California Joint Powers Insurance Authority

Stewardship Report to Executive Committee

November 1, 2010

TOWERS WATSON

Table of Contents

I. Introduction........ 1

II. Executive Summary........ 2

III. 7/1/10 Renewal and services........ 4

Liability........ 4

Workers Compensation........ 6

Other Services........ 7

IV. Current and Developing market conditions........ 8

V. Plans for 2011........ 10

I. Introduction

In the spring of 2008, Towers Watson (formerly Towers Perrin) and Arthur J. Gallagher, (as subcontractor to Towers Watson) were honored to be chosen as the Authority's Broker of Record for liability and workers compensation. Since that time, we have worked closely with your management team to earn the trust that was placed in us…to serve as the Authority's "trusted advisor."

This report builds upon last year's report and summarizes our major activities comprising the program renewal effective 7/1/10.

II. Executive Summary

Our primary responsibility to the Authority is the design, negotiation and placement of your liability and workers compensation reinsurance programs.

The Workers' Compensation program renewal flowed smoothly and, relatively, uneventful given the 2 year rate guarantee put into place at 7/1/09. The relationship with Safety National is stable and growing, and the results of the program have been favorable.

There was much activity on the Liability program renewal. Following the carry-over concerns from the 2009 renewal with Chartis (formerly AIG/Lexington) in the excess layers, much effort was placed on (1) introducing new relationships and (2) structuring the program to allow the positioning of these excess markets on layers where they can be most competitive for the Authority.

Hand in hand with the excess layers' "diversification" initiative, was the focus on the $5M x $10M layer. We targeted, and achieved, the goal of converting this layer into a reinsured layer, thus (1) obtaining follow form/follow fortunes terms from reinsurers in support of the Authority's MOLC, and (2) pushing the excess attachment up to $15M, above which the excess markets felt more comfortable and were able to deliver better terms.

The $5M x $5M reinsurance layer was renewed with a rate reduction of ~10%, reflecting the reinsurer's growing comfort with the program and the lack of adverse claims development (as had been experienced in 2009).

Through our and the Authority's management's efforts, we were able to introduce several new partners to the program and obtain a better outcome than would have been possible, had we maintained exclusively the incumbent participations. Markel remains a strong and competitive partner of the program. Chartis is now better situated on the excess program. And several new partners eagerly complement both reinsurance and excess positions.

The Authority is well situated for the coming renewal, as respects supportive markets to provide the desired capacity. Our continuing goal will be to educate these partners regarding the program, as well as monitor the internal and external conditions that could impact the renewal season.

The remainder of the report is organized to provide an overview of the services we have provided through the following sections:

III. 7/1/10 Renewal and Services

IV. Current and Developing Market Conditions

V. Plans for 7/1/11

III. 7/1/10 Renewal and services

Appendix A provides excerpts from a more comprehensive 2010 Management Report we prepared for the Authority's management to document the year's activity. Key highlights are provided, below.

Liability

Leading into the 2010 renewal

Recall the circumstances surrounding last year's renew process and outcome:

1. There was significant loss development into the reinsurance layer impacting the $8M x $2M layer, which led the Authority to restructure to a $5M x $5M layer.

2. AIG/Chartis' financial disruption resulted in learning that they would completely non-renew the program at the "11th hour", after previously verbally agreeing to renew at expiring prices. This led to a marketing scramble and, ultimately, an increase in the cost of the $40M x $10M excess layers, still with Chartis

Because of the situations above, we had heightened attention to monitoring the loss development during the year, which might impact the coverage at 7/10. Also, we wanted to work towards diversifying the excess layers away from a single partner, to assure a 2009/Chartis situation would not recur.

Following the diversification goal, we set out to grow the Authority's presence and visibility within the reinsurance and excess marketplace. We conducted various meetings between Authority management and markets at industry functions, including AGRIP and CaJPA. We also held meetings with management and the some markets in San Francisco early in 2010. Finally, Towers Watson conducted our second Public Entity Forum for clients, at which several market visits were also conducted. In addition to these meetings, we orchestrated, with much time and effort of the Authority's management, an audit in January 2010 for both underwriters and claims representatives to get more familiar with the program specifics.

An additional facet of this goal was to explore a reinsurance option for the $5M x $10M layer, as it was assumed the excess markets would be more competitive if they were able to attach at $15M, instead of $10M, given the loss activity in this layer. Excess markets are more competitive in true capacity layers - those that might experience a “shock loss” every 10 years, for example - as opposed to layers that have more frequency of large losses.

How did we do?

We experienced a favorable outcome in the $5M x $5M reinsurance layer. Because of the stabilization of loss development in this layer, which we hope will continue in the future, Markel was able to provide a 10% rate reduction and continue growing their partnership with the Authority. This result was coupled with Markel’s growing relationship and comfort with the program and the Authority.

We pushed very hard on the excess layers, in an attempt to realize the pricing from the 08/09 period. Though the market was not able to provide that pricing level this year, because of market conditions and loss experience, we were able to achieve a good outcome as a result of the diversification goal:

1. A diversified placement with three new excess relationships, resulting in a total of four excess supporters (i.e., a better spread of partners)

2. Better pricing outcomes than a Chartis-only placement would have delivered

To build, briefly, on the points above, by diversifying the excess placement, we were able to allow the most competitive markets to target layers within their appetite. In general, this approach tends to provide a better result than forcing markets to participate on layers for which they do not have a comfort level. For example, had we pushed Chartis to support the entire excess structure, the pricing for the 25 x 25 layer would have been ~23% higher than what the new markets were able to deliver. Additionally, Chartis prefers the lower excess layers, and their pricing reflects this preference, as they were between 6% and 24% lower than other markets reviewing this layer.

Finally, the $5M x $10M layer; this layer presented the most challenge for markets this year. For excess markets, there are too many historical losses to support their capacity play. For reinsurance markets, there are not enough losses to allow for credibility of an experience rating approach, so they default to exposure rating. Ultimately, the best option provided was with Markel. These terms provided the most reasonable pricing with a trade-off of some additional risk retention for the Authority ($3M Annual Aggregate Deductible) in order to keep the pricing low. Markel, however, was not able to support the entire layer (which is an indication of the aggressiveness of their own terms), so this came with the added benefit of introducing a new relationship to the Authority, Brit Insurance. Brit was able to support Markel's terms, to fill-out 100% of the layer. Now, we have two reinsurance partners that find this layer to be acceptable, which is a benefit to the Authority going forward.

Leading into the 2011 renewal, our focus will be on growing and maintaining the new relationships put into place at 2010. Additionally, we will continue to monitor and, if need be, prepare for any adverse impact that may result from internal or external conditions.

Workers Compensation

The placement was relatively uneventful for 7/1/10, given this was the 2nd year of a 2 year guaranteed program. Safety National remains comfortable with the partnership they are forming with the Authority, and results remain good.

Much work was done on the payroll topic leading into the 7/1/10 renewal, as it is important to assure a consistent approach to measuring exposures and how they change during the coverage period, as final cost of the reinsurance program is based on this.

Management put forth much effort to assure the exposure reporting will be consistent and credible going forward.

Other Services

Leading into and beyond the 7/1/10 renewals we engaged in numerous activities to support the Authority, to provide advice, and to help solve problems. In addition to all of the activities incidental to placing your reinsurance and to those detailed in Appendix A, several worth highlighting include the following:

- Financial formulas – We continued to support the Authority's management and its Ad Hoc Board Committee, which was formed to address financial formulas issues that had developed, over time,
- We provided "advisory" analysis and comments regarding the property program and highlighted areas where the Authority can better improve their positioning, long term.
- We continued to assist management by drafting program summaries and details which are posted on the Authority's website.
- We conducted our second Towers Watson Public Entity Forum (mentioned above), in which Jon Shull attended, which presents key topics on the pooling industry, as well as an opportunity to build relationships with markets
- As briefly mentioned above, we orchestrated a comprehensive audit at the Authority's office, in order to familiarize underwriters with the program, leading into the 7/1/10 renewal

IV. Current and Developing market conditions

Conditions have not changed dramatically since 12 months ago.

Heading into the 2010 renewal, here were the conditions in the reinsurance marketplace:

- Orderly 2010 renewals with modest downward pressure on rates, supported by excess capacity levels and competitive pressures
- Cedants were increasing retentions as exposures decline/top-line shrinks
- Reinsurers had gotten slightly more flexible on terms and conditions

The perspective on rates at April 2010 were:

Segment	**Rate Conditions**
Professional Liability (non-D&O)	Flat
General Casualty	Flat to down 5%
Workers Compensation	Flat to down 5%
D&O Liability	Flat to down 5%
Property Per Risk	Flat to down 5%
Property Catastrophe	Down 5% - 10%

From a supply/demand perspective, we monitored some factors that were continuing from the previous year, particularly in the Casualty segment:

Supply

- Reinsurers' capital was largely restored in 2009 due to the recovery in financial markets and a favorable year for property catastrophes
- No new capital has entered the casualty reinsurance segment
- Given the general softness in the pricing of casualty lines, there is no expectation of further allocation of new or existing reinsurance capital to casualty side in 2010
- Expectation is for reinsurer pricing discipline, with stable pricing for good accounts and increased pricing for those with higher-than-expected losses

Demand

- Factors depressing demand for reinsurance on casualty business
  - Lower primary premium writings for most carriers
  - Restored balance sheet strength of primary writers
- Factors stimulating demand for reinsurance on casualty business
  - Specter of inflation
  - Continuation of poor primary results
  - Inability to sustain levels of prior year reserve harvesting in 2010
  - Low-return investment environment

These conditions, for the most part, have not changed at this point. The industry is still experiencing a competitive environment, low CAT activity and low interest rates, though the stock market has been on a rebound in recent months. The industry remains healthy, even in light of the soft market conditions.

In summary, nothing on the short-term horizon suggests any generalized market turn toward higher prices, and conditions remain soft. However, working layer excess – a key layer of risk for the Authority especially for the liability line of coverage – will continue to be priced based on the data. There is no financially secure naïve capacity, nor is it consistent with your philosophy of building long term relationships to seek it.

V. Plans for 2011

While we continue to monitor the external environment, our focus for the Authority will be on working with you to better understand and improve your own risk environment over the long term. Specific areas of focus include:

- Liability

  1. Strengthen the incumbent relationships, especially the new markets that joined the program in 2010, via conference meetings and visits to the Authority's office;

  2. Continue to monitor the large loss situation, avoid "surprise" adverse development similar to 2009, to assure we are well-prepared for 2011 renewal under any loss development circumstances; and

  3. Continue meeting and developing relationships with underwriters from all segments of the industry- reinsurers, excess insurers, excess and surplus lines carriers - so that access to adequate capacity is always available, if needed.

- Workers Compensation

  1. Monitor and solidify relationships with Safety National;

  2. Track continued excellent results.

- Services

  1. Assist the Authority in developing better property data capture and pursuing other property options, should the Authority deem it necessary.

We are grateful for the tone of genuine partnership which the Authority's management and board has extended to us since we became your Broker of Record, and we look forward to continuing to build on our role as your trusted advisor.