CITIZENS PROPERTY INSURANCE CORPORATION

MINUTES OF THE
FINANCE AND INVESTMENT COMMITTEE MEETING
Tuesday, September 24, 2019

The Finance and Investment Committee (FIC) of Citizens Property Insurance Corporation (Citizens) convened at the Sheraton Orlando North in Maitland, FL on Tuesday, September 24, 2019 at 3:00 pm (EDT).

The following members of the FIC were present:

Bette Brown
Marc Dunbar (Telephonically)

The following members of the Board were present:

John Wortman
Blake Capps
William Kastroll
Reynolds Henderson

The following Citizens staff members were present:

Barry Gilway
Jennifer Montero
Andrew Woodward
Dan Sumner
Kelly Booten
Steve Bitar
Jay Adams
Barbara Walker
Brian Donovan
Violet Bloom
Steve Bitar
Nancy Staff
Mark Kagy
Michael Peltier

The following people were present:

Kapil Bhatia	Raymond James
Tamaa Patterson	Jefferies
Dave Newell	FAIA
Margaret Lezcano	UBS
Vince Jannetti	UBS

Mark Weinberg	Citi Group
Jeremy Ginter	Willis Re
Rawn Williams	Jefferies
Coleman Cordell	Bank of America

Call Meeting to Order

Barbara Walker: Good afternoon and welcome to Citizens' September 24th, 2019 Finance and Investment Committee meeting. That is a publicly noticed meeting in the Florida Administrative Register. It's also recorded with transcribed minutes available on our website. Two points of clarification. First, Chairman Gary Aubuchon requested via e-mail that Governor Bette Brown serve as Chair of this Citizens' Finance and Investment Committee meeting during his absence today. And secondly, under Roberts Rules of Order, if you have a quorum of two members, it is possible for the Chair to make a motion or a second motion if that is necessary. We will convene with roll call. Chairman Gary Aubuchon is not available to join us today. Chairman Bette Brown.

Chairman Brown: Here.

Barbara Walker: Governor Marc Dunbar.

Governor Dunbar: Here.

Barbara Walker: Chairman, you have a quorum.

1. **Approval of Prior Meeting's Minutes**

Chairman Brown: Thank you. **We will move to accept the minutes of the meeting of June 18th, 2019. Is there a motion to approve those minutes?**

Governor Dunbar: **Motion to approve.**

Chairman Brown: **And I will second. Any discussion or changes? The motion passes.** Kapil. Welcome. I love listening to your marketing reports. I can't wait.

2. **Market Update**

Kapil Bhatia: Thank you Governor Madam Chair, Governor Dunbar. Can you hear me okay, Governor Dunbar?

Governor Dunbar: Yes, I can hear you perfectly, Kapil, thank you.

Kapil Bhatia: Great, thank you. Good afternoon. Kapil Bhatia from Raymond James & Associates, we are your financial adviser. I will briefly go through the market update, but please stop me at any point of time with any questions or comments. There are currently six million people unemployed in the United States or the unemployment rate is 3.7%. The labor participation rate is 63.2%, which is 4% below where we were in 1997, and the reason we picked 1997, that was one of the high marks before the last recession. This difference of 4% reflects aging of population and skill set mismatch in our labor force. And this number of 4% translates into approximately 10 million people out of the labor force over the last 22 years. In addition, there are 4.4 million workers in part time job looking for full time employment. This effectively translates into approximately 15 million people either out of the workforce or looking for jobs. Primarily because of the skill set mismatch and part time workers is keeping the wage growth low and the inflation low, and effectively keeping wage growth pressure on low to medium level skill and that is where most of the growth is in the labor force. In addition to the politics, trade war and capital investment, labor skills are also keeping our global growth in check. We expect 2019 U.S. economy to grow at 2%, in 2020 to grow at 1.2 to 1.3%, however we don't expect any recession. Year-to-date S&P is almost 20%, Dow Jones is up almost 16%. However, 10-year treasury which reflects whether the recession is coming or not is down by over one percent. And that has resulted into a significant large amount of corporate bond issuance. Bond issuance is very strong. Year-to-date to the first week of September so far, corporate bond issuance is over one trillion and municipal bond issuance is approximately $240 billion. Low interest rates are leading to large corporate bond issuance. During the first week of September Apple, Disney, Caterpillar and Coca-Cola, and a number of other issuers issued a total of $75 billion worth of corporate bonds to take advantage of the low interest rate. All of this investment is not for capital investment purposes, but for financial engineering, reflecting strong merger and acquisitions activity as well as strong buy-backs and this is going to keep the economic growth low if there is no capital investment. So we can see from a labor perspective, a skill set mismatch as well as low capital investment all of this is keeping the economic growth low, not just in U.S., but also globally.

In addition, globally, approximately $15 trillion worth of sovereign debt is trading at negative rates, and now $1 trillion worth of corporate debt is also trading at negative yields. And this is nothing new, really. Basically we can see more and more countries falling into the trap of negative yields because they are following each other and central banks are also following each other.
So first it was Japan, then Switzerland, then Germany and now Netherlands and France. Sweden is also going into the negative rate. The last one is really France, which was positive until six weeks ago. We don't expect much to change, especially in the European economy because of number of issues in Europe. Japanese growth has been low as you know for almost 20 years. Europe is becoming another Japan and China to follow, reflecting aging population globally.

When it comes to the risk transfer markets still an abundance of capital, over $600 billion of capital is available. Alternate capital continues to grow in the market and the line between alternative capital, traditional markets or reinsurance markets continues to blur and eventually we will see risk transfer markets becoming as one market instead of capital markets and traditional markets. Global insured losses from 2017 and 2018 total approximately $240 billion which put significant pressure into the reinsurance market when it came to the 2019 rates. However, so far we have been lucky enough. 2019 started much better, first six months of reinsurance losses only amounts to $27 billion and Dorian added another $3 to $6 billion of losses.

And I just want to make one additional point. I am talking about capital losses, not the significant human losses here. In 2019, the renewals in Florida averaged 10% to 20%. However, with the losses significantly below we expect 2020 markets to behave differently, assuming there are no more large events. So far we have been lucky enough, whether it is the wild fire events or hurricane events. So hopefully that will continue over the next three to four months. The Market is still differentiating between efficient and inefficient cedents and the rate increases in 2019 reflected that and we expect that to continue in 2020. Lastly, SB301 and SB7065 were both helpful and are going to have significant positive impact on our reinsurance pricing in 2020. Whether it is the LAE Bill which increased the efficacy of LAE from 5% to 10%, or hopefully the AOB bill as more and more people understand it. This summarizes my market update unless there are any questions or comments.

Chairman Brown: Thank you. Members, any questions of Kapil? Hearing none, thank you very much.

Kapil Bhatia: Thank you.

Chairman Brown: And we will move on to Jennifer.

3. **Risk Transfer Programs Update**

Jennifer Montero: Thank you. Behind tab three is an update to the layer charts that we went over in June. These are related to the Florida Hurricane Catastrophe Fund changes, also known as the FHCF or the Cat Fund. These layer charts incorporate the updated Cat Fund retention and coverage estimates as well as the June 30th, 2019 probable maximum loss or PML versus the December 2018 PMLs projected forward to hurricane season which were presented at the last meeting in June. The Cat Fund coverage and retention are based on the Cat Fund premium. Our estimated Cat Fund premium was based on projected June 30th in force premium, exposure and Cat Fund rates. The Cat Fund rates however were not finalized until July of this year, and we now know Citizens' Cat Fund premium which is based on actual 6/30 exposure. This resulted in the Cat Fund coverage and retention coming in slightly higher than projected for the coastal account which caused the sliver layer to attach below the Cat Fund retention. The reverse is true for the Personal Lines Account. The Cat Fund coverage and retention came in slightly lower than projected in the personalized account. This caused the sliver to attach above the Cat Fund retention.

The Cat Fund aggregate retention level is $7.4 billion which is set by Florida Statute and is driven by changes in the reported industry exposure. The Cat Fund total coverage amount is $17 billion. Every participating company has a share of that $7.4 billion retention and the $17 billion coverage. A company's share of the retention and coverage is based on their Cat Fund premium. Citizens transferred approximately $1.27 billion of risk to the global reinsurance and capital market for the coastal account, which includes the $880 million of risk transfer that carried over from 2017 and 2018, that remains in place for this season. The total amount of surplus exposed for a 1-in-100 year event in the coastal account is approximately 31%. The 2019 Risk Transfer Layers for the Coastal Account are as follows, and they are shown on the chart in yellow. 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 Cat Fund to include the co-payment of a 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%. 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%. The third layer of the program provides that approximately $53.25 million of coverage for the commercial non-residential losses not covered by other layers of the program and for which the Cat Fund has no 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 $72.8 million in authorizations. All three of these layers provide single year coverage. Prior to the Personal Lines Account placement the PLA exposed 63% of its surplus for a 1-in-100 year event. The strategic risk transfer plan for the Personal Lines Account reduced the amount of surplus exposed in a 1-in-100 year event to approximately 54%. The wrap layer in the Personal Lines Account 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 per occurrence and provides single year coverage, and it was placed at the rate on line of 11.25%. The total 2019 Risk Transfer Program combining the Personal Lines Account and the Coastal Account placements has approximately $1.45 billion of coverage with total costs including the multi-year layers of approximately $94.6 million, with a weighted average rate on line of 6.5%. And that concludes my update on the layer chart. I will pause for any questions.

Chairman Brown: Members, any questions? Okay. We will move on then, thank you.

4. **Legacy Assets [AI]**

Jennifer Montero: Thank you. Behind tab four, I have an executive summary for our Legacy assets as well as an action item. You'll recall Citizens' Legacy securities were acquired by our former investment manager in 2007, before the financial market collapsed. They included Pacific West, Atlantic East, Issuer Entity, AFF Financing and Lehman Brothers' holdings. We evaluated the sale of these structured investment vehicles known as SIV, Legacy securities and received Board approval in March of 2016, to strategically sell security in June 2016 based on the bids received. As a result, Citizens sold two of the SIVs, Pacific West and Atlantic East and held Issuer Entity, AFF Financing and the Lehman bonds as the marked conditions for these securities was not as liquid and they were continuing to generate cash flow. Citizens has recovered approximately $206 million, $180 million of that prior to 2016, and $26 million since 2016 for Insurer Entity and AFF Financing, which includes $102.5 million or approximately 72% of the original write down of $142 million. Due to the amortization and pre-payments of the underlying assets, both securities remaining total outstanding amounts have significantly decreased, and that has increased the administrative costs as well as the associated potential risks.

Additionally market conditions and interest rates have also changed since 2016. Liquidity is constrained and the cash flow also has been reduced. Citizens can liquidate the SIV Legacy assets and reinvest the proceeds in liquid rated securities pursuant to the investment policy to maximize investment returns which will limit the future market risks and volatility and will bring the overall portfolio into compliance with the investment policy. The market sale price of the SIV portfolio is expected to be approximately in the range of $14 to $18 million which will result in estimated losses of approximately in the range of $10 to $14 million. Staff recommends that the Board authorize Citizens' staff to work with its financial adviser to develop a strategy to sell its remaining SIV Legacy securities and Lehman Brothers holdings to end the Legacy of illiquid securities. And I will pause for any questions before I read the formal action item.

Chairman Brown: Any questions of Jennifer? Jennifer, I have one question, and I hope it doesn't sound stupid. But you have already written down the loss, haven't you?

Jennifer Montero: Yes, but now they are considered other than temporary impairments, so there is a lot of accounting that goes on. There is a lot of work behind that. So we are just trying to get rid of all of those Legacy securities.

Chairman Brown: okay, I thought you had already. Thank you.

Jennifer Montero: Okay, the formal recommendation. **It is recommended that Citizens' Finance and Investment Committee approve and recommend to the Board of Governors, A: approve the recommendation to sell the remaining structured investment vehicle Legacy securities and Lehman Brothers holding escrow, and B: authorize staff to take any appropriate or necessary action consistent with this action item.**

Chairman Brown: **I need a motion on this. So I will accept a motion to recommend to the full Board that we sell these Legacy assets under this recommendation.**

Governor Dunbar: **Move approval.**

Chairman Brown: **And I will second that.**

Jennifer Montero: Thank you.

Chairman Brown: Thank you very much. And Investment Portfolio update.

5. Investment Portfolio Update

Jennifer Montero: Yes, behind tab five. On slide one the total portfolio is $9.22 billion with approximately $8.58 billion or 93% externally managed by 10 investment managers. The remaining $.62 billion or 7% is internally managed and primarily consists of operating funds, debt service funds and debt service reserve funds. The taxable portfolio is $7.91 billion or 86% of the total portfolio, and the tax exempt portfolio is $1.29 billion or 14% of the total portfolio. The portfolio is very conservative and stable with sufficient liquidity to pay future or outstanding claims from 2017/2018 events. The total portfolio average duration is a little over four years with 10% maturing in less than 90 days. Seven percent maturing between 90 days and one year and 24% maturing within one to three years. The total portfolio total and income return for one year is 6.78% and 2.73% respectively. The total return reflects significant increase in market value of the portfolio as interest rates continue to decrease. On slide two, the rates for the treasuries increased in 2018, but they have significantly decreased in 2019, and are expected to continue to decrease as the Federal Reserve tries to unwind its 2018 rate increases. The yield curves is inverted between three months and five years, by approximately 37 basis points and between three months and 10 years by approximately 22 basis points. However, the yield spread between two and 10 years is marginally positive by six basis points. The tax exempt rates have also decreased similarly since the beginning of 2019. Turn to the next slide, slide three. Both the taxable and tax exempt portfolios have very strong credit quality. Eighty-five percent of the tax exempt portfolio is in money market funds are rated AA or higher, and 80% of the taxable portfolios is in money market funds are rated A or higher. Over 32% of the total portfolio is in the treasury and agency securities or in money market funds. And the final slide four, the portfolio income return summary, 2.73% over the last 12 months and 2.53% over the last two years. And that concludes the Citizens' investment report.

Chairman Brown: Members, any questions of Jennifer?

Governor Dunbar: Yes, I have got a couple of questions, Chair, if that is okay.

Chairman Brown: Sure, go ahead, Marc.

Governor Dunbar: So help me understand just a little bit. We owe or 86% of our portfolio is taxable, 14% is tax exempt. What is the significance as it relates to our balance sheet and our tax liability of holding 14% of the assets in tax exempt as opposed to 25% for example? I mean, how did we arrive at that list? I am just curious. And then that is the first question and I will follow up.

Kapil Bhatia: Hi, Governor Dunbar. This is Kapil Bhatia from Raymond James. We issue pre-event bonds on a tax exempt basis. So right now we have outstanding tax exempt bonds which under the tax law can only be invested in tax exempt securities. So we don't earn additional income under the tax arbitrage rules. So all of the bond proceeds are invested in tax exempt securities. So that effectively reflects our tax exempt outstanding debt. We will use the proceeds, unless there is an event and we need the liquidity, to pay the bonds upon its maturity. At this point of time the final maturity is June 1st of 2025, but we have amortizing principle every year.

Governor Dunbar: So that number moves based on what we have issued, right?

Kapil Bhatia: Correct.

Governor Dunbar: Okay, good. I just wanted to make sure I understood it. And then I notice on here when we are talking about the returns, and I am looking at I guess it is on page 1, but may be on slide two. It says the one year total return in income of Citizens' total portfolio excluding Legacy securities and money markets is 6.78% and 2.73%. I am just curious, why are we looking at the return and income excluding those? Why would they not be part of the overall picture? And then jumping from that, the second part of the question is when we drop down to the last slide where it says the two-year annualized total return and income return is 3.6% and 2.53%, is that same excluding Legacy securities and money market funds? I am just trying to make sure I understand what we are doing.

Kapil Bhatia: Sure. Again, this is Kapil Bhatia. A two part answer to that question. The reason we exclude the Legacy securities is because they are very illiquid and therefore are very volatile and it is a very small portion of the portfolio, effectively around $20 million. So they are very hard to compute on a monthly basis. We get cash flows every six months as the portfolio has become smaller and smaller, because they are very hard to compute on a monthly basis. Then we talk about $20 million over the $9.22 billion, of the total portfolio, it is effectively a rounding error. So that is the reason for Legacy securities. And the reason we exclude money market funds, again, because we get the monies at the end of each month. So it shows up in the return and shows up in the proceeds and we keep very small amount of monies in the money market fund to meet day-to-day expenses. So the money comes in and money goes out. So again, they are very hard to compute because the average cash available in the money market funds is very small and because of in and out of cash. We know the balances, but they are so small that it doesn't change the numbers in any shape or form. It is within one or two basis points. And lastly the answer to your question on page 4 and page 5, that also excludes the Legacy securities and money market funds for the same reason. We try to -- and it says on the last line, taxable excluding Legacy securities and majority of money market funds.

Governor Dunbar: We do earn money on our market funds, right? I mean, our cash account, we are earning interest on that. It is just an inconsequential amount.

Kapil Bhatia: Yes.

Governor Dunbar: Is that what you are telling me?

Kapil Bhatia: Absolutely. The money market funds, as the Fed has increased rates, we are earning around two to two and a quarter percent which is less than our managed portfolio, but because the amount in the money market fund is very small, it does not change the overall return, but it is earning interest. That is why it is in the money market fund and not in the checking account.

Governor Dunbar: And the last question was going to be about the checking account. We are making money on the checking account, too, right?

Chairman Brown: Probably not.

Jennifer Montero: It's a sweep, yes.

Governor Dunbar: So just in those two, I mean, how much money between the checking account and the money market account do you think we make at the end of the year? I mean, are we talking about $10,000, are we talking about $200,000? I mean, I know it is relatively speaking to the $9 billion, it is a lot, but I am just curious on that, on those funds, how much we make off of those accounts.

Chairman Brown: I am wondering if we can get that number and bring it back.

Jennifer Montero: I will add that to my list for tomorrow's meeting.

Chairman Brown: I was hoping you would say that. A sweep account. I wasn't aware of that, but that is good.

Kapil Bhatia: And I am going to guestimate that number is probably less than half a million because of the amount of monies we keep in the money market funds and looking at our overall investment income of $88 million, it is less than -- it is almost half a percent, but we can certainly confirm that number.

Governor Dunbar: Yes.

Kapil Bhatia: We try to keep the values very, very low.

Governor Dunbar: Right, right. I appreciate that. But at the end of the day a half a million dollars is a lot of money. But thank you. If you guys could run that down tomorrow I would appreciate it. Thank you, Chair.

Chairman Brown: Sure. They have got to keep a balance that covers the activity and then anything above that they don't get paid on, but yes, you have to cover the activity. That makes sense.

Kapil Bhatia: Most of the return numbers and everything comes from our system where we keep track of every security with the custodian, and the money market funds are not in the system because they come in and out. So it gets hard to compute from a mathematical perspective. That is the reason we don't include it in the reports.

Governor Dunbar: Got it. Kapil, do you keep track? I mean, do we like grade our outside advisers, like we know who is doing an A job and who is doing a C job? Is there some metrics that we keep, you know, of our outside managers?

Jennifer Montero: Yes, yes, absolutely. In fact, we don't have a formal benchmark. They are benched, their performance is benchmarked against each other and that is sent out to them. So they see where they compare to their peers.

Governor Dunbar: Okay.

Jennifer Montero: I will mention also that in December, we will be bringing the investment policy back to the Board, back to FIC and to the Board for some suggested changes as we do each year.

Governor Dunbar: Okay. Yes, I am curious to see sort of the grading and sort of how it works, and how a little competition is good, particularly if you think you could get fired if you are not performing. So I am sort of curious about that.

Jennifer Montero: Absolutely, we can share that report with you tomorrow.

Governor Dunbar: Awesome, thanks a bunch.

Chairman Brown: Thank you Jennifer. In your book is the Depopulation Clearinghouse update. Does anybody want to speak to that? I looked at it, it didn't seem there was anything dramatic there. For information only, then I will entertain –

Governor Dunbar: I have one quick question on the depop side if I could. So and maybe I am misreading it, but so on the personal lines, I guess this is slide three. So the assumption rate that it is carrying across is obviously not very high. But then when you go down to the commercial lines, even though it is a tiny number, it is at 87%. What are the factors that go into our personal lines account, the assumption rates being at 17% for example in August of 2019? I am just curious.

Steve Bitar: Governor Dunbar, this is Steve Bitar for the record, how are you?

Governor Dunbar: Hey, Steve, how are you?

Steve Bitar: Very well. Yes, if you look at those numbers, you have to remember that we send out all of the offers to the customers. They have the right to opt out and remain with Citizens if they choose to do so. And at this point because our policy count has gotten so low, we have a lot of customers who simply continually get offers and want to remain for Citizens for whatever reason. We also include the estimated premium of the other company that is making the offer. So they can compare that to the Citizens' estimated premium, and many times those premiums quite frankly are higher than Citizens. And that is what is driving a lot of those lower assumption rates. People are not opting for that offer that quite frankly cost more. As you know, we have the legislative glide path. We have our rates and premiums where they are, and as the private carriers continue to receive their rate increases at a level that is higher than the glide path, we are going to find that anyone making an offer for the most part in general is going to be making that offer to a customer that is going to be at a higher premium than what that customer would pay at Citizens.

Governor Dunbar: Perfect. That is exactly what I thought the answer was. And so my follow up question is, the lower this assumption rate is sort of, I don't want to say a clearing coal mine, but is that not an indication of -- I mean, it is an indication of our rate inadequacy and the glide path problem, right? I mean, practically speaking this slide presents the problem that goes on in the marketplace that our rates are not adequate.

Steve Bitar: Absolutely, sir, you have hit the nail on the head. And from our perspective, I think this problem will only get worse and these numbers are going to demonstrate what is happening in the marketplace. If offers were coming in less than the Citizens' premium, I think we would see a lot of people opting to choose coverage that cost less quite frankly, that is comparable, but that is not happening.

Governor Dunbar: You read my mind as the next question, which is it is going to get worse. You think it is going to get worse. Okay, thank you. And then on the commercial lines, however, it is still competitive which is why the assumption rate is higher.

Steve Bitar: Well, I will tell you, there are a couple of things to keep in mind. On commercial lines, if you are a commercial non-residential policyholder, you have no choice to opt out. Opt out only applies to residential customers. That is why you will see the numbers high there. But take a look at those other months, March, May, July, September, and November. We didn't even have any companies participating in a commercial take-out. There was no desire. Our book has gotten so small there that it really is slim pickings and we have not had many companies even approach the office to apply to participate in a commercial lines assumption. The last one we even had was January, and it only resulted in 124 policies being assumed.

Governor Dunbar: Got it. Thanks you. That was very helpful, I appreciate it. Thank you, Chair.

Chairman Brown: Great, good discussion thank you very much. If that is all we have for the good of the order, I will entertain a motion to adjourn.

Governor Dunbar: Move to adjourn.

Chairman Brown: I will second. We are adjourned. Thank you.

(Whereupon, the meeting was concluded.)