



Fitch Affirms California Earthquake Authority's Ratings at 'A'; Outlook Stable

Fitch Ratings-New York-07 December 2017: Fitch Ratings has affirmed all ratings for the California Earthquake Authority (CEA), including the Issuer Default Rating (IDR) at 'A' and the outstanding series 2014 revenue bonds at 'A'. The Rating Outlook is Stable.

Fitch affirmed the IDR and revenue bond ratings because performance has been in line with expectations and no upgrade or downgrade triggers were activated.

KEY RATING DRIVERS

CEA's ratings reflect the risk-transfer strategy that set the minimum and maximum aggregate claims-paying levels to 1-in-400-year and 1-in-550-year return loss periods, respectively. The CEA had \$15.2 billion in sources of funds to pay claims at June 30, 2017. Included was \$5.4 billion in available capital, as well as the proceeds from the revenue bonds, reinsurance and other risk transfer, and prospective post-earthquake assessments of participating insurers.

The CEA's principal risk is a catastrophic earthquake large enough to exhaust its claims-paying resources and requiring it to access the capital markets or other sources in order to pay claims. The total claims-paying resources are estimated to cover losses for a 1-in-455-year earthquake, or a probability of (resource) exhaustion of 0.2% at June 30, 2017.

Fitch's risk assessment of the CEA's claims-paying resources is adequate (i.e. at BBB category levels). Fitch reviewed the probability of exhaustion from three independent modeling firms and from the CEA's survivability scenarios

against the insurance-linked security (ILS) calibration matrix for this assessment.

Fitch believes the CEA's financial flexibility is much stronger than similarly rated private insurers that insure catastrophe risk, which allows its final rating to be elevated a full category above the risk assessment of claims paying resources, to 'A'. The state of California, the insurance industry in California and policyholders in California all have an interest in the CEA's continuance as an organization in Fitch's view.

There are potential public policy or industry initiatives that would contribute to the CEA's ability to recapitalize following a large earthquake that exhausted its claims-paying resources. Also contributing to the CEA's financial flexibility are its strong capital formation rate and the ability to access capital markets to issue additional revenue bonds.

Additional strengths include the CEA's stable pledged revenue and performance on debt service covenants that result in part from its highly profitable operations and significant market share. The quality of the CEA's investment portfolio is very high, consisting solely of cash and equivalents, U.S. Treasury securities and CP at year-end 2016.

RATING SENSITIVITIES

Key ratings triggers that could lead to a downgrade include changes in claims-paying resources that reduced covered losses to a one-in-400-year event. However, a timely demonstration of the CEA's ability to access capital markets or recapitalize by other means, following a reduction in claims-paying capacity, could mitigate downgrade pressure.

Fitch may also downgrade the ratings if the quality of its investment portfolio or the financial strength of its industry members or reinsurers declined materially.

The key rating trigger that could lead to an upgrade is an increase in claims-paying resources to a one-in-1,000-year event.

The CEA is a privately financed, publicly managed entity that offers basic residential earthquake insurance in California. The CEA was created by the California Legislature in 1996 to assure availability of earthquake coverage for homeowners following the Northridge Earthquake.

FULL LIST OF RATING ACTIONS

Fitch has affirmed the following ratings with a Stable Outlook:

California Earthquake Authority
--2014 series revenue bonds due 2019 at 'A'.
--IDR at 'A'.

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Applicable Criteria

Insurance Rating Criteria (pub. 30 Nov 2017)

(<https://www.fitchratings.com/site/re/905036>)

Insurance-Linked Securities Rating Criteria (pub. 29 Jun 2017)

(<https://www.fitchratings.com/site/re/900286>)

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