

# INTERNAL AUDIT

Investment Management  
Audit Report

September 6, 2018



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# Executive Summary

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## Background

Citizens has approximately \$9.56 billion in total investment funds representing premium surplus and pre-event bond financing. In order to optimize the use of these funds, Citizens' overall investment strategy follows three prioritized goals: 1) safety of principal; 2) maintaining liquidity in order to pay for operating and claims expenses in a timely manner; and, 3) earning competitive returns. Citizens utilizes third-party Investment Managers to manage the vast majority of the Company's investment funds. The remaining funds are in short-term cash equivalent securities and managed internally in accordance with the Citizens investment policies by members of the Treasury & Investments Department.

The third-party Investment Managers have trading discretion within the boundaries of Citizens' investment policies. The Treasury and Investment business unit independently oversees the investment portfolio utilizing FactSet, a tracking and compliance monitoring software solution implemented in the summer of 2017. In addition to verifying trade/investment policy compliance, Citizens uses FactSet to track, assess and report on the performance of the third-party Investment Manager's portfolios, as well as the Company's entire investment portfolios.

The total investment portfolio has an average duration of 4.01 years and average credit ratings of A/A/AA. External third-party Investment Managers (15 firms) currently manage 91% (or \$8.66 billion) of the total investment portfolio while 9% (or \$0.90 billion) is internally managed by the Treasury & Investment business area.

## Audit Objectives and Scope

The objective of this audit was to evaluate the adequacy and effectiveness of the processes, procedures and controls associated with investment management practices at Citizens. Our scope included a review of the following areas:

- Citizens' overall investment strategy alignment to investment policies
- Internally managed portfolio practices
- Investment performance and compliance monitoring and oversight
- Portfolio risk management practices
- Third-party relationships, including monitoring and review of third-party processes and controls
- Access surrounding trading platforms and custodial banking system

## Audit Opinion

The overall effectiveness and efficiency of the procedures and related processes associated with Citizens' Investment Management is **Satisfactory**.

Results from our audit work indicate that Citizens' investment policies appear to be in alignment with Citizens' overall investment strategy, effective oversight is present, and access rights within critical investment systems are properly restricted.

Specifically, we noted that the FactSet system is effectively aligned with Citizens' investment policies to allow management to monitor investment activity and performance of its' third-party

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investment managers. Overall, we noted that management oversight of the Company's externally managed portfolio and the third-party managers was effective. We observed that management utilizes leading portfolio risk management practices through the use of quarterly stress tests to their portfolio. We also reviewed access rights within the NEXEN trading platform, as well as those in the Company's custodial banking system, and noted they were appropriately restricted and no segregation of duties issues were present.

As a result of our work, OIA identified a process improvement opportunity. Management is encouraged to consider the following suggestion to increase efficiencies around investment management activities:

- We suggest management utilize the FactSet system to monitor the trading activity and balances of the internally managed portfolio to ensure compliance with the Citizens' investment policies. Currently, only money market securities are available to trade and hold in the internally managed portfolio, and a periodic manual review is in place to ensure: i) Citizens is not overexposed in any one fund, and ii) those funds credit quality is highly rated. Enabling the FactSet system to monitor the internally managed portfolio will take advantage of a system already in place and reduce the need for manual intervention.

We would like to thank management and staff for their cooperation and professional courtesy throughout the course of this audit



## Appendix 1

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### Definitions

#### **Audit Ratings**

##### **Satisfactory:**

The control environment is considered appropriate and maintaining risks within acceptable parameters. There may be no or very few minor issues, but their number and severity relative to the size and scope of the operation, entity, or process audited indicate minimal concern.

##### **Needs Minor Improvement:**

The number and severity of issues relative to the size and scope of the operation, entity, or process being audited indicate some minor areas of weakness in the control environment that need to be addressed. Once the identified weaknesses are addressed, the control environment will be considered satisfactory.

##### **Needs Improvement:**

The audit raises questions regarding the appropriateness of the control environment and its ability to maintain risks within acceptable parameters. The control environment will require meaningful enhancement before it can be considered as fully satisfactory. The number and severity of issues relative to the size and scope of the operation, entity, or process being audited indicate some noteworthy areas of weakness.

##### **Unsatisfactory:**

The control environment is not considered appropriate, or the management of risks reviewed falls outside acceptable parameters, or both. The number and severity of issues relative to the size and scope of the operation, entity, or process being audited indicate pervasive, systemic, or individually serious weaknesses.



## Appendix 2

### Distribution

Addressee(s) Andrew Woodward, Sr. Director - Controller

Addressee(s) **Business Leaders:**  
Barry Gilway, President/CEO/Executive Director  
Jennifer Montero, Chief Financial Officer  
Christine Turner Ashburn, Chief, Communications, Legislative & External Affairs  
Mark Kagy, Acting Inspector General  
Long Yang, Treasury & Investment Manager

**Audit Committee:**  
Bette Brown, Citizens Audit Committee Chairperson  
James Holton, Citizens Audit Committee Member  
Senator John McKay, Citizens Audit Committee Member  
Marc Dunbar, Citizens Audit Committee Member

**Following Audit Committee Distribution:**  
The Honorable Rick Scott, Governor  
The Honorable Jimmy Patronis, Chief Financial Officer  
The Honorable Pam Bondi, Attorney General  
The Honorable Adam Putnam, Commissioner of Agriculture  
The Honorable Joe Negron, President of the Senate  
The Honorable Richard Corcoran, Speaker of the House of Representatives

The External Auditor

*Audit performed by Michael Walton, Internal Audit Manager  
Under the Direction of Joe Martins, Chief of Internal Audit*