

**CALIFORNIA EARTHQUAKE AUTHORITY
GOVERNING BOARD MEETING
MINUTES**

**Thursday, August 29, 2013
1:00 P.M.**

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

Members of the Governing Board in attendance:

Mark Ghilarducci, designee of Governor Jerry Brown
Grant Boyken, designee of State Treasurer Bill Lockyer
Chris Shultz, designee of Insurance Commissioner Dave Jones
Dietrich Stroeh, designee of Senator Darrell Steinberg

Members of the CEA Staff in attendance:

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
Joe Zuber, Senior Counsel
Marc Keller, Governing Board Liaison
Danny Marshall, General Counsel

Also present:

Bill Rosenberger, JLK Rosenberger
Mark Simmonds, Chair, CEA Advisory Panel

- 1. The meeting was called to order at 1:00 p.m. A quorum was achieved.**
- 2. Consideration and approval of the minutes of the May 23, 2013, Governing Board meeting.**

MOTION: Mr. Shultz moved approval of the May 23, 2013 Governing Board meeting minutes; seconded by Mr. Boyken. 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. Stewart reported in place of Mr. Pomeroy. He noted that for members of the public following the meeting on the Internet, the slides displayed are available on the bottom right corner of the CEA home page until the meeting ends.

Mr. Stewart welcomed Governor's Designee Mark Ghilarducci to his first CEA Governing Board meeting.

- The Legislature passed and the Governor signed into law Senate Bill 71, effective July 1. It eliminates the 25-person cap on the number of CEA employees who are "subject to civil service provisions." The CEA can now proceed to develop an efficient, more consistent staffing model.
- To develop that model, the CEA has launched a "workforce planning project" using as a resource CalHR's *Workforce Planning Model and Guide*. The project will support human-resource decisions based on the CEA mission, strategic plan, budget resources, and desired job knowledge and skills.
- CEA staff is conducting an in-depth review of the current strategic plan in order to develop a new plan. The executive team is refining the initial exposure draft. They will solicit input from interested CEA stakeholders in meetings in Sacramento, San Francisco, and Los Angeles.
- On June 2, 2013, the CEA welcomed Todd Coombes as its first Chief Information Officer.

Mr. Shultz commented on the timeline for hiring employees subject to civil service provisions. He confirmed with Mr. Stewart that the CEA will retain its contractor-furnished staff until the resolution of the workforce planning model, at which point the CEA will begin advertising the civil-service positions.

Mr. Boyken clarified that the legislation does not grant an additional 25 employees; instead, it removes the cap of 25 civil-service positions.

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

- In a review of CEA's budget, almost all budget items are within budget allocations.
- A.M. Best has reaffirmed CEA's financial strength rating of "A-Minus 'Excellent'."
- Mr. Richison reviewed the CEA claim-paying capacity as of June 30, 2013:

- The total capacity was just over \$10 billion.
 - The market value of the proceeds of CEA's 2006 revenue bonds, used exclusively for claim payment, is \$313 million.
 - The balance of the New Industry Assessment Layer stands at \$385 million and has been declining since its inception, in 2008. Every April there is a legally required calculation that it reduces the participating insurers' collective liability for that layer.
 - On the Risk-Transfer Program, staff has strived for contracts with locked-in pricing and terms. The aggregate present line for traditional reinsurance contracts amounts to just over \$2.2 billion.
 - CEA has negotiated and executed three transformer reinsurance contracts—one in 2011 and two in 2012, for a total amount under contract of \$600 million—and plans to again turn its attention to such arrangements in 2013.
 - CEA was able to reduce its reinsurance requirements (and related purchase) by \$260 million, as a result of working with rating agencies to support a capacity-level reduction yet allow CEA to stay within the bounds of its current ratings.
 - The CEA's average rate on line across all risk-transfer presently within its capacity is 6.35%. That number has been reduced significantly during the 18 years that the CEA has been purchasing risk transfer.
 - The CEA now has one-, two-, and three-year contracts. Thirty-eight percent of the risk-transfer program limit is now provided through contracts with multi-year terms, allowing the CEA to lock in more reasonable rates for reinsurance than would be expected with solely one-year contract terms.
 - The outstanding balance owed on the CEA's 2006 revenue bonds is \$94.5 million. By July 2016 the CEA will have repaid the entire borrowed principal.
- 5. Chief Communications Officer Chris Nance will seek Board approval for an augmentation of the 2013 CEA budget (marketing-services item) in order to support and finalize program production for CEA's 2014 TV, radio, trade, and online advertising.**
- This is the third year of annualized programming in the form of television, radio, and online ads, all designed to roll out the CEA brand, "The Strength to Rebuild."

- A TV spot was recently recognized by the Insurance Marketing Communications Association with an Award of Excellence.
- The four online marketing campaigns – Blueprint, Lifeline, What Moves You, and House of Cards – have prompted CEA website traffic to quadruple. And for the first time, there are more consumers than agents visiting the website.
- In using the 2013 CEA-marketing-budget augmentation, staff will replace these successful ads with new ads that will re-motivate consumers to take earthquake-preparedness action.
- For 2014, CEA marketing and ads will feature risk education, combining information about earthquake damage to homes with the role of insurance in post-earthquake recovery. The cost of producing these ads will drop by about 35%, because the CEA will be producing static and Flash (but not rich media) online advertising.
- The reason staff is seeking the \$480,000 augmentation is that in order for the ads to be available for use throughout 2014, they must be produced now, in 2013.

Mr. Ghilarducci asked about the generation of 600,000 minutes from consumers considering earthquake insurance. Mr. Nance responded with an example of a consumer browsing Zillow.com who clicks on the CEA ad—that takes the consumer to a “landing page” containing information about CEA policies.

Mr. Nance continued, that through the Cooperative Marketing Venture, staff is seeking to create a “digital handshake” between the CEA and participating insurer (PI) websites. After the consumer goes to the landing page and explores the CEA premium calculator to derive an estimated premium, the consumer can click on the name or logo of the PI that holds their homeowners policy, and the pathway forward to eventual purchase will be laid out, clearly and intuitively.

Mr. Ghilarducci asked about the rich media format versus the static or Flash format. Mr. Nance explained that static ads do not move; Flash ads do have movement; and rich-media ads enable the viewer to engage with the ad. But while rich-media ads might engage consumers well, they may not be as widely accepted across all sites where the CEA would like to see them placed.

In response to a question from Mr. Shultz, Mr. Richison explained that the \$480,000 augmentation was a below-the-line expense, under contract services.

Mr. Ghilarducci established with Mr. Nance that the \$480,000 is the advertising budget, including related consulting on the related marketing; those consulting services would help develop the ads. Mr. Nance noted that the contract with the marketing firm had been competitively procured. The CEA will issue a new RFQ for marketing services later in 2013.

MOTION: Mr. Boyken moved approval of the proposed augmentation of the 2013 CEA marketing services budget to cover the cost of producing 2014 television, radio, trade, and online advertising, including related consulting, not to exceed \$480,000; seconded by Mr. Shultz. Motion passed unanimously.

6. CEA Advisory Panel Chair Mark Simmonds will provide a summary of the proceedings of the July 25, 2013 Panel meeting.

- The Advisory Panel devoted over three hours to reviewing and providing feedback on the CEA's new strategic plan exposure draft. Kirk Sjoberg, Marianne Evashenk, Glenn Pomeroy, and the staff had reviewed the current draft mission statement, vision, core values, and strategic goals.

Mr. Shultz stated that the Board appreciated the Advisory Panel's attention to the strategic plan, including integration with the PIs, on both the IT side and the marketing side. He added that the Department of Insurance would like the Advisory Panel not just to duplicate Board meetings, but to grapple with issues in a more in-depth manner.

7. Mr. Richison will brief the Board on the completed CEA calendar-year-2012 audit conducted by the CEA's independent financial auditors, JLK Rosenberger, LLP (formerly Larson and Rosenberger, LLP); representatives of that firm will address the Board to elaborate on the written audit report.

Mr. Richison stated that the term of the contract for the CEA's independent financial auditor JLK Rosenberger, LLP, was expiring in 2013, but that the CEA has issued a Request for Proposals to secure a replacement firm.

Mr. Richison continued that JLK Rosenberger, LLP, has completed this year's audit, for the audit year January 1, 2012, through December 31, 2012 (the CEA's 2012 fiscal year). The firm conducted the audit of CEA financial statements under Generally Accepted Accounting Principles (GAAP), and it also conducted an audit of CEA statutory financial statements that the CEA files with the Insurance Commissioner.

Mr. Richison stated that the auditor's report fairly represents the financial position of the CEA.

Bill Rosenberger, audit partner in charge of the CEA audit, was in attendance and presented the auditor's report on the 2012 audit directly to the Board:

- The result of the audit is a clean opinion on the CEA's financial statements, both GAAP-based and statutory.
- JLK Rosenberger, LLP, conducted the audit using a "risk-based approach." They started by gathering as much information as possible about the CEA and its internal controls. They then identified risks related to potential misstatements in the CEA's

financial statements, and finally they developed an audit plan to respond to each of those potential risks.

- The audit firm did control testing in January 2013 and substantive testing in March 2013. They issued reports dated August 23, 2013, on the CEA's GAAP financial statements based on and using the Governmental Accounting Standards Board's statements. The firm issued a report dated June 18, 2013, on the CEA's statutory financial statements.
- The firm focused on these key areas:
 - Reinsurance and risk transfer
 - Assets
 - Cash and investments
 - Premium, in particular the internal systems related to premium accounting
 - Differences noted: deferred acquisition costs in the GAAP financial statements, as well as loss mitigation fund to assets which exist in the GAAP financial statements.
- The firm evaluated management's selection of key accounting principles and determined that they are appropriate.
- The CEA's key estimates are limited to unearned premiums and determining any credit risk in the form of an allowance for doubtful accounts.
- Mr. Rosenberger recommended no adoption of or change in accounting principles in this financial statement. But there are some required reclassifications in the GASB financial statement, particularly between current and non-current categories.
- There were no significant or unusual transactions. He pointed out that the CEA participates as a member of a Joint Powers Authority.
- There were no significant audit adjustments or unrecorded audit differences.
- There was no identification of fraud or illegal acts detected during the audit.
- There were no material weaknesses in internal control.
- The firm had no disagreements with CEA management, and CEA management never tried to influence the form or conduct of the audit.

8. Mr. Richison will present to the Board for its consideration and approval the annual transfer to the CEA Mitigation Fund of a statutorily directed portion of CEA investment income.

- Insurance Code section 10089.37 supports a set-aside of funds for the CEA Mitigation Fund, in an amount equal to \$5 million or 5% of the CEA's investment income, whichever is less.
- The Board set aside \$1.5 million for mitigation in August 2012.
- The same section of the Insurance Code requires the potential transfer of monies to the Fund to be reviewed by, and subject to an opinion of, a consulting actuary employed or hired by the CEA. Shawna Ackerman, CEA Chief Actuary, has reviewed the 2013 transfer proposal, and staff has provided her opinion to the Board (in Attachment A).
- The method and result of calculation of the transfer to the Loss Mitigation Fund is shown in Attachment B.

MOTION: Mr. Boyken moved approval of Board authorization and approval of a set-aside of \$1,238,300 for the CEA Loss Mitigation Fund; seconded by Mr. Shultz. Motion passed unanimously.

9. Mr. Richison will seek Board approval for a proposed CEA revenue-bond issuance.

- The proceeds of CEA-issued revenue bonds are an important and flexible piece of its financial structure.
- Today's interest-rate environment is favorable for high-quality-debt issuance. The CEA has mid-investment grade ratings on its existing debt from the 2006 revenue-bond issuance of \$315 million.
- The agent for sale of CEA debt is, according to the CEA law, the California State Treasurer.
- Staff moved to analyze a potential new debt issuance, and it has concluded that the amount borrowed should be no more than \$300 million.
- Staff would use bond proceeds to pay policyholders claims and claim expenses.
- The funds would be deposited in a claim-paying account, similar to the account with the current trustee, U.S. Bank.
- An investment manager will invest the funds on behalf of the CEA.

- Staff will establish a finance team with the State Treasurer's Office to develop a CEA-revenue-bond-issuance plan and then bring the Board such key bond documents such as the Indenture of Trust, Supplemental Indenture of Trust, Bond Purchase Contract, Preliminary Official Statement, and Continuing Disclosure Agreement for Board approval.

Mr. Boyken commented that the Public Finance Division of the Treasurer's Office has examined the concept and is comfortable with the steps that the CEA staff has outlined.

Mr. Shultz noted that an additional, bond-issuance-related Board meeting may be warranted in the future if staff deems it appropriate.

Mr. Shultz asked if retaining the necessary experts for the finance team will mean incurring additional cost. Mr. Richison responded that such costs are rolled into the bond issuance.

MOTION: Mr. Shultz moved Board approval to form a finance team to structure the issuance of \$300 million in pre-event revenue bonds, and for staff to bring it back to the Board for consideration and approval; seconded by Mr. Boyken. Motion passed unanimously.

10. Chief Mitigation Officer Janiele Maffei will update the Board on the CEA's Mitigation Program Guidelines Project.

- The goal of mitigation is to reduce earthquake damage to single-family dwellings. Accordingly, the CEA has identified three significant objectives for reaching that goal: guideline development, mitigation research, and incentive programs.
- The CEA and the Federal Emergency Management Agency (FEMA) are joining forces to create comprehensive guidelines for the evaluation and retrofit of single family dwellings (which term includes structures up to four units).
- These guidelines, to be known as a "pre-standard," are the first step in moving to a standard that can be adopted in the California Building Code.
- At a previous Board meeting, CEA staff was authorized to contract with the Applied Technology Council to provide program-management services. That agency has provided CEA staff with a Phase One plan: a scope of work, recommendations for the project team and an advisory panel, and a schedule.
- Staff is now negotiating the contract.

11. Ms. Maffei will update the Board on CEA-sponsored mitigation-related research.

- The objective is to fill the identified research gap regarding single-family dwellings.
- Staff is developing an RFQ to secure a program manager to oversee detailed research aimed at determining, verifying, and applying a premium discount greater than 5% for a mitigated house.
- That research could also inform the guidelines process and provide information as staff proceeds with the incentive programs.

Mr. Ghilarducci inquired whether the required data currently exist. Ms. Maffei replied that she has met with engineer Fred Turner of the Alfred E. Alquist California Seismic Safety Commission, and that CEA staff fully intends to take advantage of research already completed and data already available.

Mr. Stroeh asked about a timeline for the research. Ms. Maffei said the whole process should take two to three years. Along the way, the CEA will obtain information from the computer modeling, the elements modeling and testing, and the shake-table sessions. As a result of using interim results, the CEA should not have to wait the full two or three years—that is, until project completion—to start refining the mitigation premium discount.

12. Ms. Maffei will update the Board on the California Residential Mitigation Program (CRMP) incentive program, operated by a joint powers authority whose members are the California Office of Emergency Services and the CEA.

- Ms. Maffei presented the new logo for the CRMP's first retrofit-incentive program, which is called "Earthquake Brace + Bolt – Funds to strengthen your foundation."
- Staff is currently developing a program website.
- The pilot program will roll out this fall in the Rockridge/Temescal district of Oakland and the Eagle Rock district of Los Angeles. The overwhelming majority of homes in these districts were constructed before 1940.
- The pilot marketing program will be comprehensive, involving direct mail, stickers in local newspapers, door hangers, and so on. Local and city newsletters will provide information and encouragement to go to the website.
- Most important is to try to develop community knowledge, where people start to hear about the program from their neighbors.
- An educational module will be available for homeowners, contractors, and building officials.

- Staff will conduct a program-evaluation effort alongside the marketing program, so that they learn from the pilot with the intent of moving to a statewide roll-out as early as next year.

Mr. Ghilarducci asked about interaction with stakeholders at the local level as well as with state agencies. Ms. Maffei replied that one of the CEA's most important collaborators is Cal OES, its co-member in the JPA that manages the California Residential Mitigation Program. She said that, in addition, the Oakland and Los Angeles mayor's offices, departments of emergency services, and building departments have enthusiastically received the pilot program. Local emergency-preparedness groups are excited to have a mitigation program come to their neighborhoods.

Mr. Shultz asked about the individual contractors who will perform the work in homes. Ms. Maffei explained that the work can be done by either a homeowner or by a contractor. The CEA provides the information and offers the incentive—then, the homeowner obtains the signed building permit, shows that the work was done in accordance with Chapter A3 of California Existing Building Code, provides proof that their expenses equal or exceed the \$3,000 incentive, provides “before-and-after” photos and a little more information, and they will receive a check from the program.

Mr. Ghilarducci asked about checks and balances within the program to protect the homeowner from potentially getting fleeced. Ms. Maffei replied that a direct link to the page containing a contractor's name and number will be provided, as well as a toll-free telephone number to clarify bidding and contractor information. Controls will be in place regarding various homeowners, size of the home, and location in the state.

Ms. Maffei continued that staff has contracted with a special-inspection firm that will look at all of the pilot-program houses (in a statewide-program setting, the inspector would inspect a statistically valid sample distribution of houses). She emphasized that the most important component of quality control is the CEA's requirement of a valid building permit—with such a permit come two inspections by the local building department, which will provide a means of verifying that construction is in accordance with the building code.

Mr. Ghilarducci asked about training for contractors. Ms. Maffei explained that the website's educational module will provide important information to contractors. And the do-it-yourselfer can also use it. The educational module was written by FEMA and is intended expressly for this kind of work.

Ms. Maffei noted that staff has reached out to both the county building officials and the California Building Officials Organization (CALBO). Both groups have agreed to allow the CEA to provide newsletters and information to their group.

13. Senior Counsel Joe Zuber will brief the Board on the renewal of the CEA's Directors and Officers and Employment Practices Liability Insurance coverages and request the Board's approval to renew the policy and pay the annual policy premium.

- For the upcoming policy year, there are some minor modifications in the coverages, both expansions and deletions of coverage, but the premium remains the same: \$113, 980.
- The coverage adequately protects the CEA and its interests.

In answer to a question from Mr. Boyken, Mr. Zuber stated that the CEA has used this insurer for about six years. The CEA's broker team found the particular form of coverage through the carrier itself; it is a specialized form whose coverages are tailored for nonprofit organizations that function in the private market, such as the CEA.

Mr. Boyken asked about the process for renewing the policy. Mr. Zuber explained that the CEA has a broker team survey the market and obtain quotes. The broker team has not found a policy better suited for the CEA and at this premium level.

MOTION: Mr. Boyken moved Board approval to authorize the necessary expenditure and signature authority, so that staff may renew CEA's existing D&O EPL coverage quoted at a premium of \$113, 980, and to bind the coverage at or before the expiration of the CEA's existing coverage on August 31, 2013; seconded by Mr. Shultz. 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, subdivisions (a) and (e), respectively.

Mr. Marshall announced that no closed session was necessary.

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.

Mr. Ghilarducci adjourned the meeting at 2:30 p.m.