

California Catastrophe Response Council Meeting Minutes

Teleconference Meeting
Thursday, October 27, 2022
2:00 p.m.

Members of Council in Attendance:

Richard Gordon, Vice-Chair, appointee of Speaker of the Assembly
Kasey O'Connor, designee of State Treasurer Fiona Ma
Michael Martinez, designee of Insurance Commissioner Ricardo Lara
Bryan Cash, designee of Secretary of Natural Resources Wade Crowfoot
Kathleen Ritzman, appointee of the Senate Rules Committee*
Paul Rosenstiel, Public Member
Rhoda Rossman, Public Member
Catherine Barna, Public Member

*Member Kathleen Ritzman joined after establishment of a quorum and after approval of the Minutes.

Members of CEA Staff in Attendance: (Listed in order of appearance)

Glenn Pomeroy, Chief Executive Officer
Tom Hanzel, Chief Financial Officer
Tom Welsh, General Counsel
Dr. Laurie Johnson, Chief Catastrophe Response & Resiliency Officer
Shawna Ackerman, Chief Risk and Actuarial Officer
Susan Johnson, Governance Liaison

Speakers:

Kapil Bhatia, Raymond James

1. Quorum: Call to Order and Member Roll Call

Vice-Chair Richard Gordon called the meeting, held via Zoom, to order at 2 p.m.

Ms. Johnson called the roll and stated that a quorum was present.

2. Minutes: Review and approve minutes of the July 28, 2022 meeting of the Council.

MOTION: Ms. Barna motioned to approve the July 28, 2022 meeting minutes as written. Ms. O'Connor seconded. The motion carried unanimously by roll call vote.

3. Executive Report: CEA Chief Executive Officer Glenn Pomeroy will provide the Council with an executive report.

CEA Chief Executive Officer Glenn Pomeroy reported to the Council that the administration of the Wildfire Fund is going well, noting that progress has been made in the development of claims administration procedures and the enterprise risk management scorecard. While the Wildfire Fund has been in existence, California has experienced six of the seven largest wildfires in the state's history. Four years in, it has been beneficial to have this time for preparation.

Mr. Pomeroy also reported that he had spoken with Assemblymember Chris Holden, primary author of AB 1054, legislation that created the Wildfire Fund, about the members of this Council, the seriousness with which they take the assignment and the breadth of expertise they have. Asm. Holden was very appreciative and conveyed a message of thanks to the Council.

4. Proposed 2023 Council Meeting Dates: Mr. Pomeroy will seek approval of the proposed 2023 Council meeting dates.

Mr. Gordon stated that the proposed schedule had the Council meeting quarterly on the first Thursday of the month.

Ms. Barna stated that she had a standing commitment on the first Thursdays at 2:00, but 3:00 would work for her.

MOTION: Mr. Cash motioned to approve the proposed meeting schedule with the adjustment that meetings would begin at 3:00 p.m. rather than 2:00 p.m. Ms. Barna seconded. There was no public comment. The Motion carried unanimously by roll call vote.

5. Financial Report: CEA Chief Financial Officer Tom Hanzel will provide the Council with a financial report on the Wildfire Fund as of September 30, 2022.

CEA Chief Financial Officer Tom Hanzel reported that the Wildfire Fund's balance sheet continues to be financially strong and that from a financial standpoint, the administration of the Wildfire Fund is consistent with the intent of the enabling legislation. The new accounting/analytics software, previously approved by the Council, is now fully deployed and has helped his team considerably.

The Wildfire Fund's biggest financial headwind is the inflationary environment. The Fund has experienced unrealized losses in its fixed income portfolio because of those inflationary pressures and as a result of the Federal Reserve's efforts to control inflation by raising rates. He also reported that the Wildfire Fund's personnel expenses are down.

Ms. Rossman stated that she was impressed by the reduction in personnel expenses. Mr. Hanzel responded that it is a team effort, adding that not yet having any claims against

the fund and building the infrastructure were reasons for the reduction. We are trying to make this as efficient as possible.

Mr. Hanzel then reviewed the Statements of Revenues, Expenses, and Changes in Net Position:

- Non-bypassable charges are materially up from the prior year. Effective January 1, 2023 the non-bypassable charges will come down and by the end of 2023, the goal is to be at the normalized \$902 million per year of collection rate.
- Investment income is up 17-18%, driven by the reinvestment rate of our funds.
- The \$2 billion SMIF loan from the State for the start-up funds will be fully repaid in April 2023.

Mr. Hanzel reviewed the approved 2022 budget versus actual expenditures noting that Contracted Consulting Services are up from the prior year as consultants were brought in to finalize the work done on the claims side. He also noted the \$332,000 allocated from CEA primarily for the new investment software.

The Wildfire Fund will continue to collect non-bypassable charges monthly and staff will continue to work with the IOUs in the next month to ensure their annual contributions of \$300 million combined are received in late December.

Kapil Bhatia of Raymond James, the Wildfire Fund's Financial Advisor and Investment Consultant, then addressed the larger economic landscape. He noted that the high inflation rate of over 8% from August to September is expected to continue at least until the early to middle of 2023. However, the U.S. is still expanding, and the GDP increased at a rate of 2.6% during the third quarter, adding that trade has improved and some of the supply chain problems have been getting resolved. The U.S. added 1.1 million jobs during the third quarter and unemployment remains low at 3.5%.

To manage inflation, the Federal Reserve has increased the federal funds target rate five times this year by a total of 3.00% to the current target of 3.00%-3.25%, an exponential increase. We expect that the second rate increase in December will be 50 basis points. By the end of 2023 or the first quarter of 2024, we expect the fed funds rate to be down to almost 3.00%.

Mr. Bhatia stated that these rate increases have led to a significantly sharp upswing in the interest rate, as the market was not anticipating the level and pace of rate increases by the Federal Reserve. There were many unexpected changes in 2021 which allowed inflation to take hold, and the unanticipated Russian invasion of Ukraine added 30%-40% of inflation for energy prices. The dramatic increase in interest rates has inverted the yield curve – the short end is higher than the long end.

He then used the yield curve inversion to explain why the country is going to have an economic recession. Mr. Bhatia compared the Wildfire Fund's yield curves of September

2021 and 2022. As interest rates started to creep up, we reduced the duration of the Fund's portfolio from 3.9 years to 3.2 years, which is about 18% over the last 12 months. That allows us to try to maximize investment income as well as remove some of the interest rate risk as we go forward and wait for rates to stabilize so we can take advantage of reinvestments.

The investment portfolio is front-loaded with approximately \$1.2 billion maturing over the next six months, \$900 million maturing over six to twelve months, and an additional \$3.1 billion maturing between one and three years. Over the next twelve months we can take advantage of the higher rates. Mr. Bhatia explained that as the investment duration has decreased in the portfolio over the last twelve months the income return is moving up as those securities are reinvested.

Mr. Bhatia expects the Federal Reserve rate increases will stabilize in 2023. As of September 30, 2022, the Wildfire Fund's total portfolio market value stood at \$9.57 billion, compared to \$9.83 billion as of September 30, 2021. Overall, the Fund's portfolio, composed of 30% corporate bonds and 68% U.S. Treasury and government securities, is stable. Unrealized losses will decrease over time as the bonds in the fund mature and the bond proceeds are reinvested in a rising interest rate environment. Over the next twelve rolling months approximately \$15 million of additional investment income is expected for a total investment income of around \$215 million.

Discussion

Mr. Rosenstiel asked if the portfolio has enough funds to pay future, potential claims against the Wildfire Fund and what kind of claims-paying experience would we have before we need to start selling some of the securities before they mature?

Mr. Bhatia replied that the portfolio is front-loaded with about \$200 million maturing each month, so it can be used as needed to pay claims over time. Based on the earthquake and hurricane experiences, we will have no unrealized losses because it usually takes two to three years to make the claims' overall payments

Ms. Rossman noted that the Wildfire Fund's portfolio is earning more but not keeping up with inflation. California property values are rising, income is up, and we are not taking on too much risk, but we are shrinking in proportion to liability growth. What inflation should we look at?

Mr. Hanzel responded that we are keeping a close eye on exactly what Ms. Rossman was saying. Price appreciation is 10%-11% in California currently, definitely greater than the broad CPI. We are aware of the erosion and it goes into our thinking.

Mr. Bhatia added that while currently no fixed income funds are keeping up with inflation, the Wildfire Fund will see its unrealized losses declining in the future as inflation comes under control and the economy improves. He concluded by stating that the Wildfire Fund is well positioned to pay future potential claims.

There was no public comment.

6. Conflict-of-Interest Code Amendment: CEA General Counsel Tom Welsh will seek approval of amendments to the Council's Conflict-of-Interest Code pursuant to Cal. Gov. Code § 18730.

CEA General Counsel Tom Welsh stated that this was largely an administrative action. At the end of 2019 and early 2020, staff had prepared a Conflict of Interest Code to ensure that the Council as a state body remains in compliance with the state requirement that state bodies have such codes. The amendments today align the Code with the actual functions and duties being conducted for the benefit of the Wildfire Fund and the Council.

Staff is seeking approval from the Council of the proposed revisions to the Conflict of Interest Code, and to authorize CEA staff to take the necessary regulatory measures to finalize the revisions to the Code.

MOTION: Ms. Rossman motioned to accept the language given by Mr. Welsh relative to the action to be taken. Mr. Martinez seconded. The Motion carried unanimously by roll call vote.

Mr. Welsh stated that once the Code goes through the rest of the regulatory process, which includes working with the FPPC to get approval and going through the Office of Administrative Law for public comment, staff will provide the Council with a copy.

7. Claims Administration Update: CEA Chief Catastrophe Response & Resiliency Officer Dr. Laurie Johnson will provide an update on Claims Administration.

CEA Chief Catastrophe Response & Resiliency Officer Dr. Laurie Johnson stated that since the Council last met on July 28, they had been notified of two fires in which the utilities submitted Electric Safety Incident reports to the CPUC. PG&E released their latest quarterly SEC filing in which they noted a potential loss for the Mosquito Fire of \$100 million.

Dr. Johnson observed that for recent weeks on end, there have been no incidents reported on the CAL FIRE Incident Report page.

Staff continues to track the major fires that may reach the level of accessing the Wildfire Fund:

- The Kincade Fire in July 2020 has estimated losses of \$950 million.
- The Zogg Fire in September 2020 has estimated losses of \$375 million.
- The Dixie Fire in July 2021 has estimated losses in excess of \$1 billion with a potential recovery sought from the Wildfire Fund of \$150 million. Fire suppression costs were \$650 million. 685,000 acres of National Forest burned and 70,000

acres of National Park were impacted. As part of an expedited settlement payment program for the cities and counties involved, PG&E is reporting payments of over \$30 million as of this quarter. In addition, PG&E has 54 complaints on behalf of 1,444 plaintiffs with a trial date set for June 5, 2023, an indicator of how early PG&E is in this process of settling litigation and claims.

Lastly, Dr. Johnson reported that the Wildfire Fund continues working with Sedgwick Claims Management Services as it works to build out the claims administration procedures, including the claims data management infrastructure, operations manual, quality control procedures, personnel plan and training, and testing of the entire approach.

8. Enterprise Risk Management: CEA Chief Risk & Actuarial Officer Shawna Ackerman will deliver a quarterly report on the Enterprise Risk Management program for the Wildfire Fund.

CEA Chief Risk & Actuarial Officer Shawna Ackerman stated that staff has completed the integration of the risks associated with the administration of the Wildfire Fund into our existing ERM framework. Staff will be issuing a quarterly scorecard highlighting the key risks. This quarter's report made note of two items:

- The Information Security Team's continued enhancement of the CEA staff training and awareness has led to the successful renewal of the cybersecurity insurance program at a premium lower than expected.
- Southern California Edison's Wildfire Mitigation Plan Update for 2022 was approved by the Office of Energy and Infrastructure Safety (OEIS) in July. OEIS has released a draft decision for PG&E's update with the public comment period open until November 7.

9. Public comment: The Council will invite public comment on matters related to the Wildfire Fund that do not appear on this agenda, and to request that matters be placed on a future agenda.

There was no public comment.

10. Adjournment

There being no further business, Mr. Gordon adjourned the meeting at 2:57 p.m.