

# Executive Summary

Finance and Investment Committee Meeting, September 24, 2019

Board of Governors Meeting, September 25, 2019

## Legacy Asset Investments

### Summary

Citizens' legacy securities were acquired by its former investment manager in 2007 before the financial market collapse. Citizens held these assets during the worst of the financial crisis and recovered 71% of the original principal value up until 2016. We evaluated the sale of the Structured Investment Vehicles ("SIV") legacy securities and received Board approval in March 2016 to strategically sell the securities based on bids received in June 2016. As a result, Citizens sold two SIVs – Pacific West and Atlantic East – and held Issuer Entity (Ottimo), AFF Financing and Lehman bonds as the market conditions for these securities was not as liquid and they were continuing to generate cash flow. The purpose of Staff's investment recommendation is to highlight both the benefits and opportunity costs of divesting these assets.

### History

Citizens' originally held five securities that made up the Legacy Assets: Lehman Brothers Holdings Escrow, AFF Financing, Atlantic East, Pacific West and Issuer Entity. The original principal amount of these combined holdings was \$968.5 million prior to their default. Because these assets were determined to be distressed, writedowns occurred on December 31, 2007, September 30, 2008, and December 31, 2008 in the amounts of \$88.5 million, \$117.8 million, and \$84.3 million, respectively, for a total amount of \$290.6 million. All of the Legacy Assets, with the exception of Lehman, were restructured by October 2008 and resumed paying back both principal and interest on a monthly basis. Lehman emerged from bankruptcy to begin the full liquidation of all assets on March 6, 2012. Because the Legacy Assets were performing and providing above market returns, combined with the lack of liquidity for these securities, Citizens continued to hold these assets. We evaluated the sale of the SIV legacy securities in and received Board approval in March 2016 to strategically sell the securities based on bids received in June 2016. As a result, Citizens sold two SIVs – Pacific West and Atlantic East – and held Issuer Entity (Ottimo), AFF Financing and Lehman bonds as the market conditions for these securities was not as liquid and they were continuing to generate cash flow.

For Issuer Entity (Ottimo) and AFF Financing, Citizens had recovered approximately \$180 million of principal prior to 2016 and has recovered approximately \$26 million of additional principal since 2016 for a total principal recovery of \$206 million, which includes \$102 million, or approximately 72%, of the original write down of \$142 million.

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Although these SIVs have paid a significant portion of the principal and interest payments, the market values of remaining SIVs are expected to remain relatively unchanged. Due to the amortization and prepayments of underlying assets, both securities' remaining outstanding amounts have significantly decreased and that has increased the administrative costs as well as the potential risks. Additionally, market conditions have also changed since 2016, liquidity is constrained and the cash flow has been reduced. Citizens has the option to liquidate the SIV legacy assets and reinvest in liquid securities pursuant to its investment policy to maximize investment returns. Liquidating these securities will also limit future market risk and volatility, bring the overall portfolio into compliance with the investment policy, and end the legacy of illiquid securities.

Citizens monitors and values the SIVs by having the custodian bank price all the underlying bonds in the pool of securities to determine a market or fair value. Market prices may be at discount from what staff considers a fair market price due to different pricing techniques, market volatility, and higher trading spreads. The market sale price of the SIV portfolio is expected to be approximately \$14.3-\$17.8 million, which will result in estimated losses of approximately \$10.6-\$14.1 million.

## Recommendation

Citizens staff has worked closely with its financial Advisor on the economic analysis of the Legacy Assets. Staff also consulted with the Apollo Group who manages the underlying securities in the two structured investment vehicles (AFF and Issuer Entity).

Staff recommends that the Board authorize or allow Citizens staff to work with its Financial Advisor to develop a strategy to sell the remaining SIV legacy securities and Lehman Brothers Holdings Escrow.