

**CALIFORNIA EARTHQUAKE AUTHORITY
GOVERNING BOARD MEETING
MINUTES**

**Thursday, February 25, 2010
1:05 P.M.**

Location: State Capitol
Room 477
Sacramento, California

Members of the Governing Board in attendance:

J. Clark Kelso, designee of Governor Arnold Schwarzenegger, Chairperson
Grant Boyken, designee of State Treasurer Bill Lockyer
Peter Conlin, designee of Insurance Commissioner Steve Poizner
Bruce Patton, designee of Insurance Commissioner Steve Poizner
Deborah Doty, designee of Speaker of the Assembly Karen Bass
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, Director, Communications and External Affairs
Susan Pitton, Governing Board and Advisory Panel Liaison
Danny Marshall, General Counsel

Also Present

John Forney, Raymond James, Inc.

- 1. The meeting was called to order at 1:05 p.m. A quorum was established.**
- 2. Consideration and approval of the Minutes of the December 10, 2009, Governing Board meeting.**

MOTION: Mr. Boyken moved approval of the December 10, 2009, Governing Board minutes; Mr. Patton seconded the motion. Motion carried unanimously.

3. Executive Report by Chief Executive Officer Glenn Pomeroy, 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.

- CEO Pomeroy said that the federal legislation that would create a more efficient financing capability for the CEA is moving forward. CEA and its partners from other states have a growing list of co-sponsors, including bipartisan co-sponsors, on H.R.4014, the House version of the Catastrophe Obligation Guarantee Act (COGA), introduced less than a year ago on the Senate side as S.886.
- There will be a hearing in March that focuses on H.R.2555, a House bill that contains COGA. CEA staff will likely be offered the opportunity to testify at that hearing.
- A one-page fact sheet on COGA has been developed to summarize COGA benefits –how it works, why it's needed, and who supports it.
- Various organizations have endorsed the COGA concept, including the California League of Cities, the Alfred E. Alquist Seismic Safety Commission, and several consumer groups.
- There is also a growing recognition within the media that something is going on that could have an impact on California, and momentum is developing.

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

- Mr. Richison stated that as of the end of 2009, capital available to pay claims is \$3.5 billion. Total CEA assets exceed \$4.1 billion.
- CEA's claim-paying capacity at the beginning of January 2010 was \$9.708 billion.
- CEA's net income for the year was over \$300 million.
- Premiums written totaled \$585 million, and the projection for next year is over \$600 million.
- The CEA has over 800,000 policyholders.
- CEA investment income was about \$54 million for 2009.

5. Mr. Pomeroy and Mr. Richison will present the proposed 2010 CEA budget for Board consideration and approval.

- CEO Pomeroy told the Board that it is essential to keep in mind that the CEA is unique: It opened its doors in 1996, in direct response to a market crisis that began with the 1994 Northridge earthquake – it took on a statewide residential

earthquake market that private insurers had largely abandoned, using what is truly a public-private partnership.

The CEA is really a not-for-profit insurance company, with a public Board that's 100-percent dedicated to the public mission of offering affordable residential earthquake insurance throughout the State of California.

- The law that created the CEA also capped its overall basic operating expenses at 3% of premium income. For 2010, that 3% is \$19.3 million. The funds to operate the CEA, of course, come from the CEA's revenue, not from the state budget or California taxpayers.
- Each year, CEA staff prepares a budget and seeks Board approval. For 2010, staff has proposed a budget of \$13.9 million, a few percentage points over the approved 2009 budget and a decrease from the approved 2008 budget.
- CEO Pomeroy asked that the Board accept the staff's budget projection as their best judgment of 2010 expenditures, and approve for 2010 the same spending level the CEA had in 2009 – \$7.9 million as the base budget.

Mr. Pomeroy also proposed that CEA augment that base throughout 2010 by bringing to the Board specific budget requests for projects and initiatives, if those would require spending more than the base budget amounts. In essence, the CEA would operate from a base budget with periodic augmentations, as "earned."

- There are two augmentations staff seeks today:
 1. Moving CEA's insurance-data function from an outside vendor to an in-house operation, at a cost of \$2.3 million. As a financial institution, the CEA must have the controls in place to produce high quality, reliable financial statements.
 2. An augmentation of \$300,000 to create a more efficient work space. CEA staff acted with Board authority to renegotiate a renewal of its office lease, effective February 1, 2010. To accommodate the required enterprise data project, staff leased space on an adjacent floor, increasing CEA's total space by about 20%. Under the new lease, the CEA saves \$500,000 in rent over the next five years, and the landlord will put significant dollars towards needed tenant improvements.
- The bottom line: The overall budget forecast for 2010 is \$13.9 million; Mr. Pomeroy sought approval to move ahead and spend \$10.8 million of that amount. The CEA's 2009 budget, for everything it does – including its expensive reinsurance, which makes up the vast majority of CEA annual expenses – was just over \$310 million. In 2010, the projection (including the projects described above) is just over \$297 million, a \$13 million drop and a savings of about four percent.

MOTION: Mr. Boyken moved that the Board approve the 2010 CEA budget, as proposed and presented, and that Mr. Pomeroy's remarks be considered part of the

official record of the Board meeting to clarify the basis of the Board's budget approval; seconded by Mr. Patton. Motion passed unanimously. The record was amended to reflect a 2010 budget of \$10.5 million, and it was further clarified that the motion refers only to the Insurance Services budget for 2010.

6. Mr. Richison will seek Board authorization to set the CEA participating Insurers' maximum earthquake loss-funding assessment levels, effective April 1, 2010.

- Mr. Richison explained the changes in the industry assessment layers and requested Board approval of the calculations, specifically the market-share information from Attachment C (to the Board memo for this item) for the industry assessment layers, commencing April 1, 2009 – and direct staff to inform the participating insurers of this new assessment amount.

MOTION: Mr. Patton moved that the Board approve the calculations in Attachments A, B, and C, and then so notify the participating insurers; seconded by Mr. Boyken. Motion passed unanimously.

7. Presentation to the Board by CEA independent financial advisor John Forney (of Raymond James, Inc.) on the state of the financial markets.

- Mr. Forney noted that Raymond James has been the financial advisor for the CEA for just over a year. He discussed what lessons CEA can learn from the ongoing world financial crisis, noting that in financial markets, “what we don't know is much more than what we do know.”
- Mr. Forney provided a synopsis of recent events that led to the complex web of financial engineering that, ultimately, rested on the flimsiest of assumptions, especially by rating agencies, which rated all instruments that supported this web, based on the assumption that housing prices could never go down everywhere at the same time. In fact, such a housing-price drop started in 2007, and as a result faith in the system was shattered.
- Mr. Forney advised the Board of three areas of concern:
 1. The fear that nobody could make good on their obligations;
 2. The “Flight to Quality,” i.e., if no one can make good on their obligations, then maybe only the federal government can do so; and
 3. The Feds responded to this demand by ramping up federal services and market intervention, issuing \$1.5 trillion in indebtedness – more than double any prior year's issuance – and propped up markets with programs to (essentially) guarantee private-entity indebtedness.
- Mr. Forney said markets have now stabilized somewhat and recovered to a degree, with equity markets rebounding dramatically and leveling out. Both tax-exempt and taxable debt markets rebounded in 2009.

- He continued that, economically, with double-digit unemployment, and with the federal government taking up an increasingly large share of \$1.5 trillion of new debt issues, with resulting big federal deficits, the economic situation may be less than stable.
- Mr. Forney summed up this point succinctly by noting markets good, economy bad, and predicted that in 2010, one of two things should happen: either the economy is going to get better or financial markets are going to get worse, because the two cannot diverge for a long—a *bad* economy and *good* financial markets are contradictory, so somehow they should come back together.
- The U.S. debt market dwarfs the equity market: it's over three times as big and now stands at \$7.3 trillion and getting larger, and indebtedness is becoming an increasingly important position of leverage in the US economy. In this environment, money must be kept safe, and for the CEA, liquidity is paramount.
- Diversification standards for investment portfolios need to be resolved more finely than before, since what were once thought to be high ratings and effective diversification turned out not to be. And to some, rating agencies were essentially discredited.
- Capital-markets access is critical, and certainty is hard to come by, unless you're the federal government or somebody the federal government guarantees. That's why COGA can help insure insurance-market stability long-term, not to mention affordability, in California, by giving that certainty of capital-markets access.
- The more CEA financial managers appreciate uncertainty and that "there's a lot we don't know out there," the more they can make prudent decisions for what the CEA is doing, both in this capital structure and its investment portfolio.
- Mr. Forney expressed the appreciation of Raymond James, Inc., in working with the CEA.

8. Director of Communications and External Affairs Chris Nance will seek Board approval for a media buy to increase market awareness for the CEA and its earthquake insurance products.

- Mr. Nance told the Board that recent earthquakes, in California and around the world, have strongly reminded Californians they live in earthquake country. Historically, such reminders have translated into increased insurance sales for the CEA – from a marketing perspective, they might be thought of as “selective awareness,” i.e., people are or become selectively aware of messages that CEA might circulate.
- Staff recommends that the Board authorize up to \$200,000 for a media buy to accomplish this increased awareness.

MOTION: Mr. Boyken moved that the Board authorize up to \$200,000 for the media buy; seconded by Mr. Patton. Motion passed unanimously.

9. Mr. Nance will request Board approval of an expenditure to cover the project budget for planned, near-term, CEA product-related market research through CEA contractor Ogilvy Public Relations Worldwide.

- Mr. Nance said that for its upcoming market research, discussions had led CEA staff to recommend a move to a more complex research tool, which would cost the CEA more than the original price.
- Thus, the staff recommendation is for the Board to authorize enhanced market-research funding, from \$92,000 to \$158,500.

MOTION: Mr. Patton moved that the Board authorize the increased expenditure; seconded by Mr. Boyken. Motion passed unanimously.

10. Chief Operations Officer Bob Stewart will present for Board consideration the proposed contract for the Board-approved, CEA-supported research project entitled Improved Near-Source-Ground-Motion Characterization (generally known as NGA-West 2).

- Mr. Stewart noted that the Board had already approved the CEA's participation in the NGA-West 2 project and had also approved a spending level, which is reflected in a contract now before the Board. He asked Board approval of the proposed NGA-West 2 contract and that the Board authorize CEO Glenn Pomeroy to execute that contract on behalf of the CEA. General Counsel Danny Marshall added that the contract had been successfully negotiated, based on the Board's previous approval.

MOTION: Mr. Boyken moved that the Board approve the contract and authorize CEO Pomeroy to execute it; Mr. Patton seconded the motion. Motion passed unanimously.

11. Mr. Pomeroy will seek Board approval to fund a study, involving the services of the RAND Corporation and CEA contractor Risk Management Solutions, to aid the CEA's efforts to quantify federal aid savings on account of the purchase of residential earthquake insurance.

- General Counsel Danny Marshall told the Board that CEA staff proposes to engage the RAND Corporation for a study, to assist the CEA in two areas:
 1. Quantify federal-government savings if more people bought earthquake insurance?
 2. Determine how many Californians who actually *need* earthquake insurance actually have earthquake insurance? (For example, the penetration rate of

residential earthquake insurance is 12% in California; that is, 12% of Californians with homeowners insurance also have earthquake insurance. But some live in San Francisco, where earthquake insurance is obviously needed, while others live in Fresno, where the insurance is not needed as much. Increased granularity would be very helpful for a number of CEA initiatives.

- RAND has performed a similar quantification study for FEMA regarding the federal flood program (NFIP) to determine, when people buy flood insurance, how much money does the federal government save?
- CEA contracted modeling firm Risk Management Solutions (RMS) has offered to help on this RAND study without cost to CEA, and the firm has just updated its California database on homeowners-insurance policies.
- Importantly, combining findings from questions 1 and 2, above, will help CEA staff quantify post-earthquake federal-aid savings, data needed in presenting the COGA legislation in Congress and for overall CEA planning purposes.
- The total cost of the project will be \$140,000. Project results will be due on June 30, 2010, well timed for CEA's COGA efforts.

MOTION: Mr. Boyken moved that the Board approve the project and its budget; seconded by Mr. Patton. Motion passed unanimously.

12. Mr. Pomeroy will ask the Board to designate one of its members to conduct, on behalf of the Board, the annual performance appraisal of the Chief Executive Officer.

- Mr. Kelso volunteered to perform the appraisal, and the Board accepted his offer of service.
- **13. 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 met in Closed Session, after which it reported that it gave direction to counsel on litigation matters.

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 3:01 p.m.