CITIZENS PROPERTY INSURANCE CORPORATION

MINUTES OF THE
FINANCE AND INVESTMENT COMMITTEE MEETING
Tuesday, June 18, 2019

The Finance and Investment Committee (FIC) of Citizens Property Insurance Corporation (Citizens) convened at the Sheraton Orlando North in Maitland, FL on Tuesday, June 18, 2019 at 3:00 pm (EDT).

The following members of the FIC were present:

Gary Aubuchon, Chairman
Bette Brown
Marc Dunbar (Telephonically)

The following members of the Board were present:

John Wortman
Blake Capps

The following Citizens staff members were present:

Barry Gilway
Jennifer Montero
Andrew Woodward
Dan Sumner (Telephonically)
Kelly Booten
Steve Bitar
Joe Martins
Jay Adams
Mark Casteel
Barbara Walker
Hank McNeely
Karen Holt
Christine Ashburn
Paul Kutter
Brian Donovan
Violet Bloom
Steve Bitar
Mike Sills

The following people were present:

Kapil Bhatia	Raymond James
Nathaniel Johnsons	JP Morgan
Tamaa Patterson	Jefferies

Call Meeting to Order

Barbara Walker: We will convene with roll call for quorum. Chairman Aubuchon?

Chairman Aubuchon: Here.

Barbara Walker: Governor Brown?

Governor Brown: Here.

Barbara Walker: Governor Dunbar? Chairman, you have a quorum and we will try to reach out to him.

Chairman Aubuchon: So is Dan Sumner here by chance? No. So from a rules perspective, if there is only two of us how do we get a motion maker and a second?

Dan Sumner: Under Robert's Rules of Order, if you have a quorum, it is possible for the Chair to make a motion or a second motion if that is needed.

1. Approval of Prior Meeting's Minutes

Chairman Aubuchon: Thank you very much, Dan, I appreciate that. So we will go ahead and take care of the easy business while we are waiting for Governor Dunbar. And that is approval of the prior meetings minutes March 26, 2019.

Governor Brown: Move to approve.

Chairman Aubuchon: **Second. Any discussion on the Minutes? Any objection to the motion? Hearing no objection, let's show that motion is approved.** And I will recognize Kapil Bhatia for a market update. Welcome, Kapil, you are recognized to give your market update.

2. Market Update

Kapil Bhatia: Thank you, Mr. Chairman. Good afternoon Mr. Chairman and members. Governor Dunbar, can you hear me okay?

Chairman Aubuchon: He will be on in about another minute.

Kapil Bhatia: Great. So I will be very brief and I am not sure much has changed from the market perspective. But please interrupt me at any point in time if you have any questions.
There are currently –

Governor Dunbar: Marc Dunbar is on.

Chairman Aubuchon: Welcome Governor Dunbar.

Kapil Bhatia: Governor Dunbar, can you hear me okay? This is Kapil Bhatia from Raymond James.

Governor Dunbar: Yes, I am, Kapil, thank you.

Kapil Bhatia: Great, thank you. There are currently 5.9 million people unemployed and the unemployment rate is 3.6%. However, the labor participation rate is 62.8% of the total civilian labor force. Which is relatively very low compared to the historical standard. The highest labor participation rate was 67.2% almost 22 years ago. The U6 unemployment rate, which includes persons marginally attached to the labor force or part time workers who are looking for a full-time job is 7.1%. If we go through all of the numbers and add up what is really available to join the labor force which is the unemployed people plus the adjustment for labor participation rate and the difference between U6 and U3, that translates into approximately eight million people still available to join the labor force, and that is really what is keeping the wage growth low, the wages are not rising as much as everybody would expect when the unemployment rate is 3.6%.

The Fed have increased rates 10 times since December of 2015, which is one to two times more than what they should have done as we talked about in December and March. Suddenly December increase was a mistake and Fed is now currently on a hold. We don't expect Fed to change rates but most likely in July or September they will reduce it. So we expect at least one rate cut this year and most likely two. However, we also expect Fed to change its language to prepare the market. They will take the word patience out and send a message to the market they are ready to cut in July. The Fed expects economy to grow at the rate of 2.1%. However, with the Fed rate cut, we expect economy to grow at the rate of 2.3%, as the additional rate cuts will increase the economic growth by almost 20 basis points or 2.3% which is still lower than where we were last year at 3%. However, significantly above where the rest of the world is. In addition, Fed is going to start shrinking its balance sheet and currently which is a four and-a-half trillion and it is going to be stabilized at $3.5 trillion which reflects almost the same number where we were before the financial crisis in relative value, not in an absolute value. In relative value it was $2.2 trillion, today it will be $3.5 trillion. However, as our GDP has grown the Fed balance sheet is around 15% of our GDP. That is really where the three and-a-half trillion comes from. At its peak it was at $4.5 trillion in 2015. Year-to-date S&P is up almost 16%, Dow Jones is up 13%, but on the other side five and 10-year treasury is down approximately 100 basis points each and that reflects the slowdown in the global economy, as well as U.S. economy. U.S. interest rates are still very low from a historical perspective, but significantly above where we were three years ago. And three years was the lowest. So five-year treasury rates have increased by almost 100 basis points, and 10-year by almost 75 basis points. We expect rates to remain where they are when it comes to the long term, whether it is a five-year, 10-year or 30 years.

Global interest rates are low and expected to remain low. Some of the countries still have negative yields up to 10 years, and that includes Germany, Denmark, the Netherlands in Europe and Japan which has now negative rates for almost 10 years now. The European Union is trying everything from a monetary policy perspective, including the statement today from ECB. However, there is no hope because monetary policy really cannot do what needs to be done in Europe which is really demographic as more and more people are aging and they don't really have a fiscal policy and we shouldn't expect them to have a fiscal policy because it is not one nation and they cannot come up with a one tax structure one fiscal policy. And that means from a currency perspective, some countries have advantage over countries and it is unlikely ECB is going to change its stance, or that the European growth is going to be any different than where we are today. Japanese and Chinese economy is slow. China is expected to be another Japan in 20 years. So regardless of the trade wars and everything else, their growth is low and expected to remain low and with the trade wars these may be a bigger problem than what we all expect. And lastly from the reinsurance markets, risk transfer markets are stable. There is still an abundance of capital. One of the reasons is again emphasizing the fact interest rates are low, investors are looking for diversification. The reinsurers tried really hard in 2019 to increase the rates, especially in the Florida market and they were successful to some extent to charge for the risk premium. The rate increases were around 10 to 20% on an average, and if you pick the middle point, most likely everybody paid around 15% more with some exceptions. And lastly, some of the larger Florida based insurance companies also increased their risk transfer program, but not in the traditional market, but because of the rate increases they increased their participation in the Cat Fund from 45% to 90%, and that reduced their overall average rate at least kept them at a similar level where they were last year. The overall participation rate in the Cat Fund is 81.6% compared to 73.5% last year. So more or less all of the bigger insurance companies have participated at a much larger rate in the Florida Hurricane Catastrophe Fund to reflect the increase in reinsurance rate. With that I will stop to see if you have any questions or comments.

Chairman Aubuchon: Thank you, Kapil. Any questions? Okay. Thank you for your report.

Kapil Bhatia: Thank you.

Chairman Aubuchon: And now behind tab three is our Risk Transfer Program update. And I would like to recognize Jennifer Montero.

3. **Risk Transfer Programs Update**

Jennifer Montero: Thank you. Behind tab three you will find an Executive Summary and the layer charts. And I will go over the Executive Summary and then walk you through the layer charts. Following the approval at the May 18th Board teleconference, Citizens' reinsurance team went out to the market with a firm order term for the coastal account. Relative to prior years, the market is hardening as Kapil just mentioned, with authorizations from reinsurers that came in at a much slower rate than in the past. Although our pricing was aggressive, we believed that the pricing offered by Citizens properly reflected Citizens' risk profile and position in the market. A total of 25 markets participated in our program this year, including four new markets and nine markets from last year choose not to participate. Citizens transferred approximately $1.27 billion of risks to the global reinsurance in traditional and capital markets for the coastal account, which includes $880 million of risk transfer that carried over from 2017/2018, that remains in place for this season. The total amount of surplus exposed in a 1-in-100 year event in the coastal account is approximately 28%. So if you will refer to the layer charts, page 2. The final 2019 Risk Transfer Layers for the Coastal Account are as follows.

Layer one of the program, the sliver layer covers $100 million in excess of $393 million of personal residential and commercial residential losses, and works in tandem with the mandatory coverage provided by the Florida Hurricane Catastrophe Fund (Cat Fund) to include the co-payment of the 10% of losses not covered by the Cat Fund. This layer was placed at 100% or $100 million at a rate on line of 11.5%. Layer two of the program, the top layer, covers $239.65 million or 68.47% of annual aggregate personal residential and commercial residential losses and will attach after $493 million of losses. This layer was placed at a rate on line of 5.5%. If you will turn to page 3. The third layer of the program provides approximately $53.25 million of coverage for commercial non-residential losses not covered by other layers of the program, in which Citizens has no Cat Fund coverage. This layer was placed at 25% of the total layer of $213 million at a rate on line of 8%. This layer was oversubscribed as we received 34.29% or a $72.8 million in authorizations.

All three of these layers provide single year coverage. If you will turn to page 4 of the layer chart. To ensure the success with the coastal account placement, we waited until we received authorizations on the majority of the coastal account program before going to the market with the firm order term for the personal lines accounts. This is the first time since 2005 that Citizens has purchased reinsurance in the personal lines accounts. Prior to the placement, the PLA exposed 63% of its surplus for a 1-in-100 year event. Citizens' strategic risk transfer plan for the PLA transfers $176.5 million of risk alongside and above the Cat Fund which will reduce the amount of surplus exposed in a 1-in-100 year event to approximately 58%. This wrap layer in the PLA covers $176.5 million or 88.25% of the total $200 million in excess of $415 million of personal residential and commercial residential losses, and works in tandem with the mandatory coverage provided by the Cat Fund to include the co-payment of the 10% of losses not covered by the Cat Fund. This layer is a per occurrence and provides single year coverage. It was placed at a rate on line of 11.25%. The total 2019 Risk Transfer Program combining the PLA and the coastal placements has approximately $1.45 billion of coverage, with total costs including the multi-year layers of approximately $94.9 million with a weighted average rate on line of 6.55%. And I will pause there for any questions.

Chairman Aubuchon: Thank you, Jennifer. Members, any questions? Okay. Thank you very much. And now I believe you are going to give us an investment portfolio update behind tab four.

4. <u>Investment Portfolio Update</u>

Jennifer Montero: Yes, behind tab four, and this is the summary. As you know we also have the appendix in there that gives a lot more detail. On slide one of the summary, the total portfolio is $9.32 billion, with approximately $8.42 billion or 90% of it is externally managed by 10 investment managers. The remaining $.9 billion is internally managed, primarily consisting of operating funds, debt service funds and debt service reserve funds. The taxable portfolio is $7.67 billion, the tax exempt portfolio is approximately $1.5 billion. The total portfolio average duration is marginally over 3.8 years with 6% maturing in than 90 days. An additional 6% maturing between 90 days and one year and 25% maturing between one and three years. Total portfolio return and income return for one year is 4.92% and 2.85% respectfully. On slide two, the interest rates for treasuries increased in 2018, but that has significantly decreased over the last five months, and now the yield curve is inverted between three months and five years by approximately 37 basis points, and between three months and 10 years by approximately 13 basis points. The tax exempt rates have also decreased over the last five months or since the beginning of 2019. On slide three, the taxable and tax exempt portfolio both have very strong credit quality, 88% of the tax exempt portfolio is in money market funds rated AA or higher and approximately 81% of the taxable portfolio is in money market funds rated A or higher. Over 29% of the portfolio is in treasury and agency securities. And finally, on slide four the portfolio annual return summary is 2.85% of income return over the last 12 months, and 2.49% of annual income return over the last two years. And that concludes my report unless there are any questions.

Chairman Aubuchon: Members, any questions of Jennifer?

Governor Dunbar: This is Marc. I just have one question.

Chairman Aubuchon: You are recognized.

Governor Dunbar: Jennifer, we talked about this yesterday, but in the appendix, the downgraded securities that we talked about.

Jennifer Montero: Yes.

Governor Dunbar: Can you just give an overview of sort of where we find ourselves? I didn't know whether to bring this question up at the last meeting or this meeting, but the fact that the auditors classified the holdings that are listed on page 11 of the Power Point, in this versus the audit report, it shows it classified as NAIC six. I am just curious why the auditors would classify them as defaulting and not performing, but we are caring the note that they are still performing. Has something changed from the audit last year or have we confirmed that these downgraded securities are in fact continuing to pay principle and interest because the NAIC classification from the auditors would suggest otherwise?

Jennifer Montero: Yes. So this is on the last page of the appendix, page 7. These are our legacy assets. These are the securities that were downgraded after financial crisis of 2007/2008. We did come to the FIC a couple of years ago and got permission to sell them if we could get a certain range, and we were able to get rid of, or sell two of them, we kept the Issuer Entity or Ottimo and Axon, because we couldn't at the time sell them at that range. So Governor Dunbar, to your point, these are rated D, they are performing, we are getting interest and principle on them and they are bonds. So the longer we hold them they get closer and closer to maturity. But I believe because they only have one rating by S&P and it is a D, which is why the NAIC guidelines would have them as a five or a six, is if they're not where they should be as far as their rating. And Kapil has some more to add to this.

Kapil Bhatia: Governor Dunbar, one of the reasons for the NAIC rate category six is because they are not very liquid in the marketplace, and because they defaulted, as you can see they're not rated. So if we try to look on a Bloomberg, you will not find a tradable security because it is not widely held. But as it is controlled by a trustee and as the cash flow comes in and these are all asset backed commercial paper, as the revenue or payment comes from old mortgages or bank foreclosures or as individuals are selling it now as the real estate market has recovered, all of those flows into the trust under the documents and then we get a portion of it. So if you look at the footnote two on that one, there was a huge write down, however, the current write down is significantly smaller. So if we want to sell it we can, but it takes a little bit of effort and energy and we need to get a market pricing. We need to do a little bit more work and we plan to come back to you. Jennifer and I have talked about it a lot and we plan to come back to you in September. But because it is not liquid, that is why it is rated as NAIC six.

Governor Dunbar: Got it. Thank you very much for that clarification. I appreciate it both of you.

Kapil Bhatia: Okay, thank you.

Jennifer Montero: Thank you.

Chairman Aubuchon: Further questions? Okay, thank you very much for your presentation. Behind Tab five for information on Depopulation and Clearinghouse. Are there any questions for Steve Bitar? Hearing no questions, is there any new business to come before the committee? If not, I will entertain a motion to adjourn.

Governor Dunbar: Motion to adjourn.

Governor Brown: Second.

Chairman Aubuchon: We have a motion and a second. Show the motion is approved without objection. We are adjourned, thank you.

(Whereupon, the meeting was adjourned.)