Citizens Property Insurance Corporation

Minutes of the
Finance and Investment Committee Meeting
Tuesday, March 26, 2019

The Finance and Investment Committee (FIC) of Citizens Property Insurance Corporation (Citizens) convened at the Sheraton Orlando North in Maitland, FL on Tuesday, March 26, 2018 at 3:00 pm (EDT).

The following members of the FIC were present:

Gary Aubuchon, Chairman
Bette Brown
Marc Dunbar (Telephonically)

The following members of the Board were present:

John Wortman
Blake Capps

The following Citizens staff members were present:

Barry Gilway
Jennifer Montero
Andrew Woodward
Dan Sumner
Kelly Booten
Steve Bitar
Joe Martins
Jay Adams
Mark Kagy
Michael Peltier
Barbara Walker

The following people were present:

Kapil Bhatia	Raymond James
Dave Newell	FAIA
Coleman Cordell	Bank of America Merrill Lynch
Matt Williams	Bank of America Merrill Lynch
Henry Reyes	JP Morgan
Tom Carlson	RBC Capital Markets

Call Meeting to Order

Barbara Walker took roll.

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

Chairman Aubuchon: Welcome everyone to the Tuesday, March 26, 2019 meeting of the Finance and Investment committee. The first order of business is the approval of our minutes from our prior meeting.

Governor Brown: Moved to approve the minutes from the prior meeting December 11, 2018.

Governor Dunbar: Chairman this is Marc, I can't second that because the online link to it was bad and I wasn't able to actually read the minutes. I can trust staff and Bette, they're good to go but my link was bad and I couldn't read the minutes.

Chairman Aubuchon: **Okay, I'll pass the gavel in order to second the motion. We have motion and a second. Do we have any discussion? Do we have any objection to the motion? Hearing no objection, let it show that motion is approved.** We'll move on to our next item which is our market update. I'd like to recognize Kapil Bhatia to present the market update.

2. **Market Update**

Kapil Bhatia: Good afternoon Mr. Chairman and governors. Governor Dunbar Can you hear me okay?

Governor Dunbar: Yes, I can hear you fine.

Kapil Bhatia: Great. Thank you. For the record I'm Kapil Bhatia from Raymond James and Associates. I'll start briefly with a market update, but if you have any questions, please stop me at any time. There are currently 6.2 million people unemployed, or the unemployment rate is 3.8%. There are also currently 163 million civilians employed in the United States from a total civilian population of 258 million, the labor force participation rate is 63.2%. This compares to 62.9% during the December board meeting, the highest labor participation rate was 67.2% in July of 1997. This means we are still 4% below the highest labor participation rate. However, due to some of the demographic changes, we don't expect that number to ever reach 67% or higher again, we expect the maximum number can be probably closer to 65%. The U6 unemployment rate which includes persons marginally attached to the labor force, and those employed part time due to economic reason is 7.3%. The lower labor participation rate as well as the 7.3% U6 unemployment rate collectively reflects the slack in the labor market, as people are still moving from sidelines to the labor market. The total potential labor force available between those two data elements is around 6 to 7 million people keeping the wage pressure low and not much change from the inflation perspective.

The Fed increased rates once in 2015 once in 2016, three times in 2017, and four times in 2018, to the new target rate of 2.25 to 250 and currently the Fed Funds are trading at 2.40. There are no further increases forecast for 2019. And possibly, we expect one rate cut in September as Fed has gone too far. As we said in December, they were probably going to increase the rates in December even though they should not. The yield curve is inversion at this point of time, as you may have seen it in the financial markets between three months and five years by 22 basis points. And between three months and 10 years by three basis points. This is the inversion which the Fed was not expecting. However, because the December rate increases, we were expecting this inversion to happen. The reason Fed increase the rate in December was to prove its independence. And even though the economy was slow, the growth was slow they wanted to make sure everybody in the world knows that Fed is independent and living up to its independence stance from 1951. However, they have realized that the policy stance was not correct. And the most recent minutes are very diverse. And therefore we expect Fed to start cutting rates or at least cut once in September, to steepen the yield curve, if not steepen at least flat but not inverted.

Year to date, the S&P is up 11% and Dow Jones is up almost 9%. But five and 10 year Treasury rates are down 38 and 33 basis points and that reflects global demographic changes in the population as world is growing older. Europe is becoming another Japan and we all know about the Japanese interest rates over the last 20 years. And China is not that far behind. We don't expect fixed income markets to behave very differently or rates to go up any differently. They have been on the downward sloping curve for the last 30 years and probably going to stay that way. Global market interest rates are still low, and ECB has committed and will continue to hold its negative benchmark rate through 2019. Almost $10 trillion of global sovereign bonds are trading at a negative yield, ranging from five to 10 years in Germany, and Swiss interest rates are negative through 15 years. The GDP is growing very slowly, the European Union GDP is growing at .2% to .3%. The UK economists expect growth to go up by less than half percent in 2019. And that reflects Brexit where there is probably not a solution. Brexit is just continuing on its own path without really any exit, but just the term Brexit. Japan is no different. It's slow economic growth, and China is also slowing down. So overall economic growth is slowing, US is one of the bright spot and growing. We expect the 2019 growth to be closer to 2% or just marginally above 2%. Unlike 2018, which was a reflection of our fiscal policy of the tax impact of additional 1% and the 2018 growth was 3%. Moving on to the risk transfer market. Global reinsurers still have record level of capital around $600 billion, despite number of catastrophic events in 2017 and 2018.

2018 was unique in itself, there was not a single major event. However, lots of smaller events, such as wildfires in California, Japanese earthquake, and Hurricane Michael. They were all small relatively speaking, but the insured losses were much larger than historical insured losses have been. And simply because most of the events happened in either US or Japan where the insurance penetration is significantly higher. Generally renewals in 2018 were almost flat. We expect rates to increase by five to 10% for all of the loss layers, primarily in Japan, wildfires, as well as in Florida because of the Hurricane Irma adverse losses, and Hurricane Michael, but only for the loss layers. The layers at the high attachment point, we don't expect that to increase and probably to stay flat. And when we say flat, we mean plus/minus 2% one way or the other. During 2018 the Cat Bond market was stable, there was issuance of over $13.8 billion, and the outstanding amount is almost $38 billion at this point in time. And lastly, the investment income is stable as Jennifer mentioned earlier during the 2018 financial update. We expect 2019 investment income to be marginally higher than 2018, even though our total assets have gone down because some of our pre-event bonds have matured. With that I'll stop and answer any questions you may have.

Chairman Aubuchon: Thank you Kapil, members any questions? Hearing none, thank you very much for your presentation. We'll move on to our Risk Transfer Program Update and I'd like to recognize Jennifer Montero.

3. **Risk Transfer Programs Updates**

Jennifer Montero: Thank you. Behind tab three is the Risk Transfer Executive Summary as well as the layer charts. The summary goes with the layer charts. So I'm going to go through basically our proposed 2019 Risk Transfer Program. As you're aware, Citizens' statute requires that the board make its best effort to procure catastrophe reinsurance to cover a 1-in-100 year storm at reasonable rates. The analysis to purchase reinsurance is evaluated by staff and Citizens' financial advisor each year, and the resulting recommendation is made to the board. Essential to Citizens' goal of reducing exposure and reducing or eliminating the amount and likelihood of its assessment burden on the citizens of Florida is the transfer of risk through reinsurance mechanisms. Accomplished through participation in the Florida Hurricane Catastrophe Fund or the FHCF reimbursement program, traditional reinsurance markets and capital markets. The proposed 2019 Risk Transfer Program for the coastal account incorporates all of the strategic elements from prior risk transfer programs, which includes risk transfer alongside the Cat Fund, transfer annual aggregate risk and the transfer of commercial non-residential risk. Citizens plans to transfer exposure in the amount of approximately $1.4 billion in 2019 for the coastal account. This includes $880 million of risk transfer from 2017/2018 that remain in place for the 2019 season. And you can see that's the tan and the light blue in the chart. Included in the $880 million is $330 million of multi-year traditional reinsurance and $550 million of capital markets risk transfer through Everglades Re. The proposed 2019 renewal will include three layers in addition to the remaining multi-year layer. The first layer, referred to as the sliver layer covers personal residential and commercial residential losses, and would work in tandem with the coverage provided by the FHCF to include the co-payment of 10% of loss not covered by the FHCF. The second layer would sit above the $880 million multi-year layer and covers annual aggregate personal residential and commercial residential losses. This layer will have single year coverage.

The final layer of the program would provide coverage for the commercial non-residential losses not covered by other layers of the program and which Citizens has no Cat Fund coverage. All three layers will be placed in the traditional market the total amount of surplus exposed in a 1-in-100 year event in the Coastal Account would be approximately 22%. Moving on to the PLA a draft layer chart: after significant losses in the Personal Lines Account due to hurricanes Irma and Michael along with non-whether water losses and the assignment of benefits. The Personal Lines Account surplus has decreased significantly, and is now exposing much more of a surplus for a 1-in-100 year storm than in previous years or approximately 62%. Citizens' strategic risk transfer plan for the PLA is similar to the Coastal Account considers the transfer of a relatively marginal amount of risk in order to reduce the amount of surplus exposed in a 1-in-100 year event. In order to accomplish this, the amount of transfer purchase will be approximately $200 million alongside and above the FHCF. Staff will work with Citizens' co-brokers and its financial advisor to evaluate available options relating to the structure terms, pricing and other relevant matters in structuring the 2019 Risk Transfer Program. This team will be convening with a number of global traditional reinsurers to market Citizens' Risk Transfer Programs over a two week period in April. Following these meetings, staff will provide a recommendation to the Board of Governors in late April or early May for approval. And I will pause there for any questions.

Chairman Aubuchon: Members, any questions? Okay, thank you. Ready to move on to Commercial Banking services?

4. **Commercial Banking Services [AI]**

Jennifer Montero: Yes, behind tab four you'll find an action item for Commercial Banking Services pursuant to Section 287.057, Florida Statutes. On October 1, 2018 Citizens released invitations to negotiate 18-0036 for Commercial Banking Services. Three responses were received on November 15, 2018, and were first evaluated by an evaluation committee. The negotiation committee then met with each of the three vendors who were advanced by the evaluation committee. On March 5, 2019, JP Morgan Chase Bank, NA was determined to offer the best value for Citizens by the negotiation team. The action items seeks Board approval for Citizens to enter into a new contract with JPMorgan Chase Bank, NA to provide commercial banking services which will replace the contract number 11-10-005 with Wells Fargo. As of June 30, 2018 Citizens held approximately $20 million of total assets with the commercial banking vendor. The total balance held with our commercial bank has varied over time. The services include depositories services, electronic funds transfer services, check clearing services, fraud prevention services, online banking, reporting capabilities, electronic files transmission services, account reconciliation and custody safe keeping. The current contract is set to expire on June 8, 2020 and implementation and transition plan will take place involving the recommended vendor and the current vendor to allow seamless transition for Citizens. The contract amount is estimated to be $1.2 million, including both the base and five-year renewal terms, an estimated $600,000 for the base term and estimated $600,000 for the five-year renewal term. And I'll pause for any questions before I read the recommendation.

Chairman Aubuchon: Questions for Jennifer?

Governor Dunbar: This Marc Dunbar. Is there a projected net savings by making this shift as opposed to renewing Wells Fargo?

Jennifer Montero: The best and final offer by JP Morgan was less than the other two vendors. So we saved by not staying with the current vendor.

Governor Dunbar: What are we paying currently? Not regarding the best and final, but I mean, currently under the existing contract is there increase or decrease from what we're paying currently for the service?

Jennifer Montero: I'd have to check on what we're paying currently our incumbent vendor Wells Fargo did give their best and final offer and it was significantly higher than the JP Morgan. Theirs was $1.75 million compared to the $1.2 million.

Governor Dunbar: Right, but you don't know what we're paying them currently?

Jennifer Montero: I don't know right off the top of my head right now. I can get that and get it to you by the end of the day.

Governor Dunbar: Yeah, you can tell me tomorrow, I'm just curious if the costs associated with this service just in general, regardless of these bids. Are we paying more for the service? Are we paying less for the service?

Jennifer Montero: I believe we are paying less but I'll confirm that for tomorrow's meeting and let you know at that time if that works.

Governor Dunbar: Yeah, that's great. Thank you, Jennifer.

Chairman Aubuchon: Okay, Jennifer, if you would proceed with reading the recommendation.

Jennifer Montero: Sure. **Citizens' staff recommends that the Finance and Investment committee approve and recommends: approval of five-year base contract including the five-year renewal term for an estimated amount of $1.2 million for Commercial Banking Services, ITN 18-0036 to JP Morgan Chase Bank, N.A and authorize staff to take any appropriate or necessary action consistent with this action item.**

Governor Brown: **Move to approve.**

Governor Dunbar: Can I have one other question real quick before we vote. Sorry.

Chairman Aubuchon: Sure. If you go ahead and second, then we'll open for question.

Governor Dunbar: **second.**

Chairman Aubuchon: Okay. **We have a motion and a second.** Please proceed with your question.

Governor Dunbar: Thanks. Um, so are we coming off of a five year contract?

Jennifer Montero: No, I believe it was a 10 year contract. I'll have to check, because we actually were doing business with SouthTrust that turned into Wachovia that turned into Wells Fargo. So I'd have to go back and look at the contracts. The bank kept getting bought out. We have been with the predecessors back to the beginning of Citizen, so I'd have to check when the contract was done. I think it was 10 years.

Governor Brown: So this is really a first change?

Governor Dunbar: Yes. And that was the reason why I was asking the question is I thought that this was a change. We're basically going probably to a 10 year commitment to these guys. A five plus five, right? I didn't know from an industry standpoint, if the contracts are trending longer or shorter. Should we be doing three and three? I don't want to micromanage the procurement process, I just was curious in terms of industry trends, that's why I asked the question. If we're paying less than we were with the prior group, if the trend is going down, seems like we should be doing shorter term contracts, if the trend has been going up, and like we would do a longer contract that makes sense.

Jennifer Montero: Yes, they're usually longer because there's an infrastructure costs that goes along with switching a bank, it's pretty complicated. This contract actually is for five years, with one optional five year renewal term to be exercised by Citizens discretion. So if we don't like it, after five years, we can get out of that contract. But I will confirm what the last contract term was.

Kapil Bhatia: Governor Dunbar this is Kapil Bhatia from Raymond James, the industry standard is five to 10 years, they usually are very long term contracts because of all of the infrastructure it takes to set up the plumbing into the system. So usually, it's not less than five years, just from an industry perspective.

Governor Dunbar: And Kapil, is the trend going with the custodial banking services, the costs associated with that is going down? From an industry standpoint, which I think makes sense, or is it?

Kapil Bhatia: Yes

Governor Dunbar: That's what I figured.

Kapil Bhatia: It is significantly down from where we were 10 years with all of the technology and automation. And I don't know exactly what the number is as Jennifer said she'll come back with bids, but we were comparing the bids with what we received to see who was the most effective and efficient, but the costs have come down significantly. And you're absolutely right about that part.

Governor Dunbar: Thank you. That's very helpful. I appreciate it.

Chairman Aubuchon: Thank you. Okay, and just to bring this in, we are actually approving to recommend to the Citizens' Board of Governors tomorrow to approve this. So it's a recommendation and from what I'm understanding we'll have Governor Dunbar's questions answered before we vote on it as a full board. And then finally, that in four years' time, should we find that the downward trend continues. We have the right to then put it out for procurement once again, put out an RFP and test the water so to speak, without necessarily having to go the full 10 years.

Jennifer Montero: Yes, exactly.

Chairman Aubuchon: Okay. Great. So **we have a motion and a second. Any further discussion? Do we have any objection to the motion? Hearing no objection, let's show that motion is approved.** And we'll move on now to our Investment Portfolio Update.

5. Investment Portfolio Update

Jennifer Montero: Yes, on tab five. This is a four page summary. If you recall there is an appendix that gets into a lot more detail but I'll go through these four pages starting with the Executive Summary. The total portfolio is $9.3 billion with approximately $8.5 billion externally managed and $0.8 billion is internally managed. The taxable portfolio is $7.64 billion and the tax exempt portfolio is approximately $1.64 billion. The total portfolio average duration is marginally less than 3.9 years with 6% maturing and less than 90 days, 7% maturing between 90 days and one year and 25% maturing between one and three years. The total portfolio income return for one year is 3.06%.

On the second page the interest rates, rates for treasuries increased in 2018 but had significantly decreased over the last quarter and now the yield curve is inverted between three months and five years. As of Monday, the rates for one, two, three and five year are 2.43%, 2.25%, 2.18% and 2.19% respectively. Tax exempt rates have also decreased similarly over the last quarter year.

On slide three, the portfolio summary, 91% of the portfolio is externally managed by 15 taxable and/or tax exempt portfolio managers, 9% of the portfolio is internally managed. It consists of operating funds, debt service funds and debt service reserve funds. The taxable and tax exempt portfolios both have very strong credit quality, 89% of the tax exempt portfolio is in money market funds rated AA or higher and approximately 79% of taxable portfolio is in the money market funds rated A or higher. Over 28% of the portfolio is in Treasury and agency securities. And on the final slide portfolio returns summary, 3.06% of income return over the last 12 months and 2.51% over the last two years. And I will stop for any questions.

Chairman Aubuchon: Members, any questions of Jennifer? Okay, thank you very much, Jennifer behind tab six for our information is Depopulation and Clearinghouse update. Is there any new business to come before the committee today? Hearing none, do we have a motion to adjourn?

Governor Brown: Move to adjourn.

Governor Dunbar: I will second that.

Chairman Aubuchon: And without objection, we are adjourned.

(Whereupon, the meeting was adjourned.)