CALIFORNIA EARTHQUAKE AUTHORITY
GOVERNING BOARD MEETING
MINUTES

Thursday, August 26, 2010
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
Grant Boyken, designee of State Treasurer Bill Lockyer
Bruce Patton, designee of Insurance Commissioner Steve Poizner
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
Joe Zuber, Senior Counsel

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 24, 2010, Governing Board meeting.

- Mr. Patton noted that the address of the meeting should be corrected to "1001" I Street; and that the first bullet point on page 4 under Item 8 should read, "Mr. Nance reported that 12.3 million people statewide participated in the last two ShakeOut drills."

  MOTION: Mr. Boyken moved approval of the June 24, 2010, Governing Board minutes, as amended above; seconded by Mr. Patton. Motion passed 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 Glenn Pomeroy thanked the Board for its help in the effort to work with Congress to pass a federal guarantee for post-event borrowing. The concept is referred to as COGA - Catastrophe Obligation Guarantee Act. It is embodied in three separate pending bills:
  - On the House side, HR 2555 has passed in the committee and is pending before the full House.
  - On the Senate side, Senators Feinstein and Boxer are working to move S886 and S4014 forward.
- In the California Legislature, AB 2746 would create the opportunity for the Board to contract for the services of a chief mitigation officer. The bill has been passed by the Legislature and will be submitted to the Governor.
- The CEA hopes to make a rate filing that will include a rate reduction before the year is out. The CEA also hopes to make coverage enhancements as part of its rate filing.
- The CEA is conducting marketing research of new policyholders who fist purchased CEA policies in March and June—the months with the CEA's largest policy sales growth—to determine what motivated new policyholders to purchase CEA policies. The CEA is also conducting research to ensure that the CEA's the place that consumers look to for earthquake insurance.
- Scientific research, UCERF 3 and NGA-West 2 in particular, are very important in the follow-on to UCERF 2. Mr. Pomeroy believes that when research is completed, the science will support a greater discount for retrofit projects than the CEA's current statutory five percent discount.
- The State of California recently adopted a statewide building code, and did it in the span of months rather than decades. The CEA will now finalize work on joint powers agreement (JPA) to help create an instrumentality to manage and fund mitigation work.

  Mr. Patton commented that the mitigation discount has been elusive, and suggested for Staff to explore with the experts having an element, post-event, for enabling quick and easy collection of data that would support a mitigation discount.

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

- Mr. Richison stated that the CEA has a little over \$4.1 billion in capital, of which over \$3.6 billion is available to pay claims. As of the end of June, the CEA's claims-paying capacity stood at \$9.7 billion.
- For the budget, \$15,000 has been moved to the Department of Insurance category to pay for some of the Department of Insurance examination fees.

- The CEA has most of its cash invested in U.S. Treasuries, including 100% of its primary fund.

- For the rolling 12-month investment return, 2010's investment yield was almost double to the 2009 yield.

5. Mr. Richison will present and seek Board approval of the proposed CEA reinsurance program for 2011.

- The CEA's staff and intermediary team contacted 176 reinsurers in 28 countries this year, seeking commitments for the 2011 program. 73 reinsurers came back with commitments for the 2011 program. There are 14 more reinsurers in the program than there were in 2010, increasing the CEA's diversification of its claims-paying resources.

- Staff presented to the Board a two-stage reinsurance program:

  - The three lowest-retention contracts are the for the traditional reinsurance contract period, from January 1 through December 31.

  - Two additional contracts will have a 15-month duration, and will cover the period from January 1, 2010 through March 31, 2012. This will be keyed to the April 1, 2011 rolling off of the New Industry Assessment layer.

  - One of the contracts, the highest-retention (and lowest rate-on-line) contract, provides the CEA with an option to purchase up to an additional $350 million of reinsurance at a later point this year. That will help offset any amount of additional capacity that the CEA needs to have as a result of the April 1, 2011 rolling off the New Industry Assessment layer.

- There are benefits to bifurcating the 2011 reinsurance program.

  - By splitting the program, with the CEA is purchasing at the beginning and the end of the hurricane season, the CEA can take an opportunity to seek favorable market conditions.

  - Buying $3 billion in reinsurance at any one point in time puts a strain on the capacity level of the global reinsurance marketplace. Buying smaller amounts of reinsurance at different points in time allows the CEA to be less affected to potentially negative one-time-frame reinsurance market conditions.

Mr. Patton expressed frustration at using models to set rates and reinsurance, because if the models show the cost going up, the CEA's rates go up. However, the reinsurers do not seem to be following those models if the models indicate lower losses. Mr. Richison responded that the staff shared his frustration.

Senior Staff Counsel Zuber then explained the formal resolution.

MOTION: Mr. Patton moved to adopt the resolution prepared by the CEA counsel; seconded by Mr. Boyken. Motion passed unanimously.

6. Mr. Richison will seek Board approval to contract with additional asset managers, selected in a competitive procurement, and execute the resulting contracts with the Public Financial Management Group, RBC Global Asset Management, and Payden & Rygel.

The CEA currently has a limited number of investment managers, and the amounts they manage are quite large. The CEA's intent is to get away from that situation, and instead to have many money managers in a pool lasting five years. If an investment manager is needed, rather than having to go through the ten-month process of an RFP, the CEA would be able to go to the pool and contract with the next firm in line.

The CEA issued and RFQ for investment managers for large investment capacities. Seven money managers responded – not a large number because the CEA had specified that the fees can be no more than five basis points.

Mr. Richison outlined the key components and the selection process used by the staff. He then gave the names of the three firms that Staff was recommending to the Board: Payden & Rygel, RBC Global Management, and Public Financial Management (PFM) Group. Mr. Richison explained some of the contract terms.

MOTION: Mr. Boyken moved that the Board approve the staff recommendation of the addition of Payden & Rygel, RBC Global Asset Manager, and the PFM Group as the CEA's large primary fund investment managers; and authorize the CEO, Glenn Pomeroy, to proceed with negotiations and execute the contracts on behalf of the CEA; seconded by Mr. Patton. Motion passed unanimously.

7. Mr. Pomeroy will update the Board on the competitive search for a qualified Chief Actuary for the CEA.

Mr. Pomeroy introduced the new CEA chief actuary, Ms. Shawna Ackerman. She has 20 years of experience in the earthquake arena, and for the last ten years has been the consulting actuary to the CEA. The Board welcomed Ms. Ackerman.

8. Assistant Chief Financial Officer Mark Dawson will brief the Board on the completed CEA fiscal-year-2009 audit by the CEA's independent auditors, Larson & Rosenberger, LLP; representatives of the 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 CEA 2009 financial statement audit, and that the auditors had determined that the CEA's financial statements present fairly with all respects in accordance with Governmental Accounting Standards Board and GAAP policies.

There was one exception to the audit report, and it had to do with a slight miscalculation of premium tax expense when the CEA was initially formed. The CEA wanted to make sure that this premium tax calculation was trued up in 2009. Staff made the adjustment.

Mr. Bill Rosenberger, a partner in the firm, gave a presentation in which he presented the results of the audit. The results were sound. The only issue Mr. Rosenberger pointed out was a weakness in internal control of IT policies and procedures. CEO Pomeroy noted that additional IT staff had been hired. The next step in the process of ongoing improvement would be to contract with an outside entity to review CEA operations and give specific suggestions and assistance.

9. 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 approve the transfer of $2,772,498 into the CEA loss mitigation fund, seconded by Mr. Boyken. Motion passed unanimously.

10. Advisory Panel members Pius Lee and Sara Rualcava-Beck will provide a summary of the proceedings at the Panel's most recent meeting.

- Mr. Lee listed activities in which the CEA plans to participate:
    - News conferences set up by New American Media in Los Angeles (September 30) and the Bay Area (October 12).
    - Tsing Tao Expo, a free fair in the Bay Area.
    - The Chinese Autumn Moon Festival.
    - The Chinatown night market, meeting every Saturday evening.
- Ms. Rubalcava-Beck summarized the Advisory Panel meeting held that morning:
    - CEO Pomeroy gave an executive report on federal and state matters.
    - Mr. Richison gave notes on the financial soundness of the CEA.
    - Mr. Nance gave a talk about the marketing plan.

Mr. Patton commented that he had attended that morning's Advisory Panel meeting, and encouraged other Board members to do the same. Mr. Kelso noted the Bagley-Keene requirement that if more than one Board member is present, the meeting must be formally noticed.

11. Director of Communications and External Affairs Chris Nance will seek Board approval for funds to support the CEA's proposed 2011 sales-incentive program.

- Mr. Nance began by describing three important criteria that the CEA has been wrestling with in recent years, which have enabled the development of a strategic marketing capability.

    1. Development of strategic marketing capability requires branding research results that identify a unique consumer value proposition

    2. The CEA must have a return on investment of marketing dollars.

    3. Incentives for agents to increase policy sales have not been used in the past.

- From a marketing perspective, the plan started with “the four Ps”: price, product, place (distribution), and promotion.

- Research has shown that qualities from a consumer perspective that make the CEA unique include: it is a nonprofit provider, it is financially sound, it works through a network of reputable insurance providers, and it is publicly minded.

- Research has shown some vulnerabilities:

    - Consumers perceive no relationship with the CEA. They are not sure about how to file a claim should they have damage.

    - Agents lack a relationship with the CEA, and have no motivation to sell its policies.

- Out of the research comes a “branding story” about the organization; the story is summarized with the tag line “The Strength to Rebuild.”

- The CEA’s strength comes in two ways: its financial capacity and its participating insurer expertise in policy sales and service.

- Agents are the most effective voice for carrying the CEA story, which the CEA can further complement with traditional media and social media.

- In order for the CEA to effectively collaborate with its participating insurers, it must align with them in their strategic programming, defining how many times they contact (“touch”) their consumers.

- Mr. Nance proposed investing $5,000,000 of the CEA’s annual premium revenue to support a first-time annualized marketing program that has potential to do the following things:

    - Establish with consumers the CEA’s new value proposition, The Strength to Rebuild.

  - Produce a return on investment for new policies sold that increases the CEA's capital.

  - Deliver new policy sales incentives for each of up to 5,000 CEA-trained agents.

- The CEA would make available $1,000 incentives, by way of marketing support through three flights of media, including traditional and social, complemented by direct mail.

- This represents up to a $5 million commitment that breaks out in three ways: $1,750,000 for three flights of paid media; $489,000 for two flights of direct mail to policyholders; and $2,761,000 for three flights of direct mail to non-policyholders.

- This new policy sales-incentive program represents the first time the CEA's marketing capabilities could be planned on an annualized basis. Through annualized planning, the CEA could release advertising within days after a major earthquake – the best time to be selling earthquake insurance.

  MOTION: Mr. Boyken moved to approve the 2011 CEA budget up to $5 million to explore the first-time annualized new policy sales-incentive program. Mr. Patton seconded. Motion passed unanimously.

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

The CEA has received a renewal offer from its existing carrier, which writes a very tailored policy that is well-suited for the CEA's form of entity. For the last several years, there has been no premium increase; and the carrier has agreed to maintain the same premium for the renewal period while voluntarily increased the limit by $1 million.

MOTION: Mr. Patton moved to authorize the necessary expenditure and delegate signature authority to Mr. Pomeroy to review the CEA's existing D&O and ELI coverage at a premium of $116,085 and bind coverage at or before the expiration of the current policy. Mr. Boyken seconded. Motion passed unanimously.

13. Staff will present to the Board a proposal and justification to consolidate all CEA payroll services in-house.

CEO Pomeroy explained that the item was informational only. The CEA runs two payroll systems now: one for the employees that are outside the personnel system and another through the controller's office for those other employees. It has been decided to bring both into one unified in-house system.

14. 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.

There was no closed session.

15. 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.

16. Adjournment.

The meeting was adjourned at 2:51 p.m.