

**CALIFORNIA EARTHQUAKE AUTHORITY
GOVERNING BOARD MEETING
MINUTES**

**Thursday, December 8, 2011
1:00 P.M.**

Location: CalSTRS Headquarters Building
Board Room
100 Waterfront Place
West Sacramento, California

Members of the Governing Board in attendance:

Dave Jones, Insurance Commissioner
Pedro Reyes, designee of Governor Jerry Brown
Grant Boyken, designee of State Treasurer Bill Lockyer
Reid McClaran, designee of Insurance Commission Dave Jones
Deborah Doty, designee of Speaker of the Assembly John Pérez
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
Bruce Patton, Director of Policy, Research, and Special Projects
Michael Melavic, Director of Information Services
Marc Keller, Acting Governing Board Liaison
Danny Marshall, General Counsel

Also Present:

Wayne Coulon, Chair, CEA Advisory Panel

- 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 October 27, 2011, Governing Board meeting.**
 - Mr. Boyken moved to amend the October 27, 2011, minutes to clarify that he did not request that salaries or action on compensation of contract employees be reported on the CEA Web site but that they be reported in open session of a CEA Board meeting.

MOTION: Mr. Boyken moved approval of the October 27, 2011, Governing Board minutes, as amended above; seconded by Commissioner Jones. 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.

- Mr. Pomeroy reported on the visit by CEA staff to the area of Oklahoma where a 5.6 earthquake had occurred. He noted that Oklahoma is a state most wouldn't regard as having a high risk for seismic activity, but that it certainly isn't a stranger to it either. Mr. Pomeroy said he met with families who were affected by the earthquake, both those with earthquake insurance policies in force and those without. He said that Oklahomans without earthquake insurance were in a "tragic predicament," but their predicament should help to remind us in California of CEA's responsibility and mission to continue efforts to get Californians—only 12 percent of Californians with fire insurance also carry earthquake insurance.
- This topic led to Mr. Pomeroy's highlighting the CEA's efforts to support and advocate passage of the Earthquake Insurance Affordability Act in Congress. Those efforts are greatly helped by two new co-sponsors of the legislation in the U.S. House of Representatives, Congress Members Elton Gallegly and Dan Lungren.
- Mr. Pomeroy noted that phase two of the CEA's "IS Improvement Project" has been completed, allowing the CEA to move into phase three.
- The CEA has begun presenting an every-other-month webinar with CEA participating insurers. The next webinar is tentatively scheduled for January 26, 2012.
- Mr. Pomeroy informed the Board he completed his performance appraisal of CFO, Tim Richison; the evaluation produced a positive result.
- Mr. Pomeroy outlined the CEA's accomplishments for 2011:
 - There is tremendous depth at the CEA, with a broad collection of talented colleagues.
 - CEA's financial strength has been enhanced by combined efforts of the CFO's team and the legal team, most recently with the new CEA transformer reinsurance program. Reducing reinsurance rate on line reduces CEA's expenses.
 - CEA's investment management process has been strengthened.
 - A 12.5 percent statewide-average rate reduction for CEA policyholders goes into effect on January 1, 2012.
 - The CEA will roll out greater product choices for consumers through the CEA Homeowners Choice program.
 - CEA has achieved an important milestone in obtaining additional insurance expertise with the completion of Phase 2 of the IS Improvement Project.
 - The integrated, annualized statewide marketing plan has advantageously positioned CEA to move forward.
- Some of the CEA's activities planned for 2012 are:

- CEA's investment accounting software will be upgraded and integrated into a best-practices-based investment-compliance program.
- CEA will continue its push into the capital markets, which brings concomitant advantages of risk diversification.
- CEA will continue working to establish a centralized data-processing system, able to accomplish what is currently done by 18 different, disconnected systems.
- CEA's HR resources will continue with further enhancement, matching the complexity of our organization to the HR effort.
- CEA will continue to focus on overall IT policy and planning, which is so basic to all CEA efforts.
- The CEA's Communications Department will continue its work to establish a responsible social-media strategy and an influential online marketing plan.
- The CEA Chief Mitigation Officer will lead, as executive director, in launching the California Residential Retrofit Program in conjunction with the experts at the California Emergency Management Agency.
- The research arm of CEA will continue to ramp up efforts to develop an actuarially sound, science-based mitigation premium discount.
- And CEA will continue to work strategically to secure the enactment in Congress of the Earthquake Insurance Affordability Act.

Mr. Pomeroy concluded by acknowledging that the CEA has just celebrated its 15th anniversary, having opened for business on December 1, 1996.

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

- Mr. Richison stated that as of the end of September 2011, the CEA's available capital to pay policyholder claims was almost \$4 billion.
- Total CEA claim-paying capacity as of the end of September 2011 was almost \$9.7 billion.
- CEA anticipates a slightly higher return on investments in 2011 than in 2010.

5. Mr. Richison will present and seek Board approval of the proposed CEA risk-transfer program for 2012, which may include diversifying measures such as contracts for additional transformer insurance.

- Mr. Richison recommended to the Board that the CEA bifurcate its risk-transfer program (into Risk-Transfer Programs A & B) to avoid having the entirety of its risk-transfer contracts (approximately \$3 billion) becoming effective January 1, 2012.

The first risk-transfer program (Program A) was \$1.5 billion in reinsurance limit, approved by the Governing Board at its October 2012 meeting.

The second risk-transfer program (Program B) will be approximately \$1.2 billion in reinsurance limit and will be effective April 1, 2012.

- CEA staff recommends spreading the effective dates of the CEA risk-transfer program through the year, by using multi-year contracts, which will provide reasonable protection from fluctuating prices and capacity for the CEA.
- More than 80 reinsurers worldwide participate in CEA risk-transfer Programs A and B.
- Program B, now being proposed for Board approval, would commence on April 1, 2012, and run through March 2013.
- Mr. Richison asked the Board to approve a further transformer-reinsurance transaction. This proposed transaction would be lower (i.e., in a higher-risk position) in CEA's risk-transfer programs than program A or B of traditional reinsurance. CEA staff proposes what would become CEA's second transformer reinsurance contract at a limit of "up to" \$300 million, allowing staff more flexibility in pricing.
- Mr. Marshall presented a resolution to the Board containing two parts: traditional-reinsurance contracting and transformer-reinsurance contracting.

MOTION: Mr. Boyken moved that the Board support the resolution before them, seconded by Commissioner Jones. Motion carried and approved unanimously.

6. CEA Advisory Panel Chair Wayne Coulon will summarize the proceedings at the November 17, 2011, Panel meeting.

- Panel members were introduced to two new members of the CEA staff, Insurance Director Mitch Ziemer and Director of Policy, Research, and Special Projects Bruce Patton.
- Mr. Coulon stated that Mr. Nance provided the Panel with an in-depth review of the CEA's marketing value program, as well as the California ShakeOut Drill.
- The Panel had a lengthy discussion about product and program enhancements, particularly the issue of presenting the new CEA Homeowners Choice program to the California consumer.
- Another lengthy discussion was held on the PwC Organization and Staffing Report. The Panel hopes that the CEA can move ahead with some of the easier-to-implement recommendations, those that do not require legislation.
- The Panel accepted the proposed calendar for Advisory Panel meeting dates for 2012.

7. Chief Mitigation Officer Janiele Maffei will update the Board on the CEA's mitigation program, including its participation in the California Residential Mitigation Program.

- Ms. Maffei stated that the first meeting of the California Residential Mitigation Program ("CRMP"), a joint powers authority, was held; she was appointed executive director.
- CRMP hopes to launch residential-retrofit pilot programs in early 2012.

- Ms. Maffei spent a week in Christchurch, New Zealand, which has suffered an unprecedented series of damaging earthquakes. Because the majority of homeowners there are insured, it's an incredible, CEA-relevant "lab" for study and research.
- Ms. Maffei showed slides of the earthquake damage in Christchurch and discussed three types of damage incurred.
 - First and foremost is damage from ground-shaking.
 - The second kind of damage is liquefaction, water flowing into the pores of the soil, turning it to liquefied soil comparable to quicksand.
 - The third kind of damage is lateral spreading, essentially a horizontal avalanche.

Areas where liquefaction occurred have been red-zoned, and residents are not allowed to rebuild there; many are being bought out by the government.

Mitigation for lateral spreading is possible only on a community or a municipal level.

8. Mr. Pomeroy will update the Board on the status of the CEA organization and staffing analysis, and following that update and discussion, will seek Board approval to begin to implement certain, identified provisions of the related consultant's report.

(Mr. Pomeroy first noted that he would combine agenda items 8, 9, and 10).

- Mr. Pomeroy proposed retaining the services of well known consulting firm CPS, to come in and study the recommendations by PricewaterhouseCoopers in its written organization and staffing analysis, and then offer CPS's views on how CEA might best proceed.
- With the Board's approval and the engagement of CPS, CEA would then bring to the February 2012 Board meeting thoughts on proposed changes to the CEA.
- Commissioner Jones stated he had been prepared to vote on all the original, un-combined agenda items, but would defer to the wishes of the Chair on that matter.
 - Chairman Reyes said that he appreciated the views, but that he would need more time to work through some of the potential issues that were now before the Board.
 - Mr. Boyken, however, also stated he was ready to vote on the original agenda items.
- Commissioner Jones said he wanted the Board to be mindful that if legislation is required to implement recommendations to the Board, the Board may need to act before the next CEA Board meeting, in order to accommodate the Legislature's schedule.
- Mr. Pomeroy said he sensed that the Board agreed that a CEA staffing challenge does exist, but the Board was searching for consensus on how to deal with it.
- Commissioner Jones recommended introducing a spot bill, and if the Board reaches an agreement on how to proceed, the CEA could move forward with legislative changes.

- **MOTION:** Commissioner Jones moved that the CEA move forward with a spot bill, pending agreement of the Board on whether and how to move forward; seconded by Mr. Boyken. Motion carried on a 2-0 vote, with one abstention (ayes, Insurance Commissioner and Treasurer; abstain, Governor).

9. Mr. Pomeroy will request the Board’s authorization to recruit and hire a Chief Information Officer (“CIO”), which process would begin to implement certain, identified provisions of the related consultant’s report.

(No separate discussion—combined with Agenda Item 8.)

10. Mr. Pomeroy will request the Board’s authorization to hire or engage the services of a Human Resources Executive, which process would begin with a competitive procurement to select a search firm to assist in identifying qualified candidates and/or firms.

(No separate discussion—combined with Agenda Item 8.)

11. Mr. Pomeroy, assisted by Information Services Director Michael Melavic, will present for Board review and approval plans to implement the next phase of the “CEA Information Services (“IS”) Effectiveness Plan,” which, as recommended by staff, would begin with contracting for the services of the consulting firm selected to lead the project following the competitive-procurement process.

- Mr. Pomeroy introduced Mike Melavic, CEA Information Services director, to discuss phase three of the IS Improvement Project, also known as the IS Effectiveness Plan.
- Mr. Melavic stated that a three-phase plan was developed to deal with the findings from the financial audit two years ago.
 - Phase one was to employ the services of the consulting firm Protiviti to develop a plan to take CEA through the first two years.
 - Phase two is to become “audit-ready,” and that has been completed.
 - Phase three is about portfolio- and project-management enhancement, with Protiviti helping CEA move forward. CEA’s executive management and information-services staff also wants to make information services transparent.

Staff asked the Board approve Mr. Pomeroy’s moving forward with negotiating a next-phase contract with Protiviti, selected competitively, (with an expenditure cap of \$750,000) and then executing that contract on behalf of CEA.

MOTION: Mr. Boyken moved to approve staff’s recommendations, seconded by Commissioner Jones. The motion passed unanimously.

12. Mr. Pomeroy will present the 2012 CEA Business Implementation Plan for Board consideration and approval.

Mr. Pomeroy reported that he would combine agenda item’s 12 and 13, as the Business Implementation Plan (BIP) is the framework for the work the CEA plans for 2012, which in turn will be supported by the proposed budget.

Mr. Pomeroy highlighted the major goals in the 2012 CEA BIP.

- Goal one - provide excellent customer service and process claims promptly.
- Goal two - maintain appropriate financial strength.
- Goal three - continue to develop CEA's insurance products, in order to offer the most valuable coverage at the most affordable price.
- Goal four – determine the most effective CEA governance, including optimized use of the CEA Advisory Panel.

13. In support of the 2012 CEA Business Implementation Plan, Mr. Pomeroy and Mr. Richison will present the 2012 CEA budget for Board consideration and approval.

The proposed budget for 2012 calls for \$330.5 million in spending, broken down into two segments: operating expenses of \$11.4 million and all other expenses of \$319 million.

State law caps the CEA's operating expenses at no more than three percent of premium income. The proposed 2012 budget of \$11.4 million is well within the three percent cap and represents a 13 percent reduction from 2011's operating expense budget of \$12.3 million.

As 2011 draws to a close, the CEA will once again come in under budget. CEA projects actual expenses for 2011 to be around \$10.8 million, 88 percent of what the Board initially approved for 2011.

The proposed 2012 budget of \$11.4 million represents a \$600,000 (or 6 percent) *spending* increase, in the following categories: salaries and benefits, and administration and office expenses.

To support the two positions filled last month (Insurance Director and staff counsel), an addition to the salary and benefit line is needed.

Administration and office expense shows an additional \$146,000 for 2012: The CEA must purchase litigation-management and investment-compliance software.

There is an additional \$100,000 for EDP hardware and software, to allow the CEA to purchase EQECAT's earthquake-modeling software and run it internally, which would allow the CEA's chief actuary to do analytics much more efficiently and rapidly than in the past.

The proposed 2012 budget represents a relatively modest increase over actual expenditures for 2011. This budget is a base budget, which means that staff might come back to the Board with additional augmentations as the year rolls on.

The majority of the CEA's overall budget—\$319 million, or about two-thirds of the CEA's overall budget—is consumed by the cost of risk transfer. For 2012, some \$200 million is budgeted for this purpose.

Mr. Richison presented charts showing actual and projected expenses for 2011 and explained how those data were used as building blocks in developing the proposed 2012 budget

MOTION: Commissioner Jones moved to approve the staff's recommendation to approve the 2012 Business Implementation Plan and the 2012 proposed CEA Budget; seconded by Mr. Boyken. The motion passed unanimously.

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

There was no closed session.

Mr. Pomeroy brought to the Board's attention that Mr. McClaran would be retiring at the end of the year. He thanked him for all his hard work and professionalism.

Mr. Marshall also acknowledged Mr. McClaran for his hard work and deep skills, and congratulated him on his retirement.

Insurance Commissioner Jones acknowledged Mr. McClaran and his accomplishments with the CEA and the State of California.

Mr. McClaran thanked everyone and expressed his satisfaction at having worked with the CEA over many years.

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 was no public comment.

16. Adjournment.

The meeting was adjourned at 2:37 p.m.