CALIFORNIA EARTHQUAKE AUTHORITY
GOVERNING BOARD MEETING
MINUTES

Thursday, February 23, 2012
1:00 P.M.

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

Members of the 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
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
Susan Pitton, Governing Board and Advisory Panel Liaison
Joe Zuber, Senior Counsel

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 December 8, 2011, Governing Board meeting.**

   MOTION: Mr. Boyken moved approval of the December 8, 2011, 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 remarked that the CEA continues to pursue federal legislation (the Earthquake Insurance Affordability Act), which would allow the CEA to make its insurance products more affordable by empowering CEA to access more efficient forms of risk transfer.

- The legislation is important as well for the CEA's participating insurers (PIs), as it will immediately make the CEA more sustainable.

    - By the act of creating the CEA, the PIs' collective exposure to California residential earthquake risk was dramatically reduced. It put PI exposure into a much smaller "bucket," reducing it from $180 billion exposed to $3.58 billion.

    - Because by operation of law that exposure rolls off over time and under various circumstances, the PIs' exposure in what the CEA calls its "PI-assessment layers" has been further and significantly reduced.

    - The likelihood that any of those layers would ever attach after an earthquake has decreased dramatically: Today, some $7.4 billion in CEA claim-paying capacity guards against any attachment the participating insurers still have to earthquake loss.

- <u>Without</u> the federal legislation: If a catastrophic earthquake were to cause $5 billion in losses to the CEA, the CEA would have to raise rates by *70% over today's rates*, just to stay in business—that rate increase would be necessary to allow the CEA to buy the huge amount of additional risk transfer it would need to back up its insurance policies.

- <u>With</u> the federal legislation: The CEA would be much more sustainable, with a more efficient, flexible capital structure. First, if the legislation passes, the CEA could lower rates initially by about 25% from savings on risk-transfer costs. Then, after the same $5 billion loss as above, the CEA would need to raise rates somewhat to repay over a 20- or 30-year period any debt that had been incurred. But that rate increase would leave rates *lower* than today's rates – the CEA estimates some 5% lower.

- All this makes the federal legislation a win-win-*win* proposition: good for consumers, good for California, and good for the federal government. In expectation of a massive earthquake, we will have more homes privately insured. And there will be less need for emergency adjustments to the federal thresholds for federal assistance, most of which doesn't rebuild homes but results in Federal Emergency Management Agency (FEMA) grants and loans—the more we can do to decrease pressure on that, the better.

- Staff has been working hard to develop bipartisan support for this initiative, including among California building-industry associations, chambers of commerce, insurance-related consumer groups, and city mayors, to name a few. The task is to make it clear that this is a bipartisan piece of strong public policy, and then seek a hearing in Congress.

The well known, California-based consulting firm CPS has been brought in for its depth of understanding of the state system and the private sector, toward exploring adjustments to the statutory staffing cap that has long been imposed on the CEA. Mr. Pomeroy recommended working hard with CPS to put together a comprehensive effort on this issue this year (and in addition, staff has identified a potential legislative vehicle for related uses).

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

- As of December 31, 2011, CEA's cash and investments were almost $4.5 billion; the amount of this sum available to pay insurance claims was over $4 billion.

- At the end of 2011, CEA claim-paying capacity was $9.7 billion, well over the 1-in-500-year level required of the CEA. On January 1, 2012, several reinsurance contracts expired—a replacement amount of reinsurance was placed, enough to maintain the 1-in-500 year level.

- Mr. Richison presented a breakdown of the CEA's in-force reinsurance contracts, with expiration dates, reinsurance limits, and annual premium associated with each contract.

- At its December 2011 meeting, the Board approved a second transformer reinsurance contract. Staff was able to complete a contract for $150 million on CEA's preferred terms and pricing. This reinsurance contract attaches at the lowest level of CEA's claims-paying capacity than any of the risk-transfer mechanisms.

- Mr. Richison presented final 2011 annual budget figures, to show actual expenses compared to budgeted amounts. Insurance-operations expenses for 2011 consumed just over 91% of the total amount budgeted, while CEA mitigation activities had expenditures of about $364,000 (Staff is working on the 2012 mitigation budget which may be brought to the Board as soon as April).

- The end of the year showed a year-over-year increase in policy-count of just under 1%.

- 2011's homeowners premiums for were $540 million compared with $542 million in 2010. For 2012 premium may decrease as recent rate reductions take effect.

- For insurance-to-value, actual exposure in 2011 went up by about 3%. At year-end 2011, the CEA had almost $300 billion of total insured exposure, a figure Mr. Richison termed "significant."

Mr. Reyes asked whether staff has latitude to conduct additional transformer-reinsurance contract negotiations, like the Board approved in December 2011—that approval noted a maximum limit for the transaction of $300 million. He said he felt that in the future, the Board should set a threshold or a limit but allow flexibility to secure one-, two-, or three-year transactions. Mr. Richison agreed that this would be beneficial for CEA's marketplace negotiations.

5. 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, 2012.

Mr. Dawson presented the calculation of the new industry assessment layer roll-off amount:

- The calculation of the roll-off for the new industry assessment layer consists of the 5% reduction, as well as a retained-earnings differential (meaning that the CEA's capital growth increased more than its capacity growth).

- The net reduction of the new industry assessment layer was approximately $300 million, which brings that layer to about $500 million, the most to which the CEA will have access.

Mr. Dawson presented the determination of the new participating insurer maximum-assessment amounts for 2012.

Mr. Dawson requested the Board's approval to adopt the new aggregate assessment amount in Attachment A and recommended that the Board adopt the CEA-market-share percentages shown in

Attachment B for the maximum earthquake-loss-funding assessment levels for the CEA's participating insurers for 2012, and that the Board authorize CEA staff to notify the participating insurers of their respective assessment amounts calculated as of April 30, 2012.

MOTION: Mr. Boyken moved to approve the New Industry Assessment roll-off calculation amounts, adopting the market share information provided in Attachment B, and to direct CEA staff to notify each participating insurer of its maximum assessment liability as of April 30, 2012; seconded by Mr. Shultz. Motion passed unanimously.

6. CEA Advisory Panel Chair Wayne Coulon will summarize the proceedings at the January 19, 2012, Panel meeting.

Mr. Coulon stated that the CEA Mitigation Program and the California Residential Mitigation Program were discussed in some detail at the Advisory Panel meeting.

The Panel discussed product enhancements, as well as potential product enhancements, and what the market would bear. The Panel reviewed the 2012 Business Implementation Plan.

7. Chief Communications Officer Chris Nance will provide the Board with an update on the CEA's Marketing Value Program (MVP).

Mr. Nance presented information on the Marketing Value Program, as summarized below.

- With the significant earthquakes last year throughout the world, agents are now getting more questions from their policyholders about whether their homeowners-insurance policies cover earthquake damage. This creates an opportunity for agents to position themselves as experts on earthquake preparedness.

- Staff is developing an idea to work with the American Red Cross to combine programs, expertise, resources, and messages. The methods would complement programming that the CEA has already had underway in recent years through direct mail, including in Spanish and Chinese.

- Staff is discussing pilot programming for renters in the cities of San Francisco, Los Angeles, and San Diego, and is continuing to produce preparedness starter kits for agents and new CEA policyholders.

- Trainings are scheduled for MVP implementation for the first of two "flights," with appointed and employed agents/producers eligible for the mailings; agent eligibility for the second planned mailing will require CEA training. To the extent the CEA can join forces with the Red Cross, the Red Cross training would be optional.

- As part of the Earthquake Preparedness Month in March 2012, a programming opportunity is being developed for a CEA-sponsored auction to benefit the Red Cross.

- At this point, CEA has only the *Great California ShakeOut*, which takes place in the fall: a one-day opportunity for the media to publicize earthquake preparedness.

- In 2011, CEA's agent-training increased by 128%.

- Last August the Board approved the 2012 marketing budget, and later, the rollover and addition of unexpended dollars—the rollover from 2011 to 2012 will be $1,779,226.

- Budgeted funds will be expended in 2012 on paid media, direct mail, and exploring an online-marketing strategy.

- Mr. Pomeroy noted that the more CEA talks to the American Red Cross, the more it's clear that the CEA and the ARC have much in common, both in helping Californians prepare before disaster strikes and in helping them recover.

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

Ms. Maffei defined mitigation as it applies to the CEA's efforts: characterization and implementation.

- Characterization of the hazard and vulnerability, in this case single-family residences subjected to large, nearby earthquakes.

- There is tremendous opportunity in California for CEA, using means such as education, research, and direct implementation, to establish mitigation-supportive programs like the California Residential Mitigation Program.

- The Applied Technology Council (ATC) has provided an opportunity for "characterization" of risk. ATC is a highly regarded nonprofit organization that produced the 2002 *ATC 50 Seismic Grading System for the Detached Wood Framed Single-Family Residence*. ATC intends to update and upgrade the document, at which point it will be renamed, "ATC 71-3"; the update will include statewide and national seismic-rating systems for single-family dwellings.

  Ms. Maffei and CEA Chief Actuary Shawna Ackerman serve on the advisory committee to the ATC and are investigating potential CEA uses for ATC 71-3, which clearly gives homeowners opportunities to receive and use information they need to make good risk- and loss-mitigation decisions.

- In New Zealand after the 2010-11 earthquake sequence, Ms. Maffei observed damaging liquefaction and lateral spreading and their damaging effects on single-family residences. As a result, CEA staff is looking for opportunities to support mapping of liquefaction with enough gradation to predict when (insured) residential dwellings might be at risk.

  Mr. Stroeh commented that even in areas where mapping does occur, this could be a tremendously expensive undertaking because of the level of detail needed. Ms. Maffei agreed and noted that any area adjacent to water will have liquefaction potential.

- Working with the California Emergency Management Agency (CEA's JPA partner), CEA staff is continuing steps to set up the California Residential Mitigation Program.

  - A possible contract is undergoing negotiation with a consortium of organizations selected through a CEA-sponsored procurement process, in order to fulfill the roll of statewide program administrator.

- RFPs are being drafted to obtain insurance-broker services appropriate for the kinds of insurance coverage the mitigation programming may require.

- Treasury and financing protocols are under consideration to manage program finances.

- Pilot-program rollout could occur as soon as the summer of 2012. The program will have an online interface, so the program administrator must develop a Web portal to facilitate homeowners' determinations whether or not to participate.

- Staff is working with CalEMA on marketing strategies that will integrate existing marketing and communication programs to market the pilot program and, eventually, the statewide program. Plans are underway to engage local stakeholders and homeowners.

9. Mr. Pomeroy will seek Board approval to ratify an agreement with CEA loss modeler EQECAT, to provide modeling support for structural-retrofit research.

Ms. Maffei presented the agenda item.

ATC 71-3, an update of a previous ATC publication, represents an opportunity to provide information for homeowners to make decisions about retrofitting their homes. It will rely on empirical data from the 1994 Northridge earthquake and on professional (engineering) experience.

The CEA and EQECAT, Inc., have had a written agreement since July 21, 2011, under which EQECAT is to provide earthquake-loss-modeling services for this effort; the modeling cost is estimated at $100,000.

Ms. Maffei presented it to the Board for ratification.

In addition, Ms. Maffei presented a proposed contract with ATC to fund an effort incorporate the EQECAT-sourced damage ratios into the publication. Including the $30,000 cost of supporting ATC's incorporation efforts, the total cost of CEA involvement in this project is just over $130,000.

In addition to ratification of the CEA/EQECAT agreement, the Board was asked to approve a related 2012 CEA-budget augmentation to support the project(s) in the amount of $130,589.

MOTION: Mr. Boyken moved approval of the contract(s) ratification and associated budget augmentation; seconded by Mr. Shultz. Motion carried unanimously.

10. Mr. Pomeroy will ask the Board to designate one of its members to conduct, on behalf of the Board, the annual performance appraisal of the Chief Executive Officer, including consideration of the terms of Mr. Pomeroy's employment contract.

Mr. Shultz volunteered on behalf of the Insurance Commissioner to perform the appraisal, and the Board accepted his offer of service.

11. The Board will meet in closed session to discuss personnel matters (see item 10) and litigation matters, as permitted by California Government Code section 11126, subdivisions (a) and (e), respectively.

The Board entered closed session at 1:54 p.m. and resumed its proceedings in open session at 2:18 p.m.

Mr. Reyes reported that the Board wished to extend Mr. Pomeroy's current (expiring) contract term by two months, to May 31, 2012, to provide the Board with adequate time to work with him on renewal terms.

Mr. Zuber stated that staff would prepare a letter of agreement to that effect for signature by the Board chair and Mr. Pomeroy.

In addition, Mr. Reyes reported that the Board planned a closed session in March for personnel matters.

12. 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.

13. Adjournment.

The meeting was adjourned at 2:30 p.m.