Room Document 23

High-Level Roundtable
on the Financial Management of Earthquakes

Paris, 23-24 June, 2011

OECD Headquarters, 2 rue André Pascal, 75116 Paris

CALIFORNIA EARTHQUAKE AUTHORITY (CEA)

Glenn Pomeroy

California Earthquake Authority (US)

CEA CALIFORNIA EARTHQUAKE AUTHORITY

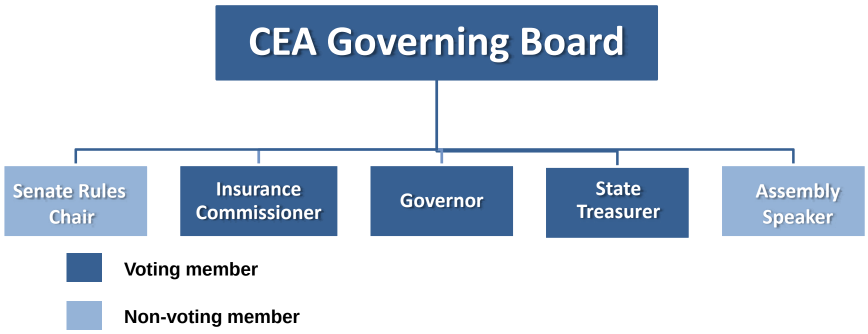
The Strength to Rebuild.SM

Glenn Pomeroy
Chief Executive Officer
June 23, 2011

The CEA today

- Publicly managed, privately financed residential earthquake insurer
- More than 800,000 policies in force
  → Largest earthquake-insurance provider in U.S.
  → Covers 70% of insured risk in California
- $10 billion in claims paying capacity
- One of largest purchaser of reinsurance in world
  → $3 billion cover annually

Publicly managed



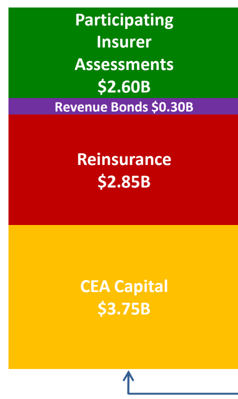
Privately financed

California FAIR Plan Property Insurance
Golden Eagle Insurance
Armed Forces Insurance
State Farm Insurance
Liberty Mutual
AAA Insurance
Safeco Insurance
CEA California Earthquake Authority
The Strength to Rebuild.
Foremost Insurance Group
USAA
Farmers
Allstate
You're in good hands.
Mercury Insurance Group
Homesite Home Insurance
Encompass
Commerce West Insurance

CEA's claim-paying capacity

2011 Financial Structure
Total: $9.5 Billion

CEA Claim-Paying Capacity:
a conservative
1-in-526 years



CEA claims are paid from "the bottom up," first using CEA capital and then accessing higher levels of risk transfer.

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Problem:

Only 12% of California households with homeowners insurance also have earthquake coverage – it is strictly a voluntary purchase.

Uninsured Insured

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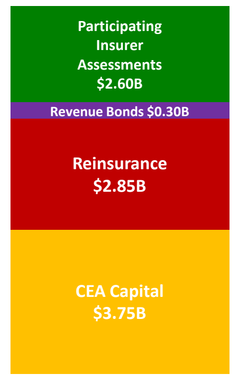
CEA is overly dependant on reinsurance

Rating Agencies:
- Require 1-in-500 year capacity

Reinsurance:
- Costs CEA about $200 Million each year
- Comprises 2/3 of CEA's overall expenses but just 1/3 of claim-paying capacity
- Absorbs 40% of policyholder premium

Costs borne by consumers:
- Expensive premium — especially in high-risk areas
- High deductible (15%)

2011 CEA Financial Structure
Total: $9.5 Billion



CEA Claim-Paying Capacity
1-in-526 years

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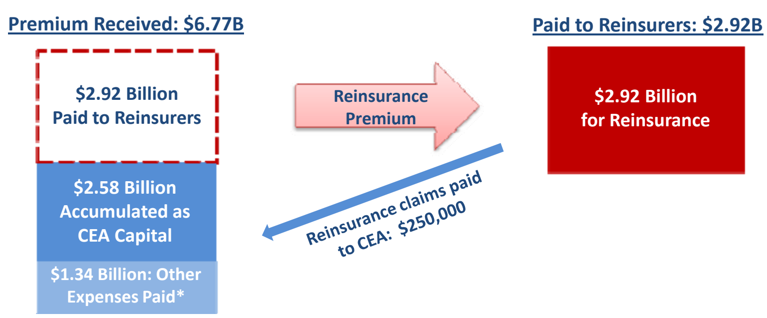
Reinsurance cost = 40% of policyholder premium

- **To date, CEA policyholders have paid $6.77 billion in premium.**
- **Almost $3 billion has been expended on reinsurance.**
- **CEA has received $250,000 in paid reinsurance claims.**



* Other Expenses Paid
- Agent Commissions
- Debt Financing
- Participating Insurer Fees
- CEA Operations

CEA must develop additional risk transfer solutions.

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The way forward for the CEA – diversification of capital sources

- Diversification of capital sources will:
  - → Reduce policyholders costs
  - → Increase CEA's ability to offer different coverage options
  - → Improve long-term stability of the CEA

Result:

- More households protected by earthquake insurance
- Faster and more complete economic recovery post-event

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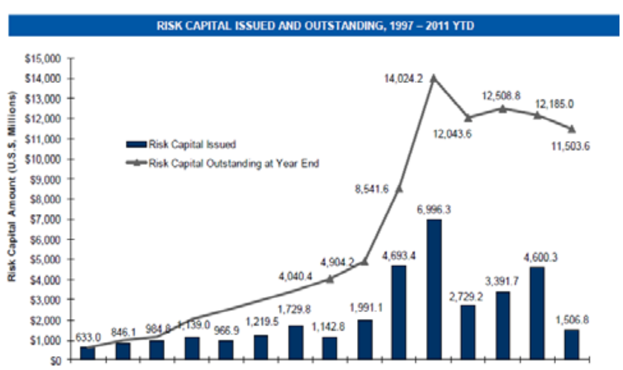
Diversification tool 1: Capital markets risk transfer

- **The catastrophe bond market has matured to become an established source of risk transfer capacity for global P&C companies - <u>9 of 10 largest U.S. insurers have accessed cat bond market</u>**
  - Provides multi-year, collateralized cover with alternative, potentially much larger, investor base than traditional reinsurance
- **Currently there is $11.5 billion of cat bonds outstanding and over $30 billion in cumulative issuance – <u>but this market still represents less than 15% of global risk transfer annually</u>**



Source: Guy Carpenter

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Diversification tool 2: S. 637

The Earthquake Insurance Affordability Act

- US Congress will consider legislation authorizing U.S. Treasury Department to create a limited federal guarantee for post-event bonds issued by eligible state programs.
- Proposal limits federal guarantee to $5 billion.
- Other states may consider creating CEA type programs.

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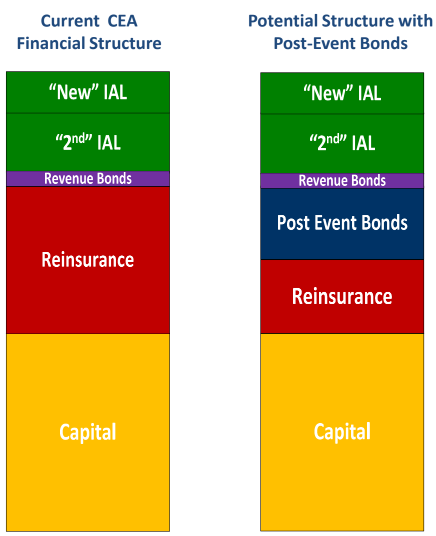
Post-event bonds will lower costs and increase financial strength



- **A limited amount of post-event bonds will replace some of the (pre-funded, annually renewed) reinsurance program.**
- **Probability of borrowing will be less than 2%.**
- **More flexible capital management strategies will strengthen CEA's ability to repay and prepare for subsequent events.**

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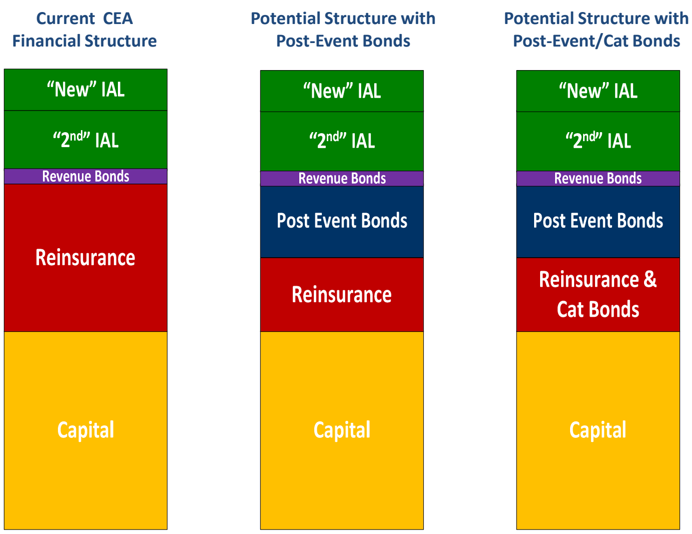
Post-event bonds and cat bonds provide needed diversification



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Risk management through diversified risk-transfer solutions

- Capital
- Reinsurance
- Catastrophe Bonds
- Debt

More arrows in the quiver

Developing access to capital markets and post event bonding capability will allow the CEA to offer more affordable, higher value coverage – and will strengthen the sustainability of the organization.

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