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Oversight Hearing on Implementation of SB 2902 (California Residential Earthquake Recovery Act) December 4, 1991

Senate Subcommittee on Earthquake Insurance

CALIFORNIA LEGISLATURE

SENATE SUBCOMMITTEE ON EARTHQUAKE INSURANCE
SENATOR CECIL GREEN, CHAIRMAN

Oversight Hearing on

IMPLEMENTATION OF SB 2902

(CALIFORNIA RESIDENTIAL EARTHQUAKE RECOVERY ACT)

December 4, 1991
State Capitol, Room 2040
Sacramento, California

620-S

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MEMBERS
ED DAVIS
DAN MCCORQUODALE
JIM NIELSEN
ALAN ROBBINS

California Legislature

SENATE SUBCOMMITTEE
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SUBCOMMITTEE ON EARTHQUAKE INSURANCE
CECIL GREEN, CHAIRMAN

December 4th, 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. EXAMINATION AND RESOLUTION OF ISSUES RAISED AT PREVIOUS HEARING: NOVEMBER 25TH

A. Department of Insurance

- **John Garamendi**, Insurance Commissioner
- **Richard Holden**, Program Manager

SENATOR CECIL GREEN, CHAIRMAN: Welcome to the hearing. And as you all know, I'm Senator Cecil Green and Chairman of the Subcommittee on Earthquake Insurance. And with me today is Senator Frank Hill.

The hearing we are having today is to meet with the Insurance Commissioner and resolve some of the most important issues which were discussed in our last hearing. What I'd like for us to focus on today would be solutions or options we have available for us to resolve the problems that we heard about: In particular, what regulation, legislative, or other action can be taken to ensure that this program is implemented properly?

During our last hearing we also gave the Department some instruction on what we expected to hear in this next hearing today, and in particular as it concerns the issue of mandatory participation, surcharge rates, and deductibles; program implementation, and mobile home and condominium coverage. We would like to either hear from the Commissioner or his staff to provide us with this information as requested.

What I will attempt to do for each issue is to briefly summarize my own thoughts about what was said last week on a particular issue, and then to have the Commissioner and his staff respond to that issue. I believe we should then attempt to resolve that issue. And I'll make some specific recommendations of my own, as I hope other Members will also.

I'm sorry to say that I do not feel good about the way the Department has handled the implementation of this program. I believe if the will -- if their will had -- if the will had really been there to get this program going, we would have been a lot further along in ensuring this program was properly implemented. However, I'm hopeful today that we can have a very positive outcome from these hearings and that we begin to search for solutions to implementation (?) this program rather than dwelling on some of the negatives which we have to overcome.

And at this point I'd like to ask Senator Hill, is there anything you'd like to say?

SENATOR FRANK HILL: (Microphone feedback) And that's all. Thank you, Mr. Chairman. [Laughter]

CHAIRMAN GREEN: Gee, you're noisy, Frank.

SENATOR HILL: Thank you, Mr. Chairman. Just a couple of quick thoughts. I appreciate the Commissioner being here. I send my condolences about the passing of your father. I understand that is very traumatic, and good to see you back.

I guess just a couple of quick thoughts. I think the first one is, it's clear -- and I assume that you've received the letter from the Governor -- that this is a program that's going to stay into effect and it's going to go forward. And I think, you know, cooperatively we need to work in that vein.

I believe the major sticking point that hopefully we can come to some resolution on is this whole mandatory issue. And I believe that once we can solve the mandatory issue -- I personally am very open about all the discussions in terms of deductibles and the size of the -- what the rate -- the range of the rates, and especially hope that we can spend some time today on the broad issue of program implementation in terms of just how we're going to sell the program to the public.

And I think a lot of that needs to be a more cooperative effort in terms of the industry whose going to be out there, really be on the front line. And so I guess from my perspective, Mr. Chairman, it seems to me if we can put that mandatory issue behind us, I think certainly I'm open, and I believe you're open, on how do we solve the other pieces of it.

But I guess the broad overview is the program is going to go into effect. I think there's a clear consensus from the Legislature, and now there's no doubt about it in terms of the Governor's statement that he wants the program to go forward. And I think that cooperatively, hopefully we can make some major progress this morning.

CHAIRMAN GREEN: And now, John Garamendi, would you like to give us your statement?

INSURANCE COMMISSIONER JOHN GARAMENDI: Yes, I would. Thank you very much, Senators, for your -- for the opportunity to come back and to appear here. My apologies for not being with you last Monday. My father did die on Monday, and I was occupied with that.

I welcome the opportunity to work with you. You have spent many months -- in fact, years -- working on this program. As I said at my last appearance before you, you're to be commended for your efforts in trying to deal with this problem that California, almost unique among the states in this nation, faces.

We've come a long way in meeting the needs of Californians in the area of earthquakes and in coverage, in providing them with insurance or coverage for their losses. However, we have not yet reached our goal of an adequate program, and I welcome your willingness to try to accomplish that.

I would like to deal with a couple of issues. I'll quickly go through some of this and shorten much of this testimony. You have it, and others can read it. And I'd like to get on to some recommendations that I would like to make.

First let me just say that my staff and the Department has worked exceedingly hard on making this program workable and implementing it. We are prepared on January 1 to have the program operate. It is a tight squeeze for everybody. We knew it would be when we took office in January of 1991. At that time there was no staff, there was no money, there was no program. In a matter of a short year or less than a year we have actually created the largest insurance program by number of customers in the State of California. There is no other insurance program that has as many customers as this one will, a very complex program that is in fact going to be a bit expensive to run and complex to run, and will require the coordination and cooperation of the entire industry, many of whom are prepared on January 1 to implement the program as designed.

I would like to just take exception, Senator, to your comment, Senator Green, that the staff has been inadequate in meeting the challenge. They have in fact met the challenge. We find in meeting that challenge that our views differ on some key issues, and perhaps the focus of today's hearing will be on those differences of view on the program itself. But we are prepared, and we will unless the law changes implement the program as it exists today on January 1. That implementation will be hopefully complete. It may not be if some of the insurance companies are unable to gear up, given the very tight time frames that they have.

Now, I'd like to just for a moment iterate that the problems of this program are not new. I have appeared before you three times and have written numerous correspondence with you pointing out some of the problems -- the problems that the program has. Some of those problems have been addressed. Basically, the rates are insufficient, given the risks and the deductibles. They're a mandatory issue that Senator Hill just spoke to must be addressed. And the free ride provision in the first year raises very serious equity as well as economic concerns.

The program does involve very -- in its present format does involve very costly reinsurance. And there are serious negative consequences of purchasing financial reinsurance and in issuing revenue bonds. All of that has been brought to your attention in previous testimony.

There are a couple of additional fundamental problems. The first problem arises from the basic premise that the program is pre-funded. My experience on the Senate Revenue and Taxation Committee, where I was Chairman, has taught me that pre-funding means that funds are readily available or are scheduled to be built over time to fund a governmental activity. In fact, this fund is not likely to build.

Although I've recommended that rates -- recommended rates that would pay for the estimated annual losses to the program, the fund is not capitalized at the outset, and we would not allow any insurance company to operate without initial capital. But this one is designed to do so, or is supposed to do so. And we actuarially cannot expect the fund to build over time unless we get very lucky; unless we beat the odds. Now, if we beat the odds then I'm wrong, and California is fortunate. But playing against the odds is not a wise thing to do. I'm trying to run a Department of Insurance, and in this case an insurance company. I'm not trying to run a lottery. And that's a fundamental issue here.

Secondly, consumer expectations. This government program is structured like insurance. The bills are paid through residential property insurance billings. The rates are set based upon risk. Coverage is dependent upon payment, except in the first year. And claims payments are made without respect to need. That's an insurance program.

At the same time this is a mandatory program, or at least it's supposed to be. It's mandatory to pay the surcharge. The program pays out basic -- the program pays out based on the fund availability, not on the contracted amount. And the program contains -- therefore the program -- furthermore, the program is intended to help reduce the need for post-disaster funding, the kind of thing that the Legislature has and the Governors in the past had done when we had a disaster -- that is, to step in and to provide relief. The program therefore contains elements of insurance and government. It contains elements of taxers -- taxes, and user charges.

But what of the consumer? What do they think? Do they and will they agree that the benefit payments can be limited to the available funds after they have paid the premiums year after year after year?

In the hearings following the 1989 Loma Prieta earthquake members of your Subcommittee were cautioned by a consumer representative when you were considering a state pool for paying earthquake claims. And I quote here that testimony: "I would express a caution about any state pool program, that it be adequately capitalized so that representations being made to the people when they pay those premiums in fact will come true when an earthquake hits, and there will be money to stand behind the claims."

Now, that was a statement by Gail Hillebrand of Consumers Union and raises the fundamental question of how government deals with its people. Are we going to be able to make good on our promise? I think not, and we'll go into that, I understand, in more detail with some questions that you have, Senator.

Finally, the Earthquake Fund has another threat to its solvency, which the Legislature and the Governor control: and that is, the siphoning of funds to pay for other programs. Even though we haven't yet received one thin dime in surcharge revenues or in premium revenues, the legislation was adopted by the Legislature and signed by the Governor which raids $750,000 from the fund to finance research projects in the Department of Commerce. I expect that I will in the future have to resist other attempts, as I did this one, to drain the fund's resources. And I would ask you and the Governor to turn away requests such as this one in the future.

Now, you have asked that I provide options, and I'm prepared to do so. I have four options for your consideration regarding the status of the California Earthquake Recovery Fund, and they are as follows:

First, as I suggested last time, the first option -- and I believe the best -- is to repeal the program and create a disaster fund. I recommend that you repeal that program and in its place establish a disaster program. Such a program would be what this program was intended to be: disaster relief following a major earthquake. Consumers would not pay through their insurance bills for the relief. It would be -- they would therefore not be disappointed, their expectations that -- in their expectations because the fund cannot and will not be able to pay full coverage after an earthquake.

I can't give you all the details. Those would best be left to the legislative staffs and the Governor's Office of Emergency Services in the Department of Housing and Community Development, two agencies that today already administer large disaster programs. I would expect, however, that the existing state relief mechanisms could be utilized, and that the delivery of funds would be based on legislative parameters; that is, we would -- you would design the parameters of the program, how much would be covered and under what circumstances.

A disaster relief program could be activated automatically following the Governor's disaster declaration, and it would set in motion either existing resources -- that is, a pre-fund that would be, could be established -- or funds that would be triggered upon the occurrence of such a disaster. All of that could be done ahead of time.

The funding source in this case, it would be some sort of tax mechanism such as the Sales Tax that was used following the Loma Prieta. The parameters for providing relief -- that is, how much would be provided, how many dollars, under what circumstances and the mechanisms -- would have to be worked out through the legislative process. But they are workable. We have done it before. And they would not result in frustrating consumer expectations or -- and also they would not result in ongoing overhead and expenses associated with running an insurance program.

I gave you the outline of that the last time I appeared before you, and I offer that as my principal recommendation. Now, should the Legislature and Governor choose not to go that route, and Senator Hill suggested that may very well be the case, I offer you three other suggestions on modifying the existing program.

I think that you envisioned, when you drafted the original legislation, that a federal program would eventually take over. I think we ought to press hard for a federal program. That option would be to work with our Congressional delegation and achieve support in Congress for a proposal to adopt a multi-peril natural hazard program at the federal level that addresses earthquakes, floods, windstorms, and other natural disasters. Adoption of such a program, instead of using the California fund, and a national earthquake project approach would have the benefit of spreading the risk throughout the United States, and it could be made mandatory by requiring the participation of lenders that carry federally backed mortgages, much the same way that the flood insurance program is mandated today.

That, obviously, is down the road. It lies out ahead of us. But I think in the end you envisioned when you drafted the original legislation, and if that is the case I certainly would concur that that would be the best of all programs.

The third alternative that I would provide for you is to require the California insurers to offer a low deductible policy. This option would expand the mandatory offer language that currently requires insurers to offer earthquake insurance by providing a lower deductible -- say, a five percent deductible. The rates charged would be subject to our rate approval process, 103 process, and therefore would be scrutinized to assure that insurers are financially sound and maintain sufficient resources to pay the low deductible claims.

Apparently, some insurers -- USAA, CSAA, State Farm and Allstate -- now offer a five percent deductible policy. This approach would extend the level of deductibles to all insurers. A variation on this theme would be to simply publicize those companies that would offer the low deductibles, and people could choose should they want to purchase that insurance.

Now, the fourth recommendation is to reconfigure the CER Fund -- the California Earthquake Recovery Program. This approach would use the existing set of rates, the premium levels. But it would phase in the coverage over a period of time. Beginning with a higher deductible -- say, $4,000 -- and perhaps a lower coverage, $10,000, in the early years of the program, thereby dealing with the principal underfunding problem that we have brought to your attention before.

The first color chart that I have in my testimony shows how this would work. It's called the catastrophic fund building options, and I draw this to your attention. If you have that before you, the annual exposures would be less. And this is shown on the blue line that you see drawn across the page. Since the annual exposure would be less, the difference between the currently adopted rates -- that's presently calculated at $50 -- and the lower annual rates that would be required -- $35 for a $4,000 deductible and $10,000 coverage -- that incremental sum could be invested with the intent of reaching a policy target of funding losses for a magnitude seven earthquake on the Hayward Fault, which is the catastrophic earthquake. That earthquake threatens the San Francisco Bay Area. There are similar type earthquakes that would threaten the Los Angeles Basin.

In this case the additional $15 per policy increment spread would generate about $94 million, plus interest, in the first year. The estimated earthquake fund loss due to a Hayward 7.0 earthquake under the $4,000 deductible, $10,000 coverage option would be $1.2 billion. Under that option it would be under the $4,000 deductible, $15,000 option, coverage option, it would be $1.7 billion. Thus with accumulating interest it would take us eight years to fund the Hayward event under the $4,000 deductible, $10,000 coverage and at least 15 years to fund $4,000/$15,000 option.

Once the fund reaches the targeted balance, whatever we choose to set, the coverage could then be expanded to what is in the present law -- a $2,000 deductible and a $15,000 coverage with rates ranging from $12 to $75. That would allow for an expected annual loss of $317 million. The fund would, on an annual basis, be taking care of the small annual losses under the more limited program -- $4,000/$10,000 or $4,000/$15,000 -- as well as allowing for the accumulation and the building of reserves for the big earthquake, which we suggest as the Hayward event.

By the way, reserving for the Hayward earthquake would provide nearly enough funds to pay losses from a southern San Andreas earthquake in the magnitude of 8.3, which is expected to be $1.6 billion in the four to 10 range.

Those conclude my remarks. Those are the four suggestions, alternatives that I offer to you to put this program in working order. I'd be happy to discuss them with you in any detail, including other issues that you might raise.

CHAIRMAN GREEN: Thank you, Commissioner. To go ahead with what I said about I believe you've been getting some faulty advice from staff, is as this program was envisioned four or five years ago after many lengthy public hearings we found that most claims were under the $15,000 category. Most insurance policies had the high 10 percent deductible. And as you say, the companies are still only offering a five percent deductible.

But when you have a $750,000 home or a $500,000 home, you will still find that the deductibles are very high and the cost of insurance is very high. We need to look at programs. And one we have that is currently being discussed is our insurance program, our earthquake insurance program, was put together for a particular purpose. The envisioning was those people that had that deductible that really was no good to them because they've been paying for something they didn't get during both of those earthquakes, that that was a need by the public.

When I envisioned the first program I envisioned a committee of knowledgeable people, which you have. I envisioned the staff, which you have, that would come to grips with the problems of how this fund is to be financed. I haven't seen that on the table yet because there are various ways to build the fund, not just what you just suggested. But we have a way to legislate saying, in the interim period we will provide "X" amount of funding. There are low loans and so forth available out there. I would think that this would be a sign to your committee that are very knowledgeable people, and give them the problem and say, what are the fixes?

Now, in my talking to some of your Commissioners, that hasn't been done. So I think what we -- where we get into today is, and I don't want to keep browbeating this along, but I don't think that your staff has done the adequate advisory for you, the Commissioner, to make the decisions of your advice of what to do. Your staff didn't sit through all the hearings that Frank and I did. Your staff has not seen the need out there on this program as we have.

COMMISSIONER GARAMENDI: Senator, if I might just respond in a couple of ways. Your initial point is that the insurance industry does not offer reasonably priced insurance for the first dollars lost in an earthquake; that they have high deductibles. And even with the high deductibles the insurance is expensive.

There is a very sound reason why that happens -- why insurance isn't available, why if it were it would be very expensive, and why there are very high deductibles. The reason is, it is enormously expensive to provide coverage because the losses are huge...

CHAIRMAN GREEN: Mr. Garamendi, we have sat in and heard hours of testimony saying just what you're saying.

COMMISSIONER GARAMENDI: Now to get (?) to that.

CHAIRMAN GREEN: Now, but there's some innovative financing, and we're a government entity. We're not a private insurance company. We're there trying to help the people.

COMMISSIONER GARAMENDI: I understand.

CHAIRMAN GREEN: And you as the advocate for the people of the State of California elected to say, we will help you people.

COMMISSIONER GARAMENDI: I would -- nothing would please me more than to be a position to say to the people of California, we're going to take care of all of your problems and it won't cost you a nickel. That isn't the fact. The fact is, you can't create -- the fact is that the losses are enormous and they have to be paid for.

Now, how to go about paying for them: We have offered to this Committee in the past many different options. One of the options is to increase the amount of money collected. The second is the requirement that it be mandatory so that everybody in the state literally be taxed. That's the word -- be taxed to fund this program. We can call it a premium, but it amounts to a tax. That's a mandatory.

Now, that's how you've got to raise the money. It goes into an insurance pool, and the money is then paid out when an incident occurs. The likelihood of a major incident exists. It exists at any moment in the future. We have to have adequate funds to meet that. The fact of the matter is that the premium level that we have today, the deductible level, combine to create an insufficient funding source.

Now, we could go out and purchase reinsurance, and we're attempting to do so. The reinsurance market also knows what we know: that this is a risky and extremely expensive business. And they're going to make us pay a mighty sum of money for that reinsurance.

The second point is that the first dollars can't be created from nothing. We have to buy financial reinsurance for the first dollars, or we have to have a line of credit from the state for the first dollars. There is no capital in this company. There's no capitalization, and therefore we start with nothing. That creates an additional problem. We have been wrestling with this issue of financing from the very outset. From the very first we looked at it it was my analysis, based upon the information we had back in January, that this thing is in serious financial trouble. We have maintained that view throughout. We have...

CHAIRMAN GREEN: It shows by what actions has been taken.

COMMISSIONER GARAMENDI: Well, Senator, we have worked with many different experts.

CHAIRMAN GREEN: Mr. Garamendi, this Senator has sat back and listened a lot to the financing of a pool. We also have to live by the history of what we do when we do have a calamity; namely, Whittier; namely Loma Prieta. And what did this state do when those things happened? They came forth with special actions of the Legislature. They came forth with the quarter cent sales tax for the Loma Prieta and raised a billion dollars because of the emergency.

Do you have -- you have no confidence in the Legislature, that if we had an emergency when this fund was low that they wouldn't act? I have confidence in the Legislature. Yes, they would act.

COMMISSIONER GARAMENDI: I have repeatedly told you and the Governor that in order to meet the financial requirements of the law to provide the full benefits, the Legislature would have to either raid the General Fund, get money out of the General Fund, or provide additional financing. Otherwise, we would be left to provide a prorated payment. I said that in January. I've said that every time I've appeared before you, and I'll say it again.

Would the Legislature do it? Perhaps they would. They've certainly done so in the past. But you and the people of California need to understand that that is the requirement that would have to be met if the full payments were to be made.

CHAIRMAN GREEN: I understand that. I ran with legislation to delay this six months to get some of that legislation on the books. It didn't happen. There has to be a loan guarantee to this fund to keep it secure when that building period is. We know that. Without the loan guarantee you can't get good low-cost umbrella insurance. You can't get bonds. You can't get all the financing needed to make this fund whole when it starts.

Yes, we have to have that. And both Frank and I are dedicated to make that happen with the Legislature, but we have to have somebody lead to really push the Legislature and the Governor to put that in place.

COMMISSIONER GARAMENDI: I've done my best to inform the Legislature and the Governor about that requirement.

CHAIRMAN GREEN: Well, I left last year, I left the legislation to Mr. Hill. I want to have him come on now and talk about the legislation that was attempted to put through the Legislature last year. And go ahead, Frank.

SENATOR HILL: I want to kind of change directions a little bit. This program is going to start in January. I mean, that's the reality. It's going to go in effect in January. That's the law. You say the Department is ready to start the program in January, and so I'm operating from that mode. How do we make this thing work starting in January?

Any discussion about changing the direction of the fund or asking Congress to get involved I think is, you know, is a great public policy debate. But the fact is for at least a year, even if there was some sort of consensus, none of that is going to happen. I think it's clear from where the Governor is that he's dedicated to making this program work.

It seems to me that common sense says, any program that's going to bring in $300 million a year, setting it aside into an Earthquake Fund dramatically improves the position of the state from where we've been. I guess my -- I agree with Senator Green's comments.

I mean, this for me, John, is a philosophical leap of faith, this whole mandatory issue. You call it a tax. You're absolutely right. It's a tax. And the reason that I with my philosophy was willing to make that jump was I was convinced, as Senator Green, that the response from this Legislature is going to be that we're going to come back into special session if necessary. We're going to help people get back on their feet. And whether that be $400 million that the state kicked in out of the General Fund from the Whittier quake or $1.2 billion in the Loma Prieta quake, the State of California is going to help people get back on their feet.

And so the issue becomes, how do we create a pot that starts growing so that we can be prepared for that contingency? My frustration is, every time somebody from the Department comes forward it's a new set of numbers. You held a press conference last August. It was $119 had to be the average premium. Then it was changed to a $78 number. The last thing I heard from your advisory committee was a $51 average premium to a $60 premium; from a $2,000 deductible to a $4,000 deductible.

And my frustration is the actuarial numbers that this program was built upon came from the Department of Insurance. These were not some legislative numbers. These were something that came from the Department of Insurance that put this whole program together. And I guess my question, again, comes back to this whole mandatory issue. John, we had in SB 412 specific language that we felt gave the Commissioner broad authority in terms of dealing with this program. The compromise that was worked out, you know, gave some -- and I don't have the specific language in front of me, but it said we're going to give the Commissioner broad authority to implement this program.

As I understand it, a decision that was made by OAL to stop at least the one track -- and there are lots of options in terms of how do you do the enforcement, the mandatory enforcement -- that that decision was made by OAL before SB 412 was even signed into law. And so I guess my question is, let's focus in on that narrow issue.

COMMISSIONER GARAMENDI: Okay.

SENATOR HILL: Do you believe that the language that was in SB 412 in terms of giving you broad authority is substantial? What's the possibility of going back in terms of the regulatory process? Now that SB 412 has been signed into law, has that changed the dynamics of OAL? What are the options in terms of the mandatory participation that you have ____________?

COMMISSIONER GARAMENDI: The mandatory language, the mandatory nature of this bill, a law, is according to the Office of Administrative Law not there.

SENATOR HILL: Now, that was before SB 412 was signed.

COMMISSIONER GARAMENDI: Yes. It -- before SB 412 was signed the Office of Administrative Law rejected our proposal to achieve a mandatory mechanism.

SENATOR HILL: One mandatory mechanism. They -- as I understand it, they gave some other options for other mandatory mechanisms. And I guess my question is, what about that OAL process with this new -- you know, with the fact that SB 412 was signed into law a couple of weeks later?

COMMISSIONER GARAMENDI: My reading -- let just read to you what I have written to the Governor in response to his questions and comments concerning this: "My reading of the decision of OAL indicates even if other approaches..." -- and these are some that you and Senator Green have recommended -- "...were cost effective..." -- and that's a big question, and I'll come back to that -- "...I would have no authority to adopt a regulation requiring those actions without a change in the law."

In particular OAL stated, quote, "Neither in Section 510 of the Insurance Code nor elsewhere in the act is any provision made for the enforcement of delinquent surcharges." Later on OAL elaborates. "The act makes no provision..." -- now, this is prior to the new law going into effect -- "The act makes no provision for any enforcement of this surcharge in the event the insured does not pay -- the insuree does not pay the insured, insurer. This silence was maintained by the Legislature in two subsequent cleanup bills: Statutes of 1991, Chapter 81 and 104," which are the bills.

"Since the Legislature has repeated opportunities to include provisions authorizing enforcement of the surcharge by the Insurance Commissioner and failed to do so, it is unclear what enforcement powers, if any, the Insurance Commissioner has in this regard."

Our lawyers have looked at that and...

SENATOR HILL: Now, all that's before SB 412 was signed into law. There's a provision in SB 412 that gives the Commissioner broad authority. And I guess my question is, do we need to add to that language?

COMMISSIONER GARAMENDI: The specific language that you have -- that was added does not provide any specificity.

SENATOR HILL: That's right. It says (?) the Commissioner -- I don't know...

COMMISSIONER GARAMENDI: Shall enforce the -- shall do what's necessary to enforce this; shall adopt -- what is the exact...

SENATOR HILL: Adopt regulation. The Commissioner shall have authority to adopt regulations to...

_________________: Implement this subdivision.

COMMISSIONER GARAMENDI: Okay.

SENATOR HILL: Now, that was all before all this OAL decision was made. OAL made the decision...

COMMISSIONER GARAMENDI: At this point we have no indication from OAL that there's any change in their attitude as a result of the new law going in. The broad authority -- they found that in the previous law which we thought had broad authority, it didn't have broad authority. Excuse me, it did not have specific authority, and it was the lack of specificity that was their basic objection and the reason why they knocked out our regulations.

SENATOR HILL: And I have to assume that the attorneys from the Department felt when you went forward that you did have a legal ground to stand on in terms of the direction that you _____________.

COMMISSIONER GARAMENDI: That is correct.

SENATOR HILL: Okay, so you felt at the time, we've got a legal ground to stand on. OAL disagreed with that and turned it down.

COMMISSIONER GARAMENDI: That's correct.

SENATOR HILL: In the interim, though, there has been a new law, SB 412, which was not part of that whole deliberation, which gives the Commissioner specific authority to adopt regulations.

COMMISSIONER GARAMENDI: No, it doesn't provide specific authority. It reiterates the broad general authority that we felt was in the original law. It is the specificity or the lack of specificity in the law that OAL rested their case on.

SENATOR HILL: I'd like to suggest two things. One would be that with the result of the signature on SB 412, that you guys go back at the mandatory participation issue again from a regulatory perspective; that you come back and try some regulations.

And secondly, that we work together in terms of beefing up whatever language you guys feel needs to strengthen your authority (?). We felt that we had dealt with this issue. We felt that by giving that language in SB 412 that that thing had been put aside. Obviously, it hasn't. So I'd like...

COMMISSIONER GARAMENDI: We agreed with you, and the Office of Administrative Law and apparently the Governor disagree. They want -- they felt that there needed to be specificity. Now, if the Governor has a different view and believes that specificity is not required and that in fact the power does exist, then I'm willing to work with him to figure out what he wants for mandatory.

We have one suggestion. If he -- if the suggestion that we have put forward is satisfactory or he agrees with that, then we can resubmit. But frankly, my experience with the Office of Administrative Law has been very negative thus far. They've rejected virtually every regulation that we put to them. I'm not sure who they're listening to, but they're not apparently listening to my office. I would like to know ahead of time what their view is and what the Governor wants in the nature of mandatory provision.

There are options I would suggest to you; that we must be careful in adopting certain of the proposals that have been put forward. For example, it's been suggested that we utilize a civil procedure against those who don't pay. Well, that's a small claims court action to collect a $50 premium, and I got to tell you that there's no way that's cost effective. We may as well not bother. There has to be a cost-effective way of doing it. It is clear to us that many people in the State of California under the current -- in the current situation will choose not to buy the insurance and simply become scofflaws. There's not much we can do about that, so we need some sort of an effective mechanism to force compliance.

CHAIRMAN GREEN: Well, possibly, Senator -- or Senator...

COMMISSIONER GARAMENDI: It's okay.

CHAIRMAN GREEN: John, going back to my experience on local government is when we put a fee or whatever against a property, then we had the lien against the property at the end of the year if it were not paid. That's very much of a possibility, and it's just an act of a computer latching the lien if it's not paid.

COMMISSIONER GARAMENDI: We considered a collection mechanism utilizing a property tax lien or an assessment against the property. There are a couple of problems with that. First of all, the initial issue about mandatory remains, and it really should be clarified by law.

Secondly, if that issue is there then the collection problem continues to exist. If it's expensive to go to small claims court to get 50 bucks out of a property owner, I can assure you that to go through the proceedings of collecting a lien is even more expensive. And so we run that problem.

CHAIRMAN GREEN: Wait a minute. We had trash rates collected through our city. Once a year we put the uncollected on the property tax roles. There was no expense. And when that property eventually had the property tax paid the money came to the city that I represented.

COMMISSIONER GARAMENDI: That mechanism could work. We would -- it would be required of -- we could not do it without legislative authorization.

CHAIRMAN GREEN: Oh, I understand.

CHAIRMAN GREEN: That's clear. Now, there is a problem for the financing of the fund in such a proposal, and that is a cash flow problem. Now, we could deal with that if we had a loan guarantee or a credit, a line of credit extended to us by the state. But without that additional financing from the state we have a cash flow problem.

CHAIRMAN GREEN: See, John, there has to be a multitude of things done to have that fund whole when we start.

COMMISSIONER GARAMENDI: I agree.

CHAIRMAN GREEN: I understand that.

COMMISSIONER GARAMENDI: I agree. The collection through the property tax is a way of accomplishing the goal, but it does require specific legislative authority.

CHAIRMAN GREEN: And there's other ways to do it also. So I think that that's, again, recommendations of how do we go from here.

COMMISSIONER GARAMENDI: We are open to your suggestions, your leadership in figuring out the best ways. We'll certainly work with you. We have considered several alternatives. The alternative that we put to OAL we felt was the most effective. But it does have a serious problem.

CHAIRMAN GREEN: Commissioner...

COMMISSIONER GARAMENDI: Senator is fine. I like that.

CHAIRMAN GREEN: Well, once a Senator always a Senator. We here, Frank and I, are the architects of the plan. We're not the operators of the plan. The operators of the plan should be coming forth with the, say, we want to do it this way. And Senator Hill and myself, either one will run with legislation. He has a good track record. I have a good track record on getting legislation passed. And we want to make this program a good program and a whole program, but we need the Insurance Department working with us, not in opposition to us.

COMMISSIONER GARAMENDI: Well, we're not in opposition. We're trying to find solutions to the problem, as are you. We have been blocked at this point from implementing a mandatory provision that we though was the most effective. It is not a particularly palatable one to people who don't want to buy the insurance. They don't like it. We understand that. The Office of Administrative Law in any case has blocked it, and we can't proceed with it. We don't think the language in the new bill provides us with the kind of specific authority apparently required by the Office of Administrative Law.

Now, if the Office of Administrative Law has changed its mind based upon the new code, we have heard no indication of that. We'll certainly engage in a discussion with them to achieve it. I think also we need to know where and what you want and what your views are on the proposal that we have before the Office of Administrative Law, and we'd like to know where the Governor is on it because ultimately he has the power (?).

CHAIRMAN GREEN: I think Senator Hill addressed that just a few minutes ago. Number one, he said that why don't you enact those regulations again, and under the new law then go from there. Because you've tried once a few months ago does not stop. For instance...

COMMISSIONER GARAMENDI: We have one problem. In a letter that the Governor sent to be yesterday he cites his specific opposition to our proposal. I don't know what effect that view may have on the Office of Administrative Law, but the proposal that we have before the Office of Administrative Law, even if we were to renew that in an emergency regulation, would apparently be opposed by the Governor.

SENATOR HILL: Here's what I would like to suggest. As I understand -- let me make sure I've got the historical perspective right. You went forward with the regulation. OAL turned it down. It was two weeks before SB 412 was chaptered into law, so that was not part of the OAL deliberation.

As I understand it, you did not attempt to appeal the OAL decision to the Governor, similar to what you did with the Prop. 103. Okay, so we didn't try to appeal that. I guess what I'm trying to do is to get back in a constructive vein in terms of what -- you know, where do we go from here? What I would propose is the Department come up with two or three or four different regulatory options that say, here's how we can enforce the mandatory provisions.

And John, just so you know, this is not some new issue for the Legislature. We wrestled with the mandatory issue. The consensus at the time was that the overwhelming majority of the public was going to participate in this program, one, because the closeness to the incident; because most people are law abiding citizens; that we felt it was a good deal for the Legislature, and to be -- for the public, and to be honest with you, I think many of the comments, specifically from you, have damaged the mandatory participation, the number of people who are willing to participate in the program (?). I mean, I think that's just the reality.

And what I would propose is that you come forward with two or three or four other options; that we prepare to go ahead with OAL. And you and I and Senator Greene sit down with the Governor and say, the program has to be mandatory. You and I and Senator Green -- the consensus, actuarially, it has to be made a mandatory program. And let's sit down with the Governor and say, what do you feel comfortable with in terms of enforcing the mandatory mechanism of this program?

I believe that the language in SB 412, you know, we thought that we had solved that issue. And if that doesn't work, if that approach in terms of dealing with the Governor, dealing with OAL, coming with four other suggestions doesn't work, then I think we ought to at the same time move down a second track, and this is legislatively make sure that you have the legislative statutory backup to make sure that we can deal with this issue. I think that's the linchpin of the entire program (?).

CHAIRMAN GREEN: And Senator Hill, this letter that John just referred to says exactly that from the Governor's Office. And if you read the full paragraph: "We urge you to use all the resources of the Department of Insurance to get this program established." And then it goes on: "Specific (?) you should amend and adopt regulations to solve the problem." And then the last part of the sentence what you read: "We do not believe that cancellation or non-renewal of homeowners or fire insurance is an acceptable means to enforce this mandate."

COMMISSIONER GARAMENDI: Senator...

CHAIRMAN GREEN: And that's been by -- that's the problem. So why not use another approach?

COMMISSIONER GARAMENDI: Senator, we have investigated many different approaches to achieve a mandatory -- mechanisms to enforce the mandatory provisions. The mechanism that we suggested in regulations was rejected by the Office of Administrative Law. The Governor apparently remains in opposition to that mechanism. Senator Hill, you expressed opposition to it when the regulations were introduced.

And the reason we put forth those regulations was that in our view that was the most cost-effective way of achieving the goal. We had several other options, some of which were vigorously opposed to by the insurance industry. For example, that they be responsible for collecting it, and if they don't collect it then they simply have to pay the bill. They didn't think much of that idea, and I can understand why. That does put the burden on the industry.

We also looked at the tax proposals, the property tax issues that you talked about, Senator. While they are -- while there is a certain efficiency with them, there are some real severe problems, not the least of which is Proposition 13 and some interpretation of whether this is a tax or a fee, and back and forth. We think we can get by that. We had -- we have some real serious concerns about the political viability of that, and it would require a new law, and we do not have the authority under any law that has been proposed to accomplish that.

We looked at several other mechanisms, none of which were cost effective. And therefore the one that we put forth was the most cost effective. Apparently it is also a very controversial, and to some, not desirable. We will be happy to share with you all of our iterations on this matter, all of our suggestions and ideas. And if you have one that you like or that you think is feasible and can get the Governor go along or the Office of Administrative Law, we'll do it.

But I want to put back in your mind the notion that it ought to be cost effective. Some of the mechanisms would simply cost more money than they're worth and would have therefore no value.

CHAIRMAN GREEN: We agree with that. However, I believe from day one on this program we've given the Insurance Commissioner's Office broad powers to regulate, to do this job. As yet we don't have the job done, and I don't want to keep going around and around this issue and saying the same thing.

COMMISSIONER GARAMENDI: Well Senator, let me just...

CHAIRMAN GREEN: All of the things that you've said is things that have been said in front of this Committee. But right now you've suggested and put one regulation in place, and this is a number of months later. And we're still arguing and debating that same part. You've been told, that can't be done.

COMMISSIONER GARAMENDI: Senator...

CHAIRMAN GREEN: Now we need another place and another regulation to proceed with.

COMMISSIONER GARAMENDI: Senator, I am prepared to work with you and Senator Hill and the Governor in devising a mandatory mechanism or a mechanism to enforce the mandatory provisions of the law. We have investigated five -- six different options. I think many of these options were discussed with your staff. Some I've already discussed today. We'd be happy to go back through those with you. Some of those options require new law, and I have no authority any longer to deal with that issue. You gentlemen do, as does the Governor.

The one that we proposed to the Office of Administrative Law has been rejected and is apparently opposed to -- the Governor is apparently opposed to it at this moment, as perhaps you are also, Senator Hill. The other ideas were rejected by the insurance companies. We have no further ideas. We're happy to work with you, and perhaps we can dream something up.

Now, even without an enforcement mechanism we are prepared, as I said at the outset, to put this program in place. But I must tell you, as I will always tell the people of this state, that the program has serious financial problems and there is a strong likelihood that we will not be able to meet the commitments of the program. Now, that's the facts as I know them, and I will not say otherwise.

Now, if the public accepts that and they pay their premiums a hundred percent, that's what I would expect them to do. But they should do that knowing that if an earthquake occurs of any significance in the early years, they will get cents on the dollar. That's the reality. I can't change that reality. There is nothing I can do with this program to change that reality. That is the way it is, the nature of the problem that we face here in California. The fact that the program is not pre-funded, it is not capitalized at the outset, and the earthquake could occur tomorrow or the first day of the operation.

CHAIRMAN GREEN: Well, I think that's where the philosophy comes differently, John. I believe that if this is done properly it can be funded from day one. And there are other problems, too. I'll go down another one is, for instance, what is an earthquake? Does it start at 1.0 on the Richter scale, or does it start off at 4.0 on the Richter scale? That has to be done. That has to be looked at and talked about.

COMMISSIONER GARAMENDI: Under the law that you have written an earthquake occurs when there is damage resulting from the movement of the earth. And so we could receive claims from a .1 earthquake on January 1. It is possible that the smallest of temblors will result on January 1 of a claim against the state.

SENATOR HILL: Mr. Chairman, before we leave this mandatory issue.

CHAIRMAN GREEN: Yeah.

SENATOR HILL: John, can we get from the Department a list of these six, and we've all talked about, these six options -- I think there are some others that are out there -- prepared in a regulatory form so that you and I and Senator Green can meet with the Governor the early part of next week and deal with this mandatory issue and set that part of it aside?

COMMISSIONER GARAMENDI: I will deliver to you later today the six options that we investigated. They will be an analysis of those pro and con of those options. That will be delivered to you later today. You can draw your own assessment. I would not recommend that we go through the process of drafting legal language associated with those. That would be a waste of time until you settled on which ones you wanted to do.

CHAIRMAN GREEN: Have you asked (?)...

COMMISSIONER GARAMENDI: Next week I'd be happy to meet with the Governor, but I am out of town at a national conference.

CHAIRMAN GREEN: Those options, have they been passed through your commission, your advisory committee?

COMMISSIONER GARAMENDI: No.

CHAIRMAN GREEN: I think you're losing a very valuable resource there, not using your committee properly.

COMMISSIONER GARAMENDI: Senator, I told you that the recommendations were not formerly presented to the committee. However, members of the committee -- perhaps not all, but the more active members of the committee -- have reviewed these options. I'm not sure that each one of those people have reviewed every option, but the options have been discussed with many members of the committee...(Inaudible).

CHAIRMAN GREEN: Well, but that's -- see, a committee is valuable when you assign __________ to it.

COMMISSIONER GARAMENDI: And Senator, it's on this afternoon's agenda for the advisory...

CHAIRMAN GREEN: Pardon (?).

COMMISSIONER GARAMENDI: It's on this afternoon's agenda for the advisory committee.

CHAIRMAN GREEN: Great. Thank you. To finally got it done have to get on the committee. That is one of your most valuable assets is those people that you have to advise you on this program. All right.

COMMISSIONER GARAMENDI: Your wish is our command. This afternoon it will be done.

CHAIRMAN GREEN: Okay.

COMMISSIONER GARAMENDI: Senator Hill, while you're finding your place, Senator Green, you indicated, Senator Hill, that the estimates have changed over a period of time, and that is accurate. Part of the package that I've delivered to you, there isn't a page number on it. It is a chart that looks like this. It's called, "The Comparison of the Average Rate Estimates." It would be useful, I think, to just go through this for a moment.

The first estimate is the Department of Insurance estimate in 1990. There were three assumptions that were implicit in that estimate, and that is the estimate that you used in drafting the law. First, there is no administrative costs. That isn't the way the world works. There are in fact administrative costs, and they're going to be in the range of $15 to $20 million a year. It costs that much to run an insurance company. If somebody can figure out a cheaper way of doing it I'll adopt it. Based on -- it was based on a scenario of...

CHAIRMAN GREEN: John, let me give you a -- before we get off of that one, you've made the statement, "I'll show you how to run an insurance company."

I was the architect of an insurance pool in the South that insured 33 cities to start with. It was a risk pool, just what we're talking about here. And it currently has over 60 cities in it. They started with nothing. They've been going since 1978. They've been refunding half of their payments in each year back to the cities. They've amassed over $60 million in a reserve pool. Now, their overhead to run that company is four percent of the annual, not premiums, but deposits.

COMMISSIONER GARAMENDI: Senator, I applaud you for your innovation in creating that risk pool. There are similar risk pools operating in California as a result of the first one that you established. And the 60 cities that are involved in it are well served by it.

The fundamental problem that we face in administering this program is that we have 100,000 times more customers than does your risk pool. We have 600 -- 6,600,000 customers that we have to serve. It makes this the largest insurance company operating in the State of California by the number of customers it has. That's where the administrative...

CHAIRMAN GREEN: The Southern _______________ Joint Powers Insurance Risk Pool is not an insurance company. It's not handled as such. The state pool should not be handled as an insurance company. It's being looked at as that. It's not. There's no cost of sales. There's no cost of overhead other than the personnel that you have working. And if you run it right it won't have to have. This is a person that has sat and put one of these in place, and I know about this sort of thing.

COMMISSIONER GARAMENDI: Senator, with all due respect, we are required to operate an insurance company. We must collect premium from individuals. There are six and a half million premiums that we must receive individually from the insurance -- through the insurance companies to us. There is an accounting mechanism that must match those premiums against claims. That's a very, very expensive process. And we then have to go out and adjust each claim. That is also an expensive process. It requires a significant administrative effort to do that. We are not operating with 60 cities who are insured against the risks of that city.

In addition to that, Senator, one of the principal problems that this fund faces is in the reinsurance area. We have to purchase reinsurance based upon the ability of the fund to collect money annually. The lack of a mandatory provision, enforcement provision that works thus far...

CHAIRMAN GREEN: John, we've been over the mandatory, and I understand exactly what you're saying. I've been over the ground. I've been there. I have worked with co-insurance. I've worked with mandatory. I've worked with all of this. Yet we were able to put it together, and we didn't say, we can't do. We set about getting it done. Now, I want to get off of that.

COMMISSIONER GARAMENDI: Senator, we are going to do this. But you must be aware of the problems because it is a serious concern for the State of California. It has...

CHAIRMAN GREEN: It is a serious problem, yes sir, Mr. Garamendi. But we should not dwell on it. We should not keep dwelling on it. And we should not say, yes, we have problems, but we can get over the problems if somebody will work and get over them.

That's all I've heard from you from the time you've sat down today is how many problems we have. And you have not come up with the cures yet. Mr. Hill made a suggestion. You have said, yes, we'll sit down with the Governor and give you six suggestions. I agree with that. But you keep coming up with the same words.

COMMISSIONER GARAMENDI: Senator, perhaps you'd like to use different words (?).

CHAIRMAN GREEN: And Mr. Garamendi, let me use some of my same words. I've been there. I've put a pool together. I was one of the first presidents of that company, as you might say. It's not a company. It is a private-public quasi-agency. And you can operate that on like a four percent of the overhead. And if you tell me any different, I've been there. I've already done it.

COMMISSIONER GARAMENDI: Senator, I welcome your advice and counsel, and we will seek it. And if you have ideas on how to run this thing, I welcome your counsel.

CHAIRMAN GREEN: If you would send your staff to Southern California and look at Joint Powers Insurance Authority and do some of the things they're doing, and that's risk management. That's going out and doing claims. I was chairman of the claims committee for about 10 years. Now, I helped to pay these claims off.

SENATOR HILL: Commissioner, can we go on to surcharges and the rates, that issue? I think we've come as far as we can go in terms of the mandatory issue. Let's talk about surcharges and rates and your suggestions on the deductibles, the size of the -- your arguments in terms of -- at least the last I understand was $12 to $75 in terms of the premium and some of the logic behind that.

COMMISSIONER GARAMENDI: I'd like to ask Richard Holden to provide you with this specific information.

MR. RICHARD HOLDEN: Your confusion on the rates, or perhaps not confusion but concern about seeing different rates, is certainly justified. It's a complex program. The information that has been developed over a period of time, we believe, has improved substantially.

Last year you were dealing with a figure of $36. That figure was based on no administrative cost. It was based on a very limited portfolio of earthquakes. It didn't include any large earthquakes. And it assumed pro rata payments. In effect, it did not make an actuarial judgment at all. It said that for certain earthquakes occurring at certain times below a certain size, you would be able to pay for some of those. But you wouldn't be able to pay for anything larger than that.

The next set of figures that you were given -- and I believe that these figures were given to you last year when you were considering the program -- were figures provided by the Earthquake Project or the National Committee on Property Insurance. And I noticed that John Drennan (?) with that organization is in the audience today.

He can provide you more detail on those if you'd like. But that number, $93, was based on 1987 data. It was based on 30 faults in the model, and it includes about $39 for loss adjustment, additional loss cost, and for administrative expenses.

We talked to the National Committee on Property Insurance and asked if they wouldn't do another cut on it for us, since they did have a model and we were in the process of collecting information to develop better estimates. They did so. They improved their model, updated the data, included more faults, and they came up with an estimate of $119, and that's the number that you've mentioned and...

SENATOR HILL: Right. Before -- just so I understand, let's look at the $93 -- that's a $93 average premium. And does that -- am I correct to assume that when it says $11 for loss adjustment, that means out of every $93 in premiums there's going to be $11 in adjustment costs and $28 for administrative cost?

MR. HOLDEN: That's correct.

SENATOR HILL: That just seems to me, just off the top of my head, seems like a huge...

COMMISSIONER GARAMENDI: That was an estimate that was based on 1989 data, and it was done by the National Committee. It was their best guess. We asked them to go back and to look at that again and to take into account the kinds of administrative procedures that we were contemplating, the kinds of organizational structure that we had set up or were thinking about setting up. And that then resulted in the next, the third column, which has lower loss adjustment expenses and lower administrative expenses.

However, it does take into account new data and information about the likelihood of earthquakes in California. In other words, 64 potential faults rather than 30 faults that could cause serious damage, and the 1990 data which was an update based on the Loma Prieta. And that resulted in even a larger suggested premium. Now, we're adjusting the administrative cost downward, but the losses were going up at the same time.

MR. HOLDEN: Now, those were the estimates prepared by NCPI, and those were their estimates of what those administrative costs would be. We estimate that those administrative costs would be less, would be $11 for the administrative cost and 4.9 percent -- excuse me, 8.4 percent for loss adjustment expense.

Our numbers compare very favorably to industry numbers. If you use "Best's (?) Aggregates and Averages, 1991," their administrative expenses are 12.9 percent. Ours are 4.9, nearly a third. Their loss adjustment expense is 9.4 percent. Ours is 8.4 percent. We're still below. So what we have done is devise a program which is in fact more cost effect than what insurance companies operate at. And that's what you would expect, and that's what we would expect to do.

The last two columns reflect really our estimates based on the best data available, and I think the best data that's ever been collected in this area. It represents a portfolio of 6.3 million households statewide. It was plugged into a model that you heard a little bit about at the last hearing, developed at Stanford. It's probabilistic. It doesn't show catastrophic loss. It shows probable loss. It includes substantially more faults, and the two rates. $50 is what we adopted because -- an average of $50 because that was the -- what we were allowed to under the law. However, if we were to charge actuarial rates, including the administrative expenses, they would be $68 on average.

The proposal that we have suggested earlier on to go from $12 to $75 with a deductible of $2,000 would reduce that average rate to $61. It would be close to the range that you had earlier envisioned. But those are the rates. Those are the differences.

SENATOR HILL: Let me make sure I hear that again. The $12 to $75 with a $2,000 deductible gets you to an average premium of $61 on this probabilistic where, as I understand it, you weight different...

MR. HOLDEN: That's correct.

SENATOR HILL: Different quakes in terms (?) of...

MR. HOLDEN: Absolutely correct.

SENATOR HILL: And the new number, the $4,000 deductible, the new -- you got a new number for me today, John. You got a $4,000...

COMMISSIONER GARAMENDI: This proposal that I made to you this morning is a way of creating a reserve, and that's what this was all about. And we went through -- it does that by reducing the maximum coverage to $10,000 and increasing the deductible to $4,000. That allows us actuarially or probabilistic each year to set aside about $100 million to create a reserve fund; in other words, to pre-fund a disaster off in the future. And that is an approach that we -- that I offered to you as a way of creating an actuarially sound program.

The down side is that there are reasonably high deductibles, $4,000, and you would reduce the amount of coverage. So you'd be providing a limited coverage for a period of years while you built up your fund. The up side is that you're likely to be able to pay what you have promised.

SENATOR HILL: How about rather than heading in that direction, let's talk about at least what appears to be the closest in terms of where the program was originally drafted and the closest scenario you lay out, and that's that last column. Talk to me about the $2,000 deductible versus the sliding scale that we now have in the program, and what does that do in terms of actuary? And then also, increasing the top bracket of the fund from $60 to $75 in terms of how many more people or what kind of structures are included in that. And what does that mean in terms of more money into the fund (?).

MR. HOLDEN: Basically, the program that was approved last year was a deductible of a $1,000 to $3,500. It was 0.5 percent, a half a percent. What that...

SENATOR HILL: __________ structure.

MR. HOLDEN: That's correct, on the value of the structures. What that turns out to be in reality for about 90 percent of the structures is a $1,000 deductible. So 90 percent of the structures have...

SENATOR HILL: Help me through that. Ninety percent. So that must mean that 90 percent of all the homes in California are valued under what?

MR. HOLDEN: Ninety percent of the structures are valued -- have a structure value of less than $200,000. So they would all be at $1,000 deductible. So the range is not much of a range, and I think is what we're trying to say. And I think 95 percent would be $1,500 or less. So really you're dealing with that $1,500 to $3,500 deducible for only five percent of the properties statewide. So effectively you really have a little over $1,000 deductible. If you change this to a $2,000 deductible it makes a big difference.

We've provided some other charts for you, and I think it's the last page. And your question was, is how do these things change under different deductible and coverage options? And I apologize that the numbers on the bottom are sideways, so you have to twist your head a little bit, but...

COMMISSIONER GARAMENDI: Or the paper.

MR. HOLDEN: The $2K/$15K, which is about a third of the way from the left, is the number that we suggested before that provides a rate of $61, a total rate of $61. On the far left is the existing program, with the $1,000 to $3,500 deductible and $12 to $60 range. And we have a $68 total rate that it should be if we were funding it to fund annual losses.

Now what the Commissioner suggested this morning is an approach or an option that would provide for fund building in a way that even our recommendation on the $2K/$15K really does not, unless we get lucky, because the $2K/$15K at that rate structure really just pays for administrative expenses and for the estimated annual losses, plus a small reserve of $10 million a year. As you can guess, $10 million a year will not build to very much very quickly. We've used what we thought was the best numbers, the most complete set of numbers, and the best technology to do these estimates. There's always uncertainty with these, but we tried to use the best information to get there.

SENATOR HILL: Tell me, Richard, because I want to stay at the $2K/$15K scenario, what does increasing that deductible mean in terms of millions of dollars a year into the fund? What's the difference between -- you've articulated why a $1,000 deductible is only good for -- is good for 90 percent of the people. What does that mean?

MR. HOLDEN: Well, if you look -- that number is also there on that chart, too. The actual total losses are represented on the right hand side, and I believe for that one it's about $380 million, $390 million in losses under that $2K/$15K.

SENATOR HILL: Um hum.

MR. HOLDEN: Whereas, if you go to the current program it's somewhere in the order of $440 million. I think it's $428 (million) I think is the exact number.

SENATOR HILL: So going to the $2K deductible is another $70 million a year.

MR. HOLDEN: That's correct.

SENATOR HILL: And so that's...

MR. HOLDEN: Oh, less than that. Yeah, about $50 million.

COMMISSIONER GARAMENDI: About fifty.

MR. HOLDEN: $428 (million) minus, I guess, $380 (million) -- $50 million or $60 million.

SENATOR HILL: Okay. And then, what about going to the $75? That's $50 or $60 million. What about going to the $75 -- the top bracket, $75?

MR. HOLDEN: Changing the top end doesn't really -- what these estimates are are what you need to earn, on an average basis, to fund the estimated losses. We would need to go to a $75 range, or at least above $60. But we would really need to go to a $75 range to be able to accommodate the $61.

SENATOR HILL: Because you need the higher average.

MR. HOLDEN: Because we need a higher average. And people in the Central Valley, most places really have low risk, and so their rates would be kept very low. And in the rates that we proposed and that we sent out, adopted, those rates were kept low -- I think $12 to $15 in the Central Valley locations, and then they were higher in the high-risk areas. But I should note that they weren't high enough in the high-risk areas to fund the actual risk in those areas.

SENATOR HILL: Now, if you don't have an earthquake for three years, you don't have a draw on the fund, the only loss, then, is the administrative cost? You're building up $350 million a year. What are we at, $61 -- $370 million a year?

COMMISSIONER GARAMENDI: You'd have your administrative cost plus your annual reinsurance costs, which I think are around $40 million a year for reinsurance, and then your administrative costs, say around -- probably around $12 (million) if you don't have any -- about $10 (million), I guess, if you don't have any loss adjustment. Is that about right?

MR. HOLDEN: That's right.

COMMISSIONER GARAMENDI: I think that's about right. So we'd be -- you know, you'd subtract $50 million to $60 million from that, whatever the revenue stream was.

MR. HOLDEN: We don't think it's reasonable to assume that there's not going to be any earthquakes. There's a magnitude six...

SENATOR HILL: I'm just trying to -- I'm just trying to...(Inaudible).

COMMISSIONER GARAMENDI: (Inaudible)

SENATOR HILL: ...go a year or two, you know, or you go...

COMMISSIONER GARAMENDI: Senator, while you're on that point, one of the issues that we've been dwelling on perhaps too long is the deductible side of it. The way the program is designed is that the smallest of earthquakes -- and I got to tell you there's a roaring debate out there about earth movement versus earthquake, but let's just call it earthquake right now -- could result in claims. And since we have such a low deductible, the likelihood of claims being filed is very high from a very small earthquake -- small cracks, shifting foundations.

And we are not going to be in a position to adjust those losses in any reasonable way because if we get a claim for $1,500 for cracks in the wall as a result of a reported earthquake, which usually occurs when the Challenger returns to Southern California, it's almost cheaper for us simply to pay the bill rather than to go out and even bother to investigate and the like. So we got a real problem, and this is the deductible issue.

SENATOR HILL: I understand. And the difference between $1,000 and $2,000 dramatically will make a difference in terms of the -- I understand from the actuarial standpoint why it makes a big difference, but does that...

CHAIRMAN GREEN: I might...

COMMISSIONER GARAMENDI: From the adjustment experience? My personal experience with painters and plasterers is you run $2,000 the moment they show up.

MR. HOLDEN: It does make it...(Inaudible).

CHAIRMAN GREEN: Well, I think it goes to Section 5001.5 of your bill: "And the Commissioner shall by regulation define structure and covered structural damage for the purpose of establishing the extent and type of damage that are covered by this chapter, and exclusions from coverage," and so forth. So you can by regulations set a 4.0 or whatever as far as damage. And you can also -- and it goes further on there in (b): "The Commissioner shall by regulation define qualifying earthquake events for the purpose of determining these seismic events that qualify for coverage under this chapter." So you have full authority.

COMMISSIONER GARAMENDI: Senator, we are aware of those opportunities to define. They present serious equity questions that we have addressed in emergency regulations. Are they in yet?

MR. HOLDEN: That's correct.

COMMISSIONER GARAMENDI: And I'll ask Richard to describe those briefly. And then if you care to we can go into it in more detail.

CHAIRMAN GREEN: Well, I don't think we need do it today.

COMMISSIONER GARAMENDI: Well, those emergency regs are available to your staff, and they do attempt to define and they do quantify.

One of the questions that we wrestled with was, do we use a Richter scale criteria as the threshold? It seemed to us to be a very inequitable criteria in that it is possible that a small earthquake located -- a very small earthquake located immediately on your property or under your home could result in severe damage, whereas a larger earthquake may have no damage at all. So that variation caused us to try to use a different definition, which is reflected in the regulations.

CHAIRMAN GREEN: I think both Frank and I over the period of time have stated, cosmetic is not what we're trying to cover with this. Structural is what we're trying to cover, and that's basically what the legislation is is for structural and the collapse of homes, not cosmetics. And I'm saying to you that yes, regulations can be developed to cover that, and it was given broad powers...(Inaudible).

COMMISSIONER GARAMENDI: I think we got into this, and we're doing so. The regulations are before you and you can judge them, and we'd be happy to respond. And I think they accomplish a goal. I think I got into this by -- through the administrative cost issue and the cost of adjustments. My point early on was that the smallest of earthquakes is going to result in claims. We are then left to adjust those claims and to determine if indeed it's structural or non-structural, and the application of the criteria that we have through the regulations. That's an expensive process, and that was the point I wanted to make (?).

CHAIRMAN GREEN: There's cost of that, I understand that, claims adjusting. Maybe you want to change your view of the way that you have your claims adjusting. Maybe you don't want to go through claims adjusting. Maybe you want to go through the Office of Emergency Services. You've got state people out in the field. I know it's mild (?), but people are out there representing the state, and with a little training program you might have -- you might could save an awful lot of money, John.

COMMISSIONER GARAMENDI: I -- you keep going along that line, you will adopt my first recommendation, which is we have an emergency or disaster program and we not make it insurance. In fact, we eliminate the insurance portion of this and simply cover claims as needed.

CHAIRMAN GREEN: Well, I don't look at it as insurance. You do. It's a difference in philosophy. I think it's still a state program, and it's a program that we all can make work if we avail ourselves of the facilities the state has.

COMMISSIONER GARAMENDI: Senator, if that is the case then please work with us to redefine the nature of the program. The law, in our view, and it has not been seriously contested, is that this is to be set up like an insurance program. Now, if you would like it set up and if it is your intent to set it up as a disaster relief program, it makes things a whole lot easier, principally because we then don't have to match premiums to claims. We simply go out and deal with the claims. We collect the money in some efficient, equitable manner and then go about paying claims as they come in and not worry about the match. It is in fact...

CHAIRMAN GREEN: I don't think you and I are going to get philosophy together, John. But let's not use semantics. This is a program, whether it's tagged insurance or whether it's tagged something else, it's still the same kind of thing. There's differences in law. That's what we're talking about. It's a difference in law, not what this is called.

COMMISSIONER GARAMENDI: I'm trying to find neutral words so as not to set of reactions here. But what I'm attempting to do is to say that if it is the intent of the Legislature to pay claims as defined -- structural, whatever criteria is to be determined -- we are required by the nature of this legislation to match those claims against the premium paid; that is, the money collected. And later after the first year it's very clear in the law that if you don't pay your premium you don't get your claim paid. That matching creates an insurance-like program.

Now, if you want a disaster assistance program, then don't require us to match the claims to the payment of the premium or the collection of the dollars. Simply devise a mechanism to collect the money, whatever is reasonable and fair and equitable. And I've got my views, you've got yours. But that can be worked out.

CHAIRMAN GREEN: Premium? I don't think those words...

COMMISSIONER GARAMENDI: And then allow us...

CHAIRMAN GREEN: ...were there as a premium, Mr. Garamendi. They were as dollars. Nowhere in the law does it say, this is a premium.

COMMISSIONER GARAMENDI: Again, allow me not to use...

CHAIRMAN GREEN: (Inaudible)

COMMISSIONER GARAMENDI: Allow me to find a different word. We are required by the nature of the program to collect the money from the homeowner or the condominium owner. The mechanism, the collection of that money is then matched against the individual's claim, and after the first year if they do not pay they cannot collect a claim. That is an insurance-like program. Now, I use the word "insurance" advisedly, but it creates what is -- what amounts to an insurance-like program.

Also, this program has a risk based element in it. We are specifically told to vary the payment from the property owner based upon the risk of that structure, and that is defined as the seismicity in the area and the nature of the structure. That, too, creates a system similar to insurance. It is that that drives us to create and forces us to create an expensive mechanism. I have suggested to you before, and in listening to your earlier statement, that it may be -- I believe it's best that we create a different type of mechanism; that we create some mechanism to collect the money. If it's from homeowners and condominium owners, that's satisfactory.

That money would go into a pool and the money be paid out not based upon whether a person paid into the pool or not, but based upon the nature of damage to their structure. That eliminates the fundamental problem that we have wrestled with throughout this day, and that is the matching of claims to the payment of the money. And that's what we've wrestled with. That's the mandatory issue. That's the issue of administrative costs. That's the issue of pre-funding, of adequate financing and the like.

And I suppose when I've suggested that we -- in my first recommendation perhaps I should have said it, let's modify this program so that we achieve what I think you just said, Senator: that is, achieve a disaster relief program that is pre-funded. The amount of payment to be made can be determined based upon the money in the fund at the time, and that can be done administratively by me or by the Office of Administrative Services, by the Governor, or by whomever. I mean, it's a matter of counting. And it would allow us to set up a far cheaper system to operate, one that we could if we chose base upon financial need.

It need not be that way. You can simply base it upon the amount of damage. And it could utilize the existing disaster relief services that exist today: Office of Administrative Services, the Department of Housing and Community Development. They're in place and they operate similar -- they operate such programs today. We would not need to build a new bureaucracy in my organization. I have not been an administrator so long as to acquire that -- desired to build an empire. I would just as soon not in this case because I think there is a better way of doing it.

I'd be happy to explore with you those possibilities. And really all it really takes to do that is to divide the notion that the payment go only to those who have paid their money. All you need to do is to eliminate that. You maintain the collection mechanisms, and we're going to wrestle with that. We've talked about that already. We also would maintain the payment mechanisms. But you simply divide, you build a wall. You don't care whether they've paid or not. You simply care whether they've been harmed or not.

The collection is on the other side, and it can be through insurance premiums. It can be through a property tax assessment, a fee, whatever you wanted to call it. Clearly that would be the most efficient. It does raise Proposition 13 problems, but it's clearly the most efficient.

SENATOR HILL: I mean, I think this discussion is fascinating, and whether it's an insurance company or not. I don't believe that it is. And maybe some ambitious Senator will carry the program that you're talking about to cover floods and fires and earthquakes and the heartbreak of psoriasis. But that's a different discussion.

And I personally am convinced that the idea of basing the amount of payment on where you live and the kind of structure you have is a fair one. That's why you have people in the San Joaquin Valley pay $12 a year. That was part of how the program was sold to the Legislature. And I think if you go away from that into some sort of a mandatory disaster fund, that's a different direction for the Legislature and a fascinating one, and maybe next year somebody will carry that bill. I'm more interested in how do we implement this program and moving ahead with that.

I will tell you that I think part of what we need to do, I'd like to get into the next issue about the program implementation and how do we sell that. I will tell you that I think part of the discussion has to be, I think, something where the Commissioner feels comfortable with the viability of this program. And I'm here to tell you as one Senator that I will support the increase in the deductible to the $2,000 and the $75 maximum on that in terms of at least showing some movement on my behalf that the actuary numbers that were first presented. So where I'm in is that the $61, the $2K/$15K, $2,000 deductible, $75 maximum top cap of that.

COMMISSIONER GARAMENDI: Senator, I appreciate that, and that would be very helpful. Public hearings are difficult places to discuss things in great detail. I would also just ask you to consider my fourth proposal today and to ponder that, and I'd be happy to talk to you after you've had a chance to do that. It may be that that proposal, given the desire of the Legislature at this time, might be the best way of adequately financing this whole thing. It puts us, I think, in the best position. I'd be happy to discuss that after you've had a chance to ponder it and to look at it in detail, and not put you in a position of having to...

SENATOR HILL: I'd be happy to do that. I know the public hearing is not -- that's the trouble with democracy.

COMMISSIONER GARAMENDI: Well, it's not that. It's just that I don't want to put you on the hot spot of having to say it's a good idea or a bad idea. I just put the proposal before you and let you ponder it. Then you can query me at your leisure.

SENATOR HILL: I'd be happy to do that. I'm convinced about the $2,000. Of course, you understand that the problem that I have with the $4,000 or even the jump from $1,000 to $2,000 is that at a certain point you start losing the benefit of the program if you've got a senior citizen on fixed income, and all of a sudden saying, well, that's great. But you've got to come up with the first $4,000. It gets...

CHAIRMAN GREEN: And they can't do it.

SENATOR HILL: It gets to be very difficult. I wonder, Mr. Chairman, if we could go onto the program implementation part. Is that -- are you following on this?

CHAIRMAN GREEN: Oh, I'm following along (?).

SENATOR HILL: Maybe I'm on a different agenda.

CHAIRMAN GREEN: It is right here, yeah. It's right down _________.

SENATOR HILL: Okay. Maybe, Mr. Commissioner, we could talk about program implementation and what are we going to do to sell this program, and where's the Department. And what do we need to do, either legislatively, administratively, to help.

CHAIRMAN GREEN: Well, and on implementation you have the problem of -- that is, those that -- on a free ride based claim (?). What are you going to do in regulation on them, and so forth?

COMMISSIONER GARAMENDI: On the free ride, for the first year, depending -- for the first -- in the first year for individuals who chose not to pay, they're covered until they refuse to pay. That's the free ride. We've discussed this since January, and...

SENATOR HILL: Wasn't the free ride issue more a matter of somebody who doesn't get their billing notice from their insurance company? You now, my normal homeowner's policy comes out in October, so I won't get that notice until next October. The issue is, what happens if we have another earthquake in Whittier in July, and am I covered or not, even though I've never had an opportunity to pay? Nobody has ever sent me a notice.

COMMISSIONER GARAMENDI: We have -- we've wrestled with this. We've made suggestions. The suggestions that we've made have been rejected for a variety of reasons. One is -- and you've described it better than I did. Your description is accurate. Until in October you refuse to pay, you're covered. So...

SENATOR HILL: But I thought you'd made a comment that said, what if I choose not to pay?

COMMISSIONER GARAMENDI: Your description was better than mine. I was inartful in my description.

SENATOR HILL: (Inaudible)...that we talk about the pay to play issue is, what happens if I just don't happen to get my notice? I haven't made a decision, yes or no, whether or not I am going to participate.

COMMISSIONER GARAMENDI: We had recommended early on and had discussions with several -- with the Administration as well as with Members of the Legislature about this, and our recommendation was that people not be given a free ride; that there'd be some method of notifying homeowners, perhaps through the insurance companies themselves, through communication, the property assessment roles and the like, whatever, telling people about the program and alerting them that they could purchase the insurance so that that free ride problem wouldn't exist.

We went through many different ideas on how to accomplish that. Those ideas did not -- were not acceptable and we stayed, and the decision was made, not by me but by others, to stay with the present situation, which does provide up to a year free ride, depending upon when your homeowner's bill comes due. Now, most people will not have the full year, but I would venture a guess that about half of the population may have six months.

CHAIRMAN GREEN: Which is a huge cost in case of an earthquake, which -- it needs to be addressed.

COMMISSIONER GARAMENDI: I'm a firm believer in that 1978 theory. It's called fee for service. In this case we don't have it.

CHAIRMAN GREEN: Well, it needs to be a part of this program, and there has to be some sort of a way that notice can go out from somebody. Now, we don't have to use the insurance companies to do that.

CHAIRMAN GREEN: The first decision is to eliminate the free ride. If that decision is made then you can move to any number of options on alerting people to the availability of the insurance program.

SENATOR HILL: Well, see, I disagree with that. Well, first of all I wouldn't characterize it as a free ride. I think it's a free ride -- if somebody has made a decision not to participate in the program, I think that's a different issue. You know, as we wrestled with this -- first of all, it's only a one-year problem. It's a problem the first year, and every month that we go through it becomes less of a problem because people, you know, as your notices go out every month.

The reason the decision was made was a couple. The first one was, if you do a separate notice from the companies -- obviously it's a tremendous expense, a tremendous burden. It disrupts the whole process in terms of, you know, as your normal billing process go forward you participate into it.

Secondly, it's also an enormous political problem, and that is, what do you say to somebody in May who never had an option or never had any discussion about whether or not he was going to participate in the program? His neighbor across the street, who happened to have his homeowner's policy send out in March, he paid his. He's covered, and I'm in May on the other side of the street. I've got the same amount of damage. My homeowner's policy doesn't come due July, and I'm not covered.

And I guess part of the reason why I feel my hands are tied on this -- this is one subject that I know specifically. I've had very direct conversations with the Governor about, and he feels very strongly that you have to in that first year let everybody phase in normally. Once they make the decision not to participate, you know, clearly that you're not covered.

COMMISSIONER GARAMENDI: Senator, you've articulated the logic that brought us to the current unfunded liability problem that the state faces or this program faces, and quite realistically, the State General Fund faces because as Senator Green said, we got an early earthquake occurring, we're not going to have money in the kitty. I'm coming back here. The law requires me to come right back before you and ask for the full amount necessary to pay those funds. That means a General Fund obligation, tax increase, whatever. And I'll be here. The law requires me to come.

You know, I disagree with the Governor's position on this. I understand where he's coming from. We offered alternatives that were rejected, and that was various notification alternatives which we could conduct ourselves which could be conducted through the county assessment roles, property tax assessment. There'd be a lot of different ways of doing it -- through the insurance companies. It just wasn't acceptable, and so we are where we are.

What to do about it at this point, unless the Governor changes his mind, we simply have an unfunded obligation here, and that's -- you know, we are conducting morning and evening prayer sessions commencing January 1 and we welcome anybody to join us.

SENATOR HILL: But it also dramatically increases, you know, any -- a likelihood, I think, that the -- see, I agree with Senator Green. I've been through it, as you have been; two special sessions of the Legislature after an earthquake, and we raced to Sacramento and fall over ourselves trying to figure out new ways to give away new money. Everything that happened in the Whittier quake was offered to the folks in Loma Prieta, and then some. And wherever the next quake is going to be, there will be some energetic legislators who will say, we did it for Whittier. We did it for...

COMMISSIONER GARAMENDI: Starting with the floods of '86, and was my bill. I know where you started.

SENATOR HILL: You know what the mentality ______________ Legislature.

COMMISSIONER GARAMENDI: I know exactly.

SENATOR HILL: Let's talk about the program implementation and some of the companies having problems meeting the deadlines in terms of data submission, collection, et cetera, et cetera.

CHAIRMAN GREEN: And, you've got the same people that were billed, say, in January, that they didn't have the opportunity because we didn't come on line and they don't know about the insurance at this point.

COMMISSIONER GARAMENDI: The bills have gone...

CHAIRMAN GREEN: Yes, it's gone out.

COMMISSIONER GARAMENDI: The January 1 bills are out.

CHAIRMAN GREEN: Yeah, so you've got a whole raft of people like that.

COMMISSIONER GARAMENDI: Those people may be good for a year. Well, those are the program implementation problems. Richard can speak to those. Richard. And if you'd like other witnesses, that's -- be happy to.

MR. HOLDEN: We've been trying to work with the insurers on implementing this, and we have the January 1 due date. I know the insurers would wish that were a later date, but we have to live with that date and that's what we have been trying to work with throughout.

We met with them several times to discuss data submission and got some feedback from them and amended our request for information from them. And I think they're much more satisfied with it. The time frame was short for them, and I think that they expected much less activity on their part to implement this program than was involved, or just didn't really estimate the size of the program and what would be required from them.

We understand that some insurers, a number of insurers will be able to meet the deadline, so it's not uniform. Not all insurers are unable to meet it. And I think those that are not are working to meet it or meet it shortly after January 1. We have continued to have contact with them, to request information from them, to request test submissions for them. We are in that process right now of requesting test submissions. And if you have further questions regarding the specific interface and the process that we've gone through with them, be glad to ask Computer Sciences Corporation to come up and talk about their experience and what they see working more directly with insurers.

SENATOR HILL: Do you feel comfortable, Richard, that in terms of -- because a month ago, I mean it was, everybody was in a panic. We don't have this data. It's not in the right format. They're asking for stuff. We don't understand why they need that. Do you feel comfortable that those issues have been resolved, or, you know, we're going to be ready on January 1? I mean, maybe I ought to get a sense from the companies.

COMMISSIONER GARAMENDI: Senator, one of the -- Richard can get his thoughts together. One of the problems that we have goes back to this free rider issue, and that is that on January 1 this fund is exposed with every dwelling in the state -- excuse me, every homeowner, home, and condo in the state. We therefore have to be prepared on January 1 to adjust claims for every one of those. That's the real burden that the insurance industry has to face. It's ours together. We need information from them so that on January 1, need be, we can go out and adjust claims. That creates the burden.

And that brings us back to the free rider issue, and so it goes round and round here. But if we didn't have the free rider then we could not -- we would not be putting that burden on the insurance companies as their premiums came in. As their renewals came in, we would automatically get that information from them. It would be spread out over the year's period of time.

MR. HOLDEN: That's correct. We have provided them information on the rates, provided them information on the notice. In the rates, close to the time in which they wanted it; with the notice, within the time in which they requested it. And I think the bigger issue has not been the notice or the rates, but it has been that we require them to submit data on the properties to let us know where they're at so that we can tell whether they're covered or they're not. That's the big issue.

And as I mentioned, some of the companies are going to be ready to move forward with the program. Others are not. Others are going to do work-arounds where they're going to provide some of the data in an electronic format and some of the data in a paper format. We would prefer it all in electronic format, but we had agreed to work with them on that, and so we will take the data in that format.

We will just have to see what happens in the coming weeks. We've requested a test submission, so that should be coming in. And then we will have to see what happens after January 1 when they have to give us their full data base on the properties statewide.

CHAIRMAN GREEN: Is there anyone from the insurance industry here that would like to say something on this issue?

SENATOR HILL: Here's your last chance, now. I mean, Mr. Holden says you're going to room together next semester. Now, everybody agree (?) with that (?).

CHAIRMAN GREEN: All right. The opportunity was given. So implementation, there's still some problems with it. We understand. We'll be working with you trying to get this implementation done properly.

COMMISSIONER GARAMENDI: Senator, I'm really reluctant to give up on this free ride business because it is the heart of a lot of the problem that we have. If -- I would -- Senator Hill, you suggested that we -- offered that we work with the Governor on the mandatory provision. We will seek that offer, and we'd like to work with you.

CHAIRMAN GREEN: Well, I think this issue is...

COMMISSIONER GARAMENDI: If possible, I'd like to bring up this issue also.

CHAIRMAN GREEN: It's like the mandatory issue, is -- they're hand in hand. There's no question.

COMMISSIONER GARAMENDI: If we could get by this issue somehow in early January. We'll yank the insurance companies one direction, then another direction. But the burden is significantly -- the administrative burdens are significantly reduced, as are the potential unfunded liabilities of the state.

SENATOR HILL: Not to mention the political problem.

COMMISSIONER GARAMENDI: Yeah. That, too.

CHAIRMAN GREEN: Okay, we've got two -- actually, basically, two things to discuss at this point, and that's the mobile home coverage and the condominium coverage. Based on the other hearings and what I've been able to glean, there are some problems with the mobile home coverage which is duplicate. And they're also some problems with the CC&Rs of condominium owners. So those two things, I think, need to be discussed, and maybe hear from what you're doing, and then also hear from the mobile home people that are here and the condominium people that are here.

COMMISSIONER GARAMENDI: I'd like Richard just to share with you the information we found that you requested, and then go from there.

MR. HOLDEN: You requested information on overlap in coverage. And we talked to two insurance companies that are active in the mobile home business. One of them sells policies on mobile homes that are written as HO-5 (?), and I believe that's a -- it's kind of a variety of -- almost an automobile type of insurance. If someone else could verify that.

Typically that is how mobile home policies have been written. It has been treated as a vehicle, and so what has been put in place are low deductible for a variety of perils, including earthquake. They indicate that they have a five percent deductible on all of their policies. If they had a $50,000 policy you'd see that their deductible would be $2,500, so there would be overlap.

The other insurance company also indicated that. They indicated that they write them as HO-3 (?) policies, which is your typical fire policy, and indicated that with mobile homes that 85 to 95 percent of their policyholders have purchased the earthquake rider with the five percent deductible. And by the same logic there would also be overlap there, too. So I think it's clear there is a problem with overlap with the mobile home area.

SENATOR HILL: Did you say, Richard, that 85 to 90 percent have purchased this earthquake rider?

COMMISSIONER GARAMENDI: For that insurance company. It's one insurance company.

SENATOR HILL: Oh, I see.

COMMISSIONER GARAMENDI: Eighty-five to 90 percent of...

MR. HOLDEN: Of their policyholders.

CHAIRMAN GREEN: Of their policyholders.

SENATOR HILL: Well, what does that mean? Do we have any idea, statewide, in terms of mobile homeowners who are...

MR. HOLDEN: The datas exists in a variety of different policy forms. Somethings it's an HO-3 (?). Sometimes it's an HO-5 (?). We have the data on both, but we haven't been able to assemble it in a way that we get any meaningful numbers.

SENATOR HILL: I'd be curious to say, well, half of all mobile home owners in the state or 90 -- you know, it obviously makes a difference in terms of the number of people who are...

COMMISSIONER GARAMENDI: I think that there's two points. That's one.

SENATOR HILL: Um hum.

COMMISSIONER GARAMENDI: They may already have the coverage, so why should they buy this additional coverage? Excellent point. The second coverage -- the second point is that apparently insurance companies already offer what the state would be offering through it's insurance program, so why should the state be in the program at all?

SENATOR HILL: Well, the state should be in the -- if 80 percent of the mobile home -- if it's offered and 80 percent of the public isn't participating in it, there is going to be an expectation. You know, the lesson that I have learned from Whittier and Loma Prieta is yeah, I didn't buy private earthquake insurance. But, you know, you're my Senator and I expect you to do something about this hole in my roof. What the heck is available out there?

And so that's why I curious as to what -- you know, part of the whole motivation behind this entire program was the statewide fact that 20 percent of the people have private earthquake insurance. Even with the large deductibles, you've got 80 percent of the public who isn't covered. Yet when something happens when you have the next earthquake, people expect the Legislature to act and they expect you to help get them back on their feet. And so I guess part of what I'd like to know, I'm curious about, you know, what's available in terms of being offered.

COMMISSIONER GARAMENDI: We'll try to...

SENATOR HILL: What's offered and how many people are taking advantage?

COMMISSIONER GARAMENDI: We will continue to try to massage that data to get the information. And the present time it isn't easily found within the data base that we've been given.

CHAIRMAN GREEN: All right. Anybody from the mobile home companies here? Would you step forward, please. Give your name and address. We understand the problem, and I think you've seen what we're discussing and in what direction we're going. Now that, I think, is where comment should be.

MR. PAUL HENNING: My name is Paul Henning. I reside at 8665 Florin Road. I'm Vice President of GSMOL (?) for the northern zone.

I think Mory (?) Priest presented it pretty well for us, our legislative advocate, where a person in an earthquake zone pays the $60, but he only reaps, I think, around $1,200 if there's a earthquake there. And a person in a stick built home, they receive $15,000. So we think that there's a bad equity there.

SENATOR HILL: I understand that. But the Commissioner has the authority, based on the type of structure, to adjust the rates. And as I recall the discussion the consensus was at $12 a year with the $1,000 deductible, when we went through the program, you know, when the bill was first implemented, the mobile homeowners thought it was a good deal for them. That's why they were included in. We had a lot of discussion about that. They felt at that point it was a good deal.

And so I guess the question is, at what point -- should there be a different deductible level, John, for mobile homes? At what point does it no longer -- based on how many people are covered, at what point does it no longer make sense for them? Because it seems to me there was a clear consensus that at $12 a year and at a $1,000 deductible, even with the existing private insurance it was a good deal for mobile home park owner. Do you disagree with that characterization?

MR. HENNING: We have our insurance agent here from American Federation, and they give us the same coverage practically what the state is trying to give us now. We have five percent. We have to pay five percent, you know, if there's an earthquake, of the total cost of the mobile home. And the insurance coverage takes care of the rest. So, you know, we're pretty well set.

MR. KIRT (?) BAKER: My name is Kirt (?) Baker, and I'm an assistant vice president with Foremost (?) Insurance Group. We currently have three companies that we market through in the State of California, primarily and specifically for mobile homeowners coverage. Through these three companies we insure probably a third of the mobile homeowner market in California, or specifically, 140,978 mobile homeowners.

We do in fact offer earthquake insurance in our package at five percent. Some of the companies have options to buy down to lower deductibles, but that is generally not widely accepted as the cost for reducing and accepting further exposure for earthquake only. As we discuss the difference between multi-peril and specific peril, it is rather costly. As all companies wish to maintain a healthy market, earthquake is our major focus in terms of how long and how much exposure do we as a company are willing to take, and continue to be a healthy market.

That is a serious question, and from our point in suggesting that this is a good opportunity for mobile homeowners to extend them earthquake insurance coverage that, yes, they have today. But down the line we've seen an exodus of insurance companies leaving the state to serve mobile homeowner markets. There are very few that make that a priority. The burden of increasing market shares and exposure, then, makes this a very important issue for mobile homeowners who on average are 62, 63 years old with a median income of $19,000 a year.

I believe the primary interest at the time Mory (?) Priest spoke in favor of supporting the legislation for mobile homeowners wasn't specifically that the -- in agreement that the rates were adequate or that the coverage was appropriate, but more in the sense of the protection...(TAPE TURNED OVER)...through the three companies. Foremost Insurance Company, our parent company, serves all markets of mobile homes, from what we would classify as a preferred risk, in-park classification, to a private property risk on its own property out in a high protection class, say.

Average values in that company are approximately $37,000 per home. With a five percent earthquake deductible they have an $1,850 deductible; only served, then, at a $1,000 deductible under the fund of $850 for their $12 to $60 surcharge. In the company that we -- that is recommended by the Golden State Mobile Homeowners League, the American Federation Insurance Company that they recommend, values tend to be higher. It's a retired customer in the more preferred parks. Average values are $46,000; again, served by a five percent earthquake deductible would give them a $2,300 deductible, again only served by $1,300 underneath the fund. And those would be the discrepancies that we would want to work with the appropriate parties to rectify.

CHAIRMAN GREEN: I would suggest that this issue is going to continue into legislation this next year. I'm sure the Commissioner is well aware, as this Committee is aware, and it's been an ongoing topic. And as yet there's no decisions made. But I'm sure that Senator Hill, in part of his legislation this next year, will be running with this issue.

MR. BAKER: The major obstacle that we find, as pointed out in the last hearing by one of the insurance industry representatives, was we find ourselves as the spokesperson for the value of this coverage to our customer for a product that we're really not providing. And in that we simply are looking for solutions to maximize the value to the mobile homeowners, but under the current conditions have a tough time providing that value to the mobile home customers.

CHAIRMAN GREEN: We understand that. Anything further?

MR. HENNING: Senator, we're willing to sit down with the Committee and with the Commissioner and iron out our differences.

CHAIRMAN GREEN: Thank you. Thank you for coming out today. Okay, anything else on mobile homes, Mr. Garamendi?

COMMISSIONER GARAMENDI: I was just going to ask, is the total market 450,000 mobile homes?

MR. BAKER (?): We would estimate that that's pretty accurate.

CHAIRMAN GREEN: Now, is that -- and that's probably pretty close to the figures I've seen too, John.

COMMISSIONER GARAMENDI: Okay. I don't have anything else on mobile homes. I think you had one more subject.

CHAIRMAN GREEN: Yeah, the condominiums.

COMMISSIONER GARAMENDI: Condominiums.

CHAIRMAN GREEN: This is another issue, the same thing. I know that you're aware of this problem as well as we are. And maybe at this point we should bring the condominium people up forward and have a presentation to -- are they here today? Yeah, come on up and -- the CC&Rs and so forth are some of the problems, and she'll tell us...

SENATOR HILL: Mr. Chairman, I don't think we need to go -- I know what the issues are. There's a couple of them. One is whether or not we have a board of directors. You know, does the mandatory issue get us away from a vote of the board of directors? And I understand that we've requested a Leg Counsel opinion on that.

CHAIRMAN GREEN: Yes, we have.

SENATOR HILL: Is that one of the issues that we have to sort out?

CHAIRMAN GREEN: Yeah. It goes down to the Davis-Stirling Act, you know, and with the powers of a condo association.

SENATOR HILL: Don't you have to go to a vote of the board of -- you know, and so...

MS. ROBIN STEWART: It's not a vote of the board. It's a vote of the members, full quorum of the members.

SENATOR HILL: Right. We'll see if the mandatory issue takes care of that. I think the consensus has to be that in terms of a mandatory program that I need cleanup legislation. We've got to eliminate that vote.

CHAIRMAN GREEN: Yeah, it's...

CHAIRMAN GREEN: John, is that...

COMMISSIONER GARAMENDI: If you're going to have it mandatory, yes, you've got to do that. Otherwise...

SENATOR HILL: I don't think that's a major issue. I mean, I think that's something we can do in cleanup.

The second issue is the question about owner-occupied versus renter units that are rented. Again, I think this is another subject for a cleanup bill. At least my reading of that is that it is unreasonable to expect a homeowners' association to find out whether or not somebody is a renter-occupied or not. I think we need to make it clear that all units in the condo are covered under the program, a mandatory program, whether it's renter or not. John, any...

CHAIRMAN GREEN: Well, the structure is what's damaged. And there's somebody that owns it. If he's -- he should be covered.

COMMISSIONER GARAMENDI: Well, the fundamental problem is that presently renter-occupied dwellings are not included.

MS. STEWART: Well -- Robin Boyer Stewart (?) with the Executive Council of Homeowners. The problem with this whole thing is the assumptions that were made in the initial legislation tends to somehow divide owners from renters, and that is a concept that doesn't exist for associations. Who you are dealing with legally through Davis-Stirling are the associations, which are comprised of the members. And each of the members has a unit ownership in the entire property.

CHAIRMAN GREEN: Even though they take and lease their ownership to somebody else.

MS. STEWART: Right, right. And so if they want to rent it, that's fine. It is the owners who are responsible for the insurance and for everything else on that property. But they do pay their own personal property tax. That is separate.

Our concern is that -- and I wanted to advise you that by in checking with the Assembly Housing Committee, evidently this issue was raised last year with Shannon of your staff. They were advised to not do that, to not make that distinction, because it's a specious one. And unfortunately, they went ahead and did it. But there is a spot bill on the Senate Housing Committee that could achieve some of these concerns that we've been talking about. The other is the mandatory issue with respect to Davis-Stirling ceiling on the amount that a board can raise an assessment.

There is another question, though, and it's more or less a political one. We are quite concerned what will happen. Assuming you give them that authority to raise the dues, it's not certain that they will pay them anyway because for many of them on the margin we are somewhat like the mobile homes in that sense. The condominiums are an affordable form of housing. They are occupied in many cases by seniors on fixed incomes. The dues that they pay represent a good chunk of their monthly income. If you, depending on what this particular premium, or excuse me, this surcharge is going to be -- and it's still not clear what that is -- in some cases it could actually bankrupt some of the associations because you have to multiply that, of course, per each unit across -- for the whole association.

They may just in fact say, sorry, we just can do it. We can't afford it. And we're quite concerned about the liability exposure to the boards for that, who on the one hand may be very eager to do it, but their membership won't allow them to do that. And that's something, it's important. I'm trying to get across to all the Members in the Legislature. In dealing with this form of housing it's a whole new level of democracy, if you will. It's a quasi-democratic entity, and they can't just jump to it when you say to do it because they have other hoops to jump through, primarily the Davis-Stirling Act.

So we are more than happy to sit with you and the Commissioner and the staff and work out some of these problems. But as things currently stand it's very, very unworkable for us.

CHAIRMAN GREEN: Thank you.

SENATOR HILL: Did John send you up here to get into this mandatory issue again? Is that what...

MS. STEWART: Yeah.

CHAIRMAN GREEN: Oh, by the way, introduce yourself for the record, because we have to have it.

MS. STEWART: I did. Robin Boyer Stewart, Legislative Director for the Executive Council of Homeowners.

CHAIRMAN GREEN: Thank you. All right. Anything else?

SENATOR HILL: Well Mr. Chairman, I'd like to get a sense from the Commissioner about the public notification, at least the last subject that I had. What are we going to do in terms of selling this program and letting people know what, you know, what the rates are going to be, what the deductible is going to be, what their coverage is going to be? -- you know, hopefully convincing them this is a good idea.

COMMISSIONER GARAMENDI: Senator, there are two levels of notification that are being contemplated at this time. One is actually going into place, and that is the notification in the insurance bill from the insurance company. There is a specific format that they must use. I think that's been made available to you. If not -- oh, I know it's been made available. So you have that. The insurance companies have it. It's going out in their bill, and every homeowner will receive that proposal, that notification. So that should be, insofar as homeowner's insurance is universal, that notification is universal.

The second notification is the general media, general public notification through the media, and so on and so forth. At this time we are trying to sort out how to do that. I know that we have a difference of opinion on how to sell this thing to the public. You've encouraged me to be positive in my comments concerning the program. I have not thus far been very positive. I have said earlier today that I intend to be honest and forthright, and I will do so consistent with the obligations that the law places upon me to notify the public and to tell them about the program, and to encourage them to be involved. I will do so.

I at the same time do not intend to promise them something that I don't believe they're going to receive, and that is specifically, full payment. It is a mandatory program, and I will make that clear. I have no enforcement mechanisms as of this moment. Hopefully we'll get that resolved very soon. Should there be enforcement mechanisms we will, of course, notify the public as to what those are. That's the basic outline of where we are today.

That will be in place and begin, that public notification, begin within the next three weeks. Insofar as we could do that, the next -- the individual insurance company notifications will go out with the individual bills, and that, of course -- that has already begun.

CHAIRMAN GREEN: Mr. Garamendi, from the Chair, no one would expect you to be other than totally honest with the taxpayers of this state. What we would expect of you is to take an act, putting it together for the best of the taxpayers of this state. I guess that's the bottom foundation, and I think you and I are working in the same direction. We just have some philosophical differences.

COMMISSIONER GARAMENDI: One of those differences I note is about .9 percent. The success of your joint powers program to achieve a four percent administrative cost is better than we anticipate at 4.9 percent. But we do have 100,000 times more customers.

CHAIRMAN GREEN: Yes, and there are ways. And you know them and I know them, innovative...

COMMISSIONER GARAMENDI: Without going back into that again.

CHAIRMAN GREEN: And so we won't go over it. But, you know, I think we've made big strides getting to where we're at. And it's moved pretty rapidly in this year. But with this deadline coming up, this notice that went out, wow, you've got to be a Philadelphia lawyer to understand it. And the people out there, they don't have that education of the law that -- and then they argue it amongst each other. So you never get two attorneys that have the same view. At least the people out there kind of take the same feeling of what they read.

COMMISSIONER GARAMENDI: In addition to the law, a semi-contractual situation is set up. And it was determined by our legal staff that the notification needed to be in a legal format, hence the difficulties that exist in the plain reading of it. We felt there was little we could do beyond that to make it more clear. The general public relations that we will be engaging in over the course of the next year, from now through the next year, will hopefully provide more understandable information than that legal notification.

CHAIRMAN GREEN: Thank you.

SENATOR HILL: I would just reiterate, that I -- John, I just felt that the -- and I understand what the attorneys, you know, try to tie your hands to do. I just felt that the official notice going out was tremendously cumbersome; very difficult to read, very...

COMMISSIONER GARAMENDI: Neither of us would write a campaign piece that way.

SENATOR HILL: That's right. And I doubt that anybody would participate in the program if this is the notice they got, so I would hope that we could work together in terms of trying to clean it up and making it a little less cumbersome, more specific in terms of, you know, who's covered, who's not, what type of -- you know, we're not going to cover your sidewalk or swimming pool, your fence, you know, et cetera, et cetera. But here's, you know, here's what the focus of it is. And just make it a little bit more attractive in terms of trying to encourage people to participate because as you and I both know, it's going to have to be a mandatory (?).

COMMISSIONER GARAMENDI: Senator, I must more enjoy being on your side of this issue than on the side that I find myself. I usually harass the insurance companies as you are harassing your state insurance company at this moment, while I'm doing precisely the same thing. [Laughter]

SENATOR HILL: I'll just -- I would just predict that if you were Senator Garamendi and I was Commissioner Hill, that the harassment would be probably a lot more difficult.

COMMISSIONER GARAMENDI: I understand where your coming from. I spend most of my day doing exactly the same thing your doing.

SENATOR HILL: I've seen you as a colleague (?).

COMMISSIONER GARAMENDI: And now I've had the opportunity to understand why the insurance companies write the language that they write.

CHAIRMAN GREEN: Okay. You add something further.

MS. STEWART: Well, I had a couple of more points, but one of them was, I had discussed with staff. I am given to understand from members of our insurance panel that there are policies available for condominiums with $1,000 deductibles and $25,000 coverage. In light of that we have asked, and I believe he's agreed, to ask the Commissioner and his staff to do a data call on that as well, so that as you look for the extent of the coverage and its cost for the mobile homes, that you would also include the condominiums.

The other point was that I just wanted to share with you that there's another trend occurring in housing in this state, and that is the condominization of mobile homes. So, and that's -- and there were five bills passed this last year that allow owner groups to form a condominium, and so they will be moving into this same forum that we are.

CHAIRMAN GREEN: Then there's also a big movement of the park people buying the whole park.

MS. STEWART: That's what I'm describing. So what I'm saying is it will be necessary, as you would address our concerns, because they will fall under Davis-Stirling when that occurs.

CHAIRMAN GREEN: Yes, I think we're aware of that.

MS. STEWART: Condoization.

SENATOR HILL: I haven't heard of the condominization of mobile homes. I didn't...

CHAIRMAN GREEN: Oh, yeah.

MS. STEWART: Condoization. Oh, it's...

CHAIRMAN GREEN: In other words the...

MS. STEWART: Oh, it's a massive movement.

CHAIRMAN GREEN: In other words, the mobile home park will get together and say, would the tenants will buy this park.

MS. STEWART: Right.

SENATOR HILL: I thought you meant they're turning mobile homes into condoms, so I...

CHAIRMAN GREEN: Oh, no.

MS. STEWART: Condoms? No. [Laughter]

CHAIRMAN GREEN: Thank you very much. John, is there any thing further?

COMMISSIONER GARAMENDI: I look forward to working with you gentlemen and your staff, as well as the Governor, on the issues that we talked about during the day. It's been, I think, a very useful session thus far and we've made a great deal of progress.

Thank you very much.

CHAIRMAN GREEN: Thank you. And if there's nothing further to come in front of the Committee at this time, we'll stand adjourned.

--ooOoo--