

**CALIFORNIA EARTHQUAKE AUTHORITY  
GOVERNING BOARD MEETING  
MINUTES**

**Thursday, October 30, 2008  
1:00 p.m.**

Location: Joe Serna Jr. Cal/EPA Headquarters Building  
1001 I Street, Sierra Hearing Room  
Sacramento, California

Members of the Governing Board in attendance:

J. Clark Kelso, designee of Governor Arnold Schwarzenegger, Chairperson  
Bruce Patton, designee of Insurance Commissioner Steve Poizner  
Paul Rosenstiel, designee of State Treasurer Bill Lockyer  
Grant Boyken, designee of State Treasurer Bill Lockyer  
Dietrich Stroeh, designee of Chair of the Senate Rules Committee Don Perata

Members of the CEA Staff in attendance:

Glenn Pomeroy, Chief Executive Officer  
Tim Richison, Chief Financial Officer  
Bob Stewart, Chief Operations Officer  
Chris Nance, Director of Communications and External Affairs  
Mark Dawson, Assistant Chief Financial Officer  
Michael Melavic, Information Services Manager  
Trudi Miller, Accounting Administrator  
Susan Pitton, Governing Board and Advisory Panel Liaison  
Danny Marshall, General Counsel

Also present:

Terry Klas, PricewaterhouseCoopers LLP  
Lee Overstreet, PricewaterhouseCoopers LLP

- 1. The meeting was called to order at 1:00p.m. A quorum was established.**
- 2. Consideration and approval of the minutes of the August 28, 2008, Governing Board meeting.**

**MOTION:** Mr. Rosenstiel moved adoption of the August 28, 2008, CEA Governing Board minutes; Mr. Patton seconded the motion. Motion carried unanimously.

- 3. Chief Executive Officer Glenn Pomeroy will present an executive report.**
  - CEA staff is continuing to revamp the CEA's insurance programs and products in an effort to find ways to make coverage more affordable throughout California.
  - Currently only 12 percent of California residents choose to obtain earthquake coverage.

- CEA policy is designed for catastrophic earthquakes, and the policyholder faces a high deductible. In California, 88 percent are unwilling to pay a premium for this type of coverage.
- Market research shows that the product is considered to have premiums and deductibles that are too high. With the existing financial structure, there are significant limitations on methods to drive down the premiums and deductibles.
- The CEA was created to run as a lean, not-for-profit organization. The major expense on an ongoing basis is the cost of risk transfer, the amount the CEA spends on reinsurance.
- To be successful in readjusting its existing financial structure, it will be critical for the CEA to get a handle on and lower risk-transfer costs.
  - There is an active legislative proposal in Washington to create a federal backstop for natural-catastrophe risk: HR3355 would allow CEA to purchase reinsurance through the federal government at a significantly lower cost than can be obtained in the private sector. The proposal stalled in the Senate, but a major push is expected in 2009. Unless CEA gets involved, such efforts will continue to be driven by Florida and its needs—if the Board approves, CEA should become actively engaged in Washington to help shape the debate and the outcome.
- Another, complementary option for the CEA is to explore more flexible policy options: This might include a customer-facing menu of options, which would allow consumers to choose different kinds of coverage, e.g., insure the structure at 50 percent rather than 100 percent of its value or provide consumers options to buy a “contents-only” or a “loss-of-use-only” policy from the CEA. Staff is in the process of reviewing product and corresponding pricing options.

Members of the Board indicated their support of the CEA’s continuing to pursue the above-mentioned processes and approaches.

**4. Chief Financial Officer Tim Richison will present a financial report.**

- Almost the entire CEA investment portfolio is presently in US Treasuries, given CEA policies regarding investments. CEA worked with its asset managers to ensure that all CEA investments were in safe securities.
- For the 12-month period ending August 31, 2008, the CEA received a 2.88 percent yield on its investments.
- The financial crisis has affected the reinsurance marketplace. The CEA’s reinsurance brokers are monitoring the CEA’s reinsurers and the wider reinsurance marketplace on a daily basis, to assure no CEA reinsurer’s ratings fall below those ratings criteria specified in the CEA’s Guidelines for Purchasing Claim-Paying Capacity.
- Reinsurance contracts for 2009 have been negotiated and settled. It is anticipated that the 2010 renewals will be a tougher market in which to find capacity and reasonable rates.
- CEA staff will propose a 2010 financial structure/reinsurance program to the Board in April 2009. CEA will then go out to the reinsurance market in May to market and obtain the 2010 reinsurance program.

**5. Assistant Chief Financial Officer Mark Dawson will brief the Board on the now-completed CEA fiscal year 2007 audit by CEA auditors. Pricewaterhouse Coopers LLP; representatives of that firm will address the Board to elaborate on their written audit report already delivered to and accepted by the CEA.**

- Mr. Dawson reported that in 2007, CEA cash and investments grew by close to 15 percent and net assets grew by approximately 13 percent, while revenues stayed about the same as the previous year. Net investment income rose slightly in 2007, to \$119 million.
- Pricewaterhouse Coopers lead audit partner Lee Overstreet and Pricewaterhouse Coopers CEA audit manager Terry Klas were introduced. Ms. Klas reported that the audit had been successfully completed and that no material weaknesses or significant deficiencies in internal controls were found.
  - During the course of the audit, there were two adjustments. The first was a write down of a commercial paper security by \$18 million. There was a reclassification made between unrestricted net assets and restricted net assets for \$18 million to further restrict equity in bond proceeds based on the payment of bonds that occurred during the year.
  - The auditors reported on no matters that are material to CEA's ability to continue in operation for the next year.
  - Other control matters brought to the Board's attention by the auditors included the suggestion that the chart of accounts could be enhanced by being on a Government Accounting Standards Basis (GASB), with quarterly statements posted on the CEA Web site, and that the internal auditing lines could be strengthened by having the CEA's internal audit function have a direct reporting line to the Governing Board. Previously, relatively minor comments related to IT controls were presented separately to the CEA IT group and management.
  - The auditors reported they found no instances of fraud or other illegal acts.
- Mr. Dawson stated that quarterly financial statements are now posted on the CEA Web site and that CEA staff was looking into converting the quarterly statements to the GASB format.
- Mr. Marshall said the internal auditor and audit staff report only to him and that as he moves on the auditors' recommendation, he will seek assistance from the Board to for suitable ways to change the current process and procedure.

**6. Mr. Dawson will present to the Board for its consideration and approval the annual transfer to the CEA Mitigation Fund of a statutory portion of monies attributable to CEA investment income earned.**

**MOTION:** Mr. Patton moved to transfer \$5 million to the CEA Mitigation Fund; seconded by Mr. Kelso. Motion carried unanimously.

**7. Accounting Administrator Trudi Miller will request Board approval of a new schedule of participating-insurer contingent-assessment levels that will be in**

**effect as of December 1, 2008, the effective date of sunset of the first industry assessment layer and the commencement of a new industry assessment owing to the passage of SB430 (Machado) in 2007.**

- Ms. Miller reported that the first industry assessment layer, approximately \$2.197 billion, will sunset on December 1, 2008. In addition, a new statutory assessment authority of \$1.3 billion was created by the Legislature and signed into law, and takes effect on December 1, 2008. The staff requested that the Board adjust the CEA market share percentages to determine adjusted contingent-capital levels.

**MOTION:** Mr. Boyken moved to approve the staff recommendation; seconded by Mr. Patton. Motion carried unanimously.

- Mr. Patton noted for the record that the total of assessments available to the CEA from its participating insurers reflects about \$900 million less than the CEA has had available to it in insurer assessments on a going-forward basis.

**8. Mr. Dawson will present the results of a CEA competitive procurement, selecting Larson & Rosenberger LLP as the CEA's independent qualified auditor to conduct the audits of the CEA's financial statements for the calendar years 2008 through 2012.**

- Mr. Dawson reported that in January 2008, staff requested bids to secure an independent qualified auditor to audit the CEA's financial statements for the ensuing five years. Responses from five qualified firms were received, two from Texas, one from Colorado, and two from California.
- After a thorough review of the proposals and interviews and reference checks, the firm of Larson & Rosenberger received the highest score from the selection panel.
- As required by law, the proposal to select Larson & Rosenberger was sent to the Insurance Commissioner and the Department of Finance for their approval. Having received these approvals, staff recommends the Board approve the staff recommendation that Larson & Rosenberger be awarded the opportunity to enter a contract with the CEA to perform the audits of CEA's financial statements for the audit years 2008 through 2012.

**MOTION:** Mr. Boyken moved to approve the staff recommendation; seconded by Mr. Kelso. Motion carried unanimously.

**9. CEA Advisory Panel member Randy Farwell will provide a summary of the September 25, 2008, Panel meeting.**

- Mr. Farwell stated that during the executive and financial updates a substantial portion of the discussion was about the reinsurance program and reinsurance purchase. From the Advisory Panel standpoint, the CEA staff has done a good job of meeting both cost and financial-strength targets for the program.
- The Panel also addressed product enhancement to achieve improved participation in CEA earthquake insurance by the public.

**10. Director of Communications and External Affairs Chris Nance will update the Board and provide a presentation on The Great Southern California ShakeOut marketing and mitigation materials.**

- Mr. Nance reported on the upcoming “Great Southern California ShakeOut” scheduled for November 13, 2008, at 10:00 a.m.—the event will simulate a 7.8 magnitude earthquake on the southern segment of the San Andreas Fault system. It is estimated that an earthquake of that size on that part of the San Andreas would cause approximately 1,800 deaths, \$33 billion in damage to buildings, and about \$213 billion in economic losses.
- As part of its participation in the simulation, CEA will release an estimate of loss to its policyholders.
- CEA is working with its participating insurers to promote earthquake preparedness, including the importance of having earthquake insurance for financial preparedness. These promotions will be in English and Spanish.
- The CEA has sponsored marketing and information initiatives in to coincide with awareness developed through the ShakeOut, and it appears that demand for the earthquake-preparedness starter kits that are part of those initiatives is running approximately 25 times greater than initial supplies. The kits are available in English and Spanish.

Mr. Pomeroy will be speaking at the International Earthquake Conference sponsored by the City of Los Angeles, scheduled to coincide with the ShakeOut; he commended Mr. Nance and his team for their effort to push awareness.

Mr. Patton stated that an earthquake conference had taken place in the San Francisco Bay Area, to coincide with the 140<sup>th</sup> anniversary of a major earthquake in 1868 on the Hayward Fault. It had received some press, and CEA-sponsored studies were presented.

**11. Information Systems Manager Michael Melavic will present a progress report to the Board on the development and implementation of the CEA’s New Earthquake Information Center.**

- Mr. Melavic reported that in January 2008, CEA entered into a contract with Natoma Technologies to develop a system to replace the current insurance data system repository. The project is within budget and on schedule for production by December 1<sup>st</sup>.

**12. Staff will present for Board consideration and approval a proposed 2009 Governing Board meeting calendar.**

- Staff proposed 2009 Governing Board meeting dates of February 26, April 30, June 25, August 27, October 29, and December 10.

**MOTION:** Mr. Boyken moved to approve the proposed schedule; seconded by Mr. Patton. Motion carried unanimously.

**13. The Board will meet in closed session to discuss litigation matters, as permitted by California Government Code Section 11126, subdivision (e).**

- There was no closed session.

**14. Public comment on items that do not appear on this agenda and public requests that those matters be placed on a future agenda.**

- There were no questions or comments from the public.

**15. Adjournment.**

- The meeting was adjourned at 2:06 p.m.