

**CALIFORNIA EARTHQUAKE AUTHORITY  
GOVERNING BOARD MEETING  
MINUTES**

**Thursday, June 30, 2011  
10:00 A.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  
Katie Carroll, designee of State Treasurer Bill Lockyer  
Bruce Patton, 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  
Chris Nance, Chief Communications Officer  
Shawna Ackerman, Chief Actuary  
Susan Pitton, Governing Board and Advisory Panel Liaison  
Joe Zuber, Senior Counsel

Also Present:

John Forney, Raymond James, Inc. (Independent Financial Advisor to CEA)  
Mark Simmonds, Vice Chair, CEA Advisory Panel

- 1. The meeting was called to order at 10:00 a.m. A quorum was established. (The Board decided to take matters out of agenda order.)**
  
- (3.) Consideration and approval of the minutes of the April 28, 2011, Governing Board meeting.**

**MOTION:** Ms. Carroll moved approval of the April 28, 2011, Governing Board minutes; seconded by Mr. Reyes. Motion passed unanimously.

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**(8.) Mr. Pomeroy will present for Board review and approval plans for an organization and staffing analysis which will include a recommendation to contract with a consulting firm selected as a result of a competitive bid process to lead the project.**

(Mr. Pomeroy noted that the Chair could not stay for the entire meeting, so the Agenda order would be changed to put the “action items” first.)

- Mr. Pomeroy reviewed the history of the CEA. Over 15 years ago, after the Northridge earthquake, insurers decided they did not want to carry earthquake risk on their books and pulled out of the market. The State of California dealt with the situation by creating the CEA; the enabling statutes were passed in 1995 and 1996.
- Since then the pace of technological change has been phenomenal, bringing information access to people in myriad ways.
- When the CEA seeks a rate or policy change, each participating insurer must go into its system and make the change – a costly and time-consuming process. The participating insurers variously estimate the cost of bringing the current new and better coverage to policyholders at between \$400,000 and \$700,000 per company.
- It’s time to study an efficient system that, among other things, will place policy administration in a centralized place where changes can be done in one location rather than many.
- After issuing an RFQ and evaluating the respondents’ proposals, staff has selected a candidate to do an organizational and staffing analysis: PricewaterhouseCoopers (“PwC”).
- Mr. Pomeroy’s asked the Board to authorize negotiating with the PwC to reach an agreement to begin the work. The agreement will be in excess of \$100,000 and will be brought to the Board in August 2011 for ratification.
- Because the changes PwC recommends might require legislation, staff is planning to ready the legislation for a January 2012 introduction.

Mr. Jones inquired whether the study will look at cost differences in different organizational structures. Mr. Pomeroy replied that the objective would be to do everything more efficiently with less cost to policyholders – the reason the CEA exists.

Mr. Reyes asked about the present involvement of the insurers in this project. Mr. Pomeroy responded that the first step for the consultant would be to hold stakeholder outreach meetings to gather their input.

**MOTION:** Commissioner Jones moved approval of the staff recommendation; seconded by Ms. Carroll. Motion passed unanimously.

**(9.) Mr. Richison will seek Board approval to enter into a transformer-reinsurance contract to augment CEA claim-paying capacity for 2011-2014.**

Mr. Richison explained that this new kind of risk transfer, introduced most recently at the February 2011 Board meeting, is called a transformer reinsurance transfer. Mr. Richison explained that the proposed transaction has three important goals:

1. To have a multi-year collateralized reinsurance contract; this transaction contemplates three years.
2. To diversify CEA's claim-paying capacity by even indirect access to the broader capital markets.
3. To diversify CEA's risk-transfer sources so as not to rely on any one source of capacity.

Mr. Richison provided a brief schematic of the transaction.

A marketing survey of potential investors showed that investors are attracted to the peril of earthquake and they are not put off by the likely complexity of the transaction. Staff is hoping to grow the overall capital market investor base with this and future transactions.

John Forney of Raymond James explained that the risks identified at the February 2011 Board meeting from a financial perspective have been mitigated in the contracts the CEA has assisted in drafting. The underlying capital markets that the reinsurer would access in order to fund and secure its potential obligations to the CEA have remained strong, even while they've been tested by the Japan earthquake and other events around the globe.

Mr. Zuber explained the content of the resolution for this agenda item and noted that staff has discretion being given reasonable discretion to finalize and enter into the transaction on behalf of the CEA, assuming that the terms are consistent with what has been described to the Board.

In response to a question from Mr. Jones, Mr. Zuber stated that if pricing turns out to be significantly higher than presently indicated, or if it would appear to be non-competitive with comparable reinsurance pricing, then staff would not have the authority to proceed with the transaction.

Mr. Richison explained to the Board the term "attachment points" from the proposed reinsurance contract.

Mr. Jones asked how CEA might ensure that the annual reset provision doesn't place the CEA in a position that is less competitive, from CEA's standpoint, than a traditional reinsurance product or reliance on the traditional reinsurance market would garner us in years two and three after a catastrophic event. Mr. Richison responded that the pricing for the transaction is negotiated now and the annual resets for pricing are based on the initial pricing – once initial pricing is determined, there is a maximum price CEA would pay for the transaction.

**MOTION:** Ms. Carroll moved approval of the staff recommendation; seconded by Commissioner Jones. Motion passed unanimously.

**2. Chief Executive Officer Glenn Pomeroy will seek approval of a Board resolution honoring the professional contributions to the CEA by CEA Advisory Panel Member Allen Martin, Ph.D., who passed away recently.**

Mr. Pomeroy announced that CEA Advisory Panel member Dr. Allen Martin passed away unexpectedly on May 27. Dr. Martin was a valued Advisory Panel member who provided sound counsel to the CEA. He will be greatly missed. Mr. Pomeroy brought before the Board a resolution acknowledging Dr. Allen's good work and honoring his memory.

**MOTION:** Commissioner Jones moved approval of the resolution; seconded by Ms. Carroll. Motion passed unanimously.

**4. Executive Report by Chief Executive Officer Glenn Pomeroy; assisted by CEA 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 that a Request for Qualification (RFQ) for a search firm to identify candidates for the new Insurance Director position is near completion. The staff goal is to have that position filled by November 2011.
- Last year, staff contracted with a consultant to explore an area that an external auditor had identified as an opportunity for improvement: controls and governance around CEA IS functions. The same auditor will return later this year to see the work that was subsequently done in response to the auditor's observations.
- At the Organization for Economic Cooperation and Development (OECD) in Paris, CEA submitted a paper at the request of the U.S. Department of Treasury. The topic of the paper was the importance of diversifying risk transfer.
- An important effort is underway in Washington to implement S.637, the Earthquake Insurance Affordability Act, introduced in the Senate. Staff is hopeful that a companion bill will be introduced soon in the House.

Staff conducted a Webinar about the proposal for participating CEA insurers. It is becoming increasingly clear how important this proposal is for the Authority from a sustainability standpoint. It's a win-win-win proposition: good for consumers and policyholders, good for the industry, and ultimately good for the country to get more homes protected against earthquakes.

**5. Chief Financial Officer Tim Richison will present a financial report.**

- Mr. Richison stated that at the end of April 2011, the amount of capital on hand to pay policyholder claims was \$3.8 billion; he estimated that it will be well over \$4 billion by the end of 2011.
- The level of financial security as of April 30, 2011, was a "1-in-516-years" level.
- The CEA's budget at the end of April reflects a large negative expenditure; this is the result of money received from CEA's building management in regard to the

space contract that Mr. Stewart negotiated last year that included a significant build-out of CEA's office.

- Mr. Richison pointed out that CEA's investments are heavily weighted in U.S. Treasuries, with some diversification into U. S. Agencies and a very limited amount of commercial paper. The mitigation fund is also heavily weighted in U.S. Treasuries, but all those investments are short-term in nature.
- The rolling 12-month return on CEA investments has steadily improved during the year and is up from this date a year ago.

Board members and staff discussed implications of the possibility that the federal government will fail to raise the debt-limit ceiling and could default on certain U.S. financial obligations. The Board and staff concluded that it's still best to hold U.S. Treasuries from a security perspective. Any defaults that arise will probably be made up by the federal government in ongoing months. It is not possible for the CEA to totally insulate itself from any negative effects, given, for example, the constraints on permissible investments.

Mr. Jones suggesting sending a communication to the House and Senate leadership indicating the CEA's concern about the current impasse; Mr. Richison supported the idea.

**6. CEA Advisory Panel Vice Chair Mark Simmonds will provide a summary of the proceedings at the May 18, 2011, Panel meeting.**

Mr. Simmonds gave the following summary.

- Staff provided financial and business updates.
- Staff provided an update on the federal legislation, S.637, the Earthquake Insurance Affordability Act.
- Mr. Stewart provided an update on the recent filing with the Insurance Commissioner's office of the rate and program changes to CEA products.
- The Panel held its annual election of officers. Wayne Coulon was re-elected Chair and Mr. Simmonds was elected Vice Chair of the Panel.
- Mr. Simmonds extended his own and the Panel's recognition of Dr. Martin's contributions. Dr. Martin brought sound professional and technical expertise, as well as a great sense of purpose and sense of humor; he will be missed.

**7. Chief Operations Officer Bob Stewart will brief the Board on the status of the rate and form application approved by the Board on February 24, 2011.**

Mr. Stewart briefed the Board on the implementation of the CEA's rate and form application, which the Board had approved on February 24, 2011.

- The California Department of Insurance is making sound progress through its review of the application.

- Staff has received significant feedback from the participating insurers expressing concern over the feasibility of the proposed January 1, 2012, implementation date, inadequate claims of inadequate lead time to plan and budget for the project. Specific concerns were expressed regarding available resources to accomplish the work requested and the perceived complexity of the unique features of CEA's new "Choice" product.

Commissioner Jones expressed concern that only six of the 17 insurers have told CEA that they can be ready for the January 2012 implementation date – some insurers are giving a date as late as September 2012.

Mr. Pomeroy commented that insurers are struggling with constraints of their "legacy" systems, in place since the CEA was launched.

**10. Chief Communications Officer Chris Nance will update the Board on the status of the CEA's Marketing Value Program.**

Mr. Nance's comments:

- The CEA staff has been wrestling with a static earthquake-insurance take-up rate of about 12% (12% of households that have homeowners insurance also have earthquake insurance from any source) and addressing the issue by focusing on "the four Ps": price, product, promotion, and place.
- Throughout California, most people don't perceive the risk of earthquakes and the damage they cause.
- Staff recently finished a major project on message research. Identifying messages that work involves moving through functional benefits and emotional benefits, short-term interests (promoting the need for supplies and having a plan, etc.), and long-term interests (having earthquake insurance). A message strategy that stakeholders can share statewide is about "being" the survival story.
- Staff has presented their research results to stakeholders in San Diego, Los Angeles, the Inland Empire, San Francisco, and Sacramento.
- Campaign materials include direct mail with consistent programming, TV spots with news anchors and reporters participating, TV station micro-(Web)-sites, radio promotion (including a graphically wrapped truck that will be traveling to home improvement fairs, etc., around the state), and ethnic media. With newspapers, online advertising is done in English, Spanish, and Chinese.
- For reaching the goal for policies sold in 2011, we are already at 40%.

**11. Mr. Pomeroy will present the results of his appraisal of Chief Operations Officer Bob Stewart's performance under the CEA Executive Performance Evaluation plan.**

Mr. Pomeroy presented a favorable performance review for Chief Operating Officer Bob Stewart.

Mr. Pomeroy recommended that the Board authorize the payment of a cost-of-living adjustment (COLA) provision and a 5% adjustment to Mr. Stewart's base salary, requiring a modification to the existing contract to memorialize the changes.

**MOTION:** Ms. Carroll moved approval of the COLA plus a 5% salary increase; seconded by Commissioner Jones. Motion passed unanimously.

**12. Chief Actuary Shawna Ackerman will seek Board approval to remove the Annual Risk Capital Surcharge (2<sup>nd</sup> year) for CEA participating insurer *Safeco Insurance Company of America*.**

Ms. Ackerman told the Board had approved Safeco's becoming a CEA participating insurer, conditioned on Safeco's paying up to five annual risk-capital surcharges.

The Board has approved the method now in use by CEA for calculating annual risk-capital surcharges. When applied to Safeco's 2009 portfolio, the method resulted in a \$1.7 million surcharge, which Safeco paid.

Staff applied the same method to the updated 2010 portfolio data for Safeco. The resulting calculation indicates Safeco has no further risk-capital-surcharge obligation.

The recommendation is to relieve Safeco of its obligation to pay annual risk-capital surcharges.

**MOTION:** Ms. Carroll moved approval of the recommendation; seconded by Commissioner Jones. Motion passed unanimously.

**13. 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 (c), respectively.**

There was no closed session.

**14. Public Comment on items that do not appear on the agenda and public requests that those matters be placed on a future agenda.**

There was no public comment.

**15. Adjournment.**

The meeting was adjourned at 11:25 a.m.