CITIZENS PROPERTY INSURANCE CORPORATION

MINUTES OF THE
FINANCE AND INVESTMENT COMMITTEE MEETING
Tuesday, December 11, 2018

The Finance and Investment Committee (FIC) of Citizens Property Insurance Corporation (Citizens) convened at the Sheraton Orlando North in Maitland, FL on Tuesday, December 11, 2018 at 2:00 pm (EDT).

The following members of the FIC were present:

Gary Aubuchon, Chairman
Bette Brown
Marc Dunbar

The following members of the Board were present:

John Wortman
William Kastroll
Jim Holton

The following Citizens staff members were present:

Barry Gilway
Jennifer Montero
Andrew Woodward
Dan Sumner
Kelly Booten
Steve Bitar
Joe Martins
Jay Adams
Christine Ashburn
Mark Kagy
Violet Bloom
Michael Peltier
Barbara Walker
Brian Donovan
Paul Kutter
Stephen Guth

The following people were present:

Kapil Bhatia	Raymond James
Dave Newell	FAIA
Adam Schwebach	Willis Re

John Generalli	Wells Fargo
Margaret Lezcano	UBS Financial Services
Doug Draper	Bank of America Merrill Lynch
Ken Vincent	Guy Carpenter
Jason Kutz	Guy Carpenter
Danny Kriss	Guy Carpenter
Coleman Cordell	Bank of America Merrill Lynch
Matt Williams	Bank of America Merrill Lynch
Mark Weinberg	Citigroup
Rawn Williams	Jefferies
Tama Patterson	Jefferies

Call Meeting to Order

Barbara Walker took roll.

1. **Approval of Prior Meeting's Minutes**

Chairman Aubuchon made the motion to approve the September 25, 2018 Finance and Investment Committee (FIC) Minutes. Bette Brown moved to approve. Governor Dunbar seconded subject to the corrections he made.

Chairman Aubuchon: Motion and seconded subject to the corrections that were submitted. All were in favor. Motion approved.

Chairman Aubuchon: And we are on to item number two which is a market update. And to present our market update is Kapil Bhatia. Kapil, you are recognized.

2. **Market Update**

Kapil Bhatia: Good afternoon, Mr. Chairman and Governors. There are currently six million people unemployed, although the unemployment is 3.7% compared to the last Board meeting in September when the unemployment rate was 3.9%. There are currently 163 million people, civilians employed, compared to a 162 million in September. From a total civilian population of 258 million, the labor participation rate is 62.9%, which is marginally higher than where we were three months ago or last year but significantly less than where we were 10 years ago in July of 1997 at 67.2%. The U6 unemployment rate which includes persons marginally attached to the labor force, all those employed part time looking for full time work, also known as broader unemployment rate is 7.6%. This number is also up by .2% from September. This reflects that people are moving from sidelines to actual job market. So even though the unemployment rate is 3.7 %, there is still a significant slack in the economy and that is why we don't see really a wage inflation or a wage pressure. All of this translates into there are 10 million people still sitting on the sidelines from 10 years ago, who are looking for jobs, but waiting for the right moment. So we should not expect any wage growth pressure or inflation and that is why we see the interest rates where they are and not expected to go up. The Feds have increased rates eight times since

2015, once in 2015, once in 2016, three times in 2017, and so far three times in 2018, and the yield curve is flat at this point. However, we believe Fed will take a look at the difference between three months treasury rates and five years treasury rates as well as three months in a 10-year treasury rate and effectively will end up increasing by 25 basis points next week.

On the other hand we believe Fed has already increased rates one time more than they should have, and this increase will effectively make it two times than they should have, and that will make the yield curve further flatter. In addition, and the fact of the flattening of the yield curve is Fed's $3.9 trillion balance sheet which they are unwinding and effectively they will be selling $600 billion worth of securities and that is artificially suppressing the 10-year. So they are increasing the Fed fund rate while the 10-year rates are coming down, the yield curve is going to get flat if not inverted at any point in time unless the Fed stop. It is possible they may not increase, but we believe Fed has gone deeper into the hole and they are actually going to end up increasing it. However, we don't expect Fed to increase even once in 2019. We also expect the economy to grow by 2.9 to 3% in 2018, compared to 2.3% in 2017. An average of 2.2% over the last five years. However, we expect growth rate to come down, and in 2019, it should be back to closer to 2.5% and with some of the trade wars or trade friction and some of the other things going on, that may change the growth rate by plus or minus .2, it depends on what happens over the next 90 days or any time after that. So the range we are thinking of is 2.3% to 2.7%, depending on what happens to the trade with an average growth rate of two and a half percent.

The global markets, the global interest rates are still low. They are still numerous countries in Europe, from Switzerland, Germany, Denmark, Netherlands, and I can name half a dozen more where the five-year rates are still negative. So the global growth rates are still negative up to five years and over $8 trillion worth of securities are still trading at negative rates. Global growth is also very low. Euro area at one percent, U. K. at one and a half, Japan at one, China at around six and a half percent, even though that is a very large number, but relatively it is not considering what they need to maintain the economic growth and stability in China. We expect the global rates to remain low and global growth to remain low. Risk transfer markets, there is still an abundance of capital in the global reinsurance market, over $600 billion despite 2017 events and 2018 events. It was more of an income event, not a capital event. We expect 2019 rates to be similar to 2018, at least for us because we have not had many losses compared to some of the other insurers. We should expect a marginal rate increase, but we don't expect anything different in our placement for 2019. And lastly, we expect our 2019 investment income to be stable to marginally higher on an average interest rate basis even though our assets are down, but our investment income should remain the same at least constant in dollars and cents because the rates have moved up. With that I will stop and answer any questions you have.

Chairman Aubuchon: Thank you, Kapil. Members, any questions?

Kapil Bhatia: Thank you.

Chairman Aubuchon: Okay, thank you very much. We will move now on to tab three which is the update of our risk transfer program, and for that I will recognize Jennifer Montero.

3. **Risk Transfer Programs Updates**

Jennifer Montero: Thank you. Behind tab three, is an updated version of the document I originally shared with you at the last FIC meeting. Given that we have had projected recoveries from the 2017 risk transfer program, I would like to highlight some of the coverages and how they work. So on slide two, this is the 2017 coastal account layer chart. Citizens' layer chart is a visual representation showing the resources available to pay claims for a large wind event. The vertical access increases as the storm size and on this chart goes up to a 1-in-100 year event. Citizens purchases private risk transfer in the coastal account and like other property insurers we are required to buy coverage from the Florida Hurricane Catastrophe Fund. The left side of the chart shows coverage for the residential portion, both personal residential and commercial residential (CNR) and the right side of the chart shows the commercial non-residential coverage. The green blocks in the chart indicate losses which would be funded from surplus. We structured the 2017 risk transfer program so that the losses below a 1-in-11 year storm would be paid from surplus. It is kind of like a deductible. For the residential portion we have Cat Fund coverage, a traditional reinsurance coverage which wraps around the Cat Fund, and then an $880 million layer of reinsurance which sits above the $350 million wrap. $300 million of the $880 million was placed in the capital markets via a Cat Bond. The remaining $580 million was placed in the traditional market as aggregate coverage. You can also see the CNR coverage in the amount of $200 million off to the right in the tan colored block. On slide three we have Irma estimated recoveries. This slide walks us through the estimated coastal account residential risk transfer recoveries from Irma. The blue diamond show the trigger point for each of the risk transfer coverages. The green boxes represent our projection of Citizens' recoveries for Irma losses and the loss adjustment expenses which are LAE. We expect recoveries from the Cat Fund and the wrap, but do not anticipate payouts from the risk transfer of the $880 million layer which consist of the traditional coverage and the Cat Bond. The Cat Fund triggers based on loss only and then pays 5% of loss as an allowance for lost adjustment expense. Our traditional coverage is triggered based on loss and actual LAE incurred, but then they have an inuring coverage which you will see subtracted out in the blue diamond. The Cat Fund recoveries inure to the benefit of the wrap contract, meaning that the Cat Fund recoveries reduce the losses which are covered by the wrap. Like the Cat Fund, the Cat Bond has an allowance for loss adjustment expense. The Cat Bond allowance is 10% for LAE versus 5% for the Cat Fund.

Slide four, this reflects the multiple storms. In addition to Hurricane Irma there was Tropical Storm Emily, Hurricane Nate, Tropical Storm Felipe, and as a reminder, although the 2017 hurricane season officially began on June 1st and ended November 30th of 2017, our risk transfer contracts run through the full year through May 31st, 2018. So Tropical Storm Alberto which occurred at the end of May 2018, also falls within last year's risk transfer program. These four storms are each projected to produce a relatively low level of losses, an aggregate total of $462,000 of loss in LAE. The traditional aggregate coverage have a lower attachment point, but also inure in coverage. It means that in order to meet the low attachment recoveries from the other lower layer contracts, such as the Cat Fund, inure or at the benefit of the traditional aggregate contract and potentially reduce payouts from the traditional aggregate contract. On the other hand, the Everglades Cat Bonds have a high retention and no inuring coverage and they attach at $2.15 billion. All the coverage in the $880 million layer have aggregate retentions. Therefore the losses from the storms together need to meet the retention, not the individual storm. Because Irma met that retention the other four storms in aggregate do as well. The Cat Fund and wrap layer are current contracts. Each storm has to meet the retention. So there are no recoveries from either of those vehicles for the four smaller storms.

Slides five and six are the 2018 coastal layer charts. One is the residential, both personal residential, commercial residential, and slide six is for the commercial non-residential. The risk transfer placement for 2018 includes $183 million of traditional reinsurance alongside the Cat Fund, $250 million of capital markets risk transfer through Everglade Re, $150 million of traditional reinsurance for aggregate multi-year risk, $300 million of traditional reinsurance for aggregate single year risk and $60 million of traditional reinsurance for commercial non-residential. In addition we had multi-year coverage that carried over from the 2017 placement. That consisted of $180 million of traditional reinsurance for aggregate multi-year and $300 million for capital markets risk transfer through Everglade Re. We have added slides seven and eight which are your 2017 and 2018 layer charts for the personal lines and commercial lines accounts. I would like to focus on slide eight which is the PLA/CLA layer chart.

Following 10 years of a minimal hurricane activity from 2006 to 2016, substantial surplus has been accumulated across Citizens' three accounts. During that time the PLA and the CLA continued to improve their financial strengths in terms of claims paying capacity before consideration of assessments relative to the coastal account. As such recent risk transfer initiatives were focused only on the coastal account. As an example in 2014, the PLA had a total available surplus of approximately $2.5 billion and a 1-in-100 year PML of approximately $1.6 billion, with surplus exposed of approximately 18%. Through a robust risk transfer program that leverages both the traditional reinsurance markets and capital markets, the coastal account has been able to reduce its surplus exposure in a 1-in-100 year event from 100% in 2014, to approximately 34% in 2018. After losses due to Hurricane Irma and Michael along with the financial impacts of non-weather water losses, surpluses within the PLA has decreased significantly and is now exposing much more of its surplus in a 1-in-100 year storm than in previous years. For Cat Fund reimbursements and credit purposes the PLA and the CLA are evaluated together where the coastal account is evaluated separately. For 2018, the surplus amounts in the PLA and the CLA are relatively equal. They are both contributing approximately 50% of the combined surplus, whereas the PLA represents approximately 90 to 95% of the combined risk profile of the PLA and CLA. While the PLA and CLA are evaluated together for credit purposes, the CLA cannot fund financial losses arising in the PLA. Therefore, the contribution of the CLA surplus to the combined claims paying resources of the PLA/ CLA, does not give an accurate picture of the claims paying ability or surplus exposure and long term financial health of the PLA. On a combined basis the PLA/CLA has available surplus of approximately $3.6 billion and a 1-in-100 year PML of $2.3 billion with surplus exposed in a 1-in-100 year of approximately 32%. On its own the PLA has available surplus of approximately $1.8 billion and a 1-in-100 year PML of $2.1 billion, leaving surplus exposed in a 1-in-100 year event of approximately 58%. Citizens' strategic risk transfer plan will include the evaluation of risk transfer for the coastal account, as well as the personal lines account in order to reduce the amount of surplus exposed in 1-in-100 year. We will come back to the Board in March with an update and we are going to evaluate the personal lines account as well this year.

Chairman Aubuchon: Thank you, Jennifer. Members, questions? Recognize Governor Dunbar.

Governor Dunbar: So now that you have gone -- we have gone through these two storms and we did not get -- we weren't able to dip into Everglade Re because we couldn't combine. So are there lessons that we should take forward when we go to market next time?

Jennifer Montero: Well, they are two different products. So the traditional, in the same layer, the $880 million layer, the traditional is actually more expensive because it does drop down, it placed net, where the Everglades, the Cat Bonds are placed gross. So they don't move. They are at the attachment of the 2.1. We could go out to the market and see if the Cat Bond market has an appetite to be placed net. It would make the cost go up.

Governor Dunbar: Right. So I guess looking ahead and maybe I misunderstood the overall sort of theme of the presentation, but it seems like our exposure is increasing. If we get hit by a couple of storms next year or more, we might have some problems if we do not either change our reinsurance profile or fix some of the more systemic issues, like the AOB problems and things like that. Is that – is that accurate? Did I hear the message correctly?

Jennifer Montero: Yes.

Governor Dunbar: Okay.

Jennifer Montero: We have not purchased any reinsurance in the commercial or personal lines account since 2005. And because we do show them together for the layer charts for credit purposes, it is an unfair picture to say 32% of the surplus exposed because it is a lot more when you look at PLA by itself. Because the CLA has been subsidizing in the picture that exposure. And we have had net loss each year since 2016 in the PLA. And we are budgeting a net loss for 2019 as well. And so as we are eating that surplus away, which means we are exposing more.

Governor Dunbar: So is it an accurate statement to say our surplus risk profile is at its highest level in the last few years? Is that accurate, is that an accurate statement or no?

Jennifer Montero: For PLA, yes.

Kapil Bhatia: Because we have never bought reinsurance and we had enough capital. But after paying for Irma and Michael and as Jennifer said, litigated losses, at this point in time it is. If we look at going back to 2015 to 2019. But the coastal account is much more stable because we have been buying risk transfer program. So we were able to get the Cat Fund reimbursement as well as the private reinsurance reimbursement. So the coastal account is more stable than the PLA.

Governor Dunbar: Got it. Okay, thank you.

Chairman Aubuchon: I have a follow up to that. On the PLA side, is our surplus diminishing because we have paid out due to cat events over the last two years, or is it because of the non-weather water is bringing that surplus down? I will stop right there.

Jennifer Montero: Yes. So not including the storms we would have had a loss anyway in 2016 and 2017 if not for AOB. I am trying to remember, there is a chart that shows it. One of the years, one of the four years they would have had a net income, but it would have been very, very small, basically breaking even $8 million. But in all the other years it would have been irrelevant of the storms. So those losses are being litigation, one way attorney fees, the AOB abused, the non-weather water litigation. So we are eating our surplus since 2016 every year, we have eaten the surplus in the PLA account.

Chairman Aubuchon: Okay. So what insurance can we buy to stop that from happening? Any further questions? Okay, thank you, Jennifer. Let's now move on to tab four which is our bond underwriting services and our action item.

4. **Bond Underwriting Services [AI]**

Jennifer Montero: Yes. So on July 9th, 2018, Citizens issued Invitation to Negotiate number 18-0017, for bond underwriting service panel. Responses were received and evaluated by an evaluation committee on November 13th, 2018 the evaluation committee recommended an award to a panel of vendors. A list of the recommended panel is as follows.
Senior managers:

- Citi Group
- Goldman Sachs
- Merrill Lynch, Pierce, Finner & Smith
- JP Morgan

Co-managers:

- Barclays Capital
- Jeffries
- Morgan Stanley
- RBC
- Samuel A. Rameriz & Company
- UBS
- Wells Fargo

The purpose of this action item seeks approval to appoint a panel of senior and co-managing bond underwriters for Citizens' future financing. A letter of appointment will be for four years with three optional one year renewals. This appointment does not guarantee nor indicate any specific decision with regard to future participation in bond or other security issuance during the vendor's term. I will pause for any questions before reading the recommendation.

Chairman Aubuchon: Members, any questions? You may proceed with the recommendation.

Jennifer Montero: Thank you. **Citizens' staff recommends that the Finance Investment Committee approve and recommend, (A): approval for appointment for the above listed senior and co-managers to the bond underwriting services panel for four years with three optional one year renewals with the understanding that the appointment does not guarantee nor indicate future participation in bond or other security issuance during the vendor's term. And (B): authorize staff to take any appropriate or necessary actions consistent with this action item.**

Chairman Aubuchon: Okay, we have heard the recommendation. Do we have a motion?

Governor Brown: **Move to approve.**

Chairman Aubuchon: **Do we have a second? Hearing no second I will pass the gavel to Governor Dunbar.**

Governor Dunbar: **Do we have a second?**

Chairman Aubuchon: **And I will second the motion.**

Governor Dunbar: Thank you. I will pass the gavel back to you.

Chairman Aubuchon: **We have a motion and a second.** Do we have any discussion?

Governor Dunbar: If I could.

Chairman Aubuchon: Yes, please.

Governor Dunbar: One thing, I am double checking to make sure that I don't need to file a form 8-A[1] on this. I still have not heard back from my firm. So I am going to go ahead and make my comments subject to an initial report from my firm that I don't have to file, but I may have to file a form 8-A. So I will confirm that. I am going to vote against this item. And I appreciate the time from lunch when we talked through it, but there are just a couple of issues that I have with a couple of the vendors that are on this, and particularly investigations that they have been under and the fines that they have paid and relative to the Foreign Corrupt Practices Act and things like that. I just don't feel comfortable voting on this list moving forward, not being able to look at the responses. And I appreciate the information that I got, but at the same time I would like to know more about what these folks did, and more importantly, what -- how we treat folks that are on the responsible vendor form are answering yes to, you know, that they have paid fines and that they have been indicted for things, and particularly with the news around a couple of these with the Foreign Corrupt Practices Act. I am just not comfortable voting yes on this moving forward and look forward to gathering more information and working on this, but I don't want to slow it down, because I know it is an important item.

Chairman Aubuchon: Is there further discussion? Barbara, would you proceed with a roll call vote, please.

Barbara Walker: Yes, sir. Chairman Gary Aubuchon?

Chairman Aubuchon: **Yes.**

Barbara Walker: Governor Bette Brown?

Governor Brown: **Yes.**

Barbara Walker: Governor Marc Dunbar?

Governor Dunbar: **No.**

Barbara Walker: It carries, sir.

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[1] Form 8-A attached

Chairman Aubuchon: **And we will show that motion is approved.** We will move on to our next action item which is custodian banking services. And Jennifer, you are recognized.

5. Custodian Banking Services [AI]

Jennifer Montero: Thank you. On July 31st, 2018, Citizens released Invitation to Negotiate number 18- 0029 for custodian banking services. Responses were received and evaluated by an evaluation committee. The evaluation committee recommended award on November 13th, 2018, to the Bank of New York Mellon. This action item seeks Board approval for Citizens to enter into a contract with the Bank of New York Mellon to provide custodian banking services to assist Citizens in its fiduciary responsibility and custody, overseeing and reporting on its invested assets. The vendor will provide custodian banking services for Citizens' approximately $8.6 billion portfolio for Citizens three separate business accounts, the PLA, CLA and the Coastal account. The contract term is to be five years with four optional one year renewal terms to be exercised at Citizens' sole discretion. And I will pause for any questions.

Chairman Aubuchon: Members, any questions? Hearing no question, please proceed with the recommendation.

Jennifer Montero: Thank you. **Citizens' staff recommends that the Finance Investment Committee approve and recommends, (A): approve the contract for five years and for four optional one year renewals for a total contract amount not to exceed $1.3 million for custodian banking services, ITN number 18-0029, to the Bank of New York Mellon as set forth in this action item, and (B): authorized staff to take any appropriate or necessary actions consistent with this action item.**

Chairman Aubuchon: And for the record, Governor Dunbar is going to be abstaining. I am going to pass the gavel to Governor Dunbar for this vote.

Governor Dunbar: Thank you. I filed a form 8-A[2]. This is a client of my law firm. **So with that I will take a motion to approve the item.**

Chairman Aubuchon: **So moved.**

Governor Dunbar: **Is there a second?**

Governor Brown: **Second.**

Governor Dunbar: **All in favor.**

Chairman Aubuchon: **Aye.**

Governor Brown: **Aye. Motion approved.**

Governor Dunbar: Thank you. I am passing the gavel back.

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[2] Form 8-A attached

Chairman Aubuchon: Thank you very much. And now we are going to move to tab six which is our annual charter review.

6. 2018 FIC Charter – Annual Review

Jennifer Montero: Yes. And staff has no recommended changes. So we bring it to you even though we have no changes so that it can be approved unless there are any questions.

Chairman Aubuchon: Members, any questions?

Governor Brown: **Move to approve.**

Governor Dunbar: **Second.**

Chairman Aubuchon: **We have a motion and a second. Any discussion? Any objection to the motion? Hearing no objection, let's show that motion is approved.** And now we will move on to tab seven which is our investment portfolio update.

7. Investment Portfolio Update

Jennifer Montero: On slide one is the Executive Summary. The total portfolio is $9.3 billion with approximately $8.45 billion managed externally, and $.9 billion internally managed. The taxable portfolio is $7.67 billion which is approximately 82% of the portfolio. The tax exempt portfolio is approximately $1.6 billion. The total portfolio average duration is marginally over four years with three percent maturing in less than 90 days, and 23% maturing between 90 days and three years. The total portfolio income return for one year is 2.76%. On slide two, the interest rates for treasuries have been increasing over the last year and now the yield curve is flat, almost inverting. As of Friday the interest rates for the one, three and five year are 2.68%, 2.72%, 2.70% respectfully. Tax exempt rates have also increased similarly over the last year. On slide three, 91% of the portfolio is externally managed by 15 taxable and/or tax exempt portfolio managers. Nine percent of the portfolio is internally managed, consisting of operating funds, debt service funds and debt service reserve funds. Taxable and tax exempt portfolios both have very strong credit quality, 86% of the tax exempt portfolio is in money market funds are rated AA or higher, and approximately 81% of the taxable portfolio is in the money market funds are rated A or higher. Over 25% of the taxable portfolio is in treasury and agency securities. On slide four, our total portfolio return summary, 2.76% of income return over the last 12 months and 2.21% over the last of the last two years. That completes my report. As always, in the appendix there is a full, much longer and more detail report. And I will pause for any questions.

Chairman Aubuchon: Members, any questions? Governor Dunbar, you are recognized.

Governor Dunbar: I am curious. Do we know how much our -- how much we invest in the state of Florida through our investments? Is that broken out at all by our money managers? I am curious as to how much, what percentage of our portfolio is actually invested in bonds in Florida?

Kapil Bhatia: How much our managers invest in the municipal portfolio which belongs to like issued by the state?

Governor Dunbar: Right, yes.

Jennifer Montero: Any or specifically Florida?

Governor Dunbar: No, no, no. I am curious how much we invest in ourselves if we know.

Kapil Bhatia: We actually don't invest anything in Florida's tax exempt securities -- our tax exempt portfolio is much smaller. However, we don't invest in the Florida paper because of the overlapping risk. We need the funds if there is an event. And if there is an event Florida paper starts to widen, means it trades at a cheaper level. So most of our managers don't invest in the Florida securities. We have some exposure, very small, but it is almost zero.

Governor Dunbar: So it is a matter of investment policy we don't invest because it would increase our risk profile.

Kapil Bhatia: Because of overlapping risk after an event, that is when we would need the liquidity and those papers don't trade as well based on some of the historical analysis.

Governor Dunbar: Okay, thank you.

Chairman Aubuchon: Further questions? Okay, thank you very much. Is there any new business?

8. Depopulation and Clearinghouse Update

Jennifer Montero: I do, on the last item, the depopulation clearing house update. At the last meeting Governor Dunbar asked a question and we have added a slide to the end of that depopulation packet about AOB and increased litigation. The question was, how much bigger would Citizens be, and the answer is about 56,000 more insured policies. So the actual risk is the predicted trend. And you can see that on page nine of the depop presentation.

Governor Dunbar: So is it safe to say we hit the valley -- if the Legislature doesn't fix the problem

Jennifer Montero: Yes.

Governor Dunbar: -- we have hit the bottom of depop where we can go and now we are going to turn around and head in the other direction.

Jennifer Montero: That is correct.

Governor Dunbar: Or we already have actually.

Jennifer Montero: Yes.

Governor Dunbar: Thank you very much for preparing that slide, I appreciate it.

Chairman Aubuchon: Okay, thank you very much for your presentation. Members, any new business to come before the committee? If not, I would entertain a motion to adjourn.

Governor Dunbar: Move to adjourn.

Governor Brown: I will second that.

Chairman Aubuchon: And without objection, we are adjourned.

(Whereupon, the meeting was adjourned.)