowners' policyholders at least once a year.

Staff Comments: Staff notes this bill would create the Mitigation and Contingent Capital Expense Reserve Fund, a continuously appropriated fund, within the California Earthquake Authority Fund and would require that funds in the Mitigation and Contingent Capital Expense Reserve Fund also be exhausted prior to the CEA issuing and selling the investment grade revenue bonds or issuing or securing other debt financing. By creating and adding a new mandatory source of funding for a continuously appropriated fund, the bill would make an appropriation.

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