Finance and Investment Committee Minutes

☒ **ACTION ITEM**	☐ **CONSENT ITEM**
☐ **New Contract**	☐ **Contract Amendment**
☐ **Contract Amendment**	☐ **Existing Contract Extension**
☒ **Other - Committee Charter**	☐ **Existing Contract Additional Spend**
	☐ **Previous Board Approval**______________
	☐ **Other**______________________________

Action Items: Items requiring detailed explanation to the Board. When a requested action item is a day-to-day operational item or unanimously passed through committee it may be moved forward to the board on the Consent Index.

☐ **Move forward as Consent**: This Action item is a day-to-day operational item, unanimously passed through committee or qualifies to be moved forward on the Consent Index.

Consent Items: Items not requiring detailed explanation to the Board of Governors. Consent items are contract extensions, amendments or additional spending authorities for items previously approved by the Board.

Item Description	The Finance and Investment Committee meeting Minutes September 20, 2022
Purpose/Scope	Review of the September 20, 2022 Finance and Investment Committee to provide opportunity for corrections and historical accuracy.
Contract ID	N/A
Budgeted Item	☐Yes ☒No
Procurement Method	N/A
Contract Amount	N/A
Contract Terms	N/A
Committee Recommendation	Staff recommends the review and approval of the September 20, 2022 Finance and Investment Committee minutes.
Contacts	Jennifer Montero, Chief Financial Officer

CITIZENS PROPERTY INSURANCE CORPORATION

MINUTES OF THE
FINANCE AND INVESTMENT COMMITTEE MEETING
<u>Tuesday, September 20, 2022</u>

The Finance and Investment Committee (FIC) of Citizens Property Insurance Corporation (Citizens) convened at the World Golf Village Renaissance Tuesday, September 20, 2022.

The following members of the FIC were present:

Chair Erin Knight (electronically)
Carlos Beruff (Board Chair)
Charlie Lydecker

The following Citizens staff members were present:

Jennifer Montero
Barbara Walker
Barry Gilway
Tim Cerio
Kelly Booten
Michael Peltier
Jeremy Pope
Jay Adams
Christine Ashburn

The following people were present:

Kapil Bhatia	Raymond James

Call Meeting to Order

Barbara Walker: Good afternoon, and welcome to Citizens September 20th, 2022 Finance and Investment committee meeting that is publicly noticed in the Florida Administrative Register to convene immediately following the Audit committee meeting with recorded transcribed Minutes available on our website. It will take place in just a few minutes once we get the table changed. For those attending today's session through the public link you are automatically in listen only mode. Panelists, thank you for identifying yourself prior to addressing the committee. We will convene in just a couple of moments. Thank you for your patience. We are convening the finance and investment committee meeting. Chair Knight, may I take role?

Chair Knight: Yes.

Roll was called and quorum established with Chair Knight, Board Chair Beruff and Governor Lydecker.

Barbara Walker: Chair, you have a quorum.

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

Chair Knight: Thank you and thank you to the committee for your patience while I am attending a conference for work and doing this remotely, at least on my end. So, I appreciate that. I would like to call the meeting to order with the first item of business being **approval of the July 12th meeting Minutes.**

Board Chair Beruff: **So moved**.

Chair Knight: Is there a motion?

Governor Lydecker: **So moved and seconded** by Governor Lydecker.

Chair Knight: Okay, well, **motion carries**, considering I think there are three of us present, correct?

Board Chair Beruff: Yes.

Chair Knight: Okay, so we have one other item for business which will come during the Chief Financial Officer Report which has to do with the reinsurance management software. Now I would like to call Mr. Bhatia up for the market update and also to answer the Chairman's question from the Audit meeting if possible.

2. **Raymond James Financial Advisor**

   a. Market Update

Kapil Bhatia: Thank you, Madam Chair. Good afternoon, Madam Chair, Governors. For the record, Kapil Bhatia from Raymond James & Associates, we are your financial adviser. Can you hear me, okay?

Board Chair Beruff: No, you need to put this a little closer.

Chair Knight: It's a little faint.

Kapil Bhatia: Is this better? Is this better?

Board Chair Beruff: Yes, you have got to get that close.

Kapil Bhatia: Thank you. So, Governor Beruff, I can answer the question first or I can go through the market update, and within that I can address the answer.

Board Chair Beruff: Go in whatever order you would like.

Kapil Bhatia: Thank you. I will go through the market update and during the investment portion I will address the answer to your question where we are and how the markets are doing, but please stop me at any point of time for any questions or comments. Inflation continues to remain elevated, albeit decreasing from its high in June of 2022. Mainly due to a decrease in energy prices. Excluding food and energy categories, core inflation increased by .6% from July to August, higher than many economists had projected and it just shows a sign of persistent inflation, and it is expected to remain high until the early to mid-2023, and I will go through some of the reasons and why everybody just moved on from transitory to permanent. Unemployment remains very low at 3.7%, but the labor force participation rate has not returned to pre pandemic level. The student loan forgiveness plan which plans to forgive up to $20,000 in student loans for individuals making less than $125,000 is expected to translate to 5% of additional spending or $1,000 per individual which will certainly add more to inflation, but not to the same magnitude as past stimulus measures which added approximately 1.5% or 25% of the current core inflation. To manage inflation so far in 2022 the fed has increased its fed fund target rate by a total of 2.25% to the current fed funds rate of 2.25% to 2.50%, and they're expected to increase by another 75 basis points tomorrow. After that hike, the U.S. Central Bank is expected to increase rates by an additional 50 to 100 basis points for rest of this year. It may seem like monetary policy is acting irrationally with so many rate increases while the economy is slowing down, however, they're trying to counter what fiscal policy did since the pandemic started or the $5.7 trillion of stimulus. There was so much money floating around and that added to persistent inflation and monetary stimulus is now trying to counteract all of those negative forces and trying to bring them into balance. So, everybody was talking about transitory without really expecting the last $1.9 trillion of build back better plan or an American Rescue Plan, which suddenly added fuel to the inflation and now monetary policy is trying to counter act, and it is probably going to take another year and another 100 -125 basis points. So, half of these monetary policy rate increases are certainly just to counteract the fiscal policy overspending and overprinting.

Global markets are in a similar position as Global Central Banks followed the Fed's policy and U.S. fiscal policy during the COVID lockdown and now the world is trying to play catch up to manage inflation. However, part of this inflation is due to the unanticipated Russian invasion of Ukraine which has worsened that inflation and economic outlook. So, looking at headline inflation numbers of almost 8% and the core inflation of 6%. One quarter or 25% or 30% is coming from fiscal stimulus and an additional quarter is really coming from Russian invasion of Ukraine. Inflation is high primarily because of these two factors. And interest rates have suddenly responded to the fed rate increases which has increased significantly since the 2022 started. One year treasury was 40 basis points when the year started and is currently at 3.96%. Two-year was 80 basis points and now at 3.85% and 10-year was at 1.63%, and now we are looking at 3.55%. The higher interest rates and lower equity prices will lead to higher unemployment, economic slowdown, and will lead to a recession over the next 12 months. Not just a technical recession which we are already seeing, but the economic recession.

Board Chair Beruff: Madam Chair, can you hear me?

Chair Knight: Yes.

Board Chair Beruff: Can I ask a question, please?

Chair Knight: Absolutely.

Board Chair Beruff: Thank you. So, with treasury bills at just a hair under 4%, how fast can you move our money?

Kapil Bhatia: Our money is almost all invested. We are moving it every month as we collect our premiums.

Board Chair Beruff: Understood, but are we precluded from buying two-year treasury bills at almost 3.968%?

Kapil Bhatia: We are not, and we are certainly buying a lot of them with all of the new money we are investing in treasury and some in corporate securities as the corporate spreads have also widened. We are earning 4.5% - 5% on our new investments.

Board Chair Beruff: How much money do you have liquid that you can invest that is not committed in an investment?

Kapil Bhatia: With our premiums coming in we are moving around $150 million approximately each month to manage, to invest at 4.50% to 5%. In addition, we have approximately $2.3 billion maturing over the next 12 months. An additional $1.8 billion maturing over the next 12 to 24 months. So, we have around $4 billion maturing in the next 24 months.

Board Chair Beruff: When do you see the turn in the diminished, in the diminished returns we have had recently when you have $400 something million in additional capital, but we had $16 million less return in the same period as we did before? When does that turn?

Kapil Bhatia: There's a two-part answer to that question. Last year the investment income as we were expecting interest rates to go up, we were able to sell a lot of securities and reinvest it. When we sold a lot of securities, we realized gains of $80 million last year in our portfolio. Those were not just accrued interest income; they were gains which we monetized by selling securities.

Board Chair Beruff: Right.

Kapil Bhatia: Our investment income is similar to last year but expected to grow each month as we invest at a higher rate. It is going to take us 12 months to basically make an additional $50 million of incremental income. So, when Jennifer talks about our investment income is almost $6 million less than what was in 2021, that is at a higher interest rate. However, we don't have any realized gains this year because the interest rates have moved up significantly.

Board Chair Beruff: What was your average return in the 12 months in the last fiscal year?

Kapil Bhatia: So far 2022 income return for the first six months, I am just going to put that in a perspective and then I will go back. Year-to-date July is 1.13%, but if we just look at the taxable portfolio which is really what the majority of our funds are, it's 1.17%, and that is just the income return. As I said, we don't have realized gains. 2021 return was 2.84% which included –

Board Chair Beruff: A gain.

Kapil Bhatia: I'm sorry.

Board Chair Beruff: Included a gain.

Kapil Bhatia: 80 basis points of 80 to 85 basis points of realized gain. Our 2021 investment income was 2% plus 84 basis points. This year so far, we have a taxable portfolio of 1.17% and we expect that number to grow in the next five months. We expect our total return to be 25 to 30 basis points higher this year because it's a large portfolio, it is like moving a large freight ship to change direction and it takes time.

Board Chair Beruff: Kapil, what is the cost, what is the cost as to buy $200 million in two-year treasury bills? What do they charge us for that transitional cost?

Kapil Bhatia: Transitional cost is fixed at five basis points.

Board Chair Beruff: Five basis points.

Kapil Bhatia: And our incremental income is 4.50% to 5%. Because we just don't buy treasury, we also buy other securities as we have changed our investment policy and that gives us the additional 75 to 100 basis points of credit spread.

Board Chair Beruff: Explain why a simple-minded builder would do anything but invest $100 million a month into short term treasuries, U.S. treasuries at close to 4%. What is there to think about? It is going to exceed the return you have had in the last three years.

Kapil Bhatia: That is correct. If we look at the total underwriting income for the year, and I don't know what is in the budget, but let's say our underwriting income for the year is $500 million, I am just going at a much larger number than what it is for a simple calculation. If you use $500 million at 5%. Our incremental investment would be $25 million in absolute dollars at 5% for the year. However, if we don't generate all of our income on day one. So, if we average it out for the year –

Board Chair Beruff: Yes, but we have, what is our reserves are $6 billion, $8 billion.

Kapil Bhatia: That is only invested. So, as it matures…

Board Chair Beruff: Right, but it matures, how much of it matures in the next 12 months?

Kapil Bhatia: We will have $2.3 billion as I mentioned earlier.

Board Chair Beruff: That is going to mature within the next 12 months?

Kapil Bhatia: Correct.

Board Chair Beruff: So why wouldn't I take that and do the same thing and just keep buying short term treasuries.

Kapil Bhatia: Correct. We were buying short term treasuries and corporate securities. So, on that $2.3 billion if we average it out, $1.2 billion will mature over the next six months.

Board Chair Beruff: And your corporate securities are above the two. What is a spread between your treasury bills and your corporate securities, we have to buy rate of securities of what, AAA, AA, what is it?

Kapil Bhatia: We buy up to single A.

Board Chair Beruff: It is a single A?

Kapil Bhatia: We diversify with a single A, AA and AAA. So, our average spread is somewhere between 50 to 75 basis points.

Board Chair Beruff: Above the treasury bill?

Kapil Bhatia: Correct.

Board Chair Beruff: Corresponding maturity?

Kapil Bhatia: Yes.

Board Chair Beruff: Okay, I am done.

Kapil Bhatia: Okay. Are we done with the market update or is there anything else?

Chair Knight: Thank you.

Kapil Bhatia: Governor Lydecker.

Governor Lydecker: (Inaudible mic was not on) What do you use to manage, just to educate me as a new person, what do you use to manage the different vendors that Citizens interfaces with to make recommendations? What is the mechanism that you measure their performances against?

Kapil Bhatia: So, the performances and everything else we have in the appendix, in the FIC report, but what we do is we have a team of investment managers. Certainly, I can go through the names, it is all listed in here and we have something called Clearwater analytical system. Clearwater system is used by most of the insurance and reinsurance industry globally. It is an analytical system where we can track each security, it’s ratings, what the yield is, and how each manager is doing. So, we can just spit out any report at any point of time and as well we check the compliance of our investment policy.

Governor Lydecker: So, does, and so forgive me because I did not see that in the book. And so I am sure it is here in one of the appendix, but is that something that we would expect to see in the future which is here are our managers that have this investments, here, here is how they are doing, A, and B, if they're not doing, if they're not doing that well, is there some kind of object system, objective system that indicates when they start moving from green to yellow and anticipation of going to red so we can make a change?

Kapil Bhatia: We certainly go through the RFP process. On page 4 of the appendix, you certainly see how many managers we have, what portfolio they're managing, and when we summarize it for the Board, we summarize it by the overall portfolio. That is what Jennifer and her team, and we do collectively.

Governor Lydecker: Yes, I think my question is more oriented towards, is there an objective system in place that would indicate whether a manager who has a chunk part investment that is part of Citizens, if they are living up to their billing or not relative to the group and/or relative to another set of external metrics?

Kapil Bhatia: Absolutely. If you look at page 8 of the report.

Governor Lydecker: So my question then is, is anybody, are there any managers that are not living up to -- like I can't give you advice on how to invest money and, you know, it doesn't seem that complicated do me, right, because it is basically a safe a portfolio as it can be other than when rates start skewing up and we are holding four-year average notes. But is -- but is there a mechanism in place and is that something we would see, and is that something I should see each time, because if it is, then if somebody isn't doing what they are supposed to be doing, then it feels to me like we just need to be changing folks out.

Kapil Bhatia: Absolutely and we have done that in the past. The Board delegates that decision once the RFP process has gone through it, but you can look at each manager's performance, how they're doing compared to it and we do show up in the color coded green and red. We certainly don't make a short-term decision, right. If you look at it everybody is performing closely because markets are behaving irrationally. In a sense fed has moved too quickly, but in the past those decisions have been done by the CFO. We provide you the report every quarter to give you the performance numbers, but at this point of time I can say all managers are performing well within it, it is just the market standard. That is why we are under compliance and some managers have been let go in the past and have been replaced by different managers. We also limit each manager's allocation, so we don't have too much risk with each manager. Our portfolio is almost $9 billion even though a true surplus is six and-a-half billion because we do invest what comes through our doors effectively. We have a limit of almost $1 Billion or not more than 5% of overall assets under management, et cetera. So, there are a lot of checks and balances to make sure we never lose any principle and to maximize the gains within the conservative nature of our portfolio and what cash flow we need to pay the claims if and when there is an event.

Governor Lydecker: Yes, yes, thank you for that answer.

Chair Knight: Yes, thank you, could we finish the market update and then we can go into any more details on this process and measurement system on the investment portfolio update?

Kapil Bhatia: Sure. Happy too. Thank you, Governor Knight. I will come closer to the speaker. So, I was just at the market update. The results of the higher interest rate and lower equity prices will lead to economic recession certainly. However, at the same time we believe the pendulum on the interest rates have swung too far and as always, the markets have overreacted and overcorrected. As seen by the 25-basis point increase in interest rates on a single day when last week the difference in CPI was three-tenths of a basis point. We expect interest rates to come down as the economy slows down for some of the following reasons. As almost all of the fiscal stimuli in the total amount of $5.7 trillion is spent and is mostly already reflected in economic growth numbers. The economy is going to slow down with the increase in interest rates and the lower equity prices. Housing sector is slowing as mortgage rates have almost increased 100 percent over the last 12 months, and at highest rates since 2007. Global macro conditions will improve as the world adjust to be geopolitical crisis. Savings rates are down and that should reduce consumer demand, and of course increase prices due to inflation. The U.S. economy shrank at a slightly slower rate than estimated during the second quarter with a reduction of .6%. However, we expect third quarter to be negative again when the numbers come out in October with the economy going down by almost half a percent again. And lastly, base effect of high prices becomes part of the base prices. As the prices have already gone up, the change in prices next year will be less than what it was this year, so the rate of inflation will come down by itself. Not the prices, but the rate of inflation or the rate of change. And lastly, this has also affected our investment portfolio as interest rates have significantly increased and has resulted in a negative mark to market value. We are not selling any securities, so we will not have any realized losses, but we are seeing higher interest income, absolute interest income on the new investments and maturing investments. Our portfolio is stable and higher interest rates are economically beneficial for us as they lead to higher interest income as we talked about a few minutes ago. I will stop here and be happy to answer any questions before going to the risk transfer markets if there are any.

Board Chair Beruff: Madam Chair.

Chair Knight: Yes.

Board Chair Beruff: I would like to ask. Kapil, if you go to page 8 of the appendix.

Kapil Bhatia: Yes, sir.

Board Chair Beruff: Will you walk me through some of the red that shows up there under Northern Trust, and particularly, I don't know how to pronounce, Macquarie, I don't know how to pronounce that one and RBC which is Royal Bank of Canada and tell me what is going on with those numbers.

Kapil Bhatia: Okay. So certainly, the red is if you are outside the plus / minus 10% of the average of all of the managers. The reason we don't use benchmarks, even though there are industry benchmarks which can be used, however, if we use the benchmark then every manager follows the benchmark and our portfolio looks exactly alike for all managers, so we don't get any value out of it and therefore we use internal benchmarks for internal references. We use the average return on our policies to evaluate each manager. If you look at some of the green numbers, the first four columns are total return which shows investment income or interest income plus realized or unrealized gains or losses. So, as you can see our return for one month is 2.53%. That is a total return. For three months is 1.59%, and as the negative returns in the third and fourth column for six months and year-to-date, July, is really a reflection of unrealized losses which we are holding onto our portfolio because of the significant change in interest rates as we talked about earlier. The last four columns are more relevant because that shows us the true income return what our portfolio has generated, not the unrealized losses which are in the portfolio which will evaporate as the portfolio matures. So, the one-month return is 21 basis points, and our year-to-date July return is 1.42% and is for the seven-month period. In the next quarter's report, you will see September and one month, three months, six months and then the nine months and then we continue to move forward.

Board Chair Beruff: Is Northern Trust and RBC underperforming significantly more than the others?

Kapil Bhatia: Northern Trust, and as you see Northern Trust and RBC have a higher duration, which you can see in the first column. Six point six years and 6.44 years compared to the other ones. So, when you have a high duration as the interest rates move up or down you have more volatility. So, if you look at their one-month return, suddenly when the interest rates go down, they perform better. If you run, put on the elastic band, they stretch more and come back quickly. The one-month total return is 2.97%, but the year-to-date return is negative 9.6%. So as interest rate starts to behave normally, their portfolio will behave better than the other ones. So that gives us the diversification in the portfolio that each manager is taking a different approach and not following the herd mentality.

Board Chair Beruff: Thank you.

Kapil Bhatia: If there are no more questions should I move to the risk transfer markets?

Chair Knight: Yes.

Kapil Bhatia: Reinsurance markets are in flux as we talked about in the last meeting and suddenly, we see all in the reinsurance prices with slightly reduced capacity. So far this year risk transfer rates have increased by 10% to 15% globally regardless of the risk, and in Florida they have increased by 30% to 40%. Some of the factors of the increase are similar to what we are talking about from a global macro perspective as everyone is anticipating for the fed to increase rates, multiple unknown variables from Russian invasion, inflation, and of course global monitor policy tightening. Just in summary, some of the major factors for risk transfer market price increases are from five years of global insured losses of half a trillion dollars, continuation of COVID crisis and associated business interruption losses, Russia's invasion of Ukraine and associated aviation losses. Significant mark to market losses in reinsurance investment portfolio as a result of higher interest rates and a lower equity price resulting in a significant mark to market unrealized losses and that has reduced available capacity to write risk transfer. Trapped capital from prior events and especially from recent hurricane events and from large number of COVID related cases.

And of course, we all know the Florida market has its own problems stemming from litigation, continued adverse loss development and credit quality concerns of primary insurance. As a number of insurance companies, we all know have gone into receivership. While the legislation passed in the special session is a step in the right direction, it will take some time for us to really see the benefit of it. It is too early to really talk about the benefit, but there will be some long-term benefits. The challenges in Florida market includes the greater frequency of secondary perils, severe thunderstorms, hale, escalated inflations, etc.. A recent report published by A & M Best really illustrates the magnitude of reinsurance losses as it comes to the Florida market. Premium assumed by U.S. reinsurers, and I know we are all talking about reinsurance rates have increased, which have increased premiums received by U.S. reinsurers have by approximately 66% over the last three years. So that is what shows up in the higher rates. However, the loss ratio has increased significantly more without any significant hurricane losses over the time. Further suggesting that the current pricing is not sufficient to cover for litigation, AOB and other Florida problems. So, reinsurance rates we expect continue to go up this year and suddenly there is not really anything insight which will balance the reinsurance rates because of all of those macro factors. And lastly, over the last three years the reinsurance losses have increased fourfold without any significant hurricane activity, and it topped $1 billion in 2021, ten times more than where we were in 2012. So, we should not expect any lower reinsurance rates. With that I will stop here and be happy to answer any questions.

Chair Knight: Are there any questions?

Board Chair Beruff: No.

3. Chief Financial Officer Report

a. Layer Charts Update

Jennifer Montero: Thank you. Behind tab three, again, you will have the layer charts. And that is the coastal account on the screen. These layer charts have been updated using June 30th, 2022 Probable maximum losses to the PML projected to September 30th, 2022. The coastal account chart is very similar to the chart presented in July that used the 12/31 PMLs projected to September 30th, 2022. The projected PMLs for a 1-in-100-year event remains at $5.57 billion. There was a slight increase in the Florida Hurricane Catastrophe Fund. It increased from $1.522 billion in coverage to $1.526 billion. The surplus exposed in the 1-in-100-year event for the coastal account is now 87%. Overall, the forecast for the coastal account has been on point. Great work from Bethany Kocher and the whole corporate analytics team. On PLA, we were not so accurate forecasting the personal lines account. The projected PML for the 1-in-100-year event decreased by 5.5% to $6.527 billion. The Cat Fund coverage decreased from $2.521 billion to $2.427 billion. Additionally, the emergency assessment decreased 2.2% from $1.278 billion to $991 million. Citizen's policyholder surcharge remains $450 million which is 15% of the PLA's premium. However, the Citizens' policyholder surcharge does not kick in until the 1-in-64-year event which you can see on the left side of the screen. And if you look to the right, you will see that it is, the 1-in-64 years or equivalent to the $4.7 billion of losses. We will have to go through those losses before the assessments would kick in. The surplus exposed in a 1-in-100-year event on the personal lines account is 100%. The next slide is the commercial lines account. Thank you. We only purchased the Cat Fund coverage as required by law. We did not purchase private reinsurance in the commercial lines account. The surplus exposed is only 13%. This was just an update because we used the updated PMLs for these charts. So, the good news is the assessments are lower. That is the only good news.

Board Chair Beruff: You can stop there.

Jennifer Montero: Yes. Any questions?

Chair Knight: Any questions?

Board Chair Beruff: No.

Governor Lydecker: No.

Jennifer Montero: Thank you.

Chair Knight: Moving to the reinsurance management software action item.

b. Reinsurance Management Software [AI]

Jennifer Montero: Thank you. Citizens request approval to contract with Effisoft USA for reinsurance management software. The reinsurance management software provides a platform to manage Citizens' reinsurance contracts from the inception through computation. It is a best industry practice. The contract approval is requested for five years base term with one three-year renewal option for a total not to exceed $2 million for the eight years. This platform is a cloud-based solution with functionality that includes preparing Schedule F for the financial statements, maintaining contracts with different attachment points and with multiple participating reinsurers. Track recoverable amounts and age receivables. Calculate collateral requirements. Calculate and generate billing statements. Generate adjusting journal entries and the import and export data either manually or integrate with existing systems or the data warehouse. The software will replace manual processes that offer little scalability in the case of multiple reinsurance triggered events. Having this software in place prior to any such new event will provide better visibility to Citizens ceded balances and reduce liquidity risks to the company that could result from the breakdown of manual reporting processes. The requested contract was negotiated on best value to Citizens pursuant to invitation to negotiate number 22-0002, reinsurance management software solution, and I will pause there for any questions before I read the action item.

Board Chair Beruff: Madam Chair, if I may.

Chair Knight: Yes.

Board Chair Beruff: We had a discussion when I was briefed on this subject and we have been doing it manually forever, right. And I did have some confusion at the tail end of the conversation, I think with Mr. Gilway. We thought the contract was eight years, but now I realize it is back to five years. Is it eight or five?

Jennifer Montero: It is eight years.

Board Chair Beruff: Okay.

Jennifer Montero: But the cost is over eight years.

Board Chair Beruff: Okay. So, is it two million divided, is it by eight or is it two million divided by five?

Jennifer Montero: Two million divided by eight.

Board Chair Beruff: Okay, that is much easier to understand. Why did we say five years here? I guess that is the confusion. In your presentation you said five years.

Jennifer Montero: It's a five-year base term with one three-year renewal option.

Board Chair Beruff: Okay, so it is an eight-year contract if we take it to term, and we take the extension, but the whole eight-year cost to us is $2 million.

Jennifer Montero: That is correct.

Board Chair Beruff: Okay. So, because my angst with it as we discussed in my briefing was that if you are at $400,000 a year, I would rather hire two people and give two people really good jobs to do this than to pay some computer $400,000 a year to make somebody's life easier.

Jennifer Montero: It's the –

Board Chair Beruff: Hold on, let me finish, because my real concern was the $400,000 a year. I am somewhat less concerned about $250,000 a year as long as it is a product that makes us, I don't know truly what it really does other than make it simpler for somebody to do a job, because between Mr. Martins' department and other people we are not going to lose any money. We are not going to -- if the reinsurance kicks in and you have to administer multiple reinsurance policies with different points where they come in and where you have to pay and all of that stuff that you have been doing for whatever, a couple of decades this has been going on. Again, I am not terribly concerned anything is going to fall through the cracks. So, explain to me one more time why we need to spend a quarter million dollars a year for essentially a software program that we have been doing without for a decade or longer.

Jennifer Montero: Okay. First, I will clarify that the first year has implementation service fees that are fixed of $188,830 and the first year for the license software subscription hosting and all that stuff is $183,600. And in year two is $183,600, year three is $183,600, so on and so forth through year five. So, it is less than $250,000. It got the top expense in the first year for implementation. And then we have on the renewals, and the renewals are $240,000 a year for those three years. And that is where you get the total. So currently we are tracking two storms and we are tracking Wilma in the PLA and Wilma in the coastal account. Both of them have one layer each, the sliver, that is all we bought at the time. And in addition to that we have Wilma that has pierced and that has pierced into two layers. One is a sliver which is the big one, but then on an aggregate basis if you remember there are four storms that made up like $250,000, but because Irma pierced it, we got that coverage dropped down. We are tracking that. We are going to try and compute that. It's less than $300,000 total recoveries, but with the other two we have been very lucky because Irma we did not write any -- we did not have any reinsurance in the PLA with Irma, only in the coastal account. So, we had one account and it only hit one layer. So, we have been very lucky and we have been able to keep track of this on a spreadsheet, but best industry practices uses a management system because if you look at our program today and we got hit and got hit big where it triggered multiple layers, each one of those layers has its own terms and where it attaches and where it exhaust. Who's on, which reinsurers are in that layer and then what are the terms with each of those, because they could be different as they're negotiated differently. And then if you take that and you add that multiple layers getting hit or you start having multiple storms in different, you know, not one hit five layers, but different storms come, and hits and you have got to track all.

Board Chair Beruff: Ms. Montero, I don't deny the complexity of multiple storms and having to manage the multiples storms and the multiple reinsurance and where it comes in and where it doesn't. I just question whether or not if we have to take on the responsibility of spending that money, okay, are we better off hiring another person or person and-a-half and giving somebody a good job as opposed to paying a software company to provide us a software tool that still has to be managed by someone on our end. If we are going to take dollars, we are a pseudo public agency, okay. We should be conscious of how we treat the money we spend, and if jobs are going to -- if our federal reserve does the thing it has to do in order to control inflation, you are going to start seeing unemployment finally go up sometime in the next two, three quarters. Kapil?

Kapil Bhatia: We believe the fed is going to increase until the end of this year.

Board Chair Beruff: Right, but what do you see, when do you see unemployment start actually racketing up necessary enough to stop inflation?

Kapil Bhatia: The whole objective for them is to stop inflation. That means that unemployment number has to be around five percent, four and-a-half to five percent to get to that point.

Board Chair Beruff: So somewhere in the next 12 to 24 months you will see an unemployment rate close to five percent, I guess?

Kapil Bhatia: That is correct, but then it is going to be –

Governor Lydecker: I am giving you big kudos for being able to predict this in the manner by which you are. I heard you predict it for sure with 100 percent certainty we were heading into a recession. I was pretty impressed with that.

Kapil Bhatia: It is not predicting the future.

Board Chair Beruff: It is predicting the present.

Kapil Bhatia: It is just what fed is using and what fed is really trying to say very clearly communicating the message what their intent is and what they plan to do, and there are enough papers published which analyzes if the rates go up 100 basis points as you have seen the number of layoffs, what that will translate into. If it is not five, four and-a-half, but the intent is to bring the economy into recession and slow down so inflation can be managed from the demand side because there is not much they can do on the supply side. So everything, even though it is not exactly, I can predict or anybody can, but what the intent or the objective is to get to this point.

Chair Knight: Mr. Bhatia, can you answer specifically with your experience with software like this and other clients that utilize this versus actual employees what is the difference to address the question of why would Citizens utilize a software versus utilize live humans?

Kapil Bhatia: All of our other clients do have a reinsurance software. I can say how does that relate to a person doing it because software is just always an efficient tool, like we all use it, but I don't know if I can specifically state how that changes the human side of it as compared to the software. We know the software, we all use Excel because it is easier to calculate than anything else, and reinsurance software is a much deeper layer and more as all of our other clients do have some software with a large insurance program to easily track it when the times comes. And the objective is to get the monies as quickly as possible and software allows us to do it. That is all I can say on that part.

Jennifer Montero: And I will add in, it is an automated process versus a manual process, and manual processes even if I hire lot more people you have errors lot of times with manual processes and this is –

Governor Lydecker: Madam Chair, may I make a comment subject to my Chairman if you have finished your thought process.

Board Chair Beruff: I am done.

Governor Lydecker: You know, I don't pretend to be any expert in, you know, in particular one software versus another, and when I was getting briefed, I asked about the other software and more about the process. I was actually a little bit surprised that you didn't have this. The best I can tell Citizens is growing, not shrinking and I appreciate the Chairman's comments relative to employment related issues and people related issues and being supportive of a concern of the direction the economy is going. So, I don't want to, I don't want my comments to suggest that I take that lightly, because I think those are really fair points. My only observation would be that the level of sophistication that is increasingly being required of Citizens and the placement of reinsurance and what is a very hard market and there is not any indication that 2023 is going to be less difficult to place. This to me really isn't a question about, you know, people versus software. This is a cradle to grave all the way through computation, I think. Software that is really important, particularly for our ability to be, be available for claims and for an efficient processing of if a storm does hit. It is something that would mean a lot to me, but you know, we are talking a little bit in the, right now in the placement side, but the potential for human error with this level of sophistication is pretty high. And so, and that could also be pretty painful at the wrong time down the road. And I only share those comments which is why I am for it. I think it is a good use of an expenditure and something that Citizens should be doing. If Citizens were shrinking or the horizon suggested that Citizens, the number of policies I think is, you know, exceeding a million and going up and up, I think that is, you know, my own sense is this is a prudent move on the part of staff quite frankly and, you know, that is why I will be for it. But having made some comments I would just preface it in the spirit of like I think my Chairman's comments are really important. I just don't know if it is as applicable on this software.

Chair Knight: Thank you, both perspectives and comments appreciated. Are there any other questions?

Board Chair Beruff: No.

Governor Lydecker: No.

Jennifer Montero: May I read the action item?

Chair Knight: Yes

Jennifer Montero: **Staff proposes that the Finance and Investment committee review and if approved recommend to the Board of Governors to, (a) authorize the reinsurance management software contract with Effsoft USA for an initial term of five years and for one three-year renewal term. For an amount not to exceed $2 million as set forth in this action item. And (b) authorize staff to take any appropriate or necessary action consistent with this action item**.

Governor Lydecker**: I will make a motion to approve**.

Board Chair Beruff: **Second.**

Chair Knight: Okay. **The same motion carries based on three, three of us on the committee**. Thank you, Ms. Montero.

Jennifer Montero: Thank you.

Chair Knight: Are you going to cover the investment portfolio update?

c. Investment Portfolio Update

Jennifer Montero: Yes. That is the next tab, and I will be quick. Yes, it is under the investment portfolio tab right before the index.

Lydecker: I have to find that again if you could just bear with me. I lost it, I had it before.

Jennifer Montero: No problem. It's behind tab three.

Lydecker: Ok, I am there, thank you.

Jennifer Montero: Okay. And the total portfolio is $9.58 billion with approximately $8.77 billion or 92% externally managed by 10 investment managers. The remaining $810,000,000 or approximately 8% is internally managed, and primarily consists of operating funds, debt service funds and debt service reserve funds. The taxable portfolio is $9.29 billion or approximately 97%, and the tax-exempt portfolio is only $290 million or approximately 3%. The portfolio is very conservative and stable with sufficient liquidity to pay claims or potential future claims. The total portfolio average duration is just over 3.96 years. The annualized total return for the last three years from 2019 through 2021 is 4.02%. The 2019 through 2021 portfolio's annualized net income as earned and reported in our financial statements is over 2.7% annually. The annual net income return for 2019 was 2.7%, for 2020 and 2.96%, and for 2021, was 2.84%. These net income returns are after investment manager fees and include net realized gains or losses as well as accretion and amortization of discounts or premium. The 2022 year-to-date July income for the total return is 1.13%, and -5.8% respectively. On slide two, treasury rates have exponentially increased over the last 12 months as they reflect the fed rate increases, as well as anticipated rate increases over the next six months as the fed tries to manage the inflation. The yield curve is flat or marginally inverted, current two to 10-year spread is negative two basis points as markets are expecting a recession again due to global macro-economic factors. The tax-exempt rates have also similarly increased. On slide three, both the taxable and the tax-exempt portfolios have very strong credit quality. Over 73% of the taxable portfolio is in the money market funds are rated “A” or higher, and 100% of the tax-exempt portfolio is in money market funds are rated “A” or higher, and approximately 37% of the total portfolio is in treasury and agency securities or in the money market fund. And slide four, the portfolio income return is stable, and this slide again reflects returns for one through three years based on the market yields. We expect income return to be approximately 2.5% in 2022, as we get the incremental interest income from rising interest rates. The portfolio total return is negative due to the significant increase in interest rates during 2022, but as the portfolio matures over time, the negative mark to market value will evaporate. That concludes my report.

Chair Knight: Are there any questions?

Board Chair Beruff: No.

Governor Lydecker: No.

Jennifer Montero: Thank you.

Chair Knight: And Chairman, are you satisfied with the answers you received from the audit committee question?

Board Chair Beruff: I am, thank you, madam.

Chair Knight: Is there any new business?

Board Chair Beruff: No.

Chair Knight: I presume no. We will adjourn the meeting at 2:11:00 p.m.

Board Chair Beruff: Thank you.

Governor Lydecker: Thank you.

Chair Knight: Thank you all.

(Whereupon, the meeting was concluded.)