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 26, 2023
Purpose/Scope	Review of the September 26, 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 September 5, 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, September 26, 2023

The Finance and Investment Committee (FIC) of Citizens Property Insurance Corporation (Citizens) convened at the August B. Turnbull conference Center (FSU) Tuesday, September 26, 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
Ken Tinkham
Andrew Woodward

The following people were present:

Kapil Bhatia	Raymond James
Sasha Stipanovich	Raymond James
John Generalli	Wells Fargo
Doug Draper	Bank of America
Tim O'Boyle	Gallagher Re
Mark Weinberg	Citi Bank
Trent Smyers	Gallagher Re

Call Meeting to Order

Barbara Walker: Good afternoon, and welcome to Citizens' September 26, 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 and Governor Lydecker.

1. Approval of Prior Meeting's Minutes

Chair Knight: Thank you. Welcome to the September FIC meeting. I would like to kick off the meeting with the approval of our July 11, 2023, Minutes.

Board Chair Beruff: So moved.

Chair Knight: Okay, no opposed. Minutes are adopted, and I would like to welcome Mr. Bhatia from Raymond James for our market update.

2. Raymond James - Financial Advisor

a. Market Update

Kapil Bhatia: Good afternoon, Madam Chair, Mr. Chairman and Governors. For the record, Kapil Bhatia from Raymond James & Associates, we are your financial adviser. I will briefly start with the market update. Not much to add, except that things have been continuing in the same circular pattern, but please stop me at any point of time for any questions or comments. Inflation rose .6% in August after increasing by only .2% in July. Over the last 12 months the CPI has increased by 3.7% as compared to 3.2% in July. So, there is a lot of variability in inflation. However, the overall trend is downward. The all items less food and energy index rose 4.3%, so that is actually higher, but that trend is also lower, except for the increase in energy prices, which we still see in the marketplace. The long-term payroll employment increased by 187,000 in August, less than the average monthly gain of 271,000 over the prior 12 months. The unemployment rate rose to 3.8%, which was higher than July unemployment rate of 3.5%. The number of unemployed people increased by over half a million to 6.4 million, and that number is marginally higher than where we were for the last couple of months at around 6 million. However, some of the labor force is coming back to work after 2020 and 2021, as they were getting all the fiscal stimulus checks. The labor participation rate rose by .2 percentage points after having been flat for the last five months or since March. The current labor force participation rate is 62.8%. Since March of 2022, the fed is on a mission to raise interest rates, and they have increased rates 11 times to the current range of 5.25 to 5.5%. The fed did not raise any rates in September meeting, but nonetheless, they expect to raise one more time before the year is over, but what they did in September meeting was that they reduced the probability of fed's cut or reduced the number of fed's cut next year. Now they expect to cut rates only two times instead of four times in 2024 c, which is what they said in June, and they expect the fiscal year 2024 fed fund rate will end at 5.1%. So, they are expecting higher for longer because they have not seen much improvement in inflation primarily because the fiscal stimulus is still out there. In addition to holding rates at relatively elevated levels, the fed is also continuing to reduce its bond holdings, too, and that is not helping the interest rates either. The fed's balance sheet has decreased by over $800 billion over the last 14 months, and fed continues to take $95 billion out of the market each month as the securities mature in their balance sheet. –however, the fiscal policy is going to require almost $1.4 trillion of additional treasury debt issuance this year. All of this is not helping the long-term interest rates, and now the industry or the market message is higher for longer. The fed is projecting inflation to steadily cool while the labor market remains historically strong. Personal consumption remains high, and energy prices have recently increased. The fed also revised their economic growth projections. They expect GDP to increase by 2.1% this year and 1.5% next year, which is almost where we were a few months ago. Consumers will make up two-thirds of all of our economic activities have been resilient and spending even as the savings have significantly diminished, and credit card debt has passed the one trillion mark for the first time ever.

I know we have been talking about recession for almost a year but one of the reasons we have been able to avoid a recession so far is the continuous large government spending through various programs, which Continued in 2021 with the American Rescue Plan, 2021 Infrastructure and Jobs Act, 2022, and 2022 Inflation Reduction Act and 2022 Chips Act. However, I think we are at the end of the fiscal spending and now it looks like same with the debt ceiling negotiations and with the recent discussions about government to shut down, we expect fiscal policies to constrain, but there is still some money floating around and that will continue in the marketplace for at least a few more months. And there is a significant lag, lag from the monetary policy because we still have not yet seen the full impact of interest rate increases as most of the corporations have not rolled over their lower interest rates. As Jennifer mentioned in the Audit committee meeting, we have a negative mark to market, but as those securities mature our portfolio will return to par. We will see the impact of higher rates once the existing debt matures, and everybody will have to rollover the debt at higher rates. That is when we will really see the back of higher rates. Right now, only approximately 20% of the debt has rolled over and the remaining 80% of the debt has to be rolled over at a higher rate, and that will have a significant impact on economic conditions and will lead to a slowdown. The only question is when as it is the function of time. We expect by the second quarter of 2024 the economy will show signs of slow down. And I know we have been talking about it for a long time, but as we see more and more impacts you can see some things are coming into the marketplace. Markets have started to behave, long time rates have started to go up, but now it is probably closer than where we were almost a year ago. Global markets are in similar position as global central banks follow the fed's monitor policy and U.S. fiscal policy during the COVID lockdown, and now the world is trying to play catch up with increasing interest rate and increasing inflation rate. All of this has led to higher interest rates, the yield curve is still inverted. The difference between three months and 10-year treasury is negative 107 basis points, and the difference between two years and 10 years is negative 63 basis points. Usually on average it takes 14 months from the initial yield curve inversion to recession. We are almost at 11-month mark from the initial yield curve inversion. The yield curve inversion have been historically 80%

correct in predicting the recession, then we are still approximately three months away from the recession. While the recent increase in interest rates have increased a negative mark to market marginally from where we were in June, but these values are non-economic and non-cash and negative value continues to pull to par as securities mature. Our portfolio short duration is much shorter today than it was a year ago and that is helping our evaporation process and we expect more than 45% of our mark to market values to evaporate over the next 12 months even at the current high interest rates. Lastly, our income return is stable, rising interest rates are economically beneficial to us as they lead to higher interest income and now, we have started to realize the benefit of high interest as our portfolio is maturing at a faster pace after paying Ian claims as less additional premiums which we are generating. We expect our annual interest income to be somewhere in the range of $285 to $300 million, maybe plus $300 depending on what happens over the next couple of months on the interest rate, and that will be one of our highest interest incomes even though our portfolio is stable.

Board Chair Beruff: Madam Chair, may I ask a question? Ms. Montero, what is our operational profit loss at this point taking the return on our investments out of the equation?

Jennifer Montero: Let me grab it. No, it is right here. Hold on.
$477.99 million

Board Chair Beruff: Profit?

Jennifer Montero: Yes.

Board Chair Beruff: Because of the increase in premium because of our growth, right?

Jennifer Montero: Excuse me?

Board Chair Beruff: Because of the increased premiums we are collecting because of the growth over the last 18 to 24 months.

Jennifer Montero: Yes. And that earned premium is $1.6 billion, losses incurred are $515 million, and LAE is $254 million, and then all your admin and underwriting is $366.8 million, that leaves you with net underwriting income of $477.99 million.

Board Chair Beruff: Thank you, thank you.

Kapil Bhatia: will stop here and answer any questions you have. And Jennifer will go through more about the investment portfolio during her report.

Chair Knight: Thank you.

Kapil Bhatia: Thank you.

Chair Knight: We have a few updates to the layer charts if you want to highlight those.

3. Chief Financial Officer Report

a. Updated Layer Charts

Jennifer Montero: Sure. Thank you. Okay, since the July Board meeting the layer charts have been updated using the most recent information available. The changes include revised estimates for the probable maximum loss, which is the PML. The Florida Hurricane Catastrophe Fund or Cat Fund's retention and coverage and adjustments to the surplus. The underlying source of the PML was updated to better reflect the mix of business as of June 30th, 2023. Previously we were using December 31st, '22 in force data to project to September 30th. Now we are using June 30th, 2023, data projected to September 30th, 2023. Between December and June, Citizens experienced less growth in the personal lines account than was forecast and more growth in the commercial residential business which impacts both the coastal account and the commercial lines account. So, in the coastal account these changes shifted the 1-in-100-year PML up to $8.542 billion, which is an increase of $704 million or nine percent over the prior estimate. The growth also translates to an increase in both the retention and coverage from the Cat Fund. So, the Cat Fund retention is $80 million higher in the tower, and the coverage now attaches at $1.23 billion of losses instead of $1.15 billion.

Governor Lydecker: Inaudible (mic was off)

Chair Knight: Sure, Governor Lydecker.

Governor Lydecker: Just for clarification you are saying that these adjustments have occurred post putting this to bed as a result of the fact that it has grown since then. Is that what is doing this or was some new information?

Jennifer Montero: No, that is correct. So, what has happened is the coastal account has grown. We are getting a lot of commercial residential property or policies coming in that we did not forecast as high as those that are coming in, and they have a relatively high total insured value which is what is used when we do the PMLs, make the layer charts, we use total insured value. So that has increased that exposure. And so, the Cat Fund coverage is based off of our exposure at a time certain end. And so, it shifts around until I believe the final cat numbers for 2023 won't come out until like March of '24.

Governor Lydecker: Can I ask a follow up question, please? I think this is going to be more of your gut feeling on this more than you would have accessed this information immediately. But is it you're feeling that this increase is coming because you have described, you know, that we weren't anticipating this. Is that as a result of Hurricane Ian and, you know, the commercial account post Ian and just seeing more activity? Is it a specific part of the state? I just wondered if you have a read at all.

Jennifer Montero: What my understanding is, is that most of this is coming from the surplus lines and they are at capacity. So now it is drifting to Citizens is what I think most of what we have been seeing is.

Governor Lydecker: So, the surplus lines market has no additional appetite at the moment.

Jennifer Montero: That is my understanding.

Governor Lydecker: And so, these commercial accounts are coming to Citizens now.

Jennifer Montero: That is correct.

Governor Lydecker: Okay, that is good to know.

Jennifer Montero: And that is what is driving the coastal account. The personal lines account is completely different, and I am happy to explain that now or we can wait until I get to that account.

Governor Lydecker: Why don't you take it in the format that you feel comfortable.

Jennifer Montero: Okay, I will stick with coastal first and then we will talk about the personal lines account.

Governor Lydecker: Thank you.

Jennifer Montero: So, the retention for the Cat Fund is $80 million higher in the tower, and the coverage attaches at $1.2 billion of losses instead of $1.152, and you can see in the chart that the Cat Fund has shifted up and that is why the traditional yellow sliver layer has -- is going underneath that now. So, as it grows, the retention grows, the Cat Fund grows and the whole thing shifts up. As far as the Cat Fund, the actual Cat Fund coverage itself increased by $140 million or 7% to $2.163 billion, the prior estimate was $2.023 billion. The increase in coverage is primarily attributable to the growth in the commercial policies. The coastal accounts surplus was adjusted to reflect differences in the cost of the reinsurance, both public and private, and anticipated losses from Hurricane Idalia, which is estimated at $15 million for the coastal account. The combined impact of these changes is an exhaustion of surplus around the 1-in-80-year PML. A Citizens' policyholder surcharge of $770 million and an estimated regular assessment of $64 million at the 1-in-100-year event. For the personal lines account the changes are moving in the opposite direction since the policy growth was not as much as anticipated. The estimated 1-in-100-year PML is now $8.75 billion, a decrease of $740 million or 7.8% lower than previously estimated. The Cat Fund retention is $185 million lower in the tower, and the coverage attached is at $1.8 billion of losses as compared to the prior estimate of $2.0 billion. The Cat Fund coverage is also reduced with the new estimate of $3.22 billion, a $326 million reduction from the prior estimate of $3.5 billion. And Governor Lydecker, what is going on in the personal lines account is when we forecast, layer charts are always as forecast to September 30th, and when we originally forecast, we had an expectation that there would be one or several companies that would go insolvent, whether they didn't have the ability to get their reinsurance program or they didn't have the, the funds to pay for a program or get the capacity, or went insolvent in other ways. So, we did budget or forecast for a couple of insolvent companies to have more policies go into Citizens because of something like that occurring and that did not occur. So that is why our estimate for September 30th originally was much higher.

Governor Lydecker: I guess that would indicate that there was a modicum of stability developing post the last legislative session and the reforms AOB, one way attorney, that you are seeing some effect on.

Jennifer Montero: That is correct.

Governor Lydecker: On the personal lines.

Jennifer Montero: That is correct.

Governor Lydecker: PLA layer.

Jennifer Montero: Yes, we had no -- we have zero insolvencies to date for 2023.

Governor Lydecker: That is encouraging.

Jennifer Montero: Yes. The PLA surplus is adjusted to reflect the difference in the cost of the reinsurance, both public and private, and the anticipated losses from Hurricane Idalia, which is approximately $109 million for the personal lines account. The combined impact of the changes is an exhaustion of surplus at the 1-in-4-year event, a Citizens policyholder surcharge of $770 million, and an estimate emergency assessment of $1.98 billion for a 1-in-100-year event. The emergency assessment is up about $146 million from the prior estimates. And due to the growth in the commercial policies this year, the commercial lines account experienced significant changes with the 1-in-100-year PML. If you go to the next slide, please. The PML increased from $755 million to $1.279 billion, a 69.4% increase. The Cat Fund coverage increased from $156 million to $239 million, an increase of 53.3%, and the commercial lines account surplus is adjusted to reflect an increase in the Cat Fund premium and reduced for estimated Idalia losses of $4.6 million. Overall, the combined impact of these changes is the commercial lines account is now exposing 51% of its surplus for a 1-in-100-year event. This is up from the prior exposure estimate in July of only 29 percent exposed. And that completes my update on the layer chart.

Chair Knight: Questions?

Governor Lydecker: No, thank you.

Board Chair Beruff: I do have a quick question. Our exposure has gotten significantly more against surplus, correct?

Jennifer Montero: Yes.

Board Chair Beruff: On the commercial lines.

Jennifer Montero: Under the commercial lines account?

Board Chair Beruff: Correct.

Jennifer Montero: Yes.

Board Chair Beruff: So, somebody explain to me why we continue, are we mandated by law to do commercial?

Jennifer Montero: I don't know if we are or not.

Kelly Booten: Yes.

Jennifer Montero: Yes, we are.

Board Chair Beruff: I would like somebody to explain that to me.

Jennifer Montero: Of what the law is?

Board Chair Beruff: Yes.

Chair Knight: Does it follow the same –

Board Chair Beruff: The logic, obviously, we are supposed to be the insurer of last resort. The commercial accounts have less restrictions on rates and so forth. So then if we are continuing to grow that business and increasing our liability against surplus, why not raise the rates even higher if we are not constrained by glide path and everything else like we are in the home insurance business?

Jennifer Montero: We only have the A ratings which are the ones that are not constrained by the glide path for certain commercial buildings where the individual buildings have a TIV of $10 million or higher. Those are the only ones that get the A rate. All the other commercial goes through the rate filings.

Board Chair Beruff: So, my follow up question then is, what part of the commercial business is growing that is restricted to the ability for us to charge whatever we want?

Jennifer Montero: So how much of it is A rated?

Board Chair Beruff: Yes. I mean, if we are going from 29% of our surplus and we are going to 51% exposure to our surplus, okay, anyway, if we are increasing our exposure by that percentage, then we should be increasing our profitability because we don't want that business because it is reducing our -- putting at risk our surplus, correct?

Jennifer Montero: Yes.

Board Chair Beruff: Okay. So, then I think it would be prudent for the Board to understand if the business is growing, what is growing under what is regulated under state statute and what is growing that is unregulated. If we are growing the unregulated business, then we are charging -- we are not charging enough. If we are growing the regulated business, we are told what we can charge or limited, we need to know that. So, we should legislate changes to that policy so that we are not continuing to expose our surplus.

Governor Lydecker: Particularly after you combine the accounts.

Board Chair Beruff Hello.

Jennifer Montero: Right.

Kapil Bhatia: (INAUDIBLE).

Jennifer Montero: So, Kapil made a good point. In that when these policies come in, and this was a big thing with Ian in the PLA last year. When the policy comes in the exposure hits right away and the premium earns over 12 months. So, you only see 1/12th each month of the premium.

Board Chair Beruff: Right.

Jennifer Montero: And so, there is a timing. As these policies come in you are seeing the exposure, but you are not seeing the full surplus for a full 12 months. But I can get this data for you.

Board Chair Beruff: Well, you can do an analysis that says, looking forward if we get another six months of redemption of you know, income, what does that do to our surplus. Does it go back down to 29% or does it stay at 51%?

Jennifer Montero: Right.

Board Chair Beruff: I am trying to figure out how much we can -- we are attracting business that we are not charging enough for, that is taking a potential and reducing our surplus if the event happens.

Jennifer Montero: Correct, and it is frozen. No new business came in all that premium had the opportunity to –

Board Chair Beruff: Correct.

Jennifer Montero: -- be earned out, that 51 –

Board Chair Beruff: Would come down.

Jennifer Montero: Correct.

Board Chair Beruff: Understood, but you can do that because you can just project it forward to a certain degree, but nonetheless, it is something we need to address, and we need to find out what is and what isn't regulated in the commercial lines.

Governor Lydecker: Yes. Just another look at it, is what tools are available to the Citizens team to ensure that on commercial Citizens is a market of last resort.

Chair Knight: Would you like to look into it and come back tomorrow?

Jennifer Montero: Yes. I could probably have it for you later today or I could give it to you tomorrow. We will have to pull all that information.

Board Chair Beruff: Right.

Chair Knight: Okay. So, a couple of things, right, understand what percentage is the A rated. Understand what the surplus, percentage of surplus exposed will look like as the earned premium pulls in, and then depending on the answer to what percentage is A rated, do we need to increase –

Board Chair Beruff: Yes, what can we do to change that dynamic, because again, I am all about being the insurer of last resort to the homeowner who can't get covered everywhere else. I mean, that is what we are supposed to exist for, but I don't think we want to be in the commercial business unless it is highly profitable, and we don't want to be in it at all. We want to drive all that business to all the independent insurance companies in the state of Florida.

Jennifer Montero: Yes, we will get all this for you.

Chair Knight: Profitable or mandated.

Board Chair Beruff: Yes, thank you, Madam Chair.

Jennifer Montero: And what are we doing to keep them out where we can.

Governor Lydecker: Well, yes, and what I am hearing from the chairman is, you know, kind of what is the potpourri of leverage that could be pulled to get us to be thinking market of last resort. Are we missing something here because it is growing as a percent of surplus.

Jennifer Montero: Understood.

Tim Cerio: I think some of these questions COO Booten can address in Exposure Reduction and then whatever we can, we will take our homework and get back to you.

Chair Knight: Thank you. Okay, moving into, moving on to the defeasance and redemption of the coastal account bonds.

b. Defeasance and Redemption of Series 2015A-1 Coastal Account Senior Secured Bonds

Jennifer Montero: Okay, behind the next tab.

Governor Lydecker: I say we keep Jennifer up here and just keep bombing her with questions from every direction. She is doing good.

Jennifer Montero: So, the next section is the defeasance and redemption of the series 2015-A. coastal account bonds. As we discussed in prior Board meetings, part of Citizens' financial strategy is to combine the three separate accounts. The personal lines accounts, the commercial lines account and the coastal account and do a single Citizens accounts effective January 2024. As a condition precedent to consolidating Citizens' accounts, no financial obligations can remain outstanding. Currently the series 2015 A-1 coastal account bonds are the only municipal bonds outstanding. There are also a number of Cat bonds outstanding which will either mature or be called after the 2023 season if they're not triggered during the season. In 2015, Citizens issues $1 billion of senior secured bonds in the coastal account for purposes of providing additional claims paying resources following a storm or a series of storms. Two series were issued in connection with the financing. $700 million of fixed rate senior secured bonds, which are the series 2015 A-1 with an initial maturity of June 1st, 2018, and a final maturity of June 1, 2025. And then $300 million of floating rate security bonds which were the series 2015 A-2, with an initial maturity of June 1, 2018, and a final maturity of June 1st, 2020. The outstanding 2015 A-1 series bonds in the amount of $275 million can be called at par value on December 1st, 2024. The series 2015-A. bonds are tax exempt, but the proposed escrow structure will allow Citizens to maximize the investment income by investing above the arbitrage yield as permitted by tax law in state and local government securities knows as SLUGs issued by the U.S. Treasury. The income in the escrow account is estimated to generate between two and-a-half to $3 million dollars above the interest expense on the bonds – -- depending on the interest rate over the next 12 months or until the call date of December 1st.

Board Chair Beruff: Let me slow you down for a second. Madam Chair, can I ask a question?

Chair Knight: Yes.

Board Chair Beruff: We, briefly we were discussing before the meeting started that apparently us defeasances the bonds which are tax exempt. All of them are tax exempt, is that correct? Okay. I thought the simple-minded person in the room that you could just take those and reinvest or put the money in tax exempt bonds at whatever the yield is at the time that we do it. What I heard a little while ago was that there is some arcadic government regulation, what a surprise, that limits us on doing that and we can't make money on the arbitrage. So, I would like for yourself or the attorney or the counsel to explain to me where the legal opinion comes from that says our ability to just take and do the right thing with it is limited by a regulation that says we can't be profitable in a transaction that we had nothing to do with, because we don't control the economy of the United States of America.

Jennifer Montero: We do have our bond counsel on the phone, Albert del Castillo, with Greenberg Traurig, and I believe he would be happy to address your question. Albert, are you there? Are you on, Albert?

Board Chair Beruff: The voice from above is missing.

Kapil Bhatia: While we are waiting for Albert, maybe Barbara can –

Albert del Castillo: Hold on, can you hear me?

Jennifer Montero: Yes, now, we can hear you, thank you.

Albert del Castillo: All right, I was trying to talk to you through my cell phone because I was plugged in both ways to make sure that I was fully connected. Good afternoon, Madam Chair, Mr. Chairman and Governors. For the record, as Jennifer said, Albert del Castillo with Greenberg Traurig, and we have the distinct privilege and pleasure as serving as your bond counsel. I'm not sure who said it, I can't see the faces and I don't totally recognize the voices, but someone made reference to an arcadic rule.

Board Chair Beruff: Yes.

Albert del Castillo: That apply and that would be a pretty good description of what we have going on here. As Jennifer said, all of these bonds that are outstanding are tax exempt bonds. And so therefore, are subject to the rules and regulations that apply to tax exempt securities. We have over the years made changes, amendments to the documents. Usually at the behest of a very good suggestion of your financial adviser, Mr. Kapil Bhatia, to try to maximize the benefits that can be obtained by Citizens on, while still, you know, staying within the rules and regulations that are applicable to these tax-exempt bonds. And we are doing exactly that with this defeasance because --

Board Chair Beruff: What is the last name?

Jennifer Montero: del Castillo.

Albert del Castillo: Albert DEL Castillo.

Board Chair Beruff: May I call you Albert?

Albert del Castillo: It is all right, just call me Albert, absolutely.

Board Chair Beruff: All right. Call me Carlos and we will get along just fine. Thank you.

Albert del Castillo: Carlos, perfect.

Board Chair Beruff: All right, so Albert, unfortunately your voice is not clear. So, I don't know what I heard, but did I hear that we, the bonds, we write the bond language to a certain agree when we float the bonds.

Albert del Castillo: We write the bond language. We don't write the bond laws or the laws that apply on a tax-exempt basis.

Board Chair Beruff: So, to be, to try to get to the gist of my question. It is we have a bond defeasance that because of the unfortunate luck of high interest rates, we can defeasance at a profit, right? But I want to –

Albert del Castillo: Right.

Board Chair Beruff: I want to understand specifically what federal regulation or tax regulation requires us to make less money than we can in the open market buying the same quality securities that we have to have under the state laws and the statutes that we have to meet.

Albert del Castillo: Right. So, the rules apply to how you can go about investing the proceeds of tax-exempt securities. I hope that you can hear me clearly. Can you?

Board Chair Beruff: So far.

Albert del Castillo: Okay. So, and this is exactly why Kapil, our tax lawyers, Jennifer and myself, we have been going back and forth on how best to structure this escrow in order to maximize the financial benefits of the defeasance while saying within the constraints of the federal tax laws that are applicable to these bonds as tax exempt bonds, and for that reason, we are looking at using a combination, and again, I am going to get somewhat into the weeds here, a combination of time deposit SLUGS and demand deposit SLUGS which given the rules that apply to what monies are invested in those types of investment obligations, will maximize the benefits of this defeasance.

Board Chair Beruff: What is the amount of bonds that we are defeasance?

Albert del Castillo: $275 million.

Board Chair Beruff: So, we have $275 million we have to defease.

Albert del Castillo: No, excuse me, Mr. Chair, that is the principal amount and then we have to add of course the interest component.

Board Chair Beruff: Right, but we are going to take the $275 and invest it in other tax deferred exempt bonds and that generates income that takes care of the defeasement.

Albert del Castillo: Well, see therein lies the rub. In your mind and in most people's mind your investment in tax exempt obligations are not really under the tax rule. Some of the investments that we are looking at in order to be able to maximize the benefits of what you are investing, and not only that, but then be able to keep the benefits of what you are reaped, and not only that, but also rebate prior, you know, investment earning. All of that goes into the mix in order to decide how much, if any, of the escrow is invested in, again, what I will refer to as the time deposit SLUGs or the demand deposit SLUGs, and if you want to even complicated it further, we then in order to minimize – just one second, this is real important now.

Board Chair Beruff: No, the problem is I can't understand you. It is not you it is part of the sound system. It is not clear enough to, to hear everything, every word. Maybe it is just my hearing, I am 65 I will freely admit, but at the end of the day I may not be hearing every word and understanding what you are saying. So, I don't think this is going to be a productive conversation without somebody figuring out how to get the voice to be clearer, because are the bonds all maturing December of '24, the $275 million –

Jennifer Montero: Maturity is due on –

Albert del Castillo: Let me just –

Board Chair Beruff: Hold on. I am the stupidest guy in this room, so I have to get it to places where I understand. We have $275 million dollars' worth of bonds.

Jennifer Montero: Yes.

Board Chair Beruff: When do they, if we didn't defease them, when are they due?

Jennifer Montero: They mature on June 1st, 2025, but they're callable December 1st, '24 at par.

Board Chair Beruff: Okay, at par. So, we have to defease if we want to call them before December of '24. So, it is an 11-month float roughly from January to December.

Kapil Bhatia: Mr. Chairman, may I add something.

Board Chair Beruff: You can say whatever you want. I am just trying to get the facts, so I understand it. Again, I ask a lot of dumb questions.

Kapil Bhatia: The bonds have an original maturity date of June 1 of 2025. They are callable six months prior.

Board Chair Beruff: Right, and you just pay a par. There is no penalty.

Kapil Bhatia: Correct. The reason we cannot invest the bonds proceeds or our money in the tax-exempt bonds which may give us a little bit more money, if we are legally defeasing them, there is a credit risk attached to that, hypothetically we invest 275 million dollars of our money in a tax-exempt bond, which the federal tax law allows us to do it, but the investors who currently hold our bonds don't like that. The tax-exempt escrow will not be considered to be a true escrow or legal defeasance. The only way we can construct a legal defeasance and bonds go away from our books if they are invested in fully secured deposits -- Treasury securities. For that reason, we have to invest in a treasury securities and state and local government securities issued, which are issued by U.S. Treasury for state and local government issuers only and that is how we can maximize the difference in investment income.

Board Chair Beruff: But is that a federal tax law provision or is that an investor requirement for the investors that hold our bonds?

Kapil Bhatia: For legal defeasance the escrow has to have no credit risk, and Albert can talk more about it hopefully. You can hear it when he walks through it. For investors to make sure they are legally defeased –

Board Chair Beruff: Okay.

Kapil Bhatia-- we need to get a verification report.

Board Chair Beruff: So, we can't buy 12-month security.

Kapil Bhatia: Commercial paper. Or any tax exempt. We cannot buy any –

Board Chair Beruff: No, I understand we can't buy any. We have to buy rated tax-exempt bonds.

Kapil Bhatia: We cannot buy, tax exempt bonds as that will not allow us to have a legal defeasance. It could be an economic defeasance which means that bonds are still on our books because we will still be obligated for regardless of how remote the risk is, default, then we will have to step in. So, they will not be legally defeased. So, for us to get off the books, it has to be no credit risk which can only come through Treasury securities. Some, some escrows allow agency securities, but they're indifferent, and by structuring the Treasury securities as Albert said, demand deposit and time deposit, SLUGS, allows us to keep that income differential, whatever that is, and we don't have to rebate it to federal government and that is where the tax law comes in. Hopefully that answers the question why we cannot invest.

Board Chair Beruff: It doesn't only because I can't understand the answer.

Kapil Bhatia: Okay, please.

Board Chair Beruff: So maybe what we will do is instead of taking up more time with this particular committee, and we will sit in a room and over a cup of coffee you will have to explain to me what the tax law says that says I can't do what I want to do.

Kapil Bhatia: will defer to Albert on the tax law, but I can talk absolutely the business.

Board Chair Beruff: Maybe we can get that done, because I still don't understand why instead of getting 240 basis points spread, we are looking at 120 basis point spread. So basically, half the income that we should be making over a 12-month period. So instead of making $2 million, we should be making four or five million.

Kapil Bhatia: And I will just make one comment.

Board Chair Beruff: The last time I checked, that is a lot of money.

Kapil Bhatia: Yes. So, if that is true hypothetical assumption, then there is no reason for you not to go borrow -- go to the market and borrow a billion dollars of tax-exempt securities and invest in taxable tomorrow. Because the federal government and the Treasury prohibits you and that is the only reason you can do tax exempt if it is for the right public purpose. They don't want you to make arbitrage profit. Otherwise, there is no reason for you not to go to the market for us, borrow a billion dollars at three and-a-half percent and invest at five and-a-half percent of Treasury and keep that difference.

Board Chair Beruff: No, you're talking about taxable treasuries. I am talking tax exempt securities, apples to apples. I am not talking about taking money in a tax deferred tax-exempt status and then going out and buying U.S. Treasury bills which are not tax exempt. I am talking about apples to apples of purchasing a spread.

Kapil Bhatia: And what we are buying is really comparable to the tax-exempt yield. So, the demand deposit SLUG which you are buying really are for one year at 4.2%, which is similar to where the tax-exempt rates will be, because if you look at the one-year Treasury it is closer to five, 5.20%. Tax exempt paper is always at around 65 to 70% of taxable yield. So, you are –

Board Chair Beruff: Of course, I understand that, but I think that the tax-exempt market is closer, you are talking about 4.2 and I am talking about 5.2.

Kapil Bhatia: The 5.2 –

Albert del Castillo: Can you hear me?

Chair Knight: Yes.

Albert del Castillo: But the other thing to keep in mind, and again, I really apologize. I have no idea why the difficulty coming through the line here, but the other thing that you have to keep in mind is that there are different categories of what you were refer to, Kapil, defease, what qualifies as a defeasance obligation for purpose of the (INAUDIBLE) venture, but we are specifically choosing to invest some amounts in time deposit SLUGs and some amounts in the demand deposit SLUGs in order to be able to take advantage of how, amounts invested in those securities, what you can do, you know, the interest rates that can be achieved without violating the yield restrictions, and then very importantly, that you don't have to rebate whatever you earn above the yield on those investments, and as you know, Kapil, also recouping some of the prior, you know, earnings that would have to otherwise be rebated. So, there is a very specific reason why this escrow is being proposed to be structured in the way that it is. Could you hear that?

Board Chair Beruff: Albert, it is not – it is not you by the way and I don't think it is the connection. I think it is partially the echo in this room and my hearing. So, so –

Albert del Castillo: Well, Mr. Chair, I am a year older than you.

Board Chair Beruff: Yes, but not everybody's hearing is affected as mine. Not everybody's hearing is affected the same. But anyway, I will have more discussions with Kapil offline so that we can move this meeting forward, thank you.

Albert del Castillo: Okay, okay.

Chair Knight: It is the nuance and restriction around the defeasance process that are the crux of the matter more than tax law.

Board Chair Beruff: I think this Board recognizes that we have to take the money that is in tax exempt and buy tax exempt, we get that. We are not foolish to enough to think we are going to borrow a tax-exempt (INAUDIBLE) and then go invest in taxable and get a 300-basis point pump up and just sit there and make a lot of money. I get that. The question is, what tax-exempt bonds are we regulated to purchase that keeps it at such a low spread? We will deal with that offline, thank you. I just wanted to close with my clarifying point.

Jennifer Montero: Madam chair, because this is an action item, can we at least move it forward to discussion tomorrow at the full Board after we have our conversation, so it doesn't fall off the agenda completely?

Board Chair Beruff: I don't have a problem with that.

Chair Knight: Sure.

Board Chair Beruff: Charlie is probably better (INAUDIBLE) worst than I am.

Governor Lydecker: I think your question is do you want to bump it to tomorrow until you can satisfy the Chairman's thought process or question, I think is a good one. Or do you want us to move it out of committee with the understanding at the full Board tomorrow it will come up again and hopefully the questions that you asked will be answered to your satisfaction.

Board Chair Beruff: I think we should move it up to the full Board for discussion.

Governor Lydecker: Would you like me to make a motion?

Board Chair Beruff: I will make the motion if you want to second. Or you make a motion, and I will second it.

Chair Knight: Just before we do that, are there any other questions, comments or things that you would like researched or brought back before tomorrow?

Governor Lydecker: I think it is a really good question, and it is complicated, but to simplify it and get just to the root of it, which is how your question is, how do we preserve more money at Citizens, right? And so, I think it is a good one. I will recommend a motion then, Madam Chair, if you would like me to.

Chair Knight: Okay.

Governor Lydecker: **This motion is to authorize the legal defeasance of remaining outstanding Citizens series 2015 A-1 coastal account bonds in the amount of 275 million and approving the attached, authorizing resolution in 22023 escrow deposit agreement. And then authorize staff to take any appropriate or necessary action consistent with this action item above. That is the motion.**

Board Chair Beruff: **Second.**

Chair Knight: Okay, **the motion carries**.

Board Chair Beruff: I think we should vote on it. A first and a second.

Chair Knight: Well, I am in favor.

Board Chair Beruff: We are done.

Governor Lydecker: Even if you weren't in favor, it would pass.

Chair Knight: Right. So, I was just expediting that.

Board Chair Beruff: Fair point.

Chair Knight: Noted. Well, the next item unless, is there anything that with regard to the escrow agreement that you would like to talk about further, any nuance to the escrow agreement that goes with it? No? Okay. The investment portfolio update, we also heard, I think everyone was here during the Audit meeting, is that right, she went through that?

Jennifer Montero: It is a different one, it is in more detail. I am happy to go through it if you would like, it is up to you.

Chair Knight: Okay.

c. Investment Portfolio Update

Jennifer Montero: It is only four slides.

Chair Knight: All right, let's move forward.

Jennifer Montero: Okay, and it is behind the tab, the next tab that says, investment report. So, the total, on slide one, the total portfolio is $9.8 billion with approximately $8.04 billion or 82% externally managed by 10 investment money managers. The remaining $1.77 million is internally managed, and primarily consists of liquidity for claims, operating funds, debt service funds and debt service reserve funds. Internally managed funds are invested in short term U.S. Treasury securities or money market funds. The taxable portfolio is $9.53 billion or approximately 97% of the remaining, and the remaining $280 million is tax exempt and makes up approximately 3% of the total portfolio. The portfolio is very conservative and stable with sufficient liquidity to pay any current or potential future claims. The total portfolio average duration is just over 2.999 years and continues to decline. The annualized net income return for the last five years from 2018 to '22, has, as earned, and reported is approximately 2.55%, and the 2022 net income return was 2.21%, and the year-to-date July 2023 net income return is 1.52%. On slide two, the Treasury rates are experientially increased over of the last 18 months. The increase in the rates reflect the fed's 11 rate increases to the current fed funds rate of 5.25 to 5.5%, as well as one more anticipated rate increase in 2023, as the fed continues to attempt to manage inflation with monetary policy. The yield curve is still significantly inverted and current, two to 10-year spread is negative 67 basis points, and the three-month 10-year spread is negative 103 basis points. Both spreads are at historical negative levels as the financial markets are still expecting a significant slowdown or a recession. The tax-exempt rates have also increased. On slide three, both the taxable and tax-exempt portfolios have very strong credit quality. Over 74% of the taxable portfolio is in money market funds or rated A or higher. 100% of the tax-exempt portfolio is in money market funds are rated A or higher. Approximately 44% of the total portfolio is in Treasury and agency securities or in money market funds. And slide four, the portfolio income return is stable and is expected to be in the range of 2.85% to 3% for 2023 as an incremental interest income continues from rising interest rates of increase investment in shorter duration securities. The portfolio's year-to-date July total return is 2.59 and is expected to be over 3% for 2023. The portfolio still has negative mark to market but is declining as the portfolio matures and durations decline. And that completes my report. There is an appendix in here as well if anyone is interested in additional information.

Chair Knight: Thank you. Is there any new business other than our items that we will follow up with?

Board Chair Beruff: Motion to adjourn.

Chair Knight: Okay.

Governor Lydecker: Second.

Chair Knight: We are adjourned. This meeting is adjourned, thank you.

Board Chair Beruff: Thank you, Madam Chair, well done.

(Whereupon, the meeting was concluded.)