CALIFORNIA EARTHQUAKE AUTHORITY
GOVERNING BOARD MEETING
MINUTES

Thursday, August 28, 2008
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, Chairperson
Steve Poizner, Insurance Commissioner
Bruce Patton, designee of Insurance Commissioner Steve Poizner
Paul Rosenstiel, designee of State Treasurer Bill Lockyer
Grant Boyken, designee of State Treasurer Bill Lockyer
Dietrich Stroeh, designee of Chair of the Senate Rules Committee Don Perata

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 of Communications and External Affairs
Mark Dawson, Assistant Chief Financial Officer
Susan Pitton, Governing Board and Advisory Panel Liaison
Joe Zuber, Senior Counsel
Danny Marshall, General 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 26, 2008, Governing Board meeting.

MOTION: Mr. Poizner moved adoption of the June 26, 2008, CEA Governing Board minutes; seconded by Mr. Rosenstiel. Motion carried unanimously.

3. Chief Executive Officer Glenn Pomeroy and the CEA Executive Staff will present an executive update including a financial report.

- Mr. Pomeroy introduced Chris Nance, new Director of Communications and External Affairs for the CEA.

- Activities of the past two months have been largely devoted to getting staff in place, dealing with the Chino Hills earthquake, putting a complex reinsurance program in place, and dealing with strategic-planning.
- The bulk of the work has been spent trying to uncover and develop ways to structure CEA business operations differently to provide greater value to consumers—this, in turn, will result in more Californians insured, thus achieving the public-policy objective of having more Californians better protected when the next earthquake occurs.
- Since the CEA's inception, it has spent more on reinsurance than it has retained in capital. During its first year, CEA purchased $2.1 billion of capacity from the reinsurance markets; in 2009, the reinsurance capacity will be between $3 billion and $3.5 billion. CEA capital has grown over time. After a decline in policyholders between 1999 and 2002, the policy count stabilized and has even grown somewhat. The CEA's insurance products are considered expensive, and as rates increase, it will be even more of a challenge to retain policyholders.
- Staff has been examining an interesting characteristic of insured earthquake losses: Analysis suggests that losses will exceed 50 percent of the value of an insured structure in only one percent of the events. The CEA's current pricing structure seeks to insure a hundred percent of the events, a hundred percent of the time—this approach forces the CEA into heavy reliance on high-cost reinsurance. Staff is looking at redesigning the financial structure, based on the analysis mentioned, and CEA products are also being closely analyzed to see whether both premium and deductible can be meaningfully reduced.
- Because of the priority of these time-consuming efforts, the strategic planning process will not be completed until 2009.

Mr. Richison provided his financial report:

- Capital available to pay claims at the end of June 2008 was just over $3 billion.
- Investment yields are just under three and a half percent, compared to just over five percent a year ago.

4. 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.

- Mr. Zuber told the Board it is time to renew the Directors & Officers and Employment Practices Liability insurance policy. This renewal will be the third with the present carrier. The annual premium has remained flat, and the coverage appears satisfactory. The insurance covers Board members and Advisory Panel members, as well as CEA officers and employees.

  MOTION: Mr. Rosenstiel moved approval of expenditure, seconded by Mr. Poizner. Motion carried unanimously.

5. Chief Financial Officer Tim Richison will present, and seek Board approval of the CEA's 2009 Reinsurance Program, the commencement date of which will be December 1, 2008. If the Board approves the 2009 Reinsurance Program as requested, Mr. Richison will seek Board approval to terminate the CEA's 2008 Reinsurance Program, effective December 1, 2008.

- The Board packet includes claim-paying capacity options for 600- and 500- year levels. In addition, staff has developed a third option for a 520-year-capacity; the 520-year capacity option would cost the CEA the same amount as it was obligated to pay for the 2008 reinsurance program, and in fact represents the maximum capacity at a cost level with that of 2008.
- Purchasing reinsurance at a 1-in-500-year level capacity would cost the CEA less than it is spending for reinsurance in 2008; purchasing reinsurance at a 1-in-600-year capacity would cost the CEA significantly more than it is spending for reinsurance in 2008.
- Between 2002 and 2008, the reinsurance program was established so as to provide an "overlap" with the first industry assessment layer. This overlap was put in place to provide sufficient capital for second-earthquake-event protection for the CEA, in case (for example) a participating insurer was unable to meet its required participating-insurer post-event assessment.
- The first industry assessment layer will sunset on December 1, 2008, and the only financial structure and capacity that would provide the same kind of overlap is the 1-in-600-year level—that level would provide a $200 million overlap. Neither the 1-in-500-year nor the 1-in-520-year level has an overlap feature.
- The reinsurance premium for the three options are as follows:
  - Option 1 (1-in-600 year level) represents a $3.5 billion reinsurance capacity for a premium of $213 million.
  - Option 2 (1-in-500-year level) represents a $3 billion reinsurance capacity for a premium of $179 million.
  - Option 3 (1-in-520-year level) represents a $3.1 billion reinsurance capacity for a premium of $184 million.
- Staff recommends the 1-in-520 year reinsurance program: $3.1 billion in reinsurance capacity, with an annual premium of $184 million.

Mr. Kelso asked for comments on the potential rate impacts of each of the three options. He also asked staff if there was a potential for rating agency concern.

- Mr. Richison responded that Option 1, the 1-in-600 year claim-paying capacity structure, would create a potential need for rate increases amounting to somewhere between five and eight percent. Option 2 would cost slightly less than the current reinsurance premium, while Option 3 would cost about the same. He stated that the current indication was that the A.M. Best financial strength rating of A-minus (Excellent) would be maintained.

Mr. Poizner asked about the procedure for getting multiple brokers to get multiple quotes.

- Mr. Richison explained that in July, he and Mr. Pomeroy had met with all the major reinsurers to explain the CEA, the desired capacity, and the proposed reinsurance programs. The reinsurers came back to the CEA with their prices, which this was significantly high, from seven and a half to over ten percent rate on line. The CEA's reinsurance broker team and the CEA went back to the reinsurers to get them to understand the program a bit better, all in an effort to try and bring the prices down. CEA and the broker team worked reinsurers independently to provide the proposed reinsurance capacity now depicted in the three options. This was a different process this year than in past years, and it worked well in obtaining the capacity at the lowest price.
- The CEA's broker team is led by Benfield, with associate brokers Guy Carpenter and Aon Re; the team has been in place for seven years, but their contracts expire in December 2008 and CEA staff is in process of getting a new broker team.
- Mr. Poizner asked what the minimum criteria are with respect to reinsurer creditworthiness. Mr. Richison replied that to participate on the CEA reinsurance program, a reinsurer must have at least $150 million in surplus and maintain a minimum A-Minus rating by either A.M. Best or Standard & Poor's. These criteria are monitored when the CEA markets the annual reinsurance program and while the reinsurance contracts are in place.

Mr. Rosenstiel asked if anything could be done to increase the likelihood that the CEA could grow its capital faster.

- Mr. Richison said that if the CEA financed its capacity without reliance on reinsurance, the CEA premium rates could go down. As rates go down, the percentage of each premium dollar that goes into CEA capital would increase, but with lower rates, premium revenue would naturally decrease. The best way to increase capital is to put in place a financial structure that relies less on risk-transfer products such as reinsurance. A significant issue for the CEA now is retaining its existing policyholders—if rates increase, the CEA will probably lose customers.

MOTION: Mr. Rosenstiel moved adoption of the written resolution provided by staff, which proposes a CEA reinsurance capacity of 1-in-520-years; seconded by Mr. Poizner. Motion carried unanimously.

MOTION: Mr. Poizner moved adoption of the accompanying written resolution authorizing early termination of the CEA's 2008 reinsurance contracts; seconded by Mr. Rosenstiel. Motion carried unanimously.

6. Assistant Chief Financial Officer Mark Dawson will brief the Board on the now-completed CEA fiscal-year 2007 audit by the CEA's independent auditors, PricewaterhouseCoopers; representatives of that firm will address the Board to elaborate on their written audit report.

- Mr. Richison stated that this item had been withdrawn, because the CEA's independent auditors have not yet presented their report.

7. Director of Communications and External Affairs Chris Nance will describe the CEA's response and public outreach following the July 29th (2008) Chino Hills earthquake in the Greater Los Angeles area and provide further updates on the ongoing and planned CEA marketing and market research activities, including plans to participate in the "Great Southern California ShakeOut" in November 2008.

- Mr. Nance reported on the Chino Hills earthquake of July 29, 2008. It was first reported as a 5.8 magnitude but it was later downgraded to 5.4. Staff had determined that about 240,000 CEA policyholders had felt this earthquake.
- It appears that there was about $10 million in damage, while the CEA has received fewer than 200 claims.
- As a result of information it received within the first 24 hours following the event, CEA staff developed a media plan that would play out in two different ways: remind CEA policyholders to contact their agent or company if they wanted to make a claim, and advise consumers who do not have earthquake insurance contact their agents or companies for more information.
- Approximately $115,000 was spent to support claim-related advertising, while $176,000 was spent to support the "preparedness" advertising. Both amounts were substantially less than originally anticipated and planned.

MOTION: Mr. Rosenstiel moved for ratification of the enumerated expenditures; seconded by Mr. Poizner. Motion carried unanimously.

- Mr. Nance reported that "The Great Southern California ShakeOut," which will take place throughout Southern California in November 2008, will be the largest earthquake drill in the history of the United States, potentially reaching as many as 22 million people.
- There will be an event simulation tied in to the Golden Guardian statewide emergency response, and an international conference and a rally, both sponsored by the City of Los Angeles.
- This will be an opportunity to educate people, as well as to collect feedback for future products, programs, and planning.
- CEA staff is planning a three pronged marketing approach: direct mail, paid media, and in-store media to generate attention to preparedness and create sales leads for agents and insurance companies that want to sell earthquake insurance. Each of these approaches will offer free starter preparedness kits.
- This program has a planned budget of $660,000.
- The event will reach the greater Los Angeles area, including the Inland Empire and Orange County.

MOTION: Mr. Poizner moved approval of the action recommending use of existing mitigation funds and the transfer of the required printing expense to marketing funds to support CEA marketing during The Great Southern California ShakeOut; seconded by Mr. Rosenstiel. Motion carried unanimously.

8. Mr. Dawson will present information to the Board in support of augmentations to, and expenditure reclassifications for, the 2008 CEA budget.

Mr. Dawson requested the Board's approval of augmentation to and expenditure reclassifications to the 2008 CEA budget as follows:

- Initially the Board had approved $2 million for the CEA's new data system. That expenditure was classified as Data Management Services but should be reclassified as Assets Over $500.
- Reclassify $320,000 from Administration and Office: $300,000 to Marketing and Outreach and $20,000 for Marketing Services.
- Move $300,000 from Contracted Services to Consulting Services.

MOTION: Mr. Rosenstiel moved for reclassification; seconded by Mr. Poizner. Motion carried unanimously.

Mr. Dawson presented the proposed budget for the Chino Hills earthquake, which includes overtime and travel pay for the CEA's earthquake-response manager to visit sites near the earthquake epicenter. It also included the media buy to advise CEA policyholders to report any damage, either to their insurance agent or insurance company. Mr. Richison stated that bringing post-event expenses to the Board after the event and after at least some of the expenditures have been made is a normal, Board-approved process and in this case represents an increase in the CEA's annual budget for the current period.

MOTION: Mr. Poizner moved adoption of the post-event Chino Hills Earthquake budget; seconded by Mr. Rosenstiel. Motion carried unanimously.

9. Public comments 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.

10. Adjournment

- The meeting was adjourned at 2:32 p.m.