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 March 28, 2023
Purpose/Scope	Review of the March 28, 2023 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 March 28, 2023 Finance and Investment Committee minutes.
Contacts	Jennifer Montero, Chief Financial Officer

CITIZENS PROPERTY INSURANCE CORPORATION

MINUTES OF THE
FINANCE AND INVESTMENT COMMITTEE MEETING
Tuesday, March 28, 2023

The Finance and Investment Committee (FIC) of Citizens Property Insurance Corporation (Citizens) convened at the Sheraton Orlando North, Maitland, FL on Tuesday, March 28, 2023.

The following members of the FIC were present:

Chair Erin Knight
Carlos Beruff (Board Chair)
Charlie Lydecker

The following Citizens staff members were present:

Jennifer Montero
Barbara Walker
Tim Cerio
Kelly Booten
Michael Peltier
Jeremy Pope
Jay Adams
Joe Martins
Mark Kagy
Violet Bloom

The following people were present:

Kapil Bhatia	Raymond James
Mathew Sansbury	RBC Capital Markets
Duane Draper	Bryant Miller Olive
John Generalli	Wells Fargo
Doug Draper	Bank of America
Nathaniel Johnson	Bank of America
Mark Weinberg	Citi Bank
Colman Cordell	Bank of America
George Smith	George Smith PLLC

Call Meeting to Order

Barbara Walker: Good afternoon, and welcome to Citizens' March 28, 2023, Finance and Investment Committee Meeting that is publicly noticed in the Florida Administrative Register to convene immediately following the Audit Committee Meeting and will be recorded with transcribed Minutes available on our website. 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. May I proceed with the official roll call?

Chair Knight: Yes.

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

Barbara Walker: Governor Lydecker. Governor Lydecker was tentatively going to try to connect by phone, but you do have a quorum without him.

1. **<u>Approval of Prior Meeting's Minutes</u>**

Chair Knight: Okay. Well, I will call the FIC meeting to order, and the first item on the agenda is the approval of the December 6th Minutes. Okay. **Minutes are approved.** And we have Mr. Bhatia with a market update.

2. **<u>Raymond James - Financial Advisor</u>**

   a. Market Update

Kapil Bhatia: Good afternoon, Madam Chair, Mr. Chairman and Board of Governors. I will briefly start with the report, but please stop me at any point in time. For the record, Kapil Bhatia from Raymond James & Associates, we are your financial adviser. Inflation rose in February, but was in line with market conditions. The CPI increased by 4% for the month and 6% for the 12 months ending February. This was the smallest 12-month increase since the period ending September 2021. The inflation rate excluding food and energy index rose 5% for the month, and 5.5% for the last 12 months. Again, it was the smallest 12-month increase since December of 2021. Inflation is coming down, but not at the pace it was expected, considering there is still enough money supply out there with the prior fiscal stimulus and a monetary easing, and I will go through that in a few minutes. Total non-farm payroll employment rose by 311,000 in February, and the unemployment rate increased slightly to 3.6%. This translates into 5.9 million unemployed persons, but still unemployment remains very low. The labor force participation rate has not yet returned to the pre-pandemic level. The labor force participation rate is at 62.5% which is .9% below the pre pandemic rate of 63.4%. Effectively 1.25 million people are out of the workforce and don't plan to join at this point of time, and it could be primarily due to fiscal stimulus and all of the other benefits received during the COVID crisis. The student loan forgiveness plan battle is still going on as it plans to forgive $20,000 in student loans for individuals making less than $125,000 which is expected to transfer into 5% of additional spending or $1,000 per individual which will again add further to the inflation, if it is passed by the Supreme Court where it has been for the last 60 days. We expect Supreme Court to decide regardless of what the decision point is, we expect the student loan payment supposed to expect to resume on or prior to August 29th, and that may actually help inflation because part of the consumer spending will go towards paying back the student loan which is on hold for last three years. And we have been hearing all about the banking crisis. Each individual bank that has been a victim of banking crisis with a different problem specific to individual banks, but the crisis broadly reflects weakness from the rapid rising of interest rates by the global central banks and the additional money supply in the marketplace which led to investment into the assets of long duration.

A rescue plan unveiled by the U.S. government on March 12th has seen banks borrow millions from the Fed using government bonds as a collateral because everybody has mark to market losses from the investment during the low interest rates environment. So far, the banks have borrowed $54 billion from the Fed's new program. It is estimated the total negative mark to market in U.S. economy is probably close to $2 trillion which were invested over the last two years when the interest rates were artificially low. Depositors have been pulling billions out of regular checking and savings account and putting them in money market accounts at large banks and investment firms that pay much higher interest rates, more than $100 billion came into the money market funds in the week immediately following the collapse of SVB, the highest inflow in money market fund since 1992. Last Wednesday, the fed increased their interest rates by a quarter point less than had been expected as it continues to battle inflation that is still running at more than twice its annual level target rate of 2%. Currently the fed funds rate is 4.75% to 5%, and that means fed has increased rate by almost 5% over the last 15 months and that is really where the financial crisis are coming from and now we all are paying for the free money, which was printed in Washington, D. C., and the market expectation is at least for one more quarter point increase before the fed pauses its rate hike to reassess due to its banking crisis. I think fed is too much into the deep statement that we have to control inflation. So they are going to increase the rates even if it is not needed and monetary policy everybody knows works with a lag, so it is going to take time, but we can certainly expect a recession to be here because of the monetary policy what it has done to the economic conditions over the last 12 months. The fear of the banking sector has spilled over to the bond market where yields in U.S. treasuries have decreased recently as demand for them has surged amid a flight to safety as less probability of recession has also increased. For example, the one-year treasury has decreased from 4.78% to 4.38%. The two-year decreased from 4.3% to 3.76%, the 10-year down from 3.66% to 3.38%, and that is really what leads to what Jennifer mentioned a few minutes ago. Our mark to market was over a billion dollars, it is now down to $711 million. That change in interest rates is over the last 30 days. The results of higher interest rates, lower equity pricing, significant mark to market losses and global banking sector pressure will lead to higher unemployment rate and economic slowdown will most likely lead to recession over the next six months.

Savings rate is down, credit card balances are up meaning the consumers are spending more money than they have, but that should reduce the consumer demand, and of course credit default swaps are trading at a very high level with the expectations that consumer is struggling. Just like if you look at Capital One as an example of a large lender with the lower credit scores, their credits default swaps are trading at significantly wider price. So, we should expect more defaults on the credit card and on auto loans, especially the used cars. While the recent decrease in interest rates had reduced the negative mark to market in our portfolio, again the current mark to market is $711 million, but these values are non-economic, non-cash, these negative values will evaporate as our matures and our portfolio is hold to maturity and we talked about it earlier in the Audit committee. Our negative mark to market will come down by $20 million each month and will evaporate over the next three years. However, our income return is stable, rising interest rates are economically beneficial as they lead to higher interest income, and we will get the benefit of increasing rates by investing the maturing portion of the portfolio as well as the new monies at higher rates Globally weather disasters resulted in an estimated economic loss of $260 billion in 2022 surpassing the 10-year average of $200 billion, insured losses in 2022 are estimated to be $115 billion, again, higher than the 10-year average of $81 billion. Hurricane Ian cost approximately $40 to $60 billion in insured damages, second only to Hurricane Katrina in 2005. As expected, and we have talked about it, risk transfer pricing is up for the year and most Florida carriers are experiencing rate increases of approximately 30% to 50%. While price indications for non-Florida risk is up 10% to 20%. The risk transfer market is experiencing some positive momentum. The capital influx due to the attractive nature of risk transfer pricing, uncorrelated risks related to the other asset classes in the current market environment, as well as lower credit risk and what is happening in the Florida market as well as what is happening in the financial market. While there is a significant amount of demand for risk transfer capacity from Florida carriers in particular investor, however, demand has been stable resulting in significantly higher spread levels than prior years. That is reflected in our prices. In addition, Capital markets transaction have been able to upsize and prices are at levels marginally below the initial price guidance, but overall spread levels remain elevated from what we have seen from a historical perspective due to the in the increased scrutiny of credit and risk, increasing cost of capital, macro level stress in the financial market, and of course the alternative investment opportunities providing higher returns. With that I will stop and be happy to answer any questions.

Chair Knight: Questions? Thank you.

Kapil Bhatia: Thank you.

Chair Knight: Ms. Montero, would you like to provide a risk transfer program update?

3. **<u>Chief Financial Officer Report</u>**

   a. 2023 Risk Transfer Program Update

Jennifer Montero: Sure. Behind tab three you will find an executive summary and the layer charts. I am going to go ahead and walk through the layer charts. The proposed 2023 risk transfer program was part of Citizens' operating budget presented at the December 22nd Board meeting. This year, Citizens has taken a two-phase approach to place risk transfer coverage with the intent of gaining better market participation and pricing. At the March 17, 2023 Board meeting Citizens received approval to purchase $500 million in coverage across all three of Citizens' accounts through a new special purpose vehicle, Lighting Re. These class-A notes provide multi-year collateralized excess of loss protection on an annual aggregate basis. The transaction closed March 24th, and the coverage is effective beginning April 1st, 2023. For the second phase Citizens will work on the remaining portion of the placement which incorporates strategic elements from prior risk transfer programs. This includes the transfer of risks alongside the Cat Fund and the transfer of occurrence and annual aggregate risk transfer above the Cat Fund, with the goal of reducing the amount and likelihood of potential assessments for a 1-in-100 year event to the citizens of Florida. Looking at the coastal account, the coverage would be approximately $2.9 billion. This coverage would be comprised of $835 million of existing private risk transfer, $625 million from 2021, and an estimated $210 million from 2023 capital market placements. And $2.055 billion of new private risk transfer with budgeted premiums of $325 million. Under the scenario the coastal account would expose all of its surplus for a 1-in-100 year event and would have a potential assessment burden in the form of a policyholder surcharge of $488 million for a 1-in-100 year event. The proposed 2023 risk transfer layers for the coastal accounts are as follows. The sliver layer which is the yellow one alongside the dark blue. It is along the Cat Fund. It provides approximately $225 million in excess of $1.152 billion of annual per occurrence coverage and covers personal residential and commercial residential losses and they work in tandem with the mandatory coverage provided by the Cat Fund, and it would include the co-pay of the 10% of losses not covered by the Cat Fund. This layer would be placed in the traditional market. Layer one will sit above the sliver layer in the Cat Fund. This annual per occurrence layer provides $400 million of coverage for personal, residential and commercial residential losses, and will attach after $1.377 billion of losses. This layer will be placed in the traditional market. Layer two of the program will sit above layer one. This layer will provide $2.265 billion of annual aggregate coverage for personal residential and commercial residential losses from the capital and traditional reinsurance markets as follows. $625 million of capital market's renewal risk transfer coverage placed in 2021 through Everglades Re II. This multi-year aggregate layer provides coverage for personal residential losses and attaches after the $3.8 billion in losses. This is the final year for this multi-year note. Approximately $1.64 billion of annual aggregate coverage from the traditional and capital markets. An estimated $210 million for the 2023 multi-year annual aggregate capital market placement through Lighting Re is included in this number. Any questions on the layer chart for the coastal account before I move to the personal lines accounts?

Okay. On the next slide, thank you. The proposed risk transfer program for the PLA incorporates elements from the risk transfer programs with estimated coverage of $2.9 billion. This coverage would be comprised of 795 million of existing private risk transfer which is $525 million from 2021 and 2022, and an estimated $270 million from 2023 capital market placements. And $2.124 billion of the new risk transfer with budgeted premiums of $400 million. Under this scenario the personal lines account would expose all of its surplus for a 1-in-100 year event and would have potential assessment burden of $2.606 billion for a 1-in-100 year event. This would consist of $770 million of a policyholder surcharge and $1.836 billion of emergency assessments. The proposed 2023 risk transfer layers for the PLA are as follows. The sliver layer of the program will sit alongside the Cat Fund. It provides approximately $394 million dollars in excess of $2.2 billion of annual per occurrence coverage which covers personal residential losses and would work in tandem with mandatory coverage provided by the Cat Fund to include the co-payment of the 10% of losses not covered by the Cat Fund. This layer will be placed in the traditional market. Layer two will sit above the sliver and the Cat Fund. It is comprised of capital market's renewals, risk transfer placement, a $525 million of coverage placed in 2021, and 2022 through Everglades Re II. This multi-year aggregate layer provides coverage for personal residential losses and attaches after $5.961 billion in losses. This is the final year for the 2021 note. Layer three will sit above layer two. This layer will provide $2 billion of coverage from the capital and traditional reinsurance markets as follows. Approximately $1.73 billion of occurrence and annual aggregate coverage from the traditional and capital markets, an estimated $270 million for the 2023 multi-year annual aggregate capital market's placement through Lighting Re is included in the total. Staff will continue to work with Citizens' traditional capital market teams, as well as the financial adviser to evaluate available options relating to the structure, terms, pricing, and other relevant matters with regards to structuring the 2023 risk transfer program. Staff will present recommendations to the Board in May and for approval or the risk transfer program. And that completes my update. I will pause for any questions.

b. Investment Accounting & Reporting Services [AI]

Chair Knight: Questions, no? Thank you for the update. Move on to the action item for investment accounting and reporting services. Would you like her to read the entire executive summary or move to the -- all right.

(Recommendation: Staff proposes that the Finance & Investment Committee review, and if approved recommend the Board of Governors: a)Approve the contract with The Bank of New York Mellon for Investment and Accounting and Reporting Services for a five (5) year term initial term with two (2) two (2) year renewal terms, for a total contract amount not to exceed $6,000,000.00, as set forth in this Action Item; and, b) authorize staff to take any appropriate or necessary action consistent with this Action Item.)

Board Chair Beruff: (Inaudible: mic was off)

Chair Knight: Action item approved.

Jennifer Montero: It's approved?

Chair Knight: Yes, we have already read it. If you have any questions? No, ok.

Jennifer Montero: Okay. Thank you. And the last item is a quick investment update.

c. Investment Portfolio Update

Jennifer Montero: Okay, thank you. On slide one the total portfolio is $8.72 billion with approximately $8.32 billion or 95% externally managed by 10 money managers. The remaining $400 million or approximately 5% is internally managed and primary consists of operating funds, debt service funds and debt service reserve funds. The taxable portfolio is $8.44 billion or approximately 97% and the tax-exempt portfolio is only $280 million or approximately 3%. The portfolio is very conservative and stable with sufficient liquidity to pay current claims or potential future claims. The total portfolio average duration is just of over 3.79 years. The annualized net income return for the last five years or from 2018 to '22, as earned and reported is approximately 2.55% annually. The 2020 income return was 2.21%. Moving on to slide two. Treasury rates have exponentially increased over the last 15 months as the increase in the rates reflect the fed's nine rate increases to the current fed's fund rate of 4.75% to 5% as well as anticipated rate increases over the next three months as they try to manage the inflation. The yield curve is significantly inverted. The current two to 10-year spread is negative 45 basis points and the three-month to 10-year spread is negative 32 basis points. Both spreads are down from historical negative levels as the markets are expecting a significant slowdown or a recession. Tax-exempt rates may also have similar increases. Both, slide three, please. Both the taxable and tax-exempt portfolios have very strong credit quality. Over 73% of the taxable portfolio is in money market funds are rated A or higher, 100% of the tax-exempt portfolio is in the money market fund are rated A or higher, and approximately 33% of the total portfolio is in treasury and agency securities or in money market funds. Slide four, please. The portfolio income return is stable. We expected some returns to be in the range of 2.75% to 3% in 2023, as we get the interest increase from rising interest rates. The portfolio's total return in 2022 was negative due to significant increases in interest rates, but as the portfolio matures over time the negative mark to market values will decrease and total return will increase. And that completes my report.

Chair Knight: Thank you. Any questions from the committee? I have one question for Mr. Bhatia. We reference ratings and we also see that ratings can collapse overnight, and I wonder what is our strategy with the investment managers to look at ratings or analyze them apart from some of the agencies?

Kapil Bhatia: We continue to monitor our portfolio. We look at our portfolio every day from an analytics' perspective and we do have some financial exposure through some of the financial names. Not in the news, but we are all continuously evaluating our portfolio to see if anything is wrong. So, we are not at this point of time our portfolio is stable, we are not concerned. We are not concerned, but there are some names we are watching very closely. As I mentioned earlier, we don't have any exposure to Capital One, but there is a one name, and I don't want to say the name in a public meeting, but we are watching it closely because it has a large exposure to consumer credit cards. We have a very small position and we may exit out of that position as we continue to evaluate it. But we are not concerned with any of the names in our portfolio.

Board Chair Beruff: Madame Chair. On that note, the unnamed, how big would the loss BE if we had to sell that position?

Kapil Bhatia: That position at this point of time that is more of an interest rate movement loss. It will be negative $400,000 and I think our position is $4 million, $3.9 or $4 million, something like that, but we can reinvest at a higher rate to continue to earn higher interest earnings.

Board Chair Beruff: So, we will probably make the decision by its minimal amount of exposure to us?

Kapil Bhatia: Yes.

Board Chair Beruff: Thank you.

Chair Knight: Is there any new business? No. Okay, the FIC March meeting is adjourned, thank you.

Kapil Bhatia: Thank you.

(Whereupon, the meeting was concluded.)