**CITIZENS PROPERTY INSURANCE CORPORATION**

**MINUTES OF THE**
**FINANCE AND INVESTMENT COMMITTEE MEETING**
**Tuesday, September 27, 2016**

The Finance and Investment Committee (FIC) of Citizens Property Insurance Corporation (Citizens) convened at the Sheraton Orlando North in Maitland, FL on Tuesday, September 27, 2016 at 3:00 pm (EDT).

**The following members of the FIC were present:**

Chris Gardner, Chairman
Jim Henderson
Bette Brown

**The following Citizens staff members were present:**

Barry Gilway
Jennifer Montero
Barbara Walker
Andrew Woodward
John Rollins
Christine Ashburn
Dan Sumner
Violet Bloom
Brian Donovan
Michael Peltier
Mark Casteel
Kelly Booten
Steve Bitar

**The following people were present:**

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| Kapil Bhatia | Raymond James |
| Dave Newell | FAIA |
| Lisa Miller | Miller & Assoc. |
| Kevin Stokes | Guy Carpenter |
| George Smith | Bryant Miller Olive |
| Scott Cabalka | RBC |
| Matt Williams | BOA Merrill Lynch |
| John Modin | Citi Group |

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| Nadine Mentor | Ramirez |
| Nathaniel Johnson | JP Morgan |
| Eugenio Glavcon | JP Morgan |
| Henry Reyes | JP Morgan |
| Mark Weinberg | Citi Group |
| Coleman Cordell | BOA Merrill Lynch |
| Adam Schwebach | Guy Carpenter |

**Call Meeting to Order**

Barbara Walker took roll.

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

**Chairman Gardner made the motion to approve the June 21, 2016 Finance and Investment Committee (FIC) Minutes. Jim Henderson seconded the motion. All were in favor. Motion approved.**

**Chairman Gardner:** Item two is our market update, Kapil Bhatia you are recognized.

2. **Market Update**

**Kapil Bhatia:** Thank you, Mr. Chairman, and good afternoon, Mr. Chairman and Governors. I will briefly go over the market update, but if you have any questions please stop me at any point of time. The U-3 unemployment rate is 4.9 percent or 7.8 million people are unemployed. However, the U-6 unemployment rate which includes marginally employed or part time workers looking for full time employment is 9.7 percent. The labor participation rate is 62.8 percent which is a 38-year low, and if we adjust the unemployment rate for participation rate from 1997, then the actual unemployment rate will be over 11 percent. Technically, right, but not fundamentally correct. U-3 unemployment rate is not really a right indicator. We have a skill mismatch and structural deficiency in our labor force and therefore, there is a significant slack in the labor force and because of that inflation is going to remain low and pressure on wages also is going to remain low. And therefore, the end result interest rates are low and expected to remain low. If the Fed increases the interest rates in December by 25 basis point. The last time they did was in December of 2015. That would make it two increases in the last eight years, and we don't expect any further rate increase at least until late 2017. So again, interest rates are expected to remain low. Monetary policy has done its part since the 2007 financial crisis, but there is no fiscal policy, and therefore, the growth is going to remain slow also. For example, the growth rate from 1977 to 1999 was 3.2 percent. Since 2000, the growth rate has been under two percent and so far in 2016, one and a half percent. Not just in the U.S., global economic growth is also very slow. Because the U. S. reflects 25 percent of the global GDP of approximately 18.4 trillion, the rest of the world is moving slow because the U. S. is moving slow. Demographics with aging population in a developed world is one of the big reasons of slow growth. Actually Europe and Japan have bigger economic problems than the U.S. and their reliance on monetary policy through the negative rates is not working. There is more capital available in the marketplace with a pension fund investment for the aging population and the demand for capital is really slow.

To reflect all of these changes and the future of interest rates we are proposing some additional changes to the investment policy which we will go further down in the agenda and Jennifer has a brief summary of the agenda in your packet. Foreign market issuance for example is very strong because interest rates are low. Corporate issuance again this year is expected to be over $1.5 trillion and municipal issuance is expected to be closer to $385 billion. Most of the corporate debt is for financial engineering and not for infrastructure, and that is keeping the corporate profits marginally growing. And low interest rates are also keeping the risk transfer market both strong in the traditional and capital market, significant capital, even an abundance of capital we expect in 2017, risk transfer rates to be five to 10 percent lower than what would appear in 2016. With that I will stop unless you have any questions.

**Chairman Gardner:** No, I think we are set.

**Kapil Bhatia:** Thank you.

**Chairman Gardner:** Thank you. Jennifer, you are recognized.

### 3. <u>2016 Layer Charts Update</u>

**Jennifer Montero:** Thank you. Good afternoon. If you will turn to tab three of your FIC book you will find the updated 2016 layer chart. As you recall I presented a similar document at the June 21st FIC meeting that was prepared using the 12/31/15 data. Since then we have prepared updated layer charts using 6/30/16, data. Some of the more significant changes to the layer charts using the more recent June 31st data are as follows. For the coastal account the PML decreased by more than 10 percent from what was presented in June. The coastal account's PML used in June was the 12/31/15 PML, reduced by a projected five percent decrease in the PML. Therefore, the June 30th PML, had an actual reduction of more than 15 percent of the December 31st PML. The Cat Fund layer in the coastal account decreased by approximately $97 million with Cat Fund premium decreasing approximately $6.6 million or five percent. This is due to lower June 30th actual exposure. Due to the Cat Fund layer changes the wrap layer now attaches above the Cat Fund attachment point. The wrap layer now attaches at the 1-in-13 year event as compared to the 1-in-10 year event and exhausts at 1-in-44 year as compared to the 1-in-40 year event.

The 2014 CAT bond shifted up slightly and returned times and now attaches at the 1-in-44 year event versus the 1-in-39 year event and exhaust at the 1-in-121 year event versus the 1-in-100 year as shown earlier. The decrease in the Cat Fund layer has eliminated the slight overlap between the wrap layer and the 2014 CAT bond providing a small sliver of surplus between them of approximately $8 million. The 2015 CAT bond also attaches higher than anticipated, attaching at the 1-in-83 year event compared to the 1-in-72 year event as presented in June, and extends beyond the 1-in-100-year storm exhausting at the 1-in-112 year event. In addition, the CNR layer now attaches at a higher return time, 1-in-43 years versus 1-in-37 years. The coastal account is projected to support a 1-in-100 year storm followed by second storm of approximately 1-in-25 year. For the PLA/CLA account, the 1-in-100 year PML decreased by approximately six percent from what was presented in June. However, the Cat Fund layer in the PLA/CLA account increased by approximately $33 million with Cat Fund premiums increasing by approximately $2.3 million or three percent. Although the PLA/CLA, PML decreased, the mix of business has changed. The PLA, TIV increase over the first half of the year while the CLA, TIV decreased significantly. The PLA/CLA is projected to support two 1-in-100 year storms followed by a third storm of approximately 1-in-22 years. Are there any questions with the layer charts?

**Chairman Gardner:** Just one question.

**Jennifer Montero:** Sure.

**Chairman Gardner:** Where were we off on our assumptions going back to the coastal account?

**Jennifer Montero:** Well, the December 31st, it's the amount of depopulation.

**Chairman Gardner:** Okay.

**Jennifer Montero:** And it is also the commercial, both the commercial residential and commercial non-residential have been dropping significantly.

**Chairman Gardner:** Okay. Thank you. Okay, any questions for Jennifer or Kapil? Moving on to the next item is the investment policy overview, Jennifer.

4. **Investment Policy Overview**

**Jennifer Montero:** Thank you. As you know, each year we evaluate our investment policy and bring recommendations to this committee for final approval by the Board. Earlier this month we held an all investment manager meeting at Raymond James, St. Petersburg office. During that meeting we shared proposed investment policy changes with our external investment team for thoughts and suggestions. The proposed changes that we bring to you today incorporate feedback from that meeting. You will find a deck behind tab four that outlines our proposed changes. Slide one and slide two show the 2015 investment policy and the 2015 investment policy changes that were previously approved. Currently Citizens has four investment policies. The taxable liquidity fund consists of funds and surplus that the first monies to be used to pay claims after an event, and also can be used to pay operating expenses on an ongoing basis. The tax exempt liquidity fund consists of tax exempt pre-event bond proceeds and other monies required to be invested in tax exempt instruments that will be used to pay claims after an event or to pay principle and/or interest payments on pre-event bond on an as needed basis. The tax exempt liquidity fund is not currently funded at this time. The taxable claims paying funds consists of funds that will be used to pay claims post event after Citizens has expended all monies in the liquidity fund. The tax exempt claims paying fund consists of tax exempt pre-event bond proceeds required to be invested in tax exempt instruments to pay claims after an event. Typically after it has spent all funds from the liquidity fund and the major portion of the taxable claims paying funds. Slide three is a matrix of the 2016 proposed investments changes, with the details on the follow slides. If you will turn to slide four I will take you through the proposed changes starting with the taxable liquidity fund.

So for the taxable liquidity fund we propose increasing the corporate composition percentage from 50 to 60 percent and reduce the treasury agency composition from 50 percent to 40 percent. This increase will provide incremental yields. Increase the floating rate note composition percentage from 35 percent to 40 percent. This increase allows Citizens to take advantage of the rising short term interest rates. Reduce the minimum credit rating for the maximum of 20 percent of the total portfolio from BBB+ to BBB. This lower limit will provide additional portfolio diversification and will provide incremental yield. Increase the dollar weighted average maturity from 397 days to 548 days. This increase in duration allows Citizens to take advantage of the rising short term rates, and include publicly issued asset-back securities for prime automobile loan and lease receivables with ratings of AAA with a maximum maturity of 548 days. At original issuance the deal size must be at least $500 million and the tranche size must be at least $75 million with a maximum limit of five percent.

On slide five we have the taxable claims paying fund. We propose increasing the corporate composition percentage from 65 percent to 70 percent and reduce treasury and agent composition from 35 percent to 30. This increase will provide incremental yield. Increase the dollar weighted average maturity from five years to six years. This will allow Citizens to take advantage of this steepening yield curve. Reduce the minimum credit rating for 20 percent of the total portfolio from BBB+ to BBB. This lower limit will provide additional portfolio diversification and will provide incremental yields, and include publicly issued asset-back securities for prime automobile loan and receivables with ratings of AAA with a maximum maturity of seven years one month. At original issuance the deal size must be $500 million, the tranche size must be $75 million with a maximum limit of five percent.

On slide six you have the taxable claims paying long duration fund. As Citizens has built its surplus and increased its risk transfer program, Citizens currently has surplus above the 1-in-100 year probable maximum loss. The current exhaustion point of Citizens surplus for aggregate event is approximately 1-in-162 years for the coastal and 1-in-239 years for the personalized and commercial lines. As such Citizens can invest its surplus above the 1-in-100 year probable maximum loss, and a separate externally managed investment portfolio called the taxable claims paying long duration fund. As the money is invested pursuant to this policy will be Citizens last source of available funds. The duration limits of this policy will be longer than the duration of the taxable claims paying fund. The parameters for this policy are the same as this taxable claims paying policy with the following duration changes. Maximum permitted final maturity is 15 years one month versus 10 years one month. The dollar weighted average maturity is 10 years versus six years and include publicly issued asset-back securities for prime automobile loan and lease receivables with a rating of AAA with a maximum maturity of 10 years one month with a maximum limit of five percent versus the seven years one month. In addition, there is a separately managed account. Due to the money market reform, Citizens may choose to invest a portion of its taxable liquidity funds in a separate externally managed account similar to the 2a-7 money market funds, and continue to use its own investment personnel and investment procedures to manage its operating fund portfolio. The operating fund portfolio will consist of a portion of funds needed to pay the day-to-day operating expenses of Citizens as determined by the chief financial officer.

The separately managed account would be managed pursuant to the taxable liquidity fund investment policy. The monies in this account would be used to pay operating costs and the average expected portfolio size is $300 million. On slide seven are all of the other 2016 proposed investment policy changes. These are minimal changes, mostly to clean up our investments policy. For the taxable liquidity fund it is the dollar weighted average life maturity of the VRO shall not exceed three years. That is an increase from two years, calculated using the stated legal maturity for any VRO. On the taxable claims paying fund an increase the maximum permitted final maturity from 10 years to 10 years one month to provide for new issuance. No more than 25 percent of the portfolio may be invested in fixed rate securities with remaining time to maturity of 30 to 42 months. This is an increase of invested and maturities of 24 to 42 months. The dollar weighted average life maturity of VRO shall not exceed six years, which is an increase from five years, calculated using stated legal maturity for any VRO. Lower the minimum underlying ratings of variable rates securities with mandatory put options from A1 from Moody's, A+ from S&P and/or A + from Fitch to A2, A, and A, respectively. And then the tax exempt claims paying fund, lower the minimum underlying ratings of subordinate obligations from A2 from Moody's, A from S&P and A from Fitch, to A3 from Moody's A- from S&P and A- from Fitch. Are there any questions regarding the proposed changes?

**Chairman Gardner:** Members, any questions?

**Governor Brown:** Yes, I have a couple of questions.

**Jennifer Montero:** Sure.

**Governor Brown:** So do we have any statutory requirement to keep a level of credit ratings at a certain level? Is there any requirement?

**Jennifer Montero:** Not statutorily.

**Governor Brown:** There's no requirement?

**Kapil Bhatia:** You have no statutory requirements. However, there are some for tax exempt funds as we have bond requirements under the bond indenture and our policy requirements exceed whatever the minimum requirements in the bond documents are.

**Governor Brown:** Okay, we can manage our own investments?

**Kapil Bhatia**: That is right.

**Governor Brown:** Okay, then the second question I had was, I am sure you have modeled the rate change effective rate change of perhaps rates going up by a quarter percent, because that is what your model is. Now, did you also model it that the rates don't go up at all and how does that effect the change in your proposal?

**Kapil Bhatia:** All of these changes we have gone through are basically done for two reasons. One to minimize risk by adding more duration as we don't expect interest rates to rise. So we have done all of those analysis and we expect these changes to be marginally beneficial from an economic perspective in addition to the diversification. These changes should increase our investment income, the annual investment income by $25 to $30 million depends on where the market conditions are.

**Governor Brown:** Okay, so I guess my question was, interest rates aren't going, one way or the other it is more the duration that is going to effect the extension of the duration that is going to effect the rate yield?

**Kapil Bhatia:** Mostly it is the extension of duration. We can go through each item and there is a marginal change from the ratings going from BBB+ to BBB. That only produces a very marginal benefit, most likely two to two and a half million. So one tenth of the total increment we expect. However, it does bring more diversification, we can add some additional names to our portfolio which so far we have not been able to do, and we have a list of names if you are interested.

**Governor Brown:** No, thank you.

**Chairman Gardner:** Jim, anything?

**Governor Henderson:** Yes. I guess just curiosity more than anything. The particular asset class dealing with automobile loans and lease receivables as to why the particular class was picked out as a specific recommendation.

**Kapil Bhatia:** We had a lot of discussions and the credit work done with all of our asset managers and we went through the credit analysis. So then we picked the AAA, we are talking about a name which everybody knows from BMW's to Toyotas to Hondas. So from a credit risk perspective it was minimal. We picked a total size of $500 million that gives us the liquidity in the marketplace, in the secondary market if we ever have to sell it. The $75 million tranche is for the same reason. It is the highest rated tranche which gives us the additional incremental return. And then we limit it for the credit exposure, by limiting it to a maximum of five percent of our portfolio. All of these changes if we invested around $100 million in our portfolio this should bring an additional yield of $1 million. So we went through all of the commercial mortgage-back securities, residential market back securities. The risk was higher and as historically we have done it, we take incremental marginal risk and we think this is where the biggest risk reward return is and based on that this credit security was picked from a credit risk profile.

**Governor Henderson:** Thank you.

**Chairman Gardner:** Thanks, and just for clarification, VRO.

**Kapil Bhatia:** Variable rate obligation

**Chairman Gardner:** Great.

**Kapil Bhatia:** They are tied to Libor and Libor is increasing significantly more than the fixed rates.

**Chairman Gardner:** Great, thank you. Okay.

**Jennifer Montero:** There is an action item for this item, Mr. Chairman.

**Chairman Gardner:** Why don't you go ahead and read it, please?

**Jennifer Montero:** **Okay. It is recommended that the Finance and Investment committee approve and being before the Board changes to Citizens investment policy duration, credit quality and composition for the taxable liquidity fund and the taxable claims paying fund and marginal changes for the tax exempt claims paying fund as described above. Approve the creation of a taxable claims paying long duration fund as described above.**

**Chairman Gardner:** Questions? Is there a motion?

**Governor Brown:** So moved.

**Governor Henderson:** So moved.

**Chairman Gardner:** I hear a motion and a second to approve. Any objections? Hearing none, the motion passed.

**Jennifer Montero:** Kapil would like to add one more thing.

**Kapil Bhatia:** Not to the motion, but just in general the separately managed money in the account which we are talking about, that Jennifer went through, the money market fund reform is effective October 14th. We would like to evaluate that. So we would like to implement the separately managed account prior to the hurricane season as we are not really changing any investment policy, but we want to make sure that the money market funds are available and we can capitalize on what the markets are offering. It is not in the action item because we are not requiring any new investment policy changes.

**Chairman Gardner:** All right, well, I am not going to tell you are out of order, but I think motion passed. But Barbara, are we clear to that? Members, would we like to have another vote?

**Governor Brown:** I think he is subject to the changes that may happen October 14th.

**Jennifer Montero:** What Kapil is saying is these changes to the investment policy we don't want to implement until December 1st, after hurricane season, with the exception of adding that additional just segregating some money out already that just follows under a policy we already have.

**Chairman Gardner:** **Okay, so for purposes of clarity we will retake the motion.**

**Governor Henderson:** **With additional clarification. It is still a motion to approve.**

**Governor Brown:** **I second.**

**Chairman Gardner:** **Okay, any objections? Hearing none, that motion carries. Thank you.**

**Jennifer Montero:** Thank you.

**Chairman Gardner:** We are to the next item, the investment portfolio update.



**5. Investment Portfolio Update**

**Jennifer Montero:** Thank you. Behind tab five you will find the investment summary report. This is a summary version. The full report is behind the appendix. Our total portfolio is $12.59 billion with taxable portfolio of $8.94 billion, and the tax exempt portfolio of $3.65 billion. Ninety-three percent of the portfolio is managed by 15 external investment managers with an average duration of 2.99 years and seven percent of the portfolio is internally managed. The taxable one year return of 3.11 percent exceeds the 30-year Treasury rate of 2.29. It is almost twice the 10-year Treasury rate of 1.56. On the interest rates the short term rates are increasing and the long term and intermediate rates are stable. On slide three we have 88 percent of our portfolio is rated A or higher in the taxable portfolio, and in the tax exempt portfolio 99 percent of the portfolio is rated A or higher. It is a very strong, stable, high yielding portfolio. On the portfolio return summary, the total portfolio duration is 2.79 years. The one year annualized total return is 2.62 with income return of 1.25 and the two-year total return is 1.83 percent and income return is 1.13 percent. Additional points that can be found in the appendix. Only $29 million of securities are out of compliance with no net losses and only three remaining legacy securities which we are still evaluating. The underlying securities will be updated at the next committee meeting. As you recall we did sell two of those legacy securities. And that concludes my report.

**Chairman Gardner:** Any questions, members? Thank you, Jennifer.

**Jennifer Montero:** Thank you.

**Chairman Gardne**r: And I appreciate this abridged format by the way. I think it is easier for the committee to digest. It is a lot of information, so thank you for that. Is there any new business for the good of the order? Okay, hearing none, this meeting is adjourned, thank you.

(Whereupon, the meeting was concluded.)