

CITIZENS PROPERTY INSURANCE CORPORATION

**MINUTES OF THE
FINANCE AND INVESTMENT COMMITTEE MEETING
Tuesday, June 21, 2016**

The Finance and Investment Committee (FIC) of Citizens Property Insurance Corporation (Citizens) convened at the Sheraton Orlando North in Maitland, FL on Tuesday, June 21, 2016 at 2:30 pm (EDT).

The following members of the FIC were present:

Chris Gardner, Chairman
Jim Henderson

The following members of the FIC were present telephonically:

Bette Brown

The following Citizens staff members were present:

Barry Gilway
Jennifer Montero
Barbara Walker
Andrew Woodward
Matthew Gerrell
John Rollins
Karen Holt

The following people were present:

Kapil Bhatia	Raymond James
Dave Newell	FAIA
John Generali	Wells Fargo
Mark Weinberg	Citi Group
Coleman Cordell	BOA Merrill Lynch
Tamaa Paterson	Jefferies
Adam Schwebach	Guy Carpenter
Rawn Williams	Jefferies
Nathaniel Johnson	JP Morgan
Randy Hanna	Bryant Miller Olive

Call Meeting to Order

Barbara Walker took roll.

Chairman Gardner: Great. Governor Brown, thanks for making the call today. Otherwise Jim and I would have to agree on everything. So we appreciate your being here.

1. Approval of Prior Meeting's Minutes

Chairman Gardner made the motion to approve the March 15, 2016 Finance and Investment Committee (FIC) Minutes. Jim Henderson seconded the motion. All were in favor. Motion approved.

Chairman Gardner: Second item of business is the market update Kapil Bhatia, you are recognize.

2. Market Update

Kapil Bhatia: I will be very brief. Please stop me at any point of time with any questions. There are currently 7.4 million people unemployed in the U. S., and the unemployment rate is 4.71 percent. There are currently 158 million civilians employed in the United States, which is 62.6 percent of the total population of 245.2 million. The participation rate in the labor force is the lowest since 1978, at 62.6 percent. The lower participation rate reflects really a structural deficiency in our labor force and a mismatch of skill set. The U. S. economy added only 38,000 jobs in May, the lowest level in six years. So 4.7 percent is not really the true unemployment rate. What we are missing here is the people who are marginally attached to the labor force as well as who are working part time due to economic reasons. If we include that the total unemployment rate which the Bureau of Labor and Statistics calculates it is at 9.7 percent, which really is what the unemployment rate is, and that is one of the reasons we have no base growth in our economy and no inflation. And actually there is more fear for less of deflation in the marketplace.

The Fed increased rates in December of 2015, by 25 basis point and they were talking about four rate increases from 2015 to 2016. However, we are yet to see one, and most likely we will only have one rate increase and that may be in December of 2016. The economic growth is very slow. We don't expect much things to change. Interest rates are low and expected to remain low and the growth forecast is expected to be around two percent for 2016 and for 2017. The equity markets have been on a risk off and risk on mode regardless of the reason and its different every day, it is a risk off and risk on trade. The S&P 500 is relatively flat for the year after being approximately down by eight percent in the early part of 2016.

Nothing much is different in global economy. Global economy is also slow. There is a lot of discussions going on regarding Brexit however, regardless of what it is, it will have a short time impact on global economy, at least in the U. S. but there may be a much bigger impact on the European Union. The rates are very low. We think they are low in U. S., they are actually lower in

Europe. Looking at some of the numbers it may be helpful to put it in perspective. Rates are negative for almost \$11 trillion of fixed income securities trading in the marketplace. Rates are negative for up to nine years in Germany, up to 30 years in Switzerland and up to five years in Denmark and that is not really helping the growth of any economy globally. Some of the side effects of negative interest rates include, it encourages cash holding, not a productive use of cash. For example, Munich Re, one of Europe's largest reinsurers is actually storing cash in vaults instead of leaving it in the bank and not producing anything. So that effectively means shrinking of money supply even with the negative rates. Damage to the savings industry and particularly for insurance and pension funds which are getting lower and lower return and in some cases negative return, so they are not investing it. All of this leads to a strong bond market issuance.

Bond market issuance in the corporate world is very strong, over \$1.5 trillion issued in 2015, and the estimates for 2016 is over 1.6 trillion. So far year-to-date issuance is \$722 billion and all of the issuance is not really going into productive use, it is going for the financial engineering in the form of merger, acquisition, stock buy backs and others to boost the corporate profits. As a nation we invest less today in infrastructure than we did in 1999. The conclusion here is the monetary policy is not working regardless of what Fed does or what ECB does or what the Japanese Central Bank does. Fiscal policy is nowhere to be found and that effectively means we are going to see the same one to two percent growth and same static inflation in the marketplace. Interest rates are low as I said earlier. One year at 53 basis point, five year at 116 and 10-year at 164. That five and 10-year effective rates reflects that there are no expectations of significant growth in the marketplace. Lastly, on the risk transfer market the rates are flat to lower by five to 10 percent in the U.S. market for 2016, and Jennifer will go through our placement for 2016, and you will see how the pricing has changed. Reinsurance demand is projected to grow which may finally stabilize in late 2016 or early 2017, as more and more perils are coming into the insurance market. 2016 is also projected to have only minimal to modest change to 2015, and overall marketplace in the insurance link securities as alleged in the reinsurance market. With that I will stop to see if you have any questions or any additional details you want.

Governor Henderson: None, thank you, good update.

Chairman Gardner: I have one question. How do you see beyond growth, you know, how do you see the unwinding of these negative interest rates in these economies?

Kapil Bhatia: It is almost impossible to know how they are going to unwind it because they have never done it. So at this point in time we think it is going to be a slow approach and they are going to hope that the inflation picks up at some point of time. Otherwise, we probably don't see negative interest rates going away at any time in the near future, especially in Europe. I don't think that is an issue or concern in the U. S., but once the Japanese Central Bank and European Central Bank have taken that path, probably it is harder to come out of that, especially in Japan they have a much bigger problem. They have been in economic kind of circular, vicious circle with no growth for almost 20 years with the changing demographics that it is really going to be hard for them to come out. Europe may see the growth once the refugee crisis and migrant crisis stabilizes, there is a good chance they can come out of it. However, it is unlikely at least for the next 24 to 36 months.

Chairman Gardner: Okay, thank you.

Kapil Bhatia: Thank you.

Chairman Gardner: All right, so we are to item three, the reinsurance update, Jennifer.

3. Reinsurance Update

Jennifer Montero: Thank you, Mr. Chairman. If you will turn to tab three you will find the coastal account layer charts which I will reference as I walk you through the successful placement of the 2016 risk transfer program which the Board approved at the May 24th Board of Governors teleconference. The 2016 placement involved reallocating \$443.3 million of the 2014 and 2015, multi-year aggregate reinsurance coverage to a layer that wraps alongside and above the coverage provided by the Florida Hurricane Catastrophe Fund. This shifted the multi-year aggregate reinsurance coverage to a single year per occurrence wrap layer that works in tandem with the mandatory coverage provided by the CAT fund. The rate online for this layer was 10.25 percent which is one percentage point lower than the 11.25 percent rate online to the wrap last year. In addition we placed \$221 million of commercial non-residential coverage within the global reinsurance market. This layer provides coverage for 50 percent of CNR losses in excess of \$517 million. This program provides coverage for commercial non-residential losses not covered by other layers of the program and for which Citizens has no CAT fund coverage. This layer was oversubscribed by more than 100 percent and the rate online was 6.0 percent as compared to 6.75 percent last year. As mentioned previously, 2016 has been a transition year for the Citizens' reinsurance program. Staff has worked extensively with our co-brokers and our financial adviser to evaluate available options relating to the structure, terms, pricing and other relevant matters in structuring the 2016 risk transfer program.

The team worked with a number of global traditional reinsurers over the past few months regarding the implementation of this transition strategy. The 2016 risk transfer program consists of approximately \$646.3 million of coverage in the traditional market and \$1.8 billion of coverage in the capital markets through the 2014 and '15 CAT bonds. These together provide Citizens with more than \$2.4 billion of risk transfer coverage for the 2016 storm season. Although this is a decrease of more than \$1.4 billion of coverage as compared to last year, our surplus exposed in a 1-in-100 year storm continues to remain less than 60 percent. Total program costs for the private risk transfer program are expected to be approximately \$180 million, which is approximately 10 percent less of the budgeted amount of \$204 million. And if you don't have any questions that will complete my reinsurance update.

Chairman Gardner: Questions, Jim?

Governor Henderson: No, well done, and who are out there ordained that we do not have hurricanes for 10 years, thank you very much. And for the investment community that has found their way into this market, thank you very much. We will continue to buy from you and protect the citizens. So job well done.

Jennifer Montero: Thank you.

Chairman Gardner: Those are good comments and I agree. So good job this year, Jennifer, thank you.

Jennifer Montero: Thank you.

Chairman Gardner: Okay, so we are to item four, the investment portfolio update.

4. Investment Portfolio Update

Jennifer Montero: Yes, behind tab four we have a couple of updates to this report. We have updated some of the charts, et cetera, that kind of make it more -- what is the word I am looking for, Kapil?

Kapil Bhatia: User friendly.

Jennifer Montero: User friendly that is the nicer way to say it. So hopefully you find it easier to follow. The total portfolio is \$13.48 billion, the taxable portfolio is \$8.83 billion which is about 65 percent of the total portfolio. The tax exempt portfolio is about \$4.65 billion which is about 35 percent. The total return for one year is 1.71 percent and the total taxable return for one year is 1.97 percent. Tax exempt return one year is 1.27 percent. Turning to slide two, rates for 10 and five year Treasury have been volatile and are marginally lower than March 2016. It is significantly lower than last year. The tax exempt interest rates, SIFMA rate has increased in the last month and the two year MMD rate has increased one basis point over the last year. Slide four is the market update which Kapil just provided, so I am going to skip that slide. The portfolio summary is on slide five. Over 88 percent of the portfolio is externally managed by 15 money managers. Approximately 12 percent is internally managed consisting of operating funds, debt service funds and debt service reserve funds. The next slide reflects how the \$11.8 billion externally managed funds are allocated among the 15 managers. There are 14 taxable managers and eight tax exempt managers. The portfolio is diversified, balanced, liquid and stable with strong total returns. Turning to slide seven, both the taxable and tax exempt portfolios have strong credit quality. Thirty-eight percent of the taxable portfolio is in Treasury and agency securities and approximately 81 percent of the tax exempt portfolio is rated AA or higher with 49 percent of the taxable portfolio being rated AA or higher.

The portfolio return summary is on slide eight. The one year total return is 1.71 percent and the income return is 1.15 percent. The duration is 2.39 years, which is an increase of 15 percent over the last three months, and that is because we have changed the investment policy to increase the duration. So, we are seeing that. The taxable liquidity portfolio on slide nine provides the first source of funds for liquidity and claims paying after a storm. The portfolio is very liquid with strong credit quality. It has duration of one year and a one year total return of 86 basis points. The chart compares total return, income return and duration for each of the liquidity fund managers. The taxable claims portfolio, slide 10, it is stable, diversified liquid with high credit quality. The duration is 3.3 years and the total return of 2.3 percent, which is greater than the return on the 10-year Treasury. And the chart below compares the total return, income return and duration for each of the claims paying fund managers. On slide 11 is the tax exempt claims portfolio. It is also

stable, diversified, and liquid with high credit quality. Duration is 2.3 years and the total return is 1.5 percent and the income return is 1.1 percent, and the chart also compares the total return, income return and duration for each of the claims paying fund managers. Slide 12, this is the maturity distribution slide. It is a staggered approach. Approximately 25 percent of the portfolio matures in less than nine months, and approximately 60 percent matures between one and four years, and the average duration is 2.39 years.

And the last slide is the downgraded securities. It is excluding the legacy assets are less than .45 percent of the portfolio and are currently trading at cost with stable pricing. The legacy assets are old securities and represent approximately .75 percent of the portfolio but are currently trading significantly above the amortized cost. As you recall at the March Board meeting the Board approved the sale of the legacy securities at a market sales price of between 80 percent and 90 percent of its market value. Since that time Citizens sold two of the four legacy securities. Atlantic East and Pacific West were sold at 88.2 percent of the December 2015, market value. Proceeds for the sale totaled \$60.5 million including approximately \$13 million in realized gains and I believe \$11 million of that is within the coastal account. Currently the other two legacy securities, Issuer Entity (Ottimo) and Axon Financial Funding are valued significantly below Citizens' minimum pricing threshold of 80 percent of their expected market value. Therefore, we will continue working with Raymond James to evaluate the underlying securities and will update the Board in September. One note, the report incorrectly states on the last page that Axon Financial Funding was sold. That was actually Atlantic East that was sold in May. And that completes my investment report.

Chairman Gardner: Any questions, Jim?

Governor Henderson: Remind me again how do we balance between the taxable and non-taxable portfolio?

Jennifer Montero: When we issue pre-event bonds, those proceeds have to go into the tax exempt bucket and our operating costs are the taxable.

Governor Henderson: Thank you. I guess similar to the CAT fund, I think they were into same issue. Thank you. And thank you, by the way, too, in looking at the portfolio that maturity schedule.

Jennifer Montero: Yes.

Governor Henderson: It does appear we are picking up some rate there with some minor expansion of the portfolio and the timing without any threats. It is great to get the additional return.

Jennifer Montero: Yes, thank you.

Chairman Gardner: Great, thank you. We are to item five, the financial advisory investment consulting action item.

5. Financial Advisory & Investment Consulting [AI]

Jennifer Montero: Yes, this is an action item that I will need approval from both this committee and the Board tomorrow.

Chairman Gardner: Okay.

Jennifer Montero: So this action item seeks board approval to engage the services of Raymond James & Associates to provide financial advisory and investment consulting services listed in the contract resulting from invitation to negotiate 16-0004. On February 19, 2016, Citizens issued Invitation to Negotiate 16-004 for financial advisory and investment consulting services. Vendor responses were due by March 29, 2016 and one proposal was submitted. This proposal was reviewed by the evaluation committee after negotiation regarding annual fees, the evaluation committee recommended the award of the contract to Raymond James & Associates. The contract term is anticipated to be five years and at Citizens' discretion have two, two year renewals. It is a budgeted item. There are, the financial advisory and investment consulting service fees including renewals not to exceed \$6,120,000. In addition, there are transaction fees in the event that Citizens issues pre-event or post event bonds, or if Citizens acts as a sponsor in an issuance of a catastrophe bond, the transaction fees are as follows. The pre-event and post event bond issuance are \$1 per 1,000 unit and catastrophe bond is 1.25. Can I read you the final, the formal recommendation?

Chairman Gardner: Please.

Jennifer Montero: **It is recommended that Citizens' Board approve the recommended award and resulting contract, including the renewal terms as set forth in the financial advisory and investment consulting services action item and we authorize staff to take any appropriate or necessary action consistent with this action item.**

Chairman Gardner: Great. Before we talk about motions I just want to say that we have enjoyed a true partnership with Raymond James. Kapil, you have just exceeded every expectation, you have been a great partner. I am sure the reinsurers out there would agree and the bankers would agree, staff would agree, you have really helped us work through some difficult times and you have helped us in some easier times, but you have lent a lot of support to Jennifer and her team and we are very grateful. So this is -- this is well earned. So thank you for what you do for us.

Jennifer Montero: Yes, thank you, Kapil.

Kapil Bhatia: Thank you, thank you, Mr. Chairman.

Chairman Gardner: **So with that if there is discussion. I will accept a motion.**

Governor Henderson: **So moved.**

Chairman Gardner: **Governor Brown, are you there to second?**

Governor Brown: I second.

Chairman Gardner: A motion and a second.

Chairman Gardner: Great, thank you. Seeing no objection to the motion, it carries. Thank you. We are to new business, is there any new business for the good of the order, Governor Brown?

Governor Brown: Not from me.

Chairman Gardner: Jim, are you good?

Governor Henderson: I am good.

Chairman Gardner: I just want to say as one of the users on the user friendly, we can still go with maybe a little more detail. If we could have that as maybe an appendix to show the detail, but we are covering a lot of information particularly on the investment update, so maybe we can –

Jennifer Montero: Make it shorter.

Chairman Gardner: Right, it might be the user issue, I am sure Jim is fine with it.

Governor Henderson: Yes, absolutely, it was a very good idea. I think one there has been certainly a lot of press with respect to our friends in the islands south of us, Puerto Rico, and their bonds and all. I guess without detail do we have an exposure there or is there an issue for us with respect to their securities?

Kapil Bhatia: No, we don't have any exposure to Puerto Rico. We kind of saw that and their ratings are beyond our investment policy guidelines. Our portfolio is very stable and we have a much stronger credit rating. So we don't have any exposure. As you can see from the last page, downgraded securities reflects .4 percent of our portfolio, and that is only marginally downgraded securities. We are very comfortable with our portfolio.

Governor Henderson: I commend you for your advice to us.

Kapil Bhatia: Thank you.

Governor Henderson: Of course, a lot of my friends didn't dodge that as well. So they own a piece of Puerto Rico now. But thank you for that update. It is very helpful.

Chairman Gardner: Okay, with that said, no other business, the meeting is adjourned, thank you.

(Whereupon, the meeting was concluded.)