CALIFORNIA EARTHQUAKE AUTHORITY
GOVERNING BOARD MEETING
MINUTES

Thursday, February 28, 2013
1:00 P.M.

Location: CalSTRS Headquarters Building
Board Room – Lobby, E-124
100 Waterfront Place
West Sacramento, California

Members of the CEA Governing Board in attendance:

Pedro Reyes, designee of Governor Jerry Brown
Grant Boyken, designee of State Treasurer Bill Lockyer
Chris Shultz, designee of Insurance Commissioner Dave Jones
Deborah Doty, designee of Speaker of the Assembly John Pérez

Members of the CEA staff in attendance:

Glenn Pomeroy, Chief Executive Officer
Tim Richison, Chief Financial Officer
Bob Stewart, Chief Operations Officer
Shawna Ackerman, Chief Actuary
Janiele Maffei, Chief Mitigation Officer
Chris Nance, Chief Communications Officer
Bruce Patton, Director, Policy, Research & Special Projects
Susan Pitton, Board Liaison
Danny Marshall, General Counsel

Also present:

Wayne Coulon, Chair, CEA Advisory Panel

1. **The meeting was called to order at 1:01 p.m. A quorum was achieved.**

2. **Consideration and approval of the minutes of the December 13, 2012, and December 31, 2012, Governing Board meetings.**

   MOTION: Mr. Boyken moved approval of the December 13, 2012, and December 31, 2012, Governing Board minutes; seconded by Mr. Shultz. 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 emphasized the importance to the CEA of proceeding with the federal proposal in Washington D.C. In the new Congressional session, CEA staff still finds strong support within the California delegation, but staff will work with sponsors to consider any needed enhancements to the existing legislative proposal for purposes of reintroduction.

The Chief Information Officer recruitment efforts have restarted, after the previous top candidate withdrew. Mr. Pomeroy noted that in August 2012 the Board had delegated to the CEO the responsibility of negotiating and contracting for the CIO position, with the assistance of the CEA General Counsel. New advertising of the position will be consistent with earlier efforts, when the CEA published an annual-salary range of $185,000 to $225,000.

Mr. Reyes said he was comfortable with the Board's providing the same authority to Mr. Pomeroy, and he preferred to stay within the specified salary range and not go beyond it. Mr. Shultz agreed, noting that hiring a CIO before the May 23 Board meeting would be a positive for both the organization and the participating insurers. Mr. Boyken agreed, as did Ms. Doty.

Mr. Reyes stated that a legislative provision to eliminate the present statutory cap of 25 civil service positions for the CEA is making its way through the Legislature; it should appear in a trailer bill.

Mr. Pomeroy noted that the CEA is again rolling off part of the industry assessment layer, the portion of CEA capacity for which CEA participating insurers (PIs) are contingently liable. Since its inception, the CEA's accumulation of capital and financial management have together dramatically reduced the amount PIs' collective surplus that is exposed to California earthquake risk. Before the CEA was formed, PIs' capital exposure to earthquake risk was essentially unlimited, but with CEA, the exposure is both limited and decreasing rapidly with time and additional CEA capital accumulation.

After the upcoming roll-off, that exposure will be reduced substantially, to under $2 billion. Mr. Pomeroy noted that the exposure is now shared by a new PI, Nationwide, which joined the CEA last year.

The potential for attachment of the contingent exposure has also been dramatically reduced, now standing at $8 billion before attaching—at some point in the near future, the topmost industry assessment layer will disappear altogether.

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

- Staff has devised a new format for the financial report, organizing it into financial statements, budget, investments, debt, claim-paying capacity, and risk-transfer programs, followed by policy, premium, and exposure.

- Cash and investments for the year grew $295 million, even with premium down. In 2011, the CEA had written premiums of $612 million. For 2012, the CEA had premiums of $569 million, $43.5 million (or 7.11%) below 2011—much of the decrease is attributable to the substantial rate decrease the CEA put in place, effective January 1, 2012.

  - Consistent with the downward revenue trend, 2011's $275 million underwriting gain slipped to $236 million in 2012, a 13.94% decrease.

  - Staff will continue to update the Board on gross written premium, watching to see if the revenue decline is short-lived or may continue.

- Budget expenses for November and December came in a little higher than anticipated. But for the first time, staff used almost 96% of the budget proposed to the Board, so improvement has been made on the budget processes.

- The CEA was significantly under budget in its mitigation program, mostly in salary and contracted-services expense. As Ms. Maffei rolls out the CRMP program, however, the expenses should go up a bit.

- The CEA ended the year with investment income at $18.4 million, due in part to a conservative investment policy. (In part, the reported figure is the result of a change in accounting in 2009, when under GASB rules, the CEA had to begin to account for "unrealized gains and losses." The CEA uses careful procedures to monitor the CEA's investment managers, who work hard to ensure the best execution while buying at the best possible price.

- Mr. Richison showed the Board and the public information on the CEA investment portfolio as of year-end 2012, showing long-term and short term investments with cash equivalents. He explained the investment categories and the principle of laddered investments, aimed at preventing liquidation losses in the event of an earthquake's causing an unplanned cash need. Staff conducts an annual loss scenario exercise with CEA's investment managers to determine whether the current mix of maturities is correct.

  - The available-capital report showed $4.2 billion, which would go toward paying policyholder claims.

  - The 2012 year-end financial structure showed a total capacity of over $10.1 billion. The CEA's A.M. Best rating of A- had been added.

- The risk-transfer-program graphic conveys limits, contract type and term, 12-month rates-on-line, and 12-month premiums. The graphic shows both traditional and transformer reinsurance.

- A new chart breaks down reinsurance at year-end 2012 between traditional and non-traditional.

  - 80% of CEA's reinsurance contracts are of a one-year duration, while 20% are multi-year.

  - Multi-year contracts aid the CEA in post-event scenarios and provide diversification, especially with variable contract dates for risk-transfer; diversification makes the CEA more viable post-earthquake.

- CEA reinsurance consists of 75% traditional (non-collateralized) and 25% collateralized, which breaks into two components: collateralized "non-traditional" (or transformer) and traditional. CEA Senior Counsel Joe Zuber has worked hard to help perfect a collateral-account-control agreement that CEA consistently uses in conjunction with collateralized contracts to require, as with CEA's long-term investments, collateral to consist of either cash or U.S. Treasuries.

- The CEA's risk-transfer as of January 1, 2013, has increased by $170 million.

- A new chart shows average risk-transfer-program rates for five years. In 2011 and 2012, average rates-on-line decreased, helped by the transformer transactions. Staff makes major efforts to ensure appropriate pricing for all CEA risk-transfer products and programs.

- A bar chart shows total policies and total insured value. During 2012, CEA's total insured exposure increased by 16.5%, while policy count was up by 20,000 (2.5%).

- Additional charts show trends for homeowners, mobilehomes, condominium owners, and renters policies:

  - In 2012, homeowners policies increased 1.9%, while mobilehomes were up 3%, condominiums up 1.8%, and renters up 13.4%.

Mr. Shultz inquired about the expiration of CEA reinsurance program's "Contract B" and whether Mr. Richison thought that the existing delegation by the Board of authority to the CEA staff was sufficient consummate the contract, with staff to inform the Board about the transaction at the May 2013 meeting? Mr. Richison replied that staff would report to the Board rather than wait to request approval; he said he would keep the Board informed during the process.

5. Mr. Richison will present to the Board a risk-transfer-program strategy for 2013.

Mr. Richison presented a 12-month risk-transfer strategy covering both traditional and transformer programs.

While the rating agencies have pegged CEA capacity to a 500-year level, staff has sought to widen the range of acceptable capacity, from 1-in-450 to 1-in-600. Of course, staff wants to ensure that CEA has capacity to pay all claims, not only 100% of claims for the first event but for a second claim that might occur shortly after the first.

MOTION: Mr. Shultz moved approval of the 12-month risk-transfer strategy outlined above; seconded by Mr. Boyken. Motion passed unanimously.

6. Chief Communications Officer Chris Nance will seek Board approval of a Cooperative Marketing Venture, designed to permit the CEA and each of its participating insurers to work together toward the same ends by promoting both the CEA's and the participating insurers' insurance products.

Mr. Nance stated that the Cooperative Marketing Venture (CMV) concept evolved from the Marketing Value Program (MVP), which in turn was based on marketing, branding, and message research and additional work with policyholder preferences. For budget, staff has used industry standards for sales and retention, then focused on bolstering agent and media relationships and brought a new brand to the marketplace.

In 2012, programming was working as intended:

- Staff increased agent and media value through registration and training.
- Advertising was working.
- The online marketing strategy was also working: consumer Web-site traffic quadrupled.
- The most exciting initiative was the co-branding with the American Red Cross.

The CEA still faces significant market-environment and sales-channel challenges.

- California has been affected by the global economic downturn.
- Californians still believe the government will pay to help repair earthquake damage.
- Californians believe that earthquake damage will be covered by their homeowners policy.
- Social scientists have found that people believe earthquake damage "will not happen to them."
- Damaging earthquakes occur infrequently.
- Some marketing challenges are beyond CEA control—for example, the mandatory-offer that is written to satisfy state law rather than advance a marketing strategy.
- CEA policy sales bring exposure to PIs – that point factors into PI decisions about how they interact with the CEA on shared marketing programs.
- CEA earthquake policies are joined to homeowners policies, whose sales volume may go down for business reasons unrelated to the CEA.
- Many PIs have more products than resources to promote them.

- The CEA Web site does not yet have in place a “digital handshake,” which would enable a consumer to pursue the purchase of earthquake insurance. The CEA has no current ability to establish a *direct CEA-policy sales lead* from potential CEA policyholders who visit the CEA’s Web site.

The most efficient use of CEA resources would be to establish that digital handshake between the CEA Web site and PI Web sites through use of a Cooperative Marketing Venture. Staff is studying the concept to permit and encourage the CEA to work cooperatively with its PIs to promote both CEA’s its products and theirs.

Through a CMV, the PIs would receive pay nothing to receive targeted, message-specific advertising and promotion to generate sales leads, not only for earthquake insurance but for their own products.

The CEA would extend its programming through co-branded advertising, the presence of the CEA on the PI Web sites, and the opportunity to push its own messages to people who are considering the earthquake product. This would be accomplished through an online lead-generation campaign.

Mr. Nance emphasized that staff was seeking assurances that the Board not only supports, but approves, this concept. He asked that the Board approve the CEA CMV concept based on three cornerstones for developing the CEA’s 2014 MVP:

1. Allocate CEA CMV funding according to the current percentage of CEA-earthquake-insurance policies sold by the respective PIs.
2. Share programming between the CEA and its PIs that projects available budget plans, places media buys, develops co-branded creative templates and online pages, and integrates IT teams to place co-branded marketing assets and links.
3. Enable the CEA to share sales links to allow PIs to convert people considering earthquake insurance into new CEA policyholders under a budget developed according to industry standards.

Mr. Nance said that if the Board approves these recommendations, staff would present its budget for 2014 at the May meeting, meantime working with PIs to identify those that want to participate with CEA in the CMV concept.

Mr. Nance reported that there will be protocols set in place, with assistance from Mr. Marshall.

There are two prongs to this approach.

1. The CEA will develop turnkey programming that integrates input from the PIs, resulting in a campaign the CEA is responsible for producing.
2. The same protocol documents would be central to driving this scenario, if the CEA shares ownership in the final product should a PI produce the campaign.

Mr. Reyes asked if the allocation for the CMV according to the current percentage of the CEA is within existing budget or is a significant budget augmentation. Mr. Nance responded that staff believes the 2014 budget would be similar to the budgets for the past two years. While direct-mail dollars might move to CMV, the net takeaway is that the total budget amount will not change and no dollars would be sought above it to support the CMV.

Mr. Shultz asked about a scenario where a PI chooses not to participate: Would staff be back to reallocate the budget from that PI's share of the marketplace? Mr. Nance explained that the percentage would be rolled back into traditional advertising and promotion.

MOTION: Mr. Boyken moved approval of the Cooperative Marketing Venture concept with the three cornerstones, as listed; seconded by Mr. Shultz. Motion passed unanimously.

7. Mr. Nance will seek Board authorization to amend the current contract with Natoma Technologies, Inc., to increase the development and quality-assurance resources needed to support CEA programs at the levels approved in the 2013 CEA budget.

Mr. Marshall stated that the CEA has worked with Natoma Technologies for over five years of a six-year contract, which expires at the end of 2013. The contract contains an expenditure limit that is $300,000 shy of being exhausted, and the CEA still has work for Natoma to accomplish. But the spending-rate exhibits to the contract do not appear to contemplate money being spent in 2013, despite remaining time available in the contract.

The work for Natoma Technologies involves the MVP and the CEA's claim-system stress testing that the Operations and IS groups are conducting.

Mr. Marshall explained that the Board had already approved spending $200,000 on Natoma projects in its approval of the 2013 budget, so a simple amendment could be handled in-house (i.e., without further Board approval) as long as the Board was comfortable with handling it that way. The Board agreed that such an amendment could be handled in-house.

8. Mr. Nance will seek Board approval of a 2013 budget augmentation to support the printing of new CEA insurance-policy brochures.

Mr. Nance stated that although 30,000 brochures remain in stock, staff anticipates needing about 60,000 new brochures that describe new CEA products. Staff seeks a $65,000 2013 budget augmentation to pay costs of printing new brochures.

MOTION: Mr. Shultz moved approval of the 2013 budget augmentation to the CEA insurance operations budget; seconded by Mr. Boyken. Motion passed unanimously.

9. CEA Advisory Panel Chair Wayne Coulon will provide a summary of the proceedings of the January 17, 2013 Panel meeting.

- The Advisory Panel welcomed new member Rose Conroy, appointed by Governor Brown. The Panel is now at full strength.

- For some time the Advisory Panel has supported the Earthquake Insurance Affordability Act and understands that efforts will continue to gain sponsorships, both in Congress and in the business community.

- The Advisory Panel unanimously endorsed support of legislation to eliminate the Insurance Code limitation of 25 civil service positions for the CEA.

- The Advisory Panel reviewed the Claim Reimbursement Project with the Claim Manager.

- The Advisory Panel is evaluating and shuffling the Business Implementation Plan (BIP) assignments.

- The Advisory Panel is now following a quarterly meeting schedule, holding BIP committee meetings as appropriate.

10. Assistant Chief Financial Officer Mark Dawson will seek Board authorization to set the CEA participating insurers respective maximum-earthquake-loss funding-assessment levels, effective April 1, 2013.

Mr. Dawson reported that staff had an annual recommendation for:

- Approving the calculations for the roll-off of the "new industry assessment layer."
- Increases in both the "second" and "new" assessment layers to account for the addition of Nationwide as a CEA participating insurer.
- Approval of calculations of the loss-assessment shares for each participating insurer and communication to them of the assessment.

MOTION: Mr. Shultz moved approval of the staff recommendation to set the CEA participating insurers respective maximum-earthquake-loss funding-assessment levels; seconded by Mr. Boyken. Motion passed unanimously.

11. Chief Mitigation Officer Janiele Maffei will update the Board on the California Residential Mitigation Program (CRMP) incentive program.

Ms. Maffei reported that staff has completed the RFP process for auditor, Web-site developer, and insurance services provider. And staff is in process of scheduling interviews with special inspection, pilot program evaluation, and marketing and PR services.

When the CRMP team is put together, staff can roll out the program. A JPA board meeting is scheduled for March 19, 2013. Then staff will move directly into developing the Web site and marketing/strategy materials, and launching the pilot program.

12. Ms. Maffei and Director of Policy, Research and Special Projects Bruce Patton will report on the CEA-sponsored Mitigation Research Workshop held on January 24, 2013.

- Ms. Maffei reported that Bruce Patton, Shawna Ackerman, and Marianne Knoy had worked to put together the workshop, which was a great success. She thanked Advisory Panel members Jonathan Leong and Rod Garcia for participating throughout the day.

- The full title of the workshop was Development of an Experimental and Numerical Modeling Program to Evaluate the Effectiveness of Selected Seismic Mitigation Measures for Single-Family Dwellings. The resulting project will deal with both one- and two-story single-family dwellings with raised foundations and cripple walls, and will employ both numerical modeling (done on a computer to simulate earthquakes) and experimental modeling (done by building elements of a house, or an entire house, and pushing on it or shaking it).

- Over 70 persons participated: engineers, academics, researchers, and representatives of CEA participating insurers.

- After detailed remarks from research professors, attendees broke into smaller groups to discuss elements needed before embarking on a research program.

- Ms. Maffei explained the prototypical structure which involves older materials.

- The group concurred on three essential phases:

  1. Simplified modeling and risk analysis.
  2. Examining the lesser-known elements, such as stucco and plaster.
  3. Detailed analysis and research, including shake-table testing.

- The group agreed on the following:

  - Public review and comments should be conducted at regular intervals.
  - The work will be completed by a project team with an advisory committee.
  - A separate steering committee will oversee the program, composed of professionals that represent all stakeholders.

- The CEA anticipates that this structure will be established through an RFP process later in 2013.

- Ms. Maffei showed a video of a shake-table test with a traditional Japanese house.

- The group would like its research program to include an actual shake-table test of the retrofitted and un-retrofitted California single-family dwelling, so that they have a proof of concept of the retrofit program and understand how to reduce the damage in this type of structure.

Mr. Reyes inquired about the public review of comments at regular intervals: who would this consist of? Ms. Maffei responded that review would come from direct participants (test engineers, the steering committee, and the advisory committee) and non-participants.

In response to a question from Mr. Shultz, Ms. Maffei explained that in pre-1940 houses, well over 50% have the potential of having a soft story. In pre-1979 houses, the percentage is smaller. Also, the protocols they will develop in this research program will be relevant to future research on other types of houses for which there currently is no building code.

13. Mr. Patton will update the Board on recent developments in the CEA's Research Program.

Mr. Patton reported participants were behind schedule on two of the CEA's contracted research projects, and he provided the practical implications.

The NGA-West 2 project, which will provide ground-motion-prediction equations, was originally scheduled to be complete in August 2012, but some of the contracted eight tasks have been delayed. The most important tasks, however, should finish in time to give to the USGS, so these ground-motion-prediction equations can go into the National Seismic Hazard Maps on which building codes are based. The maps are also used as consensus documents in the scientific and engineering communities for commercial loss models, such as those under contract to the CEA.

The other project is UCERF3, which will predict earthquake-fault-rupture locations, magnitudes, and frequencies. It is an ambitious project that uses, for the first time, GPS recordings of crustal strain throughout California to determine earthquake rates in different sections of California. UCERF3 also now includes more multi-segment ruptures.

The part of UCERF3 that will not be done in time for the National Seismic Hazard Maps is the "time-dependent" part, but since the National Seismic Hazard Maps do not use time-dependence, that delay will not affect the completion of the maps. Our commercial loss modelers do require time-dependent modeling, so they will be unable to use that feature until it's completed.

Mr. Patton noted that the CEA has a multi-disciplinary research team consisting of, among others, two earth scientists, a structural engineer, a claims expert, an operations expert, and an actuary. This expertise helps bring an important insurance focus to the scientists and engineers.

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.

The Board entered closed session at 2:27 p.m. and resumed its proceedings in open session at 3:22 p.m.

Mr. Reyes reported that the Board was briefed by counsel on legal matters and addressed personnel issues.

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 3:22 p.m.