

**CALIFORNIA EARTHQUAKE AUTHORITY
GOVERNING BOARD MEETING
MINUTES**

**Monday, February 10, 2014
10:00 a.m.**

Location: State Capitol
Room 437
Sacramento, California

Members of the Governing Board in attendance:

Mark Ghilarducci, designee of Chair, Governor Jerry Brown
Grant Boyken, designee of State Treasurer Bill Lockyer
Chris Shultz, designee of Insurance Commissioner Dave Jones
George Wiley, designee of Speaker of the Assembly John Perez
Dietrich Stroeh, designee of Senator Darrell Steinberg

Members of the CEA staff in attendance:

Glenn Pomeroy, Chief Executive Officer
Chris Nance, Chief Communications Officer
Bruce Patton, Director of Policy, Research and Special Projects
Marc Keller, Acting Governing Board Liaison
Danny Marshall, General Counsel

- 1. The meeting was called to order at 10:00 a.m. A quorum was achieved.**
- 2. Chief Executive Officer Glenn Pomeroy, assisted by CEA executive staff, will ask that the Governing Board adopt a resolution of sponsorship and support of proposed legislation that would modify the present law, which provides that insurers selling residential property insurance in California must also offer, on defined terms and under defined conditions, earthquake insurance.**

Mr. Pomeroy provided the background for the resolution.

1. In 1983, the Coalinga earthquake showed that as a result of prior judicial determinations, the concurrent causation doctrine applied to earthquake losses effectively required homeowners insurance policies to cover those

earthquake losses, even though such losses were expressly excluded in policy language.

2. In 1984 a bill was passed in the Legislature, clarifying that losses from the peril of earthquake was excluded from homeowners policies, but directing that the same insurers offering homeowners coverages would be required to offer separate earthquake coverage in what is usually called today the “mandatory offer.” The Governor signed the bill, and the mandatory offer became law on January 1, 1985.
3. In 1994, the devastating Northridge earthquake caused \$40 billion in property damage, \$20 billion of which was residential—and half of that was insured. Some 40% of the Northridge recovery dollars—fully \$10 billion—came from private residential earthquake insurance. The industry had not priced its earthquake insurance coverage for this eventuality, and companies found they had been over-exposed to earthquake risk.
4. In 1994 and 1995, the insurance industry sought to repeal the mandatory offer requirement, but the Legislature was not interested in that approach to the over-exposure contention. With no relief from a potentially ever-increasing earthquake exposure in sight, insurers chose to severely restrict their writing of homeowners insurance, to avoid taking on more earthquake exposure.
5. The Legislature authorized the so-called “mini policy,” which reduced both coverage quality and permissible limits in a residential earthquake-insurance product. At the same time, companies were filing for rate increases, and earthquake rates were doubling or tripling.
6. In 1996 the California Earthquake Authority was established and began operations. Operating on a not-for-profit basis, the CEA is privately financed but publicly managed.
7. The impacts of the events in the mid-‘90s are still felt today with the loss of a million residential earthquake-insurance policies and much increased pricing.
8. Scientists agree that within the next 30 years, another catastrophic earthquake will take place—but in today’s California, 90% of homes are not protected or prepared for it with earthquake insurance.

Mr. Pomeroy summarized some of the obstacles that prevent getting more homes protected:

- Twenty years have passed since the last damaging earthquake, and people have forgotten about the danger.

- Homeowners are uncertain about what their policies cover.
- Homeowners feel that after an earthquake, the federal government will come in and solve everything.
- Homeowners feel that other people face earthquake risk but they, themselves, do not.
- Homeowners feel legitimate concern about the cost of the policy and the size of the policy deductible.

The CEA's new Strategic Plan is built on the core principles of Educate, Mitigate, and Insure, which Mr. Pomeroy detailed. The CEA will be focusing intently on these principles.

The 30-year-old mandatory-offer law presents a huge barrier to prospective purchasers of earthquake insurance: Although statutorily required, it is hard to read, boring, and inaccurate.

To address this clear weakness in the basic way that earthquake insurance is explained and sold to individuals and families, the CEA has been working with stakeholders to design a different offer, to change the way Californians learn about and buy earthquake insurance. It does require an act of the Legislature to accomplish these steps, so staff has drafted a bill which has been circulated among interested parties and is currently under review by the Office of Legislative Counsel.

Mr. Pomeroy summarized the bill draft.

- It would replace the old language with new, modern, consumer-friendly language.
- It would amend the 17-year-old CEA expense cap of 3% of annual premium to at least 5%. With a little more time working with stakeholders, the CEA could devise language that would keep in place overall spending restraints but enable the Board to fully administer CEA's expenditures.

Mr. Marshall explained that the resolution before the Board is higher-level than most the Board has seen in the past. It is a form the Board used when it endorsed the Earthquake Insurance Availability Act, now pending again in Congress.

Mr. Pomeroy noted that staff has been working very actively with stakeholders recently, meeting with representatives of insurance trade associations and individual insurance companies to vet the draft.

Mr. Shultz pointed out a problem cited by some that, if a consumer selects and buys one of the CEA's Choice products, some insurers still send the statutory mandatory offer, informing the Choice purchaser—wrongly—that they don't have earthquake insurance. Other problems he cited are that the mandatory offer's statutory language is not sales-oriented, and that insurance companies think of it as a compliance burden, not a marketing opportunity.

Mr. Shultz continued that during the time Insurance Commissioner Dave Jones has been in office, the CEA has brought rates down by 12.5% and has implemented the Choice product. But every time the CEA lowers the rate and gives consumers a better deal, the CEA gets closer to the spending cap. He said the Department of Insurance supports the flexibility that would be afforded the CEA and its Board, for example, in moving towards a new cap of 5%. The Department also considers the bill a good idea, although it is still a work in progress.

Mr. Boyken stated that the Treasurer completely agrees with the need to update the mandatory offer. He is willing to let the legislative process play out, and his sense is that the CEA runs a lean operation.

Mr. Stroeh commended staff on developing a resolution that is understandable. He extended his support.

Mr. Wiley confirmed with Mr. Marshall that the administrative spending-cap issue is addressed in the present draft bill language.

Mr. Ghilarducci pointed out that the current mandatory offer is embedded in other documentation, but it should be the first thing that homeowners see. He also asked Mr. Pomeroy to explain a bit more how the spending cap works.

Mr. Pomeroy said that over the history of the organization, the CEA has lowered its rates by about a net 48%. With each rate reduction comes a reduction in the premium collected; with that comes a reduction in the 3% that is allowed for operating expenses. He noted that similar organizations throughout the country have no statutory spending or expense cap.

Mr. Pomeroy emphasized that the CEA is governed by the Governor, the Insurance Commissioner, and the State Treasurer. Whether there is a cap or not, the CEA does not have a budget until those three officials approve it, and the CEA staff brings its annual budget request to the Board every December for review and approval.

Mr. Ghilarducci asked about the possibility of an increase in people buying earthquake insurance when the offer letter is revised. Mr. Pomeroy explained that in research last fall, addressing both consumers and agents, there was a clear showing that the change in the policyholder communication would positively affect the take-up rate.

MOTION: Mr. Boyken moved approval of the resolution of support of the legislative modernization of the mandatory-offer law and the increase in the CEA's allowable expense level; seconded by Mr. Shultz. Motion passed unanimously.

3. Chief Communications Officer Chris Nance will seek Board approval of a contract to support the services of a newly selected contractor to provide the CEA with marketing and strategic communications services.

Mr. Nance referred to the large number of Californians without earthquake insurance and the need to recapture the number who had insurance before the Northridge earthquake in 1994.

He pointed out that all of the CEA's communications- and marketing-related spending for 2014 will be accomplished according to the 2014 budget for those expenditures, which the Board approved in 2013.

In addition, all spending under the proposed agreement will be accomplished only with CEA revenues—those revenues come from premiums collected from the CEA's 840,000 policyholders and from interest returns on the CEA's invested assets.

The CEA issued an RFQ for a marketing and strategic communications contractor in October 2013. Five qualified firms responded, and all five were interviewed. Three of those firms were interviewed in a second round. And from those three, two firms were selected to be interviewed in the third and final round.

In the third round, staff challenged the remaining two candidates to think about how to evolve *California Rocks!*, and evaluated their understanding of how the CEA works (including the unique CEA sales method).

The winning candidate was a new team consisting of a San Diego-based marketing and advertising agency called AdEase, collaborating with the well-known public-relations firm Burson Marsteller.

Mr. Marshall explained the terms of the agreement. It is a "3-1-1," with a three-year basic term during which professional fees are held flat. With the fourth year the fees can rise a little, and in the fifth year a little less. Therefore, it could be considered a five-year contract, depending on the willingness of both sides to continue past the end of year three.

All of the spending—about \$8.955 million is within the contract for 2014—has already been approved by the Board in 2013 for the CEA's 2014 budget. For that reason, it can be seen that the agreement contract actually directs the flow of funds, spending only those already-budgeted sums.

Mr. Shultz asked if the Mandatory Offer Law were revised and the CEA were to bear more of the burden of the marketing directly—could that work be folded into the multi-year contract? Mr. Marshall replied that the contract as presently drafted operates only through 2014. If there is an expenditure in 2014 for 2015, staff would come back and seek funds for that, or it was possible that other, unspent 2014-budget funds could be appropriately diverted.

Mr. Ghilarducci confirmed that the scope of work and strategic objectives account for the dollars in the 2014 period, including the major initiative that will be getting underway. All of the dollars will be expended.

Mr. Nance read the staff recommendation for the Board.

MOTION: Mr. Shultz moved approval of the contract; seconded by Mr. Boyken. Motion passed unanimously.

Mr. Marshall stated that he would substitute the phrase “*unanimous support*” of the Board for the term “*support*” of the Board in the version of the resolution passed out to the Board.

4. The Board will meet in closed session to discuss personnel matters and litigation matters, as permitted by California Government Code section 11126, subdivisions (a) and (e), respectively.

The Board entered into a closed session at 10:44 a.m.

It reconvened into open session at 10:57 a.m.

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

There was no public comment.

6. Adjournment.

Chair Ghilarducci adjourned the meeting at 10:58 a.m.