

# Investment Policy Proposed Changes



September 2016

## 2015 INVESTMENT POLICY

Fund	Liquidity Fund		Claims-Paying Fund	
	Taxable	Tax-Exempt	Taxable	Tax-Exempt
<b>Purpose</b>	Funds and surplus that are the first moneys to be used to pay claims after an event, and also can be used to pay operating expenses on an ongoing basis	Tax-exempt pre-event bond proceeds and other moneys required to be invested in tax-exempt instruments; Citizens will use these monies to pay claims after an event or to pay principal and / or interest payments on pre-event bonds on as needed basis	Funds that will be used to pay claims post-event after Citizens has expended all moneys in the Liquidity Fund; only moneys eligible for investment in taxable instruments will be deposited in this fund	Tax-exempt pre-event bond proceeds and other moneys required to be invested in tax-exempt instruments; Citizens will use these moneys to pay claims after an event, typically after it has spent all funds in the Liquidity Fund and a major portion of the Taxable Claims-Paying Fund
<b>Credit Quality (Long-Term)</b>	Must be rated by at least two of three rating agencies (Moody's, S&P, and/or Fitch) and must have minimum ratings of Baa1/BBB+/BBB+ (Moody's/S&P/Fitch) for the financial and non-financial sectors	Must be rated by at least two of three rating agencies (Moody's, S&P, and/or Fitch) and must have minimum ratings of A3/A-/A- (Moody's/S&P/Fitch)	Must be rated by at least two of three rating agencies (Moody's, S&P, and/or Fitch) and must have minimum ratings of Baa1/BBB+/BBB+ (Moody's/S&P/Fitch) for the financial and non-financial sectors	Must be rated by at least two of three rating agencies (Moody's, S&P, and/or Fitch) and must have minimum ratings of A3/A-/A- (Moody's/S&P/Fitch)
<b>Corporates / Treasuries / Municipals (Non-AMT)</b>	<u>50% / 50% / N/A</u>	100% Municipal (non-AMT) Securities	<u>65% / 35% / N/A</u>	100% Municipal (non-AMT) Securities
<b>Maximum Final Maturity</b>	<u>3 years and 6 months</u>	3 years and 6 months	<u>10 years</u>	5 years and 1 month for pre-event bonds issued prior to 2015 and 6 years and 1 month for Series 2015A pre-event bonds
<b>Dollar Weighted Average Maturity</b>	<u>397 days</u>	397 days	<u>5 years</u>	3 years for pre-event bonds issued prior to 2015 and 4 years for Series 2015A pre-event bonds
<b>Current Portfolio</b>	\$1.3 billion	N/A	\$7.1 billion	\$3.1 billion
<b>1-Year Total Return)</b>	0.82%	N/A	3.53%	1.69%

## 2015 INVESTMENT POLICY CHANGES – DIVERSIFICATION AND DURATION

### Diversification

- *Increased the maximum total limit of 10% to 20% for Baa1/BBB+/BBB+ securities and increase the limit from 1% to 1.5% per issuer*

### Duration Change

- *Increased the overall dollar-weighted average maturity from 48 months to 60 months for the taxable claims-paying fund*
- *Increased the maximum permitted final maturity of the taxable claims-paying fund from 85 months to 121 months – securities with maturities between 85 months to 121 months may not exceed 20%*

## 2016 PROPOSED INVESTMENT POLICY CHANGES

Fund	Liquidity Fund		Claims-Paying Fund	
	Taxable	Tax-Exempt	Taxable	Tax-Exempt
<b>Purpose</b>	Funds and surplus that are the first moneys to be used to pay claims after an event, and also can be used to pay operating expenses on an ongoing basis	Tax-exempt pre-event bond proceeds and other moneys required to be invested in tax-exempt instruments; Citizens will use these monies to pay claims after an event or to pay principal and / or interest payments on pre-event bonds on as needed basis	Funds that will be used to pay claims post-event after Citizens has expended all moneys in the Liquidity Fund; only moneys eligible for investment in taxable instruments will be deposited in this fund	Tax-exempt pre-event bond proceeds and other moneys required to be invested in tax-exempt instruments; Citizens will use these moneys to pay claims after an event, typically after it has spent all funds in the Liquidity Fund and a major portion of the Taxable Claims-Paying Fund
<b>Credit Quality (Long-Term)</b>	<b>Must be rated by at least two of three rating agencies (Moody's, S&amp;P, and/or Fitch) and must have minimum ratings of Baa2/BBB/BBB (Moody's/S&amp;P/Fitch)</b>	Must be rated by at least two of three rating agencies (Moody's, S&P, and/or Fitch) and must have minimum ratings of A3/A-/A- (Moody's/S&P/Fitch)	<b>Must be rated by at least two of three rating agencies (Moody's, S&amp;P, and/or Fitch) and must have minimum ratings of Baa2/BBB/BBB (Moody's/S&amp;P/Fitch)</b>	Must be rated by at least two of three rating agencies (Moody's, S&P, and/or Fitch) and must have minimum ratings of A3/A-/A- (Moody's/S&P/Fitch)
<b>Corporates / Treasuries / Municipals (Non-AMT)</b>	<b>60% / 40% / N/A</b>	100% Municipal (non-AMT) Securities	<b>70% / 30% / N/A</b>	100% Municipal (non-AMT) Securities
<b>Maximum Final Maturity</b>	3 years and 6 months	3 years and 6 months	<b>10 years and 1 month</b>	5 years and 1 month for pre-event bonds issued prior to 2015 and 6 years and 1 month for Series 2015A pre-event bonds
<b>Dollar Weighted Average Maturity</b>	<b>548 days</b>	397 days	<b>6 years</b>	3 years for pre-event bonds issued prior to 2015 and 4 years for Series 2015A pre-event bonds
<b>Current Portfolio</b>	\$1.3 billion	N/A	\$7.1 billion	\$3.1 billion
<b>1-Year Total Return</b>	0.82%	N/A	3.53%	1.69%

## 2016 PROPOSED INVESTMENT POLICY CHANGES – TAXABLE LIQUIDITY FUND

- ***Increase Corporate composition percentage from 50% to 60% and reduce Treasury / Agency composition from 50% to 40%***
  - The increased Corporate composition will provide incremental yield of approximately 0.19%, or \$2.4 million
- ***Increase floating rate note composition percentage from 35% to 40%***
  - As money market reform is taking place later this year, an increase in floating rate note composition allows Citizens to take advantage of rising short-term interest rates and provides a natural hedge against any interest rate increases
- ***Reduce minimum credit ratings for 20% of the total portfolio from Baa1/BBB+/BBB+ (Moody's/S&P/Fitch) to Baa2/BBB/BBB (Moody's/S&P/Fitch)***
  - The lower limit of minimum rating criteria will provide additional portfolio diversification and will also provide incremental yield of approximately 0.11%
- ***Increase dollar weighted average maturity from 397 days to 548 days***
  - Again, due to money market reform, an increase in the duration of the taxable liquidity fund from 397 days (13 months) to 548 days (18 months) allows Citizens to take advantage of rising short-term rates and will provide 0.10% of incremental yield, or \$ 1.3 million
- ***Add publicly issued asset-backed securities for prime automobile loan and lease receivables with ratings of Aaa/AAA/AAA (Moody's/S&P/Fitch) with a maximum maturity of 548 days. At original issuance, deal size must be at least \$500 million, and tranche size must be at least \$75 million. Maximum limit of 5%***
- ***The proposed changes will provide an additional 0.30% of incremental yield to the taxable liquidity fund, or \$3.9 million***

## 2016 PROPOSED INVESTMENT POLICY CHANGES – TAXABLE CLAIMS-PAYING FUND

- ***Increase Corporate composition percentage from 65% to 70% and reduce Treasury / Agency composition from 35% to 30%***
  - The increased Corporate composition will provide incremental yield of approximately 0.04%, or \$2.2 million
- ***Increase dollar weighted average maturity from 5 years to 6 years***
  - This change will allow Citizens to take advantage of the steepening yield curve and would generate approximately 0.14% of incremental yield, or \$7.4 million
- ***Reduce minimum credit ratings for 20% of the total portfolio from Baa1/BBB+/BBB+ (Moody's/S&P/Fitch) to Baa2/BBB/BBB (Moody's/S&P/Fitch)***
  - The lower limit of minimum rating criteria will provide additional portfolio diversification and will also provide incremental yield of approximately 0.15%
- ***Add publicly issued asset-backed securities for prime automobile loan and lease receivables with ratings of Aaa/AAA/AAA (Moody's/S&P/Fitch) with a maximum maturity of 7 years and 1 month. At original issuance, deal size must be at least \$500 million, and tranche size must be at least \$75 million. Maximum limit of 5%***
- ***The proposed changes will provide an additional 0.20% of incremental yield to the taxable claims-paying fund, or \$10.4 million***

## 2016 PROPOSED NEW INVESTMENT POLICY PORTFOLIOS

### Claims-Paying Long Duration Fund

- *Purpose:* Funds that will be used to pay claims post-event after Citizens has expended all moneys in the Liquidity Fund and Claims-Paying Fund (currently 1-100 years, or 1%, for Coastal and PLA/CLA)
- The parameters are the same as the taxable claims-paying fund policy with the following duration changes:
  - *Maximum Permitted Final Maturity:* 15 years and 1 month
  - *Dollar Weighted Average Maturity:* 10 years
  - Add publicly issued asset-backed securities for prime automobile loan and lease receivables with ratings of Aaa/AAA/AAA (Moody's/S&P/Fitch) with a maximum maturity of 10 years and 1 month. At original issuance, deal size must be at least \$500 million, and tranche size must be at least \$75 million. Maximum concentration of 5%
- **The proposed portfolio will provide an additional 0.60% of incremental yield, or \$12.0 million based on a portfolio amount of \$2 billion**

### Separately Managed Account

- *Purpose:* Funds that will be used to pay operating costs; only moneys eligible for investment in taxable instruments will be deposited in this fund; similar to a money market fund, but will be managed pursuant to the Taxable Liquidity Fund investment policy
- Average expected portfolio size of \$300 million

## ALL OTHER 2016 PROPOSED INVESTMENT POLICY CHANGES

### Taxable Liquidity Fund

- The dollar weighted average life maturity of VROs shall not exceed 3 years (an increase from 2 years), calculated using the stated legal maturity for any VROs

### Taxable Claims-Paying Fund

- Increase maximum permitted final maturity from 10 years to 10 years 1 month to provide for new issuance
- No more than twenty-five percent (25%) of the portfolio may be invested in fixed rate securities with remaining time to maturities of 30 to 42 months – an increase from a maximum of 25% invested in maturities of 24 to 42 months
- The dollar weighted average life maturity of VROs shall not exceed 6 years (an increase from 5 years), calculated using the stated legal maturity for any VROs
- Lower the minimum underlying ratings of variable rate securities with mandatory put options from A1 from Moody's, A+ from S&P and/or A+ from Fitch to A2 from Moody's, A from S&P and/or A from Fitch.

### Tax-Exempt Claims-Paying Fund

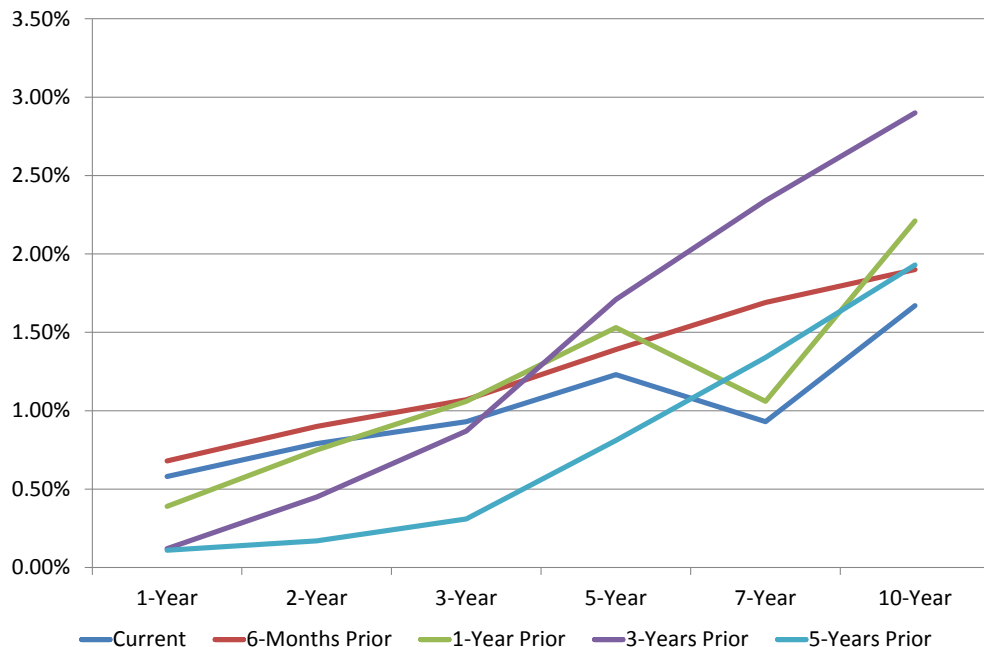
- Lower the minimum underlying ratings of subordinate obligations from A2 from Moody's, A from S&P and/or A from Fitch to A3 from Moody's, A- from S&P and/or A- from Fitch



## INTEREST RATES

- The Federal Reserve raised interest rates by 0.25% in December 2015 and has yet to raise rates since
- The market has priced in a 50% probability that the Federal Reserve raises rates sometime this year, and we expect a rate increase in December 2016
- New money market rules will take effect October 14<sup>th</sup> requiring “prime” funds that invest in corporate paper to make clear that investors can lose money and allow the funds to bar the exits in a crisis. As a result, short-term interest rates have been rising due to the decrease in demand
- Current Treasury rates are significantly lower than their historical averages with the 3-year, 5-year, 7-year, and 10-year lower than their 10-year averages by 37]%, 39%, 67%, and 42%, respectively

**Current and Historical Treasury Curves**



U.S. Treasury Rates				
	3-Year	5-Year	7-Year	10-Year
Current	0.93	1.23	0.93	1.67
6-Months Prior	1.07	1.39	1.69	1.90
1-Year Prior	1.06	1.53	1.06	2.21
3-Years Prior	0.87	1.71	2.34	2.90
5-Years Prior	0.31	0.81	1.34	1.93

## INVESTMENT PORTFOLIO RETURNS (AUGUST 31, 2016)

Fund	Current Portfolio Amount (\$MM)	1-Year Total Return	1-Year Income Return
Taxable Liquidity	\$1,267	1.14%	1.09%
Taxable Claims-Paying	\$7,123	3.53%	1.66%
Tax-Exempt Claims Paying	\$3,137	1.69%	1.12%
<b>Total/Average</b>	<b>\$11,527</b>	<b>2.77%</b>	<b>1.45%</b>

Fund	Current Portfolio Amount (\$MM)	2-Year Total Return	2-Year Income Return
Taxable Liquidity	\$1,267	0.82%	0.72%
Taxable Claims-Paying	\$7,123	2.34%	1.49%
Tax-Exempt Claims Paying	\$3,137	1.08%	1.11%
<b>Total/Average</b>	<b>\$11,527</b>	<b>1.83%</b>	<b>1.30%</b>