CALIFORNIA EARTHQUAKE AUTHORITY GOVERNING BOARD MEETING MINUTES

Thursday, December 13, 2012
9:00 a.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
Susan Pitton, Governing Board and Advisory Panel Liaison
Marc Keller, Legal Office Assistant
Danny Marshall, General Counsel

1. **The meeting was called to order at 9:00 a.m. A quorum was established.**

2. **Consideration and approval of the minutes of the October 25, 2012 Governing Board meeting.**

   MOTION: Mr. Boyken moved approval of the October 25, 2012, Governing-Board-meeting 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 reported that, the President had just submitted to Congress a request for $60 billion in supplemental relief for the victims of Hurricane/Superstorm Sandy, with

$15 billion of that targeted for HUD's Community Development Block Grant program, which provides funds for disaster victims whose homes are not insured.

Once again, when residential losses occur on a massive scale without sufficient insurance available to aid recovery, Congressional leaders seek a Congressional response—that happened with 9/11 in 2001 and with Hurricane Katrina. And it underscores the importance of the Earthquake Insurance Affordability Act, a common-sense measure that will reduce reliance on federal assistance after the next big earthquake.

Since the last CEA Board meeting, Congressman Dennis Cardoza has officially signed on as an EIAA supporter, as have the City of Sacramento and several additional counties, Chambers of Commerce, and Realtor associations.

But the bill has not been heard this Congressional session, although it might become part of the debate in the weeks before Congress adjourns.

Mr. Pomeroy gave a year-end 2012 report and a look ahead at initiatives planned for 2013.

On the financial side:

- CEA staff has made significant progress in diversifying the CEA's claim-paying capacity, reducing the rates on line that CEA pays and cutting expenses to the benefit of policyholders.
- We have taken comprehensive looks at the structure of CEA's claim-paying capacity, exploring opportunities that make us better prepared for second events.

On the legal and compliance side:

- We have established an Investment Compliance Committee.
- We have established a strong internal audit function.

On the operations side:

- We have successfully implemented a 12.5% statewide average rate reduction, the fourth major rate reduction that the CEA has put in place for its policyholders.
- We rolled out a new product this summer, the Homeowners Choice policy.
- We are focusing on the claim-paying process, having engaged in performed extensive review. We will do major testing of new systems next year.

On the communications side:

- We implemented an online marketing strategy and quadrupled our Web-site traffic.
- We joined forces with the American Red Cross, which benefits that worthy organization while allowing the CEA to present itself to the public more deeply and broadly.

- We again promoted the Great California ShakeOut, the world's largest earthquake preparedness drill—and it keeps getting better every year.

On the mitigation side:

- We have done comprehensive work on developing seismic-retrofit guidelines: the mitigation/retrofit program will be launched next year in cooperation with the California Emergency Management Agency.

On the research side:

- The work of our new Director of Research and Special Projects, Bruce Patton, will help us in Washington as well as for the CEA internally as we begin to develop a mitigation premium discount.

New initiatives for 2013 are as follows:

- New Governmental Accounting Standards Board requirements mean work to do on the financial-reporting front.

- CEA investment policies will be revamped for Board review, requiring additional software and a multi-disciplinary internal/external term to oversee the process.

- A new set of guidelines for risk-transfer acquisition represents some exciting potential in terms of additional flexibility.

- CEA statutes are in need of some adjusting. This will require state legislation and a Board meeting in January to discuss the subject. We hope to work with our participating insurers, consumer groups, and with the Board to develop a package that we hope will be non-controversial.

- There is more work to do in the claims-reporting-process area.

- We hope to bring a Chief Information Officer on board next year.

- We need to assess our rates to see if adjustment is needed, and we will be working with our participating insurers to explore whether some additional product enhancements might be appropriate.

- The communications team will be rolling out a strategy to do social media internally. This will allow us to have a more sophisticated customer-relations management system.

- The residential retrofit program will be launched as staff continues its work with FEMA to develop retrofit guidelines.

- Mr. Patton will continue to oversee research on two projects: Next Generation Attenuation (NGA)-West and Uniform California Earthquake Rupture Forecast (UCERF)3.

Mr. Boyken commented on the proposal to consider updating the CEA's statutory framework; the Treasurer has said that he would support evaluating the existing operating-budget cap and staffing cap, which clearly don't meet the needs of the organization. Mr. Boyken added that the 12.5% rate reduction for 2012 reduces the denominator on which the operating budget is determined, something we need to take a look at next year.

Mr. Reyes addressed the financial overhead associated with securing temporary help. He said that he and Mr. Pomeroy were ready to move forward in eliminating the restriction on the number of civil service employees. He noted that in the prior year, Insurance Commissioner Jones was supportive of this as well. One of the 2013 initiatives will be to pursue legislation to eliminate the staffing cap. The CEA needs to decide whether it should attempt to do this as part of a budget-process issue or to do it on its own.

Mr. Pomeroy said that he felt that staff would be able to help design a legislative package that will gain the support of all interested parties, in partial recognition that 16 years after the CEA's inception, it may be time to "tighten things up."

He also said that at the upcoming January 2013 Board meeting, staff hoped to have a finalist selected for the new CEA executive position of Chief Information Officer. A nationwide search has been underway, and three finalists have been selected for interviews.

Mr. Reyes noted that another initiative for 2013 was to move from six Governing Board meetings per year to four.

Mr. Pomeroy closed by pointing out that the CEA's policy count is up about 100,000 from about 10 years ago and that he and the CEA staff want that trend to continue.

He then described the "Gifts From the Heart" program at the Sacramento Department of Health and Human Services, which identifies young and old who are in need of gifts around the holidays. CEA staff had collected and boxed up about 100 presents to donate in support of the program.

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

- At the end of October 2012, CEA available capital to pay claims was over $4.2 billion, with total capital over $4.7 billion. The available total limit of risk-transfer at the end of October 2012 was (an additional) $3.5 billion.

- The CEA's surplus has not grown as much as it did in 2011 because when the CEA reduced its insurance rates to benefit policyholders, the reduction in revenues also reduced the amount of funds added to surplus.

- Available capital is growing, but its growth is not enough to make up for the increase in CEA's policies and insured exposure.

- The CEA risk-transfer program contains traditional reinsurance contracts with varying effective dates throughout the year: June, April, May, and September. For the CEA's transformer reinsurance, the contracts have effective dates of February and August. Many of the contracts are multi-year rather than single-year, meaning that the CEA can better handle a second event.

- Mr. Richison showed slides that illustrated the CEA's lines of business: homeowners, mobilehome owners, condominium-unit owners, and renters.

- For single-family dwellings, the average insured value of a house has increased from $432,000 in 2011 to $446,000 currently. During the same period, however, the average premium decreased from $829 to $780.

5. Mr. Richison and CEA General Counsel Danny Marshall will seek Board approval of new, written guidelines for the CEA's securing of risk-transfer products; Mr. Richison will ask that the Board grant CEA staff, under the new Board-approved guidelines and within stated pricing and time parameters, authorization to secure reinsurance and other risk-transfer on an as-needed basis.

Mr. Marshall explained the new risk-transfer guidelines prepared by staff, using both internal resources and expert consultants.

- The CEA's first risk-transfer guidelines were written by its initial reinsurance intermediaries and tended to focus on traditional reinsurance.

- The principles of the new guidelines are financial strength and stability of those providing the risk-transfer; efficiency in their pricing and performance; and flexibility for the CEA as it brings new products to the marketplace and seeks new financial and risk-transfer products.

- The strategy is based on the need to assure that CEA's practices are in keeping with what it needs for its risk-transfer and claim-paying capacity. For the first time, the guidelines will speak not only to traditional reinsurance, but also to alternative markets: cat bond-based transactions and collateralized reinsurance, included.

- Mr. Marshall noted that in the draft guidelines before the Board, staff has worked with its outside expert to amend language on page 2, which now provides that CEA staff must prepare and submit to the Governing Board for its approval a comprehensive risk-transfer strategy, on at least an annual basis.

Mr. Reyes asked whether that strategy would be submitted to the Board for an annual review even if staff were not seeking to amend it; Mr. Marshall confirmed that it would. The strategy-submission process will provide the Board with a look at the market and the CEA's plans for approaching it.

Mr. Reyes then confirmed with Mr. Boyken and Mr. Shultz that they were comfortable with submission of the strategy every year rather than every other year.

Mr. Marshall continued:

- The section on traditional reinsurance has been updated and reorganized. Language in that section and throughout should now be understood by everyone.

- There is a credit-enhancement section explaining techniques for dealing with reinsurers that require support of their credit in order to provide capacity to the CEA.

- The new alternative-risk-transfer section addresses transformer reinsurance and collateralized reinsurance, developing areas for risk transfer that access the capital markets.

    - In that section, a subgroup has been created with the Chief Executive Officer, Chief Financial Officer, and General Counsel as its core. The subgroup is tasked with the basic compliance function within the alternative risk-transfer section.

    - This subgroup can bring in expert viewpoints as needed: outside counsel, reinsurance intermediary firms, and the CEA's independent financial advisor (at present, Raymond James).

- The most effective safety feature in the CEA's alternative-risk-transfer arrangements is full-risk collateralization.

- The CEA now routinely seeks term-extension options—risk periods that are longer than the typical one-year, traditional reinsurance contract.

- The CEA is looking, possibly, to adjust retentions each year (which in risk-transfer contracts function roughly like the deductible on an insurance policy).

- In any alternative-risk-transfer transactions, the CEA wants to consider and determine whether there is securities laws exposure for the organization, and the guidelines deal with and address means of mitigating those risks.

- There are also restrictions in place to ensure that the CEA's liability does not increase by providing an indemnification in a deal.

- The CEA wants to ensure that it is able to select from across a broad group of underwriters.

- Mr. Richison stated that over the years staff has abided by the guidelines then in place, bringing them to the Board periodically for approval. The guidelines have now been expanded and updated, but the present effort is the first time that outside experts has taken a look and reorganized them.

  Staff will continue to keep the guidelines updated since they supply needed flexibility for constructing sound risk-transfer deals.

- Staff is focusing now on putting in place risk-transfer to deal with multiple events. With the ability to handle multiple events, the CEA is not a "one-shot wonder."

  Rating agencies have always been concerned about whether the CEA is well situated to handle multiple events, and for this reason the agencies have insisted on a conservative financial structure, with a loss return period of 1-in-500 years. Staff is aiming in the near future to seek to have these restrictions loosened to permit the CEA to maintain a lower capacity but maintain its rated strength.

- The guidelines offer added benefits, not only in getting lower rates of reinsurance with better terms and conditions, but also in making more reasonable (and reasonably priced) the capacity the CEA may need to buy in the future.

Mr. Marshall led the Board carefully through each relevant section of the resolution.

MOTION: Mr. Boyken moved approval of the resolution adopting the guidelines for securing risk-transfer and approval of the resolution providing the CEA staff with the pre-authorization to enter into future risk-transfer transactions in compliance with the terms of the guidelines for securing risk-transfer, in keeping with the written resolution; seconded by Mr. Shultz. Motion passed unanimously.

6. Chief Actuary Shawna Ackerman will present for Board consideration a renewal and extension of the CEA's contract with earthquake modeling firm Risk Management Services (RMS).

Ms. Ackerman stated that CEA's current contract with RMS is set to expire at the end of 2012. For a contract-renewal period, CEA had negotiated with RMS to continue performing the same types of analyses as under the current contract: a biannual loss portfolio analysis and part of the CEA's proprietary Earthquake Loss Estimation ("EARLE") system.

There are two key differences in the proposed new 3-year contract:

- Price. The present contract provides a $50,000 annual fee for EARLE support, while the new annual fee would be $55,000.

- Deliverables. The present loss-portfolio-analysis annual fee is $160,000, but RMS has proposed an increase to $190,000 per year because of enhancements in the deliverables. Given the introduction of the CEA's Homeowners Choice product in 2012, CEA does need expanded loss-portfolio analysis, thus justifying a higher fee.

MOTION: Mr. Shultz moved approval of the renewal of the contract with RMS; seconded by Mr. Boyken. Motion passed unanimously.

7. Chief Mitigation Officer Janiele Maffei will present a summary report on the September 17, 2012 Guidelines Workshop, and provide an outline for continued work on the Guidelines development.

The development of statewide standards (guidelines) for the seismic retrofit of single family dwellings is a collaboration between the CEA and the Federal Emergency Management Agency (FEMA). CEA and FEMA hosted a well-attended workshop in September 2012 to devise a guidelines-development process.

Buildings in California not designed to newer codes may be vulnerable in earthquakes. Dwellings with significant damage significantly affect the resiliency of a community following a natural disaster. The guidelines process and the CEA will continue to learn from the information coming out of Hurricane/Superstorm Sandy.

In fact, FEMA currently has pressing, broad responsibilities to persons affected by Sandy's destruction. When FEMA personnel return to their Washington offices, the guideline-development process will continue.

8. Ms. Maffei will update the Board on the California Residential Mitigation Program (CRMP) incentive program.

The CEA is putting together Requests for Qualifications (RFQs) from consultants. The Web-site and independent-financial-auditor RFQs have been advertised, and we expect the selection process to begin in January 2013.

The other RFQs, which pertain to marketing for the pilot and statewide program roll-out, an evaluator for the pilot program, site inspectors for quality-control inspections, and insurance, will be posted in January 2013.

9. Ms. Maffei will report on the CEA-sponsored Mitigation Research Workshop, to be held in Millbrae, California, on January 24, 2013.

Within the CEA, the research group and the actuarial group are collaborating to develop a research program to identify how the damage to single-family dwellings might be reduced with mitigation.

The workshop in January 2013 will bring together modelers, researchers, engineers, and insurance professionals. The objective is to develop a roadmap for the research program.

Key to the CEA's interests is an appropriate mitigation-related insurance-premium discount for homeowners, as well as support of the guidelines-development process.

Ms. Maffei showed pictures illustrating seismic testing on representative residential-structure walls completed at California State University, Sacramento, and Stanford University.

10. Mr. Pomeroy will present the 2013 CEA Business Implementation Plan for Board consideration and approval.

The 2013 Business Implementation Plan ("BIP") is based, as always, on the CEA Strategic Plan. Mr. Pomeroy highlighted the major goals in the 2013 CEA BIP:

1. Ensuring that the CEA's earthquake response, supported by sufficient claim-payment capacity, are ready to go. The CEA's objective always is to provide excellent customer service in processing claims promptly, fairly, and consistently.

2. Having the financial strength to pay the claims.

MOTION: Mr. Boyken moved approval of the 2013 Business Implementation Plan; seconded by Mr. Shultz. Motion passed unanimously.

11. In support of the 2013 CEA Business Implementation Plan, Mr. Pomeroy and Mr. Richison will present the 2013 CEA insurance-services budget for Board consideration and approval.

Mr. Pomeroy began by reviewing the structure of the CEA. He noted that the CEA has grown significantly over the past decade.

- The CEA's overall proposed budget for 2013 seeks an overall increase in spending of just 1.3%.

- Actual spending for 2012 will be about $344 million, or 96%, of the budgeted amount of $357.7 million.

- The proposed 2013 budget seeks spending authority for $370.4 million. There are two important reasons for the increase of $27 million:

    1. $18.8 million is a first-ever depiction of certain *potential* spending related to reinsurance, a potential that has always been there but shown in the budget for the first time.

    2. CEA's overall risk-transfer costs are projected to increase by about $3.4 million. CEA will continue to sell more policies, and the average insured value of customers continues to grow, requiring, in turn, more capacity, to be secured by purchasing risk-transfer.

- The statutory spending cap for 2013 will rise from 2012's level from $16.6 million to $17.7 million—there should be enough of a continued upward trend in policy sales that additional revenue should materialize despite the recent rate decrease. For 2013, the operating expense budget is proposed at $15.1 million, up slightly from the 2012 amount of $14.9 million.

- As the CEA has grown over the years, it has obtained staffing from employment agencies. Beginning in 2013, however, staff believes it is more consistent with longstanding CEA budget practices to treat the amount that CEA pays staffing agencies as a payment to a third party, to be recorded below the line, which places that amount and like amounts outside the cap.

  Beyond questions of budget consistency in this recommendation, there's also a practical consideration: If the overhead, admin, and profit the CEA pays pay for non-employee staff remains within the cap, a shrinking cap would reduce the CEA's capability to innovate, to lead, and to be responsive to policyholders.

  When the Board meets in January 2013, Mr. Pomeroy said that he would ask the Board to consider supporting legislation to lift the staffing spending cap, because its existence and provisions have outlived their relevance. Lifting the cap would allow the CEA to establish a sustainable, cohesive workforce. Every year thereafter, directly employing that workforce would automatically produce multi-million dollar savings for the CEA.

Mr. Richison reviewed the financial aspects of the 2012 budget. He explained proposed adjustments.

He showed a graphical comparison of the 2012 budget to the proposed 2013 budget. For 2013 the salaries and benefits were annualized. There were changes in rent, travel, training, new investment and compliance software, and the like. Operating expenses totaled about 2% higher than 2012.

Mr. Richison pointed out the addition of new categories, in keeping with the Board's request in prior years to display larger amounts paid to third parties for consulting services and other contracted services.

- Consulting services include compliance, government relations, human resources, and internal audit.
- Contracted services include rating agency fees.

A risk-transfer exposure adjustment category has been added as well.

Mr. Boyken stated that the Treasurer was not comfortable allowing the CEA, without clearer statutory authority, to move employees hired through a temporary staffing agency out of the operating budget.

Mr. Shultz stated that the position of the Department of Insurance is that the statute does not give much clarity about what should be treated as an operating expense. In the absence of such clarity, it is appropriate for the Board to make that determination.

Mr. Shultz, Ms. Doty, and Mr. Reyes felt that moving the amounts paid by CEA for the overhead and profit of the employment agencies out of the 3% cap makes sense.

Mr. Reyes commented that the CEA is doing a commendable job bringing in people of more modest means to insure. This does not reduce the CEA's workload, but it does decrease the CEA's revenue.

Mr. Boyken stated on behalf of the Treasurer that they very much appreciate the conundrum that the CEA finds itself in, and they therefore believe it is necessary to find a long-term solution: doing away with or changing the spending cap and doing away with the civil-service cap of 25 employees.

MOTION: Mr. Shultz moved to approve the staff's recommendation to approve the proposed 2013 CEA Insurance Services budget; seconded by Mr. Reyes. Motion carried on a 2-1 vote. (ayes, Governor and Insurance Commissioner; nay, Treasurer)

12. In support of the mitigation-related parts of the 2013 CEA Business Implementation Plan, Ms. Maffei and Mr. Richison will present the 2013 CEA mitigation-program budget for Board consideration and approval.

Mr. Richison stated that the mitigation fund receives annually 5% of the CEA's investment income or $5 million, whichever is greater. He reviewed the mitigation budget.

- The budget the Board approved in June 2012 was $557,000, and staff has actually spent $464,000.

- The proposed budget for 2013 is a substantial increase; most of the increase is the mitigation project, which involves much in the way of contracted services and temporary staffing.

- Staff is asking for a mitigation-program budget of $853,000 for 2013, knowing that as the year progresses, an augmentation may be justified and requested based on events occurring in the mitigation program.

- The CEA mitigation fund balance is $26 million.

Mr. Shultz asked about the increase in the administration and office line item. Mr. Richison explained that it was due to the expenses captured in services to be provided through procurements.

MOTION: Mr. Shultz moved approval of the Mitigation Budget; seconded by Mr. Reyes. Motion carried on a 2-1 vote. (ayes, Governor and Insurance Commissioner; nay, Treasurer)

Mr. Reyes requested, in the future, that staff break out administrative and office line items, as those together comprise a significant portion of the entire budget. Mr. Richison agreed.

13. Mr. Pomeroy will request Board approval to extend the term of and modify Mr. Richison's CEA employment contract.

Mr. Pomeroy stated that he would extend Chief Financial Officer Tim Richison's employment contract for a two-year term and an additional two-year potential extension, with an additional week's vacation.

14. Mr. Pomeroy will present for Board consideration and approval a revised 2013 Governing Board meeting calendar.

Mr. Pomeroy stated that the proposed set of dates comprised a quarterly meeting format. The meetings in such case might last a little longer, but could be more substantive and would represent overall a more efficient use of the participants' time.

Mr. Reyes noted that the proposed quarterly meeting calendar should not preclude a meeting in-between the scheduled dates if the need were to arise; Mr. Pomeroy agreed.

MOTION: Mr. Boyken moved approval of the proposed quarterly format for meetings; seconded by Mr. Shultz. Motion passed unanimously.

15. 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 10:39 a.m. and resumed its proceedings in open session at 12:04 p.m.

Mr. Reyes reported that the Board was briefed by counsel on litigation matters and would continue the personnel matter until next year.

16. 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.

17. Adjournment.

The meeting was adjourned at 12:05 p.m.