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# Oversight Hearing on Implementation of SB 2902 (California Residential Earthquake Recovery Act) November 25, 1991

Senate Subcommittee on Earthquake Insurance

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CALIFORNIA LEGISLATURE  
SENATE SUBCOMMITTEE ON EARTHQUAKE INSURANCE  
SENATOR CECIL GREEN, CHAIRMAN

Oversight Hearing on  
**IMPLEMENTATION OF SB 2902**  
**(CALIFORNIA RESIDENTIAL  
EARTHQUAKE RECOVERY ACT)**



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## SENATE SUBCOMMITTEE ON EARTHQUAKE INSURANCE

CECIL GREEN

CHAIRMAN

### SUBCOMMITTEE ON EARTHQUAKE INSURANCE CECIL GREEN, CHAIRMAN

November 25th, 1991  
9:00 a.m. - 12:00 p.m.  
STATE CAPITOL, ROOM 112

#### AGENDA

**SUBJECT: OVERSIGHT HEARING ON IMPLEMENTATION OF S.B. 2902  
(CALIFORNIA RESIDENTIAL EARTHQUAKE RECOVERY ACT)**

**I. CALL TO ORDER**

- A. Opening Statement by Senator Cecil Green
- B. Remarks by Other Members

**II. ISSUE: DOES THE COMMISSIONER HAVE ADEQUATE AUTHORITY TO  
IMPLEMENT THIS PROGRAM AND REQUIRE PARTICIPATION?**

- A. Department of Insurance
  - John Garamendi, Insurance Commissioner
  - Richard Holden, Program Manager

**III. ISSUE: IS THERE A NEED FOR INCREASING THE SURCHARGE  
AND/OR DEDUCTIBLE FOR THE FUND? WHAT STEPS HAVE  
BEEN TAKEN TO OBTAIN REINSURANCE AND TO SELL  
REVENUE BONDS?**

- A. Department of Insurance
- B. Risk Management Software, Inc.
- C. Jardine Insurance Company

IV. **ISSUE:** IS THERE A NEED FOR FURTHER DELAY OF THE PROGRAM AND WHY? THIS INCLUDES PROBLEMS WITH COMPLIANCE, REGULATIONS AND DATA SUBMISSION REQUIREMENTS.

- A. Department of Insurance
- B. Computer Sciences Corporation
- C. Insurance Company Representatives
- D. Insurance Agents and Brokers

V. **ISSUE:** WHAT ROLE DO INDEPENDENT CONTRACTORS AND ADVISORY COMMITTEE PLAY IN THE OVERALL IMPLEMENTATION OF THE PROGRAM?

- A. Department of Insurance
- B. SB 2608 Advisory Committee
  - Lonnie Atkisson, Chairman
- C. Computer Sciences Corporation

VI. **ISSUE:** HOW IS PUBLIC BEING NOTIFIED ABOUT THIS PROGRAM?

- A. Department of Insurance

VII. **ISSUE:** IS CLARIFICATION NEEDED ON PARTICIPATION OF MOBILEHOMES, CONDOMINIUMS AND OTHER MULTIPLE FAMILY DWELLINGS?

- A. Condominium Owners
  - Representatives, Executive Council of Homeowners
- B. Mobilehome Owners
  - Representative, Golden State Mobilhome Owners League
- B. Department of Insurance

VIII. **OTHER ISSUES:** UNSCHEDULED WITNESSES

IX. CLOSING COMMENTS

X. ADJOURNMENT

CHAIRMAN CECIL GREEN: Ladies and Gentlemen, I welcome you to the hearing. As you all know, I'm Senator Cecil Green and I'm Chairman of the Insurance Subcommittee on Earthquake Insurance. And with me today is Frank Hill to try to come to some conclusion on this earthquake insurance.

The hearing we are having today is to review, once again, the current status of the California Residential Earthquake Recovery Program. This program which will provide \$15,000 of earthquake damage coverage for every homeowner in the State is due to take effect on January 1st, and that's a little more than a month from today.

The problem is that several issues have been raised by a number of insurers and others about the implementation of this program. We were willing to deal with these issues at our last hearing, but were rather surprised to learn that the Commissioner wanted to make it take a different approach. It was suggested by the Commissioner that we now repeal this program and consider some sort of other disaster assistance program. After this announcement, we were given only a short time to question the Commissioner, both on the reasons for requesting a repeal and what he intends to do at this point in time. As chairman of this committee, I felt it was necessary to continue the hearing until such time the Commissioner could adequately respond to questions from Members of this Committee and from other Members who worked on seeing that the original legislation was passed. I believe the Legislature and the Governor took a big step in passing a program like this. If a repeal is considered as necessary, then it certainly deserves more discussion than it could have been given last time. And even if we proceed, we still need to address problems with the current program before it begins. I'm sorry to say, however, that we will still not be able to meet with the Commissioner today. His father passed away last night and he will be unable to attend today. We give him our best and the sympathy for the loss of his father. And because of this, we will still proceed with the hearing and focus on the issues in the agenda. But our primary purpose

will be to receive responses to concerns we raise in this hearing by the next time we meet. We still fully intend to meet with the Commissioner on the future date so that some finality can be reached on these issues.

At this point, Frank, is there anything you'd like to say?

SENATOR FRANK HILL: Well, Mr. Chairman, I would just add my condolences to the Commissioner. I'm sorry about the passing of his father. It's unfortunate that he can't be here, but certainly it's understandable.

I agree with you that we ought to work through the agenda at least to try to crystallize some of the issues that are remaining out there, and I think it's critically important that we pick out a date and set a time for a hearing, and I think in the very near future. It's my sense that this program is going to go into effect in January, that we need to work to figure out what issues need to be resolved to put it into place. I do not believe, if there is a Special Session call of the Legislature, that it's going to deal with the direction that the Commissioner talked about a couple weeks ago. And so I think we need to be responsible and work on trying to solve the outstanding issues. Maybe if we can just deal with that first item of business in terms of that additional meeting. Was it my understanding that December 4th was a good day for the Commissioner?

MS. MASAKO DOLAN: Masako Dolan with the Department of Insurance. We looked at his calendar and it appears that he will be in Sacramento on December the 4th and we would make every effort to change his appointments to facilitate a hearing.

CHAIRMAN GREEN: Well, since we didn't have even the first hearing and through the death of his father, not being here today, we need to have some sort of guarantee that that date and time he will be here for that meeting.

MS. DOLAN: I believe - Yes, he will be here. We will make the changes in his schedule.

CHAIRMAN GREEN: All right. So, we do have a guarantee that he will be here on the December 4th. So then we can direct staff to start the process in having another hearing December the 4th. OK?

SENATOR HILL: My hope is, Mr. Chairman, that today we can - I'm not sure, let me just throw out one of the issues, obviously, that has to be resolved is the whole mandatory issue, and I'm not clear in my own mind what are all the different options out there in terms of the mandatory aspect of the program. And I know the Commissioner headed in one direction, there's the debate about legislative action versus regulatory action, and so I'd like to hopefully, when we're done, when we come in on December 4th, be able to say, "here is what the staff has worked on, between the Commissioner's office and all of our staffs",

and say, "here's four options that we - are available to us in terms of dealing with that mandatory issue," or the deductible, etc., etc., and so that we can, you know, bring some finale to this.

CHAIRMAN GREEN: Well, I believe you're absolutely right, Senator Hill. We do know some of the issues and we do know some of the problems; however, we haven't had that closeness of working between your staff, my staff, and the Commissioner's staff to bring forth some type of recommendation that says this is what we're going to do in the future. And, like on the mandatory participation, we have several different Leg Counsel rulings and one particular one is that the Commissioner, by regulation, can make it mandatory. There are some other rulings that we've seen from Leg Counsel, that says he cannot. So maybe we need to focus on what can be done and not what is currently being done. All right?

With that then, we'll have the Department's staff, and you're here. We're going to go through the agenda issue by issue. You've been furnished with a Subcommittee Questions-Based-On-Issue paper so that we'd like to have you start with any opening remarks and then we'll go through that paper issue by issue. I have made the headings 1, 2, 3, and so forth, and then you do have the questions that we, as a subcommittee, feel should be answered. I'll probably read them so that the audience will know what we're talking about before we go through them, the questions. All right? Now, do you have anything that you'd like to say?

MS. DOLAN: Let me just briefly make a few comments. The Commissioner called me this morning and he had every intent of being here, however his father died at 7 o'clock, and could not come here. We will schedule the hearing so that he can be here to answer the broader policy issues. He really was sorry that he had to leave, but he had the Executive Life decision pending and had to leave last time.

We do not, the Department does not propose to outline a detailed program that would better meet the disaster needs. Our major concern is the financing structure that the current program doesn't add up. And I think that the questions that you asked, we will be able to go into the details of our concerns. It is the combination of insufficient rates, deductibles, no means to make the program mandatory, and a provision that provides free coverage in the first year to millions. In addition, we recently learned from the experts that we hired on reinsurance that, of the high cost of purchasing reinsurance for the program and the serious negative consequences of purchasing financial reinsurance are issuing revenue bonds. The fact that the program - the prior provisions, the rates, the deductibles, and no means to make the program



mandatory really undercuts the financial stability of the program. The Commission also has real concern, given this difficulty in the financing, that since it is prefunded and funded through an insurance mechanism, that the consumers will expect, even though we will try and make every effort to tell them about prorate of payments, that they will have different coverage than what would be possible in the program, particularly in the current years, that unless there are changes that we will discuss later in much more detail for the long term of the program.

With that, I think that, you know, I believe that we ought to go point by point and have an actual ...

CHAIRMAN GREEN: All right then if we can start, I'll start with - the issue No. 1 is mandatory participation, and we know that your department knew that based on a Legislative Counsel's Opinion requested by Senator Hill, you could not propose a regulation which allowed you to prohibit the issuance or renewal of residence or property coverage for nonpayment of the surcharge. And notwithstanding that fact, you proposed such a regulation which was rejected by the Office of Administrative Law. Your new regulations have deleted this controversial issue. What option did you consider? And explain why you rejected each option. And why did you reject the option provided by the Legislative Counsel, which allowed you to require insurers to initiate collection actions for delinquent surcharges?

MR. RICHARD HOLDEN: We did review the Leg Counsel Opinion that was requested by Senator Frank Hill, and in that Opinion there were basically two options that were discussed. One was requiring insurance companies to initiate collection actions for the surcharge, which I believe is the option that you've alluded to in your Implementation-Issues paper. And the second was requiring that they purchase the reinsurance or else they would not be able to be renewed or issued a new policy, which was discussed as an option at the first hearing on February 6th. We chose to go with the renewal or a new issuance option because after legal review, we believe that we did have the authority to do that. We submitted that option in the regulations. The OAL disapproved that particular option, struck it out, and in fact in their comments they indicated, and this is quoted and it's included in the first page of your packet, that "the Act makes no provision for any enforcement to this surcharge in the event the insured does not pay the insurer. This silence was maintained by the Legislature and the two subsequent cleanup bills passed. Since the Legislature had repeated opportunities to include provisions authorizing enforcement powers, if any, the Commission has in this regard. However, it cannot be said that the Legislature

ignored the consequences which arise from failure to pay the surcharge", and they mention the two things that are in the bill.

It's our feeling that including the option to require collection by insurers has two problems: First, the OAL suggests very strongly, in their opinion, that unless there is specific authority for a mandatory enforcement, that they will disapprove it; and secondly, it's really more political. We believe that the insurers would be much more adamant about opposing a collection action activity on their part than they would on renewal or new issuances. And so that is the reason why we chose that first option.

CHAIRMAN GREEN: Which leaves probably some questions on that decision to choose that option. No. 1, you were told that it was illegal, it couldn't be done, and then it did come forth and bring forth something that was legal and could be done by regulation and then that was not done. You didn't answer that.

MR. HOLDEN: Our reading of the Leg Counsel Opinion was not that it was illegal or couldn't be done. In fact they suggest that it might be a possible option, but it would be something that would be subject to challenge. After we had Department attorneys look at it, we felt that we probably did have the authority to do it. OAL has subsequently ruled that we don't. And given their ruling on the first, we think it would be very unlikely that they would approve an enforcement option that would require collection actions on the part of the insurers.

CHAIRMAN GREEN: Well, I guess the next step was to - you found that that regulation wouldn't work, but you didn't put another regulation in place that possibly could work as far as Leg Counsel was concerned.

MR. HOLDEN: We felt that we were out of options at that point and that given their very clear and specific language that specific legislative authority was required, that we felt that we needed to bring this back to the Legislature.

CHAIRMAN GREEN: But you see we don't have the subject of time. Something has to go in place by regulation before January the 1st, and you only have to bring forth a regulation. Any change in the Legislature and any change in the bill will require a period of time. So be sure and address that point for our next hearing because I think this is a key point to the total legislation, the mandatory participation of all property owners within the state of California.

And by Leg Counsel and the way I read the ruling and findings, is that they did give you an option for regulation. It might not be the best regulation, but it is a regulation that you can put in place and is legal. And then we'll get, maybe later, some word from the insurers themselves as to the cost of that type of a regulation, it could be high. Next question ...

SENATOR HILL: Mr. Chairman, before we leave that.

CHAIRMAN GREEN: Yes.

SENATOR HILL: I guess I've got a couple of questions. The first one is I'd like to get a sense, and I think that's what your comment was about, from the insurers in terms of which of these options - you know, I'll accept your characterization that you think the cancellation is less - I assume they don't like any of them, or I know they don't like any of them - is less onerous than the option which you took on. It seems to me, and I don't have a copy of the OAL decision here, but it seems to me that there was - I believe that was my bill this, the 412 that we went through - we had a battle in the Senate Insurance Committee, the insurers put some prohibition language in that stopped the cancellation process. We got to, I think, Assembly Ways and Means, and that language was taken out and there was a compromise that, as I recall, essentially said what we will do is give some broad authority to the Commissioner in terms of enforcing that. And I guess - so my question is is my recollection of that legislative process correct? I remember that owner's provision was taken out and if that was true, if we, you know, what was that language that was put into that bill at that point, and why doesn't - you know, how come the OAL - I guess the second part of it - when you originally went forward with your initial set of regulations, you obviously had some attorneys who said we think that we have the authority to do this.

And, you know, there's also that question about - no, you know, OAL is one step in the process, there're other options in terms of challenging that and have you talked about that, and what's the implications of that?

MR. HOLDEN: The language that was in SB 412 was - it was broad language and it was tied to collection of the surcharge, remittance of the surcharge by insurers and I believe the language said the Commissioner shall have the authority to adopt regulations under this subdivision. We had referenced a similar type of language that was already in SB 2902 authorizing adoption of regulations by the Commissioner, and OAL did not believe that it was specific enough to provide us the authority to do something specific. We did have attorneys look at it and they felt that we had a case but that it was a call, it could go either way depending on the decision. And I think the insurance industry was very interested in these regulations, particularly with this provision, and they didn't want this provision and we felt that they probably wouldn't like the collection provision, they would dislike that even more. We felt that at that point, given the time frame, that our hands were really tied in terms of proceeding, and that we were basically stuck and required a

legislative authorization.

I hope that's responsive.

SENATOR HILL: Now what options do you have if you want to challenge that OAL ruling?

MS. DOLAN: In the past ...

SENATOR HILL: Do you go to court? Is that what happens?

MS. DOLAN: Well, in the past, the Commissioner has appealed to the Governor to overrule OAL, that would be one. And then, I believe, we could try and go through the court process.

SENATOR HILL: Uh-hum.

CHAIRMAN GREEN: Senator Hill? Is that ...

SENATOR HILL: Well, just so we understand the point, the - just as I suspected, the next step, and if I recall, now we're talking about a different issue, but I think there was a Prop 103 rebate issue. Or wasn't there a process where the Commissioner asked the Governor to overrule OAL and that the Governor did that.

MS. DOLAN: And he did. Yes. He has ten days to overrule.

SENATOR HILL: So that's - Oh, he has ten days to overrule, so that option has passed?

MS. DOLAN: Um, in terms of the first set of regulations, yes.

CHAIRMAN GREEN: So we're left with no regulation?

MS. DOLAN: For mandatory, yes.

CHAIRMAN GREEN: Right. All right, according to the briefing you provided legislative staff, your department indicates that your implementation RFP calls for the use of the program administrator, which currently is CSC, to collect the surcharge and enforce collection. How have you determined your authority to accomplish this when you have publicly stated that you have no authority to do so?

SENATOR HILL: Mr. Chairman, while they're thinking about that, before we leave this mandatory issue I just want to make another broad observation and I'd like to hear the reaction from the Department.

It's my opinion that because of the Commissioner's statement about the program not working, being a disaster for the California homeowners - I can't remember all of the comments that he made - if it was an insurance company I would have to deny it, etc., etc. - that the possibility of a legislative authorization is nil. That if you think that - you know, after you set up the scenario that says this program's a disaster, it's not going to work, it's insolvent. Now what you've got to do is get a bill through the Legislature to

force people to opt into a program that we've already said is a disaster and is not going to work, that legislatively that, you know, you've foreclosed that option as well. And on the same hand I do not believe that the legislative option is foreclosed in terms of defining more specifically the Commissioner's authority. I thought we already did that in that Ways and Means language. Obviously, there seems to be dispute about that. But at least my reading of the political situation is there's a possibility of getting legislation through that gives the Commissioner more authority in terms of enforcing it through regulations, but I don't believe that you can come back with a bill, maybe Rusty wants to carry it, that says if you don't pay your earthquake surcharge, your homeowner's policy is going to be canceled.

MS. DOLAN: You understand that the Commissioner has the same concerns that you do. And given that OAL - he has attempted on one occasion to put in what we felt were very onerous provisions. Having that overturned, he feels that it is now back in the legislative court. He has done that once, found it very onerous, as you recalled he criticized in the press for it, and the options are very poor. That's part of the problem, structurally, with the program. That as the first legislative opinion stated, that Assemblyman Connelly had, the program is mandatory. However, there is no enforcement mechanism. From OAL's point of view, to say that an administrator has the ability to implement a program and then develop whatever enforcement mechanism, particularly in view of the fact that the Legislature failed to act on two occasions in terms of two separate follow-up bills, we find that difficult.

SENATOR HILL: Well, except, I don't think you ought to - I think you're jumping to the wrong conclusion. This is not some new issue that Senator Green or I or anybody, or Rusty, who worked through this, the mandatory issue is something we talked about all the way through. We knew how controversial it was. The Legislative response to that issue, we knew the program had to be mandatory for it to be actuarially sound, was we will give language we thought brought authority to the Commissioner through regulations to impose that. So, I don't think you can jump to the conclusion that nobody ever thought about it and we forgot about this issue and it was just going to go away, now we had to deal with it. We thought we had dealt with it and now there seems to be a road block. And I guess my point is when you then stand up and say the program is a disaster, go back and fix it legislatively, I think you have taken away a lot of, at least a lot of the parameters in terms of a Legislative solution.

ASSEMBLYMAN RUSTY AREIAS: If I could ...

CHAIRMAN GREEN: Yes, Rusty.

ASSEMBLYMAN AREIAS: ... interject. I mean, I couldn't agree with Senator Hill more. Political environments result in lots of actions, there are lots of people on both sides, or all four sides of the issue, that are looking at the sixth successive year of drought as an opportunity to make some changes in how we allocate water. The incident in Stockton as it relates to assault weapons certainly created an atmosphere that allowed some things to be done. And those of us that have worked in the whole earthquake area, Brian Stoner, Tom Tobin, my colleagues up here, all recognize that with every earthquake, or with every significant seismic event there provides a window of opportunity to get some new things done. And we did that in the aftermath of Loma Prieta. I don't know if the statistics were right, but they said that this program, had it been in place at the time, would have covered 25 of the 27 thousand homes that were damaged, completely. And as we get further and further away from that seismic event, the opportunity to bring together the critical mass to put a program in place, I mean it's probably gone now.

So the next time there's a seismic event, people will be asking the same questions that they asked with the recent events in the Persian Gulf: Why don't we, after all these years, have a comprehensive energy policy? What happened to Operation Independence? Those were front-burner issues nationally in terms of our national policy back in the mid-70's and early 1980's. And they're going to be asking the same thing: Why didn't the Legislature do more? What happened to this comprehensive earthquake insurance coverage that we were going to have. And that's what's unfortunate. I mean, I had to read that this plan should be repealed, through the newspapers.

SENATOR HILL: Well, we had 60 seconds advanced notice.

CHAIRMAN GREEN: Yes. We didn't even have the newspaper advanced warning. (Laughter.) Rusty, you're absolutely right as far as the windows of opportunity. This subcommittee was formed after the Whittier earthquake, which goes back to 1987. And I believe probably of us sitting here, I have sat in probably more earthquake insurance and earthquake hearings than anyone in this Legislature. Because it was in my district, Whittier was in my district in 1987, and I heard all those cries for help from all those people out there with the high deductibles insurance. And each time we've had a quake, the Loma Prieta after the Whittier, we've heard the same thing.

So here is a Senator that has been now for almost six years in this issue. We've had several issues, or several bills in front of us. When this bill was signed we knew there were some problems with it. We knew that what we had done was major in effort and it was a major thing to put it in place. All of you sit

back and say this won't work; however, what we've been doing in the past, and if you'll analyze what happened in Whittier and Loma Prieta, was that the State, in emergency session, authorized a billion dollars worth of coverage to help those people. That won't stop. We're not going to let the people in the State suffer. None of us will. And I don't think you've fed that factor into your equations on regulations and so forth. You're looking at this as a major, major earthquake. Now, what the history of the State has been is one or two major earthquakes over a 20, 30 or 40 year period, and as we go along, we have the minor quakes that come along that give the people the big problem. And this coverage would work if, through regulations, which is authorized in our mind by this legislation, the regulation to make this mandatory, I think that's your charge as staff members, is how do you make the legislation work. And as all we're getting from staff at this point is it can't work. I think that that's what our next hearing is going to be about, and I don't want to make this into a debate. We want to make it work, all of us sitting here. And we, then, will do our political thing with the Legislature.

Now, early last year, the Commissioner came to me and said, "Will you extend this for six months?" We, the staff, I, Senator Hill, and Areias, said, "Is that enough time to get this fixed this year?" And the answer from your office was "Yes", you didn't want more than six months continuance. And so now all of a sudden at the last minute, we find it wasn't enough time. The issues are still there. So I charge that staff should be doing a little more. And that's why the hearings today, is let's go through these.

And I won't go off on these kind of tirades because this is an important program, and it is our charge to make this program work.

MS. DOLAN: The Commissioner full acknowledges the problems that confronted homeowners when they were - when they filed and understood the impact of the deductibles and the serious problem it is for a number of people.

The concern that we have, as I have stated before, is that we cannot put the financing mechanism together under the perimeters of the bill's - or the law, as it is, to give any assurance to the people. If, in fact, there was another Loma Prieta, we will be paying cents on the dollars or if we go into a revenue bond mechanism, we would have ...

ASSEMBLYMAN AREIAS: Wait a minute, wait a minute. Can I interject here?

MS. DOLAN: OK.

ASSEMBLYMAN AREIAS: OK. Now the statistics that I'm aware of, of the 27,000 homes damaged in Loma Prieta, 25,000 of them would have been covered by the program assuming that the fund was fully funded and had an opportunity to

build up. Now, why is that a mistaken notion?

MS. DOLAN: The problems - the reinsurance market has drastically changed since Senator Green went to London and talked ...

CHAIRMAN GREEN: Well I understand that, but let me correct you just a moment. The reinsurance is only one equation. There is the State of California with loans. There is the State of California with bonds. There are all kinds of mechanisms where you can guarantee your fund. But the big problem is the mandatory participation, because to pay those moneys back. We recognize that. That's why the mandatory participation is such a big issue.

MS. DOLAN: You're right. It is a basic issue.

The other problem is the current deductible and surcharges are such that the annual expected losses are not covered by what we can collect, so it makes it worse in terms of ...

CHAIRMAN GREEN: But, listen to me. At Loma Prieta we had no \$15,000 worth of insurance and 25,000 of those people would have been covered. We, the Legislature, put a billion dollars into that. And so when you say to me it wasn't covered, then it doesn't go in here and come out the other side because we did take action to make sure that those people were covered.

MS. DOLAN: Senator Green ...

CHAIRMAN GREEN: So you have to have a combination of thinking.

MS. DOLAN: If it were possible for you to put a General Fund commitment or a State guarantee to the unfunded liability, we would have no problems with this program. The problem that we have is it appears as insurance when you collect it through an insurance mechanism and people think that they will have a certain amount of coverage. And, in the early years, or if the surcharge or deductibles are not changed, we will be faced with proration unless the Legislature comes to backfill for the program. Now, the Legislature did, you know, raise revenue through a quarter-cent sales tax and it made a lot of changes and helped a number of people. Whether or not the Legislature would see fit to backfill in terms of a deductible given the other drains on things like highways or public buildings, I don't know, and I think that that would be an issue that they would address.

ASSEMBLYMAN AREIAS: Can I - I want to interject here for just a minute. When the fund was fully funded, how much was in it? It was 1. - \_\_\_\_\_: It was \$400 million a year.

ASSEMBLYMAN AREIAS: Yeah, but then it went up to 1.7 billion. Wasn't it 1.5 or 1.7 billion. I mean if you have an earthquake of the magnitude that you're talking about that would force the kind of proration and return dimes on



the dollars, let me tell you that our priorities as the Legislature are going to change significantly anyway, just like they did with Loma Prieta.

It's increasingly clear to me that this is not bad policy, it was never bad policy, it's bad politics, and it's always been bad politics. It was bad politics the day after Loma Prieta and it's just getting worse and worse and worse, and I'm convinced that a part of any preparedness plan has got to include comprehensive mandatory earthquake homeowners insurance. We talk a lot about preparedness and we talked a lot more about it in the year after Loma Prieta, but of all the things that we do, the most heroic act of all is to be prepared. And if you're going to be prepared, you need this part of the equation. I mean I'm not hearing anything that indicates to me that this is an insurmountable problem. The politics may be insurmountable given the worsening economy and maybe changes in the insurance industry, but we still have got to put a shelf-ready proposal in place. And if the politics don't allow it right now - I mean all of us know something about politics - we've got to have that proposal in place so that the next opportunity in terms of an improved economy or another earthquake, heaven forbid, that we can put this plan into place. I mean, I'm not hearing anything that makes this insurmountable.

CHAIRMAN GREEN: Well, you know, and you're absolutely right. There is a gamble to doing this and there is no way you are ever going to take totally the gamble out, because if you have this start January 1st, which the law says it will happen, and if you don't have any money there, you can't pay off.

Now, if you were to look at the time that has gone by, six months, and figure \$400 million a year in collections, you would have \$200 million sitting in your Fund today. And then if we go through another year, you'll have a \$400 million figure plus the \$200, and that's \$600 million.

The administration of the Fund is very critical. Now we're going to get further down into the hearing and I understand you've even authorized building a new building. Where are you going to put these offices. See, we hear a lot of rumors of what's happening on this and if you ...

MS. DOLAN: Is it the Department of Insurance? I haven't heard that.

CHAIRMAN GREEN: Sal. Can you help me with this one?

MR. SAL BIANCO: What Senator Green is alluding to is the Department's RFP and the building in Natomas, and the details on the building in Natomas. Whether the building is being - The questions were was the building being constructed prior to the time; is there a lease for the building; who's building is it? Those were the questions that Senator Green's going to get into.

MR. HOLDEN: The building you're referring to is Computer Sciences

Corporation's Career Fund Operations Center, and that is a leased building and is a building that has been there. They are leasing out a portion of the building and currently, right now, they're having tenant improvements made so they can occupy the building and run the program from there. That will be the location of the data center and where Computer Sciences Corporation staff will reside.

CHAIRMAN GREEN: Well, we'll get into a whole raft of questions on how you handle that part of this insurance program, so let's get back to the agenda.

And I asked the question, No. 2. - Sal, did you have a question on mandatory participation?

MR. BIANCO: Yes, Senator and Members. I'd like to ask one quick question before I look at the written record. Could you tell us whether or not the May 22nd amendments added to Senate Bill 412 were finally removed from that bill? Those were the amendments you had a great deal of problems with, the amendments that were added as it related to mandatory. Do you recall?

MR. HOLDEN: I don't recall the - what those amendments did specifically.

MR. BIANCO: OK. Well then, let me just ...

MR. HOLDEN: Were these in Senate Insurance, Davis amendments?

MR. BIANCO: Yes. Were those amendments deleted?

MR. HOLDEN: They were.

MR. BIANCO: OK. If they were deleted, then let's look to your memorandum to Steve Sutro dated July 12th, from you to Steve Sutro, it's a document that's already been handed out to the Committee the last time. Let me quote, if I might. You go on to say "as I mentioned to you, the amendments to SB 412 adopted in Senate I.C. & C. at the request of Senator Davis undermine the financial solvency of the California" - of the Fund, I'll just paraphrase - "The amendments I am particularly concerned about undermine the Department's ability to make participation in the program mandatory and shift interest earnings from the Fund to the coffers of insurance companies. We urge that the Committee amend out the May 22nd amendments as specified."

And then under mandatory participation you say, "The strike out text on page 5, lines 1 through 6, represent provisions that in our view would have provided sufficient authority for enforcement of mandatory participation in the program. These provisions would have permitted the adoption of regulations that make nonpayment of surcharges required under the program equivalent to nonpayment of premium. Homeowners that refuse to participate would therefore have to face a notice of cancellation from their residential fire insurance carrier. This approach was discussed extensively and has the endorsement of the

Governor's office." That latter point I'll get to in a moment. "The amended provisions on page 5, lines 7 through 19, undermine mandatory participation and allow homeowners to pay into the fund program on an installment basis. Mandatory participation is undermined because surcharges under the May 22nd amendments are no longer part of premium and specific authority for the Commissioner to adopt regulations to enforce participation was deleted. Installment payments to a hazard program are dangerous because additional enforcement activities are required and interest income that can be received under the Fund is reduced."

One final note, you say, "Senator Hill proposing amendments in the July 16 hearing", that would be Assembly Insurance, "that'll allow all homeowners in the first year of the program to be covered until their first renewal date." And then you go on on the free rider.

So my first question is, did the May 22nd - and then you have attached the amendments that you propose. Were those amendments adopted by the Assembly Insurance Committee?

MR. HOLDEN: No, they were not.

MR. BIANCO: Were they adopted at all before this bill went to the Governor?

MR. HOLDEN: I think the only thing that was adopted was the last sentence: "The Commissioner shall adopt regulations to implement this subdivision." It was not - the surcharge was not included as part of the total amount due on premium.

MR. BIANCO: So therefore, the amendments that you suggested for deletion were never deleted from the program, deleted from that bill?

MR. HOLDEN: The amendments were taken out. These amendments that - the proposed amendments that you have were added in only in part, really only that last sentence.

MR. BIANCO: So, as a result, those amendments made in the Senate Insurance Committee remained in the bill? They were removed from the bill.

MS. DOLAN: They were removed.

MR. BIANCO: If they were removed from the bill, in the process of their removal, what makes that different than what you say in your memorandum that says if you take them out, you've dealt with mandatory? Maybe you can help explain that, that's my confusion.

MS. DOLAN: It just has to be read with the amendments.

MR. HOLDEN: Yeah, it really has to be read with the amendments in there, and what the amendments say is that the only thing that is there, the only

change from existing law is the Commissioner shall have authority to adopt regulations under this subdivision. That is the only change.

And a note - I should note this on timing because this came up before on the regulations and the appeal of the regulations, the emergency regulations were approved by OAL on September 16th. However, SB 412 was not approved by the Governor until October 14th, I believe, 13th or 14th, so there would have been - we couldn't have appealed to OAL based on 412 since it was not yet law.

SENATOR HILL: Well, then, does that mean that that provision which we put into SB 412, the Commissioner has broad authority, was not part of the OAL decision when that decision was made?

MR. HOLDEN: That's correct. Could not have been because it was not chaptered.

SENATOR HILL: OK. So that provision which we thought we gave to the Commissioner the authority, you went ahead with regulations before that bill was chaptered into law?

MR. HOLDEN: As we were required to, right.

SENATOR HILL: The OAL looks at it and says you don't have the authority to do that and turns them down. Two weeks later a bill gets chaptered into law specifically says a Commissioner has authority to implement these regulations, and you guys don't do anything with it? At that point you don't decide well the whole game is changed because OAL has to look at a new piece of legislation, or a piece of legislation which now has been chaptered into law?

MR. HOLDEN: OAL was very clear in saying that specific authority needed to be there for ...

SENATOR HILL: But two weeks later a bill passed that said the Commissioner has authority to implement regulations to enforce the provision.

MR. HOLDEN: There was similar language in SB 2902 in terms of authority to adopt regulations, and that is what we based our ability to adopt regulations. The language is not that much different between the current existing law at that time, SB 2902, and what was in SB 412.

SENATOR HILL: But you cite a couple of times and I guess OAL cites a couple of times, saying, "well this mandatory issue has not been dealt with". Yet, indeed, the mandatory issue was dealt with again and it just hadn't been chaptered into law yet, the Governor hadn't signed that bill yet, at the time OAL made its decision.

MR. HOLDEN: It's our rating of OAL that they would not accept a provision based on that general language to adopt regulations.

SENATOR HILL: And did you ask the Governor's office to overturn the OAL

regulations, similar to what you did on the Prop 103 rebate?

MS. DOLAN: No, we did not.

SENATOR HILL: And any reason why? Any - I mean, what was the thinking on that?

MS. DOLAN: We saw your press release criticizing the mechanism that we had chosen. Commissioner also had very strong feelings that he wanted specific legislative authority for the, um, the enforcement mechanism, given the concerns that had been expressed.

MR. HOLDEN: And of course 412 was not yet chaptered. We didn't have any - we didn't even have that to appeal on.

CHAIRMAN GREEN: OK. I think Sal has another follow-up question.

MR. BIANCO: Yes. Um, to follow up to Senator Hill's question. If 412 was now chaptered into law, do the new regulations, not the emergency regs, but the draft regulations; i.e., the basis for the tomorrow's hearing. They're going to become effective in January. Am I not correct? Do they reflect the provisions of 412 as chaptered law?

MR. HOLDEN: They reflect the provisions as they pertain to condominiums and other things, but we have not, uh - we have not dealt with the mandatory enforcement.

MR. BIANCO: OK. So therefore, neither the emergency regs nor the new regs that will supersede the emergency regs reflect yet the provisions of 412 as it relates to how the Legislature changed the May 27 amendments added into 412 by the Senate Insurance Committee. Is that correct?

MR. HOLDEN: It's correct, but neither version contains the mandatory enforcement.

MR. BIANCO: May I ask a follow-up question?

CHAIRMAN GREEN: Sure.

MR. BIANCO: OK. I'd like to turn for a moment to your letter of June 24th to the Governor. In that you say, on page 3, on mandatory participation, say "consequently, I am having my staff study whether I would have the authority to issue regulations that will make the program mandatory. I am alerting you to this problem because a legislative solution still may be necessary to insure that the program is truly mandatory and therefore widely subscribed." My question on what I've read to you is what was the result of the staff's study and does the Governor's office know, as a follow up to this letter of June 24th, what you found? I didn't find it in any other documentation that went to the Governor beyond that date, so I'm just wondering if there was just a document you did that we haven't seen.

MR. HOLDEN: There was not a study, per se. There were discussions about what we could put in the emergency regulations and we did put - we believed at that time that we could put in the provisions that would make it mandatory through renewal and new issuances. When OAL struck that down we had a change of, uh, a change of thinking on that. They were very specific in terms of wanting specific legislative authority.

MR. BIANCO: OK. \_\_\_\_\_: Which didn't come for two weeks.

MR. HOLDEN: Which didn't come for two weeks and I think it's arguable that it's specific in that it doesn't prescribe an enforcement mechanism.

CHAIRMAN GREEN: But don't you put yourself in the position of passing judgment without giving OAL a regulation. How can they make a ruling whether it's right or wrong? Don't you think that you should've taken the effort to pacify OAL?

MS. DOLAN: The Commissioner concluded, based on the information provided, that he did not want to propose another onerous regulation without further direction from the Legislature.

CHAIRMAN GREEN: Well, it's not the Legislature's responsibility to administer this fund. It is the responsibility of the Insurance Commissioner. Did you take the other step and contact the industry and have suggestions from the industry on how this mandatory participation can be handled?

MS. DOLAN: There have been numerous discussions on the mandatory provisions with the industry. I'm sure they will comment on their feelings about that provision.

SENATOR HILL: Mr. Chairman. I don't think we need to spend a lot more time on the mandatory issue, but I just want to make this observation.

There's going to be another earthquake. There's going to be another earthquake, the Legislature is going to race back to Sacramento in a special session. We fell over ourselves to spend \$400 million out of the reserve fund to put into the Whittier quake. We fell over ourselves, raced up to Sacramento, we couldn't give money away fast enough in terms of new programs and new ideas. After the Loma Prieta quake we raised the sales tax to finance, I think it was \$1.4 billion in rebuilding when we went back. There's going to be another earthquake and the Legislature, unlike the statement which the Commissioner has made and you repeated today, that people will be paid cents on the dollars. My prediction is the mentality will be exactly the opposite, that we will be figuring out whatever it takes to fund that program.

And I agree wholeheartedly with Mr. Areias's comment that we need to be prepared, we need to put a program into place. To rub our hands about well this

mandatory issue, we didn't get the regulations, we didn't have the bill for two more weeks. We're just missing the boat, and I think the issues in terms of whether the fund is sound or that the different actuaries - you know, we have these dueling actuaries. I will point out to you that those actuarial assumptions did not come from me as the author of the bill, did not come from the Legislature. Those actuarial assumptions came from the Department of Insurance. Now there was a different Insurance Commissioner, I'll save you that breath, a different Insurance Commissioner, but ...

MS. DOLAN: Thank you. (Laughter.)

SENATOR HILL: ... I see some of the same players right here who pushed that bill through the Legislature who worked for the Department of Insurance are still here in public policy positions today in the office. And so my point is how am I supposed to know whether that program is supposed to be \$12 to \$60, \$25 to \$75, if it's a \$51 average premium, a \$36 premium? That's all based on whatever assumptions you put in there.

We're going to have an earthquake and the first day the fund is not actuarially sound. If you had one five years down the road, it is. Senator Green's point about coming up with \$400 million a year or substantially more, I think is well taken. This program is going to go forward and I think the more we talk about it isn't going to work because of what I believe are really minor problems that your office keeps coming up with, I think the more irresponsible that we're being in terms of putting a program into place and waiting for that rainy day.

MS. DOLAN: I think on that issue that we should proceed perhaps with the other issues about the financing or with the surcharges so that we can share the technical information. You will at least have the benefit of the information that the Commissioner had.

CHAIRMAN GREEN: Well, I guess, to finish with this mandatory participation, I still feel the Department has not done an adequate job. I would hope that you will be able to come up with some of these questions and answers that we have just given you. You can hear our concerns and December the 4th is how many days away? Two weeks away? Two weeks away. I would hope that we will hear something different from your department December the 4th. There is a way to make it mandatory. And you should not be in a position to second guess OAL. You have times of - and this Legislature did put some language in the bill to work for. It seems that you're not - you're reading into it what you want to read into it, and we are challenging that. I believe that's our position of the Committee. We want this program to work. It will work if it is administered

properly.

So with that in mind, let's go to the next issue. And it's issue No. 2 on your paper. And does the Commissioner have adequate authority to implement this program and require participation? That's what we just finished. So we'll go into the issue: is there a need for increasing the surcharge and our deductible for this fund; and what steps have been taken to obtain reinsurance to sell revenue bonds?

MR. HOLDEN: Senator Green. Richard Holden with the Department. I'll begin by giving you a brief overview while people are ...

CHAIRMAN GREEN: Can we make room here at the table - some more chairs for the insurance companies because there are some other people that will be on this issue. Yeah, this is risk management and reinsurance. Why don't you identify yourselves for the record so that we know who is here and then we'll ask questions as we go along.

MR. RALPH MAURER: I'm Ralph Maurer, Risk Manager for the State.

MR. LARRY LAWRENCE: Lawrence with Jardine Insurance Brokers in Los Angeles.

MR. HEMET SHAW: And I'm Hemet Shaw with Risk Management Software in Mountain View, California.

CHAIRMAN GREEN: Thank you. All right, now from the Department.

MR. HOLDEN: Just a brief overview. As you know, the issue of rates has been a concern since February 6th and what we decided to undertake shortly after that hearing was a data collection process, an extensive data collection process that I don't think has been done heretofore, to collect data on actual residences that are insured by residential property insurance statewide. We began that effort in March and sent out a data call to property insurers throughout the State to receive that data. Now the purpose of receiving that data was to do a risk analysis, to give us some real numbers or some better estimated numbers than we had been working with or than you had been working with last year. So, we collected that data. It finally came in from the insurers in July. All the data was received.

We put out a Request for Proposal to get loss estimates from various firms that perform this type of work, particularly for insurance companies, and are very skilled at using computer models to develop loss estimates for insurance purposes. Subsequent to release of the RFP we selected a firm to proceed with that, Risk Management Software of Mountain View, California. Mr. Hemet Shaw is here from that firm, and they undertook the process of analyzing this large data base using the software that they have developed over a number of years, in fact that were actually developed at Stanford University and is actually a licensed



product of Stanford University, and was developed, I believe, mostly at the Department of Civil Engineering at Stanford. I will let RMS talk more about that.

We put them on a very short time frame because we did want the estimates before the end of the Session. We gave them basically a week to respond to the RFP, gave all firms a week to respond to the RFP. They turned around a quick RFP. Their proposal was selected as being the best technically at the lowest cost and they have proceeded to do the loss estimation and they did it in a record amount of time, in a couple of weeks, working weekends, working nights, to get us the estimates before the end of the Session. As you all may recall we had made the commitment to provide this information. We were delayed in that because a lot of the data didn't come in until July from the insurance companies. Once the data came in, it needed to be cleaned up and prepared for this type of estimation. They prepared an initial report August 30th and we shared those results with you and your staffs September 3rd. Since then they've gone back and looked at the data, cleaned up some of the items and have prepared a final report which is in your packet that we handed out to you, the thicker packet, and there are a number of estimates. The selection of estimates that are included in that package were based on recommendations by the SB 2608 advisory committee. They suggested that we look at a number of different options and we had RMS do that, look at different deductibles, different coverages and see how the rates would shake out under those different conditions.

That report was completed and I believe it provides quite a bit of information for policy judgment, and I think the best thing for me to do is to turn it over to Mr. Shaw of Risk Management Software and he can give you further information about the model, its operation and the process.

MR. SHAW: As Richard just mentioned, several months ago we were brought in to this process to take a look at the risk to the Fund. The models we used had been under development for approximately 20 years at Stanford University, primarily. And our firm is essentially a spin-off from the University comprised of the key researchers on that project. Rather than get into the details of the methodology up front, what I'd like to do is just get straight to the results of our analyses and then address any questions you may have on the model or what we've done.

Basically, we took a look at this situation as a classic portfolio management decision process that we go through routinely with our insurance industry clients. We had a portfolio detail data that was collected by the

Department, approximately 6.2 million policies. In a sense, what we did was look at it from two different perspectives. The first perspective was that of a catastrophic-scenario basis where we took a look at this enormous portfolio of risk, given the original coverage perimeters set forth in SB 2902. We ran through our model the various earthquake scenarios that were both expected to cause the maximum amounts of damage to this portfolio, and more moderate size quakes that are higher probabilities of occurrence. And, um, those results are included in your reports. We also took a look at this particular portfolio from an annual-expected-loss basis, which essentially is what kind of annualized losses are expected over time to the Fund given the risk, given the portfolio distribution and given the various coverage perimeters. Based on that analysis, the average rate that we computed which would cover the annual expected losses, and again this is a pure premium rate which does not consider any sort of expense allocation because we're in a position to comment on that, was \$57 per policy on average per year. So that is the work that we performed. I'd be happy to discuss the details.

MR. BIANCO: I'd like - Thank you. I am familiar with your study. You were kind enough to make a presentation to all of us. I have very specific questions I'd like to ask you. Just so the Committee has it very straight in their mind.

Your study which we have is, if I'm not mistaken now, the Department of Insurance gave you data based on its initial call from 94 insurance companies. Is that correct?

MR. HOLDEN: Uh, correct. I think it was somewhat more than that, I think it was 137.

MR. BIANCO: Well, the document says 94, but I don't care. I'll go with with 137, out of approximately how many, 400?

MR. HOLDEN: It was, it was those ... Yeah, but it was all those companies that sell residential property insurance.

MR. SHAW: Right. The portion of the personalized market is substantially less than the overall industry.

MR. BIANCO: And then you took that data and you made various assumptions in order to come to some kind of a data base that brought the numbers to six and a half million homes. Is that - am I saying that correctly so far?

MR. SHAW: Well actually the assumptions - we had a set of data record by record. In fact it's not just based on our computer systems, but we did not - done an earlier study in the beginning of where we had to make assumptions of what the actual portfolio looked like because we didn't have access to all the data. The final series of analyses actually used the entire data base to draw

our conclusions from.

MR. BIANCO: OK. Did you use the data that was available to you from the lending institutions when you talk about the large data base? Is that what you mean?

MR. SHAW: No. We used the data that was provided by the Datacol (??) from the Department of Insurance.

MR. BIANCO: OK. Only the Datacol.

MR. SHAW: Right, only the Datacol.

MR. BIANCO: All right. And you excluded some 16,000 residences, I believe, because of the fact that the data was insufficient for you to consider. Is that correct?

MR. SHAW: There are in any data base, we're looking at approximately 6.3 million records, there's going to be data in there that's not entirely complete, or in some cases even corrupted. So there may - there were certain records in there that may have had to have been excluded to perceive the analysis, but it was essentially a very minute percentage of the overall portfolio.

MR. BIANCO: And then you took the 6 million residences and you calculated a catastrophic earthquake occurring which would have been of what Richter magnitude? I think I know the answer, but I'd like you to tell me.

MR. SHAW: We actually took a look at several. We took a profile - we model in our various data bases approximately 227 faults.

MR. BIANCO: Right.

MR. SHAW: And we can simulate any number of magnitudes on any one of those faults. The largest quake that we simulated was a magnitude 8.3 on the San Andreas Northern Segment, which is essentially a replay of the 1906 quake.

MR. BIANCO: OK. And that produced a catastrophic loss of around \$10 billion, if memory serves me right.

MR. SHAW: Gross, about \$5 billion falling to the coverage provided by the Fund.

MR. BIANCO: OK. \$5 billion. And of the the \$5 billion, then you annualized it over 20 years. Am I correct?

MR. SHAW: That was one perspective we took a look at this with.

MR. BIANCO: OK. Under that perspective, then it was a \$400 million a year annualized loss. Is that right? Go ahead, tell me the probabilistic. Or tell everyone else.

MR. SHAW: Yeah. The methodologies that are used - they're essentially - when you take a look at risk to earthquake, there's two ways to look at it. One

way is what we call a deterministic analysis. Which is, given a portfolio of risk, such as the 6.3 million dwellings; given a defined earthquake event, what is the scenario losses to that particular event. That is, earthquake occurs, what are the losses. That's nice to know for planning purposes, what kind of claims that are expected. It does not give you a very good feel for the frequency of loss, but just the severity of loss.

MR. BIANCO: All right.

MR. SHAW: So we took a completely different look at the risk from the perspective of frequency as well as severity, where we employed a what's called a probabilistic loss model. Which essentially, on an annual basis, considers the possible loss contributions from every fault in the data base, every conceivable magnitude that may occur, and essentially aggregate those losses on a probabilistic basis. So what we did not do is we did not say the loss in the San Andreas situation will be an \$8., uh, \$10 billion or \$5 billion to the Fund and divide that by a number of years to come up with \$400 million. We actually looked at it from a completely different perspective.

MR. BIANCO: And that perspective is the 227 faults?

MR. SHAW: Correct. So ...

MR. BIANCO: OK. Now when you did - I'm sorry, I didn't mean to interrupt you.

MR. SHAW: Oh, OK. So as yeah - so we took a look at ...(inaudible)... We did not make any sort of preconceived decisions on what particular earthquakes might occur. We looked at it probabilistically; that is, given a given fault which may have a probability of having certain faults over a certain year and given each one of those earthquakes occurring, there'll be a certain damage. You can sum up all of those particular events probabilistically, sum that overall 227 faults and take a look at the losses to your particular portfolio.

MR. BIANCO: I think I heard what you said, but I'd like to repeat it in my words. You tell me if i'm wrong. What you're saying is that you use - probabilistically you said over a 20-year period 227 faults were going to move? Were going to experience an earthquake of some magnitude on them? Is that what you've said to me?

MR. SHAW: Varying probabilities of occurrence over any given time.

MR. BIANCO: So some might and some might not. San Andreas might move once or twice ...

MR. SHAW: Correct.

MR. BIANCO: Or not at all.

MR. SHAW: Or X times.

MR. BIANCO: Or X times. Basically does every one fault move in your scenario, in your probabilistic scenario?

MR. SHAW: Well, each particular fault has a probability of a various size earthquake occurring over any given time frame. I mean, they might - for certain faults it might be quite low, for certain faults it might be quite high.

MR. BIANCO: I know we have an expert that can talk more about that, but just let me ask a quick question right here though. San Andreas: what's the probability in your model? My numbers show about every 30 years. Now, what did you find? Did you have it move once in 20 years?

MR. SHAW: Well, I think it's that you're - the perspective that you're taking is slightly off, given - it's that we're not looking at fault movement, we're looking at probability that certain magnitudes might take place. For instance ...

MR. BIANCO: OK.

MR. SHAW: ... we showed in our model there's approximately a three to four percent chance in the next 30 years we'll have a replay of an 8.3 magnitude. Now the probability of a magnitude 7 is substantially higher and a 6 is even greater than that. So when you take a look at losses on an annualized basis, you have to consider the entire spectrum of possible magnitudes that might occur on each fault over all the faults in the data base.

MR. BIANCO: OK. I'm sorry to take this time, but I want - so we fully understand what you've done here. Now, in saying that then, if you looked at the actual Loma Prieta earthquake loss that took place in 1989, and now I'm referring to a document that the reinsurance intermediary sent out, they calculate a loss of \$144 million, for Loma Prieta. Now, what did you calculate Loma Prieta?

MR. SHAW: We've calculated a loss of approximately \$700 million for Loma Prieta.

MR. BIANCO: How? How did you do that?

MR. SHAW: Well, there are - I guess I - I try not to get too much into the depth of the methodology, but essentially ...

MR. BIANCO: Well, maybe I should just stop and not do that to the Committee. But the thing is, your number is around \$700 million. The document that has been circulated to reinsurers suggests \$144 million. Am I correct?

MR. SHAW: Um, I'd have to look at that number. There's a number of different numbers that can be associated where the losses are participating, but ...

MR. BIANCO: We also know that whether you use Assemblymember Areias's

number of 25,000 homes or other numbers of 18,000 homes and multiply it by even \$15,000, I don't even think you get at \$700 million. But now let's use your \$700 million for a moment. Have you subtracted - did you assume that that loss was based on the enabling legislation's definition of coverage and deductible, No. 1?

MR. SHAW: Correct. Yes.

MR. BIANCO: OK. You've done no further analysis - You've not been asked, I should say, to do any further analysis as it relates to the trailer legislation and regulations that further define deductible, etc. Is that yes or no?

MR. SHAW: We have done a series of what we call sensitivity studies to see how various changes in the deductibles of coverage terms insurance would affect the total losses, yes.

MR. BIANCO: OK. If you look at the reinsurance document that's being circulated, it's suggesting that we're looking at coverage at 5.5 million residences, not 6.5. Do you happen to know why there's a million discrepancy?

MR. SHAW: No.

MR. BIANCO: OK.

MR. LAWRENCE: Perhaps I can help explain the differences between some of these numbers.

MR. BIANCO: Um-hum.

MR. LAWRENCE: My firm was involved in putting these alternate numbers together. As I mentioned, I'm with Jardin Insurance Brokers in Los Angeles. For many years we've been involved in the purchasing, on behalf of the Department of Veterans Affairs, the insurance for the Cal Vet program. The Cal Vet program in California has represented, over the years, approximately one and a half to one percent of the statewide residential population. And the Cal Vet program for earthquake insurance was in effect for both Whittier and Loma Prieta earthquakes. In the Whittier earthquake that loss - as I recall, the Cal Vet program was about one and a half percent of the state population. That's a declining base as loans are paid off. What we did on Whittier, in order to do our own estimates of loss, is we took the Cal Vet loans that were in the effected zip codes and changed the model to reflect the total population within those zip codes, exclusive of Cal Vet, which is not in this program.

MR. BIANCO: So, to stop you for a second, what you're saying is that his .65 million residences included Cal Vet and yours did not?

MR. LAWRENCE: No, that's - Well, the Cal Vet would be a very small difference.

MR. BIANCO: OK.

MR. LAWRENCE: I mean whether it did or didn't include them because Cal Vet is, say, 80,000 residences today.

MR. BIANCO: I think it's - I think your letter says 70,000, that's OK.

MR. LAWRENCE: Or 70,000 today. And we're talking about six and a half residences in the state. It would not be a significant difference, but the main reason for the five and a half million is with the evolution of 2902 and the finding of the Office of Administrative Law that we cannot - the Department cannot put teeth in the mandatory aspects of it, in order to get moving with respect to placing of the insurance and reinsurance, we just made an arbitrary assumption that 85 percent of the eligible properties would actually be in the program. Obviously, that's going to be wrong, high or low. But we had to get going in order to try and put insurance in effect.

MR. BIANCO: OK.

MR. LAWRENCE: So that was the reason for this change in numbers.

MR. BIANCO: So the RMS study figures 100 percent participation and you say 85. That's a 5.5 and you've backed out various types of residences that would not be eligible.

MR. LAWRENCE: Correct.

MR. HOLDEN: I'd like to note that the portfolios are really quite different. The Vets Affairs is a home loan program that basically is a low-income loan program. There's a limit in terms of the value of houses. I think the average value of a house in that program is - Ralph you can correct me, but I believe it's in the 80,000 range. Whereas the numbers for the RMS portfolio that we did were well over 100,000 - 130,000 I believe. So there is a big difference in terms of that. There's also a big difference in terms of where those homes are located. Those Vets homes are not located in beautiful hillside areas, as well.

MR. BIANCO: That's fine. I appreciate that, Mr. Holden, but I think the Committee, the Subcommittee understands that that's already been backed out of the equation. What I do want to know about is whether or not your \$700 million estimation for Loma Prieta included - is that loss, and have you backed out of that loss any other type of coverage that would reduce the \$700 million? Or is that, for spare use of a better term, pure loss?

MR. SHAW: If I can back up just one minute. The \$700 million loss actually ties quite well with what actually happened. If you'd like to look at the actual insured losses that are - the data that's available, excess of deductible which is generally a 10 percent deductible, vis a vis quake, the insured claims were approximately \$3 or \$400 million for that piece alone. The piece that the

Fund is participating in is the piece essentially filling that deductible gap where a vast majority of the losses fall for residential, especially wood-framed, dwellings. And so while we don't have a final confirmation on the data, the data that we do have suggests that the estimate of \$700 million loss to the Fund seems to tie quite well with what actually happened back in 1989.

SENATOR HILL: Is that based on everybody getting the full \$15,000?

MR. SHAW: That is correct.

SENATOR HILL: But common sense tells you that there were 89 - I means it seems to me there was some figure in the neighborhood of \$9,000 - that typical damage was \$9,000.

MR. SHAW: Correct. That ties quite well with the data we have that shows that when you take a look at actual losses collected by the insurance industry, \$3 to \$400 in claims were paid excess of the 15 or 10 percent deductible.

SENATOR HILL: Um-hum.

MR. SHAW: So most of the losses under a quake actually are falling in any quake, especially wood-framed construction, will fall between essentially 0 and approximately 10 percent damage to a structure which is around \$15,000 for a typical replacement cost structure. So \$700 million loss estimate to the Fund, if the Fund were in place during the time of the Loma Prieta, of \$700 million is quite reasonable, actually.

SENATOR HILL: And that's based on everybody who has a structural damage getting the \$15,000.

MR. SHAW: That's everybody who's participating in the program receiving full compensation within the perimeters - the coverage terms.

CHAIRMAN GREEN: It is becoming quite apparent to me that what you've done with these numbers is you've taken a worse-case scenario.

MR. SHAW: We've taken a number of scenarios. I mean if you take a look at the worse-case scenario which is - would be by our analysis a repeat of the 1906 quake, we're look at approximately \$5 billion of loss to the Fund which would require about 15 years to fill up. We took a look at a number of more moderate quakes as well. And we took also a look at what the loss would be on an average basis on an annual basis.

CHAIRMAN GREEN: Did you ask any questions of predictability of earthquakes to the experts that are in this field?

MR. SHAW: Correct. That's all we do ...

CHAIRMAN GREEN: And I think that you needed to equate some of that knowledge into the predictability of what the quake is going to be.

MR. SHAW: Correct. Actually, Senator Green, when we - that's why we take a



look at the loss from two perspectives. One is this - what we call the scenario loss, which is given some relatively severe events, what kind of losses might be expected. And that is to a certain degree a high-risk, worse-case type perspective. To balance that we also took into the losses on a - what are they expected to be on an average annualized basis where we don't necessarily assume that these back earthquakes happen. Because when we looked at them on the annualized basis and that's where we computed that the annualized losses would be approximately \$4 - \$360 million per year to the fund.

CHAIRMAN GREEN: But I might say to you that since 1800 that hasn't happened.

MR. SHAW: Excuse me?

CHAIRMAN GREEN: That hasn't happened since 1800 by the paper that's in front of me. The amount of quake that we've got and we have earthquakes - record of quakes in this state since 1800. Since 1906 we have kept the damage in millions of dollars. And it does not equate to the dollars that you're giving us right here at this committee.

MR. SHAW: OK. Well, it sounds like we're talking at various different levels here and we might be referring to the same numbers in different ways.

SENATOR HILL: Senator Green?

CHAIRMAN GREEN: Yes.

SENATOR AREIAS: Can I interject here for a minute? Has the Department of Insurance determined which losses are going to be covered and which aren't going to be covered yet? Have those regulations been adopted? Have they?

MR. HOLDEN: Yes.

SENATOR AREIAS: Which losses are going to be covered and which aren't going to be covered? Outline them for me.

MR. HOLDEN: If your question is have we determined whether certain earthquakes will receive coverage and others will not?

SENATOR AREIAS: No, no, no. Individuals' claims. I mean which claims? What types of claims are going to be adopted? Those regulations haven't been adopted yet, have they?

MR. HOLDEN: That's correct.

SENATOR AREIAS: OK. Then how can you talk about losses that are going to be covered or that there are going to be annual losses to the Fund when we don't - when you haven't even adopted regulations that determine which claims are going to be accepted and which ones aren't, which are going to be covered and which ones aren't?

MR. HOLDEN: Mr. Areias, I'm sorry, I misspoke. We have adopted

regulations. Those are the emergency regulations that were adopted August 30th. We will be adopting final regulations and what we cover is structural damage, we do not cover contents, and we do not cover habitability expenses.

SENATOR AREIAS: You mean structural damage. I mean, that's a pretty vague and broad term, structural damage. I mean within - under the umbrella of structural damage ...

MR. HOLDEN: But there's detail in the legislation that says the focus shall be on habitability, it's not going to cover sidewalks, driveways, pools, spas, fences, ...

SENATOR HILL: The cosmetics. That's correct.

MR. HOLDEN: etc., etc. that kind of ...

CHAIRMAN GREEN: OK. I think at this point I'd like to get Lloyd Cluff up here to talk about earthquake predictability. If you would come to the rostrum. I don't think there's a seat, but there is a microphone right there.

SENATOR HILL: Mr. Chairman. I want to make another observation, and that is, I've been through this before with these actuaries and I ...

CHAIRMAN GREEN: So have I. (Laughter.)

SENATOR HILL: Actuaries are guys who don't have the personality to be accountants. (Laughter.)

Everybody bases some scenario and defends it to the death about how much the claims are going to be, whether it's going to be \$700 million or \$145 million. And I guess my question to the Department is I'd like to have the actuaries from the Department who created the original program, who came up with the original numbers. I'd like to hear their - because they will make an impassioned defense about how their numbers held together. And I think the critical point that Mr. Bianco was pulling out is that it's all based on what assumptions you put into it.

CHAIRMAN GREEN: That's right.

SENATOR HILL: We're going to have an earthquake, an 8.3 earthquake like the 1906 earthquake. Here's, you know, it's going to cost us X amount. If we think we won't have a Loma Prieta style quake for three years, this is what we think the program's going to cover. Even the assumption that everybody is going to get the full \$15,000, which we know from our testimony that the average structural damage was \$8,000. All these different assumptions can come up with actuaries who will defend to the death their numbers and I'm positive that under their scenarios, they're probably absolutely right. And the question is what scenario do you buy into and at that point, you know, what level of payment and deductible and surcharge ...

CHAIRMAN GREEN: Well, I think that's why I made the statement that what I'm hearing is the worse-case scenario.

MR. HILL: Which I understand there's no insurance company in the State would be in business if we have that ...

CHAIRMAN GREEN: If they use those figures in the industry, they would not be insuring.

MR. SHAW: Excuse me. As far as - I think there's been a bit of miscommunication between the two of us on this; i.e., worse-case scenario, especially, vis a vis the \$15,000. When we did our analyses, we assumed that the coverage limits were \$15,000, not necessarily that a dwelling would suffer \$15,000 under a given level of damage.

SENATOR HILL: OK.

MR. SHAW: So when we did our analysis we actually tried to model the actual loss to that dwelling and then compare that loss to the coverage perimeters, deducted out any deductibles and if it exceeded the coverage limits, we maxed it out at the \$15,000.

SENATOR HILL: And you estimate that the program ought to be a \$57 average?

MR. SHAW: Based on our analysis, yes. Yes.

SENATOR HILL: And I guess that's the second part of the frustration. The program was initially drafted on a \$36 average premium between \$12 and \$60. Commissioner held a press conference several months ago and said "well it has to be \$119" I remember, "otherwise it's unfunded. But maybe we'll appoint the advisory committee and let them go out and look at it." They come back and say \$51, as I recall. Is that right? Their estimate was it had to be a \$51 number. Or \$25 to \$75 during that range. Now I've got a fourth number, \$57. And I guess one of my questions to the Commissioner would be, you have total authority within \$12 and \$60 to set any rate that you want to. One of the ways to make the program actuarially sound, I guess according to even this scenario that has been laid out, let's make everybody a \$51 average premium - everybody a \$57 premium - charge everybody \$57.

MS. DOLAN: That was an issue that was considered. The recommendations of the advisory committee and the Commissioner was that the surcharges should be levied based on the risks so that to charge a person in at-low-risk areas a \$60 seemed to be very inequitable to pay for the losses of the high-risk areas. And therefore ...

SENATOR HILL: But the point is ...

MS. DOLAN: ... we have taken what we thought would be equitable for the consumers in California.

SENATOR HILL: And so the scenario that you have based this on is based on - rather than a \$60 top premium would be a \$75 top premium. Is that right?

MR. HOLDEN: That's correct.

SENATOR HILL: You're asking for \$25 to \$75.

MR. HOLDEN: \$12 to \$75 is what the Commissioner asked for.

SENATOR HILL: OK. \$12 to \$75. It was \$25 to \$75.

MR. HOLDEN: That's correct. And the Governor indicated \$12 to \$75 would be more acceptable.

SENATOR AREIAS: The carrying, you know, carrying that logic out further, Senator Mello and I carried the quarter-cent sales tax increase bills which raised \$800 million. There were people that were non-homeowners that paid their quarter-cent sales tax. People that lived in areas with the lowest seismic risk in the state paid out their quarter-cent sales tax and we raised the \$800 million. I mean, we're one State. When there is a major earthquake, another earthquake like the Loma Prieta, people are going to pay one way or another. The only question is whether we're going to have this legislative mandated program in place as a preparedness vehicle to disperse the money expeditiously so that people can get their lives back in order. If it's not, then what we're going to do is we're going to trot up here, as Mr. Hill said, and raise the sales tax by whatever the necessary amount is so we can match whatever Federal funds are available and help people and communities put their lives back together. But we're going to be putting the program together again ad hoc, new Legislature, with probably little experience in this area, putting it together with Band-Aids and bubblegum and nail polish.

CHAIRMAN GREEN: Let's hear it from the Seismic Safety Commission at this point, and it's Lloyd Cluff who is the predictor of earthquakes.

MR. LLOYD CLUFF: Yes. I'm Lloyd Cluff with the Seismic Safety Commission. I'm an earthquake geologist and have been involved in the two definitive reports on forecasting earthquakes that were published under a US Geological Survey publication, one in 1988 on the probabilities of large earthquakes occurring on the San Andreas Fault system and a publication then on the San Francisco Bay Area, 1990, on the probabilities of large earthquakes in the San Francisco Bay region.

So maybe rather than me talking, you could ask me some questions.

CHAIRMAN GREEN: You've heard the testimony today, especially on the predictability and basing these rates on the worse-case scenario. From what we've heard, would you come to that same conclusion?

MR. CLUFF: Well, I, uh, I think that was explained, I think, by Mr. Shaw,

and the difference between using a worse-case deterministic scenario basis opposed to a probabilistic method. And I would agree with what I think he said, the probabilistic way of modeling this is a much more appropriate way because there are certain segments of some of our faults that have a very low likelihood of releasing damaging earthquakes and there are others that have a high likelihood of releasing damaging earthquakes. And if that is - that input data is adequately modeled and then the assumptions that go into looking at the consequences of a certain earthquake occurring, that has a high likelihood of occurring - if those assumptions are accurate, then you should be able to match reality in a probabilistic model. So I support the probabilistic approach rather than taking a doomsday approach in assuming that 1906 is going to be repeated. Our study in this report concluded that the likelihood of that earthquake occurring in the next 30 years is less than 2 percent.

CHAIRMAN GREEN: So its - to have a magnitude of 8.0 on the Richter scale in the next 30 years which is where the high - the \$10 billion cost would happen, is only 2 percent of the chance of it happening.

MR. CLUFF: That's right.

CHAIRMAN GREEN: So when we reach assumptions, then we come to the conclusion on the assumption that - then that fund will not be hit that heavily - the \$10 billion in the next 30 years.

MR. CLUFF: That's right. The likelihood of that occurring, say, in the San Francisco Bay Area is very low. So I would say the one that you should worry about is a more likely earthquake which would be a magnitude 6.5 to 7 on say the Hayward Fault or the Peninsula segment of the San Andreas, which nevertheless would still do a lot of damage, but that would be a more likely one to look at.

CHAIRMAN GREEN: But it wouldn't do the kind of damage that a one like in 1906. Even the Loma Prieta was a 7.1.

MR. CLUFF: Yes. Right. Uh, of magni - I don't know - I would like to ask them some questions, but what's the consequences of, say, a magnitude 7 earthquake on the northern segment of the Hayward fault. In my judgment that's a very likely event and could be extremely catastrophic because that's right in the heart of the San Francisco Bay Area. I haven't seen the results.

SENATOR HILL: Mr. Chairman. I wonder if we could have the actuaries from the Department of Insurance who designed the original program, if they could come forward. I mean, I remember going through similar scenarios saying if it's this kind of quake, or you don't have, or this magnitude, etc., etc., this is what the numbers ought to be. And maybe they could give us the assumption. I'm having a tough time figuring out what the difference is.

MS. DOLAN: ...for the next hearing. I would like to say that the data that is available because of the datacol (??) that we asked for on each home that we thought would be covered is much more extensive and the modeling that we've had is a lot more than what was available to our actuary. The other provision, when I discussed the issue with him and the Commissioner, about the differences in the numbers as they were coming from the various individuals who had done projections which were all higher than his, he felt that it was actuarially sound based on the assumption that you have pro rata. So we need to be real clear about what he was saying, and I think that you certainly were advised by him. We actually have gone out, secured new data and hired people who do this on a regular basis, but we will make him available.

SENATOR HILL: You can understand what my frustration is. We could have sold this program to the Legislature, to the public at \$12 to \$75 just as easily as \$12 to \$60. It could have been a \$36 average premium or a \$51 or a \$57 - you know, that was not what the debate was through the legislative process, it was a philosophical leap of faith for me just in terms of dealing with the whole mandated issue. And I became convinced we're going to have another quake, people are going to expect the Legislature to act, the television cameras are going to be rolling, we're going to race back to Special Session and we're going to be giving the money away, and it seemed to me it made sense that in a state like California, as opposed to doing what we do where we just, you know, come back for three days and try to figure what programs we ought to put together, we ought to do what the Federal Government does. There's no special session of Congress trying to figure what programs are available for this flood or this fire or this earthquake. They have a set program in place. We should have done the same thing as well. But my prediction is the further we get away from the episode, Mr. Areias is right on target, it gets more difficult when those \$12 and \$60 premium notices start going out in January, the public is going to start squawking. All of a sudden the Legislature is going to forget about that last earthquake. The Commissioner is going to say you're never going to see your money anyhow. And to try to then put aside that rainy day or that shaky day fund, it gets extremely difficult.

CHAIRMAN GREEN: Sal. Do you have a question?

MR. BIANCO: I just was curious on this probability. Hemet Shaw, correct?

MR. SHAW: Yes.

MR. BIANCO: Yeah, I'm looking at an article that appeared in one of the Bankers periodicals. And in that article that allegedly you wrote, I guess, you indicated Loma Prieta had 18,000 damaged homes. And I'm wondering how you came

up with - if you - if this is what you wrote and how you came up with that number.

MR. SHAW: The data from the situation in Loma Prieta is sort of a moving target, and the 18,000 homes that I mentioned in that article were the best understanding we had at the time of the homes that suffered significant damage. The actual number now of total homes that were damaged to some degree is more like 24,000 or 25,000, from my understanding.

MR. BIANCO: OK. And I'm curious of this - are you familiar with this chart and did you happen to put this in, the one with all the potential earthquakes and the probability? Do you know where that ...

MR. SHAW: Yeah. That chart was put in by the CBA and it's taken from one of the USGS circulars that Dr. Cluff has been discussing.

MR. BIANCO: OK. I notice that on probability that for the North Coast an 8. earthquake is less than 10 percent ...

CHAIRMAN GREEN: He just said 2 percent.

MR. BIANCO: This is strictly the North Coast now.

CHAIRMAN GREEN: Oh.

MR. BIANCO: Northern East Bay, a 7. earthquake looks to be somewhere around 25 or 30 percent, you could correct me if my numbers - is that correct Mr. - How close am I, Mr. Cluff, to that?

MR. CLUFF: 28 percent.

MR. BIANCO: OK. And Parkfield, which is down in Monterey, for a 6. quake is way up there at about 90 percent. Thank you.

MR. SHAW: Actually the probability assumptions that we use in our model, we drew quite heavily upon the studies that we've just heard about from Dr. Cluff and both the USGS circulars. And as far as any new studies that become available, we attempt to update our models to reflect the latest findings.

CHAIRMAN GREEN: I think that one of the issues and one of our questions is: how closely did you work with your advisory committee making these recommendations?

MR. HOLDEN: We had the estimates prepared by Risk Management Software, and as soon as those were completed we provided those to the advisory committee. We had an extensive discussion that day which was, I believe it was September 2nd, but it was just prior, in fact I think it was September the 3rd, the same day that we provided those estimates to the Legislature, of the implications of the different rate scenarios and surcharge scenarios. And their recommendation, I know that they are here today so they can speak to that directly, but their recommendation was to have a rate range between \$45 and \$75 and a flat

deductible of \$2,000. We felt the lower end should be lower than \$45 and so that is why we drafted the letter suggesting \$25 to \$75. The Governor felt it should be even lower, and given the fact that there are so few properties in low-risk zones in California. I'm referring to your district, Assemblyman Areias, and other areas that are generally considered low-risk relative to the State, we felt that we could accommodate a \$12 to \$75 ...

ASSEMBLYMAN AREIAS: Wait a minute. Wait a minute.

MR. HOLDEN: You're going to tell me about Coalinga.

ASSEMBLYMAN AREIAS: No. \$100 million worth of damage in Hollister. I mean, that's the earthquake epicenter of California. I represent Gilroy and Santa Clara County. Now, what part of my district are you talking about, Monterey County?

MR. HOLDEN: Los Banos. The area more on the Central Valley.

ASSEMBLYMAN AREIAS: Right on the San Andreas Fault.

MR. HOLDEN: Well, I don't know if Los Banos - is Los Banos - I don't believe it's right on the San Andreas Fault. But there are certain parts of your district, if I understand it correctly, that are more Central Valley that are considered low-risk, both in terms of the loss estimates that were provided in terms of the Uniform Building Code which estimates risk for California and has a lot of that area as zone 3 as opposed to zone 4.

CHAIRMAN GREEN: But you did pacify the Commission and that was their recommendation?

MR. HOLDEN: That's correct.

CHAIRMAN GREEN: All right.

Why don't we leave this subject unless there are any further questions. I think we've hit this around a bunch. And let's get into reinsurance.

I guess, if you want me to start with a question and we need to know your method of selecting some reinsurance and consortium on what basis did you exclude bidders based upon price and coverage and etc. and etc.?

MR. HOLDEN: With regard to reinsurance, we consulted with the State's Office of Risk and Insurance Management which is in the Department of General Services. We consulted with them because we knew that they had in fact arranged the reinsurance for the Department of Veteran Affairs' Cal Vet program, and they had been in the market on a number of occasions purchasing excess insurance or reinsurance for that program. So they had a long experience in purchasing and in fact as you all know, the Cal Vet does have an earthquake insurance program with a low deductible. So that was our first step. We went with them and they were, in fact, involved throughout the process of designing the program,



providing input on claims adjusting, providing input on reinsurance in a number of areas. We subcontracted with that office and through an interagency agreement. In addition we brought on board the former State Risk Manager, Gene Marquart, who had been instrumental in setting up many of these coverages, and we asked them to develop a process that we could purchase reinsurance.

And what I'd like to do now is turn it to the chief of that office, the Office of Insurance and Risk Management, and he can tell you a little bit about the process. I believe we've provided some charts at the last hearing about the structure of that and he will detail that for you.

MR. RALPH MAURER: Briefly, the Office of Risk and Insurance Management is the insurance procurement branch for state government. And over the years we do get involved in purchasing a variety of insurance for - We either go out to bid or by negotiated placement, place the insurance with the various brokers throughout the State. With this particular program, being the largest insurance program we've ever been involved in, we determined that the best course of action was to use our third option that we frequently go to and that's to establish a consortium of brokers which is what we did. We recommended that to the Insurance Commissioner. We went out to the nine largest international brokerage houses, invited them to give us their proposals on how they would work together on a consortium to establish the procurement process for this program. We selected four of the nine to be on the consortium, the lead broker being Jardin with Larry Lawrence. And in addition to Jardin was Alexander and Alexander, Marsh and McClinnon (??), and Johnson and Higgins, very large and well-respected insurance brokerage houses. They in turn took over the marketing of the program, have been packaging it, preparing it, came back with a plan to us and the Department of Insurance, recommending that the reinsurance be handled through E.W. Blanch (??) on the domestic, Alexander Howdin (??) on the foreign markets, and including Bauering (??) on the excess market. Essentially, from that point on it's in the hands of the consortium and Larry Lawrence, as the chair of the consortium, is working on it.

CHAIRMAN GREEN: Question. Reinsurance is reinsurance. How did you approach it? Did you approach it from the \$15,000 deductible, I mean the policy itself? Or did you reinsure the Fund, itself? And then what was your deductible to the Fund?

MR. MAURER: The plan that came back from the consortium - and maybe I should defer to Larry on this - basically is to the Fund, not the individual. And the plan that came back from the consortium was that we initially opt for a self-insured retention of \$150 million to the State, and that we consider

purchasing various levels of excess and reinsurance above the \$150 million retention. And that is the plan that came back from the consortium which we and the Department of Insurance ...

CHAIRMAN GREEN: So you worked on an assumption of \$150 million deductible, basically is what you're talking about.

MR. MAURER: To the Fund.

CHAIRMAN GREEN: To the Fund, itself. And what kind of dollars was that premium as far as that umbrella policy.

MR. MAURER: Larry, I'll let you respond to that.

MR. LAWRENCE: Senator Green. As I recall, the - we're in the market now looking for \$350 million excess of that \$150 million retention or deductible. And the budget that we're operating on for that \$350 million is in the area of \$40 million, premiums.

CHAIRMAN GREEN: So for \$300 million you're going to be paying \$400 million, or \$40 million.

MR. LAWRENCE: Correct.

CHAIRMAN GREEN: And that would take - would make your Fund whole up to \$450 million, counting the retention.

MR. LAWRENCE: That's right. If we could anticipate that we wouldn't have more than one major loss in a given year, the Fund could sustain that loss of \$150 million and still come out whole at the end of the year after paying reinsurance and operating expenses.

CHAIRMAN GREEN: OK. This equates in my mind to a 10 percent cost of what has been said here today. We're talking a \$400 million pool. Ten percent of that's \$40 million, and so you would then have \$360 million plus your insurance. And it would have to get over for the first year, in other words, we would have this coinsurance. The Fund actually would only be at risk up to \$150 million.

MR. LAWRENCE: Assuming we can get the insurance in effect, that is correct Senator.

Also, the thing that perhaps I should mention is \$400 million now has been used quite regularly and I've had the premium to the Fund be something of a moving target. We're estimating less than that because of the 85 percent assumptions with respect to this mandatory issue and the actual number of residences and the actual rate.

ASSEMBLYMAN AREIAS: But, if it's 100 percent, is it \$400 million, right, if it's a mandatory program?

MR. HOLDEN: We're basing our estimates on the rates that we've set and 100 percent and under those two assumptions, it's \$313 million.

ASSEMBLYMAN AREIAS: OK. The rates - which rates.

MR. HOLDEN: Those are the rates between \$12 and \$60 that are based on risk that we adopted and sent out to the insurers in October.

Just a note, Senator Green. We have authorized the consortium to go out for \$350 million and they are in the process in securing that so that it is effective January 1, 1992.

CHAIRMAN GREEN: OK. So you have moved in that direction to have a coinsurance. And you feel there is an availability of that \$350 million?

MR. LAWRENCE: We feel that at least \$200 million is available, but we'll know a lot more in another couple of weeks, because we're in the market very actively now, Senator.

CHAIRMAN GREEN: OK. Sal.

MR. BIANCO: Thank you Mr. Chairman. I have a number of questions to ask.

The first one is, perhaps Mr. Lawrence or Mr. Holden can answer it. This is a letter dated November 12 from the consortium regarding the primary insurance layer, that's the \$350 million I assume we're talking about, that went out. Are you familiar with the correspondence?

MR. LAWRENCE (??): Got a letter from me, yeah.

MR. BIANCO: It's actually from Johnson and Higgins, from Mr. Shebert?

MR. LAWRENCE: I don't know the subject of that letter.

MR. BIANCO: Well, let me tell you what the letter says. This is a letter: "We are pleased to enclose specs for the caption 'Residential Catastrophic Earthquake Risk'. Enclosures include extensive underwriting data, etc. Please pay special attention to the insuring terms and coverage definitions contained in this package.

We seek your net authorization only, excluding treaty or facultative reinsurance, in the primary layer of coverage of \$100 million excess of \$150 million self-insured fund retention. The rate on line is 14.6 percent or \$146,000 per million of limit.

Despite some controversy surrounding this program, the broker consortium has a firm order from the Department of Insurance to proceed with this placement to be effective January 1, 1992, unless deferred by further legislation or administrative action. Accordingly, we seek your prompt attention and ask you to advise us by November 27 your firm or provisional authorization.

We are asking all companies writing significant California volume to participate in this program and the State has indicated they will track program participation.

Please give this proposal your most favorable consideration both from an

underwritten view and a corporate 'fair share' participation."

The questions that - and that's the extent of the letter and it has a number of interesting attachments - but the first question is, would any of you know how someone came to the conclusion in this letter that the program could be delayed, could be deferred by further legislation or administrative action? Where that may have come from?

MR. LAWRENCE: Perhaps I can answer that. The - not the language of that letter which I'm not familiar with - but we were anxious to get into the market and begin working on actually placing the insurance. And it seemed like one of the reasons that we weren't given authorization to proceed was that it was possible that there would be some Special Session to defer the implementation of the law, as there was in July. At least, we had that impression, and so in order to eliminate that as a problem, we felt we could structure the actual placement to take effect on January 1, or in the event that there was a deferral of the law, the later date, whichever was subsequent to the other, just to get moving on the program.

CHAIRMAN GREEN: (...inaudible...) Have you done that?

MR. HOLDEN: Yes we have. We did draft a letter just following that hearing and I believe you - we also drafted a letter which went to the Legislature indicating the same thing, which you should have received.

CHAIRMAN GREEN: The next point. We were put - well, we had the Caucus here a couple weeks ago and put on notice that the probability of a Special Session after the first week in December. I now have notification from the Rules Committee that the probability of a Special Session is pretty nil. So it's the - having the Legislature act, unless the Governor or the Assembly and the Senate getting together requesting a session, it's not going to happen. So, we have to go on that assumption, that there's not going to be a Special Session of this Legislature on this issue particularly.

MR. HOLDEN: We are proceeding on the assumption that the program takes effect January 1. That's why we've authorized reinsurance coverage to take effect January 1. That's why we're proceeding with our system development and that's why we're still trying to hire staff.

MR. BIANCO: Mr. Chairman. I'm wondering if it would be appropriate if you would want to ask the Department to answer for us what - for them to find out for the person who wrote the letter representing the broker consortium what "further delay by administration action" means - what they meant by that?

MR. HOLDEN: We'll be glad to check on that. We have not given them any direction to delay any of the activity. You know, it may reflect the fact that

they saw things in the media and insurers have been interested in delaying it.

MR. BIANCO: That's fine. I was just kind of curious ...

MR. HOLDEN: But we will check on that and get back to you.

MR. BIANCO: In the document, you may want to look at the following points. I will be happy to make you a copy if you don't have one. It mentions for purposes of direct physical laws that it includes damage to structure and debris removal. And I'm wondering if you might be able to tell us later where 'debris removal' came as part of the coverage as it relates to direct physical loss. You don't have to answer it right now, that's just fine.

It also, in the document, indicates that we're talking about privately-owned single-family residential structures, individually-owned condos, two-unit residential structures, etc. There's no mention about the discussion later in the agenda as it relates to condominium associations and owner-owned which thereby are rented. So I am assuming from this document that they are covered under the program, but we know that there is some discussion about some of those not being covered under the program. The only exclusion, according to the definition of residential property, is single-family structure rented for individual residential purposes. And I know that's different than a condo definition.

The document also talks about revenue base and annualized revenue using a \$55 annual average premium. Different than \$57 that we heard just a little while ago, so there must be some - I don't know if there's some new numbers that have been kicked around.

MR. HOLDEN: Larry, is that \$55 85 percent of \$60? Or do you have any idea?

MR. LAWRENCE: No. At one of the meetings when the rates were still in development, it was suggested that the average rate with many of - the high percentage as I understand the contemplation was, would be at \$60. There would be smaller numbers at lesser figures and it was felt, during the developmental phase, that perhaps a rate of \$55 on average, between \$60 and whatever the lowest rates are, might be appropriate. That's where the \$55 came from. The \$57 is an actuarial loss estimate only. It's a different kind of a number.

MR. BIANCO: I have one more question on this letter and then, Mr. Chairman, just one further question on reinsurance in general, if its permissible.

In this document, there is a detail of various findings and losses and it indicates it's based on the RMS study, with an 85 percent participation with the various alternatives. Now on Loma Prieta, they're calculating an alternative 1: \$141 million loss; Loma Prieta alternative 2: \$142 million; Whittier \$234, one alternative, that's in the millions; and Whittier narrows alternative 2 with

\$234 million. I'm wondering if you might be able later to tell - find out for us where this came - where these numbers came from. You don't have to do it right now, it's not ...

MR. HOLDEN: Yeah. Since we haven't seen that, we can't speak to anything that's in there. I take it this was something that was by the, by a consortium member that was sent out to ...

MR. BIANCO: It went out to apparently every insurance company around. For purposes of them agreeing to purchase - help with reinsurance.

MR. HOLDEN: I'm assuming they correctly cited the RMS numbers and those are the only numbers that are ours.

MR. BIANCO: The last point, if I can. What about financial reinsurance, and I want to, for a moment, go back to the legislative briefing and a one-page document that we saw but didn't get a copy of. Where you showed the three layers. And there was a third layer, if memory serves me right, which was financial reinsurance. Maybe you could touch on that for a moment?

MR. HOLDEN: Um, financial reinsurance is, I think, something that you have discussed quite a bit, Senator Green, and we undertook an analysis of financial reinsurance within the Department, a review of that. We have had some concerns with certain insurance companies' use of financial reinsurance because it's not a true risk transfer insurance. But our analysis was really confined to what good would financial reinsurance do us in terms of building the Fund.

And I'd like to, if I could, just take the example that you had cited, Senator Green, before on the ability to get \$2 billion worth of financial reinsurance with the \$250 million-a-year premium. Now, financial reinsurance is really a line of credit and as such, once you access that reinsurance product, you begin a repayment schedule. If we were to access - and we have some figures which are provided in the handout that we have given you on page three - if you would access \$1 billion or one half of that \$2 billion financial reinsurance, then it would then trigger annual repayment amounts. And I will have to defer to Larry on this, but I would expect most insurers would want repayment within a short period of time. I've calculated based on five to ten years, I don't know if that's correct or not, but I assume it would be a short period of time. If that is correct, then the annual repayments would be \$136 million to \$250 million, depending on the interest rate that you choose. Therefore, you would have payments that greatly exceed the resources of the fund. And in fact homeowners in the future would end up paying their surcharge to pay back this financial reinsurance without any reasonable expectation that they might receive anything from the Fund. I say that because the annual premium is \$250. If you

access the \$1 billion, then you will pay between \$136 and \$250 more. So, in other words, you're up to \$386 to \$500 million per year, which, as we've testified earlier, is more than the resources of the fund.

The other thing about financial reinsurance is since it is a line of credit, there is a cost associated with setting it up, and it's a significant cost. Larry Lawrence can talk about that some more. In addition, the repayment of the financial reinsurance will involve some spread, we will pay back at an interest rate. Hard to estimate what that would be, but we will pay that back and that's part of the repayment schedule. We believe that if the Legislature wants to go with a line of credit approach, which is really what financial reinsurance is and really what revenue bonds are, that it in fact makes a lot more sense to establish a pool of money investment account line of credit. We will be - we will not need it until we need it. That means that we will not have to pay that set-up charge for it, that annual premium for it. And in addition, when we pay it back, it's very likely that we will pay back at rates that are much better than we would expect to pay a financial reinsurer. So we see it really as a much better option to provide the same thing. And that line of credit could be used to underfill the reinsurance in the event that we don't have enough money.

But we do have concerns about developing a debt service payment scheme over many years that homeowners would end up paying a portion of their surcharge really just to retire the debt of the losses from a large event.

CHAIRMAN GREEN: I don't know where you got it in your head that I was suggesting a financial scenario. I was suggesting to you as I've gone through the experience of joint powers insurance authority that I helped found, an umbrella policy or treaties with actual insurance. As far as the financial is one of the things that you can do, it's a tool available to you. I no way suggested that that's what you should do.

MR. HOLDEN: Well, forgive my assumption then. And I think in terms ...

CHAIRMAN GREEN: I don't know how it could be assumed when I've equated it to Lloyds of London. They are not a financial group, they are an insurance group and they are underwriters writing treaties. And this is what I've told to and what I equated back to when I made those statements.

MR. HOLDEN: Larry is involved in the market. He can speak to the market much better than I can. The only thing that I can do before I give it to him is reference that there is an article in your packet from Business Insurance that indicates that the market has shrunken considerably. Some experts estimate there may only be \$150 to \$180 million worth of reinsurance. We're obviously trying to get more than that and, you know, we will continue those efforts. But

perhaps you could talk about the market, what your assessment is of available capacity.

MR. LAWRENCE: All right. Thank you, Richard.

As you know, we've had discussions with other major brokers as well as with leading reinsurance brokers throughout the country and in other places in the world. Our estimate at this time is that in today's environment, and the environment does change in our business regularly, but in today's environment that probably the very most that we can hope to implement, and almost without regard to price, is \$350 million. Because at this point, price doesn't seem to have a big impact on the amount of capacity that's available. It may have been that, in fact for certain, that there were higher limits available in past, in the past, but the reinsurance business has had one of the largest losses in their history over the last 18 months and it has constricted the market, particularly in Lloyds. The foreign market is very, very restricted.

CHAIRMAN GREEN: Sal?

MR. BIANCO: Yes, thank you. Just a couple of points that perhaps you might want to bring out that you haven't done so yet for the Committee in terms of delineation.

When we talk about a restricted reinsurance market, are we not talking about the fact that one of the things that is also occurring, that this program is a single-peril program. It is not a multi-peril program. And if that's not the case, then why not? In terms of the differentiation and the ability to spread risk.

MR. LAWRENCE: Sal, you're absolutely right. One of the complications of this program is that it's earthquake only. Many underwriters that have broad authority for property types of insurance can write earthquake insurance as part of a fire insurance policy, say on a multi-million dollar office structure. They do it every day, it's no problem. But their authority does not extend to earthquake-only placements. And when you have an earthquake-only contract to negotiate, then very often you have to deal with completely different people, you have to deal with home-office levels and the like of that, and it slows down the procedure and limitations come into play.

CHAIRMAN GREEN: Let me read a paragraph out of Business and Insurance and it's November 4, '91, which is pretty current. And it says "despite the decrease in reinsurance capacity, the earthquake insurance program for insured property owners in New Zealand obtained \$570 million in catastrophic coverage", and that's during April 1 renewals and the same coverage it had the previous year. He said the program is believed to be the largest single catastrophic



reinsurance placement in the world. Maybe we're just a little too late with what we're doing here. Other people can be doing it.

MR. LAWRENCE: Senator, on that point. That earthquake program in New Zealand is a very interesting program because of its similarity to what we have here. That is, a billion New Zealand dollars, excess of a billion-dollar deductible that the New Zealand fund retains. The distinction between that program and this program is that that's been in effect for quite a few years and it's in the renewal, ongoing mode, whereas we're creating this one from scratch and it's a little different.

CHAIRMAN GREEN: Well, maybe our deductible should be a billion dollars then. Because we can handle a billion dollars rather than \$150 million. Maybe we've picked the wrong deductible to fund our coinsurance program. That's the first question that comes to mind.

MR. LAWRENCE: I believe part of the deductible had to do with the fact that while the Fund's resources were building up, if a deductible were negotiated which would protect the assets of the Fund during the developmental years, that there was a value to that.

CHAIRMAN GREEN: But you have to pay a price for that, and then you end up not getting the coinsurance which you're looking for.

AREIAS' AIDE: I just have a quick question. When you say you're speaking with major brokers and reinsurers, can you be a little more specific with who you're talking to?

MR. LAWRENCE: The brokers that we consult with on this are the three other consortium brokers which is Marsh and McLennan (SP??) which is the largest broker in the world, Alexander and Alexander which I think is number 2, Johnson and Higgins which is 3rd or 4th, depending on who's telling the story. Our position, I believe, is 8th internationally. And the reinsurance brokers that are in this program are EW Blanche, they are the 2nd largest in the United States. They do \$1.5 billion in annual premiums. And the foreign intermediary is Howden Reinsurance, which I think is the 2nd largest reinsurance brokerage internationally. So these are all people that have their pulse well tuned in to the market place, I think.

MR. BIANCO: May I follow up with that? A couple of things. First off, although you named those entities off, what about the others. And in particular, the four bidders that did not win the award. Does anyone tell us why they're not being consulted with?

MR. LAWRENCE: Well Sal, you know as part of that process, we - as we went through a request for proposal to the Department of Insurance, we requested

proposals from what we felt were the leading reinsurance brokers in the United States. We evaluated them and came up with two. And the reason we came up with two is it's cumbersome to work with more than that.

MR. BIANCO: Was it all based upon cost of service or line? One rate?

MR. LAWRENCE: It was based upon - I'd say the key issues were - the cost of their services was certainly an important factor. But again, I would say the most important factor was what we perceived was their attitude of the program and what we thought would be their aggressiveness in doing the job because this is a very difficult program to market.

MR. BIANCO: OK. Mr. Chairman. A follow-up question. Touching a little bit on Senator Green's point about New Zealand and following up with yours. Isn't it not correct though, New Zealand is not a single-peril program, but a multi-peril program?

MR. LAWRENCE: Sal, I really can't say for sure. But the only part of the program that's been discussed with me is the similarity with respect to the earthquake.

MR. BIANCO: Then I'm wondering to what extent, this goes back to the Department, has the Department and the Department of General Services that was involved in the bidding process, looked at all - or did you look at all at the possibility of the State of California allowing some of its self-insurance as it relates to some of its perils that it is currently self-insuring become available for purposes of a multi-peril program, thereby reducing the cost of this single-peril coverage.

MR. MAURER: No we didn't, and I don't think it would match up. But, that was not considered.

MR. BIANCO: Is there a reason why it wasn't considered? Knowing ...

MR. MAURER: The programs are very dissimilar, I don't think that they would've, uh, they would've matched up.

MR. BIANCO: Well, I guess if I put it a different way. We know that the State of Cali - correct me if I'm wrong - there are two programs in particular that where the State utilizes - they're not necessarily self-insurers - that's the bridges \_\_\_\_\_ CalTrans, and the Cal Vet program. Are there any other programs that the State of California could divorce itself from from a self-insured process that would be a pearl which could be covered just as in homeowners coverage, insurance companies do the same thing?

MR. MAURER: No. The State is basically uninsured for almost all of its property and liability. We don't - we buy very little insurance, in fact.

MR. BIANCO: That's what I'm pointing out. But, are there, to your

knowledge, are there any risks that the State is currently self-insured, of which there are all of them but two, if I'm correct, that could become an insured risk?

MR. MAURER: If you wanted to insure the State buildings? Is that what you're aiming towards?

MR. BIANCO: We have lots of risk. I'm not picking one over the other.

MR. MAURER: It's not cost effective for us to buy insurance.

MR. BIANCO: It's not cost effective? To what extent was there a cost-effect analysis done in terms of the purchase of reinsurance for this program as a single-peril program versus this program being a multi-peril program?

MR. LAWRENCE: Sal, may I answer that question?

MR. BIANCO: Yes.

MR. LAWRENCE: One of the considerations that the brokerage consortium went through as specifications were being put together addressed this specific point.

MR. BIANCO: OK.

MR. LAWRENCE: To consider making it a multi-peril program which included quake, and to thereby perhaps loosen up some underwriting markets that might be difficult to access, the conclusion that we came to - and it wasn't done just within the brokerage, we discussed this with some major underwriters to get their feeling for it - the conclusion was that this program is so highly visible that it is an earthquake program regardless of what you call it and regardless of the policy form that you put together to insure it. And as such, the normal access that you'd have on a multi-peril or a difference-in-conditions policy would not make any difference as far as the availability of reinsurance or excess insurance.

MR. BIANCO: OK. So what you're saying to us is that because we intend to cover 6-1/2 million individual residences, therefore there's a total spread of risk for the entire State where no area is left uncovered, it is truly a single-peril program and no matter what you do, there is no way that you can in any way mix your book of business to make it easier.

MR. LAWRENCE: Not any significant way.

MR. BIANCO: No significant way. Thank you.

CHAIRMAN GREEN: All right. Anything else on this issue? OK, we've covered it quite well, and so why don't we go into bonds? What's the status of the advisory committee for the bonds? And has the committee made any recommendations on the type of bonds and have you begun working with the Treasurer's office? And there has to be regulations on this also. And I guess,

is your department going to request any changes in legislation in the future in trailer bills?

MR. HOLDEN: Yes. Senator Green, we have been pursuing the bond issue. We have had a number of discussions with the State Treasurer's office regarding the issuance of bonds and the result of those discussions from them is that marketing bonds that would be repaid by the proceeds from this program would be very difficult because of the uncertainty in the revenue stream that would pay the debt service payments. Although there is language in the legislation which does say that the proceeds to the Fund - the revenues to the Fund would go to debt service payments, they feel that in fact the uncertainty of the revenue stream, the fact that the authorizing legislation has a term basically of five years in which the Commissioner is to come back, re-evaluate the program and make recommendations as to continuation of the program, are all factors that complicate the comfort of bond holders or bond purchasers, if you will.

Secondly, and this was unknown to us last year when we began the budget process for this program, the cost of issuing bonds is at least two percent of the issue amount. So an issue of a \$1 billion bond would cost, right off the top, \$20 million. In addition, there's the financing cost of those bonds. And, again, we believe that a better approach to do the same type of - provide the same kind of cash flow remediation would be to use a pooled money investment account line of credit. We think it would be cheaper, it would be there when we needed it, and it would serve the same function. Would also be the delay in time that would be associated with bonds which the Treasurer's office has estimated would be nine months after beginning the process. And that would probably be complicated by the fact that we haven't yet received one dime in surcharges. I would imagine that they would recommend - I don't know if they are here or listening - I imagine that they would recommend that we begin that process after we begin to receive surcharges, when we know what our proceeds really are.

So, we have begun the process but we have not gotten very positive readings from the Treasurer's office on the marketability of these bonds, or the cost.

CHAIRMAN GREEN: It was my understanding that there was, in the legislation, there was a bond advisory committee to be put in place. Have you done that?

MR. HOLDEN: The bond committee is established in statute and it's the typical committee that's set up whenever you have bonds. This one is composed of the Insurance Commissioner, the State Treasurer, the State Controller, and the Director of Finance. We don't have a bond package for them, and there's no reason to bring them together at this time.

CHAIRMAN GREEN: Well, I would think one of the reasons to bring them together is to get some advice on should you issue bonds or not and a comparison. Those are your financial people and they should be giving you the financial advice.

MR. HOLDEN: We are preparing some materials which is one of the requested studies, and I believe it was your requested study, that we look at the utilization of bonds as a way of building the Fund. And we are, in fact, in the process of doing that study and we will take that to our advisory committee. We, in fact, have taken the outline of the study to the advisory committee and gotten their input. And we have started that process. And I think the due date for that study is January 1. So we have been looking very seriously at bonds, but the indication was different than we thought it would be and I suspect different than you had imagined also. We will continue with that bond utilization and study and see what results we get.

CHAIRMAN GREEN: The whole insurance package is different than I visualized. Go ahead.

AREIAS' AIDE: Richard. Have you solicited a formal opinion from the Treasurer with regard to revenue bonds, the mandatory issue, or use of a PMIA? Where is she at on this?

MR. HOLDEN: They have indicated ...

AREIAS' AIDE: Is there a formal position from the Treasurer?

MR. HOLDEN: No. Not that we know of. We ...

AREIAS' AIDE: Why not?

MR. HOLDEN: Why is there not a formal position? I can't respond for them.

AREIAS' AIDE: Have you requested one?

MR. HOLDEN: We have talked to them about use of a line of credit. And they've advised us that there's really two routes. One you can go to the Pooled Money Investment Board and request a line of credit and the other is statutory.

When you take a request to the Pooled Money Investment Board, they will want to look at our ability to repay that line of credit once an event occurs. Statutory solution is highly superior to a request.

AREIAS' AIDE: But the Treasurer has not provided a formal recommendation with regard to this issue to the Commissioner.

MR. HOLDEN: Not a formal recommendation, just discussions.

CHAIRMAN GREEN: I don't think that you can put a package together with one part of the puzzle in place. One part of the puzzle is bonds, one part is reinsurance, and one part is a line of credit. And I believe that you have to use all of those tools to make your Fund whole. And, now, I would hope that you

would look at that approach because you're going to have to take some innovative financing to make that Fund whole so that this program will work.

MR. HOLDEN: We'll continue to look at that, and I've shared with you our preliminary results on that.

CHAIRMAN GREEN: OK. Thank you.

OK. Sal, do you have something on the bonds?

MR. BIANCO: Yes, just one question. This deals with the revenue stream and the uncertainty of it. In the big red binder that we handed out, in Roman Numeral No. 8, it's the - it contains the October 31 letter from the Department to all the insurers, and attached are the technical requirements for the career fund. In particular, on Page 13 of that document - I want you to get a chance to look at it, Richard - No. 5.5, the Earthquake Event Submissions. This is where the Commissioner may request a special surcharge submission to be sent within 10 calendar days immediately following the conclusion of a qualifying earthquake event, as designated by the Department. "The event submission is identical to a regularly monthly submission with one exception: the event submission will cover only the activity occurring from either the last regularly monthly surcharge submissions or the last event submission, whichever occurs last, the day immediately preceding the date of the start of the earthquake event. In the case of submission or detailed transaction rejection, 10 business days will be allowed to submit corrections unless a written request for extension has been approved by the Fund." What that seems to say to me is that we have a qualifying event and as a result the Commissioner can call for a submission from the insurer based upon the date of its last submission, i.e., the money it collected on a surcharge. Am I correct so far in what I'm understanding there?

MR. HOLDEN: Let me clarify submission.

MR. BIANCO: OK.

MR. HOLDEN: There's a data submission and there's a money submission. This refers to a data submission.

MR. BIANCO: A data submission. Have you ever thought of having a money submission?

MR. HOLDEN: We did think of it, and in fact, I think we did put that in our emergency regs and OAL disapproved that. They - in discussions with them, they said "No, you only have authority to receive it at the end of the month. You don't have authority to receive the emergency money."

MR. BIANCO: Let's take a second on that, if we can Mr. Chairman?

I don't think that's necessarily a bad idea relative to a special event

submission, so I'm wondering, would - when you were thinking about this, were you looking at that in terms of additional dollars coming into the Fund at that particular time?

MR. HOLDEN: What it really is is not any additional moneys over and above what's forecasted, it's just an estimate of what funds have been collected by insurers so that we can base our Fund balance for purposes of prorata on.

MR. BIANCO: And also your report to the Legislature in terms of the status of the Fund.

MR. HOLDEN: That's correct.

MR. BIANCO: OK. Do you feel comfortable that with the new draft regulations that are scheduled to take effect next year that this technical requirement as currently spelled out can in fact take place from a data point of view? I mean if OAL's not going to say anything about this?

MR. HOLDEN: They have not said anything so far. I don't think this specific recommenda - specific language is in the regulations.

MR. BIANCO: Oh, that's fine. I'm not saying it has...

MR. HOLDEN: What it says is other information requested by the Commissioner.

MR. BIANCO: But for purposes of looking to the future for this Fund and specifically needing legislative statutory authority so you don't have a problem with proposed follow-up regulations in terms of dollar transmission. Is that something that you think we ought to look to in our deliberations?

MR. HOLDEN: Providing specific authorization for this?

MR. BIANCO: And I'm thinking in particular the fact that the burden that's been placed on the Commissioner in the enabling legislation in terms of reporting to the public, and to the Legislature and Governor, the status of the Fund and how the value of that monetary event transmission may assist you in being as accurate as possible and being able to pay claims to the best of your ability.

MR. HOLDEN: It's possible that it would provide more accurate information. It would be nice if we had the cash in hand, of course, and we would earn interest on that cash during that period of time. So, it would be helpful. I think we're prepared to go with it the way it is because what we really need is to know what money is available that we can calculate. I think the increment in interest would be small having calculated it, would be small.

MR. BIANCO: But the actual dollar figure - the actual dollars without the interest earned is still something that's worthwhile. Is that what I heard you just say to me? Or you didn't say that? What did you say? Please help me, I'm

lost.

MR. HOLDEN: Well, it's always better to have money in the bank than to be counting on it coming.

MS. DOLAN: It's a matter of cash flow, essentially. The early reporting is for the proration. The amount, the interest on, depending on when the event occurred in the month. It may not be worth the hassle in terms of overcoming the objections.

MR. BIANCO: OK. Thank you. Thank you Mr. Chairman.

CHAIRMAN GREEN: All right. Then let's get in the next issue. And I think on this one I'd like to bring the insurers up here to have the input. This is program delay and I think this is - there's been a lot of people speak to me on this issue so if the insurers will come up forward.

OK. And I think the overall, and this is the main question: Is there a need for further delay of the program and why? And this includes problems with compliance, regulations, and data submission requirements. All of these kind of good things has kind of been alluded to here today. So, you want to start with the Commissioner's office and then we'll go to the insurers.

MR. HOLDEN: I'd just like to point out, in terms of the regulations, we in fact did adopt regulations consistent with law. The Commissioner adopted the regulations, emergency regulations, as required on August 30, in fact two days before the SB 289 deadline. And although we understand that the insurers and their advocates may have preferred to have 120 days from the date of final regulations, they must have been aware that language in SB 289 stipulated emergency regulations. In addition, the Department requested and received the input of several insurance associations prior to adoption of emergency regulations, so these participants were fully aware of the Department's compliance with the September 1, 1991, requirement to adopt emergency rather than final regulations.

I think - we've had a number of discussions with them regarding data submission requirements and have tried to the extent possible to accommodate the varied systems that they have. We are dealing with approximately 200 different insurers and many of them have very different data systems that we have tried to accommodate while still maintaining what we believe is the integrity of the system that we think is required.

And then finally, a surcharge rate matrix was sent to the insurers October 4, so that they could begin programming. The actual rates were sent on the 16th and then again on the 24th when an error, a data error was detected in the October 16th submission, which changed some of the rates.



We are sympathetic to the insurers' concerns about bringing up their systems in a very short period of time. We have to do that ourselves. And I think they are the best spokespeople for that. And I will just defer to them on that issue.

We feel we have a statutory January 1, 1992, deadline. We have to try and meet that the best we can. We've tried to work with them on it, and I think we've made some accommodations. But nonetheless, it is a statutory deadline and we are working towards that.

CHAIRMAN GREEN: Any questions? OK. Who's going to start it off?

MR. RON GASS: My name is Ron Gass. I'm here for the American Insurance Association.

I guess I want to start off by saying that our companies are making their best effort to comply with the requirements of the California Residential Earthquake Recovery Fund. I think that, as the Chairman may understand, it requires enormous amount of effort, both in terms of manpower and dollars, to reprogram our systems to match what the Fund would like. I think that it was no secret that insurers needed a 120-day lead time. I know we told them, and I'm sure the other trades did as well, both publicly and privately. The fact that the emergency regulations were issued by the beginning of September or so, I think really didn't help us much because we have to design our systems, computer systems, in a very specific way to capture the specific information required. The regulations did not address that, they were, in effect, efforts to clarify some aspects of the statute, but not to specifically deal with data elements, which is what you get down to when you start talking about transferring information via various media.

I think that, unfortunately, our experience with the Department has been plagued with a failure to communicate problems.

I don't recall that any of the AI companies were contacted in advance of the issuing the protocols and procedures that the Fund published in October. In fact it wasn't finalized until the end of October, I might add. The advisory committee, as I understand it, was not consulted about the specific data elements which I think would have helped grease the skids a little bit to make things move more smoothly. Trade associations, at least my trade association, I don't recall being consulted until after the initial draft of the protocols and procedures were published, which I don't believe was until October.

But, that aside, I think the biggest problem is that, as people pointed out before, you're talking about a program with 6.3 million policy holders. While insurers have very sophisticated systems, computer systems, to handle their own

policy holders, you're talking about in some instances melding four or five different separate computer systems within each company. There's a billing system, there's a claims system, there's an underwriting system, and this program requires you to pull elements from all aspects of those systems.

And I think the basic message, you know, I'd like to convey here and I don't want to, unless you ask me to, go through chapter and verse on all the programming problems. I think that Mr. Holden is familiar with that and I do commend them for making a number of substantial changes in their protocols and procedures that I think alleviated many of the early problems we had when they were first published. But I think our companies are prepared to try and give the Fund the basic reports as soon as possible. I think it's inevitable that there will be delays of getting this running for at least the first three months, if not up to six months. Our companies are scrambling to do what they can to get the systems on line, to begin the reporting process and the billing process. Renewals, by law, have to go out at least 45 days in advance and we've already passed that timing because many companies send their renewals out 60 to 90 days in advance. So, as a result, we got caught in the switches here where we have to bill our policy holders so that they know what they have to pay for the next year. And also trying to meet the funds requirements of publishing the surcharge billing figures so that that can be paid.

There were some other important components of this program that really weren't ready, again, until the end of October. We're required to include a notice that the Commissioner was to develop that was not ready until October 30th. And the matrix Mr. Holden referred to; well, it was given to us without numbers on October 4th. It wasn't really finalized - I guess it was published with numbers on, I think, October 16th, but some of those were in error, and then republished, I think, around October 24th or so. So, again, we've only had literally two or three weeks to get systems on line to meet the Fund's requirements.

And I think the biggest problem that needs to be addressed from our point of view is: Will the Fund create some mechanism for insurers to capture those persons whose renewals have already gone out and haven't been billed because of these delays so that everyone can be on board. I think they've taken the position that if you haven't paid the surcharge - let's say you're a January renewal and the surcharge has not been paid for whatever reason because we haven't had time to get our systems on line and that person doesn't somehow get their surcharge money to the Fund, they're not going to be covered. And I think you're going to have a lot of mad constituents out there who didn't have an

opportunity to pay even though they might have wanted to because of the time delays. And I think that is probably a procedural problem that can be easily ironed out if the Department would perhaps cut everybody some slack and start talking about how we can get these people into the system because of the delays.

There are some other aspects that I'd be happy to talk about or answer questions, but I'll defer to my colleagues here so they can get their word in. Thank you.

MR. TIM HART: Mr. Chairman and Members. Tim Hart representing the association of California Insurance Companies. I have with me today John Drennan who is a Vice President and Actuary for Allstate Insurance Company. And John is here wearing at least three hats. Most of you know John as a source of information and data during the course of the debate, legislative debate, on the establishment of the Career Fund program. John also is active with the Federal Earthquake Project in providing data assistance to them on follow-up modeling and losses. And finally, John is the vice chairman of the advisory committee selected by Commissioner Garamendi and so he has been active in that process as well.

Before I turn in over to John I'd like to make a couple of observations about testimony that's been made this morning. First of all on the mandatory issue, it is entirely true that insurers have opposed canceling or nonrenewing policies. This is part of the legislative debate on the creation of the Career Fund. Our industry and our members essentially agreed to be conduits for a State program. But I wanted to make it clear that the position we have does not extend to remedies exercised by the State on its own behalf. We're kind of surprised that there hasn't been discussion about perhaps the Commissioner taking action either directly or through the Attorney General against people who do not pay. As far as insurers are concerned, this is with all due respect to the Commissioner's position, we don't feel this is an insurance product and it's not directly tied to the insurance market except in the sense that the purchase of insurance is a threshold qualification for benefits and insurers have agreed to function as a conduit.

One other minor technical point. I was noticing in the Jardin perspectus this morning that there was a statement attributed to the Association of California Insurance Companies about this proposal being innovating and exciting. And I just wanted to clarify that that was a February, 1990, response by the Association to the Governor's proposal as outlined in his State of the State Address and it should not be either interpreted literally or implicitly as an endorsement of the program, because we have not taken that policy position.

One final remark with respect to the chronology of acquaintance with an adoption of regulations. Two other significant events I'd like to point out. Our trade association and members became first aware of the content of the regulations in a document dated August 20th, which we received on the 22nd, which was captioned as an outline of the regulations. It was 17 pages. We had a meeting with the Department with eight days turn around and provided some comment on that. I'd simply wanted to point out that the final regulations as proposed aren't very much significantly longer than that, and we're a little distressed on our members' behalf that they don't answer some of the fundamental questions that we believe need to be answered before the program can be implemented responsibly.

The one other thing I wanted to mention is that the trades and several insurance technical representatives met with the Department and the vendor on September the 16th and we tried to make it clear to them at that time that if we were going to get billing notices in the mail to all renewals or as many renewals as possible, we'd have to have the rate surcharge information and the notification of benefits no later than September the 30th. And even then it would be a stretch.

With that I'd like to recognize John and ask - he has a few comments, I think, on Allstate's compliance experience to date.

MR. JOHN DRENNAN: Mr. Chairman and Members of the Committee. I appreciate the chance to bring a few comments from a company perspective to this.

My company, in particular, has been extremely aware of what earthquake means to the people that we sell our products to and obviously that's very much the citizens of this state. My responsibilities at Allstate include attention to how those issues are handled in Legislatures and also the programs that are put in place to try to deal with that. Frankly, our commitment is to our policy holders to make sure that we serve them with the products that we sell, but also with the regulations that are put in by a State Legislature.

I've been asked to participate as a member of the advisory committee and have done so. And I think that's a demonstration of our desire to have a program that does indeed accomplish its objectives. I'm also trying to demonstrate the commitment that the industry has to carry out the intent of the Legislature. Since the day that this legislation was passed and through the changes that have come in further legislative meetings, we've paid attention and tried to anticipate in the best way we can what does it mean to us to deal with our customer, and how are we going to put a program in place that carries out the intent. The best that I can say is that a significant amount ...

(LAUGHTER.)

CHAIRMAN GREEN: That was the workmen in the Senate Chambers, it wasn't an earthquake. (Laughter.) They just dropped the new camera they're installing in there. Go ahead.

MR. DRENNAN: As people say, "I knew that." (Laughter.) I wish I could say that I knew that in my dealings with earthquake, one of the things that I've never experienced is an actual event, so ...

CHAIRMAN GREEN: Oh, really?

MR. DRENNAN: I'm not sure whether that's good fortune ...

CHAIRMAN GREEN: Let me tell you, I've been here in California since, well I was born here, but I've experienced every earthquake from 1932 till now.

MR. DRENNAN: Well, I don't plan to stay here indefinitely, but (Laughter.) if that is the cost of avoiding an earthquake in the State of California of any significance, and I am willing to participate in that way.

Our company is wrestling with this by putting together various groups, various task forces, in our organizations to implement this legislation. We have task force that are dealing with the compliance issue. We are concerned mostly about the dealings with our customers who, for whatever reason, decide that they do not want to participate in this program. With the lack of what appear to be effective implementation of the program, we are anticipating that some of our customers are going to opt out. And thus, we are planning to continue our relationship with them as insurers without jeopardizing that relationship by virtue of this program. Now, I think that what we are looking for is removal of the uncertainty as to how to deal with the customer. That is exactly what we're asking that the Insurance Department, through regulation, and if that is not possible, that the Legislature through revised legislation, remove from the dealings with our customers. But, being committed to that, we have been and are moving towards introducing to our customers the necessary billings and establishing the accounting procedures to transmit the funds to the program.

We feel that the issues have been reduced as we have proceeded over the last several months, but the real critical ones that we have talked about today remain. And to the extent that they can in fact be addressed and removed, then I think you will see that the insurance industry will be able to do the job that the Legislature presented to them. Whether we will have everything working on January 1st as we would like it to have been, as we might have been able to do it with sufficient advance warning, is really immaterial. The things that must be done, I think, are in fact going to be done and that is conveying to the

customers the evidence that this program is in place, the cost to them and to transmit the funds into the California Earthquake Fund.

The details of reporting the information to make sure that this works correctly are being worked out and will be worked out. We ask that the Department be aware that only what is essential need be reported because by adding the reporting requirements to the industry, we are adding additional costs to our delivering our product to our customers and that is of very much concern.

So I think that - I just would like to reaffirm that the industry, and especially my company, is committed to do the intent of the legislation, and we will participate in any way possible to try to resolve any of the problems. We ask the Department to listen to us because I think we have experience in collecting large amounts of money and responding to needs of policy holders when they arise, so we're asking for cooperation in that respect, too.

CHAIRMAN GREEN: I bounced around in my head, should I ask this question or shouldn't I, and I'm going to. You're a member of the commission, it's a very key element and part of what I felt the intent of the legislation was was the advisory committee. Have you been used properly?

MR. DRENNAN: In my opinion, we have not been used in the spirit that I thought the advisory committee was created, and that was to truly be a source of not only input, but also discussion on those matters that were necessary to implement the program. I do think that the advisory committee has had the benefit of many of the decisions that the Department has had to make by themselves, but generally it has been basically to review them and to comment after the fact as to help - rather than to help shape some of the decisions. And particularly in the selection of the vendors. It's my belief that the advisory committee was simply alerted as to who was being contacted and ultimately who was decided, but the advisory committee was not asked to put it's opinion forward in any great detail as to what was required. I don't know whether that's the result of the extremely constricted time frames that the Department had to operate under or whether it was their opinions as to what their authority were. But as far as the committee goes, I feel that we have basically been reviewing and giving agreement to decisions that have been made by the Department as opposed to actually putting input to many of those decisions.

CHAIRMAN GREEN: Thank you. That's kind of my opinion.

ASSEMBLYMAN AREIAS: Senator Green? I have a follow up question. Question for the witness. In your opinion, can a workable program be put in place?

MR. DRENNAN: In my opinion, it can.

ASSEMBLYMAN AREIAS: It can't.

MR. DRENNAN: It can. Yes, it can.

ASSEMBLYMAN AREIAS: It can. OK. From your experience as a member of the commission, why aren't we further along on this? I mean, I've heard and read all the reports and all the excuses and all the horribles conjured up and paraded out in terms of what's going to happen or what isn't going to happen. But in your studied opinion and from your experiences, why isn't it happening?

MR. DRENNAN: I think very many of the delays are because of the uncertainty of what the authority of the Department is via regulation and the conflict with the legislation which basically tells us that we cannot impose penalties on insureds for failure to pay the surcharge.

ASSEMBLYMAN AREIAS: Do you think the will exists within the Department to establish this program?

MR. DRENNAN: I think that the Department has acted to try to implement the program, but I guess my feeling is that they have not used the advisory committee whenever questions of - or barriers in the existing program are identified.

ASSEMBLYMAN AREIAS: Give us some examples of how the advisory committee could have been used more effectively to help remedy this impasse.

MR. DRENNAN: Well with the question as to the emergency regulations and how they would enforce compliance, the advisory committee was not asked how would we get around that barrier.

ASSEMBLYMAN AREIAS: How would you have done it? What advice would you have given to the Department had you been asked?

MR. DRENNAN: I think I would have recommended that the Department of Insurance put a somewhat lengthy list of ways to comply with the mandation together. One of the ways would obviously have included the possibility of cancellation of the insurance policy, but that interpretation by counsel appeared to be taken away. And I know we've had comments today about whether or not that was the proper interpretation, but nevertheless, that was the one. But many other ways to allow the revenues to be collected including using something other than the insurance mechanism should have been listed that would, if followed, have assured the revenue stream. My feeling would be if in any way the revenue stream for this program had been assured, then the questions with respect to identifying available reinsurance and the issuing of revenue bonds would've been able to be dealt with much more specifically, but since the revenue stream was not protected, then I think those entities have every reason

to suggest - I can only go so far, but I can't give you firm recommendations.

ASSEMBLYMAN AREIAS: I guess what frustrates me and the others, at least those of us that were involved in promoting and sponsoring this program and the legislation that created it, is that - and I carried Senator Hill and Senator Green's bill on the Floor when it went off the Assembly - and there's no doubt in my mind that every Member that voted for or against that measure recognized that this was a mandatory program. That was the legislative intent. Now, if afterwards interpretations determine that there was some technical glitch in the legislation that allowed somebody to get out of it or challenge it, then fine. We face those dilemmas in this Legislature all the time, and we go back with corrective or technical legislation, you bring everybody together. But to use that to stalemate and stymie this program and frankly put the whole thing in jeopardy, to me is inexcusable. If the will is there to get it established, or had been there, it would be established and it would be on time.

MR. DRENNAN: The uncertainty that insurers are facing right now really is not whether there's going to be mass defection. We do not expect that. We expect that the majority of our customers are going to receive the bill and they in fact are going to comply with the wishes of the Legislature.

ASSEMBLYMAN AREIAS: What percentage? When you say the majority, what percentage of compliance would you anticipate, even under the current environment?

MR. DRENNAN: I, personally, would be very surprised if more than 10 percent of our policy holders do not comply with the billing requirement.

ASSEMBLYMAN AREIAS: So it doesn't put the revenue stream in serious jeopardy, while we're straightening out these glitches?

MR. DRENNAN: It, frankly, doesn't put the revenue stream in serious jeopardy not only because of the relatively small percentage that won't comply, but secondly, those that don't comply in putting money into the system also do not take money out of the system. So the testimony that we heard early today about the average cost per participant really is not going to change significantly by those who opt not to be in the system. There could be some adverse selection because the people who opt out of the system may do that because they feel they don't need the program. But I don't think, personally, that the adverse selection issue is a serious one, in the pricing matter. But it is a serious one when you ask the reinsurers community to try to place coverage and you frankly do not know where your retention is truly going to end up, nor do you know what the true excess amount of coverage you're actually seeking. Those are questions that are going to be defined by the number of



participants in the program. And while I can say that I would be surprised, it's entirely possible that I could be surprised, that there could be significantly larger numbers. But our experience would say that the vast majority of the policy holders will pay and especially they will pay when they are informed that it's the law of the State.

ASSEMBLYMAN AREIAS: Well, the more that issue is used to put the death neli or nail in the coffin of this program, the more defections you're going to get. If we would use that collective energy to go in and fix any technical flaws in the Program with follow-up legislation, whatever it requires, I think it would be used much more effectively. But, in order for this program, Senator Green, in order for this program to be effective and to reduce the number of misunderstandings that, and expectations that may not be met in terms of the general public that would be covered by this program, we need the cooperation, the full cooperation, of the insurance industry and their agents. And the only way that can happen is if they know what to do and what the program is. And until now and remaining, they don't, they don't know what it is and there's a great deal of uncertainty.

MR. DRENNAN: One more point I would like to make, and frankly it's one that hasn't been brought out very well in any discussion up to now, and that is, who are going to be the spokespersons for the program. In general, the legislation says that insurers will surcharge and will collect revenues, but by having that duty then insurers are probably going to have to become the spokespersons for the program. The agents of our company are the people who talk with our customers and our customers trust the agents to tell them why they have to do some things. We are, we are having serious problems in meeting the implementation program because of how to educate our agents to deal with our customers. Now I say problems, and they are not insurmountable, and we do expect to be ready on January 1st to do the tasks that we have, but we really want our agents to be speaking as ambassadors for our company and doing the intent of the Legislature. And we will caution them and we will educate them to do just that.

CHAIRMAN GREEN: Thank you. Go ahead.

MS. DOLAN: I just wanted to convey to the Commissioner the discussion over mandatory and I thought it might be useful if the insurers would comment on the Legislative Counsel's Opinion that the Department has the authority to require them to collect the surcharges.

MR. TIM HART: Mr. Chairman, just on behalf of our members, we're familiar with Legislative Counsel's Opinion. I think the problem we have in responding

to the Commissioner's question is what is meant by collection proceedings instituted by insurers. Now if by that the Department is talking about getting insurers more involved in rebilling people who either refuse to pay or are not paid in that process, that's one thing. But if they're talking about using insurers or requiring insurers to enforce the law of the State by prejudicing independent contractual relationships with their own customers, I think that's a different story entirely. There is a provision in - there was a provision in SB 2902 which specifically provided that the fund law was not to be construed to impair or interfere with independent contractual relations between an insurer and an insured. I'd simply renew our point. With all due respect to the Commissioner's point of view, we view this as a benefit program and not an insurance policy. And the position that we took when this Fund was created is that we would carry the State's water, but not drown our own customers.

CHAIRMAN GREEN: OK. Finished?

MR. HART: Sure. Thank you.

CHAIRMAN GREEN: I think probably the biggest thing I heard right here right now is that there is a wealth of information and knowledge on a committee that's not being used. And I would certainly like a very pointed answer as to why. The intent of this legislation when it was proposed was that these regulations, the financing, all of the problems that we're talking about and have been talking about was the responsibility of a commission. Yes, the Commissioner is the final decision maker, but this commission can give you an awful lot of help and you're losing a resource by not using it.

MR. HOLDEN: I agree with you. The committee is a very valuable resource and it has been our impression that we have in fact used them extensively and gotten tremendous feedback from them. I believe the chairman from the advisory committee is here and another member of the advisory committee is here. We have, to the greatest extent possible, welcomed their input on any matter related to the program. We have provided to them issues that we think need to be discussed for us to move forward for the program. To that extent, and we provided a recommended agenda for them to use in their meetings and have had discussions with the chairman before we set that agenda. In addition, during the advisory committee meetings, we ask if there are other things that need to be discussed. We have tried to use that advisory committee as much as possible and it's really a sterling committee and they've provided us excellent advice on a number of issues, and some of that advice the Commissioner has adopted directly, such as on the rates and on a couple of different occasions and they've been, I think, a terrific sounding board. I'm disappointed that John

hasn't brought up some of these issues in the committee. I think if there are additional things to be discussed, we are open to them. We had planned on using that committee in that process and once again, it's really ...

CHAIRMAN GREEN: It depends on how you use a committee, before the fact or after the fact. And it is my interpretation is that you're using them after the fact. We'll get off of that subject. Next.

MS. MARIALEE NEIGHBORS: Yes. Marialee Neighbors for the Alliance of American Insurers. I share the concerns that have been raised by the other trade associations and John for Allstate. The greatest problem for us has been that the information that we needed from the Department in order for companies to move forward and implement the program had arrived and were received by companies at a time that was really very late in the process. Our final protocol and procedure guidelines weren't received until the end of October. We know the Department has worked hard to implement the program. We've tried to cooperate, but this has been a really insurmountable problem particular for our smaller, our medium sized companies. And we had written the Department. We've asked our companies to share their concerns with the Department regarding the actual implementation issues and they have also sent letters to you indicating some of those technical problems. Our companies have wanted to cooperate, but you can realize that particularly for a small company that doesn't have 40 or 50 persons to take off other projects and devote solely to this project that when they don't have all the information available and they have to process something in a very, very short period of time, it does become a great problem. Nevertheless, we want to continue to work with the Department and you in terms of implementing this program, we'll do the best we can. The problem of not having adequate time to go through the computer changes and reprogramming and programs is quite a problem for the companies.

MS. DIANE COBALT (??): Diane Cobalt for State Farm Insurance Companies. We also agree with a number of the points that were made by the previous insurer speakers. We are in the process of having to go through and reprogram our massive computer systems which are centralized in Illinois. And while there's certain problems that are faced by smaller companies that Marialee pointed to, even the larger companies like State Farm, this is not something that can be done over night. And there's time that we need to go through test runs of the system once we get all of the data inputted to make sure that we're not creating other problems. And we, early in the Fall, began the process of informing our policy holders, we sent out an earlier notice to them that this program was going to be coming on line, that we did not have the surcharge data yet, that

when we did get that there would be - you know, that this would be coming on board, but we just - as I think someone else mentioned, the law requires that the renewal notices go out so many days before they're due and so the notices for the January renewals had to go out already, and we just didn't have the data in time to do that. But we are doing the best we can to comply with it as soon as possible. Meeting the January deadline is going to be difficult.

CHAIRMAN GREEN: Push the button, if you would.

MR. LONNIE ATKISSON: ...inaudible... and I thought maybe I would move forward just a spot on the agenda.

We have had a total of five meetings now and yes when we first formed there were bids already out for the administrator of the program. Since that time we have participated in all of the activities that the Department of Insurance has brought forward.

And if I may, I'd like to share for a moment what my feelings were as the chairman. And I received a letter from the Commissioner that said the committee was formed to help evaluate and select earthquake loss estimators for the purpose of establishing a financial structure that is actuarially sound, as well as to sort out the options for modifying surcharges, deductibles, and coverage in a way that insures solvency of the CRER Fund. And that is exactly what we have attempted to do over the last five meetings, taking into effect first of all that there was not a mandatory program. The mandatory program is not there because of either the Legislature or the Department. The participation level, I think, is unknown. The private market right now is about 25 percent of the private market people actually purchase earthquake coverage. Maybe because it's too high, but that is the limit, basically, where they are. And I don't know that we can predict how many people will in fact come on board should the program not be mandatory, just as we cannot predict exactly what kind of an earthquake we're going to have next. I think as a committee we've tried to work with an awful lot of unknowns and uncertainties as to exactly how many people will be insured, exactly what the losses might be.

We have changed programs. For example, when the program first went out for loss estimation, it included cosmetic damage which changed drastically the amount of money that might be involved for a total loss. It was later changed to include structural damage only, and I'm sure that this may release or reduce the loss estimation as far as the total dollars as a result of an earthquake.

It has been difficult to try and create, if you will, an insurance company of 6.3 million. And that may be another assumption that keeps coming up, as to whether or not we're talking about creating an insurance company or if we are

talking about creating a fund or a pool. It seems as though as we talk about items that are in the bill, such as reinsurance and bonds, we seem to be depleting the funds available to almost 50 percent or at least 40 percent almost immediately. And that is reinsurance at maybe \$40 million, bonds indebtedness at maybe as much as \$100 million a year. And I think that there has to possibly be a decision as to whether or not we wish to be able to pay everyone in the first year or whether or not we wish the Fund to accumulate as fast as possible with no other drains in the way of reinsurance and bonds ...

CHAIRMAN GREEN: You can't guarantee there won't be a drain the first year because you can't guarantee there won't be an earthquake.

MR. ATKISSON: That's true.

CHAIRMAN GREEN: So you have to cover it for a long period of time. Here's one person that's had the experience you're talking about and what we're trying to do. We build a joint powers insurance authority with no money for 30 cities and it was started with a fund. We got coinsurance at a cost. We got through for a number of years and a few years ago that went to self insurance and away from the umbrella policy, but it was a planned structure and it was something this plan can do and should do. It's possible, if it's planned properly. And if the people that are in it to plan it want it to succeed, it will succeed. But what I hear from you is kind of what I'm hearing from staff.

MR. ATKISSON: OK. Well, I think it's a situation that we don't know exactly what ballpark we're playing on because we don't know exactly how many participants there will be.

CHAIRMAN GREEN: I've gone through this and in 1978 I put together an insurance risk pool for 30 cities that now have 65 cities in it. They have went together when in 1978 dollars and charge an 80 percent deposit every year of that dollar and until I came to this Legislature that pool had given back to those cities 50 percent of the 80 percent on \$78. It has now built up an amass over \$65 million in an excess pool to pay off the insurance. Now why can't we do that on a the state level when we can do it on local government level. And it's totally self insured. That's what I envisioned when we wrote this legislation. And as all I hear from everyone is we can't do something.

MR. ATKISSON: I think there's a lot of things we can do, there's just some things that we don't know. And the things that we don't know ...

CHAIRMAN GREEN: Well, we don't know because we don't take the chance and we don't put it in front of the committee. And if the committee won't look at it and say let's work it out, then what can we expect?

I'm sorry, that's an outburst I don't normally give, but I find this whole

issue one of - I've sat there for hour after hour after hour of this testimony from everyone, and that homeowner out there is hurting. We must help that homeowner! And we have to find a way to do it.

Anything from anyone else now? Thank you.

This next issue we'll go into and it should have a lot of discussion, but I would ask that we not give it over 20 minutes and we'll have to continue it to our next meeting on December 4th, because this is something that has surfaced and it's clarification on participation of mobile homes, condominiums and other multiple family dwellings. This is - so anyone on that part of the issue, if you would come forward please.

MR. MAURICE PRIEST: Mr. Chairman and Members, Maurice Priest representing Golden State Mobilehome Owners League. We had asked to make a comment on the Earthquake Recovery Fund.

There are approximately a million people in California who live in mobile homes and we had several discussions with Senator Hill's office last year with regard to his measure, and believe that mobilehome owners in California could also benefit from the Earthquake Recovery Fund. And we looked at some of the aspects of deductibles and how it might help address their problems if they suffered damage from an earthquake. And we're very concerned about the application of the Earthquake Fund to those homeowners in California. I know that the mandatory provisions of the Fund were not only to make it economically viable, but also based on the assumption that the homeowners who pay that surcharge are also going to have a chance to equally benefit or participate in the fund. And we're finding out upon closer examination that mobilehome owners in California will not be benefiting equally at all from the fund.

And let me give you an illustration. For the last 25 years, GSMOL has worked closely with insurance carriers in California and in some cases we have endorsed and recommended to our statewide membership certain carriers who develop policies that we consider to be very, very beneficial to our members. And the homeowners insurance policies that we have recommended for a number of years also include earthquake coverage. Since the passage of this measure we've had a chance to go back to those insurance carriers and the agents to work through a scenario, what if this happens? And we've also had the benefit of examining the Insurance Commissioner's map imposing the three zones where mobilehomes, also within those three zones, would be paying the maximum \$60 surcharge. Our insurance carriers have been able to advise us that the average mobilehome owner in California is insured for \$50,000 or less. That means that on those plans, which also include earthquake coverage, their deductible is

going to be \$1,000. Because the deductible under the Earthquake Recovery Fund is also \$1,000, they would be collecting -0- from the Fund. Now, someone who may be two or three blocks away living in a conventional home paying the \$60 surcharge could collect up to the maximum of \$15,000 from the Earthquake Recovery Fund. That's - when the - as one of the gentlemen on the commission stated just a few moments ago, when the billings go out and the questions come from our members, from our insureds, and they contact their agents and the carriers who are very cooperative and very helpful and very professional and they're reassured by their own agents that yes they do have to pay the \$60 surcharge if they're in those three zones, and yes they will not be able to present any type of claim. There's not going to be very many happy mobilehome owners within those districts.

And I would remind the committee, as you know - as you already know that most of the mobilehome owners in California are senior citizens. A survey done by Foremost Insurance several years ago indicated that the average of our own members was 69 years plus. Most of them are on fixed incomes. Many of them totally dependent upon Social Security.

Our comments at this time, we're very motivated to work with the Legislature and with the Department of Insurance to make an appropriate adjustment. And I'm not suggesting to you now what that should be, but we've all assumed that the people who contribute would somehow be able to benefit from the Fund. And through information we've recently been able to get from our carriers and agents, the mobilehome owners are really going to come out at the short end. And it appears that they're going to contributing and subsidizing a fund that they're not going to be collect from, and we think that inequity should be addressed.

CHAIRMAN GREEN: Thank you. I think the Department ought to respond on this one because I know of no policy that has that small of a deductible.

MR. HOLDEN: We had heard last year when there were hearings on the legislation, clean-up legislation, that in fact that mobilehome owners did have very low deductible policies. And I attempted a couple of times to contact Mr. Priest to find out - to get resolution on that early on. Mr. Priest, I understand, contacted Senator Hill's office and expressed concerns about mobilehome owners being included in the program, that there would be some coverage overlap, which is consistent with what we had heard. They were asked to provide additional information, correct me if I'm wrong Shannon - provide additional information, and they wrote a subsequent letter saying that they did want to be included in the program. Our information has to be based on what the

mobilehome owners have told us and they did not request an exemption at the end.

CHAIRMAN GREEN: Yeah, I think this issue, then, is one that has to be addressed legislatively, because currently you are in the legislation. Whether you got there voluntarily or - that has nothing to do with the fix later on, because there's going to be a continuum of fixes on this legislation. So, it's good that you come forth and let us know that there is a problem with the mobilehome.

OK. Thank you.

Sal, do you have a question?

MR. BIANCO: Yes, Mr. Chairman. I would like to suggest that the Subcommittee request the Department of Insurance at the next hearing to just provide in summary writing, verbally or whatever, what the status is in terms of coverage for mobilehomes relating to deductible. The mobilehome association is attempting to tell this committee that mobilehome coverages have only a two percent deductible. That's what you're telling us, and I think it's really important that we know what policies are out there, if in fact they're all two percent policies. If they are, then the \$1,000 is absolutely correct. If they're not, then there's a totally different view on this issue.

CHAIRMAN GREEN: Yeah, and then you got several issues because the issue is: does everyone have the policy? Because I sat in hearings with mobilehome owners that had their mobilehome shook off the wheels and they were in big hurt because they were seniors and couldn't put it back together because they didn't have the money.

MR. MARK RAKICH: Mark Rakich with the Department. I just wanted to comment on Sal's request.

As I guess some Members of the committee and staff know, we don't have policy approval in filing requirements in property casualty. We're certainly more than happy to try to dig that out. I suspect that we don't have that data on anything better than an anecdotal basis based on complaints and things like that coming in. We did look at this question of whether mobile homes are in - should be in or out based on whether there would be any viable economic benefit. And we heard, anecdotally only, very mixed signals. Some saying there was, you know, standard homeowners type deductibles, and others saying that it was the same as the traditional residential earthquake policy.

CHAIRMAN GREEN: But they're not the same, they don't have fireplaces. They don't have a lot of those things that are damaged by earthquake damage.

MR. RAKICH: With respect to this question, we had received mixed signals both in the course of the 1991 legislative year as well as in the 1990



legislative year when this came up. I don't have the committee reports with me here, but I suspect Sal could confirm that we didn't hear about the mobilehome problem very early and with any degree of definiteness as to what the situation is.

CHAIRMAN GREEN: Well I think that we should have some formal report of what you do have coming back and this is an issue we can't fix today, because it's going to take legislation in the future.

MR. HOLDEN: We'll try to secure more information on that.

MR. PRIEST: And Mr. Chairman, I was here during the testimony today when there was some discussion as to whether the Department of Insurance has the regulatory authority to address certain concerns. And if this happens to be an area where they have such regulatory authority, we'd be happy to cooperate with them and to suggest that they might exercise that with regard to the mobilehome issue until we can do something legislatively.

CHAIRMAN GREEN: And it's a possibility because mobile homes are treated differently than property taxes. I don't know, they'll look at it.

Thank you.

MS. ROBYN STEWART: Senator Green?

CHAIRMAN GREEN: Yes.

MS. STEWART: Could I also request that in your report back on this issue, you give some attention to utilizing that maximum surcharge amount of \$60 in three of the zones for this type of structure.

MR. HOLDEN: I can respond to you right now on that. The rates that were set for mobilehomes - we didn't pick the highest number. These are actual numbers that were based on the actual risk in those zones, and that's why it turned out to be \$60. If private insurers are selling it for less, they're getting a deal.

MR. BIANCO: Mr. Chairman. I think the other thing you may want the Department to also think about is the extent to which if it were a true \$1,000 deductible on mobilehome policies. And I think there has to be a distinction made clearly between coverage for mobilehomes and the use of an affiliate insurer for purposes of meeting current laws' requirements on the mandate to offer earthquake coverage. There is a difference. OK? In other words, the statute has provided ever since 1985 that for purposes of meeting the mandate to offer earthquake coverage that an affiliate insurer may be utilized to do that; i.e., the carrier that's providing the mobilehome coverage does not necessarily have to be the same entity providing the earthquake coverage. And that's an important distinction that needs to be made when you're looking at the extent to

which there are policies out there. You may also want to look at, for purposes of this, whether or not you might want to sell first dollar coverage for that deductible on - and look at it from an actuarial basis for the \$1,000, if that's truly the number.

CHAIRMAN GREEN: Thank you. OK, anything else? Then thank you for coming. Do we have anyone here from condominiums? You're a condominium.

MS. STEWART: Not really, I'm a person. (Laughter.)

My name is Robyn Boyer Stewart and I'm here representing the executive council of homeowners. We are an association that represents condominiums as well as planned developments. In California there are about three million homeowners who live in this form of housing.

CHAIRMAN GREEN: And it's growing.

MS. STEWART: And it's growing. It's the fastest growing form of housing in California today.

We're here to refer primarily to the letter that we provided the Committee in November which outlines two of our concerns. With respect to your question on the agenda: Does this need some clarification? We have to answer: Yes, we do. Our particular concern is that as we understand the regulations and as we understand SB 2902 as it would be implemented, it would currently put our members essentially in between a rock and hard place, and let me explain. Right now California Civil Code Section 1366, which is referred to as the Davis/Stirling Act which is the governing law for condominium and planned development associations, requires of its members that they provide, for instance 60 days before the end of their fiscal year, a proforma budget. And in that budget they have to anticipate what the costs are going to be for the year. And if there is a need for an increase in the assessment, then it has to be dealt with at that time. Davis/Stirling has a ceiling on it which does not allow a board to raise the dues in excess of 20 percent in any given year without a vote of the membership. We're concerned that given the uncertainty of what the cost of the premium would be, and we've heard figures ranging from \$12 to \$60 or \$25 to \$75, that this will create tremendous problems for us for the number of reasons. One of which is many, many of our associations are operating very close to a margin as it is, and when you levy an assessment of \$60, for instance, per unit, for many, many associations that could constitute a number in excess of 20 percent of the budget. Ordinarily to amend the CC&Rs or to take an issue to the vote of the membership requires anywhere from \$3,000 to \$5,000 to retain an attorney, to issue the votes, and it's a huge problem.

There is also a requirement in some CC&Rs that they have to notify the

lenders when there is this kind of an increase. And in that case that's often impossible because many people don't know who has the paper on their loans. So these are issues which our association is continuing to deal with primarily in the housing committees and as this form of housing sort of comes to maturity, they've only been around 15 - 20 years, more of this will emerge and will become clearer.

Our responsibility to you and to the Department is to sort of educate you as to what these particular concerns are.

Specifically, we would ask that there be some sort of legislation next year, some emergency legislation, which would for instance allow a board to increase the dues as necessary, in this case because of a State mandated program. That would essentially take care of that.

So, there are though problems with the business of rescinding budgets that have already been sent out. Having to reconfigure them or redefine them, and then to mail them all out. And as this gentleman earlier recognized, most of the people living in mobilehomes are seniors. A good number of people living in condominiums are seniors as well, living on fixed incomes, and they in fact - an increase of this kind represents a huge hit on them. So we ask you to be aware of that.

The other concern that we have has to do with the fact that the law and then the subsequent implementing regulations make a distinction that doesn't really exist. That is, in trying to, - and I appreciate why this was done - in trying to distinguish between owner-occupied units and tenant-occupied units, although well intended I'm sure, it's impossible to do that. The state law and the governing documents of condominiums do not allow them to make that distinction. The only recognized legal entity in a condominium association are the unit owners. There are several problems that arise; again, it is very difficult to know who is renting and who is owning. Not all associations have that information. There's been suggestions that the insurers would know that, but I submit that that's not always true because who they deal with are the association boards, not with unit owners. So we would ask that that be clarified in the law as well as in the implementing regulations. The problem is that when a claim - it's our understanding that as these assessments or this surcharge is made, assuming all these other problems were dealt with, as this assessment would be made based on owner occupancy. Then assuming there is an earthquake and then there is a claim made, it's the structure that is, in fact, insured. Then you're going to have some discrepancy in terms of whether or not it was owner occupied. Then when claims are made, who gets paid? We posed this

question to the Department and were told that who would be paid would be the association. So that essentially you're giving the responsibility to distribute the claim money to owners or - it would have to go to the owners because they're the only legal entity that they can recognize, to a lay volunteer board. And I can assure you this would give rise to tremendous litigation.

Unfortunately, many condominium associations are known as litigation factories, given the problems that go on in them with enforcement of the CC&Rs and all of that, they're very quick to go to court because there aren't a lot of alternative ways. I submit to you that the way this is currently set up it would be not only a burden, but it would be a real challenge to these boards to try to be responsible for that.

CHAIRMAN GREEN: Let me break in here. In the legislation, doesn't it address regulations for condominiums?

MR. HOLDEN: Yes, it does. It specifies that condominiums are covered under the program, individually-owned condominiums. And then later on it provides one exclusion for rental properties and that is to single-family dwellings.

CHAIRMAN GREEN: Well, but these regulations are set up ...

MS. STEWART: So you can't do that ...

CHAIRMAN GREEN: Wait a minute, wait a minute, wait minute, pardon me.

The Insurance Commissioner has the authority and is mandated to make regulations for condominiums. What you're talking about is not a change of law, but a change of - this is something that should go in front of the committee and in front of the Commissioner as far as the regulations affecting the condominiums.

MS. STEWART: Well, we're more than happy to work with whomever is the responsible entity to change that because as I say ...

CHAIRMAN GREEN: Am I right in this?

MS. STEWART: ... you cannot make that distinction.

MR. HOLDEN: You are correct, but I think what Ms. Boyer-Stewart is saying is is that there is the problem with Davis/Stirling on the budget end.

CHAIRMAN GREEN: Well, that's a minor thing. She's talking about a whole bunch of other issues. These issues set down by regulations. I can, yes, the Stirling thing is legislative, but the overall package of what she's talking about is squarely in the Commissioner's lap.

MS. STEWART: Well, it was my understanding that it was - in 412 where it named owner-occupancy, it made that distinction. Is that correct?

MR. HOLDEN: That's correct. It is in statute that it's owner-occupancy with respect to condominiums.

MS. STEWART: So we just need to remove that, because it's important to recognize that the legal entities are the associations which are governed by documents referred to as bylaws and CC&Rs which, by the way, vary throughout the state. So when you make that distinction between owner-occupancy and rental, you're opening up the board to incredible liability as well as ...

CHAIRMAN GREEN: Well, I want to continue this on through to our next meeting, December 4th, and give it some time ...

MS. STEWART: OK.

CHAIRMAN GREEN: ... because I think it's an important enough issue and I want to get a report from staff is who's responsibility is this, Legislative or is it the Commissioner? We have to come to some conclusion on that. I hear both things.

MS. STEWART: OK. There was one other thing and I've talked with your staff about it. That is, it may be advisable to request a Legislative Counsel Opinion with respect to this problem that a board may not raise their dues in excess of 20 percent should this surcharge exceed that. If they comply with the mandate, they're in violation of Davis/Stirling and if they do not, they're in violation of the mandate. So we would like to see some clarification there.

CHAIRMAN GREEN: Well, on the words of the Stirling Act, the last words in your own sentence, it answers that, except as necessary for emergency situation. It's an emergency thing when the State mandates a cost to you.

MS. STEWART: I hope so, but we would like to see that clarified. Obviously if there were an earthquake, then it's an emergency, but just implementing a program to address the possibility of an earthquake.

CHAIRMAN GREEN: Well it's an emergency as far as the Fund is concerned to keep it in balance. Yes it is an emergency. If you didn't pay it, you would have an emergency.

MS. STEWART: Well I can assure you again that there are going to be any number of homeowners who will sue their boards because the board construed it in your way when it can in fact be construed another way. And again this opens up tremendous exposure for our board people.

CHAIRMAN GREEN: There is no way in the World that we here in Sacramento can write all laws where we're not, where people are not going to sue. I wish it were totally possible. And if your people want to be sue happy, so be it. But somebody has to sit back and say this is the way it is. OK?

MS. STEWART: Well that's what we're asking is if you would clarify this as the way it is, then we're really satisfied.

CHAIRMAN GREEN: You have attorneys for that and ...

MS. STEWART: And they have said that in fact they would be in violation of Davis/Stirling if they raise ...

CHAIRMAN GREEN: I bet I can poll 20 attorneys to take the other opinion.  
(Laughter.)

MS. STEWART: Well there you are, see.

CHAIRMAN GREEN: So you're going to be sue happy anyhow.

MS. STEWART: No, we're (Laughter.) - we're just asking for clarification.

CHAIRMAN GREEN: All right. Thank you.

MS. STEWART: OK? Thank you.

MR. HOLDEN: I would just say, we had suggested that they try to obtain a Leg Counsel Opinion on that and that might be helpful to all of us.

CHAIRMAN GREEN: It possibly could. And Leg Counsel is real loaded as far as these opinions are concerned and we don't get them very rapidly, but we'll request one.

Anything further to come before the hearing?

\_\_\_\_\_ : --Inaudible--

CHAIRMAN GREEN: Yes. If you can take about ten minutes, I'm about a half hour late now to my appointment.

\_\_\_\_\_ : We'll be very brief.

CHAIRMAN GREEN: OK. I'm sorry it kind of got out of hand as far as time is concerned, but it's a big subject.

MR. BILL GLASCOCK: My name is Bill Glascock. I'm an independent insurance agent and broker in San Rafael. With me is Michael Cabbot who is the executive director of the Western Association of Insurance Brokers. I'm also representing the Independent Insurance Agents and Brokers of California.

For 15 years now we have been, as a trade association, enthusiastic about governmental help in solving this residential earthquake insurance program. Without going into any detail about our proposals, we have hoped that this program would be a good program because we, our members, have to sell this insurance program to our clients, consumers. We had hoped that we could, in all honesty, tell our clients that this is a sound program, it's a good program, you should pay the premium, pay the assessment. Our members are having some serious concerns about it now given the proration possibility and, indeed, probability if there's a blowout in the first couple years of this program.

We're also concerned about the fact that this is really not insurance, this is a disaster relief program. It bears none of the incidence of insurance, true insurance, and the thought that has occurred to me, sitting here this morning listening to these deliberations, that maybe one of the problems in this is that

it's tagged on to the insurance policy and we tend to think of this as being insurance. We keep falling back into that trap. I had hoped that the collection problems could be resolved thus assuring a mandatory program which is so necessary to the integrity of the program. We'll just have to wait and see how that works out.

My clients, about 30 percent of my clients, carry earthquake insurance, the other 70 percent really don't care about it at any price, and I'm in the north bay area here in San Rafael. I'm very concerned that - Lonnie Atkisson testified that he wasn't sure, but he felt there might be a number of people who didn't pony up when asked to. I feel that there will be a significant number in our area of people who, given the opportunity to not pay, will not pay this assessment.

I'd like to suggest, in conclusion, that a better way logically, as I see it and our trade association sees it, for the assessment to be made is through the County Assessors office where the records exist already.

CHAIRMAN GREEN: That's one of the options that the Commission should be looking and the Commissioner's office should be thinking about.

MR. GLASCOCK: Thank you. Great. Because that really makes sense to us. And so much of this would be avoided, so much of this discussion could have been avoided had a simple system been designed, or hopefully can be designed.

That's all I have, Senator. Thank you.

CHAIRMAN GREEN: That's one of the options that should be really looked at and has been and that's been come out in front of the Committee many, many times.

MR. MIKE CABBOT: I echo what Bill said. There's only one other thing I'd like to bring up. We represent some 13,000 independent producers in this state.

One of the problems we see with the program is that even though this is a state program and the companies are going to tack it on to their policies, the insured's will be calling us to service the policies. They will be calling us to take care of their claims. They will be asking us to do a lot of work for them on this. We will be doing record keeping work in our own office, which we have to keep records for seven years. We'll be doing all of this for the grand sum of \$1.00 which we split with the carriers. I would submit that our average member to put a policy in his office cost him between \$25 and \$30, just base without any profit at all. Now the members of our association are going to be going to a great expense and there should be some way to address this. They shouldn't be subsidizing the program. That's what I want to say.

CHAIRMAN GREEN: Thank you very much.

MR. CABBOT: Thank you, Senator.

CHAIRMAN GREEN: Anything further? Then we'll stand adjourned until December the 4th by which we'll then continue our hearing.

--ooOoo--