SENATE RULES COMMITTEE
Office of Senate Floor Analyses
(916) 651-1520 Fax: (916) 327-4478

THIRD READING

Bill No: SB 254
Author: Hertzberg (D)
Amended: 1/6/20
Vote: 21

SENATE INSURANCE COMMITTEE: 7-3, 4/24/19
AYES: Rubio, Archuleta, Dodd, Glazer, Hueso, Portantino, Roth
NOES: Jones, Bates, Moorlach
NO VOTE RECORDED: Borgeas, Galgiani, Mitchell

SENATE APPROPRIATIONS COMMITTEE: 7-0, 1/23/20
AYES: Portantino, Bates, Bradford, Durazo, Hill, Jones, Wieckowski

SUBJECT: California Earthquake Authority

SOURCE: Author

DIGEST: This bill removes obsolete provisions that authorized the California Earthquake Authority (CEA) to impose an assessment on participating insurance companies when the CEA exhausts other resources used to pay claims.

ANALYSIS:

Existing law:

1) Requires insurers to offer earthquake coverage as part of the homeowners policy or as a separate policy ("mandatory offer").

2) Establishes the CEA in the form of a privately financed, publicly managed entity authorized to write only earthquake insurance coverage.

    a) Allows, but does not require, insurers to fulfill their mandatory offer obligation by offering CEA policies to their residential insureds.

b) The CEA may only offer coverage through participating insurers that voluntarily market and service the policies ("participating insurers"). Nonparticipating insurers may offer their own coverage directly or make arrangements through another insurer.

3) Establishes a layered system for paying claims that requires the CEA to exhaust specified resources. In aggregate, these resources make up the CEA's "claims paying capacity" and include available capital, reinsurance and bond proceeds, assessments on policyholders, and two separate assessments on participating insurers.

4) Caps the aggregate amount of one of the assessments on participating insurers to $1.78 billion, but reduces that amount on an annual basis until the CEA's authority to issue that assessment ceases entirely. (The cap was reduced to zero on April 1, 2018.)

This bill repeals the language authorizing the CEA to impose the assessment, originally capped at $1.78 billion, on participating insurers.

Background

California's mandatory offer law has long required insurers to offer earthquake coverage with a homeowners policy. At one time, insurers included the coverage in their basic policy. The CEA was created after the 1994 Northridge caused massive and unexpected losses. The earthquake revealed insurers' risk exposure and triggered a crisis in the homeowners insurance market. Reportedly, 82 insurers restricted the sale of new homeowners policies. During this period, enrollment in the Fair Access to Insurance Requirements Plan, the state's homeowners insurer of last resort, reached 291,617 in 1997. Once the CEA was formed in 1996, participating insurers could offer CEA coverage, instead of their own coverage, to meet the mandatory offer requirement. This allowed insurers to shift the earthquake risk exposure off their books and remain in the homeowners insurance market. According to the CEA's 2018 Annual Report, by October 1997, only three insurers were still restricting the sale of new policies.

The CEA offers residential coverage to a little over one million policyholders through participating insurers; it does not cover commercial risks. In order to offer CEA coverage, an insurer must meet certain criteria, sign a participation agreement, and make an initial capital contribution. Participating CEA insurers represent about 80% of the total homeowners insurance market.

When an insurer offers a policy, it doesn't actually set aside the face value of the policy dollar-for-dollar; rather it sets aside assets used to pay a claim based upon the probability of losses at a certain level or it arranges for other resources that may be used to pay claims. Because earthquakes potentially involve massive losses at one time, the CEA must have access to substantial resources in order to pay claims, but it doesn't actually have that much cash. The CEA's ability to pay claims after an earthquake is based on a layered capital and assessment structure. Each layer is triggered as the prior layer is exhausted, including accumulated capital, reinsurance, bond proceeds, an assessment on policyholders, and two statutory insurance industry assessments. The industry assessments are only triggered under certain conditions, are subject to an aggregate cap, and only apply to CEA participating insurers.

One of the industry assessments has become obsolete by its own terms, although the status of the assessment would not be clear from the language itself. That assessment authority, established by SB 430 (Machado, Chapter 303, Statutes of 2007), was added to replace a prior assessment that expired in 2008. The new assessment authority was originally capped at $1.78 billion, but is also subject to annual reductions in the maximum potential assessment according to a statutory formula. The cap is also impacted by other factors, such as whether insurers have previously paid the assessment. According to the CEA, that assessment was never imposed and the cap has been effectively reduced to zero as of April 1, 2018, according to the reduction formula.

Because the cap on that assessment has been reduced to zero, the statutes authorizing it and defining its calculation and reduction formulas are now moot; however, that language remains and requires external information to interpret. The existing language potentially creates problems and confusion, particularly during a time of crisis. SB 254 repeals that language, eliminates any cross-references, and clarifies the financial obligations of CEA participating insurers.

Recent amendments taken in the Senate Appropriations Committee significantly narrowed the bill and removed all prior opposition. The support listed below reflects the prior version of the bill.

FISCAL EFFECT: Appropriation: No Fiscal Com.: Yes Local: No

According to the Senate Appropriations Committee, this bill results in no cost to the state. The industry assessment deleted by this bill was subject to a statutory reduction formula, which effectively reduced the assessment authority to zero as of April 1, 2018.

SUPPORT: (Verified 1/24/20)

American Red Cross
California Earthquake Authority
City of Los Angeles
City of San Francisco
County of San Francisco
State Building and Construction Trades Council, AFL-CIO

OPPOSITION: (Verified 1/24/20)

None received

Prepared by: Hugh Slayden / INS. / (916) 651-4110
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