

California Earthquake Authority
May 1st, 2007

According to a study by the Federal Emergency Management Agency (FEMA) in September 2000, the estimated annual losses in the United States from earthquakes totals \$4.4 billion dollars. This is very close to the average annual losses from hurricane and flood damage, while the majority of these earthquake losses occur in California.¹ Typically auto policies do cover earthquake damage under comprehensive loss, but it is not included in a standard home or business owner's policy and must be purchased through an endorsement. California state law mandates that all insurance companies offer earthquake coverage to their policyholders while many decide not to purchase it.

The integrity of the insurance industry in California was severely threatened in January 1994 when a 6.8 magnitude earthquake struck southern California. According to the Insurance Services Organization (ISO), insured losses were estimated at \$12.5 billion which erased all earthquake premiums that insurance companies had collected over the past 30 years. While no companies went insolvent, a drastic change was required as insurance companies increased their rates, increased their deductibles, and wrote fewer policies threatening the rebuilding process and future feasibility of providing earthquake insurance coverage at a reasonable cost.¹

This change was the creation of a publicly managed, privately funded entity called the California Earthquake Authority (CEA) that offers insurance coverage for earthquake losses. Governed by a board of five elected officials; California's Governor, Treasurer, Insurance Commissioner, Speaker of the Assembly, and Chairperson of the Senate Rules Committee; insurance companies join the CEA to then be able to sell these policies. According to the CEA homepage, "The funds to pay claims come from premiums, contributions from and assessments on member insurance companies, borrowed funds, reinsurance, and the return on invested

funds.” Consumers are able to purchase this at an affordable rate while the CEA is still able to maintain adequate reserves for an extremely volatile line of insurance.² Depending on certain rating variables, the average annual premium is \$500 while some exceed \$3,000.¹

Today the CEA continues to be a very financially solid company as it is currently rated an A- by A.M. Best.³ Through an extremely strong reinsurance program and additional financial flexibility, CEA has large enough reserves to provide aggregate payments of \$6.7 billion or losses associated with a 1 in 850 year earthquake.⁴

Currently however in California, only 15% of homeowners have earthquake coverage. This is of particular concern to Insurance Commissioner John Garamendi as he attempts to lower earthquake insurance in an attempt to make it more affordable and attractive for homeowners.⁵ Because of this pressure, the CEA has decided to cut premiums on average by 22.1% or \$100 per year after re-evaluating a geographical survey of predicted earthquake damage. However, about 15% of policyholders will experience an increase in their rates at the same time. Clearly this is a step in the right direction for making overall earthquake insurance more affordable in California as the CEA writes approximately 70% of the policies in the state.⁶

Since the CEA sells policies through private insurers, these insurance companies are ultimately liable for any losses the CEA can't pay. Therefore this could threaten the future of the CEA and insurance companies with such a drastic increase as illustrated by Sam Sorich, president of the Association of California Insurance Companies, "We feel that the rate decrease is too extreme. We thought the analysis should have been more conservative."⁵ Just like all insurance, there is a delicate balance in making insurance economically feasible for all consumer's to purchase, while still charging appropriate rates to ensure insurer solvency.

Notes

1. "Earthquakes: Risk and Insurance Issues." Insurance Information Institute. 10 April 2007
<<http://www.iii.org/media/hottopics/insurance/earthquake>>.
2. California Earthquake Authority. 10 April 2007 <<http://www.earthquakeauthority.com>>.
3. "California Earthquake Authority." A.M. Best Company. 10 April 2007
<<http://www3.ambest.com/ratings/RatingsSearch.asp?AltSrc=9>>.
4. "Best Affirms Rating of California Earthquake Authority." Insurance Journal. 13 Oct 2006.
10 April 2007 <<http://www.insurancejournal.com/news/west/2004/10/13/46883.htm>>.
5. "California May Lower Quake Insurance Rates in Wake of Katrina." Insurance Journal. 3
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<<http://www.insurancejournal.com/magazines/west/2005/10/03/features/61171.htm>>.
6. Smyth, Andrew. "California Earthquake Insurance Rates Decrease." The Insurance Policy.
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<http://www.theinsurancepolicy.com/2006/06/california_earthquake_insuranc.html>.