

**CALIFORNIA EARTHQUAKE AUTHORITY
GOVERNING BOARD MEETING
MINUTES**

**Thursday, October 25, 2007
1:02 P.M.**

Location: CAL/EPA HEADQUARTERS BUILDING
1001 I Street
Sierra Hearing Room, 2nd Floor
Sacramento, California

Members of the Governing Board in attendance:

J. Clark Kelso, (designee of Governor Arnold Schwarzenegger, Chairperson)
Bill Lockyer, State Treasurer
Jim Zerio, designee of State Treasurer Bill Lockyer
Bruce Patton, designee of Insurance Commissioner Steve Poizner
Dietrich Stroeh, designee of Chair of the Senate Rules Committee, Don Perata

Members of the CEA staff in attendance:

Tim Richison, Chief Financial Officer and Acting Chief Executive Officer
Bob Stewart, Operations Manager
Mark Dawson, Controller and Assistant Chief Financial Officer
Rolf Erickson, Mitigation Program Coordinator
Susan Pitton, Governing Board and Advisory Panel Liaison
Danny Marshall, General Counsel

- 1. The meeting was called to order at 1:02 p.m. A quorum was established.**
- 2. Consideration and approval of the minutes of the August 13, 2007 and August 30, 2007 Governing Board meetings.**
 - Mr. Patton moved to approve the minutes of August 13, 2007, and August 30, 2007, subject to amending the August 13th minutes to clarify that (1) Commissioner Poizner had stated that SB 430 (and not post-event financing) was a Band-Aid, and (2) it was Mr. Kelso who had pointed out that the Legislative session is two years; seconded by Mr. Zerio, as amended. Motion carried, approved unanimously.
- 3. CEA executive staff will present to the Board an executive update, including a financial report.**
 - Mr. Richison reported that SB 430 had passed and been signed by the Governor. As a result, insurer rating agency A.M. Best had reaffirmed the CEA's A-minus "Excellent" financial-strength rating and removed the previous rating's "negative outlook."

- The CEA has 763,000 policyholders, the highest count since year-end 2002; Mr. Richison said that it appears a “turn-around” has been accomplished.
- Almost 28% of CEA policyholders have purchased at least one supplemental coverage. Almost 35,000 people who buy CEA supplemental coverage differently than had been available through the former “package” approach, and almost 27,000 people now purchase additional building-code upgrade coverage.
- Word is getting out about the CEA’s product offerings, which Mr. Richison attributed to agent training. In 2007, about 1,500 agents have been trained, making them better able to help their clients.
- The Insurance Commissioner has scheduled a hearing for November 2nd on a CEA petition for regulation changes which the Board approved last spring—the regulation changes would allow combining of base and supplemental program financing.
- Mr. Marshall attended the Second World Forum of Catastrophe Programs, composed of public entities from around the world that underwrite or otherwise address losses from natural disasters. The Forum is established to ease the exchange of ideas in finance and other program issues in responding to catastrophes. This sharing of ideas enables CEA to better understand its own procedures and techniques.
- Mr. Stroeh complimented the staff on the CEA’s ubiquitous “Every day is earthquake season in California” ads he has heard on Bay Area radio.
- Mr. Richison reported that as of August 31st, almost \$8.5 billion is available to pay CEA policyholder claims in the base program. The CEA’s investment yield has dipped just below 5% on account of recent changes in the economy.
- The CEA supplemental program can stand on its own for the rest of 2007, and staff will make no request to transfer money from the base program for fourth-quarter expenses.
- Growth from 2006 to 2007 in base claim-paying capacity is attributable to growth in CEA capital.

4. Chief Financial Officer and Acting Chief Executive Officer Tim Richison will discuss with the Board the continuing applicability of the CEA’s policy and guidelines for audit services.

- Mr. Dawson, CEA Controller and Assistant Chief Financial Officer, stated that the CEA’s five-year contract with PricewaterhouseCoopers LLP is expiring. The CEA’s current independent-auditor policies require that CEA rotate audit firms every five years. The CEA issued a Request for Bids (RFB) on September 10th but received only one response. Upon review, it was determined that the bidder did not meet the minimum qualifications for a CEA audit contract.
- Staff reviewed the Sarbanes-Oxley Act of 2002 and the rules adopted by the Securities and Exchange Commission, which require a company subject to Sarbanes-Oxley to rotate its audit firm’s managing partner and

concurring partner every five years, not the auditing firm itself. Although the CEA is not expressly subject to Sarbanes-Oxley, many of its provisions are widely accepted best practices.

- As a result, staff proposes that the Board change CEA independent-auditor policies to track Sarbanes-Oxley in the rotation of concurring and managing audit partners. The CEA would still seek bids every five years to contract for auditing services, but the policy change would allow the incumbent firm to bid. During the first quarter of 2008, the CEA will reissue the RFB for the audit year ending 2009, which would be completed in 2010.
- Pending a new competitive bid process, staff recommends that CEA negotiate with PricewaterhouseCoopers LLP a two-year extension of its existing contract.

Mr. Kelso asked what factors disqualified the company that had bid. He also asked whether the five-year rule was an earlier interpretation or statutory requirement of Sarbanes-Oxley.

- Mr. Dawson said that the RFB had specifically sought insurance company audit experience. The sole bidder had audited small investment (Mr. Dawson meant “insurance”) pools, and reviewers felt that experience did not qualified the bidder to audit an investment (Mr. Dawson meant “insurance”) company such as the CEA.
- The five-year policy was adopted just after Sarbanes-Oxley was signed into law. At the time, the SEC was still discussing whether to rotate the entire firm or just the two partners every five years. In early 2003 the SEC adopted the five-year partner-rotation rule.

Mr. Zerio asked whether the CEA might attract more bids in the near term solely by changing the independent-auditor policy. Mr. Dawson replied that he had contacted several of the larger auditing firms and found that they actually needed more lead time in order to plan for staffing a potential CEA engagement.

Mr. Richison added that auditing firms seem to be taking a hard look at their workflow requirements and need a longer timeframe to take on new clients. By changing the CEA’s policy and extending the present auditor’s contract term, the CEA would create ample time in which to receive qualified replies to another RFB.

MOTION: Mr. Zerio moved that the CEA independent-auditor policy be changed as reflected in the materials and that the staff be directed to negotiate a two-year contract extension with the current independent auditor; seconded by Mr. Patton. Motion carried unanimously.

5. CEA Mitigation Program Coordinator Rolf Erickson will update the Board on CEA marketing programs.

- Mr. Erickson reported that the September 2007 media buy has concluded. There were direct marketing spots (“Kid in Therapy” and “Neighbors”) as well as spots done for organizations such as the Red Cross (“Prepare Bay Area”) and a southern California campaign (“Dare to Prepare”), which included airtime for spots on Spanish-language stations. There were also 155,000 Spanish-language copies of *Putting Down Roots in Earthquake Country* inserted in a leading Spanish-language newspaper.
- The Southern California Earthquake Center has reported an increase in hits on their Web site. The American Red Cross has its Web hits increase as well, but because ARC is running different spots it cannot be determined if their increase can be credited to the CEA spots.
- The staff will review what they learn from their mitigation partners to determine if they can attribute increased interest in the mitigation programs to the media campaign. Findings will be reported at the December Board meeting.
- As a result of responses from agents asking for marketing materials, a postcard was developed for direct mail. Five thousand were printed, and currently 1,750 have been distributed to three agents. Follow-up will be done with each agent to determine if this marketing tool has affected CEA policy sales.
- The executive staff has met with CEA research contractor Meta Research to develop a detailed plan for statewide market research, which will consist of consumer telephone surveys and agents to gauge their perceptions of CEA products.
- Mr. Richison added that the last such survey the CEA conducted was in 2001 and it is therefore time to determine whether people’s perception of CEA products has changed.

6. Mr. Erickson will provide an update on the CEA’s Mitigation Program and its ongoing pilot projects.

- Mr. Erickson stated the multi-element CEA Mitigation Program supports efforts that encourage mitigation, like the *Putting Down Roots* handbooks, and also incorporates mitigation information in CEA insurance product brochures.
- In recent years CEA has focused on pilot projects to identify effective mitigation-program models. The first four pilots concluded in 2006, and a report of the results was presented at the December 2006 Board meeting. Currently, six additional pilots are being conducted or are under consideration. Three of the six are in response to an RFP seeking proposals for personal-property-mitigation projects, and three are in response to an RFP seeking proposals for structural-retrofit projects.
- The one pilot currently being conducted by the American Red Cross/Ready America, Inc. was launched in September and has thus far

educated 2,400 consumers. The project includes pre-test and post-test surveys to pick up any changes in consumer perception and awareness after participation in the educational events. Participants are also requested to voluntarily provide contact information, which is being used to do random-sample follow-up interviews to measure further the effectiveness of the program.

Mr. Lockyer asked about the TELACU pilot and was told that the TELACU pilot is awaiting review by the CEA's risk-management contractor.

7. CEA Operations Manager Bob Stewart will update the Board on activities of the CEA's Multi-Disciplinary Research Team (in addition to CEA staff, team members under contract and drawn from the Alfred E. Alquist Seismic Safety Commission and the California Geological Survey).

- Mr. Stewart said this agenda item is offered to promote Board awareness of the CEA's research plan and gain a sense of support for continued research activities.
- Mr. Stewart explained that CEA is mandated by law to use the best available scientific information for assessing the risk of earthquake frequency, severity, and loss in the ratemaking process. He said research has been key in allowing CEA to fulfill this requirement, and while Board-approved research has provided positive impacts, staff is considering a formal research plan to guide the CEA's support of research activities.
- In spring 2007, the CEA announced the creation of the CEA Multidisciplinary Research Team, led by Mr. Richison and Mr. Stewart. The team's role is to advise CEA executive staff on areas of CEA interest where there is need for relevant scientific or engineering research.
- Recognizing the team's need for professional expertise in earthquake science and engineering, CEA executive staff collaborated with the Alfred E. Alquist Seismic Safety Commission and the California Geological Survey to welcome Bob Anderson, Senior Engineering Geologist, and Badie Rowshandel, Senior Research Engineer, to the CEA-MRT.
- In March 2007, the research team convened a group of high-level experts (including geologists, engineers, modelers, and an actuary) for a day-long conference in gap analysis for the research plan. The research plan will be presented to the Board in December 2008.

Mr. Kelso remarked that CEA research support is a topic that should be folded into CEA strategic planning to make sure it fits on a go-forward basis.

Mr. Patton commented that he was glad to see the CEA team included an engineer and a geologist.

8. Mr. Richison will update the Board on legislation, including federal catastrophe-insurance legislation.

- Mr. Richison updated the Board on HR3355, the “Homeowner Defense Act of 2007,” a bill currently in the U.S. House of Representatives. CEA has spoken with staff of the bill’s authors and with the Department of Insurance. In its current form, it is doubtful the CEA could qualify to take advantage of the bill’s provisions—with modification the CEA could realize some benefits. Currently *ProtectingAmerica.org* is pushing a proposal that also could benefit the CEA.

Mr. Kelso asked whether amending the bill to make CEA part of the national risk consortium would provide lower reinsurance rates. Mr. Richison said this would be staff’s intention. He said staff was also hoping the bill could provide more efficient access to capital markets. CEA will watch the bill and keep the Board informed.

Mr. Patton said that Commissioner Poizner was unable to attend the Board meeting today due to the fires in Southern California and sent apologies. He said the Commissioner feels the CEA Board should be more actively involved with federal legislation. He pointed out that there had been no discussion on the loan aspect of HR3355. The commissioner supported pursuing anything that might help California’s earthquake-insurance take-up rate and that the federal government could be a potential source.

Mr. Kelso suggested that the next Board meeting should provide for a more detailed description of the federal legislation, followed by discussion—to support the Insurance Commissioner’s belief that the Board should be more actively involved in legislation, the Board could benefit by more information and education on the bill.

Mr. Lockyer noted that there are California members on the financial services committee as well as a Speaker of the House from California. He suggested the CEA’s best opportunity to influence federal legislation would come from accessing those California members.

Mr. Patton said that if H.R. 3355 comes up for a vote before the next Board meeting, the Commissioner would like CEA staff to exercise its discretion and act appropriately, or, if necessary, call a Board meeting. Mr. Richison said staff would provide information to the Board after completing a more detailed analysis. He asked whether the Board wished staff to engage with members of the California delegation.

Mr. Richison noted that CEA staff had been contacted by Congressional staff, seeking CEA’s views on how the bill should be changed to benefit the CEA.

Mr. Kelso stated his concern that if H.R. 3355 was drafted primarily from a Florida perspective, it could end up hurting the CEA.

9. Staff will present for Board consideration and approval a proposed 2008 Governing Board meeting calendar.

- Mr. Lockyer moved that the proposed 2008 Governing Board meeting dates of February 14, April 17, June 26, August 28, October 30, and December 11 be adopted; seconded by Mr. Patton. Motion carried unanimously.

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

- The Board entered closed session at 2:04 p.m. and resumed open session at 3:52 p.m.
- Mr. Kelso said he would conduct on behalf of the Board the annual performance review of CFO Tim Richison.

11. 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.

12. Adjournment.

- The meeting was adjourned at 3:53 p.m.