

CITIZENS PROPERTY INSURANCE CORPORATION  
TRANSCRIPT OF THE MINUTES OF THE  
AUDIT COMMITTEE MEETING HELD MONDAY JUNE 19, 2017

A Board meeting of the Audit Committee of Citizens Property Insurance Corporation (“Citizens”) was held at 1.00 pm on Monday June 19, 2017 in Maitland, FL.

The following members of the Audit Committee were present:

Juan Cocuy, Chairman  
Bette Brown  
Jim Henderson

The following Citizens staff members were present:

Jay Adams	Christine Ashburn
Steve Bitar	Violet Bloom
Kelly Booten	Jennifer Dilmore
Brian Donovan	Matt Gerrell
Barry Gilway	Karen Holt
Paul Kutter	Mona Markell
Joe Martins	Bruce Meeks
Jennifer Montero	Stephen Mostella
Michael Peltier	Sue Register
Carl Rockman	Dan Sumner
Carrie Thomas	Mike Tush
Barbara Walker	David Wheat
David Woodruff	Andrew Woodward

The following persons were present:

Brian Smith, Dixon Hughes Goodman  
Matt Church, Dixon Hughes Goodman  
Tameka Patterson, Jeffries  
Raul Williams, Jeffries  
Ian Hanson, Willis Re  
Leslie Dughi, Greenberg Traurig, LLP  
Dave Newell, FAIA  
Kapil Bhati, Raymond James

Call Meeting to Order

MS. WALKER: Good afternoon, and welcome to Citizens June 19th, 2017, Audit Committee meeting.

CHAIRMAN COCUY: Good afternoon. I would like to call the meeting to order. First order of business is roll call, Barbara.

MS. WALKER: Called roll call, all committee present, quorum established.

CHAIRMAN COCUY: Thank you very much. With that, item number one is the approval of the prior meetings Minutes. I would entertain a motion to approve those unless there are any comments?

**Governor Brown proposed motion to accept minutes of Audit Committee meeting of June 19, 2017, Governor Henderson seconded, all in favor and motion was passed.**

CHAIRMAN COCUY: The motion carries. The Minutes are approved. Item number two on the agenda is the report of the Office of the Internal Auditor. With us we have Joe Martins who will give us a status report.

MR. MARTINS: Thank you, Mr. Chairman. I refer to tab two of the presentation and the dashboard. On the first page of that dashboard I refer to the audit plan and plan changes. We mentioned that the plan is a risk based plan, and as we progress throughout the year, and processes and risks within the organization change, we will reassess the plan and make changes to that plan. This time around one of the areas that came to light was a specific piece of work that we got involved in with the organization on the loss adjusting expenses and we commenced with performing an end to end claims process review and procedure review including key metrics, decisions and resource usage. That specific project resulted in us revisiting the plan and we combined two of the pre-scheduled audits that we had into that project. At the end of the day we added two engagements to the plan. We canceled five, combined two engagements and deferred two other engagements to 2018. Part of the reason that we had these changes as well was execution of the COBIT assessment within the internal framework project. Following our search for a resource and the fact that we couldn't find a suitable resource, I tasked two of the auditors on to that project, resulting in cancelling two IT engagements in consultation with management. When you look at the plan in total we have 27 audit projects remaining, of which we have 12 audits, 12 advisory engagements and three projects that we monitor. Of these we have completed nine and in total 67 percent of the plan is either completed or in progress. During the quarter we completed two engagements, the first one was in procurement. The second one legal billing litigation expense vendor management and then we also issued a progress report on the ERP project. On the two engagements that we finalized, both of them were rated as satisfactory. Specifically when you refer to the procurement project I think you will remember that during 2014/2015 we brought on the vendor management organization and they worked with the procurement function, they improved the processes and we are pleased to say the work that we have done has shown that there has been good progress. The function is operating quite well and we found the processes are operating effectively. We have made some minor proposals to the team which they accepted and are currently addressing. Similarly, with the project that we have, legal billing and litigation expense vendor management, you will recall that in 2014, we issued a report that was unsatisfactory. This time around we did a follow up on the work that they intended to put in place then, and again we are pleased to say that the function has been corrected well. There is new management and new staff in place and the procedures are operating effectively and are well designed and they are really doing a good job. Again, we had some minor process improvements that we brought to them which they are currently addressing. Those were the two main audit reports that we delivered.

When you turn to page 4 of the dashboard, I refer to the control deficiency resolution and you will see when you look at the first graph on that page that the open items have been reducing steadily since the beginning of last year. We have currently five open items. These are being managed well within the organization. There is nothing major to report and very good progress

in terms of the organization taking care of the risks that have been identified. On page 5 I highlight the progress on the internal controls framework project. This project has been split into two areas. The first one on that page is our COSO execution and that phase focused mainly on the operations and financial controls. We have 51 processes that we need to review, of those we completed 14; we currently have eight in progress, three remaining and we are planning to complete this project by the end of this year. We are scheduling the first complete self-review throughout the organization in September, and we are preparing the organization for that, the self-review and the self-reporting in terms of the strength of the controls. The Internal Controls Office will work closely with management to execute that for the first time and thereafter the following year it will be business as usual.

If you turn the page to page 6, we refer to the COBIT self-assessment that we are currently doing within the organization. That project has kicked off during quarter two. We have the IT security function as the pilot for that study which is progressing well and with great support from the organization. We are learning a lot in developing our procedure and making sure that it is solid. You will notice that on that page we mention 171 total engagements. When you go through the COBIT framework there are 36 processes and approximately 210 sub processes. With these we scoped out the number of processes. We are currently looking at a total of 31 processes in COBIT as compared to 51 in the COSO review. The 31 processes for us related to 171 total engagements, and these engagements are small mini projects compared to COSO and they execute relatively quickly against them. That is why you will see that we already have 40 of those in progress when you look at the two processes that we are focusing on which is IT security risk and governance.

Then when you turn the page I would like to mention progress in the Enterprise Risk Office. I am pleased to introduce to you our new addition to the team, Mike Tush. When we developed the framework we decided to break it up into two specific areas. The first area will focus on an operational risk assessment. Therefore working bottom up we have David Wheat and he commenced with that assessment and developed a plan around that, and that is the plan that we show on that page where we highlight a total of 260 engagements. Those 260 engagements refer to 260 processes throughout the organization that we will be assessing and will complete operation of risk assessments work. David has commenced with that and he is progressing relatively well. You will see that we completed 45 assessments. We currently have 14 in progress and 201 to go, and our intention is to complete that risk register by the end of 2018.

Mike Tush joined us and he will focus on strategic risk and work with the organization to assess risks associated with the implementation of strategy; he started a week ago and he is developing the process around that. We are redefining or solidifying our methodology and he is building strength in that area currently and will work very closely with the organization as it goes through the strategic plan this year to help identify the risks that need to be mitigated that are allowing flows to strategy. And I guess as we get closer to the end of this year we will be in a position to present a list of what we call the top risks for the organization and present that to the Board for consideration and awareness. Just on Mike, when we look at the last page of my presentation we look at value and staffing. I mentioned that we brought on Mike Tush. You will see on that page I have a short bio on Mike, he has a lot of experience. He joins us from Guidewell, Florida Blue, where he was responsible for the reengineering of the Enterprise risk management strategy and processes and developing and implementing Board and senior management reports with key risk indicators for critical risk. You will also see that he has a lot of other good experience and that will help us to achieve the tasks ahead.

Following that we have a couple of vacancies still in the office. The one that I would like to mention is the forensic audit manager position. Of the vacancies that we have that is the only one that we currently are recruiting for. It has been a challenging engagement for us and our supporting recruiting staff. John Fox is our recruiting manager; he is the Director in Internal Audit and I know that he has a couple of resumes that he is currently assessing and doing some interviews. So hopefully we will be able to get that person in and then place the necessary focus that we need on occupational Florida as well. That is all I have for this meeting, sir, if you have any questions?

CHAIRMAN COCUIY: And I see you have included the audit reports for the procurement and for the legal billing and litigation vendor management. Everything is pretty much in there, but is there anything you would like to either emphasize or reiterate regarding those two audits?

MR. MARTINS: Certainly, sir. I can refer you to the report for the procurement. When you look at page 2 of that report at the bottom we highlight the opinion and we mention that the report was rated satisfactory and noted that efforts to strengthen the controls and the implementation of improvement initiatives for various procurement processes were noted throughout the audit. Strengths noted included solicitation, summary memos documenting key details of each solicitation and lessons learned with areas of improvement in implementation of additional controls to ensure key steps and documents are completed. So really in essence we are saying that they have strengthened the control environment quite well and focused on the areas that needed attention. On page 3 of that report we highlighted the work, identified opportunity for improvement focused mainly on the scoring criteria. As you know, scoring is by the members of the selection team, and we felt that they can focus on providing some training to the evaluation team and clarity around scoring and making sure that there is synergy among the team members. That has been taken on, they accepted that and they are working at developing a training module around that going forward for each of the solicitations. The second report that we have is the legal billing litigation vendor management that I mentioned. Previous work was relatively negative in terms of the strength of the management process in place. This time around we felt that they have done quite a lot to improve the processes. On page 2 of that report we mention which of the specific areas that they are improving. We also highlight the areas that they are currently working on. We mention legal billing management recognizing the need for a departmental quality assurance program and they are developing and building that already. They declared that to us before we started with the audit, and the vendor relations management that identifies the need to report if there are any cross method billing from the acuity system which they use as the administrative system. And on the next page we go through and observe some of the positive improvements in the area. And also had a couple of improvement actions; the first one focused for them to utilize currently available software to electronically compare invoice documentation instead of a manual comparison. They recognize that and they work towards utilizing electronic software. During the audit we also performed some data analytics which we passed on to the business unit. They found that helpful and they are going to use that going forward. We requested improvement in communication of new cross departmental policies which they are going to do to make sure that the various functions that are involved in the processes are aware of the new policies that came out. And then the last report that we had was on a remote password reset process. A very quick assessment by the audit function. After a report from within the organization to the Inspector General, the Office of Internal Audit did a quick assessment and identified that the procedure around remote password reset could be enhanced. The business recognized that and immediately took action and implemented a new procedure which is already in place and operating well. And that is the results from the three reports that we have the package, sir.

CHAIRMAN COCUY: Okay. Very good. Other members of the committee, do you have any comments or questions?

GOVERNOR BROWN: Yes, I will just make a quick comment. The audit on the legal billing and litigation, it sounds like you guys worked really well hand in hand. I remember that was a bit of a bug-a-boo before. So I compliment everybody who worked on that, including the legal and litigation group, because that was a big thing to get your arms around and it sounds like you made some good recommendations and they were heeded and in much better shape. So thank you.

MR. MARTINS: Thank you.

GOVERNOR HENDERSON: No comments, thank you.

CHAIRMAN COCUY: Okay. And I guess in closing on your report I would like to commend you and say how proud I am of the progress on the COSO efforts and on the beginnings of the COBIT effort. I know a couple of years ago we were discussing how do we get our arms around it, how can we really strengthen the internal controls of the organization similar to a Sarbanes-Oxley for the private entities and this effort is really having Citizens take a look at the processes and documenting them and making sure that the controls are effective and preventative, and if not preventative, good detect controls and the documentation is there. So it is a living document and I guess I would encourage the organization going forward to be constantly reviewing that to make sure that it is current and that we are doing what we are saying we are doing in those policies and procedures.

MR. MARTINS: Thank you very much, sir. From our point of view, we had excellent support from the organization, business unit, management and staff, great buy in. Really eager to work with the Internal Controls Office and to get those primary risks documented and I think the business units are really in great support of those. They understand why we are doing that, they see the benefits of that and they are eager to continue managing and strengthening the control environment going forward. So we are very pleased with the support that we have had, and that is really what makes us successful in this project.

CHAIRMAN COCUY: Okay, thank you very much. Okay, with that I will call to item number three, the Chief Financial Officer's report.

MS. MONTERO: Thank you, Mr. Chairman. Good afternoon, Governors. Behind tab three of the audit section of the committee book you will find the summary of financial position and operations, and the first quarter financial report. Although these documents have a different look from the past reports we feel they mark an improvement in providing relevant information on the company's financial position and results of operations. We expect to continue building out our financial reporting process by leveraging our new ERP system and it's approved reporting capabilities. In summary, through the first quarter of 2017, the personal lines accounts comprised 41 percent of consolidated net earned premium in contrast to 44 percent through the first quarter of 2016. Due to concentration of H-03 policies, particularly those that have a much higher tendency to produce litigated water claims and the absence of wind only policies, underwriting margins in the personal lines accounts are much more compressed than in the commercial lines accounts. Through the first quarter of 2017, the personal lines account earned four cents of underwriting income per dollar of net earned premium, sharply lower than the commercial lines accounts of 71 cents and the coastal account of 52 cents. As business in the commercial lines accounts and the coastal account continue to decline, we expect our

consolidated operating margins to be more heavily influenced by the personal lines accounts. Through the first quarter of 2017, premiums written in the personal lines accounts increased three percent, whereas premiums written in the commercial lines account and coastal account decreased 50 percent and 23 percent respectively as compared to the first quarter of 2016. Relative to year end 2016, and on a direct basis, loss in LAE activity has shown marginal improvement. On a direct basis the consolidated loss ratio declined from 35.1 percent to 30 percent from year end 2016, to the first quarter of 2017. Likewise, the consolidated LAE ratio declined from 17 percent to 14 percent over the same period. Contributing to the decline in loss and LAE ratios were the absence of hurricane losses during the current period which added 3.4 percent to the 2016 loss ratio, and no adverse development on litigated non-weather water claims from prior accident years which added five percent to the 2016 loss ratio, indicating no improvement or further atrophy with non-weather water claims and reflecting the continuation of reserve strengthening at year end 2016. During the first quarter of 2017, Citizens experienced immaterial adverse loss development related to sinkhole claims that was generally offset by immaterial favorable development on LAE, also related to sinkhole claims. Although the non-weather water claims predate the first quarter of 2016, the increase in litigated rates and associated costs did not fully materialize in development until the third quarter of 2016, at which point reserves were adjusted upwards to account for the expected litigation rate of roughly 50 percent of all non-sinkhole claims in the personal lines accounts. This litigation rate is expected to persist on policies written through the first quarter of 2017. The decrease in consolidated net written premium of roughly eight percent approximates the decline of administrative expense of eight percent, which in turn, led to negligible change in expense ratio. At March 31st, 2017, Citizens' capital position remains strong in advance of the 2017 hurricane season, with consolidated surplus of \$7.48 billion. And I will pause now for any questions.

CHAIRMAN COCUY: Committee members, are there any questions?

GOVERNOR HENDERSON: You mentioned on the loss adjustment expenses that there was what an actuarial adjustment for LAE.

MS. MONTERO: last year we did an adjustment in the reserves to account for the litigated, non-sinkhole litigated claims and the PLA being 50 percent of the claims going into that level of -- 50 percent would go into litigation of the non-sinkhole claims in the PLA account.

GOVERNOR HENDERSON: And that caused the, I guess the variance from '17 or I guess from '16.

MS. MONTERO: It caused the loss ratio to go in go up in 2016, but we are carrying that same 50 percent, we don't see a need to increase it anymore at this point.

CHAIRMAN COCUY: I guess just in terms of bottom line performance, it always seems like the first quarter is extremely profitable and then the last quarter is usually a big loss. Is it at the end of the year where -- how -

MS. MONTERO: It is not until June that the reinsurance payments and other large payments are, we start making those payments. So the first quarter does not have a lot of large payments in it. Expenses, I should say not payments, expenses.

CHAIRMAN COCUY: Yes, would there be a reason to possibly kind of smooth it out a little bit and accrue?

MS. MONTERO: Well, we accrue it over hurricane season because it is catastrophe reinsurance. So we accrue it from June 1 to November 30, since that is the period that it covers. We did it for the CAT fund and for the private reinsurance. Behind the next tab you will see the December 31st, 2016, audited financials, both stat and GAAP. There are no changes from the December financials that we presented at the last Audit Committee meeting. However, we do have Dixon Hughes here to go over the auditor's report for you. We also have bound copies of both stat and GAAP that will be available tomorrow if you would like a bound copy, Barbara has it and we can put them out for the Board. So if there is nothing else I will turn it over to Dixon Hughes.

CHAIRMAN COCUY: So our external auditors, item number four on the agenda, Brian Smith and Matt Church of Dixon Hughes Goodman, and gentlemen, before you begin I understand that Brian just got promoted to partner in the firm, congratulations.

MR. SMITH: That is right, thank you, I appreciate that.

MR. CHURCH: First off, thank you to the committee for having us today, and a big thank you to management and to the finance team for their cooperation during the audit this year and the timely responses and the fact that the things they gave us, they agreed to what they should agree to and it was clearly thought out and easy to follow, which is a lost art in our profession, so a big appreciation to them. Just a quick reminder on scope for Citizens. We did an audit of the GAAP financial statements or what we call sort of a GASBY, even though it is still a GAAP standard, but you will have two sets and then the other financials were audited under statutory accounting principles prescribed or permitted by the Florida Office of Insurance Regulation on both of those statements unmodified audit reports. So that is good news. And professional standards require that we communicate certain things to those charged with governance. So that would be the Audit Committee in this case. And so to talk about a couple of those. One is our responsibilities, we did communicate those to you in our engagement letter dated November 2nd, and then we are also required to communicate sort of the plan, scope and timing of our audit which we did at the December Audit Committee meeting live here. And then further Brian is going to discuss the required communications regarding the execution and completion of the audit through the wrap up phase.

MR. SMITH: Brian Smith. If you look in tab four, which is the report that we are providing to go over today. I will hit the highlights unless you want me stop with any questions. When we complete our audit we look for not only test procedures across the entire company, but we also focus heavily on significant risk areas or significant estimates. Loss reserves being a large and significant estimate to the company, we spent a lot of time in that area. Just to hit the highlights we do test procedures of claims, paid losses. We also do a lot of analytical procedures around trends, loss ratios, etc. And at the end of the audit we also engage a third party actuary we discussed in our plan which is Merlinos & Associates and they review the assumptions and methods that Citizens actuaries internally use. At the conclusion we did not find any material differences in loss reserves, so that is a good sign. The other significant area we look at as far as significant risk is the evaluation of investments, particularly the bond portfolio. We will engage third party evaluation resources to go through and to test the prices, not only of all of your securities, but also your financial instruments, being your debt as well. We did not have any material differences there, so that is significant. Another required communication is any difficulties encountered during the audit. We did not have any. Management and the finance team were terrific to work with, so we applaud them. We have no corrected or uncorrected misstatements to communicate. We have no disagreements encountered with management.

And then the last two reports which are on page 6 and page 7, is our required communication around internal controls. Just to refresh our scope, we are not engaged to audit internal controls, but we are required to communicate any significant deficiencies or material weaknesses we identified during the audit and we did not identify any during the audit. So overall a clean report. Ask any questions you would like.

GOVERNOR HENDERSON: Sounds like a clean report.

CHAIRMAN COCUY: Pretty much. In layman's terms it is a clean report on modified auditor's opinion, no major, no material weaknesses or significant deficiencies in internal controls. And then I guess going forward for next year, any suggestions, anything that we could do to make it more efficient? Is there a different approach to testing perhaps more through the systems versus substantive testing, anything you guys have in mind?

MR. CHURCH: I think one thing we discussed actually this morning was the ledger conversion the company has gone through with its own internal systems. We are going to work with the internal audit group as well as the finance team to look at that early in the year. A lot of times when you have a large transition, it is easier to detect any variances early. So we will get out in front of that here early in 2017. Outside of that I think our plan will remain as consistent with prior years. We will change a few test procedures just to have that unintentional bias you could have within the finance group, but we will change it up every year.

CHAIRMAN COCUY: Excellent. Anything else? With that, thank you guys. I commend your efforts and I again compliment the efforts of our internal staff and the team work between the internal staff and our internal auditors to be prepared for the external audit, and as you can see it was a success. So thank you very much.

MR. CHURCH: Thank you.

MR. SMITH: Thank you.

CHAIRMAN COCUY: Okay, with that we will move on to the complaint management statistics. I think that is just for our information. Do we have anybody to report on that? Fine, so I guess on tab five, pretty self-explanatory. So with that unless we have any other new business or anything to add I would entertain a motion to adjourn the Audit Committee meeting.

**Governor Henderson proposed a motion to adjourn the meeting, Governor Brown seconded, all were in favor and the meeting adjourned.**