CALIFORNIA EARTHQUAKE AUTHORITY
GOVERNING BOARD MEETING
MINUTES

Thursday, August 25, 2011
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:
Pedro Reyes, designee of Governor Jerry Brown
Grant Boyken, designee of State Treasurer Bill Lockyer
Bruce Patton, designee of Insurance Commissioner Dave Jones
Dietrich Stroeh, designee of Chair of the Senate Rules Committee Darrell Steinberg

Members of the CEA staff in attendance:
Glenn Pomeroy, Chief Executive Officer
Tim Richison, Chief Financial Officer
Bob Stewart, Chief Operations Officer
Chris Nance, Chief Communications Officer
Shawna Ackerman, Chief Actuary
Janiele Maffei, Chief Mitigation Officer
Mark Dawson, Assistant Chief Financial Officer
Dan Dyce, Earthquake Response Manager
Susan Pitton, Governing Board and Advisory Panel Liaison
Danny Marshall, General Counsel

Also present:
Wayne Coulon, Chair, CEA Advisory Panel
Bill Rosenberger, Larson & Rosenberger
David Keum, Larson & Rosenberger

1. **The meeting was called to order at 1:00 p.m. A quorum was established.**

2. **Consideration and approval of the minutes of the June 30, 2011, Governing Board meeting.**

   MOTION: Mr. Boyken moved approval of the June 30, 2011, Governing Board minutes; seconded by Mr. Patton. Motion passed unanimously.

3. Chief Executive Officer Glenn Pomeroy will present his executive report; assisted by CEA executive staff, Mr. Pomeroy's report will include an update for the Board on federal and state legislative activities of interest to the CEA.

- Mr. Pomeroy began by noting the historic 5.8 earthquake that had hit the East Coast. Because of the soil configuration there, energy waves spread far and wide, causing far more people to feel the earthquake than might be expected from the magnitude alone. The event served as a reminder that earthquakes happen anywhere, unpredictable and unstoppable.

  The CEA received a large number of media calls, and hits to the CEA Web site were up 50% the day after the earthquake.

- On January 1, 2011, the CEA will be able to implement for policyholders an overall 12.5% rate reduction, as approved by the Insurance Commissioner.

- A second step will happen next year when the CEA's "Homeowners Choice" product will be implemented. The CEA's 17 participating insurers (PIs) are in process of adjusting their information-service systems, so the exact implementation date is yet undetermined.

- This project reminded the CEA that communication is important, so the CEA plans to try a new method for communicating with its PIs: a bimonthly webinar. Between the webinars and attendance at Board meetings, the new method will enable PIs to be in continual monthly contact with the CEA.

- A search is underway for an Insurance Director. Candidates are being screened by the executive-search firm selected through a competitive procurement.

- At the end of 2010, the Board authorized the CEA to engage an outside consultant, Protiviti, to perform a top-to-bottom analysis of the governance and quality of its information technology systems. The project is underway and is nearing completion.

- The CEA has a growing list of supporters for the all-important piece of legislation introduced by Senators Feinstein and Boxer in Congress: the Earthquake Insurance Affordability Act. The list of supporters includes the Seismic Safety Commission and Mercury Insurance Company (one of the CEA's PIs). CEA staff is hoping that a companion bipartisan bill will be introduced in the U.S. House of Representatives.

- Mr. Pomeroy quoted House Majority Leader Eric Cantor regarding what Mr. Cantor said was the appropriate federal role following events like the East Coast earthquake and his view that it is a problem that Virginians don't have earthquake insurance. The CEA's federal-legislative proposal is all about requiring lower federal help and appropriations after a disaster, because more people have taken the step to insure their homes.

- Joyce Lin, a Ph.D. student from the University of Wisconsin, Madison, and a summer intern at the CEA, did wonderful work for the CEA. She pioneered groundbreaking awareness into CEA data that is bringing powerful new ways of thinking. The CEA is now better equipped to analyze the extent to which policies are "new" policies versus "retained" policies, and will be able to have a better read on the effectiveness of the CEA's agent-training program.

The great results that will follow on Ms. Lin's internship underscore Mr. Pomeroy's belief that the success of an enterprise is about the intellectual capital devoted to it.

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

- Mr. Richison stated that at the end of June 2011 the CEA's available capital on hand to pay policyholder claims was almost $3.9 billion. Actual cash and investments are a little over $4.4 billion.

- Since the Board gave its approval earlier in the year, staff worked on a transformer-reinsurance project with three objectives in mind:

  1. Cheaper risk-transfer than traditional reinsurance.

  2. A "repeatable" transaction.

  3. A multi-year contract.

  The transformer reinsurance transaction just completed met all three objectives.

- Mr. Richison gave a status on the 2011 budget.

  - As of June 30, 38% of the CEA's operating-expense budget had been used.

  - CEA anticipates that the reinsurance expense will exceed the most recent estimate by $4 million because of the cost of completing the transformer-reinsurance transaction—staff will report on this at the October 2011 Board meeting.

- Even though Standard & Poors downgraded United States debt, bond buyers are still flocking to U.S. Treasuries. The Board and staff concluded that CEA's investment are safe. CEA investment managers are buying securities with a maturity date that is (permissibly) longer, to get the best return.

- The CEA tracks its investment yield against the State Treasurer's Pooled Money Investment Account fund (PMIA); the CEA and PMIA operate under similar investment-related restrictions.

- The CEA reached a minor milestone at the end of July: CEA had paid-off half of the outstanding balance of the 2006 revenue-bond issuance.

- On June 21, 2011, the Department of Insurance made public its just completed four-year financial review of the CEA; the report contained six recommendations. The CEA constructed the required *Company Plan of Action* and presented it to the Insurance Commissioner's office during the week of August 21, 2011.

5. Mr. Richison will present and seek Board approval of the proposed CEA Financial Structure for 2012.

- CEA staff is continuing to recommend a financial structure at a 1-in-500-year level of financial security. To set the claim-paying capacity sufficient to reach that 1-in-500-year level, four components were considered:
    - Average annual losses based on CEA's book of business as of December 31, 2010,
    - exposure adjustment for growth in 2011,
    - demand surge, and
    - Loss adjustment expenses paid to the Participating Insurer.
- As a result, the CEA's claim-paying capacity will reach $9.8 billion at January 1, 2012.
- Mr. Richison made the following staff recommendation:

1. For staff to proceed with a 2012 risk-transfer program composed of traditional and transformer reinsurance, in two sub-programs of risk-transfer—one program effective January 1, 2012, for $1.77 billion and the second effective April 1, 2012, for $1.363 billion. Staff will present both risk-transfer programs at the October 2011 Board meeting.

MOTION: Mr. Patton moved approval of the staff recommendation; seconded by Mr. Boyken. Motion passed unanimously.

6. Mr. Pomeroy will seek Board ratification of the CEA's contract with PricewaterhouseCoopers (PwC) and recommend a related budget augmentation for services in support of a CEA organizational and staffing analysis; the Board authorized the contract in June 2011.

- The CEA was formed almost 15 years ago, and an organizational review is needed to provide the resources, tools, and structure necessary for the future.
- A team from PwC is assigned to this project. They are on the floor of the CEA full-time, interviewing staff and stakeholders in nearly 50 one-hour sessions. They will develop a series of proposals, including some to bring to the Legislature in January, with the Board's concurrence.

MOTION: Mr. Boyken moved to support the staff's recommendation to ratify the PricewaterhouseCoopers contract and to augment the 2011 budget; seconded by Mr. Patton. Motion passed unanimously.

7. CEA Advisory Panel Chair Wayne Coulon will summarize the proceedings at the July 21, 2011, Panel meeting.

- Mr. Coulon highlighted the many contributions to the CEA by the late Dr. Allen Martin.
- At the last Panel meeting, Mr. Pomeroy updated the Panel on the federal legislation. Mr. Coulon made the comment that the Panel's Rate Subcommittee studies the rates a great deal, and it's clear that rates they can be considerably lower, perhaps as much as 20 – 30% with post-event funding. Federal legislation is perhaps the best way to implement something like that.
- Since the earthquake in Virginia, interest and traction in Washington, D.C., may increase substantially.
- The transformer-reinsurance contract was a tremendous accomplishment.
- PwC effort is much needed at this point. Today's world is very different from the world of 1994–95, when the CEA was formed. .

8. Chief Communications Officer Chris Nance will present, and seek Board approval of, the proposed 2012 Marketing Value Program.

- Mr. Nance provided a brief history of CEA marketing efforts, including the SAFER Program, preparedness-kit distribution, and participation in and sponsorship of ShakeOut earthquake drills.
- Research in marketing, policyholders, branding, and independent social science has been completed.
- The new brand is called *The Strength to Rebuild*. The CEA is introducing it to the marketplace through insurance agents of CEA PIs.
- The focus is on increasing awareness among consumers, specifically earthquake-insurance-related views on CEA's claim-paying process.
- Highlights from the CEA's first annualized marketing program included a paid-media and direct-mail program, and new-policy-sales initiatives for agents.
- Marketing value program ("MVP") results to date include:
  - Participating insurers are strongly engaged at varying levels.
  - Agent training is up 129% from last year.
  - Midway through the program, we are at 54% of goal in new policy sales.
  - Of agents engaged thus far, 96% are looking forward to doing so again.
  - 93% would recommend this programming to their colleagues.

- We have learned to place greater emphasis on retention – so we will reduce direct mail to non-policyholders from three flights to two, and increase direct mail to policyholders from two flights to four. We will need to have a paid-media program year-round.

- We are recommending creating an online-marketing strategy, a cost-efficient way of delivering programming year-round.

- Mr. Nance made the following recommendation:

  - To invest less than 1% of CEA annual premium revenue to support annualized marketing programming. The main focus this year is on policy acquisition and retention, to produce a return on investment that increases capital. A commitment of up to $7.715 million would be appropriate:

    - $4.775 for year-round paid media and online marketing.

    - $1.832 million for direct mail to non-policyholders.

    - Quadrupling the budget for direct mail to policyholders.

  - To approve the rollover of previously authorized but unspent 2011 marketing funds in 2012, of which no more than $75,000 would be paid near term for a subcontractor to develop a 2012 online marketing plan.

MOTION: Mr. Boyken moved approval of the recommendation; seconded by Mr. Patton. Motion passed unanimously.

9. Assistant Chief Financial Officer Mark Dawson will brief the Board on the completed CEA fiscal-year-2010 audit by the CEA's independent auditors, Larson & Rosenberger LLP; representatives of that firm will address the Board to elaborate on the written audit report.

Mr. Dawson announced that the CEA's independent auditors, Larson & Rosenberger, had performed the audit of the CEA 2010 financial statement on both a Generally Accepted Accounting Principles basis and a statutory basis, and the auditors had determined that the CEA's financial statements were presented fairly in all material respects.

The auditors said they didn't find any material misstatements. There was an exception of the 2009 adjustment to premium tax, presented in last year's audit—a non-material misstatement.

Highlights for the year include an increase of $291 in net assets million and an underwriting profit of $250 million.

In addition to the financial statements in the audit reports, Bill Rosenberger, partner, and David Keum, audit manager, presented a management comment letter and other communications to the Board that are required by Generally Accepted Auditing Standards. Following is a summary of his presentation:

- The firm's approach to the audit was a risk-based approach, which involved establishing an overall strategy for the audit of the CEA's financial statements in establishing a planning level of materiality that guides the scope with regard to the audit.

- In terms of audit timing: planning took place in January 2011. Field work was completed by May 2011. Reports on the financial statements were issued in July and August 2011.

- Key areas of risk were the assets and the balance sheet. Cash and investments represented $4.2 billion of the balance sheet. The firm drove its efforts towards the premiums and the reinsurance.

  Mr. Rosenberger noted that the CEA actually maintains records on three bases of accounting: private entity GAAP, public entity GAAP, and statutory.

- The resulting auditor's report for 2010 gave unqualified clean opinions for both the GAAP financial statements and the statutory financial statements, as first noted above by Mr. Dawson. The qualification in the GAAP financial statement for 2009 was the correction of the premium-tax calculation.

- The one item Mr. Rosenberger pointed out as unusual was the risk capital surcharge recognized in the financial statements as a result of the recent participation of Safeco. That risk capital surcharge was recognized as a reduction of the cost of ceded reinsurance in the financial statements.

- There were no significant audit adjustments or unrecorded audit adjustments, a testament to the good job that the finance team, accounting team, and management are doing at the CEA.

- The firm issued a letter regarding matters of internal control that identified two areas deserving the attention of CEA governance:

  - Information Technology (IT) processes and procedures, currently being addressed by the Protiviti team.

  - Audits of PI records, particularly their source documents.

- Mr. Rosenberger commented that management had been completely transparent and helpful throughout the audit process. His firm felt that the audit had gone very smoothly and efficiently.

Mr. Marshall expressed the intention of having PI-records examination become part of a planned, larger effort to make the CEA's internal-audit program broader, deeper, and more robust.

10. 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.

Mr. Dawson stated that with the audit complete, the official amount of the CEA's investment income to be set aside to the mitigation fund has been calculated. The Chief Actuary, Shawna Ackerman, has evaluated that amount and has determined that the set-aside amount to the mitigation fund will not impair the CEA's actuarial soundness.

Mr. Dawson made a recommendation to the Board that it authorize a set-aside of $2,019,253 for the CEA Loss Mitigation Fund.

MOTION: Mr. Boyken moved approval of the requested set-aside amount into the CEA Loss Mitigation Fund; seconded by Mr. Patton. Motion passed unanimously.

11. Chief Mitigation Officer Janiele Maffei will provide the Board with an update on the CEA's mitigation programs.

- The Joint Exercise of Powers Agreement was signed on August 16, 2011, by Acting Secretary Mike Dayton of the California Emergency Management Agency (CalEMA) and Mr. Pomeroy.

- With the signing of that agreement, the CEA selected CEO Glenn Pomeroy and CCO Chris Nance to represent the CEA on the California Residential Mitigation Program (CRMP) governing board.

- CalEMA will select two members from its organization to represent it on the CRMP governing board; with the board in place, the first meeting will be scheduled.

- The Board will be a part of the overall California residential mitigation program. The Federal Emergency Management Agency (FEMA) has authorized its contractor to create a training module that coincides with the new California Residential Seismic Retrofit Code.

- In order to proceed with the program, they are identifying potential retrofit pilot program locations within California.

- Once the Board is in place and required processes have been established and implemented, we will then come back to the CEA Governing Board and propose a mitigation fund budget, that includes the expenditures for various retrofit programming, including the expanded JPA involvement.

12. Chief Operations Officer Bob Stewart and Earthquake Response Manager Dan Dyce will present for Board consideration and approval proposed changes to the CEA's Claim Manual and seek Board authorization to send the approved Claim Manual to the Insurance Commissioner for review and approval.

Mr. Stewart outlined the proposed changes to the CEA's Claim Manual and asked for Board approval for CEA to forward it to the Department of Insurance for its review and approval .

MOTION: Mr. Boyken moved that the changes be approved by the CEA Board and then forwarded to the Department of Insurance for further approval; seconded by Mr. Reyes. Motion carried on a 2- 0 vote, with one abstention (ayes, Governor and Treasurer; abstain, Insurance Commissioner).

13. Senior Counsel Joe Zuber will brief the Board on the renewal of the CEA's Directors and Officers and Employment Practices Liability insurance coverages and request the Board's approval to renew the policy and pay the annual policy premium.

The CEA has received a renewal offer from its existing carrier for D&O and EPLI coverage. This year there is a premium decrease of about $5,000 from last year.

Mr. Zuber asked that the Board approve and delegate the authority to the CEO to bind that coverage and pay the premium for another year.

MOTION: Mr. Patton moved to authorize the necessary expenditure and delegate signature authority to Mr. Pomeroy to renew the existing D&O EPLI coverage, and bind the coverage on or before August 31; seconded by Mr. Boyken. Motion passed unanimously.

14. Mr. Pomeroy will present the results of the appraisal of Chief Actuary Shawna Ackerman's performance under the CEA executive-performance-evaluation plan.

Mr. Pomeroy presented a favorable performance review for Chief Actuary Shawna Ackerman.

Mr. Pomeroy recommended that the Board authorize the payment of a cost-of-living adjustment (COLA) provision and a 5% compensation adjustment in October to Ms. Ackerman's contract.

MOTION: Mr. Patton moved approval of the COLA plus a 5% salary increase; seconded by Mr. Boyken. Motion passed unanimously.

15. 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 (c), respectively.

The Board entered closed session at 2:49 p.m. and resumed its proceedings in open session at 3:21 p.m. The Board had nothing to report.

16. 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.

17. Adjournment.

The meeting was adjourned at 3:21 p.m.