

2-6-1991

Hearing on California Residential Earthquake Recovery Act, Chapter 1165 of 1990 (SB 2902 - Hill)

Senate Subcommittee on Earthquake Insurance

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

Hearing on
**CALIFORNIA RESIDENTIAL
EARTHQUAKE RECOVERY ACT,
CHAPTER 1165 OF 1990 (SB 2902 - HILL)**



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SENATE SUBCOMMITTEE ON EARTHQUAKE INSURANCE

CECIL GREEN
CHAIRMAN

SUBCOMMITTEE ON EARTHQUAKE INSURANCE CECIL GREEN, CHAIRMAN

10:00 a.m. - 1:00 p.m.
STATE CAPITOL, ROOM 2040

AGENDA

**SUBJECT: California Residential Earthquake Recovery Act,
Chapter 1165 of 1990 (SB 2902 - Hill)**

I. CALL TO ORDER

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

II. DEPARTMENT OF INSURANCE

- John Garamendi, Insurance Commissioner

III. ACTUARIES

- Peter Yanev, Chairman
EQE Engineering
- Rusty Kuehm, Risk Management
Ernst & Young

IV. SEISMIC SAFETY COMMISSION

- Tom Tobin, Executive Director

V. CONSUMERS UNION

VI. INSURANCE AGENTS AND BROKERS

VII. INSURANCE COMPANY REPRESENTATIVES

- American Insurance Association
- Personal Insurance Federation
- Association of California Insurance Companies
- Alliance of American Insurers
- California State Auto Association

VIII. UNSCHEDULED WITNESSES

IX. CLOSING COMMENTS

X. ADJOURNMENT

CHAIRMAN CECIL GREEN: We'll call the meeting to order, and a good morning to all today and welcome to this hearing. As you all know, I'm Senator Cecil Green, Chairman of the Subcommittee on Earthquake Insurance. And I would introduce my fellow members of the committee if they were here; at this point they haven't arrived.

The hearing we're having today is to review the current status of the new Residential Earthquake Recovery Act, which was passed last year. This program, which provides for \$15,000 of earthquake coverage for every homeowner in the state, is due to take effect July the first of this year. The problem is that several issues have been raised about the implementation of this measure and they all need to be addressed.

These issues include such things as how the surcharge on the homeowner's will be enforced; whether the funding mechanism is adequate to administer the program; what role insurance companies and agents and brokers will play in the implementing of this program; and whether a delay is necessary to ensure that the program is implemented properly, and I underline that word properly. These questions and others must be answered before we allow this program to take effect.

If legislation is necessary, both Senator Hill and I have agreed to do what is necessary to assist the department in implementing this program.

With that brief statement, the issue we have in front of us is important. I would ask everyone to be to the point and address the questions that I've raised and if you have any others so they can go on the record.

So let's get started, and we have with us today our Insurance Commissioner, John Garamendi. John?

COMMISSIONER JOHN GARAMENDI: Thank you very much, Senator and staff. It's good to be with you this morning. I want to thank you for holding the hearing and dealing with this very important issue.

As you know, I have the responsibility of carrying out this program, and it's really important that you hold the hearing on the California Earthquake Recovery Fund. We call this the "career fund" in our office now. It was established by Senate Bill 2902. This landmark legislation is a result of your work, Mr. Chairman, and Senator Hill's. The Assembly Members who coauthored it -- Areias, Farr, Speier -- all did so in response to the serious financial problems faced by victims of the devastating 1989 Loma Prieta earthquake.

I'm pleased to have the opportunity to work with you and the members of your

committee and other legislators who have an interest in this matter. We want to make this program work as quickly and as effectively as possible.

As you stated in your opening remarks, the "career fund" program provides for minimum earthquake insurance protection to every homeowner in California. By banking funds to pay for earthquake damage in advance, the program reduces the need by state policymakers to resort to disaster appropriations following an earthquake. The bill also requires that fund rates vary according to how likely a home is to suffer from earthquake damage. And the final major point is that it provides financing for safety improvements such as strapping water heaters and anchoring foundations.

We all agree that the concept and many of the features included in SB 2902 are extremely valuable to California homeowners. In addition, the state government and taxpayers will benefit by pre-funding disaster losses and providing a means to help finance seismic hazard reduction measures.

This program, together with the Field Act (the School Safety program) and the Hospital Seismic Safety Act, demonstrate that the California Legislature, and in particular the Chairman and others who have been involved, has responded to California's urgent need for earthquake preparation. In my judgment, SB 2902 is good public policy and that's why I voted for it, one of the very last bills I had the opportunity to do so.

As the new Insurance Commissioner I have the responsibility of implementing this bill, and I intend to deliver an earthquake insurance program which meets the letter and the intent of SB 2902. I'm here today to advise you, however, that legislative changes are necessary to ensure that California homeowners are protected from the devastating consequences of earthquake damage; that the risks are fairly distributed and that the state's financial commitments can be met.

Let me summarize my principal findings now and then go on to these and other issues in whatever detail you may desire.

First, the payments by homeowners must be mandatory. Without universal participation, this plan simply cannot work.

Second, a comprehensive actuarial study must be completed to determine the appropriate amount that homeowners should pay and what the proper level of deductions should be. Early studies indicate that if you want the fund to be more actuarially sound, premiums should rise to about \$90 on average, or the deductible should be increased to a 5 percent of the fire insurance policy, at least until such time as the fund is established at a sufficient level to pay the cost of a major earthquake.

And the third and final major point that I would like to make is that the prior commissioner did virtually nothing to begin to implement this law. There was no staff, no budget, and no substantive work carried out. Given the enormity of the

task -- that is, creating the largest earthquake insurance company in the world -- the effective date of coverage should be pushed back at least 6 months to begin on January 1, 1992.

Now, those are the three major recommendations that I have. I'd like now to go into them in a little more detail.

SB 2902 directed the Department of Insurance to start up this enormous venture just nine months after the bill was chaptered and became law. Unfortunately, as I mentioned, the previous administration must have overestimated my ability to get things done in the Department of Insurance because they requested no staff or funding for the current year to carry out this legislation. So when I began to ask questions regarding the Department's progress in starting this program after the November 8th election, I found that there was no one in charge, there were no resources available, and no real progress had been made. Since then, I have appointed a staff in an attempt to make up for lost time and to develop an earthquake fund program that we all can be proud of.

Before I get to the legislative and implementation issues that we have identified, let me give you a brief status report on our progress to date.

The major activities that were required to run an earthquake insurance program are the following: First, actuarial. That is, the setting and adjusting of rates, analyzing exposure and determine the appropriate levels of reinsurance. Second, claims management. Again, this is the adjusting and paying of claims after an earthquake. Thirdly, there's the transaction processing. This is the recording of millions of payment transactions by insurers and claims adjusters. Fourth, there is the process of fund management. That is, the accounting for funds that have been paid in, and we estimate this to be over \$200 million a year, and then the claims paid out, and assisting also in the issuance of bonds. Fifth, there is the public information function. That is, advising the public of the benefits and limitations of the program and how they are going to be required to participate. And finally, there's the contract management function, managing the performance of the private contractors and consultants who will be doing much of the work.

Our review of these activities and the resources within the Department led us to conclude that it was essential that private contractors handle the claims and perform the transaction processes. These are called fiscal intermediary or servicing agencies. Our review of these activities and resources within the Department led us to conclude that private contractors will be needed to handle the claims and to perform the transaction processing. That's the fiscal intermediate and the servicing agencies.

In addition, we need to secure a private reinsurance from the world's property

and casualty reinsurance market.

We're now in the process of detailing the transaction processing and claims management needs in a major Request For Proposal, known as an RFP. I'm committed to seeing that this RFP is done correctly.

As a result, we have recruited various risk management, actuarial, systems analysis professionals from inside and outside state government to work in developing a management system that is efficient, effective, and maintains the proper fiscal controls. Moreover, I am committed to offering contracts on an open and competitive basis with full consideration given to the necessary requirements of the state control agencies.

Beyond this, we have drafted a budget change proposal that will soon be presented to the Governor and to the Legislature that will provide us with the staff and contract funding that we will need in the current and in the future budget year to undertake this program. I believe that approximately 50 people will be required, and the contracts are likely to range from \$5 million to \$15 million per year. Of course, we will not know the exact amount until after the bids have been received.

Because legislative change will have a direct effect on the regulations that we are presently required to draft by April 1, my staff and I have had several conversations with legislators and their staffs regarding the key issues that must be resolved before the regulations are drafted and the program proceeds.

Senator Hill, we appreciate your gracious offer to carry two pieces of urgency legislation that we think will be required. The first piece, which I understand may be contained in your SB 125, it will be primarily technical changes that must be adopted on an emergency -- I mean, a real urgency basis. The second bill, which is, I understand, still unidentified, may carry other language that will be required before July 1, but which is somewhat more controversial and will therefore require fuller deliberation by the Legislature. Depending on the results of these deliberations, other bills may also be needed to address the issues within the earthquake program.

At this time, I would like to get into the major legislative issues and the options that provide the reason for this hearing.

First, the need for mandatory surcharges. As I stated earlier, in order to make this program work actuarially, surcharges on homeowners must be truly mandatory. Although the bill presently requires homeowners to pay and insurance companies to collect, homeowners may, in effect, opt out -- that is, refuse to pay -- and under SB 2902 there is very little, if anything, that can be done about that.

Therefore, there are several different ways of accomplishing this. My written testimony lays out the options. The option that I think works best, and one that I

recommend, is that the Legislature adopt a similar system for the career fund as we have for the CIGA (the California Insurance Guarantee Association). In this way, insurers will be required to remit an amount that covers the total surcharges due, regardless of what the homeowner does. Uncollected surcharges would be considered as an administrative cost to the insurer when the insurer applies for prior approval of rates under Proposition 103.

The second major legislative issue is the time frame for implementation. As I mentioned earlier, the career fund program will immediately become the world's largest earthquake insurance program.

In spite of this fact, the 1990-91 budget did not include any staff or funding. We're going to be very hard pressed to award bids; to seek bids and award them well before the July 1 implementation date. We have been advised that the fiscal intermediary servicing agencies' activities cannot be completed and tested by July 1. In fact, the National Flood Insurance Program startup period, which is now in effect, encompassed a six-month period after the contract was awarded. Because of the previous administration's reticence and the stringent time frame in SB 2902, bidders under the present law would be required to bring up a system in half the time -- three months -- for nearly four times the number of insured.

Moreover, although we have made progress in drafting an RFP, I am especially concerned that the RFP must be well thought out and it must undergo rigorous and systematic review before it goes out to bid. I think we all understand that if we fail to do this, we may be asking bidders to operate under a program that is either ill-conceived or incomplete.

I know that all of us are also aware that the insurers -- and I expect that they will talk about this a little later -- may have trouble adjusting their billing systems in time to issue bills between the regulations which we are now required to issue by April 1 and the notices for renewals which are supposed to go out either in May or June.

Now, there are also some additional legislative issues that we'll be discussing today that will take some time to move through the two Houses, and I'll briefly outline those less time-crucial issues to you.

First, let me just iterate that I would recommend that the Legislature adopt and implement an implementation date of January 1, 1992 with regulations being due on October 1, 1991. This will allow the urgency legislation to receive a full hearing and, also, it gives us the time to issue an RFP and the regulations to be drafted with somewhat more specificity and certainty.

Now, the other problems beyond these two immediate problems that we must deal with are the actuarial issues. There are three interrelated actuarial issues

presented by the bills. The first is the rate of the surcharges. The second is the level of deductibles. And the third is that the additional program burdens in the future years, such as retrofitting and loan program.

Let me start with the surcharges.

SB 2902 sets a range for surcharge payments between \$12 and \$60 for the first year. Unfortunately, this range may not fund damage from a major California earthquake. We may, therefore, be forced to use the pro rata provisions of the bill where people would get so many cents on the dollar of damage. In fact, at the moment we just don't know what our exposure truly is. Estimates are wide ranging, and they give me very little confidence in the fund's ability to pay claims, particularly if there is an earthquake in the first years of operation. If there's a major earthquake in an urban area, we could very well end up paying 10 to 20 cents on the dollar for earthquake damages. Based upon my review of some of the existing loss estimates, we just don't have a clear fix on the exposure to the fund under various scenarios, much less know how to set the rates for future events.

By example, I'd like to point out to you Chart number 1 which demonstrates the range of losses that have been estimated for a magnitude 8.2 earthquake on the northern San Andreas Fault. As you may notice, these estimates range from \$3.9 billion from the USGS to over \$11 billion from the Steinbrugge estimates. Although this fund may not have ever been intended to cover losses from a great earthquake -- that is, an 8.2 earthquake -- the chart illustrates the fact that rigorous and detailed estimates are needed in order for us to adequately manage this fund.

We have requested a private firm to prepare an improved preliminary estimate so that we will know what the exposure is from the expected annual losses, from catastrophic losses and from losses due to moderate or major earthquakes in urban California. When I have those estimates I will certainly be happy to share them with you. They are, in fact, the basis under which we would then recommend the level of payment.

Chart number 2 shows that the surcharge under SB 2902 and what prices this coverage -- and the prices that this coverage should be based on the National Earthquake Projection estimates. The National Earthquake Project is one that this committee is familiar with.

By the way, the National Earthquake Project is preparing additional estimates for us but they're not going to be available until the end of February, and that may cause some modifications in this chart that you see.

What this chart shows is that our highest surcharge -- that is, \$60 per year -- is just a little over the average amount that the Earthquake Project

estimates is needed for the pure premium -- that is, to pay claim losses only. So to be actuarially sound, we must be charging somewhat more than \$60 -- probably close to \$90 on average. However, we are currently limited to \$60 and that is supposed to be the maximum not the average.

The bottom line here is that this fund is, in all probability, badly underfunded based upon the level of coverages that we are required to provide.

I have a suggestion for you on how we can address this, and I'll go into that a little later. But first let me show you the chart that depicts how the risk is distributed between the homeowner, the state, and the insurance companies.

Chart number 3. As you can see from this chart, we're showing the risk burden to the homeowners, to the state, which is the hatched columns, and to the insurance companies which are the lighter columns. There are five different scenarios. This is according to data from the Earthquake Project, Carl Steinbrugge, and from the Senate Office of Research.

Under the present program, homeowners' risks will consist of the deductible amount. That's somewhere between \$1,000 and \$3,500. The state's share is the next amount up to \$15,000 less the deductible. Assuming a homeowner purchases a private earthquake insurance policy in addition to the state program, the insured's risk is the next level. That is, the amount above \$15,000. This chart shows that the average annual loss of fund would be borne 20 percent by the homeowner, 60 percent by the state program, and 20 percent in the excess loss by the insurance industry, if, of course, a person has private insurance.

The next two scenarios are from the Steinbrugge studies, and therefore the northern San Andreas and the Newport-Inglewood earthquakes. Those are the two and three on that chart. They show that the state would bear almost 80 percent of the loss, while homeowners will pay around 10 percent, and the balance of the risk in excess of \$15,000 would be borne by the insurance companies, if there is a private insurance policy.

Finally, the last two scenarios are based on the Senate Office of Research review of the actual U.S. Small Business Administration data from the 1987 Whittier and the 1989 Loma Prieta earthquakes. The data shows that the state earthquake bridge -- that is, the state risk -- would be 60 percent if the program was in effect at the time of the Whittier event, and 35 percent if it had been in effect at the time of the Loma Prieta earthquake. The apparent cause for the difference in percentages here is that the Loma Prieta quake resulted in a high number of catastrophic failures. That is, the whole house fell down, therefore kicking the claim off to the insurance companies.

In addition, the Loma Prieta event was centered in the Santa Cruz mountains,

certainly a less densely populated area than Whittier. If the Loma Prieta type event were centered in an urban area, the share of risk might very well be similar to what we found in Whittier. That is, in the 60 percent range.

CHAIRMAN GREEN: John, if you would, a question at this point. Those figures are -- this is what the actuaries were after the quake, so we know what those dollar figures are. Did they use the aid that we gave those people, the billion dollars that we put in place for Loma Prieta and the \$800 million or whatever that we did in the Whittier quake? Was that figured in as cost at this point in your 61 and 35 percent?

COMMISSIONER GARAMENDI: My understanding -- I might ask Richard to join me here -- but my understanding is that these are the actual losses.

CHAIRMAN GREEN: But there's no factor, in other words, for what the state actually put into the disaster relief.

COMMISSIONER GARAMENDI: No. These are the actual losses, and based upon those actual losses by homes and dwellings, a calculation was made by the Senate Office of Research of how much would fall 1,000 less than 3,500; how much would then fall within that range and the \$15,000 and then how much was over that.

CHAIRMAN GREEN: The question I have is we did enter into both of those in the earthquake relief. What percentage of that 61 percent for Whittier and the 35 percent for Loma Prieta was actually paid for by the State of California with our normal disaster claim fund? And then what would be left on this insurance?

COMMISSIONER GARAMENDI: Richard tells me that this data is from the Small Business Administration and was used for projection purposes. It is not based upon the actual state expenses. And it's done for estimating purposes, not for the actual expenditure of money or how it was spent or who got it. So we don't know that data. I suppose it could be developed.

CHAIRMAN GREEN: Can we get an answer to that at a later time?

MR. RICHARD HOLDEN: Sure we could. As the Commissioner pointed out, this is data from the SBA, so it reflects the SBA claims and what they paid, but it doesn't reflect any of the state money.

CHAIRMAN GREEN: We'd kind of like to compare what we did at the state level with the quarter-cent sales tax in Loma Prieta and the aid that we gave in Whittier. We know that we did some insurance because basically the disaster aid is insurance. We know the state did that and I'd like to kind of compare that. If you can furnish those figures to me I'd appreciate it.

COMMISSIONER GARAMENDI: If the Senate Office of Research will cooperate, as they have in the past...

CHAIRMAN GREEN: Oh, I'm sure they will. It's a good department. I think there

are still some employees there, aren't there?

COMMISSIONER GARAMENDI: You'd know better than I. I hope so. They did a good piece of work on this analysis.

The last point that this chart raises is the question as to whether the state should provide such a comprehensive bridge for homeowners and shoulder up to 60 percent of the burden, or should the state's insurance fund take a different shape, perhaps a 33 percent. If you agree that the state should provide a bridge, but perhaps not such a "Golden Gate" bridge, then you may want to alter the coverages provided here by modifying the deductible or the maximum coverage.

This relates to the previous discussion I had about the fund itself. As these percentages are in the higher range -- in the 60 percent range -- the fund becomes unsound and we'd probably, in all probability, wind up with a pro rata, thereby achieving a lower percentage.

CHAIRMAN GREEN: Senator Hill.

SENATOR FRANK HILL: John, I want to make the observation that these charts actually prove out my argument, as the bill was going through, that this \$15,000 worth of coverage was going to cover the overwhelming percentage of losses. If you remember, Cecil, you and I had this discussion where you were saying, well, \$15,000 simply is not enough and we need it to be 50 or 100. And of course, you can point out to the extent that if we were at \$50,000 or \$100,000, you obviously dramatically increase those percentages.

I guess my question to you, John, would be the 33 percent figure. I mean, we're just trying to figure out some sort of a...

COMMISSIONER GARAMENDI: I think it's a balancing situation we have to deal with here. I'm going to talk in just a moment about the deductible level. There are the three factors, the actuarial factors, that I spoke to at the outset, but we have the level of coverage -- you have your deductibles and you have the amount that you're paying for the premium -- and we need to get this actuarial study so that we can all analyze and see where the level ought to fall here.

It's pretty clear from the information developed thus far that at the present level of deductible, the present maximum level of payment and the level of maximum coverage that this fund is, in a significant earthquake, going to be paying a pro rata amount and I think it needs to be understood.

Let me just talk about the deductibles here and then perhaps spend a little...

CHAIRMAN GREEN: John, if I may, this is a thing that Senator Hill and I've discussed many times and it's a direct relationship in those graphs that we see in front of us: the higher the deductible the less cost to the fund on those cosmetic type damages.

COMMISSIONER GARAMENDI: That's my next sentence.

CHAIRMAN GREEN: Which is the big cost to any policy is the cosmetic. We want to cover the catastrophic type thing.

COMMISSIONER GARAMENDI: At least the structural damage.

CHAIRMAN GREEN: The structural damage. So when you get into \$15,000 worth of structural damage, you do not get into very much. The high cost of any insurance is the first dollar figure, and after you get to a certain figure, the cost to that pool for the 50 or the 100 is like a 2 percent factor of what you're providing the first \$15,000 for. So what you can provide for like this at \$60, and for \$75 you can provide 100 with the same type of coverage with a higher deductible which puts them into it sooner, and then the fund is not in jeopardy as fast. I journeyed to England and went to Lloyds of London; I talked to the underwriters; and I got the low deductibles, and that's what we passed. A one thousand dollar deductible is not enough.

COMMISSIONER GARAMENDI: I think I'll make part of that point, and another part of that is shown that the insurance companies, I think, would accept your logic, and these charts tend to prove the correctness. As you get into your higher amounts, the total dollars that are going to be expended in all but a catastrophic earthquake are not so great a percentage. It's your lower amounts where you're going to run up the big dollars.

Let's talk for a moment about deductibles. I'm very concerned that the nuisance claims due to the very low deductible may very well devastate the resources of the funds. The deductible of only \$1,000 is likely to prompt many homeowners to report wall cracks, broken windows, or other minor items that may or may not be the result of an earthquake, but which would be repaired by the homeowner at a modest cost. I'm afraid that the low deductibles under the program will encourage homeowners to request adjustments for minor claims. Even if the claims adjuster finds no earthquake damage, it will cost from \$250 to \$500 simply to adjust the claim. And if there are claims appeals, the cost will go even higher. We may end up, therefore, paying a disproportionate share of the fund to claims adjusters, to the process, rather than to needy homeowners. Moreover, if the fund cannot support the low deductibles called for in SB 2902, claimants will wind up receiving a pro rata payment. Thus, if the pro rata payment is, say, 50 percent, the homeowners with the minor damage of \$1,000 over the deductible would receive \$500; while those with full claims, say, of \$14,000 would receive only \$7,000. They'll be out \$7,000 and those with the minor claims would be out \$500, so we run into an equity issue there.

I believe that the deductible should be raised. Perhaps up to a 5 percent level. We could set the deductible at 5 percent initially and then lower it over time as the

fund builds and as we gain more experience in paying claims. Moreover, it's important to build the fund rapidly so that we would be in a better position to meet our obligations in the event of a major earthquake in the early years of the program.

If you're following along on the reading, I'm going to skip over some of the remaining detail. I'll just quickly outline them to you. There's the program enhancements. These are questions that deal with -- I'm working on page 12 right now. There are program enhancements. This has to do with what we're going to do in terms of retrofitting and the like. That really ought to depend upon the actuarial study so that we can see how much money we really have.

Then there's the issue of what kind of structure should be covered. Presently, the language could cover everything on the property, and that's going to get to be extremely expensive. Awnings, decks, outbuildings, satellite dishes and so on. I would recommend that you adopt a narrower definition. Again, this is a financing and actuarial issue.

The third issue deals with financing. As I said, we are -- this bill covers everybody from day 1 until their first renewal date. That is, from July 1 until their renewal date which may be many months away, perhaps as many as 11 months away, or 12 actually; thus, we would provide coverages, in some cases, for people who may never pay. That is a true freebie.

There's a need also in this bill for some loan language so the Department can get the program up and running. We have detail on that.

And finally, my recommendation on this would be that the coverage be phased in when homeowners pay for the surcharge along with their renewal payment. I suspect that's going to be a tough political issue for you to deal with, but nonetheless, I'll make the recommendation.

There are also a whole series of technical issues -- condominiums, mobile homes, provisions for home offices, clarification of half-plexes, duplexes, the making of homeowner the sole payee. We need to clean up the bond language and some cleanup related to SB 3897. We need some cleanup language so that the amounts payable to the Seismic Hazard Identification Fund are based on the surcharges deposited.

And finally, I'd like to be on the advisory committees for all of the CRERF programs. And then also we need some specificity as to when the claims must be filed. Presently, that's an open-ended question.

In conclusion, as I said earlier, the California Residential Earthquake Recovery Program is landmark legislation. It attempts to address a very real need in a very thoughtful manner. Unfortunately, not all of the myriad issues were resolved when the bill was chaptered, and many of those issues could cause problems when the program is implemented or when a major earthquake occurs. It is likely, given our

recent experience, that may happen.

I want to work with you to see that these issues are resolved before we wake up one morning to shaking walls and find thousands of Californians are relying on us to repair their damaged homes and then finding that we're unable to do so. If we move quickly to secure the integrity of this fund, we will be able to provide a critical safety net for millions of California families who need and deserve our help.

Thank you. I'm here to answer questions and Richard Holden will assist me in that.

CHAIRMAN GREEN: Thank you, John. I have to apologize, I had to leave for a few minutes but I pretty well know what was in your statement.

COMMISSIONER GARAMENDI: I can go back and read that again.

CHAIRMAN GREEN: No, I've already read it. I did review it ahead of time. A question: If we were to do legislation putting off the date of implementation, how long would you need in the Department to implement this? What would be the date that you'd like to shoot for?

COMMISSIONER GARAMENDI: Well, that was part of what you missed. We think 6 months would be sufficient. There are some of us that think maybe several years would be needed, but we think in 6 months we can get this thing done and done correctly. That would allow us until October 1 to issue the regulations.

As you can see from the kind of issues we've raised here there's going to be, in all probability, new legislation that will modify SB 2902, and that would, therefore, cause some modification in the regulations that we're presently required to write by April 1.

CHAIRMAN GREEN: So you're going to have to wait the time for that legislation to be enacted so you'd know what regulations that you would write they could put in place.

COMMISSIONER GARAMENDI: Exactly. Nevertheless, the process of beginning the regulation writing is under way. Discussions have taken place with insurance companies and agents and brokers and others who are interested in this matter, including the State Seismic Safety Commission. So we're well into the process. But the final regs should wait until the final.

CHAIRMAN GREEN: Well, in other words, what you're saying is that it's not sitting and waiting for the legislation but that you're going ahead with the implementation even while that is going on. You would modify the regulations at the last minute to reflect any legislation that was done to straighten up the problems we found.

COMMISSIONER GARAMENDI: We'd have draft regulations out some time during the spring. Some drafts are already circulating, but the final draft -- well, let's say,

drafts that are well along would be available in the spring, and then we'd work on them while the legislation was being worked on. Now, if there isn't a delay, we'll meet the April 1 deadline, but it will not be, I think -- the chance for error would be very high.

SENATOR HILL: I was going to ask you about that, John. I appreciate your willingness to work with us, and, you know, clearly this is a major project, a major bill.

COMMISSIONER GARAMENDI: It's an excellent program. We just need to make it work well.

SENATOR HILL: And I'm sure Cecil can attest to this. As he and I were working the bill through the Legislature, whenever we came up with some of these thorny issues the consensus was well, we'll just let the Commissioner decide that.

CHAIRMAN GREEN: Like a brick wall.

COMMISSIONER GARAMENDI: I thought that's what you had in mind.

SENATOR HILL: Glad to see you here.

I want to make a comment and kind of get your observation about the actuarial issues, because as you pointed out in your charts, contrary to what these actuaries -- and I'm sure we're going to be hearing from them next -- would lead you to believe this is not an exact science. I think the chart that you showed up with there's an \$8 billion discrepancy in the same scenario, in the same earthquake, in the same place. You know, one of the questions that I have posed, and I would like to see the answer, is: Are the insurance companies themselves solvent on the earthquake insurance that they now write in terms of these same scenarios? And as I've asked this question before, the consensus seems to be no, that they are not; that they want to wring their hands and tell us how nervous they are about this program and why it needs to have a higher deductible and why we need to do all these sorts of things, and in the same standpoint they're out there writing insurance, and if we have the big major quake that you point out that indeed that they are not solvent. I guess maybe that kind of hits this federal Earthquake Project and I guess I get a little skeptical about some of their numbers just because of the incentive or the -- to the extent that you can make the problem look worse and worry about the stock market collapsing and all these companies. You know, you make things awful, maybe we can convince somebody in Oklahoma and West Virginia to pay into an earthquake fund to help cover the rest of us. I wondered if you had any reaction to that.

COMMISSIONER GARAMENDI: Well, I've heard the same discussions that you have, that in the event of a major earthquake the insurance industry has a very serious financial burden, one that some will not be able to carry. I do not have information

at the present time as to whether that is accurate or not. I know that that is said.

It's very clear, I think, to all of us, and I know that's why you and Senator Green were so involved in this legislation and Assemblyman Farr and others, that the problem goes well beyond the industry. The problem is that if there's a major earthquake, California's in a world of hurt, and this state's financial resources will be severely stretched to meet the requirements. The Loma Prieta was not a major earthquake, and yet, we were stretched. Hence, this is why you develop this program. You're pre-funding at least some portion of that expense, and I think that's very, very wise.

What we need to do, as I stated as my second point here, is that we have to carry out these actuarial studies. We need to pull together the present knowledge, get a working group together, and to try to sort out the level of risks, the level of premium that we're going to charge, the deductible, and the rate -- or the maximum payout under this program needs to be analyzed more thoroughly. The ranges are just too great for us to make a definitive decision. If we have to, we will. We'll simply go and hope that we're right.

But I think in our discussions with these actuaries and experts on the issue that we can get a better definition if we take the time during the spring and cause them to work together.

SENATOR HILL: Let me tell you, it seems to me one of the ways you deal with the actuarial soundness of the fund is in terms of who's going to be applying, and you raised the deductible -- raising the deductible to 5 percent. My initial reaction to that is, you know, what we do by raising the deductible is we say to a senior citizen who is on a fixed income, sorry, you're going to have to pay the first 8,000 bucks out of your pocket, and we say, you know, now you're going to pay \$1,000. You know, for a lot of people that is a tremendous burden. My instinct would be that instead of at least initially raising the deductible, that instead we ought to head in the direction that you talked about, the cosmetics, Cecil, the driveways, the sidewalks, and those kinds of things to try to tighten up that definition in terms of keeping these cosmetic changes out of it, and obviously, therefore, increase the soundness of the fund.

COMMISSIONER GARAMENDI: You've got a great debating point here. There is no correct answer and you're balancing public policy desires on both sides. We need to develop a more factual base on which all of us can analyze the problem.

Presently, with the July 1 implementation date, we're heading toward something that in all probability -- and I think in high probability -- will lead to enormous number of cosmetic claims; that frankly, it'd be cheaper just to -- if somebody puts in a claim just send them a check for \$1,000 and be done with it. The cost of

adjusting the claim is too high and you get into debating things that there is no clear answer. Was the damage by the earthquake, was the damage by the drying out of the wall?

CHAIRMAN GREEN: Also, you have the factor here that this fund has to be actuarially sound. It cannot be social in this aspect. We have to address the senior citizen in a different way and we can do that. We can set up a special loan fund, we can do these things for those people who can't afford the thousand dollars. But the fund itself has to be actuarially sound.

Now, for instance, if we go to Lloyd's of London, which is the place to go for co-insurance...

COMMISSIONER GARAMENDI: Well, excuse me for a second. Under the contracting laws of the state, we're going to put it out to bid and they and others can bid for it.

CHAIRMAN GREEN: Well, but that's where we'll end up.

COMMISSIONER GARAMENDI: Well, maybe so.

CHAIRMAN GREEN: Anyhow, but I just use that name because that's the major world insurance company. Well, it's not a company, it's a consortium. But if we go there with the package we have in hand right now, we won't be able to get any co-insurance, because those people say your deductible is too low and it's not a good risk and we won't co-insure it.

COMMISSIONER GARAMENDI: They probably will not co-insure. They will undoubtedly provide insurance for a level superimposed on top.

CHAIRMAN GREEN: Well, I understand.

COMMISSIONER GARAMENDI: So if we take the first billion dollars of risk, they'll take the next segment. They'll probably do that, but...

CHAIRMAN GREEN: But they will also look at our fund to see if it is a legitimate good fund and that's the first decision they make when they're underwriting is what is the fund and is the fund in jeopardy. And then the next step is then to see whether they can underwrite what we're doing. And for a \$5 billion tap, we can get \$5 billion worth of co-insurance like starting at \$100,000 or \$50,000, or whatever, for a cost of about \$250 million. So we can put the pool in place originally with the co-insurance and each year drop off some of that. And it is available, but our fund has to be actuarially sound to have that happen.

COMMISSIONER GARAMENDI: Senator Hill raised the point of if it's 5 percent, you may wind up with a deductible that is very high. There are different levels that you could choose to eliminate the cosmetic type problems, just deal specifically with structural. We will, during the course of this year, provide more data to you as we develop it as to what that level might be. Maybe it's two, three, 4,000, we don't

know. I'd like to avoid a situation of a verbal or a written description of it, saying that we're not going to repair cracks in walls that are caused by things other than earthquakes. You could debate that forever; you'd never get an answer to it. Excluding outside buildings, walks, and whatever, fence damage and the like is, we think, a very good idea and essential, otherwise there's no way this thing will work.

SENATOR HILL: Sure. Tell me about -- the Insurance Commissioner has broad powers in terms of declaring an emergency and emergency regulations and what is that process? Do you have to make a declaration? What happens if we can't get the extension that you ask for? And it seems to me that to the extent that we can involve all the people in this room and collectively talk about it, that maybe there might be some advantages in terms of that emergency regulatory process to resolve some of these thorny issues.

COMMISSIONER GARAMENDI: We certainly have the power to issue emergency regulations. However, those regulations have to be consistent with the law. The law specifies -- the July 1 date specifies these deductibles and does not specify what outside the building is covered, leading one to the conclusion, or a possible conclusion that it's on the property, the premise. We have the power to carry out the law and issue regulations, emergency where possible, if indeed it is, but it has to be consistent.

The fundamental problems that I've addressed here are with the law and I can't change that.

SENATOR HILL: Well, what about the first point you made about the mandatory issue and what do you do for somebody who doesn't pay. Since the law is clear, Leg Counsel says it is a mandatory program. Is that something that you have the authority to say clearly it's a mandatory program, you have to pay into it, and if you don't pay into it we are -- I think your proposal was we'll put that burden on the insurers, or we say to the homeowner we're not going to allow you to have a homeowner's policy? It sure sounds to me like that's consistent with your view.

COMMISSIONER GARAMENDI: I think we have a problem with that. We might be able to write a regulation under the present law that says that the insurance companies -- that we collect it from the insurance companies.

However, my understanding of the legislative history of the bill is that this was a bit of a debating point and the language was written in such a way as to not do that. So we may wind up being challenged if we were to write such a regulation.

I think you will hear from the insurance companies a little later and it'd be a good point to put to them. That is a controversial issue, how we collect this. My suggestion is the burden be placed on the insurance companies. That is, we assume that they have collected it. If they haven't, then that's a problem that they could

then come back to the Commissioner through the 103 hearing saying we have these expenses on the earthquake, "X" number of dollars uncollected, we had to pay that into the fund, therefore our rates have to go up for everybody to cover that expense. Now, that could be an allowed expense; in all probability would be an allowed expense under 103, and then everybody's rates go up for the bad debt. That, of course, keeps the fund whole. It shifts the burden and spreads it around to the entire paying public, premium paying public.

SENATOR HILL: And the insurance companies come up and say well, wait a second, this is not our program, this is the Legislature's program; why make us enforce it if people don't want to pay into it; we only want to take credit for it when it works well and...

COMMISSIONER GARAMENDI: And we want the state to have the big risk; we'll take the little risk at the back end. Yeah, that's what they'll say, probably. We'll find out in a few moments.

There are other options that we could do beyond the one I suggested, and they're laid out in my discussion on page 6. Quickly, they are requiring fire insurance policies be canceled if the payment is not made. Well, that's kind of a meat ax approach -- a fire ax approach. That would certainly motivate a person to pay. You could put a lien on the property. You know, you can imagine that certain banks, and I assume the title companies and others would be in here to talk to you about that, but that's a possibility. Counties undoubtedly would be here too because they'd have an expense on that. We could require the banks to require that all new and existing mortgages participate in the state program. Something like termite inspection. Or you can do the local governments be required to participate in the program by paying the premiums or causing the premiums to be collected when the property is transferred. That, of course, would eventually get us the money from everybody but we may wait a long, long number of years.

So all of these things have problems, and if there's a better idea out there on how to really make this mandatory -- that is, to actually collect it -- we're open for discussion on it. The one recommendation that I think is best I've made. There's no easy way to do this, however. And each one has certain political and administrative problems.

SENATOR HILL: What direction are you headed in terms of putting some money into the fund July 1 or August 1? Are you looking at some different options? Or maybe January. Let's say we postpone it until January 1. There's still the potential that on January 15 we have an earthquake.

COMMISSIONER GARAMENDI: We have a couple of options. All of them make my administrative people nervous. The first is the immediate; right now. We're using

the reserve in the insurance fund -- that is, the fund that pays for the operations of this Department; it's a non-general fund operation -- but we're using the reserves in that fund to pay for Richard and to pay for the studies that we -- not the studies, the process that we presently have under way. There is no budget. Finance knows what we're doing and they've acquiesced; at least the past administration did and I'm sure the present one will also.

We will, in the process, run up a certain deficit (IOU) to the insurance fund. That should be repaid. We also have a budget change proposal and a deficiency proposal that we will be making very shortly to the Department of Finance that will confirm the borrowing from our own fund.

Our present recommendation is that for the period of this next six months until we have a new budget, that we use our fund, borrow from it. We would like to have the Legislature and the Governor sign off on that as soon as possible. That would then be repaid. As the premiums come in, we would repay that, which is the only appropriate thing for us to do. That borrowing could continue at a modest level into the budget year to pay for the start-up costs in the budget year. And I believe our present proposal is to go in that direction. Again, that would be repaid. As the premiums start coming in, we would repay the insurance fund.

The major expenditures, and there are some potential major expenditures -- for example, the earthquake could occur on the second of July 1991. Well, we're in a world of hurt if that happens. We're out of business before we even get started. We'd come to the Legislature -- I assume there'd be a request for some revenues to honor the commitment here. By extending to January 1, 1992, we do not eliminate that particular problem, but we can find a way of dealing with it, perhaps with a reinsurance program, perhaps by getting the revenue bond in place or ready to be sold. There are certain things that we could do that are very difficult or impossible to do in this short time frame that could be done if we had an extension.

SENATOR HILL: What's your political assessment? I remember we ran one of the scenarios on this program, looking at every earthquake that occurred in this century, and I think it was based on if the program had been in effect for five years that the fund was actuarially sound based on what we knew. I think that was kind of the assumption. But what's your assessment of what's the Legislature's reaction in terms of the prorating issue? Because it seems to me that's one of the real critical issues in terms of what happens to the fund if we don't have the money, and do we really go out and do that prorating?

COMMISSIONER GARAMENDI: Let me ask Richard...

SENATOR HILL: Let me just make one last comment, one last point, and that is, I've been involved in two special sessions now, as all of us have, on the Whittier

and the Loma Prieta quake. It seems to me those were special sessions that indeed the Legislature was racing, bending over backwards, trying to spend more money. In fact, I remember trying to slow down the Deukmejian Administration and saying, "I think in the Whittier quake, we" and this was my own data, "I think that we have been fair and more than reasonable," and it's kind of tough to try to factor that in. But at least my brief experience has been that whenever we do have an earthquake that the Governor commits to do whatever is necessary and the Legislature comes and if it means we're going to raise the sales tax or whatever, that there's a mentality that says we're going to try to help people as much as we can.

CHAIRMAN GREEN: Well, I think you're right in that respect, but if we can get a pool going, we won't have to react that way and won't jeopardize our General Fund monies.

SENATOR HILL: That's the whole idea behind the bill, yeah.

CHAIRMAN GREEN: That's the whole idea of this. And if this fund, as it's sitting right now, is not adequate to do that with, we would be doing a disservice if we were to insist that it go in place right away. The fact is, I've already put a bill through Leg Counsel to put off the time of this and I'm hoping that...

SENATOR HILL: But the time delay doesn't help us. If we move it from July to January, it takes care of some of these issues that John has pointed out. It still doesn't help us with that fundamental issue about what happens if a week after we started now in January we have an earthquake. And I'm kind of curious about that.

CHAIRMAN GREEN: You'll never ever know what's going to happen. You're never ever going to have a total answer. You're going to be rolling dice here and saying if it happens; well then, if it happens, we will do a special legislative session to save our General Fund. We have to do that sort of thing because the General Fund is in jeopardy the day this goes in place, even in January.

COMMISSIONER GARAMENDI: Let me refer you to this particular chart here which deals with this issue. If you have a significant earthquake in the early years, you're not ever going to be able to get this fund whole. You're in a hole and you'll never be able to get out of it because you have a revenue bond that you have to pay off, you have your reinsurance costs which are going to go on, and you're just going to wind up paying for the past earthquake. And that's one of the problems with the present level of deductibles, the present level of premiums and the like. And that is a major concern that goes beyond the question you raise, Senator Hill, of how would the Legislature respond.

If we have an earthquake in the early years, a significant earthquake in an urban area, we immediately go into a deficit situation, and I don't see how we get out of it, at the level of premiums presently in the bill.

What we want to deal with here, and the reason for the actuarial studies and part of the delay, is to analyze that level of premium and the deductibles in particular so that we can set a level of premium and a level of deductibility that doesn't put us into a deficit situation in the early years. And that's why I said a 5 percent deductible in the early years. As the fund builds up it puts us in a much better posture for not having a deficit should we have an earthquake in the early years. You could have a big one in the first year or the first day and you're out of business and that's it.

The second thing that we have to do here, regardless of what the level of premium is and what the level of deductibility is, the public needs to know that in the early years the fund is at risk and the likelihood of pro rata payments does exist, and we shouldn't fool the people about that, otherwise we're all going to be sorry at some point in our future careers. But they ought to know that in the early years the fund is not built up, that the premiums and the deductibility are combined to create a situation that would result in pro rata. The pro rata possibility is reduced as you increase your deductibility and as you increase your premiums, but that's a political issue and we ought to accept that.

Now, the Legislature, I believe, would be less willing to step in if this fund exists, say, after a year or two and there's some money there because there is political cover. Assuming a tight budget situation, which is a fair thing to assume, the Legislature is going to be pressed; there's a lot of demands for tax money, a lot of demands for programs. There'll be at least a pro rata payment being made, even under the existing program, and I think the Legislature and Governor would point to that and say that's all we can do. You know, I may be wrong. The moment, the nature of the incident, the extent of the disaster, all of those things are part of the equation and I couldn't even guess at how those would be. But the program, as we've said several times, is designed to provide a pre-funded program.

SENATOR HILL: Of course, John, a lot of that becomes a self-fulfilling prophecy. I mean, I will guarantee you that tomorrow the newspaper stories will be that this fund is insolvent, you're not going to get your money, it doesn't all hold together, here's the chart that proves it. Of course, I don't know what assumptions you made on that chart. My guess is if you said what happens if we have an earthquake after seven years of paying \$250 million a year, that it would be just reversed, that we've got plenty of money to pay it out. It's all based on assumptions of how long you've been paying into it.

COMMISSIONER GARAMENDI: This is early years; say, three or four years.

SENATOR HILL: But that's exactly my point, that it's all...(cross talking)

COMMISSIONER GARAMENDI: Let me correct myself. Richard tells me that this

actually is based on -- this is a long-term projection. This is over time, assuming, you know, a program that goes on forever that at this level this is the situation.

SENATOR HILL: But my point is, as we deal with the mandatory issue, which we all agree we have to resolve in terms of making actuarial soundness to the extent that -- you know, we say, well, you're never going to get any money, this thing is a rip-off -- and it just increases the difficulty of, you know, trying to deal with that part of it as well. I think where the estimate is \$250 million a year that's going to be generated, put in that account, and the question is: Is that enough? And how do you, through deductibles and taking out the structural things through definitions, how do you make sure the people -- and I think your point is well taken in terms of being intellectually honest with the public and saying, hey, the possibility is out there, that it may be a pro rata thing and we'll have to see what we have.

COMMISSIONER GARAMENDI: We have the possibility of an earthquake that would damage five homes in one block of a community, and we have a possibility of an earthquake that could damage an entire city such as an earthquake on the San Andreas or the Hayward Fault or the Newport-Inglewood Fault. The range is there, and depending upon the earthquake that occurs, this fund is going to either be sound or it will be another one of the disasters that'll have to be dealt with.

What I'd like to have is a fund that has the best possibility of being financially sound, where we can be as straightforward with the public as possible, that their premium will result in 100 percent on the dollar, with the understanding that if we have the major earthquake in an urban area that won't happen. Then you deal with people accepting. I think they would accept in that situation that there's going to be a world of hurt for this state, and that everybody is going to suffer and they probably wouldn't receive 100 percent on the dollar. They'd receive something and...

CHAIRMAN GREEN: I guess I can't understand why the state is any different than an insurance company. If I buy an insurance premium and I have a loss, I expect to be paid. Now, I don't care whether it's the state giving that policy or whether it'd be giving an insurance company. And I think all the public out there is like that. And we have to make our policy just as safe as possible, and we have to not put it in place until we have an actuarially sound program. And I think that's the bottom line for me, is that if I can see something of this nature that it's not well planned, well put together, actuarially sound, then I think that we've made a mistake, even if we think about putting it in place.

COMMISSIONER GARAMENDI: Well, Senator, I don't think we've made a mistake to try to pre-fund.

CHAIRMAN GREEN: Oh, no.

COMMISSIONER GARAMENDI: I think that we need to be...

CHAIRMAN GREEN: I didn't mean that.

COMMISSIONER GARAMENDI: ...straightforward with the public, that this thing works for most of the earthquakes that we're likely to see. A major earthquake is a different game, and if a significant earthquake occurs in the early years, we do have troubles here with the fund.

We can reduce those risks substantially by some of the suggestions, or by all of the suggestions that I've made here: increasing the deductibility to get away from the cosmetic type, dealing with real structural damage that a home may have. That obviously is going to put more of a burden on individuals. But I think the public will understand that we just are not going to be able to pay for cosmetics here, and I don't think they really expect us to. But they would like to have a habitable home and we ought to do that.

I think the public also would understand that we're not going to be providing coverage for chicken houses and dog houses and for outbuildings of one sort or another or for swimming pools. We're dealing with essentials here, the essentials of life. Now, somebody may consider their swimming pool or their hot tub to be an essential, but I think that's a public policy decision that we legitimately make and say it's not.

CHAIRMAN GREEN: We're going to insure the inhouse but not the outhouse.

COMMISSIONER GARAMENDI: Well, if you only have an outhouse, that may be an essential.

SENATOR HILL: My last question was, John, if we adopted all of the recommendations that you have -- the mandatory provision on the insurers, the 5 percent deductible, the definition of cosmetic and structural -- is it your assessment that the fund is sound? I mean, there's no definition of what is actuarially sound. I mean, is that your best guess in terms of making...

COMMISSIONER GARAMENDI: I have one other recommendation that I made here today and that is that we be given -- by moving the data forward, we would have the time to pull together the actuarial studies; the studies that have been made to try to sort out the major differences in either assumptions or analysis that result in such varying estimates of damage, and use that time to determine the appropriate level of premium -- 60 or 90 or 45 or whatever -- and the appropriate level of deductible. We may want to modify the top amount that we pay, but that seems to be less of a problem than the bottom that we pay. But we need to get those studies and try to coordinate and to rationalize the differences that exist there, and that would give us the numbers.

There's always risk here. We're not going to be able to do away with the risk. There's going to be a certain political risk in that pro rata may occur, depending upon time and the level of the earthquake and where it occurs. There's also a risk to the fund that we cannot do away with; that's the nature of this business. If the deductible's at 5 percent, then the risk is substantially reduced. You know, you can make the deductible 100 percent and we have no risk, so. You know, we're going to balance that out and we'd like to work with you in trying to reach that appropriate level, and it is a political balance as well as an actuarial number balance.

The final point that was -- not the final, but one additional point; you were asking earlier about the low-income dwelling. I think it's reasonable to suggest that most low-income residents live in buildings that have a higher risk in that they're older buildings -- they were built under different building codes -- and for the general average low-income person, if we were to be able to structure this fund in such a way as to have a significant amount of money available for retrofitting -- tying down the home to the foundation, strapping the water heater; other kinds of things that we can do -- chimney retrofit and so forth -- then we would, in all probability, do a far better service to the low-income recipient than a loan program after the earthquake.

So that kind of -- what is the word? -- I think our Governor is using it now -- prevention? is applicable here as well as it is to all the other programs.

SENATOR HILL: Of course, the balance there, again, is -- I believe the number is, what, \$1,250,000,000? Is that right, Sal, in terms of -- once the fund reaches \$1,250,000,000, then the loan program kicks in. To the extent that we do that sooner, obviously, then again, we're weakening the actuarial soundness by pulling it out.

I want to make a comment about the adjusting the \$12-60 and the 93 figure. You know, the bill was based on the Department of Insurance assessments of the \$15,000 program -- I understand that was the previous administration from you -- with an average premium of \$36, and based on their projections, they felt that this was actuarially sound. Don't you, in effect, have that authority to adjust that, even with that \$12-60 range? I mean, that assumption was based on the \$36 average payment. However, since you set those rates county by county, if you instead decide within a \$12-60 range that we're going to have an average payment of \$45 or \$50, haven't you, in effect, accomplished the same thing?

COMMISSIONER GARAMENDI: Within that range -- 12 to 60 -- we can set such a level.

SENATOR HILL: But you're going to decide who pays 12 and who pays 60. You have that authority now in the bill.

COMMISSIONER GARAMENDI: That is correct.

SENATOR HILL: This is based on a \$36 average. So if you decide within that 12 and \$60 range that 36 bucks doesn't cut it, and we need to be \$52, you'd have less people at \$12 and more at \$60 and a bunch of them at \$52. Does that, in effect, (inaudible) the same place?

COMMISSIONER GARAMENDI: Yes. We can certainly move the average up probably as high as 60. It means everybody pays \$60. There are some problems associated with that because the present law is written and structured in such a way that there is a sliding scale, depending upon two risk factors -- the risk of location and the risk of the building itself. If you have the average very high, we cannot accommodate those two factors in the law. And somebody probably with some justification could object to that, perhaps with some success, and that's why we're suggesting that a higher range that might lead to a different average would fulfill the present notion of the law that there is a sliding scale.

One of the ideas in the present law that would be lost as we eliminate the average, eliminate that range, is that a homeowner who has taken measures to retrofit their home to make it earthquake safe should be rewarded with a lower payment. If we go to \$60, everybody at \$60, we not only are contrary to at least the thrust of the law but we eliminate the incentive.

SENATOR HILL: Sure. But the point is there is nothing in the law that requires that \$36 average payment. That is the assumption that the bill was put together on.

COMMISSIONER GARAMENDI: We could push it upward, without a doubt.

SENATOR HILL: For instance, I wonder what a \$45 average payment does. I have no idea how much fund money we're talking.

COMMISSIONER GARAMENDI: Let's just focus on this for a second, and Richard, why don't you help me here. I'm going to take a stab at it, and then, Richard, back me up here.

If you want a fund that over time -- now, this is based upon the present information we have, and as I say, we have to get additional information here and we have to rationalize the discrepancy because...

SENATOR HILL: But this is the Earthquake Project numbers. Is that right?

COMMISSIONER GARAMENDI: Yes. Using their numbers, a 5 percent deductible and a \$15,000 coverage, over time doesn't work at a \$60 level. And if we move to a \$90 level, what happens, Richard? It does not work. Is that correct?

MR. HOLDEN: That's correct. What the Earthquake Project numbers show is that the pure premium -- that's just the amount for paying the claims -- would be about \$54. So if we set it at \$54, we'd be able to pay claims but we wouldn't be able to pay for loss adjustment, expenses, or pay for our own cost in administering the fund.

So that's why we have the two other categories. I think when the fund was put together last year, the administrative costs were assumed to be zero. Well, we've all been around state government, we know that's not true. We're going to have costs just like any other insurance company. Whether they'll be the same as what the Earthquake Project has in terms of that additional cost and the expense amount, they'll probably be less, frankly. But in terms of the pure premium, it's \$54. So we're probably underfunded to begin with.

SENATOR HILL: Now, wasn't that -- as I remember, that \$54 figure, I believe that included the bill in its original form which included contents as well. Is my recollection correct?

MR. HOLDEN: I'm not certain but I think it included primarily structural damage and -- no, it did not include contents.

SENATOR HILL: Now, is the Earthquake Project numbers, were they the most pessimistic? I know you looked at five or six different examples.

COMMISSIONER GARAMENDI: No, Steinbrugge...

SENATOR HILL: Was the most. And who was the least pessimistic? I'm just trying to get a sense for that range.

MR. HOLDEN: I think it was USGS.

SENATOR HILL: So what would the USGS number be, the \$60-93? Any idea about that? I'm just trying to get a gage for where we're at.

MR. HOLDEN: Sure. I don't know what that would be, because the numbers for the USGS and some of those others were taken from an analysis by the Legislative Analyst's office. And I think what they did is they took some gross numbers that the USGS had and tried to refit them to our program. So I'm not sure what that would work out to be.

COMMISSIONER GARAMENDI: I think that this discussion makes the point that with some additional time, we can try to rationalize the difference between these estimates. It's not a good idea to pick the one you like the best. That may lead to even worse results later on. What we'd like to try to do is to get these various estimates and the people that made them all in the room at the same time and lock the door, and when they've decided that they agree on both assumptions and process of analysis then we can get a little computer to work out the result.

CHAIRMAN GREEN: Well, I think we've come a long way from this time last year. There was really no package in place, or there were about seven or eight proposals in this Legislature. There's a difference this year. We have one thing to look at today of what we put in place. We now have a leader to help that goal and one person pushing to get a good actuarial sound earthquake insurance package. And so the scenario now is...

COMMISSIONER GARAMENDI: At least we have two people -- the two of you.

CHAIRMAN GREEN: Well, but, I mean, we had to work a lot of compromises to get to where we're at. Now it's getting the facts done and getting the job done properly. Sure, there'll still be compromises, but not like we did last year. I know we spent many hours with the six or seven players that were in this earthquake package. We have learned a lot in a year, and I, for one, I know I'll be swayed by what I hear today, but I don't think we have a good package today; and I, for one, would not want to put the package in place until it is good and the best we can do with what we have to work with. I'm sure Senator Hill would feel the same as I do on that.

So with that in mind, John, I appreciate your coming over this morning.

COMMISSIONER GARAMENDI: If I might just -- once again, the California Residential Earthquake Recovery Fund program is landmark legislation.

CHAIRMAN GREEN: Yes, it is.

COMMISSIONER GARAMENDI: You two gentlemen and several other legislators played a key role in creating this very, very important piece of legislation. It really attempts to deal with a continuing and very real problem in California and you've gone a long way in making it happen.

Some adjustments will, I think, substantially improve the program, make it administratively and actuarially sound and gives us the opportunity to fulfill the promise and hopes that both of you had when you conceptualized and created the program. So I want to congratulate you. I look forward to working with you.

The gentleman seated here -- Richard is running the program for us and he's responsible for running it. Masako Dolan, my deputy commissioner there, is overseeing this whole section, including Richard's program. So the two of them are available at your call and we're here to work with you and make this thing happen.

CHAIRMAN GREEN: Appreciate it, John. You'll find us working with you too because this program is important, and as you say, it was landmark and it is landmark and we want to see it done properly, and I'm sure with your tutorage and the help of you and the cooperation between your office and this committee we'll get the right legislation put in place.

COMMISSIONER GARAMENDI: Thank you very much.

CHAIRMAN GREEN: Okay, next we have the actuarial people -- Peter Yanev and Rusty Kuehm. I don't pronounce names very well, do I? These are a couple of tough ones.

Have you heard some of our conversations around the actuarial stuff we've been looking at with me when I was...(cross talking)

MR. PETER YANEV: Let me make something perfectly clear. I've been called a lot of things; this is the first time I've been called an actuary. I'm an engineer. I happen to know quite a lot about earthquake risk analysis, etc., so perhaps I can

qualify as that but I am not that.

CHAIRMAN GREEN: Oh, you don't really speak -- actually, what you say is right down the line of what it is. That's actuarial.

MR. YANEV: Well, engineers try to do that. Well, I'll represent myself...

CHAIRMAN GREEN: Your science is exacting and not a practice.

MR. YANEV: What I would like to do is go over a series of issues, and I have some notes which I can leave with you or I can write it up in a better format afterwards if you'd like.

I thought since I was invited by the staff to make a presentation, to introduce myself briefly since I have not appeared in front of you before. I attempted to but I had conflicts previously.

My name is Peter Yanev. I'm an engineer. I'm co-founder and Chairman of EQE Engineering. It is the largest earthquake engineering company in California. And among other things, we look at several thousand buildings a year in terms of earthquake risk; most of them are substantial commercial buildings.

More interesting, to give you a bit of background, I have made a point, since I got out of college, to go to every significant earthquake worldwide. So I've been to about 28, 30 earthquakes, including all the big ones in the last 20 years. I've also made a point of studying every earthquake that's ever occurred and I've fielded other teams to about 40 earthquakes. So I have a lot of direct knowledge and I'll try to give you some of that.

Finally, I've brought two copies of a book that originally I wrote 17 years ago. It just came out a couple of weeks ago called, "Peace of Mind in Earthquake Country." Perhaps you're familiar with it. It was the first book for the layman written by an engineer to put down on paper the various problems with earthquakes from soils to structure to insurance and what people should do about it. Back in '74 when it came out, I guess it was really the first published general work to warn people about the problems with the lack of bolts, the lack of sheeting in the critical space, about the marina, etc., etc. All the problems we see time and again, and we just saw them again a little over a year ago in the Loma Prieta.

I have two copies of it for your use. It details a lot of the types of problems that you've already heard from the Commissioner, you will hear from me and everybody else, in terms of what can be expected, the kinds of ratio that's happened and so on.

First, I'd like to talk about a few of the concerns I have with the legislation. I wrote the letter to our previous Governor soon after the legislation was proposed, and I'll kind of summarize some of that.

First, a minor earthquake can cause extensive small claims, and I can use as an example for you the Morgan Hill quake that happened in the vicinity of San Jose in

'84. I was involved in -- probably before that, I did on my own time in the '70s look at several hundred houses for people who were concerned about their risk. Basically the information that's in the book, to summarize quickly. So I looked at a large number of houses, advised them about insurance, about what to do; have been responsible for fixing several hundred houses in California so they now are earthquake resistant -- they don't need insurance, period.

Back to small claims. A typical earthquake causes extensive damage over a large area that is -- I should say damage over a large area that's minor -- cracking in the sheetrock, damage to the paint, loose bricks in the chimney which may require alterations to the chimney, etc. In a typical earthquake, thousands of houses have very minor damage. These are the small quakes.

The ultimate scenario for the Bay area, for example, I tried to get some numbers together -- about 1.6 million houses in the Bay area -- on that order. In a big earthquake like in 1906, they will all have some minor damage -- pretty much all of them. Now, to repaint the house under those conditions, to fix the sheetrock, to take care of the cracks in the driveway that will probably be there before to start with, to take care of all of the expansion cracks in the house, you're going to come probably close, in most cases, to the \$15,000. So you may be looking at a maximum loss in the Bay area with the \$15,000 program of about \$24 billion. So the numbers you've heard, in fact are somewhat low.

That goes from direct experience with a number of houses where homeowners were trying to convince me the damage was from an earthquake, a small earthquake, Morgan Hill. Well, it's kind of difficult to back up that statement when you see two or three different colored paints in the cracks that were there a long time before the earthquake. It's sort of a cascading problem. One neighbor does it and all the neighbors do it afterwards -- filing the claims.

You are facing a huge nightmare of handling claims in a moderate to large earthquake. I suspect in your earthquake in Whittier -- and again, I was there; I saw the houses, I saw the buildings, the tilt-ups -- you probably could have had a million claims because there were probably about a -- my guess is on the order of a million houses probably had trivial minor damage but it was earthquake damage, some of it was fresh, therefore the old damage could be lumped into it and it becomes a nightmare.

SENATOR HILL: Excuse me. Did you hear our discussion about dealing with cosmetics and window frames and...

MR. YANEV: Right. That's just what I'm talking about.

SENATOR HILL: I understand that's what you're talking about. But do you have some suggestions in terms of how we define what collectively I think we agree is

structural? We realize what the problem is out there. The question is: How do you define what really is a structural damage?

MR. YANEV: A crack in the sheetrock is only indicative of structural damage if it usually exceeds certain width. One-inch crack wide definitely indicates something went wrong behind to separate the sheetrock like that. So those numbers could be worked out. You could come up with a clean definition of what is. I think that would be a very good way to keep the existing legislation.

SENATOR HILL: I think that's what we're talking about doing. I mean, the question is: Do we do these types of definitions, excluding sidewalks and fences and cosmetic cracks, etc., etc.?

MR. YANEV: That can be done.

SENATOR HILL: Or do you increase the deductible, or maybe we've got to do both.

MR. YANEV: That can be done. The increase in the deductible is that typical structural damage gets up pretty high very quickly, because when you have structural damage, you have major finishing damage, typically.

Let me get back to that because I'm trying to work in...

CHAIRMAN GREEN: And there's other ways to look at structure, too. You'll have sagging doors and...

MR. YANEV: All of us have that.

CHAIRMAN GREEN: You have some even in a house without an earthquake.

MR. YANEV: Mine is as earthquake resistant as you will find in California, and I've got cracks and I have to fix those now and then, etc., etc. That's California. We have to live with it.

But I thought that as part of this maybe I should give you some of the statistics on what the problem really is that you're dealing with in terms of gross numbers. We have access to the entire -- pretty accurate, I believe -- to the entire portfolio of residences in California on the computer. So I ran a couple of cases yesterday for this presentation, because I got noticed finally. But there are roughly 11½ million dwellings in California. Housing units, I should say. Of those, we're really concerned here with this legislation, as I understand it, with about 8.1 million. And I'm not sure if that includes mobilehomes or not but let's assume it doesn't. About 8.1 million homes is what we are really concerned about in California, plus a minor, some significant percent.

SENATOR HILL: Before we leave that though, it seems that we kept working with the figure of 6½ million.

CHAIRMAN GREEN: Yes, that's the figure we've been working with.

SENATOR HILL: Now, what are we doing differently?

MR. YANEV: Well, that's our big computer file with 11 million units and there

are about eight...

SENATOR HILL: Did you include apartments?

MR. YANEV: Those are pulled out separate. That's a rough number. Perhaps yours is correct, perhaps ours is correct. It's not very important right now for my scenario.

So what I'd like to do is now define what I think is the real problem as an engineer, not as an insurance person. And I think given the large number of homes, the problem in California is, first, the old houses, and second, the bad locations. It doesn't matter how good the house is; if it's on top of the fault, sooner or later it will go. It will be in two pieces or far more. An old house has code type structural capacity problems.

So, of these 8.1 million homes, individual dwelling units, that we've got files on, we come up with roughly 1.1 million homes that were constructed prior to 1950; 1950 roughly being the year after which most, if not all, houses -- most -- houses are bolted down. They are on higher raised concrete foundations so the cripple studs, the ones that collapsed in Watsonville that folded over, or in your towns recently, do not exist.

CHAIRMAN GREEN: Unless they're on a hillside or something of that nature.

MR. YANEV: There are always exceptions, right. A steep hill, for example, it's much worse.

So we're looking at roughly 1.1 pre-1950 housing units that we're concerned with -- 1.1 million.

Now, the next question is: How strong is the earthquake? Typically, a house of that age is in trouble in what we define modified (inaudible) intensity 8 -- predense from shaking is what it is. Pardon me for using (inaudible) modified (inaudible) intensity. Eight is where brick buildings start falling apart massively. Old houses, because they're not bolted, slip off their foundations and drop. Below 8.7, typically damage is minor. It's certainly the deductible type of damage, typically. There's always an exception.

So now what happens is we have about 570,000 of these houses, old houses, in this eight intensity. In addition to that, we have another roughly 100,000 -- another roughly 290,000 houses in the high intensity area, meaning these houses are all collapse hazards.

Now, those are gross numbers based on zip code evaluations. We did one thing further for other studies we have looked at, a grid of 100 meters -- or 110 yards roughly -- grid in California of the soil conditions for the heavily populated areas. Five hundred meters for the rest of the state. So we have very detailed geotechnical data here. There's a percentage of error here and these are quick numbers.

But typically, if we go to a smaller grid risk assessment, you find out that about 45 percent of the houses in zone 8 are on better foundations, etc., so in fact the intensity is lower.

So in effect, to summarize all this, what comes out of it all is there are about 475,000, plus or minus something, old houses in California that are potentially a collapse hazard. That defines it as roughly -- some of them have been fixed already. I've been involved, as I said, many that were fixed. So that roughly makes it between a 5 and a 10 percent problem that we are really dealing with with the old houses.

Now, let me go back to the new houses.

SENATOR HILL: Before you leave that, 5 to 10 percent of these 475,000 houses...

MR. YANEV: Okay, the 475,000 out of 8 million is roughly a little over 5 percent is the real problem now.

SENATOR HILL: But then this is of a collapse danger?

MR. YANEV: That is of a collapse nature, correct.

SENATOR HILL: And that's under an 8.0?

MR. YANEV: Yeah, now this is for the whole state so one earthquake will never get them all.

SENATOR HILL: Oh, I understand.

MR. YANEV: Right. And that is for -- it could be for a magnitude 5½ underneath your house. It could be for a magnitude of 6 as in Whittier, a couple of miles away, or it could be a magnitude of 8 for long distance.

CHAIRMAN GREEN: Of course, even what you're saying is arguable, because in Whittier, for instance, that city was built probably in the '20s -- most of those houses there.

MR. YANEV: Correct.

CHAIRMAN GREEN: You had houses that were built exactly the same next to each other. The one fell down and the other one didn't. And just because it was an old house doesn't mean that it was going to collapse.

MR. YANEV: But it has risk.

CHAIRMAN GREEN: Well, it has the risk.

MR. YANEV: On top of the risk charts but it doesn't fall down. In fact, the statistics are very low, the percentage. Except if you go to a place like Watsonville, in this last earthquake, and there were streets where almost every house had fallen off a small area. This is local amplification due to specific soil conditions, perhaps a lot more rock and so on. I'm giving you the overall -- what are you trying to hit with this legislation? What are you hitting at is between 5 and 10 percent of the old houses in California, really hitting it hard and covering

it. It's not all of them, no.

Post-1950 housing. We roughly get about 7 million units of those. With the same logic now, newer housing is better and, therefore, intensity 8, not much of it is really damaged. So I'm now going to give you some statistics at 9 and 10 -- the highest intensities, the really strong shaking -- the Santa Cruz Mountains. The localized areas such as the mall in Santa Cruz or the Watsonville housing area that got it, I think Lincoln Avenue it was, I get roughly that about 13 percent of the more modern houses in California and what we'll define as a high risk area. That's all high risk area. Many of them are just fine. I may be on the borderline of that area. My house is fine, I've no concern with it with a 95 percent probability.

So that's about 925,000 houses now we're concerned with because of location primarily and some structural characteristics coupled. Now, when I add the old and the new houses, we're looking at approximately 1.4 million houses in California or about 16 percent, using these data in California, that have high risk. The rest theoretically are okay.

Now, further, I'm involved in setting up an insurance company. I am the engineering side of it, myself and our employees, the engineers. And we have looked in detail now at 905,000 units in California that we wanted to insure -- 905,000. What we found out there is that in (inaudible) 9 and 10 areas, the problem areas, about 8 percent of the houses fell into those.

SENATOR HILL: Help me out with this (inaudible) 9 and 10. Is that the same as what a Richter scale 9 or 10?

MR. YANEV: No, a Richter tells you how big the earthquake is; (inaudible) tells you how strong it shook right here.

SENATOR HILL: Oh, the intensity.

MR. YANEV: Right, the intensity. So, using that particular data, to keep it simple, I come up with a number of about 15.8 percent, 16 percent of houses in California are not a good risk to insure, if you know what you're doing. The two numbers are pretty close. Maybe the real number is 10, maybe it's 20. Anyway, these are quick statistics for you. We're dealing with a limited problem. It's not a universal problem. And we engineers can tell you this house is okay, this is not, with certain level of probability attached to it because we simply don't know where the fault's at. There may be one under my house. I'm pretty sure there isn't but we don't know enough. So that's always a probability game.

So with that, what I've tried to do is tell you what the problem is. We limited it to on the order of a 10 percent kind of a game.

Now, since Loma Prieta, the number of homes insured in the Bay area has increased very dramatically. I'm led to believe about 50 percent insured. So therefore,

people that think they need the insurance they're getting, that are smart enough to get it by getting it. I know a lot of people engineers who have perfectly good houses but they carry insurance in addition, just in case.

Given all of this, to me, and I said this in 1974 after exhaustively studying the problem to the best of my abilities, is that insurance is not the solution. Engineering is typically the solution and we know enough to solve the problem.

The next part of the problem is the money -- where is it coming from? You're facing this with the brick buildings. To me, the brick buildings are a much more serious problem.

But anyway, insurance also does not protect people from getting killed. We were very lucky in Loma Prieta in the houses. There were, I think, a couple -- anyway, a few casualties -- that may or may not happen in a very large earthquake as we have two story houses and if it happens at night or whatever the case is. Insurance does not cover life lost; engineering does with a high certainty of success.

So again, to me insurance is part of the solution that we're facing. The real possible solution to me can be looked into two ways, and I'm trying to be brief on that.

I'd like to be talking -- instead of getting into the insurance business, the state should be getting into making sure the houses are safe and then insure those that we cannot make easily safe, a house sitting on top of the Hayward Fault, a house sitting on top of the San Andreas Fault. From the engineering perspective, there's little we can do with certainty.

So, I'd like to focus on preparedness in this legislation somehow, and that's been mentioned extensively. I strongly support the idea of doing something about preparedness. I think we should pass legislation -- there's pending legislation -- requiring all the homes to be retrofitted upon sale or transfer, that termite inspection analogy. It's amazing how much lower the price of earthquake retrofit is coupled with termite inspection and fixed, because a typical termite inspection deals with the foundation where typically the problem is with most houses, especially those old houses that are collapse hazards. With some of the new houses it's a little more sophisticated. But the real problem, the old houses, we can fix those. And I told you, I see about a half a million houses that need the work.

Offer low-cost loans to encourage through a bond issue or whatever. Half a million houses. Half a million houses of the old kind. We should probably fix all million of them but half a million, they're a real risk, so we have to assess which are the real risk and which are not. One up near Lake Tahoe may not be a real risk. One in downtown Berkeley is, an old one, just because of the nature of the earthquake area.

Okay, half a million houses, the typical fix -- and I've been involved in many of them -- for a small house is somewhere between a thousand dollars -- if the homeowner does it himself it could be half of that -- between a thousand dollars for contractor work and 5, 6, \$7,000. If we say \$5,000 per house to fix the real risk houses, old houses in California that I think you're going for -- that's what you really saw in Loma Prieta, in Watsonville, etc., where the low-income people are -- you're talking about \$2½ billion of structural work -- retrofit. I thought I heard \$250 million per year reinsurance. In 10 years you could eliminate the problem and pay the people using those numbers. Insurance is not really the problem -- the solution. It's a combination of the two.

CHAIRMAN GREEN: Well, that's what we've been saying from this committee for a long time and that's why originally in the legislation we put this retrofit in the bill so there can be low-cost loans and stuff and they'll get a reward as far as their premium is concerned if they do retrofit. Yes, the committee has recognized that.

MR. YANEV: So, I'd like to urge you to focus on preparedness but possibly there is another solution, partial solution, which is requiring insurance on homes that are at high risk, especially in the high risk areas -- the 9 and 10, the bad players, potentially bad players -- they're not all bad -- and the older houses in intensity 8. Those areas are reasonably well defined. The software exists to define them in a lot of detail. The engineering skill in the field certainly exists to do that in as good a detail as I think we'll ever need today.

Now, as I said, there are a manageable number of individual cases -- half a million; if you include the new houses perhaps a million. I think there's somewhat of a precedent in this area for insuring high risk, and that's the -- I don't know much about it but the fair plan that you have for high fire risk locations as an example, zeroing in on the houses with higher fire risk potential such as on top of a hill in a brush area. This sort of thing.

Some of the advantages of the proposed solution I would be more than pleased to provide you further with written material if you like. I'll just quickly go over it. I think that the number of potential insured catastrophic losses, the real problem, the major structural damage, will be drastically reduced. We can knock that down in the high 90 percentile if we really try -- if we try. The potentially large administrative costs of the present legislation going primarily the insurance route will be avoided. And I said enough about the small claims.

The existing reinsurance markets undisturbed and therefore pricing existing earthquake coverage not artificially increased. People will still want the insurance, no matter what you do, at reasonably low levels -- 15,000, a hundred

thousand. They're still a lot above that.

I think that potentially in the next decade to the cost of a low-interest loan program is substantially less than an insurance fund cost, and we could probably work out those numbers. Technology certainly exists for that.

Consistent with the legislative stated goal to make California less at risk from an earthquake by the year 2000, if we put our mind to it, we could fix half a million houses. And I am not going to be involved in that business. I've written about it; I did my fair share; I've made the public aware of it. I was the first one to really publicly say, "Fix our house and this is how you take advantage of the insurance company. You know more than they do because they go on large numbers and you know your house individually."

There are probably 20 or 30 other things I'd like to say but I can't think of them right now.

CHAIRMAN GREEN: Well, we're kind of running out of time, so if you can wind it up, I'd appreciate it.

SENATOR HILL: Let me ask one question before you go. I'm intrigued about this termite inspection. For a, what, 1,200 square-foot house in uptown Whittier that was built in 1925, what's it cost to do the kind of things that you're talking?

MR. YANEV: With a raised crawl space?

SENATOR HILL: Mm hm.

MR. YANEV: Twelve hundred square-foot house, you'd probably need about 50 bolts. If you do it yourself it'll cost you about 3 or 4 dollars a piece...(cross talking)

SENATOR HILL: But I'm assuming people can't do it by themselves.

MR. YANEV: Actually, most people can as long as -- most people can. Let me say most people that are in reasonably good physical shape and can crawl under their house can do it.

CHAIRMAN GREEN: And have a good swinging arm to put those lag bolts in.

SENATOR HILL: But are we talking about \$200, \$500, \$1,000?

MR. YANEV: No, you're talking about 2 or \$300 worth of materials, \$400 worth of materials at most, and you're talking for the typical house of this sort, depending on how complex it is, between a thousand and three thousand; let's say \$2,500 average.

CHAIRMAN GREEN: It's a variable (inaudible)...

MR. YANEV: It may be high.

CHAIRMAN GREEN: ...because you might have your cripples in at 6 inches, you might have a sloping lot that goes 18 inches from one end to the other. So the cripples out here is 18 inches, up here it's 1 inch.

MR. YANEV: For Berkeley -- it was funded by (inaudible) National Science

Foundation -- in the late '70s I did a study with the University of California at Berkeley as the engineering consultant. And we have very good statistics on what it takes to fix old two story, large Berkeley-type/Oakland-type houses. We have very good data on that and the costs were very reasonable.

CHAIRMAN GREEN: There's another type structure we used here in California at the turn of the century and up into the '30s, was what we called the "California bungalow" which had no foundation -- it was a pad, a redwood pad on top of the ground, and it was single wall. In other words, it didn't have the two-by-four studs. It was just a plate on the bottom and a plate on the top and tongue and groove with windows in it. There's a lot of California bungalows in this state.

MR. YANEV: Especially so in California. Those are much cheaper to fix because you have to restrain it from moving.

CHAIRMAN GREEN: They just move around.

MR. YANEV: Yeah. You can put some steel angles around them and bulldozing so that it doesn't slide. And that's quite a large number of the houses I was talking about in the half a million actually.

CHAIRMAN GREEN: You put some piers in there. You can go down under the pad and put piers and so forth. Engineering has different ways.

But we appreciate your testimony this morning. It's surely a different look and the committee will take any written information you have; we would appreciate it for the file.

MR. YANEV: I urge you by all means, please; rely on the engineers to help you define the real dollar problem.

CHAIRMAN GREEN: Well, the real dollar is collapsing buildings and we understand that, but somehow we've got to get the economic factor in too, so it's a combination.

Thank you very much.

Okay, next is Rusty Kuehm. I don't like to push a time on anybody, but we're being a little more long-winded than we anticipated and we're scheduled to adjourn at one. So if you can make it brief, we would appreciate it.

MR. RUSTY KUEHM: Okay, I certainly will.

CHAIRMAN GREEN: If you do have a written statement, give us the overview of it and then we can put the written statement on file.

MR. KUEHM: Okay, yes. As a matter of fact, I do have a written statement -- I think you've just been handed it -- and what I'd like to do is take a few moments and hit the high points instead of going through each item.

CHAIRMAN GREEN: That's right, because we'll be reading all of this anyhow. I can say that for Frank because I know he reads it and I know I read it.

MR. KUEHM: My name is Ronald Kuehm -- Rusty is a nickname -- but I actually go

by Rusty. I'm a partner with Ernst & Young and I'm the national Director of Risk Management Consulting for Ernst & Young, and I'm a fellow of the Casualty Actuarial Society, a member of the American Academy of Actuaries. I also have my charter property casualty underwriting designation, associate in risk management, and I'm a fellow of the Conference of Actuaries in Public Practice.

I'd just like to go over some of the issues that we've raised in this letter to Mr. Holden of the State Insurance Department.

The very first one on page 1 under the Key Issues where it says General, you've heard this before already and I'll kind of hit on it again because this is a very important actuarial issue. I think that it's very important. I'd like to highly recommend, if you could, to make the program be a mandatory program. If it's not a mandatory program, we have a phenomenon in insurance called "adverse selection" where all the good risks opt out and the bad risks stay in and then you just end up with a residual program. And I think it would be a lot easier to make the program be actuarially self-supporting if it is a mandatory program.

CHAIRMAN GREEN: That was our intention early on that it would be mandatory in the entire state by everyone in the state, and the way it was originally written we thought it did that. Unfortunately, there's been some amendments down along the line and it doesn't have the thrust of law when it was finally passed and these questions have come up. Unless you do have the high risk and the low risk in together in the pool, it will never get healthy, as you say. We've recognized that, too.

MR. KUEHM: Right. Okay. The next item I'd like to raise is in Section 5002 (b) of the bill. There's an issue here of what we call consequential versus direct damage as far as what is covered.

CHAIRMAN GREEN: Well, I think, and our intent originally, and what you're doing -- I'm glad to see this because a lot of the things that we looked at early on, like 3 or 4 years ago, flooding was not the intent of the legislation. Flood insurance would kick in as far as the houses are concerned if it was a flood. We were looking at strictly only earthquake insurance. Isn't that right to you, Mr. Hill?

MR. KUEHM: Okay. And one other thing, in addition to the consequential are things that could be indirectly caused by an earthquake.

There's also something we coined as potential structural damage. In other words, an earthquake could weaken a structure and then some future thing cause the structure to collapse. So that's something just for you to consider.

CHAIRMAN GREEN: And that's a thought we haven't looked at -- one earthquake causing some weakness and then the second earthquake knocking it down. That's a new factor.

MR. SAL BIANCO: I just wanted to point out that in 1985 the Legislature eliminated the doctrine of concurrent causation in the statute as it related to earthquakes. So if you were speaking of that particular issue, I don't think it would be anywhere impacted at all on 2902 since it is directed only to residential structures. Are you speaking of the doctrine of concurrent causation when you were...

MR. KUEHM: No, I was just reading directly from 2902 and it really is unclear as to what would happen if there was, the term we call "potential" structural damage where a structure is weakened. That's really what I was referring to.

MR. BIANCO: Thank you.

MR. KUEHM: A few small implementational issues such as insureds paying the premium and installments and defining whether they're covered or not, would they pay the installment -- pay the earthquake premium all up front, which we would recommend for cash-flow purposes for the fund.

I'll skip over to the next page, on page 2, the second one down, Section 5004 (a) (1). We recommend not to be overly restrictive with the rating factors enumerated in the bill. The bill mentions locations, type of residential property, and age of residential property, and we recommend that the Commissioner be permitted to determine the most appropriate rating factors in accordance with sound actuarial principles. One item would be construction type as also a rating variable, and another one might be the value of the dwelling also.

Similarly in 5004 (a) (2), we recommend that the surcharge amounts not be limited to a maximum or a minimum. The amount should be determined by an actuarial funding study, and you've heard that over and over again so I don't mean to be repetitive.

Also in the bill there is somewhat of a limitation on the annual adjustment, and we recommend that that be more determined by an actuarial funding study based on all the available data.

I think those are the main items. I don't want to be taking up more of your time. We do have a number of other implementational issues but, at this point, if there's any specific actuarial questions you'd like to throw at me, please feel free.

CHAIRMAN GREEN: No, I think this -- what you've done here, the key issues, says you have read the bill. I think some of the answers we have already, but it's part of the study of which we should be doing these next few days and this will be a help in doing that, to have someone from a risk management company give us the key issues as you have read the bill. We will be putting our heads together with what you think and what we think, and from that we'll come up with probably the right answer.

Are there any questions, Senator Hill?

We thank you very much for coming out today, and thank you, again, for being

brief and holding you here for a long time to be brief.

MR. KUEHM: You're quite welcome.

CHAIRMAN GREEN: Okay, that puts us down to Tom Tobin, Director of Seismic Safety Commission.

MR. TOM TOBIN: Mr. Chairman, thank you very much, and I'll be brief because you can always find me, I guess.

First of all, one of the major concerns we have is with mitigation and I think that the earthquake insurance program we have now is the foremost anywhere in how it treats mitigation. It does provide loans, it provides variable premiums, it funds some hazard mapping programs, and certainly we'll be making a lot of information available. However, there is still a very big weakness in terms of mitigation.

Last year we had a bill we found as a companion matter bill that would have required the residential strengthening and it was vetoed. We're having it reintroduced this year by Assemblyman Cortese. It's AB 200. I believe it speaks to the issue of -- the solution is in the mitigation of these houses with the obvious problems. I believe that's absolutely essential to bringing the fund into some kind of control eventually. The mitigation is still of great concern and I believe it can be done.

Secondly, I want to strongly endorse the need for the actuarial study. The Commission has concerns about the low deductibility, really for two reasons. One is the actuarial reason but the second's really an operational reason, and I'll speak to that a bit later. And the second is that the premium certainly is so narrow that the differential would be so small but it really doesn't serve as an effective incentive for encouraging mitigation as it is.

What I'd like to stress is that you do consider the post-earthquake situation, perhaps ask the question: Will the presence of this program help in disaster recovery and how? Certainly the matter of speedy payment is one of the key issues in this. However, when you're working against the potential for hundreds of thousands of visits by adjusters, looking for a period of time of several months to tally up the total costs before we can get into the pro rata, only then to go back to see what's happened in aftershocks, we're looking at a nightmare in terms of paying it out. And I don't envy the position that the Insurance Commissioner is now in trying to make this work in a speedy, equitable way, dealing with the number of adjustments that would be required as well as doing the calculations that are required through that pro rata.

CHAIRMAN GREEN: One way it could be done is we have the Office of Emergency Services. We have people out there immediately into that earthquake area as far as the state is concerned. Could we, as a foundation of appraisers, kind of train those

people to be claims adjusters up to a point and handle that for a whole lot less dollars?

MR. TOBIN: Conceptually I would recommend that. There are a lot of problems, and without the insurance program, when we see the number of people who come by to judge what the costs are, representing local government, representing the Small Business Administration or FEMA programs or OES programs, we have an awful lot of problems. People are coming in from out of state to do this work; they're not trained under an earthquake -- a lot of earthquake damage is incredibly subtle. I mean, you don't see it until you start removing some of the finishes, for example, and it is something that has to be done very, very carefully. If I was the Insurance commissioner I'd be very concerned about that to make sure it's being done well or...(cross talking)...you know, the (inaudible) life in trying to adjudicate these.

CHAIRMAN GREEN: He can't gear his office to the major quake and have 10,000 appraisers sitting there waiting for one to happen. So you have to have a plan and who starts this procedure and where do you get your people to do all of that.

MR. TOBIN: Well, I think that is potentially one solution. And to add to that, really the second to last point I want to make is to coordinate this with those disaster aid programs. And I was thinking that coordination -- if the deductible limit is raised up to a level that becomes onerous for certain individuals, we do have other programs that are in place, and they are independent and they probably should not be so independent. But you have an individual in family grant programs administered by the Department of Social Services with state and FEMA money. That provides grants up to \$20,000. You have the Small Business Administration with their real property loans of up to \$100,000 at 4 percent if need be, and certainly SB 8 also has a personal property loan program for, I think, up to \$20,000.

CHAIRMAN GREEN: But that all sounds good but in actual fact, in Loma Prieta and in Whittier the people that couldn't afford to pay that back were turned down and they didn't get those grants and those loans, and that's why some of us want to do this type of fund so that...(cross talking). You don't need the money so they'll loan it to you.

MR. TOBIN: I understand that, but I think if you do look at some of the numbers in terms of Loma Prieta, there are a lot of Small Business Administration loans that have gone out to single family houses.

SENATOR HILL: John, I wanted you to hear this comment before Tom left. I mean, I've got tremendous confidence in the Insurance Commissioner's ability to put this program together. We've given him a lot of leeway and I just want to make sure...

COMMISSIONER GARAMENDI: (Inaudible.)

SENATOR HILL: Well, I just want to leave you -- at least where I'm at, I

couldn't disagree more with Tom about the idea of putting additional responsibility on the Office of Emergency Services. I think that the reason this program has the potential to be successful -- we've already been through what we went through with FEMA -- is the idea of having private adjusters from the private companies come out and provide that service, and I have a lot more confidence in...

CHAIRMAN GREEN: Well, I'm not talking about FEMA.

SENATOR HILL: Well, I'm talking about having John keep an eye on those guys and tighten them up and make sure they're doing the right thing. I think that's a lot better approach than to...

COMMISSIONER GARAMENDI: When Tom was speaking a moment ago about the Office of Emergency Services and FEMA -- they're more or less the same -- I was thinking that perhaps they'll get to the earthquake some time after they get to the 1986 flood (inaudible).

SENATOR HILL: So you've had experience as well.

CHAIRMAN GREEN: We don't have too much confidence in FEMA. Go ahead, Tom.

MR. TOBIN: The last thing I think is terribly important in this and that's the communications, and I think having an elected commissioner at least brings the matter of communications to the forefront. The matter of how these programs are sold and how agents relate to the actual homeowners I think is absolutely critical in terms of whether or not this program can also be effective. You know, if the person is selling the policy, collecting the premiums, an independent agent or an agent for a company, that's an absolutely key contact, and some provisions really have to be made so the program is really fairly and clearly represented by those non-state employees who are collecting the premiums who really fear the idea that people are going to assume this program does a lot more for them than what it actually does do -- (inaudible) out the catastrophic coverage, for example, and that communication's element is of critical importance.

CHAIRMAN GREEN: Tom, from what you've heard here this morning, and I know you've studied the bill too, what would be your recommendation as to do we delay this or put it in place July 1 as it was set down by legislation. In other words, is there enough problems that have been pointed out to hold the legislation for an extra 6 months?

MR. TOBIN: I think a delay is the only responsible thing to do. The suggestion for an actuarial study and to have this lined up with the regulations and so forth, I think is absolutely necessary to make the program work. What the length of that delay should be I have absolutely nothing to base that on, but I think a delay certainly is important.

CHAIRMAN GREEN: I would hate to rush into it. Well, thank you for that advice.

MR. TOBIN: Well, I think the last thing I wanted to close with is, you know, up until today I've always looked at the big one as being the magnitude 8.2 or 3 earthquake on the San Andreas Fault and I think we now find out that the big one is actually the Insurance Commissioner. (Laughter.)

CHAIRMAN GREEN: Thank you. Thank you, Tom, for your testimony. From the Consumers Union -- I don't have a name here. Not here. Insurance and Agents and Brokers.

MR. JERRY MILLER: Good morning, Senator.

CHAIRMAN GREEN: Good morning.

MR. MILLER: Senator Hill.

CHAIRMAN GREEN: Would you identify yourself for the record, please?

MR. MILLER: My name is Jerry Miller. I'm an independent agent. I am here representing the Independent Insurance Agents and Brokers of California.

CHAIRMAN GREEN: I know you but the record doesn't.

MR. MILLER: We appreciate the opportunity to have input into this process. First of all, Senator, we'd like to clearly state that we, as agents -- obviously as was just stated by Tom, we'll end up explaining this program to your constituents and our customers, the consumer -- we'd like to be dealing with a sound program.

In that connection, we urge you to deal with the problem in two phases. One, we support the recommendation to extend the effective date until January 1, 1992, but as part of that legislation recommend that a requirement be included that an advisory task force, if you will, perhaps the advisory committee that your original legislation envisioned, be convened to consider the many technical details that are involved in this.

There are, as you know, many technical issues involved. Condominiums, mobilehomes have been mentioned. These are mentioned quickly but they're very serious issues that need to be dealt with.

That the first phase therefore be the delay, recognizing that there are many technical issues. That the second phase be the cleanup legislation. And we would like to make it clear that we are willing to work with all of the interested parties, including the DOI, to help construct a cleanup bill that will truly address all of the issues. That then will give us the confidence we feel we need as agents to deal with this issue with our customers, with a confidence that we can deliver a good service to them.

CHAIRMAN GREEN: You're going to be on the front line.

MR. MILLER: That's right. That's very important and we're glad that you recognize that.

If agents and companies are going to be involved, as we believe they must, then

we obviously are going to have to have some consideration for the time and services that we will render. There are instances where our services may be minimal, as in the case of a person who doesn't carry private earthquake insurance and where our function might be limited simply to preparing a report to either the insurance adjusting firm or the DOI. We recognize that our services may need to be compensated at a different level, depending on the type of customer we're dealing with. If we have to prepare a report simply because of the existence of the state fund, that's a function we would not have performed otherwise. If we prepare a report for a private insured customer, that's a function we would have performed anyway, and simply a copy of that report can go to the interested party. And obviously we don't need as much consideration of our services in that case as we would in the former.

We agree very strongly that the surcharge must be mandated. There are, however, some concerns that we as agents have in that area, especially in view of some of the suggestions that have been made this morning, and some of them are more properly those that'll have to be considered by companies. But we have a difficulty with the suggestions that involve some sort of back door collection of the surcharge. We feel the collection needs to be made up front, needs to be clearly stipulated as to what it is and what it's for. We find that there are a lot of problems developed when you get into a method of collection where the consumer doesn't understand that.

The CIGA charge today, for example, is very clearly stated on the face of a policy declaration. That's not to say that many people understand what it is but it is there and it is clearly identified.

It was suggested, for example, that we might consider this as an after-the-fact part of a Proposition 103 rate hearing. We feel that would be somewhat unfair to the consumers who would end up paying for that because they're paying for what someone else hasn't paid for. In effect you have a double surcharge.

We don't know what the answer to that is. You might consider adding the charge to property tax bills, collecting it that way. That may not be the best suggestion for a number of reasons, but I think this is an indication of the technical areas that need to be considered where we would appreciate the opportunity to have some input.

Most of the other issues that we are concerned with, Senator, are technical in nature, and recognizing the constrictions that you have on time, we won't get into all of those.

We do feel, however, that it's very important that we not get into the mindset that we're creating a whole new insurance mechanism, that we are creating a completely different type of insurance company and fail to recognize that the existing system has an awful lot to offer, and that the service mechanism is there,

that it can be effectively utilized, and that we, as agents, and I'm sure the companies feel the same way, want to be part of it, and we'd like to be part of the answer as well as part of the problem.

CHAIRMAN GREEN: You've been that and we appreciate this up to this point and I'm sure we'll be working a partnership from this day forth. And thank you so much for coming out today.

All right. Okay, we've got the insurance company representatives. I'm told American Insurance Association and Personnel Insurance Federation, Associated California Insurance Companies, Alliance of American Insurers, California State Auto Association. Let's all come up and have a party.

MR. RON GASS: Thank you, Mr. Chairman. My name is Ron Gass. I'm Senior Counsel with the American Insurance Association. It's a pleasure to be here with you and Senator Hill this morning. You obviously have a few other representatives here. I'll try not to take too much time.

Aside from being delighted to be here again and appearing before your panel, I want to compliment you on getting Senate Bill 2902 out of the hopper and into law. Obviously there are some problems which have been identified that we would like to continue to work with you and your staffs on. I agree with you, it is landmark legislation. In fact, I wanted to let you know that I got a call from one of our members from Japan who is closely watching to see what happens in California because they're considering this perhaps as a model for their country. So I think there are more than just the eyes of California policyholders on what this committee does and what the Legislature ultimately does.

SENATOR HILL: Well, Cecil, maybe with reapportionment, the Japanese -- put part of that in your district maybe.

CHAIRMAN GREEN: What part do you want? What end? East or West?

SENATOR HILL: That's right.

MR. GASS: I'd also like to point out that we, of course, are going to continue to work with the Insurance Department. We look forward to working with the new Insurance Commissioner. I appreciated his remarks this morning. I think it's the first time we've had an opportunity to see what approach he would like to take to solve some of these thorny problems with the legislation as it stands now.

Let me just start off with what seems to be the thorny issue and that is the enforcement problem. When I appeared before you and Senator Hill on other occasions, I heard the comment -- I believe it was from you, Senator Green -- about this being a partnership, and I think that the industry has worked hard to try and keep up their end of the partnership but I think there's some other players here that need to be kept in mind.

Obviously, the state is playing a large role in putting this program together, and the policyholder has to do his or her part as well. And I think there's another hidden partner here, the banks, which I'll talk about in a minute, that I think can play a role in the enforcement mechanism, and I will offer that for your consideration.

I guess one of the concerns I have about the CIGA approach is what kind of message are we sending to the policyholders? It wasn't clear from Commissioner Garamendi's remarks what he intended if the surcharge were fronted, in effect, by the insurance companies and we had the quake. Does that mean that everyone who didn't pay but whose money was fronted by the insurance companies would still be covered by the fund? If that's the public policy message that we're going to send to the policyholders, why would anyone pay?

CHAIRMAN GREEN: That's the question.

MR. GASS: People will get a free ride.

SENATOR HILL: Well, because I assume, Ron, what you guys will do if we accept the Garamendi approach, you won't write a policy unless somebody pays it.

MR. GASS: Well, I think cancellation...

SENATOR HILL: Isn't that what's going to happen?

MR. GASS: Well, I'm not sure.

CHAIRMAN GREEN: Maybe we have an answer here.

MR. GASS: Okay.

CHAIRMAN GREEN: Sal?

MR. BIANCO: It seems to me that you've raised the same issue on the California Insurance Guarantee Association. If someone fails to pay their surcharge to their company and the company goes insolvent, do you deny the claim? I don't think you do. I think you pay the claim.

MR. GASS: Well, let me ask this, then. Are you saying that your approach would be to include the policyholder in the fund even if they never pay the surcharge and it's never collected?

CHAIRMAN GREEN: It wouldn't be my approach but it seemed to be Senator -- or Commissioner, whatever he is now. I worked with John for so long as a Senator I still call him Senator Garamendi. But it seemed that that was kind of a question he arose. In other words, could the fund -- the people that didn't pay -- for instance, if it goes in place July the first and your homeowner's is not due until January the first, you have six free months there to be without paying and you will have insurance. We have to fix that, because if a person pays, he gets coverage; if he doesn't pay, then he doesn't get coverage. That's simple business.

MR. GASS: Yeah, I think one of his interesting suggestions was to try and do a

pro rata approach up front to cover what was in effect...

CHAIRMAN GREEN: Well, it could very well be to bring it all up into one payment schedule. You could prorate policies and say this year you're only going to pay \$10 because you're going to pay in another three months the full \$60. So that can be done, too. But I don't think he took a position -- at least because I left the room for a while and I wasn't here during part of that -- but I don't think he took a position that somebody should be paid. He said that's a problem and one of the things that we have to draw the regulations to.

MR. GASS: Sure. Well, if you assume that everyone's going to be in the fund, whether they personally pay the surcharge or not, then I think that link in the partnership is weakened from a policy point of view, that you need to have some way to make the individual responsible for their obligation to pay to make this whole thing work. Because obviously their monies are critical to make the fund work.

One way to do that would be perhaps to have the actuaries, as they figure out what the surcharge is going to be, to include what companies include when they do their own rate analysis of bad debt charge. You'd be spreading it the same way as if you would go back through this rate hearing process that the Commissioner said, and that way it may be pennies per policy for everybody. I don't know. You'd have to come up with some sort of appropriate actuarially sound estimate of what you think the deadbeat's factor is going to be.

SENATOR HILL: But, Ron, if the Commissioner adopts a regulation, or we, through legislation -- I can't remember what he preferred -- but the point is, if we handle it like the CIGA surcharge, my assumption is that you guys won't write any policies where they haven't paid their \$36 payment. And so the reality is we have zero bad debt charges because they haven't paid into the fund. Is that not what you guys would do?

MR. GASS: (Cross talking)...structured is that the surcharge is not considered premium; so, in effect, we're assuming the way this would work, someone would pay the underlying premium in full and say, oh, on that \$36 surcharge, forget it, I'm not paying that. So, in effect, the company has received its full premium so it has no grounds to cancel.

CHAIRMAN GREEN: Well, that's true and I think that's the problem that's been pointed out. Some of us have been pushing from day one to make it mandatory with your homeowner's policy but we didn't put the little teeth into the law to make it happen and that has to be done.

MR. GASS: Well, we're not going to resolve that today. All I'm suggesting is that whatever is politically feasible to encourage policyholders to do their part in this partnership I think is critical.

Now, as far as the banking aspect of it, I think -- and I've discussed this with staff a little bit and I think they had some good ideas too -- that the banks play a very crucial role. Every home that has a mortgage has, in many instances, an escrow account where there's an insurance element to it; that the banks could be sending little notices about hey, we haven't seen your -- well, the way it works out, if you haven't paid your homeowner's policy premium, which is usually a condition of the mortgage, they'll send you a notice saying, you know, if you don't pay -- you know, send us a certificate for insurance, we're going to buy insurance for you. There's no reason why that kind of operation can't be pulled into the earthquake component of this.

CHAIRMAN GREEN: We recently had that happen here in the Sacramento area. When the flood plain was found, the houses that were in that flood plain all of a sudden found they had to write the policy and if they didn't write the policy, the policy was issued by the bank. And I think the same thing could be done here.

SENATOR HILL: I think that's a great idea. We'll put it off the insurance guys and put it onto the banks. I'm sure we'll be hearing from Maurine shortly about what a swell idea she thinks it is.

CHAIRMAN GREEN: But I think there has to be some authority, there has to be some way to insist that the homeowner's policy...

SENATOR HILL: No, I understand. I mean, I guess my question would be: What do you do with my grandmother who has paid off her home -- she doesn't have a mortgage, the bank's not involved -- and now she wants to be included in the program?

CHAIRMAN GREEN: See, that's the 5 percent factor we talked about. There's 95 percent of the houses in the state that will probably go just like we're talking about. Five percent are not...

MR. GASS: Yes, there are going to be gaps, I agree.

CHAIRMAN GREEN: There's some gaps and that's where your premium has to come in and make a difference. And they're not deadbeats; they're just people that, hell, they're not going to pay anything, their house is paid for; so it falls down, they go buy another one.

SENATOR HILL: Ron, what's the percentage of people who do not pay their CIGA surcharge now?

MR. GASS: I do not know that.

SENATOR HILL: Does somebody have an idea here, guys?

MR. GASS: We can try and find out.

SENATOR HILL: I mean, because really, we're talking about the same analogy. With what we have right now, the CIGA surcharge, we have people who don't pay, it's a mandatory surcharge. What do you do with somebody who doesn't pay the CIGA

surcharge? I mean, we can talk and talk and talk and worry about this thing but the reality is, whatever mechanism in place now for the CIGA surcharge is working -- I guess it's working because I don't hear you guys up there saying that we need to repeal it. And so my question, you know, we're going to create this big issue -- is it really an issue? Are 99.9 percent of the people going to pay this surcharge because it says it's mandatory?

MR. GASS: Well, I think that depends on a couple of factors. First of all, I don't know how much the CIGA surcharge is. I don't think it's \$60 or \$90. I mean, I think it's a fairly small number.

Secondly, the CIGA law, as currently written, provides that companies can apply to CIGA under the plan of operation to ask not to try and collect money where it would cost more to collect it than it's worth. And I think maybe many of those fall in that category. We're talking about amounts that could be substantially higher than that, and that's why I'm not sure the CIGA analogy is a perfect one. I think there's a big difference between a company eating \$60 in one way or another or having difficulty trying to recoup it and \$12 or \$5.

SENATOR HILL: I guess my question is -- and I think you've hit the fundamental point -- is do you really eat the 12 or \$60 or the 36 bucks average payment, or are there internal policies that are adopted that just simply don't allow that to happen?

MR. GASS: Well, that's something we'll need to explore a little bit further.

I think that there are other possible alternatives that may not be politically feasible. That's something you all will have to decide. Perhaps prohibiting the transfer of the property unless this lien is paid. Another possibility might be to require the fund to create its own sort of mini collection agency to en masse send out letters, and I think at the outset let everybody know that they're going to be tough on this, that they're not going to let people get away without paying this. And again, how far you can push that, whether it's just a couple of letters or perhaps, you know, via the banks a letter about, you know, we're concerned that you don't have your earthquake coverage paid up. And I think this should be of major concern to banks because they have something on the hook here. They have the property on the hook if it's not covered for earthquake.

CHAIRMAN GREEN: Well, and it could very well be that we can tie this to the property tax bill itself and it would save a lot of money instead of going through the insurance companies, is that this fee would be then on your property every six months and the money'd be sitting there and it comes in like property tax does. So it's a possibility that could be done.

MR. GASS: Senator, I'm not trying to shift this burden entirely...

CHAIRMAN GREEN: No.

MR. GASS: ...to the banks. We have a role in this, I think they do too, and they're not part of the partnership yet. I think that's something that ought to be investigated.

CHAIRMAN GREEN: Well, one of the things that I think brings this to mind is one of the things that people hate to pay the most is their trash bills, and those cities that have, in their eminent wisdom, tied it to their water bills and to the property tax have no problem with their trash rates. Those that haven't, every year they end up with a big squabble of how do you raise the rates.

SENATOR HILL: Of course, the problem with having the banks do it or property tax or whatever...

CHAIRMAN GREEN: There's still a cost to it.

SENATOR HILL: But the entire theory behind the bill was that since the mechanism is already in place -- the insurance carriers are sending out a homeowner policy notice once a year or on a quarterly basis, that mechanism -- we're going to try to tap into that mechanism. We spent a lot of time talking about having all of the billing done by the state and we rejected that saying we're just adding another layer of bureaucracy, weakening the actuarial soundness.

CHAIRMAN GREEN: What's happened though now, Frank, I think the difference is that those discussions we had last year of how to collect this now are kind of moot. We're going to have to think of a way because, number one, how do we mandate then the homeowner's policy?

SENATOR HILL: Oh no, I understand.

CHAIRMAN GREEN: So it's given us a whole new bunch of problems that we didn't recognize last year. So now how do we mandate? Every piece of property in this state has a property tax on it. There is none that doesn't, including your grandmother. So maybe that's the best approach, to make it mandated and make it part of the property tax as we do in the fines and forfeitures in courthouses. We've taken fees to raise and build new courthouses. People don't like to put their money into that courthouse, but for those people who pay a fine, they have to pay a surcharge and that's what this is.

MR. GASS: Senator Hill, I'll check with my membership, but I'm willing to bet that the bad debt activity on the part of my members is relatively a minor part of their operation. Those people who want the policy pay the premium. And if they don't pay the premium the policy is canceled. There isn't this need for an elaborate collection mechanism to send out letters to get the homeowners to pay back the companies who have fronted the -- the companies aren't banks. They work on a cash receipt basis, and for them to front the money and wait six months or a year, they lose the investment income which they depended on in order to make their rates in the

first place. And that's why I think that the actuaries working and developing the surcharges can figure out what the approximate bad debt charge might be, spread that over everybody who's supposed to be in this pool, which is virtually every homeowner, and if it works out to be 50 cents, why create this elaborate administrative mechanism that their companies don't have already and make them spend money sending out letters or hiring a collection agency to collect \$12 or \$50 when every policyholder in the end, whether it's a rate adjustment or an adjustment in the surcharge, will be paying the extra 50 cents. And you can do directly and void all the bureaucratic hassle what you're trying to do indirectly by using this sort of CIGA analogy.

CHAIRMAN GREEN: What is the federal program as far as the way they've figured to get it paid for?

MR. GASS: Well, Mr. Gage asked me that question the other day so I'm prepared to answer that.

CHAIRMAN GREEN: Good, I hoped you were.

MR. GASS: There are really two components. One is everyone who wants to participate in a federal mortgage will be required under federal law to have earthquake coverage. That's enforcement mechanism number one, and this is, again, where I think there's some harmony between what the federal program is doing and having the banks involved in your program.

The second part is every company that participates in the reinsurance program of the Earthquake Project legislation will be required to offer as part of the basic homeowner's package earthquake insurance. In other words, it won't be a separate endorsement anymore. If you buy from "X" company and they are reinsured from the fund, you will get earthquake coverage whether you want it or not. If you don't want it, then what you have to do is shop around for a company that is not willing to participate in the reinsurance program and therefore not obligated to offer earthquake coverage.

So using those two mechanisms in tandem, you're going to cover a fair majority of all the policyholders that way.

Now, some of those mechanisms, maybe with the exception of the mortgage, I'm not sure that the reinsurance component which says you don't have a reinsurance in your program is applicable. I think the mortgage requirement that if you have a mortgage you'd better have earthquake insurance well might be, and that's again why I suggested that the banking part of the partnership needs to be explored a little bit.

SENATOR HILL: I guess my comment would be this is not a surprise issue to us. I mean, we had a lot of discussions about the mandatory issue. The reality was we decided that for political reasons let's deal with that next year. The conceptual

agreement was let's put the program together, and we all agreed that it was going to be a mandatory program. The enforcement of how you do that is not some surprise issue.

I would be curious as to what the carriers' position would be if we put in a bill that said you cannot write a homeowner -- or maybe better than that, you cannot write a fire policy unless you've paid your surcharge. You can't have a homeowner's policy -- a homeowner's policy cannot be in effect in the State of California if you haven't paid your 36 bucks.

MR. GASS: Well, that's a possibility. I don't know what my members would think about that.

SENATOR HILL: Well, that's what I was trying to get, your reaction. What would they think about that? Do they hate that? Do you guys go crazy about that? Dan, you don't like this?

MR. DAN DUNMOYER: Dan Dunmoyer, Vice President of First Alliance for the Personal Insurance Federation of California.

On the whole, we don't like that concept in the sense that we try to separate this program from our own insurance. We don't view this as insurance; we view this as the California Earthquake Recovery Fund. I think the Commissioner has already mentioned that he felt that was a little overly draconian and we would concur with that. So from the outset that would be our perspective. We'd have to come back with an official position.

SENATOR HILL: But is that preferable, I mean to the Garamendi approach that says, well, essentially you guys eat it as bad debt and we'll take care of it in the Prop. 103 hearings?

MR. DUNMOYER: One of the things about eating it in the sense of bad debt (inaudible) to CIGA, many of our agents will eat it themselves, the 2 or 3 dollars that CIGA cost. If you're writing a \$2,000 auto policy and someone doesn't want to pay 3 bucks, he'll eat the commission and he'll go ahead and take care of it. If you're writing a homeowner policy for \$400 and you'll get 7½ percent commission, you just lost \$30 on your commission.

So it's a little bit different than -- we're talking also in CIGA companies we represent probably pay 3 or 4 million in CIGA. I would imagine we'd have to front \$120-150 million to pay for this approach. That's a little different amount of money.

So there are some different numbers here. And you're also talking about there's no way to cover this, so the traditional agent would be taking the role of responsibility.

SENATOR HILL: So does that mean, reading between the lines, that probably we

would rather have a state law that says you can have a homeowner's -- if the two choices out there are the Garamendi approach -- it's going to be the CIGA analogy on bad debt -- or you can't have a homeowner's policy in the state in effect unless you pay into it, that the second alternative is preferable?

MR. DUNMOYER: Our basic public policy concept is we don't want to reward people who don't buy insurance or for them to gain coverage for not buying it. So that's going to be the underlying policy. You don't want your law-abiding citizens who pay for their program to be subsidizing people who choose to not pay for the mandatory program. So for that reason we don't want to reward that. If that comes through nonpayment or a cancellation, I'd have to agree with Mr. Gass that currently we can only cancel for nonpayment of a premium and this is not a premium, not subject to premium tax, so we don't have the authority. So we don't want to encourage people to think they can get coverage by not paying for it because you destroy the whole concept of contract.

MR. TIM HART: Mr. Chairman, Tim Hart, with ACIC.

I think -- and I can't resist to observe that we feel the same *deja vu* all over again like Yogi Bear that you do, Senator, because we proposed rolling it into property tax payments, I think in the first meetings last February.

CHAIRMAN GREEN: Yes.

MR. HART: And we understood fully the reasons for not pursuing that particular alternative. The key to the success of this program is its perceived fairness and equity and (inaudible) a lot of discussions we had about mobilehomes and renters and everything else. And to our way of thinking, the more adversarial you make this process from the standpoint of the consumer, especially those of our customers who consider themselves at low risk, given the price sensitivity of this product, the less likely they are going to be to participate actively in this program. Given that the over-arching policy goal here is economic recovery in the residential sector, and I stress that because the commercial sector is in better shape, to the extent that the industry becomes the hammer rather than the conduit for this program, it's going to affect their perception of its equity on the part of the individual policyholder. And the more that takes hold, as we've already seen with the Leg Counsel opinion, the worse off the fund is actuarially.

So between those two alternatives, Senator, we'd have to evaluate those carefully. But it seems to us the perception of fairness extends to a policyholder who agrees to self-insure and pay the surcharge voluntarily but is being asked to subsidize perhaps a higher risk for those who are unwilling to pay and want to try to take advantage of the system and ride on other policyholders.

SENATOR HILL: I don't think there's any doubt, though; it's going to be

mandatory. The issue is how do you do that in a fair way. My prediction will be that three years from now if we have an earthquake, the carriers and the agents and brokers will be out there spending this \$15,000 from the state fund and taking credit for all of these wonderful things that are being done, and that's fine. I mean, as long as the program works. But it just seems to me, then, if you're going to put together some sort of a mandatory issue that one of the ways you keep the companies out of this adversarial process -- let me back up. It seems to me you're in a much more adversarial process on the CIGA surcharge kind of approach, because maybe you do end up with letters, and if it's \$150 million, then that's a big number, it isn't something that we can just let slide. On the other hand, if the local agent says hey, I can't write you a policy, nobody can write you a policy in the State of California unless you pay into it, that's the law, it seems to me that you have dramatically eliminated this adversarial kind of potential, assuming that Maurine isn't tough enough to keep you guys from making the banks do it.

CHAIRMAN GREEN: Well, it might be a combination, you know. They could be...

MR. GASS: Well, then the banks will get involved because if you don't write the homeowner's policy and you have a mortgage, the bank's going to say whoa, what's this, I don't have a certificate of insurance.

SENATOR HILL: The reality is if you can't write the policy, everybody will pay.

CHAIRMAN GREEN: Yeah, there's no question.

MR. GASS: Right. Just to wind up -- I'm sure my colleagues will have some other remarks -- I think on the six-month delay, the Commissioner has made a compelling case for why there needs to be some delay in it. I certainly don't want to handicap him in any way in trying to rush it faster than he feels he has the staffing and budget and wherewithal to do it, so we have no problem with that.

And I think on some of the definitional issues, which we didn't get into very fully today, I think there are ways to resolve that. I think the first step is for you and your staffs to decide what you want to include and what you want to exclude. I'm sure the industry and others can come up with the words to help you accomplish that -- the condominium problem. We came up with the issue of what do you do about farm dwellings which are normally written on commercial property policies not personal -- not residential property policies. So there are a few glitches that I think the industry in its 200 years of experience in doing all this can help you with. And I know Sal and Bill have my card, and I just met Ms. Hood today, and feel free to call me and we'll be happy to help.

CHAIRMAN GREEN: Well, we've been working with all of you for a long time and we appreciate what you've done as a partnership, and I want to reemphasize that word. We are in a partnership. Some people might not recognize it but we are, and we'd

better stay in a partnership because that's the only way we're going to be successful.

SENATOR HILL: Before you go, I just wanted to get -- maybe it's too early to tell, but one of the problems that I have with the 5 percent deductible level, and as I'm sitting here thinking, I think I want to put together a series of five or six suggestions in terms of how do we improve the actuarial soundness of the program, making sure that every time you transfer property you pay in, the cosmetic things, lots of different ideas. But one of the problems I have with increasing the deductible to 5 percent -- first of all, we have -- is it State Farm, Dan, who already offers the 5 percent earthquake policy in the state? Part of the idea was that this program hopefully was going to fill the gap that was going to kind of be a bridge. One was what do you do with the guy's chimney that falls down, and I have private earthquake insurance, the deductible is so large that I get no benefit. And secondly, what if my whole house falls down and now I'm stuck with a big deductible; I've got to pay the first 20,000 bucks; now I've got \$15,000 to help me towards that deductible. We kind of get away from all of that, going to this 5 percent concept. And so my fundamental question is: What's your reading in terms of what's going to happen in the private earthquake insurance market if this fund goes into effect? Because we've got a lot of different opinions. Some people said we think there's going to be a dramatic increase in the purchase of private earthquake insurance because a lot of our market studies show people aren't buying earthquake insurance because of the high deductible. And to the extent that they see this \$15,000 and eventually a \$27,000 payment takes care of that issue versus the other side of the equation. I think the gentleman from the agents and brokers was saying, hey, we may get people who no longer take the private earthquake insurance, figuring I paid my 36 bucks, I'm covered, and they opt out. I mean, do you guys have any reading on what happens with that private earthquake insurance that's out there on top of the 15 grand?

MR. GASS: Well, I mean, I think it's obviously difficult to predict what the reaction will be because there are a lot of factors related to the fund -- how much money the fund will have, will it pay out fully, or will I have to go to a pro rata distribution? My sense is, and it's in the legislation now, that the insurers are permitted to conform their rating schedules and deductibles to somehow coordinate with what the fund's doing. And the expectation was that if they're paying to the extent where there's overlap, they will adjust their deductible upwards, and theoretically that ought to have some effect on the premium itself because they're not covering as much of the risk.

To the extent that the fund's \$15,000 is under the standard deductible on a

policy -- say the fund pays 15,000 but the deductible on the policy, because of the value of your house, is \$25,000, is not going to have much impact. As you raise the amount of the deductible, I guess it becomes less useful for those individuals who you want to cushion that deductible element and it becomes more like, I think, Senator Green's 2608, where if the insurance becomes more like an excess policy over basic coverage provided by the state fund.

So I guess I kind of look at it like a lotus spread sheet -- you adjust one number here and it affects all the other numbers on the other part of the equation -- how much you have to take in, how much the surcharge is going to be -- and, you know, you're wrestling with the immutable laws of actuarial science when you get into that. And in the end there's no free lunch. I mean, you've got to figure out what your policy is going to be, who you want to help the most, and then I think the actuaries can figure out how to work the deductible. You might want to raise it to 1 percent or something like that, whatever you think your constituency can really bear in that regard.

SENATOR HILL: But what do we have? Twenty-five percent of California has private earthquake insurance now? Does that sound right, Bill?

MR. GASS: On the average, yeah, I think that's right.

SENATOR HILL: So my question, you think that's high? Okay, let's say 20 percent of the state has private earthquake insurance. Do you guys have any reading of where we are three years from now? Are we going to be at 40 percent of 10 percent? I mean, I guess that's really what my fundamental question is.

MR. GASS: It's too early to guess.

CHAIRMAN GREEN: I think you've got an answer with -- go ahead.

MR. HART: Senator Hill, just to take a stab at that, I think it's going to depend entirely -- I mean, all the data that we've looked at and all of the studies that have been done, earthquake insurance, the purchase of it, is an economic decision that's directly correlative to the perception of risk. And some of the surveys that were done in the four-county area Bay area after Loma Prieta seemed to indicate that perceptions of risk changed downward rather than upward in some of the at-risk counties because of the nature of the (inaudible).

So I think it's going to depend on the confidence that our member companies have in the program and the confidence that the agents and brokers have in talking to their customers. And I can tell you right now, just as a personal observation, the confidence level is not high for a lot of the reasons that the Commissioner articulated.

SENATOR HILL: The actuarial...

CHAIRMAN GREEN: It's getting back to what you and I have been discussing for a

long time, the amount of coverage: the higher it goes, the more people get the coverage and a higher percentage buy it at the lesser cost. In other words, it's what do I get for the dollar I pay? And if you get a lot of coverage for a low factor, then you have more people wanting it. But when you have the low factor and even a low premium, they say, well, what do I get for my \$60? I only get that type of coverage. And they don't like that. They want to get the high coverage for the smaller figure.

MR. GASS: I mean, I think what you're wrestling with here is whether you want to have a program that pays for any loss related to earthquake damage or catastrophic loss. And I think what the insurance companies are doing currently with their deductible is making it more of, if you were on a continuum, a catastrophic loss type program.

The way you've designed 2902, it's basically with such a low deductible and such a low -- both the dollar threshold and a one-half of one percent threshold, I think you get back to the problems that were mentioned before. You have a frequency problem and a severity problem. So that the lower the severity of the quake, you still will have quite a bit of damage and you'll be paying out more often than you would if you had a higher deductible. So that's the other sort of practical angle. I mean, the claims adjustment process is facilitated in a sort of expedient way when you increase the deductible because you're not sending everybody out after every tremor.

Now, again, this is where the public policy decision comes in: Do you want to insure everybody against any damage from any quake whether it's a 4.0 or an 8.2? Or do you want to reserve this fund to help people in a more catastrophic circumstance? And that's the hard decision.

CHAIRMAN GREEN: Well, no, it's not really for me but it's how do you set it. You have two factors. You have the premium factor and the -- not the premium but the deductible, which is like we have it, it covers the cosmetic stuff, too. Then you can also, in the wording in what we're going to do in the cleanup, say this is structural and not cosmetic, and then you have to put exclusions in there saying that if a door falls off the hinge, this is cosmetic, and that's tough. That's tough. The only other way to do it is we would mandate the regulations the Insurance Commissioner writes, which is something that can be changed easier. And so that committee that we're suggesting to put in place would be that committee which would do those regulations and draw that out of what is cosmetic and what is structural.

MR. GASS: I think one factor you need to bear in mind when you start getting into a discussion about what the definition of structural is for this program is remember, the people who are going to be adjusting these claims are people who work

primarily for the insurance industry. The definition of a structure from a typical homeowner's policy definition is almost set in stone. And everyone knows what the means.

When you start adjusting what structure might mean for this program, you may be increasing your administrative costs because now adjusters have to think more than once about okay, if this were a homeowner's policy, this would be included; but if it's not a homeowner's policy and they're excluding paint and cracks in the plaster, so now I've got to sit down and actually look at everything and decide what's included or excluded; whereas before, you know, I'm trained to recognize structural damage in a homeowner's policy when I see it.

So I think you need to be careful. I think my members were saying the more you can harmonize structural damage in your program with what it currently is under homeowner's program, the better I think everyone will be, realizing that there may be political imperatives on your part to try and modify that to some extent. But I think the actuaries and claim adjustment experts can probably help you pinpoint at least those things that you might want to exclude that will make the most difference. I don't think you want a claims adjuster running around and spending three hours trying to adjust the claim, especially after you have a quake because there's going to be a shortage of adjusters, when having a practical definition of structure will enable them to do it in an hour.

CHAIRMAN GREEN: Yeah, and people have said that fireplaces are cosmetic. I say to you it's a structure.

Sal, you had a question?

MR. BIANCO: Yes, Senator, I just wanted to point a couple of things out to the Subcommittee based on three years of prior hearings that came out, in particular last year's hearing in Loma Prieta, after Loma Prieta.

What we found, and I think the representatives of the trade associations will echo this, is that insurers on the whole paid lots of claims and they paid losses on items under a homeowner's policy, many of which were structural in nature and some of which that were not. In fact, many of them indicated to us that they did their best to pay a claim. And I'm wondering that we may want to think about the fact that the issue of a nuisance claim may not be as serious as one thinks. That is, under a homeowner's policy you're going to have to go out as a private insurer and deal with that claim.

Secondly, glass breakage, for example, might be covered under a homeowner's policy, but glass breakage would not be covered under the 2902 program, thereby eliminating that cost. And there may be some other items where insurers have paid in the past and have set their rates accordingly. So the premiums collected that have

paid for it, once again could obviate some of the costs that the 2902 program might face.

CHAIRMAN GREEN: A whole bunch of new worms.

SENATOR HILL: Sal? I wasn't (inaudible) one of your comments that your perception was that the companies were being overly generous trying to pay claims, or not being hardlined about it because of a public relations concern. Is that...

MR. BIANCO: I just refer back to the published testimony of the Subcommittee where in Santa Cruz the representatives of the companies indicated in testimony that they made the best effort possible to pay a claim. And the witnesses that came in substantiated that. Some of them, of course, did not. And what I was saying to that effect is that if they've done that then they must have added that into their homeowner's policy's premium rate and coverage, and some of those items may not necessarily fall within the 2902 definition for purposes of loss cost.

MR. GASS: I think where Sal raises a good point, and that is you want to try and preserve some harmony between what your program does and what insurers do as a matter of course, and the more gaps or discrepancies you have, I think you're going to have some angry policyholders saying look, you know, I've got broken glass; for some reason your guys aren't covering this but I know it'd be covered under my homeowner's policy, my claims adjuster told me that.

CHAIRMAN GREEN: Thank you.

MR. GASS: Thank you very much.

CHAIRMAN GREEN: Anything further?

MR. DUNMOYER: Just a couple of quick comments, and I won't be redundant. The issue of solvency versus insolvency, something that's been raised by many, I think it's an important thing to realize that this is not insurance, this is an earthquake fund. I know we've said that before, but it's always been written and portrayed both in public and private communications in insurance. There is no way that this fund will be solvent in the first year if there's a major quake. That's just a fact and I think that's been recognized. But in raising the price in this product, you could raise it to a thousand dollars a policy and if there's a major earthquake within the first year, there isn't going to be enough money.

So what's different for us versus the state is when we sell the product, in order for us to sell a product, we must have some sort of capital behind it, some sort of surplus or policyholder protection plan. And I think we need to be careful about that, otherwise you could raise the price on this to the roof and never claim solvency.

Real quickly, just to give some additional credibility to the argument of extending the implementation time period, one of the problems that we've dealt with

in working with some of our agents is that if on July 1 this program is put into place without some of the changes having already occurred through urgency statute, the agent will be in the following scenario: Someone will call up and say, "What is this \$60 on my policy?" And they'll explain, "It's the California Recovery Earthquake Fund for your home," and they'll say, "Well, is this mandatory?" "Well, today it's not but probably in a month it will be, so we would advise you to pay it." The next question they'll ask is, "Well, how much is it?" "Well, today it's \$60 but the Commissioner may want it to be \$90, and by the way, you may be getting less coverage because we may be paring back the actual definition of residential."

I give this scenario just because I really have to agree with Mr. Tobin. The agents play a crucial role -- and also with the representative of the independent agents -- the agents will play a crucial role in the public relations and communication of this, and the last thing we want to do is tie their hands by making them say, "Well, today it's 60, tomorrow it may be 90; today we cover this, but now we cover less, and we're not sure about the solvency." A good agent up front will have to say, "Well, you may want to drop your private coverage from us, but the fund will not be solvent in the first year," and the fewer negative messages that the agent's required to send we feel is better for everyone -- yourselves, the Commissioner, for us, the messengers out there.

And other comments have been made -- I won't be redundant -- I'd just like to concur that we do have concerns about the CIGA concept of collection.

Thank you.

CHAIRMAN GREEN: Thank you.

MR. HART: Mr. Chairman, Senator Hill, staff, Tim Hart with the Association of California Insurance Companies.

I won't reiterate the CIGA problem. We fully support the delay in the program. We have intended to work with the Commissioner's staff. We have appointed -- or recommended to be appointed to his advisory committee under this law people who bring not only investment expertise from the reinsurance funding mechanism but also people with actuarial underwriting and marketing expertise to try to provide as much practical advice as we can to implement this thing.

I think the handwriting is on the wall, Mr. Chair and Members. This program cannot be done and to be made to work, to get the companies to hold up, to meet a July 1 date. The timetable that the Commissioner has set forth we think is reasonable. We'd like as much time to help the state make this work. We've already made that commitment as possible, but 90 days is probably do-able assuming that the questions the Commissioner has raised are addressed either by legislation or regulation.

And that's your call, Mr. Chairman. We believe that these problems are imminently fixable.

Just a couple of other observations based on some of the testimony that's been provided, for Senator Hill's benefit. We feel some responsibility for these last estimate numbers since it's one of our members who does the actuarial work for the Earthquake Project. But in looking at Charts 1 and 2, I just thought I'd observe that the Earthquake Project loss, it seems to me that there are differing comparisons of loss here in Chart 1, Senator Hill. It looks like the Department's and the Earthquake Project estimates are based on insured loss, not just residential but insured loss of all lines of coverage; whereas, some of the others may be based on total loss. And that may explain as to why they are more catastrophic than the others.

And on Chart 2, when you look at the Earthquake Project analysis, the \$93 is reflective of some additional costs and expenses which I believe may have included commissions -- I'm not sure -- at a time when numbers were run when those sorts of issues haven't been resolved in the bill.

So probably the pure premium plus some degree of additional cost is a more accurate reflection, with the caveat that we'd like to assist the Commissioner in running some new numbers based on policy decisions that are made.

One other observation -- I just can't resist this one -- the engineering observation that if you fix all the good risks you only have to insure the bad risks. Well, I just would like to observe if we only insure the bad risks, then the premiums and the deductibles you're going to see are going to be totally unacceptable because you defeat both the law of large numbers and spreading the risk.

In summary, I think that's where our members are at this time, and we look forward to working with you and the Commissioner to make this program work. Thank you.

MR. SEIG MARSHALL: Mr. Chairman and Senator Hill, I'm Seig Marshall with the California State Automobile Association. Coming as late as I do, there's little new ground to be tilled. I'd just like to echo our support for an extension in the effective data and also raise those concerns about a CIGA model. As we did last year, we're completely prepared to work with the committee and staff on working those problems out.

CHAIRMAN GREEN: Thank you.

All right, anything further? We appreciate all of you coming out today and answering so many questions, and believe me, we will be in touch and stay in touch with our staff because this is where some of the answers are going to come, and thank you very much for your advice.

All right, we have now California Bankers Association -- Maurine C. Padden. I'm sure she wasn't scheduled to speak but we've addressed a lot of issues to her so she felt it necessary that she should be up here and address some of them, and we feel that too.

MS. MAURINE C. PADDEN: I'd like to summarize the testimony that I gave last year in Santa Cruz before this Subcommittee, and briefly that is that the suggestion that in fact the financial institutions and in particular that the banks would be responsible for collection of the surcharge for the insurance fund or for the fund itself would really be unfeasible and would have a very unequal application as to coverage in the state.

CHAIRMAN GREEN: I don't think anybody suggested the banks collect it here. I think what they said is either your mortgage is contingent upon the homeowner's policy and if you don't have one you can't get a mortgage.

MS. PADDEN: Well, that may be a very interesting concept, Senator, but my concern is the issue that I believe was addressed earlier and one that needs to be reiterated here. If, in fact, the banks have the responsibility for collecting the surcharge, we have to address the issue of the fact that California banks alone are not the all of the institutions that are making the mortgages, and that we believe that the best method of collection would in fact be through the tax collection process or by way of the insurance companies in that...(laughter)

SENATOR HILL: Let me get that down now, Maurine. (Laughter.)

MS. PADDEN: ...in that in many cases, but not all cases, we have impound accounts established for the payment of taxes and insurance. We will always be involved in this process in one way or another.

We're committed to working with this Subcommittee. We're committed to working with other members in other industries to try and resolve the difficult problems that mandatory enforcement will generate.

Thank you.

CHAIRMAN GREEN: I appreciate it. And that's the same testimony you gave over in Santa Cruz because I remember it.

MS. PADDEN: That's correct.

CHAIRMAN GREEN: And one of the reasons that I had listened because at the time my mortgage company was in Florida and how could I have mandated through that mortgage company the earthquake insurance.

And so yes, it's very valid. There's an awful lot of bankers and banks that do business outside this state, and there's a lot of these mortgages that are not held in the State of California. So we have to find the correct way, and I think that's what this committee will be striving to do.

MS. PADDEN: Thank you, Mr. Chairman.

CHAIRMAN GREEN: Thank you, Maurine.

Okay, any other unscheduled witness that we have out there?

Okay, not, so then the closing comment I might make is that this, again, has been very informative. This chairman has been sitting here in this committee now over three years and we have heard some repeat testimony but we're constantly getting new things to this committee on each of these hearings. And I know staff appreciates and I particularly appreciate all of your input into the problem we have. And I can't speak for Senator Hill -- he'll have time to do that himself -- but Senator Hill being new on the committee this year, and we welcome him here because he and I worked very carefully together last year. We battled a lot because he was coming from one side and I was coming from the other. But you see, what has happened is that we have a program. Had we not gotten together in that period of time, we would have had nothing. And at least through compromise we got to the point where we are today. I think that with Senator Hill and myself working on a nonpartisan basis and saying this is the issue, that we -- between he and I -- will get this thing straightened out and have a good program for the entire state that everyone can be happy with, and it'll be modeled -- as somebody said, Japan is looking at it even. I knew that this was the only one in the United States and we're breaking new ground, but I didn't know we were breaking new ground in the world. But Frank wants the western end of Tokyo and I want the eastern end because that has all the high rollers in it, the eastern part, and I get my property tax out of that area.

Okay, Frank, do you have anything to say?

SENATOR HILL: Just in closing. Thank you, Mr. Chairman. I mean, I do look forward to working with you again. I think as I was sitting here listening to the hearing, I think we made a wise political decision in postponing some of these thorny issues. It's my conclusion...(laughter). It's my conclusion that we are miles ahead of where we would have been had we tried to sort all these things out and I just want to pledge to certainly work with you and Mr. Robbins' office as well as the Assembly coauthors and the insurance carriers. I've been very pleased so far with Mr. Garamendi in his approach in terms of being open. It's a collective issue; we have to solve it; the program's in place; and I do believe it's landmark legislation. These kind of major programs take a lot of work and I think we'll get it done.

CHAIRMAN GREEN: Thank you all for coming out today, and we are now adjourned.

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