CITIZENS PROPERTY INSURANCE CORPORATION

MINUTES OF THE FINANCE AND INVESTMENT COMMITTEE MEETING

Tuesday, July 9, 2024

The Finance and Investment Committee (FIC) of Citizens Property Insurance Corporation (Citizens) convened at The Westin Lake Mary, Lake Mary Tuesday, July 9, 2024.

The following members of the FIC were present:

Chair Erin Knight
Charlie Lydecker
LeAnna Cumber

The following Board members were also present:

Robert Spottswood

The following Citizens staff members were present:

Jennifer Montero
Barbara Walker
Tim Cerio
Michael Peltier
Jeremy Pope
Jay Adams
Joe Martins
Mark Kagy
Brian Newman
Andrew Woodward
Chirstine Ashburn

The following people were present:

Kapil Bhatia	Raymond James
Sasha Stipanovich	Raymond James
Coleman Cordell	Bank of America
Danny Kriss	Gen Re

Call Meeting to Order

Barbara Walker: Good afternoon, and welcome to Citizens' July 9, 2024, 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, Governor Lydecker and Governor Cumber.

Barbara Walker: Chair Knight, you have a quorum.

1. Approval of Prior Meeting's Minutes

Chair Knight: Thank you. Welcome to the July 9th, 2024, FIC meeting. I apologize I'm not able to be with you all in person. Thank you for being here. And the first order of business is the **approval of the April 9th, 2024, committee meeting minutes**.

Chair Beruff: **So moved**.

Governor Cumber: **Second.**

Chair Knight: Thank you. I presume we're all in favor and the **meeting minutes are adopted.** Thank you. I'd like to welcome Kapil Bhatia, our financial adviser with Raymond James, for our market update.

2. Raymond James – Financial Adviser

a. Market Update

Kapil Bhatia: Thank you, Madam Chair. Good afternoon, Madam Chair, Mr. Chairman, and governors. For the record, Kapil Bhatia from Raymond James and Associates. We are your financial adviser. I'll briefly start with the market update, but please stop me at any point of time to answer any questions or to expand on any point. CPI was unchanged on a seasonally adjusted basis in May after rising .3% in April. Over the last 12 months, the all-items index, or the CPI, increased by 3.3%, again, before seasonal adjustments, more than offsetting a 2 percent decline in the energy index. Housing prices continue to put upward pressure on inflation by rising 0.4% for the fourth consecutive month. Core CPI rose by 0.2% in May and 3.4% over the last 12 months. Shelter, the largest spending category for the average household and the largest component of the core CPI, which has risen by 5.4% over the last 12 months. There are approximately 175 components in the

CPI -- overall CPI. 38% of those components actually have declined, but shelter is one of the sticky ones, and that's keeping the inflation still on the upward trend. Total non-farm payroll employment increased by 206,000 in June, and the unemployment rate increased to 4.1% with 6.8 million unemployed persons. These numbers are higher than a year earlier when the unemployment rate was 3.6% and the number of unemployed persons were 6 million, and it's the highest rate over the last year and a half, or since October of 2021. The labor force participation remains unchanged at 62.6% and has been fairly constant over the last 12 months. The fed has left its benchmark interest rate unchanged over the last 12 months, or the last time they increased was in July of 2023. As of June, the interest rate is 5.25% to 5.50%, and since March of 2022 to July of 2023, the fed increased the rates by 11 times.

The market is currently expecting the first of the potential two rate cuts this year, first one to occur in either September or November, but economic data will really derive the timing and the number of cuts this year, whether it's one or two. The fed is still on a campaign against elevated inflation while ensuring the economy does not slip into recession, but just a slowdown. The fed has also indicated that it will slow the process of letting its balance sheet roll-off, which has seen approximately $1.5 trillion of bonds roll off to a current balance sheet of approximately $7.4 trillion. Since the fall of 2022, the fed has been allowing up to $60 billion of treasuries and $35 billion of mortgage-backed securities to mature and not to be replaced, effectively reducing their balance sheet by $100 billion per month. Now the Fed will reduce its roll-off of treasuries from $60 billion to $25 billion while keeping the mortgage securities roll-off constant at $35 billion, so that all the process will slow, and that is the first step towards -- before they start cutting the interest rates. The fed is projecting inflation to steadily cool, while the labor markets to remain historically strong and personal consumption to remain high. We expect GDP to increase by 2.1% this year and slow down to 1.6% in 2025. However, we believe the U.S. economy will slow this year but we do not believe the slowdown will lead to a technical recession or the negative two quarters of GDP growth. And the economy will lead to a soft landing. Two of the reasons for soft lending is resiliency in the housing market and continued non-residential investments. The lack of supply of homes, especially in the existing homes market, has increased real residential construction and new homes construction, as well as sales are continuing to keep residential investments in positive territory. The impacts from feds' rate increases, however, are neutralized by the effects of CHIPS Act, Inflation Reduction Act, as well as other fiscal spending, which is leading to an additional construction of manufacturing plants in U.S. So that is keeping the economy in a relatively better position just because of the fiscal spending.

The yield curve remains inverted with the spread between three-month and 10-year treasury to be approximately 109 basis point and spread between two-year and ten-year treasury at approximately 33 basis point. Since the beginning of this year, one-year treasury has increased from 4.8% to 5%, and five-year has increased from 3.93% to 4.2%, and 10-year from 3.95% to 4.2%. So even though it has normalized, it's not increasing, but it is still marginally going up, and we expect it to come down by early next year. The current unrealized losses in the portfolio have continued to decrease, but are still negative; however, these values, again, are non-economic and non-cash, as these negative values pull to par as the securities mature. Our portfolio duration is much shorter today than it was a year ago, so the evaporation pace will increase.

The current negative mark-to-market is approximately $600 million and is expected to decline by $50 to $75 million every three months as the portfolio matures and without any change in the interest rates. If interest rates start to decline, the negative mark-to-market will decrease by $100 million every six months. Lastly, our income return is stable, and historically high interest rates are economically beneficial as they lead to higher interest income. Currently, the book yield for the portfolio is around 3.22%, and $4.25 billion of our portfolio, which is approximately over 40% of the portfolio, will mature over the next 12 months, which will lead us to invest in a higher yielding securities and lead to higher investment income. We expect overall investment income this year to be around $360 million to $400 million, depending on the market conditions. And, lastly, the reinsurance markets are stable, but are capacity constrained with a pricing of flat to +/- 5%, depending upon the cedent this year for this upcoming hurricane season. With that, I'll stop and be happy to answer any questions.

Chair Knight: Are there any questions from the committee?

Chair Beruff: Nope.

Kapil Bhatia: Thank you.

Chair Knight: Thank you, Kapil. Ms. Montero.

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

a. Risk Transfer Program Update

Jennifer Montero: Behind Tab 3, you'll find the 2024 Risk Transfer Program Executive Summary and layer charts. I'll provide a quick update. So, in 2024, reinsurance markets softened slightly despite the higher demand for reinsurance capacity in Florida related to the expiration of the RAP and FORA programs. This softening can be attributed to additional capital added to the risk transfer market, especially in the capital markets, due to the attractive nature of risk transfer pricing relative to other asset classes and optimism around the anticipated impact of Florida's legislative reforms specific to litigation, which have only just begun to be realized. However, there was also some slight hardening as capital was reduced related to multiple forecasts of a very active Atlantic hurricane season. Additionally, reinsurance capital levels are still significantly affected by Ian losses of approximately $132 billion and remaining investment portfolio unrealized losses, which have not yet evaporated due to stable but still higher interest rates. As a result, risk-adjusted risk transfer pricing was relatively flat, or approximately plus or minus 5 percent, for most of Florida carriers, as Kapil just mentioned. And capital market transactions were able to upsize and price at levels close to initial guidance. However, specific to Citizens, risk-adjusted pricing was down approximately 7.9%. As approved by the board of governors at its May 14th, 2024, board meeting, Citizens sought authorization for a total of $5.5 billion of coverage with a cost not to exceed $750 million. Citizens was able to place a cost-efficient risk transfer program of approximately $3.564 billion, which includes $3.064 billion of new placement and $500 billion of existing multi-year coverage through Lightning Re from 2023 at a cost of approximately $482 million. Approximately $1.964 billion was transferred to the global traditional reinsurance markets and approximately $1.6 billion was transferred to the global capital markets.

All of the 2024 risk transfer layers cover personal residential and commercial residential losses and are as follows: The sliver layer sits alongside the CAT fund. It provides approximately $630 million in excess of $3.514 billion of annual per occurrence coverage. This layer was placed in the traditional market. Layer one sits above the sliver layer and the CAT fund and provides $1.122 billion of coverage from the traditional and capital markets as follows: $397 million of single year, per occurrence coverage placed in the traditional market, attaches after losses of $4.144 billion. $225 million of multi-year annual aggregate coverage placed through Everglades Re II attaches after losses of $9.809 billion. This is the first year of this three-year coverage. And $500 million of multi-year annual aggregate coverage placed through Lightning Re. This coverage utilizes an industry loss index trigger based on PCS published insured losses in the state of Florida for Florida named storms. This is the second year of this three-year coverage. Layer two of the program sits above Layer one and provides $850 million of coverage from the traditional and capital markets as follows: $380 million of single-year, per occurrence coverage placed in the traditional market attaches after losses of $5.644 billion and $425 billion of multi-year annual aggregate coverage placed through Everglades Re II attaches after losses of $11.309 billion. This is the first year of this three-year contract coverage. Layer three of the program sits above Layer two and provides $793 million of coverage from the traditional and capital markets.

Chair Beruff: Ms. -- Madam Chair?

Chair Knight: Yes.

Chair Beruff: Can I ask Ms. Montero a question?

Chair Knight: Absolutely.

Chair Beruff: Ms. Montero, will you just for my benefit cut to where the exposure of the red line is? I think when we were discussing this, it comes in at 1-in-74-year event and one in a –

Jennifer Montero: Yes.

Chair Beruff: -- (inaudible) 74-year event. So, for the audience and the rest of the board, whose maybe hadn't had a chance to digest this, we have no exposure except at a 1-in-74-year event, correct?

Jennifer Montero: That is correct. We run out of surplus and coverage. When we get to the 1-in-73-year event, the Citizens policyholder surcharge would kick in. It's 15% of direct written premium, so it's approximately $895 million, and it would trigger at the 1-in-74. A 1-in-74-year event would experience approximately $14.4 billion of residential losses –

Chair Beruff: And then we, the board, had authorized how much spend total? 750? $750 million?

Jennifer Montero: $750 million.

Chair Beruff: And we spent how much?

Jennifer Montero: $482 million.

Chair Beruff: $482 million. So, the difference is going to go into reserves?

Jennifer Montero: Yes.

Chair Beruff: So that's the long and short of it. Does anybody have any questions? Obviously, Ms. –

Jennifer Montero: Would you like me to go over the emergency assessment as well, Chairman?

Chair Beruff: Yes, when you get into that category.

Governor Spottswood: Madam Chair?

Chair Knight: Yes.

Governor Spottswood: Just one question. You know, this year where we are, that's -- I'm seeing that as well. Just really quick, what were we insured to last year at this point in time going into hurricane season? We're about –

Jennifer Montero: 5.38 -- $5.308 billion.

Governor Spottswood: We're -- no, till we get to the surcharge amount before that, we're at 14.4?

Jennifer Montero: That was when we had separate accounts. So, in the personalized account, we hit the Citizens' policyholder surcharge at the 1-in-4 year event and the emergency assessment at the 1-in-9 year event on the personal lines account because it grew so quickly and the surplus was the -- majority of the premium was unearned premium and was not in surplus. So –

Chair Beruff: We were much more exposed.

Jennifer Montero: Much more, much more exposed, yes.

Governor Spottswood: Okay. Better position- -- thank you. I'm good.

Jennifer Montero: May I carry on with the emergency assessment?

Chair Knight: Yes.

Jennifer Montero: Thank you. So once the Citizens' policyholder surcharge exhausts at the 1-in-83-year event, that's when the emergency assessment of up to about $2 billion would be triggered. A 1-in-83-year event would experience approximately $15.4 billion of residential losses and LAE. And the reason I mentioned that is to put it into perspective. As a reminder, ultimate direct loss in LAEs of March related to Hurricanes Ian and Irma were $3.6 billion and $2.6 billion, respectively. So, it would take quite a few of those events to reach that mark. So, in summary –

Chair Beruff: Excuse me, Madam Chair, if I may add a comment. The only difference, of course, is the factored inflation in that time period since those storms hit has been pretty significant. So, the claims could be exceedingly larger.

Jennifer Montero: It's true.

Chair Beruff: Go ahead.

Jennifer Montero: So, in summary, the 2024 risk transfer program totals $3.564 billion of coverage with a weighted average gross rate online of 14.07% and a net rate online of 13.44%. The 2024 risk-adjusted price reflects some improvement in the market, despite the appearance of an increase in pricing in both the traditional and capital markets. For coverage placed in 2024, the price is approximately 7.9% lower than it would have cost for similar coverage in 2023. So that completes my update, and if you have any questions.

Chair Knight: Thank you. Go ahead.

b. Investment Portfolio Update

Jennifer Montero: The next tab is the investment summary.

Chair Beruff: Madam Chair, if I may ask a question and cut to the program? Kapil, please tell us what we would lose if we liquidated our investments today.

Kapil Bhatia: We have approximately -- Mr. Chairman, as I mentioned earlier in the market update, our negative mark-to-market as of today is negative -- approximately negative $600 million. So, if we have to liquidate all of our portfolio, not
--
Chair Beruff: We understand. So that's not going to happen. The burn rate is about $25 million a month.

Kapil Bhatia: Each three months, our mark-to-market declines -- the negative mark to market declines by $40 to $50 million.

Chair Beruff: $40 to $50 million.

Kapil Bhatia: Each three months, because we look at it –

Chair Beruff: So quarterly, so you're talking about $40 to $50 million and reduce risk to us as every quarter goes by.

Kapil Bhatia: That's true with no change in interest rates. If the interest rates –

Chair Beruff: Right. If the interest rates were to diminish, then, obviously, our portfolio is more valuable.

Kapil Bhatia: Correct.

Chair Beruff: When do you find that -- what is the estimated burn before you get down to, say, $100 million?

Kapil Bhatia: It will take us -- in the current interest rate environment, it will take us almost two years to get to that point, and that would be only the long-dated assets because 40% of our portfolio will mature in the next 12 months, another 30% will mature over the next 12 to 24 months. It's the remaining 30% of the portfolio which has a long duration.

Chair Beruff: So, the only good news is that to the extent that the portfolio's liquidating and paying off, you're reinvesting in higher yield treasury bonds.

Kapil Bhatia: That is correct. We are looking at -- because our credit is still perfect. I mean, we have some corporate exposure around 30 to 40%, and Jennifer will go through that in a minute, but, yes, we have a higher rate. So, our current book yield is around 3.50%, and we expect our book yield to increase as the portfolio matures by around 25 to 30 basis points each quarter. And next year, we expect our book yield to be closer to 4.5%.

Chair Beruff: Okay.

Kapil Bhatia: So, our investment income is increasing each quarter by around $20 to $25 million.

Chair Beruff: Thank you.

Chair Knight: Okay.

Jennifer Montero: (Inaudible). Okay.

Chair Knight: Go ahead. I apologize.

Jennifer Montero: Thank you. The total portfolio is $10.06 billion with approximately $8.43 billion, or 84 percent, externally managed by nine money managers. The remaining $1.63 billion, or approximately 16%, is internally managed and primarily consists of liquidity for claims and operating funds. The internally managed funds are invested in short-term U.S. Treasury securities or money market funds. The portfolio is very conservative and stable with sufficient liquidity to pay any current or potential future claims. The total portfolio average duration is stable and is currently just over 2.74 years. As of May 2024, the one-year net income and total income return is 3.34% and 4.24%, respectively, and the 2024 net income return is expected to be approximately 3.6%. The annualized net income return for the last four years is approximately 2.75% annually. Next slide, please. Treasury rates have increased over the last 24 months but have stabilized over the last six months. The increase in rates reflects the feds' 11 rate increases to the current fed funds rate of 5.25% to 5.5%. The fed is done with increasing rates as inflation has started to come down, and, therefore, the interest rates have stabilized a bit at relatively higher levels but are expected to start coming down in late 2024. The yield curve is still inverted. The current two to ten-year spread is negative 33 basis points, and the three months to ten-year spread is negative 89 basis points. Both spreads are still at significant negative levels as the financial markets have either expecting a soft landing or a slowdown. Next slide, please. The portfolios have very strong credit quality. Overall, 78% of the portfolio -- taxable portfolio is in money market funds or are rated “A” or higher. Approximately 44% of the total portfolio is in treasury and agency securities or in the money market funds. And, finally, slide four the portfolio income return is stable and the net income for 2024 is expected to be over 3.6%. Incremental interest income continues from rising interest rates with increased investment in shorter duration securities. Lastly, the portfolio still has negative mark-to-mark value, but it is declining as interest rates are coming down and the portfolio is maturing with declining duration. The 2024 total return is expected to be over 4.5% as existing securities mature. And that completes my report.

Chair Knight: Thank you. Are there any other questions or new business?

Chair Beruff: No questions.

Chair Knight: Okay. Thank you. Then we will call the meeting adjourned for July 9th FIC meeting.

(Whereupon, the proceedings were concluded.)