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BEFORE THE INSURANCE COMMISSIONER

OF THE STATE OF CALIFORNIA

In re Petition for Rulemaking to Amend

TITLE 10, SECTIONS 2697.6 AND 2697.61 OF THE CALIFORNIA CODE OF REGULATIONS

File No. ___________

TO THE HONORABLE STEVE POIZNER, INSURANCE COMMISSIONER:

Petitioner CALIFORNIA EARTHQUAKE AUTHORITY (the "Petitioner" or the "CEA") petitions under Government Code section 11340.6 for adoption of amendments to California Code of Regulations ("Regulations") sections 2697.6 and 2697.61, which pertain to the coverage types and limits for earthquake insurance policies offered by the CEA.

I. INTRODUCTION

1. Following the catastrophic 1994 Northridge earthquake, insurance companies, fearing insolvency from another huge earthquake, severely restricted (or refused to write altogether) earthquake insurance. In fact, many insurers also refused to sell new homeowners insurance policies because of the statutory mandate that insurers offer earthquake insurance to individuals who purchase homeowners policies. This triggered a crisis that by mid-1996 seriously threatened to harm the vitality of the state's housing market and stall the state's economy.

2. In response, the California Legislature established the CEA as a privately-financed, publicly-managed entity to provide earthquake insurance to California residents. The legislation was

codified at Insurance Code section 10089.5 et seq. (the "Act"). As directed by the Act, the Insurance Commissioner issued Regulations to implement the CEA legislation, and as authorized by the Act, those regulations were promulgated on an emergency basis. Among other matters, the original Regulations set forth the insurance products the CEA was authorized to sell, within the rubric of "basic residential earthquake insurance," the basic authorized product under the Act.

3. In 1999, in response to what the CEA Governing Board found to be a significant public need and demand, the Board authorized a request for regulatory change to permit the CEA to sell additional insurance products within the statutory scope of basic residential earthquake insurance. The new Regulations, among other things, would re-term the CEA's minimum-limits policy a "base-limits" residential earthquake insurance policy and would permit the offering of additional, higher-limits coverage or policies and a lower deductible, newly termed "optional-limits" coverages. (Cal. Code Regs., tit. 10, § 2697.6.)

4. The Insurance Commissioner promulgated the regulatory change, and upon its authorization by the Office of Administrative Law and filing with the Secretary of State, the CEA proceeded to implement the optional-limits program as additional limits and coverage. A quota-share reinsurance contract and financial guaranty insurance contract (since dropped) were negotiated to support the earliest optional-limits program; under the quota-share reinsurance contract, the CEA ceded to reinsurers 100 percent of the premiums (less a ceding commission) and 100 percent of losses for the optional-limits coverages.

5. The CEA has offered optional-limits coverage since June 1999. Some 183,600 CEA policyholders currently purchase optional-limits coverage, paying about $41,000,000 in 2006 written premiums.

6. In 2005 and 2006, quota-share reinsurance premiums for the optional-limits coverage rose and the desired quota-share limits at reasonable prices became unavailable. With Governing Board approval, the CEA in 2006 switched some of its supplemental-program reinsurance to an excess-of-loss reinsurance program – additional premium needed was paid using accumulated ceded commissions, which exhausted all capital attributable to and available for the supplemental program. For 2007, the CEA Governing Board approved a complete change in supplemental-program financing to an excess-of-loss

program; the CEA's retention was $50 million, financed by a portion of proceeds of CEA revenue bonds issued in July 2006. To address the increased costs associated with the program, the CEA filed – and the Commissioner granted – an application to increase rates for its optional-limits coverages, effective January 1, 2007. But, because the CEA receives and earns its premium income gradually over the 2007 calendar year (and subsequent years), while the first quarterly reinsurance premium became immediately due on January 1, 2007, prior to the accumulation of significant earned premium income, the cash flow from CEA premium collections was projected to be insufficient to pay in a timely manner the reinsurance premiums due by contract and other expenses, including program expenses attributable to borrowing, throughout 2007 and part of 2008.

7. Accordingly, in 2006 the CEA sought authority to transfer and use a limited amount of funds from its base-limits program, which had ample funds to support the short-term transfer. The Commissioner granted the Petition of the CEA to amend the Regulations to permit the limited transfer and filed the amended regulation with the Office of Administrative Law on October 15, 2006. The Governing Board authorized a transfer in December 2006 using the new Regulation provisions. In early 2007 revenue projections for the supplemental program were revised, based on actual year-end 2006 CEA policy data, revealing the likelihood of an additional shortfall in money available to pay supplemental-program expenses; the Board authorized a further transfer in April 2007 and discussed contingencies regarding the possibility of additional shortfalls.

8. The CEA's continuing ability to access the reinsurance market remains good for the base program, but the supplemental program continues hobbled, requiring the CEA to anticipate additional fund transfers and casting substantial doubt on the CEA's ability in the future to maintain the separate optional-limits program.

9. The CEA has reviewed the continuing need to provide consumers with optional limits and the available means to meet that need and has determined that the need exists and that it can best be met by integrating the base-limits program and the optional-limits program and eliminating the regulatory requirement of separate financing for the two programs. Accordingly, the CEA petitions the Commissioner to amend sections 2697.6 and 2697.61 of the Regulations to permit the integration of the base-limits program and the optional-limits program. (A redlined version of the proposed amendments

to the Regulations is attached as Exhibit A; a clean version of the text as proposed is attached as Exhibit B.)

II. PETITIONER

10. Petitioner CEA is a California public instrumentality, created by statute (Ins. Code, § 10089.5 et seq) and authorized by statute to sell earthquake insurance (Ins. Code, § 10089.6, subd. (a)) to California homeowners, condominium owners, mobilehome owners, and renters. The CEA commenced operations on December 1, 1996, and since then has become one of the world's largest residential earthquake insurers and ranks 132 among all property and casualty insurers in the United States, as measured by A.M. Best Co. The CEA was formed in response to the widespread unavailability of earthquake and homeowners insurance after the 1994 Northridge earthquake, and one of the CEA's primary objectives continues to be to maintain and increase the availability of earthquake insurance in California.

III. JURISDICTION AND LEGAL DUTY

11. Government Code section 11340.6 provides that "any interested person may petition a state agency requesting the adoption, amendment, or repeal of a regulation." Upon receipt of such a petition, the state agency must "notify the petitioner in writing of the receipt and then shall within 30 days deny the petition . . . or schedule the matter for public hearing." (Gov. Code, § 11340.7, subd. (a).) If the petition is denied, the notice must indicate "why the agency has reached its decision on the merits of the petition in writing." (*Ibid.*)

12. The Commissioner has the authority to adopt the proposed amendments to the Regulations under Insurance Code section 10089.11, subdivision (a).

IV. STATEMENT OF FACTS

A. Summary of Existing Law

13. Section 2697.6 of the Regulations sets forth the coverage types and limits for "base-limits" residential earthquake insurance policies that the CEA can offer to owners or renters of qualifying residential property. (Cal. Code Regs., tit. 10, § 2697.6, subd. (d).)

14. Under section 2697.6, the CEA is authorized to offer a "base-limits" policy, which currently has a deductible of 15 percent and provides coverage for damage to personal property (Coverage C), loss

of use (Coverage D), and cost of reconstruction to bring the insured property up to applicable residential building code standards (Coverage E). (*Ibid.*) For homeowners and condominium or cooperative-unit owners, the base-limits policy also provides coverage for the dwelling or real property (Coverage A).

15. In addition to the coverage provided by the base-limits policy, section 2697.6 also permits the CEA to offer policyholders the option of raising their coverage limits for both Coverage C and Coverage D by purchasing the CEA's "optional-limits" coverages. The base-limits policy covers losses up to only $5,000 for Coverage C, but the optional-limits coverages provide $25,000, $50,000, $75,000, or $100,000 of Coverage C. Also, the base-limits policy provides only $1,500 of coverage for Coverage D, but the optional-limits coverages offer increased limits of either $10,000 or $15,000. (Cal. Code Regs., tit. 10, § 2697.6, subd. (e).)

16. The optional-limits program also offers a decreased deductible for dwellings: 10% of the Coverage A limit, as opposed to the base-limits policy's 15% deductible. Many CEA policyholders, such as those who own valuable personal property, who are concerned about significant loss of use expenses, or who desire a lower deductible, believe that the base-limits policy by itself does not provide adequate protection for their particular financial needs, and they therefore opt to purchase one of these optional-limits coverages. The CEA believes, based on consumer comments, that many such policyholders would forego earthquake insurance entirely if such optional-limits coverages were not available.

17. The optional-limits program has been highly successful. Approximately one-quarter of all CEA policyholders choose to purchase at least one of these optional-limits coverages.

18. Under section 2697.61 of the Regulations, as they were initially enacted, the optional-limits program was to be strictly separated from the base-limits program. Over time, changes in the reinsurance market have made strict separation of the two programs impossible, and it has been necessary for the CEA, with the Commissioner's authorization, to transfer funds from the base-limits program to the optional-limits program.

19. Section 2697.6, subdivision (e), of the Regulations also requires that the "plan of finance [for optional-limits coverages] must operate effectively to protect policyholders of the Authority's base-limits residential earthquake insurance policies from any financial liability arising from any offer of

policy limits in excess of the base limits [i.e., any optional-limits coverages]," and further demands that this plan of finance must "neither rely on nor impair the [CEA]'s available capital."

20. This formalistic prohibition on commingling of funds between the two programs was intended to ensure that each program would operate independently and on an actuarially sound basis. (E.g., Cal. Code Regs., tit. 10, § 2697.61, subd. (a).)

B. Proposed Amendments

21. Recently, reinsurance premiums for the optional-limits coverages have risen dramatically, attributed in large part to the unprecedented losses to reinsurers caused by various natural disasters, such as the United States hurricanes in 2004 and 2005 and various other, concurrent catastrophes throughout the world. Because the CEA's optional-limits program relies heavily on reinsurance, the costs of maintaining this program have increased significantly as well. Since 2006, the 100% quota-share reinsurance the CEA had used since the inception of the optional-limits program as financing for that program has become unavailable at any price level that would enable the CEA to sell the optional-limits coverages at prices that would be affordable to consumers, and the CEA therefore has not been able to purchase such coverage since that time.

22. The CEA has taken steps to reduce these costs and to compensate for the limited availability, such as switching from "quota-share" reinsurance contract, where reinsurers bear the entire risk of program claims, to a more available, less-expensive "excess-of-loss" reinsurance contract, where the CEA must bear the risk of the first $50 million in loss and reinsurers bear the risk of losses in excess of $50 million.

23. Despite these remedial actions, the optional-limits program has remained under-funded.

24. The CEA's Governing Board and the CEA staff have determined that the only feasible solution is to integrate the base-limits and optional-limits programs, so that reinsurance and other forms of capacity can be obtained in an integrated manner.

25. Petitioner emphasizes that this integration will be implemented in a manner that maintains the actuarial soundness of all of the CEA coverages. Rates for optional limits shall be set to reflect the differential risk each optional limit presents.

26. The CEA therefore seeks amendments to the Regulations that would permit such action.

Specifically, the proposed amendments would enable the CEA to offer, through the participating insurers, each of the coverage options presently available through the optional-limits program as a part of a single, integrated program of residential earthquake insurance.

27. Petitioner also seeks a non-substantive amendment to subdivision (d)(1) of section 2697.6 of the Regulations to make clear that the reference to "Coverage A" in that subdivision refers to the numerical dollar-amount specified in the underlying policy of residential property insurance, unadjusted by "inflation-guard" or other adjustments to dwelling coverage found in some residential property insurance policies, along with other non-substantive conforming amendments.

C. Mandates on Local Agencies or School Districts

28. The proposed amendments to the Regulations do not impose any mandate on local agencies or school districts. There are no costs to local agencies or school districts for which Part 7 (commencing with section 17500) of Division 4 of the Government Code would require reimbursement.

D. Cost or Savings to State/Local Agency or School District or in Federal Funding

29. Other than the ordinary regulatory costs of adopting them, the proposed amendments to the Regulations will result in no cost or savings to any state agency, no cost to any local agency or school district that is required to be reimbursed under Part 7 (commencing with section 17500) of Division 4 of the Government Code, no other nondiscretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the state.

E. Economic Impact on Businesses and the Ability of California Businesses to Compete

30. The proposed amendments to the Regulations will not have a significant, statewide adverse economic impact directly affecting businesses, including the ability of California businesses to compete with businesses in other states.

31. If the proposed amendments are not adopted, however, the CEA will need to discontinue its optional-limits program, which could have a substantially negative economic impact on businesses. Insurers that participate in the CEA and, indirectly, agents and brokers who sell earthquake insurance policies of CEA participating insurers would no longer be able to offer these coverages, thereby decreasing the number of choices consumers have in purchasing earthquake insurance, and likely decreasing the number of policies sold. In the event of a major earthquake, the absence of optional-limits coverage will

mean billions more in uninsured losses, exacerbating the economic crisis the earthquake will have caused.

32. It is unlikely that the proposed amendments will adversely affect the ability of California businesses to compete with businesses in other states.

F. Potential Cost Impact on Private Persons or Entities/Businesses

33. Petitioner is not aware of any cost impacts that a private person or business would be reasonably certain to necessarily incur in reasonable compliance with the proposed amended Regulations. There could be a contingent impact on CEA participating insurers' costs in the form of a slight statistical increase in the participating insurers' risk of the payment of assessment obligations under Insurance Code sections 10089.23. and 10089.30, estimated by the CEA to be an increased risk of payment of assessments in the first industry assessment layer (Ins. Code § 10089.23), which expires on December 1, 2008, of approximately 0.33% for the 2008 calendar year, and an increased risk of payment of assessments in the second industry assessment layer (Ins. Code § 10089.23) in any given calendar year of approximately 0.05%. In that the proposed amendments pertain exclusively to internal CEA procedures, no other cost impact on private persons or businesses is anticipated.

G. Finding of Necessity

34. It is necessary for the health, safety, or welfare of the people of the state that the proposed amendments to the Regulations apply to businesses.

H. Effect on Jobs and Businesses in California

35. Petitioner does not foresee that the proposed amendments will have a negative impact on the creation or elimination of jobs in the state, the creation of new businesses, the elimination of new businesses, or the expansion of businesses currently operating in the state. In the event of a major earthquake, the increased coverage the optional-limits coverages afford will enable more homeowners to rebuild and recover, creating more jobs in the homebuilding and related industries.

I. Impact on Housing Costs

36. The proposed amendments will have no significant effect on housing costs.

J. Alternatives

37. Petitioner is aware of no reasonable alternative that would be more effective in carrying

out the purposes for which the amendments to the Regulations are proposed or would be as effective and less burdensome to affected private persons than the proposed amendments.

K. Impact on Small Businesses

38. The proposed amendments will not affect small businesses. If the proposed amendments are not adopted, however, small businesses may be adversely affected, to the extent insurance agents and brokers (those who are not insurance company employees) qualify as small businesses. As discussed above in paragraph 31, without adoption of the proposed amendments, the CEA will no longer be able to offer optional-limits coverages, which could decrease the number of policies sold by such small businesses.

L. Comparable Federal Law

39. There are no existing federal regulations or statutes comparable to the proposed amended Regulations.

V. CONCLUSION

40. For the foregoing reasons, Petitioner respectfully request that the Commissioner grant this Petition and commence proceedings for Rulemaking to Amend sections 2697.6 and 2697.61 of the Regulations.

Dated: June 25, 2007

Respectfully submitted,

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By ______________________
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EXHIBIT A

Proposed Amendment to California Code of Regulations, Title 10, Chapter 5, Subchapter 7.7

(Showing Proposed Changes in Text)

§ 2697.6. Earthquake Policies, Coverage Types and Limits.

(a) The Authority must offer, in accordance with the provisions of Division 2, Part 1, Chapter 8.5, of the Insurance Code, a basic residential earthquake insurance policy to any owner of a qualifying residential property, as long as the qualifying residential property meets the eligibility standards of the Authority and the owner has first secured a residential property insurance policy from a participating insurer.

(b) The Authority must renew any basic residential earthquake insurance policy it has written, provided that the Authority receives payment of the applicable renewal premium on or before the expiration date stated in the policy. The Authority must nonrenew, rescind, or cancel a policy on any otherwise ~~the grounds that the~~ qualified residential property whenever the property is no longer covered by an underlying residential property insurance policy issued by a participating insurer.

(c) No policy issued by the Authority will provide coverage in the event there is no underlying residential property insurance policy issued by a Participating Insurer at the time of loss. In that case, any unearned premium shall be returned to the policyholder on a pro rata basis.

(d) The types of policies, base-limits policy ~~and~~ coverage limits, and base-limits policy deductibles of Authority policies shall be as follows:

1. Dwelling policy:	~~15% Deductible~~
Coverage A (Dwelling)	Limit of insurance e~~E~~qual to the stated Coverage A limit (~~or its equivalent limit~~however the limit on liability for the structure may be denominated in the residential property insurance policy, without adjustment of the stated dollar amount for inflation or similar modification) of underlying residential property insurance policy; maximum deductible 15% of Coverage A limit
Coverage B	~~Not available~~Limited coverage, included in Coverage A limit and subject to Coverage A deductible

Coverage C (Personal Property/Contents)	No less than $5,000 limit of insurance; no payment unless structural loss meets Coverage A deductible
Coverage D (Loss of Use)	No less than $1,500 limit of insurance; no deductible
~~Coverage E (~~Limited Building Code Upgrade~~)~~	No less than $10,000 limit of insurance, subject to Coverage A deductible

~~The CEA may also, at its option, offer dwelling policyholders an additional $10,000 in coverage for Limited Building Code Upgrade.~~

2. Individual condominium or cooperative unit policy:	~~15% Deductible~~
Coverage A (Real Property)	No less than $25,000 limit of insurance; maximum deductible 15% of Coverage A limit; plus no less than $10,000 Limited Building Code Upgrade coverage as additional insurance, subject to Coverage A deductible
~~Coverage B~~	~~Not available~~
Coverage C (Personal Property/Contents)	No less than $5,000 limit of insurance; maximum deductible 15% of Coverage C limit
Coverage D (Loss of Use)	No less than $1,500 limit of coverage; no deductible
~~Coverage E (Limited Building Code Upgrade)~~	~~$10,000~~
Coverage ~~F~~E (Loss Assessment ~~(condominium value > $135,000)~~)	For condominium units valued at $135,000 or more, no less than $50,000 limit of coverage; for condominium units valued at less than $135,000, no less than $25,000 limit of coverage; maximum deductible 15% of Coverage E limit
~~Coverage G (Loss Assessment (condominium value < $135,000))~~	~~$25,000 or $50,000~~
3. Renter's policy:	~~15% Deductible~~

~~Coverage A~~	~~Not applicable~~
~~Coverage B~~	~~Not applicable~~
Coverage C (Personal Property)	No less than $5,000 limit of insurance; maximum deductible 15% of Coverage C limit
Coverage D (Loss of Use)	No less than $1,500 limit of insurance; no deductible

(e) The Authority may issue basic residential earthquake insurance policies with limits of insurance greater than the required minimum limits of insurance set forth in subdivision (d) or with lower deductibles than the maximum deductibles set forth in subdivision (d), referred to in this Chapter as "optional limits basic residential earthquake insurance." In issuing ~~its~~ optional-limits basic residential earthquake insurance policies, the Authority must provide full financial backing in accordance with a written plan of finance. ~~The plan of finance must operate effectively to protect policyholders of the Authority's base-limits residential earthquake insurance policies from any financial liability arising from any offer of policy limits in excess of the base limits.~~ The plan of finance may include the purchase by the Authority of reinsurance and financial guaranty insurance on terms and at ~~the~~ limits that the Authority may find reasonable and appropriate, to secure the payment of claims obligations and expenses that may arise under its optional-limits basic residential earthquake insurance polic~~y~~ies ~~and related contracts of reinsurance.~~

~~Upon the governing board's approval in a written finding of an appropriate plan of finance that will protect policyholders of the Authority's base-limits residential earthquake insurance policies from any financial liability arising from the sale or issuance of a basic residential earthquake insurance policy with limits in excess of the Authority's base-limits policies and which will neither rely on nor impair the Authority's available capital, as available capital is defined in Insurance Code Section 10089.5, subdivision (b), the Authority may offer the optional coverage types and coverage limits in paragraphs 1, 2, and 3, below, subject to the provisions of Section 2697.4. Authorized intra-Authority transfers made pursuant to the provisions of Section 2697.61, subdivision (c) are not and shall not be deemed reliance on or impairment of the Authority's available capital.~~

~~The optional coverage limits for Coverages C and D described in paragraphs 1, 2, and 3, below, are stated as gross limits that include the base limits provided in subdivision (d) of this section, and those portions of the gross limits that exceed the applicable base limits are to be written in excess of the base limits.~~

~~1. Dwelling Policy only: Optional deductible amount for Coverage A, and additional excess contents (Coverage C), and additional living expense (Coverage D) limit options. A dwelling policy that does not carry a 10% deductible must be issued at a 15% deductible. The lowered policy deductible and increased limits for Coverage C and Coverage D may be offered in any of the following amounts:~~

~~(i) Optional decreased deductible~~	~~10% of Coverage A limit~~
~~(ii) Coverage C (Contents)~~	~~$25,000, $50,000, $75,000, or $100,000~~
~~(iii) Coverage D (Loss of Use)~~	~~$10,000 or $15,000~~

~~2. Individual Condominium and Cooperative Unit Policy only: Excess contents (Coverage C), and additional living expense (Coverage D) options may be offered in any of the following amounts:~~

~~(i) Coverage C (Contents)~~	~~$25,000, $50,000, $75,000, or $100,000~~
~~(ii) Coverage D (Loss of Use)~~	~~$10,000 or $15,000~~

~~3. Renter's Policy only: Excess contents (Coverage C) and additional living expense (Coverage D) options may be offered in any of the following amounts:~~

~~(i) Coverage C (Personal Property)~~	~~$25,000, $50,000, $75,000, or $100,000~~
~~(ii) Coverage D (Loss of Use)~~	~~$10,000 or $15,000~~

(f) ~~For~~ With respect to individual condominium unit policies, ~~and in accordance with its underwriting or eligibility guidelines, the Authority will issue earthquake loss assessment coverage in connection with its basic residential earthquake insurance policy for condominium owners in the amount of $50,000.00 (fifty thousand dollars) for a unit valued at more than $135,000.00 (one hundred thirty-five thousand dollars) and in the amount of $25,000.00 (twenty-five thousand dollars) or $50,000.00 (fifty thousand dollars) for a unit valued at $135,000.00 (one hundred thirty-five thousand dollars) or less. T~~the value of the land on which a condominium unit is constructed is to be excluded when determining the value of ~~the~~at condominium unit for the purpose of determining the minimum limit of insurance for Coverage E (Loss Assessment).

§ 2697.61. Additional Requirements for Offer of Optional-Limits Basic Residential Earthquake Insurance Policies.

(a) Before the Authority ~~can~~ may offer optional-limits basic residential earthquake insurance policies, the governing board must first certify that selling ~~those policies~~ such insurance furthers the Authority's charge in Insurance Code Section 10089.10 to achieve maximum capacity for writing earthquake coverage. The sale by the Authority of any optional-limits basic residential earthquake insurance policies must be actuarially sound ~~and must neither rely on nor impair the Authority's available capital, as available capital is defined in Insurance Code Section 10089.5, subdivision (b). The Authority is authorized to sell optional-limits basic residential earthquake insurance policies only to Authority policyholders, and only Authority policyholders are eligible to purchase the Authority's optional-limits basic residential earthquake insurance policies~~.

~~(b) All funds directly attributable to the sale by the Authority of optional-limits basic residential earthquake insurance policies must be maintained in accounts that are separate from the accounts maintained for funds attributable to the sale of base-limits basic residential earthquake insurance policies and must not be used to pay any obligations or expenses arising from the sale of base-limits basic residential earthquake insurance policies. Except as otherwise provided in this section, the Authority must not use funds attributable to the sale of base-limits basic residential earthquake insurance policies to pay any obligations or expenses that arise out of the sale or issuance of optional-limits basic residential earthquake insurance policies.~~

~~(i) If, following the commencement of sales or issuance of optional-limits basic residential earthquake insurance policies, the Authority is unable to gain access to the financial backing for those policies that is outlined in the plan of finance specified in Section 2697.6, subdivision (e), so that it reasonably appears that the continued sale and issuance of those policies might financially burden the fund that provides backing capital for the Authority's base-limits residential earthquake insurance policies, the Commissioner may order the Authority to stop the sale and issuance of the optional-limits basic residential earthquake insurance policies until the Authority's access to the financial backing is restored and the Commissioner approves, by further order, a resumption of the sale and issuance of optional-limits basic residential earthquake policies.~~

~~(ii) If, following the commencement of sales or issuance of optional-limits basic residential earthquake insurance policies, the Authority is unable to gain access to the financial backing for those policies that is outlined in the plan of finance specified in Section 2697.6, subdivision (e), so that it is reasonably certain that the continued sale and issuance of those policies will financially burden the fund that provides backing capital for the Authority's base-limits policies of residential earthquake insurance, the Commissioner must order the Authority to stop the sale and issuance of the optional-limits basic residential earthquake insurance policies until the Authority's access to the financial backing is restored and the Commissioner approves, by further order, a resumption of the sale and issuance of optional-limits basic residential earthquake policies.~~

~~(c) Upon a finding by the Governing Board that the Authority's optional-limits program has adequate financial backing, that the program is or reasonably can be made financially sustainable, that the program's continuation in existence is in the best interests of the Authority and its policyholders, that the program has rates in place or applied for that, as verified in writing by a qualified actuary hired by or employed by the Authority, are actuarially sound and reasonably calculated to financially sustain the optional-limits program, and that any such requested transfer will have no material negative impact on the financial stability or capacity of the Authority's base program, the Board may authorize a transfer of funds to any designated account of the Authority's optional-limits program from any designated account of the Authority's base program. Each such authorized base-capital-funds transfer shall be subject to full reimbursement by the optional-limits program within a reasonable period, not to exceed three years from the date of each actual transfer of base-capital funds. As a condition to any transfer, the Authority's chief financial officer shall certify in writing and provide to the Board at a public meeting the business need for the transfer and, in reasonable detail, the anticipated reimbursement terms and conditions, including a reimbursement schedule. Any known inability or failure to reimburse transferred funds in accordance with the authorized reimbursement terms, conditions, or schedule shall be reported forthwith to the Board by the Authority's chief executive officer, the chief financial officer, or the general counsel, each of whom shall have an independent duty to so report.~~

~~(i) The funds transfers authorized by this subdivision are subject to an Annual Transfer Cap; as used in this paragraph, the "target calendar year" is the calendar year for which base-capital funds transfers are required to meet financial needs of the optional-limits program. The maximum amount of base-limits capital-funds transfer in or for a single target calendar year pursuant to the authorization for such transfer set forth above in this subdivision is the Annual Transfer Cap, which shall be calculated according to the following formula:~~

~~Annual Transfer Cap = P + (E/3) - (W/2) - C - (UEP/2) - (II/2)~~

~~Where:~~

~~P= Reinsurance premium by contract for the target calendar year~~

~~E= Estimated operating costs, supplemental program, for the target calendar year (includes (allocated) commission and fees payable to participating insurers and capital financing cost)~~

~~W= Estimated written premium, supplemental program, for the target calendar year~~

~~C= Estimated CEA capital attributable to supplemental program at January 1 of the target calendar year~~

~~UEP= Estimated unearned premium at December 31 for the year prior to the target calendar year~~

~~II= Estimated net investment income, supplemental program, for the target calendar year~~

~~All estimated amounts used in the formula must be confirmed by the Authority's chief financial officer as accurately determined and either based on or utilizing the reported, past figures for such costs, premiums, and capital that the Authority uses for its financial-reporting obligations. If so directed by the Board, the Authority during the target calendar year shall adjust the Transfer Cap as derived from application of the formula by the (1) substitution of revised estimates and actual figures, to the extent such actual figures are known, in place of the estimates called for by the formula and (2) recalculation of the resulting Transfer-Cap amount; in such case, the recalculated Transfer Cap shall be and become, for all purposes and until any further Transfer-Cap adjustment, the maximum permitted transferred amount of base-limits capital for the calendar year. Any sums transferred in or for a target calendar year shall be limited to amounts reasonably calculated to accomplish the certified purpose(s), and no more, as calculated pursuant to this paragraph, and in no event more than the annual Transfer Cap.~~

~~(ii) If the Board is informed in a public meeting by December 31st that the optional-limits program's gross costs and expenses associated with risk-transfer, such as costs of reinsurance, are reasonably likely to increase in the target calendar year by 50% or more over the present calendar year, the Authority shall make no transfer pursuant to this subdivision. Notwithstanding any other provision of this section, the authority to transfer capital as provided in this subdivision shall expire on December 1, 2008.~~

~~(d) Participating Insurers are permitted to offer their policyholders, or applicants for their policies, the Authority's base-limits basic residential earthquake insurance policy (1) without any optional coverage limits on that policy, if the Authority sells its optional-limits basic residential earthquake insurance policies by way of coverage-limits options on a single policy form, or (2) without making available the Authority's optional-limits basic residential earthquake insurance policy, if the Authority sells optional-limits basic residential earthquake insurance coverage by way of a policy form separate from that available for the Authority's base-limits residential earthquake insurance policy. No Participating Insurer is required to offer to its policyholders the Authority's optional-limits basic residential earthquake insurance policies, as long as the Participating Insurer continues to offer to its policyholders the Authority's base-limits residential earthquake insurance policy.~~

~~(c) An offer by a Participating Insurer of the Authority's base-limits residential earthquake insurance policy constitutes a mode of CEA Participating Insurer compliance with Chapter 8.5 (commencing with Section 10081) of Part 1 of Division 2 of the Insurance Code, and as set forth in Section 10084 of the Insurance Code.~~

(b) The Commissioner finds that integrating the formerly separate optional-limits program that had been in operation from 1999 through 2007 with the base-limits program serves the public interest by permitting the two programs to be financed together at an expected overall saving and by simplifying the program for the Authority, participating insurers, and consumers. This integration renders the former maintenance of separate funds within the Authority unnecessary and inappropriate. Any inter-fund transfer obligation that may exist at the time of integration will cease to exist.

EXHIBIT B

Proposed Amendment to California Code of Regulations, Title 10, Chapter 5, Subchapter 7.7

(Showing Final Text as Proposed)

§ 2697.6. Earthquake Policies, Coverage Types and Limits.

(a) The Authority must offer, in accordance with the provisions of Division 2, Part 1, Chapter 8.5, of the Insurance Code, a basic residential earthquake insurance policy to any owner of a qualifying residential property, as long as the qualifying residential property meets the eligibility standards of the Authority and the owner has first secured a residential property insurance policy from a participating insurer.

(b) The Authority must renew any basic residential earthquake insurance policy it has written, provided that the Authority receives payment of the applicable renewal premium on or before the expiration date stated in the policy. The Authority must nonrenew, rescind, or cancel a policy on any otherwise qualified residential property whenever the property is no longer covered by an underlying residential property insurance policy issued by a participating insurer.

(c) No policy issued by the Authority will provide coverage in the event there is no underlying residential property insurance policy issued by a Participating Insurer at the time of loss. In that case, any unearned premium shall be returned to the policyholder on a pro rata basis.

(d) The types of policies, base-limits policy coverage limits, and base-limits policy deductibles of Authority policies shall be as follows:

1. Dwelling policy:

Coverage A (Dwelling)	Limit of insurance equal to the stated Coverage A limit (however the limit on liability for the structure may be denominated in the residential property insurance policy, without adjustment of the stated dollar amount for inflation or similar modification) of underlying residential property insurance policy; maximum deductible 15% of Coverage A limit
Coverage B	Limited coverage, included in Coverage A limit and subject to Coverage A deductible
Coverage C (Personal Property/Contents)	No less than $5,000 limit of insurance; no payment unless structural loss meets Coverage A deductible

Coverage D (Loss of Use)	No less than $1,500 limit of insurance; no deductible
Limited Building Code Upgrade	No less than $10,000 limit of insurance, subject to Coverage A deductible

2. Individual condominium or cooperative unit policy:

Coverage A (Real Property)	No less than $25,000 limit of insurance; maximum deductible 15% of Coverage A limit; plus no less than $10,000 Limited Building Code Upgrade coverage as additional insurance, subject to Coverage A deductible
Coverage C (Personal Property/Contents)	No less than $5,000 limit of insurance; maximum deductible 15% of Coverage C limit
Coverage D (Loss of Use)	No less than $1,500 limit of coverage; no deductible
Coverage E (Loss Assessment)	For condominium units valued at $135,000 or more, no less than $50,000 limit of coverage; for condominium units valued at less than $135,000, no less than $25,000 limit of coverage; maximum deductible 15% of Coverage E limit

3. Renter's policy:

Coverage C (Personal Property)	No less than $5,000 limit of insurance; maximum deductible 15% of Coverage C limit
Coverage D (Loss of Use)	No less than $1,500 limit of insurance; no deductible

(e) The Authority may issue basic residential earthquake insurance policies with limits of insurance greater than the required minimum limits of insurance set forth in subdivision (d) or with lower deductibles than the maximum deductibles set forth in subdivision (d), referred to in this Chapter as "optional limits basic residential earthquake insurance." In issuing optional-limits basic residential earthquake insurance policies, the Authority must provide full financial backing in accordance with a written plan of finance. The plan of finance may include the purchase by the Authority of reinsurance and financial guaranty insurance on terms and at limits that the Authority may find reasonable and appropriate, to secure the payment of claims obligations and expenses that may arise under its optional-limits basic residential earthquake insurance policies.

(f) With respect to individual condominium unit policies, the value of the land on which a condominium unit is constructed is to be excluded when determining the value of that condominium unit for the purpose of determining the minimum limit of insurance for Coverage E (Loss Assessment).

§ 2697.61. Additional Requirements for Offer of Optional-Limits Basic Residential Earthquake Insurance Policies.

(a) Before the Authority may offer optional-limits basic residential earthquake insurance policies, the governing board must first certify that selling such insurance furthers the Authority's charge in Insurance Code Section 10089.10 to achieve maximum capacity for writing earthquake coverage. The sale by the Authority of any optional-limits basic residential earthquake insurance policies must be actuarially sound.

(b) The Commissioner finds that integrating the formerly separate optional-limits program that had been in operation from 1999 through 2007 with the base-limits program serves the public interest by permitting the two programs to be financed together at an expected overall saving and by simplifying the program for the Authority, participating insurers, and consumers. This integration renders the former maintenance of separate funds within the Authority unnecessary and inappropriate. Any inter-fund transfer obligation that may exist at the time of integration will cease to exist.