CITIZENS PROPERTY INSURANCE CORPORATION

MINUTES OF THE FINANCE AND INVESTMENT COMMITTEE MEETING

Tuesday, December 10, 2019

The Finance and Investment Committee (FIC) of Citizens Property Insurance Corporation (Citizens) convened at the Sheraton Orlando North in Maitland, FL on Tuesday, December 10, 2019 at 4:00 pm (EDT).

The following members of the FIC were present:

Bo Rivard
Marc Dunbar
Carlos Lopez-Cantera

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
Jay Adams
Barbara Walker
Brian Donovan
Violet Bloom
Steve Bitar
Nancy Staff
Mark Kagy
Michael Peltier
Christine Ashburn
Paul Kutter

The following people were present:

Kapil Bhatia	Raymond James
Adam Schwebach	Willis Re
Matthew Williams	Bank of America Securities
Coleman Cardell	Bank of America Securities
Mark Weinberg	Citi Bank

George Smith	Bryant Miller Olive
Henry Reyes	J.P. Morgan

Call Meeting to Order

Barbara Walker: We will convene with roll call. Governor Brown. Governor Dunbar.

Governor Dunbar: Here.

Barbara Walker: Governor Lopez-Cantera.

Governor Lopez-Cantera: Here.

Barbara Walker: Chairman, you have a quorum.

Chairman Rivard: Okay, great. I thought he was attending by phone. So, Governor Lopez-Cantera, welcome. Glad to have you in person. Well, thank you all for being here today. This is the meeting of the Finance and Investment Committee on December 10th, and we are going to jump right in with the market update and Kapil is going to lead us in that. So, Kapil, it is all yours. I'm sorry I say it is all yours, but I am going to steal it back. Just so we know, we have a new Governor here with us, Lopez-Cantera, and we are going to save your official introduction to tomorrow for the Board meeting. We do appreciate you being here and welcome aboard, glad to have you.

1. **Market Update**

Kapil Bhatia: Good afternoon, Mr. Chairman and Governors. For the record, Kapil Bhatia from Raymond James, we are your financial adviser. I will start with the market update. I will be brief, but please interrupt me at any point of time for any questions and will be happy to go through the details. From the U.S. economy perspective there are currently 5.8 million people unemployed while the unemployment rate is three and-a-half percent. There are currently 164 million civilians employed in the United States out of a total civilian population of 260 million. The labor participation rate is 63.2% which is four percent less than where we were in July of 1997. In addition, there are 4.4 million workers who are working part time looking for a full-time job. If we add up 4.4 million people who are part time workers and looking for full time jobs and adjust for the labor participation rate which is four percent less from historical perspective, there are around 12 million people who still have not joined the labor force on a full-time basis and that is keeping our productivity low, our wage growth low as well as low inflation. There is not much pressure on the wage growth low and that is one of the reasons why the interest rates are low in addition to several other reasons. The Fed increased rates nine times starting from December of 2015, until December of 2018. However, as we said in the December 2018 Board meeting, the Feds have gone too far, and they have increased rates too many times. They should not have increased the rates in December 2018, but at that point in time it was almost a done deal. If we go back to look at December of 2018, they went ahead, and increased rates two times more than they should have. Since that point of time, Fed has reduced rates three times and now Fed rates are somewhere in the range of 1.50% to 1.75% with an effective rate of 1.55%. We don't expect Fed to do anything differently for the next 12 months. We think the next Fed move will be a reduction in December of 2020, and they're going to wait until the elections are over and see how the economy is doing globally.

In addition, the Fed expects U.S. economy to grow at the rate of 2.2%. That is a very optimistic projection looking at everything else that is going on globally. We expect the economy to grow at almost one and-a-half to one and three-quarters percent in 2020. Year-to-date markets are significantly up, S&P is up 25% and Dow Jones is up 20%. However, putting it in a different perspective, a 10-year treasury is down 130 basis points from the beginning of 2019 to where we are today. There are roughly $1 trillion of corporate bonds globally trading at negative yields, and $17 trillion of sovereign debts trading at negative yields. U.S. rates are low from a historical perspective, but our rates are higher than where they are in Greece, Spain, Portugal. This reflects something unusual is happening in Europe where rates are almost at an unsustainable level. Europe is becoming Japan; China is not that far behind. We don't expect global economy to pick up any pace over the next 12 months and maybe even longer than that, and partially because of aging of population and demographic changes have changed significantly. There is too much investment being made in the fixed income simply as more and more people are retiring, as well as what is happening in Europe with rates.

The corporate issuance and municipal issuance are significantly up in 2019, but the corporate issuance in U.S. reflects more of a financial engineering than actual capital investment. Over $1.3 trillion of corporate investments have been done this year, but none of these have gone into the corporate investment. It is all mergers and acquisitions. Numerous countries have negative yields as we talked about earlier. Switzerland has negative yields going up to 50 years. That is unheard of and probably with no end in sight and everybody is just printing money. From the risk transfer market, there is still abundance of capital, risk transfer markets are stable. There are around $610 billon of capital available in the reinsurance markets. Global insured losses from 2017 and 2018 were over $200 billion. However, 2019 has been very benign. Reinsurers are trying to set a stage to increase rates in 2020, however, I am not sure how much leverage they have considering how much capital is available. They are going to look at the efficient organizations and how efficient they are before deciding on how much the rate increase should be. Considering where we are, we should not expect much increase in our risk transfer rates in 2020. And lastly, the Cat Fund participation rate increased from 73.5% to 82% in 2019. We expect that trend to continue as more and more Florida primary insurance companies are going to participate at a higher percentage rate in Cat Fund. We expect overall weighed average participation in the Cat Fund to be around 85%. Overall reinsurance markets are stable with enough capital and when we are ready for 2020 Risk Transfer Program, we should see similar rates to where we were last year. And our investment portfolio is very stable. We will go through that briefly. I will stop to see if you have any questions or any additional parts I should expand on.

Chairman Rivard: Any questions? Governor Dunbar.

Governor Dunbar: So, Kapil, in the news clips that got sent out today, there is a lot of news about, I will just read the headlines, "Reinsurance glory days are over as dependence on ILS increases," that is from AM Best. And it doesn't -- it paints what appears to be a pretty bleak picture in the reinsurance market or at least projecting a bleak picture. What do you think that means to the other insurers in the marketplace, not us, and the potential for re-population or can you speculate a little bit on what these kinds of clips mean for us potentially?

Kapil Bhatia: Two-part answer to your question. The reinsurers are trying to set a stage so they can charge higher rates. Some of the insurers in Florida, and without naming any names, are not really efficient and we have seen how the AOB losses, not just the AOB losses, but overall how the losses have developed over the last two years. So those insurers did pay higher rates for risk transfer in 2019 by approximately 20 to 30%. And effectively reinsurers are trying to set that stage globally that we want higher rates, we want to charge premiums for your inefficiencies. And to some extent they succeeded last year, and they are trying to continue that. So primary insurance will actually have to work hard and prove that they are efficient, they are writing good business to maintain their reinsurance rates. And one of the reasons they will be able to maintain is by increasing their participation in Cat Fund which will effectively allow them to buy less from the private market. So that means they have a little more leverage in the marketplace. Considering they don't have much surplus and therefore they don't have much leverage. However, regarding, the changes to depopulation, I am not sure if that is going to have any impact yet because they don't have to raise capital. 2019 has been benign so far this year. If 2020 remains benign, I think they will be okay. It depends on how many losses or much of losses we see in 2020. It's too early to say, but the reinsurance market is expecting or sending the messages, we want higher rates.

Governor Dunbar: So, our little children that are out there that may have taken policies from us, they are probably going to have to raise capital in 2020 or they might not be around, and they are praying the wind don't blow. Is that crystalized where we are?

Kapil Bhatia: They are looking for capital. I am not sure if they can raise capital. Some of the stronger ones may or will be able to raise the capital. Some of them will have to survive with existing capital, they will just have to buy more risk transfer and pay more for reinsurance. That means the net profit or net income will come down.

Governor Dunbar: Thank you.

Kapil Bhatia: I am sure they will be okay in 2020 considering 2019 was relatively a benign year.

Governor Dunbar: Thank you.

Chairman Rivard: Thank you. Jennifer.

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

Jennifer Montero: I think we need to go back to number one. We have to do the approval of the prior meeting Minutes from September 24, 2019.

Chairman Rivard: That is what you think, huh?

Jennifer Montero: That is what I was told.

Chairman Rivard: Are you trying to make me look bad? I was going to get back to it. So, I will entertain a motion to approve the Minutes from the last meeting, September 24th.

Governor Dunbar: Move approval.

Governor Lopez-Cantera: Second.

Chairman Rivard: All right, all in favor Chorus of ayes. Thank you, Jennifer.

Motion made to approve the September 24, 2019 Finance and Investment Committee meeting minutes. All were in favor; Motion carried.

3. **Optional Redemption of Series 2015A Bonds**

Jennifer Montero: Thank you. Behind tab three is an executive summary, an action item and a Board resolution for the optional redemption of the $150 million Series 2015A Bonds. So, in 2015, Citizens issued $1 billion of Series 2015A pre-event Bonds for the coastal account. $700 million of the series 2015A-1 bonds were fixed rate bonds with maturities on June 1, 2018, 2020, 2022 and 2025, and $300 million of Series 2015A-2 Bonds were floating rate bonds with maturities on June 1, 2018 and 2020. The Series 2015A Bonds are callable six months prior to the respective June 1 maturities on or after December 1 of the calendar year immediately preceding the maturity date of the particular Series 2015A-1 Bonds to be redeemed at par with no additional premium. This was the first time that Citizens included an optional redemption feature for the pre-event financing. The purpose of the six-month optional redemption feature was to proactively plan to minimize interest expenses for the pre-event bonds after the end of hurricane season, and this call option also provides flexibility if needed to call the bonds and issue long term post event bonds after an event.

In December 2017 Citizens utilized the optional redemption feature to redeem $50 million dollars of coastal account Series 2015A-1 Bonds maturing on June 1, 2018, as well as the series 2015A-2 SIFMA floating rate bonds that were outstanding in the amounts of $150 million maturing on June 1, 2018, and $150 million maturing on June 1, 2020. By utilizing the optional redemption for the bonds that are currently callable, $150 million of Series 2015A-1 Bonds with a maturity on June 1, 2020, Citizens will save approximately $2.8 million in gross interest cost and $1.7 million in net interest cost. The notice of redemption to the investors of the bonds to be redeemed must be issued at least 30 days prior to the redemption date. Citizens plans to issue the redemption notice immediately following Board approval, and the bonds will be redeemed on January 10, 2020. Bond counsel has prepared the Board resolution and the redemption notices for the bonds to be redeemed. And I will pause there before going to the action item to answer any questions.

Governor Dunbar: So just a couple of questions. These are pre-event bonds, right. So, are we going to -- is it likely we are going to be issuing additional bonds in the future to cover the pre-event need?

Jennifer Montero: No, we don't have any liquidity needs. We have plenty of liquidity.

Governor Dunbar: So, we are good there. We are now going to save interest expense, right, by calling these… now?

Jennifer Montero: That is correct. The purpose of the bonds is to be that bridge for us if we need to pay claims and we are waiting for reimbursements from reinsurance from the Cat Fund, and they mature on June 1. Hurricane season ended on November 30. So, we are not going to utilize them.

Governor Dunbar: Right.

Jennifer Montero: The idea is to go ahead and call them now rather than pay that interest expense for the next six months.

Governor Dunbar: Okay, so when we budget, we budgeted the interest expense, or we didn't budget the interest expense because we knew we were going to call?

Jennifer Montero: We budgeted as though that these were not going to be on the books so we wouldn't have the interest expense from the $150 million and we wouldn't have the interest income also.

Governor Dunbar: Okay. What I am trying to do is, when we go to try and figure out premium and we open the books and everything else like that, we factored that we were going to call these bonds in when we were going through and trying to make that evaluation?

Jennifer Montero: That is an assumption in the budget, yes. We did have that these bonds would be called on January 10, and it would not be available.

Governor Dunbar: So even though this is not a huge amount of money, I just want to make sure that I get the sound bite right. The fact that we are saving this money now, we anticipated saving it when we put our rates together, so that this isn't any kind of like, oh, we found money in the couch that somehow will come back from a rating standpoint, is that right?

Jennifer Montero: Correct.

Governor Dunbar: I know it is a weird way, but I just wanted to make sure. Okay, thank you.

Jennifer Montero: If there are no more questions, I can read the action item.

Chairman Rivard: Please proceed.

Jennifer Montero: **It is recommended that Citizens Finance and Investment Committee approve and recommends that the Board of Governors approve the redemption documents and authorize staff to utilize the optional redemption feature for the $150 million coastal account series 2015A-1 bonds maturing on June 1st, 2020. Authorize staff to take any appropriate and necessary action consistent with this action item.**

Chairman Rivard: Okay. Any more questions or I entertain a motion?

Governor Lopez-Cantera: **Move to approve.**

Chairman Rivard: **Okay, motion and second. All in favor.**

Chorus of ayes.

Chairman Rivard: Okay, thank you, Jennifer.

4. Investment Policy Changes [AI]

Jennifer Montero: Behind tab four is the investment policy changes and action item. Near the end of each year staff presents any proposed investment policy changes to the Finance and Investment Committee and then the Board for approval. Staff works with our financial adviser, Raymond James as well as the 10 external money managers to propose investment policy changes that will allow Citizens to take advantage of market conditions and provide additional diversification and incremental yields. And behind tab four you will find all of the investment policies; clean and red lines and the action item goes through each of the different changes. And I am happy to read through them. Okay. Changes to all taxable investment policies include the following. Change to the rate and requirements from an average rating of Baa2/BBB to minimum ratings of Baa3/BBB-. Securities that have average ratings of BBB-/Baa3 shall not represent more than 7.5% of the portfolios with the securities of the single issuer representing no more than one percent of the portfolio. Increase the maximum allowed municipal securities from 20% to 25% within the portfolio. Increase the maximum allowed agency MBS, CMBS, RMBS, CMO from 7.5% to 15% within the portfolio. Allow credit card under ABS guidelines and increase the maximum allowed ABS for prime automobile, equipment loan and lease receivables and credit card receivables from five percent to 7.5% of the portfolio for the taxable liquidity fund and from 7.5% to 10% of the portfolio for the taxable claims paying funds and taxable claims paying long duration fund. ABS for prime automobile, equipment loan and lease and credit card receivables shall use the weighted average life of the final maturity date, with the maximum weighed average life of three years and six months. For the taxable liquidity fund, six years for the taxable claims paying and 10 years for the taxable claims paying long duration fund. Changes to the taxable claims paying long duration fund include increase to the final maturity of the fund from 15 years one month to 20 years one month with no more than 10% of the portfolio consisting of securities, excluding securities where weighed average life is used with a final maturity between 15 years and 20 years, one month. And I will pause for any questions.

Chairman Rivard: So just maybe if we could back up just a little bit and maybe just if you guys could walk us through why we are doing this now, and the changes that are being proposed.

Jennifer Montero: We usually bring the changes to the FIC meeting at the end of the year after hurricane season so that in case there was a big event, we don't want to become less conservative when we need lots of money. The fact that we didn't have an event, we go through, we work with the investment managers, our financial adviser on ways to be able to add the additional diversification and get some incremental return.

Chairman Rivard: This is something we do every year?

Jennifer Montero: Every year we evaluate it and every year we have marginal changes that go up just a little bit, little bit, a little bit why we can, since we do have so much surplus that we want to invest that.

Chairman Rivard: I knew that, but for the new guy over here I was just making sure.

Jennifer Montero: No problem.

Chairman Rivard: So, this is something we go through every year.

Jennifer Montero: Yes, every year.

Chairman Rivard: All right, more questions, guys?

Governor Dunbar: We go through the policy every year, but did we make adjustments like this to the -- did we -- let me see if I can say it the right way. Did we change our policy to allow lower grade and adjust percentages, do we do that every year? And if so, how many notches have we lowered it over the last couple of years on what we can hold?

Kapil Bhatia: Good afternoon, Governor Dunbar. Again, for the record, Kapil Bhatia from Raymond James. We have not done that, every year we don't go through the same changes. In 2007 right after the '04 and '05 events, and I am just going back in time to present perspective. Right after the '04 and '05 events we had no money left because we used all of our resources to pay claims. So effectively we only had one policy which was called a liquidity fund policy and we almost had a $1 billion or one and-a-half billion dollars. As each year our surplus goes up and over time, we have added a little bit more duration and that is where the claims paying fund taxable policy came in and then more duration in claims paying fund long duration taxable policy. What that does is we look at our total PML, what our exposure is and how to maximize the investment income and what the markets are offering. So, a couple of years ago we added mortgage-back securities as the housing crisis was gone and agency mortgage-back securities are fully backed by U.S. government. We added those into the investment policy to increase the income. If you look at our investment income over the last 10 years it is going up even adjusting for reduction in portfolio size. If you look at our investment income in 2019, which is approximately $120 million for the first nine months compared to $84 million for 2018. What we do is we try to take advantage of the market, where the markets are. Each year we don't go through downgrade and downgrade and downgrade. The reason we are going to BBB- and Baa3, I want to go back to the market update. As more and more financial engineering is happening, more and more corporate issuers have stopped caring about the rating agencies. One of the reasons of housing crisis or the financial crisis of 2007 was the rating agency. Everybody was giving too much credibility to the rating agencies and not looking at the fundamentals. So more and more corporate entities have stopped focusing on the ratings and they are more focusing on their business lines and where the cash flow is, what the net incomes are. That is what we are evaluating and that is why we are downgrading the ratings requirements by one notch. Minimum ratings requirements to BBB- and Baa3. For example, Verizon falls into this bucket, AT&T falls into this bucket, and their ratings were downgraded just because they have gone to the mergers and acquisition. We believe there is strong cash flow. We work with the managers to look at the future income and try to invest at the lower ratings but with better cash flow. As the rating improves and the cash flow improves, and they pay down their debt, but our investment income remains higher. We try to diversify our portfolio, reduce the overall risk and increase the income. For example, our portfolio as of this moment is $9 billion and our downgraded security is $9 million which is .1 percent of our portfolio. We do care about the credit. We do care about the investment income and we do look at the markets and that is what all of these changes reflect. Where the market is at, where the issuance is, and we don't want to focus too much on concentration on some higher ratings and missing the big picture on the diversification itself.

So, to answer your question specifically, we started with A3 and it is down to BBB-. It is still investment rate and it is only limited to seven and-a-half percent and we reduced the issuance of concentration by saying if it is BBB- you cannot invest more than one percent of your portfolio in one name. So that kind of puts you in a perspective that the overall objective is to diversify the portfolio, have more names and maximize the investment income.

Chairman Rivard: More questions? Sure, Governor Lopez-Cantera.

Governor Lopez-Cantera: Thank you, Mr. Chairman. As the new kid on the block, could you explain to me the rationale behind the recommendation to increase municipal security from 20 to 25% and then double the amount of investment of mortgage-backed securities?

Kapil Bhatia: Sure. The reason we are increasing the municipal securities from 20 to 25% is as the interest rates have gone down more and more municipal issuers are actually going to the taxable market rate. In 2017, the tax law changed, and the advanced refunding were eliminated under the tax code. So now issuers, the municipal entities, can save money by doing the taxable refunding because the tax law does not apply. For example, and I will just give you some data elements which may be helpful. In 2019, the taxable issuance of municipal securities increased by 142%. In 2018, the overall taxable municipal issuance was $23 billion. In 2019 so far it is $56 billion, because there is so much issuance on the taxable municipal side which are higher rated, this increase will allow us to capture some of the additional issuance in the marketplace and lock in some of the higher rates. That is one of the reasons on the municipal side. And on the agency securities, agency securities have an implicit guarantee and more and more mortgages are being refinanced. They are implicitly backed by Federal government. We can lock in the higher incremental income by increasing the participation of our portfolio from 7.5 to 15%. Effectively we can diversify from other corporate sectors by going to the mortgage-backed securities which allows us to maximize our income while reducing the credit risk.

Chairman Rivard: More questions? Carlos.

Governor Lopez-Cantera: Thank you, Mr. Chairman. So, on the mortgage-backed securities, the reason it is less risky is because it is backed up by the U.S. Treasury.

Kapil Bhatia: Correct.

Governor Lopez-Cantera: If they default it doesn't come out of their pocket, our pocket, it comes out of the Treasurer's pocket.

Kapil Bhatia: There is no default because effectively, the reason why I am saying there is no default, even during the housing crisis the mortgage-backed securities did not default because Federal government is implicitly backing it up. If there is any shortfall in payment it comes back from the Treasury. So, there is no default ever. They cannot default by definition. If it is a private mortgage-backed security with a private label above the Fannie Mae limit, those can default because those are issued by private companies. Our investments policy doesn't allow that.

Governor Lopez-Cantera: Thank you.

Chairman Rivard: Governor Dunbar.

Governor Dunbar: Thanks. A few questions. How much more risky does it make, I am sure you have modeled it, if we make these changes, how much more risky could our overall portfolio get if we go to the limits of these changes? And I understand we are chasing return, but I am trying to understand the downside exposure that we potentially take on by virtue of these changes.

Kapil Bhatia: I don't want to answer the question by saying it is zero, simply because if you eliminate corporate securities, so that risk is going down and add the mortgage-backed securities, so there is a down side on the credit risk. It is not necessarily that our risk is going up. It is going in a different risk bucket to where the returns are higher for the same risk profile. That is what these changes allows us to do. From an overall incremental risk perspective there is only one item where there is an incremental risk which is going to a BBB-. Right now, we use the average ratings of BBB. So, if you buy some BBB- and some BBB+, the average is still BBB. What we are doing is we are implicitly saying you can buy BBB-. So that effectively will increase our risk in the portfolio by one to one and-a-half percent overall. Not the risk profile, but overall portfolio risk. If our portfolio is $9 billion and you say one percent, it is $90 million of BBB securities you will have which we don't have right now.

Governor Dunbar: Maybe either I am not understanding my question, I am definitely not understanding the answer. But let me make sure I am trying to understand. So, we are trying to increase our return, right. I mean, that is the goal of this is trying to increase what we make on our money.

Kapil Bhatia: A two-part answer to that question. One is to increase our investment income marginally. Second is you take advantage of the market condition where there is more issuance. We are fully invested and diversified. So not necessarily the only objective is to increase income.

Governor Dunbar: So, I kind of understood that when you said that in the municipal side it basically doubled the issuance out there. So, and maybe I am not looking at it the right way and this is a dramatic oversimplification, I guess. But if I have three kids and all of them have maxed out their credit cards, that has increased the debt load, that doesn't mean I want to buy a percentage of each one of their debts, right. And so, by saying a bunch of local governments out there have doubled the amount of debt that they have thrown out in the marketplace, in and of itself doesn't tell me that I want to expose that whole marketplace. Now, I know our investment adviser, the ones that are going to say the City of Oakland is good, the City of Clearwater is bad, et cetera, et cetera, right, I mean, that is what they're going to be doing for us. They're going to be evaluating their bucket based on the potential debt that they're going to want to purchase within this, right. I mean, that is their job.

Kapil Bhatia: They look at the ratings, there is an issue of concentration. We are not over exposed to any one name. There are issuer limits, there are sector limits and there are ratings requirements. We cannot be in one sector more than 25%, or we cannot be more than in one name, more than one percent or two percent or three percent, it depends on what the ratings are. So yes, we look at the overall spectrum.

Governor Dunbar: So, what I am trying to understand is, you have modeled the impact of this, right?

Kapil Bhatia: We model the impact from how much risk it will be. So, the proposed changes are effectively impact 15% of my total portfolio.

Governor Dunbar: But if we don't adopt this, what am I leaving on the table by not adopting?

Kapil Bhatia: If we don't adopt this we will probably lose -- we expect the incremental income to be two and three quarter of a million dollars each year. It is not huge in terms of the basis points. It is 20 basis points. The value, the risk profile is going up marginally, but our investment income is expected to go up only 20 to 30 basis points which is also marginally.

Governor Dunbar: So, this change is worth 20 basis points basically.

Kapil Bhatia: Increment of 20 basis points, but it only effects 15% of the portfolio. So effectively we are exposing $1 billion which will add marginal risk of our portfolio and that will generate an additional income of 20 basis points, 20 to 30 basis points. We estimate somewhere in the middle of 25 basis points.

Governor Dunbar: Got it, okay.

Kapil Bhatia: So, if we don't adopt it, it is not a huge positive or negative. It's not going to change the whole ball game considering our overall expected income, investment income is $150 million, and this only changes our investment income by two and three-quarters of a million dollars approximately or somewhere, two and-a-half to $3 million estimate point. Each year when we come to the FIC and to the Board, we always look at what the markets are offering, how to take advantage of it without increasing the risk profile. That is a very important for us because after an event we have to pay all those claims. We don't want additional risk in our portfolio but trying to take advantage of how the markets have moved and how we can take advantage of it.

Governor Dunbar: Okay, one final question, Mr. Chairman, I promise.

Chairman Rivard: Sure. I don't believe you, but okay.

Governor Dunbar: It depends on his answer, right. Is SBA doing the same thing?

Kapil Bhatia: SBA has different investment policies.

Governor Dunbar: I understand, but are they making similar adjustments based on the expanded municipal debt that is being issued and all those kinds of things?

Kapil Bhatia: I can't speak for SBA. We don't advise them; we don't work with them. I can speak for the Fund, itself, the Cat Fund, the Florida Hurricane Catastrophe Fund. Their risk profile is different. They have average ratings; they have similar things in their investment portfolio. But I can't speak for the SBA.

Governor Dunbar: So now I have got to ask a follow up question, I am really sorry. And it is probably my fault not catching this item sooner. But the concern that I have, if we don't approve this at this Board meeting, but bring it back for the next Board meeting, is that somehow going to prejudice us at all?

Kapil Bhatia: That is why usually why we come right after the hurricane season because for the six months we have no event risk. We try to take advantage of the market in the first six months. If it is approved by the Board, we will implement it and try to maximize everything in the first six months so that way when we don't have an event risk and we don't really take the credit risk. If we wait until March, the benefit will go down by half.

Governor Dunbar: Got it. So, here is the problem and I will own this one. In moving forward, maybe we will do this a little differently. At least two of our principles sits on the SBA and I have not asked him and it is again my fault, what he thinks of this, but since he sits basically managing the big budget and he is designating us to manage the little budget, I would like to at least know what his viewpoint and what his experts over in that budget think of this kind of move. And I am sure he will be like, yes, absolutely it is great. I don't know that. I really don't feel comfortable voting to approve this today. Now, I will vote to move it on to the committee or out of the committee or whatever if that's needed but I do have concerns and I would like to check with the CFO to see if he is okay with it. I will go ahead and throw that out there, Mr. Chair.

Kapil Bhatia: Thank you. If I may answer the question and I appreciate that. Certainly, it is not a significant or huge value. We are happy to go through more details. It's not as I said, on a $9 billion portfolio we are talking about three million dollars of investment income. It is our job to bring you back what the market offers. It is your call as you see appropriately, but SBA has different funds and different portfolios. SBA doesn't have anything similar with an event risk, except for the Cat Fund portfolio. The Pension Fund is managed differently, the Money Market Fund is managed differently.

Governor Dunbar: I understand.

Chairman Rivard: And thank you for answering all the questions and going through all of this. I think we can appreciate or I certainly can from where you are coming from, to try to take advantage of market conditions and if there is some flexibility that we need to give you to go and capture that and we have you on board to advise us on these things and it is your opinion that this is a reasonable move to make. And so obviously we are relying on this advice, but to Governor Dunbar's point, sometimes that is a lot of information that we get and every now and then we miss things. There are things that we like to bounce back to our, you know, those who appoint us to this Board to make sure. And the thresholds for that is different for different Board members and all that. But I appreciate the presentation and the spirit of what you are trying to accomplish. So, thank you for that. Any other questions?

Governor Lopez-Cantera: Earlier in your presentation did you say that corporate America is moving away from reliance on the rating agencies and their ratings?

Kapil Bhatia: They are not moving away from using rating agencies but their reliance on rating agencies have gone down simply because they are running their businesses. If they see an opportunity requires additional debt, then they are going to invest even if they get downgraded. So that is why you see more and more mergers and acquisitions and financially engineering, including issuing debt to buy equity. Rating agencies, ratings are important, but not that important considering the spreads are so low, interest rates are so low. The corporate decisions are not based on maintaining their ratings.

Chairman Rivard: Follow up.

Governor Lopez-Cantera: But when Mr. Dunbar asked about the municipalities and the financial advisers, your primary response was that they would focus on the ratings.

Kapil Bhatia: The municipal entities are focused on the ratings because they don't do financial engineering. So, for municipal issuers ratings are important, but for corporate side it is a different. Municipal issuers are not running a business. They are running a public -- it is a public sector, a public agency, whatever you want to call it. It is a different objectives and different goals.

Governor Lopez-Cantera: So one of the things that makes me uncomfortable about doubling the amount of investment in municipalities and I can't speak for how municipalities in other states do it, but primarily in this state the municipalities revenues come from property taxes, and if they are issuing these bonds based on this revenue and values are very high now. We are at I have to think at the peak or a plateau in the market, the only way it can go from here is down which would mean less revenue for the municipality. And if they're at their high points of revenues yet they're going out and issuing all kinds of debt, I just don't understand the logic in investing in that strategy.

Kapil Bhatia: Municipal entities don't just issue debt based on property taxes simply because they have sales tax revenues, water waste revenues, airport revenues, post revenues. So, each municipal issue is a different credit. It is not just the property tax, and there are different covenants in the document. They just can't go out and issue additional debt as they feel like. They have to maintain certain coverages and requirements. When we say municipals are issuing more debt, it is refunding of existing debt. They have issued old debt and they are trying to lock in the savings by refunding high interest rate debt by borrowing at a lower rate. Not that they're just going out on a spending binge.

Governor Lopez-Cantera: Okay. Then that clarification is very helpful, because if they are out there refinancing high interest debt for low interest debt, that makes more sense. You made it sound like earlier like they are issuing new debt.

Kapil Bhatia: They cannot issue more tax-exempt debt. Like I said, the tax law changed in 2017. So now even they are retuning old debt with a taxable debt and therefore, the taxable issuance has gone up. When we talk about the changes it is for our taxable policy we only invest in taxable because it gives more value to us. And maybe I just tried to answer all of those questions, maybe I didn't express myself clearly.

Chairman Rivard: Thank you.

Governor Dunbar: Moving forward. This is for clarification. Moving forward in the future let's do a call before this meeting to go through these questions so that we do have more educated, at least for me, I mean, I don't know about these guys, they are smarter than I am, if we could have a call so I could ask my dumb questions not on the record. No, just kidding. So, it might help me the next time. If and when we are going to do a change to investment policy, let's socialize it more in advance and be able to chat through it at least for me if that is okay.

Kapil Bhatia: I understand, I appreciate it, thank you.

Chairman Rivard: Okay, with that, I will entertain a motion if there is one.

Jennifer Montero: I have to read the action item.

Chairman Rivard: Okay. Please read the action item.

Jennifer Montero: May I go forward with the action item?

Chairman Rivard: Do we need to reapprove the Minutes again?

Jennifer Montero: No, I think we did that.

Chairman Rivard: Go ahead, I am sorry.

Jennifer Montero: **Thank you. It is recommended that Citizens Finance and Investment Committee approve and recommends to the Board of Governors, approve the changes to Citizens' investment policy, duration, credit quality and composition for the taxable liquidity fund, taxable claims paying fund and taxable claims paying long duration funds. These changes also allow Citizens to take advantage of market conditions and provide additional diversification, incremental yields to Citizens' investments portfolio and authorize staff to take any appropriate and necessary action consistent with this action item.**

Chairman Rivard: **Now I will entertain a motion if there is one.**

Governor Lopez-Cantera: **Out of respect for my colleague, I will recommend moving it on to the full Board for discussion, withholding the recommendation for approval right now, an**

agnostic.

Governor Dunbar: I will second the agnosticism.

Chairman Rivard: Okay, all in favor of whatever we just did. All in favor. We will take it to the Board tomorrow.

Jennifer Montero: Thank you.

Chairman Rivard: Okay, thank you.

Jennifer Montero: The next item –

Chairman Rivard: No. 5, so Jennifer.

5. **<u>2019 FIC Charter: Annual Review</u>**

Jennifer Montero: This is the investment charter. I am sorry, the Finance Investment Committee Charter annual review. Each year staff reviews the FIC charter and proposes any updated changes to the FIC. And this is a clean copy in your book. There were only two changes. In the statement of purpose under number one, in the sentence, "This includes periodic evaluation and review of the performance of Citizens' external investment managers", we added, "comma, approval of Citizens' investment policies." That is also stated in section three, responsibilities and authority, but we just added it to the statement of purpose. And the only other change is on section 2-E. "The committee Chair or such staff as is designated", that was a typo. So that was corrected. So those were the only two changes that staff recommends.

Chairman Rivard: Okay, any questions? All right. This is not an action item. You don't need to read anything else.

Jennifer Montero: No.

6. **<u>Investment Portfolio Update</u>**

Jennifer Montero: Yes. So behind tab six is Citizens' Investment Summary. On slide one is the Executive Summary. The total portfolio is $9.3 billion with approximately $8.6 billion externally managed by 10 money investment managers. The remaining $.71 billion is internally managed and consist of operating funds, debt service funds and debt service reserve funds. The taxable portfolio is $8 billion, and the tax-exempt portfolio is $1.3 billion. The portfolio is very conservative and stable with sufficient liquidity to pay any future or outstanding claims from 2017 and 2018 events. The total portfolio average duration is slightly over 4.1 years with 11% in cash or cash equivalence or maturing in less than 90 days. An additional 9% maturing between 90 days and one year, and 23% maturing between one and three years. The total portfolio total and income return for one year is 8.62% and 2.49% respectfully. The total return reflects a significant increase in market value of the portfolio as interest rates have significantly decreased over the last nine months. On slide two, the interest rates for treasury increased in 2017 and 2018, it has significantly decreased in 2019, and are now expected to remain unchanged or slightly decrease as the Federal reserve is done with unwinding its 2018 rate increases. The yield curve is flat and expected to remain flat as we expect five to 10-year treasury rates to further decrease in 2020. Tax exempt rates have also decreased since the beginning of 2019. On slide three the taxable and tax-exempt portfolios both have strong credit qualities. 81% of the taxable portfolio is in money market funds rated A or better. 86% of the tax-exempt portfolio in money markets are rated AA or higher, and over 29% of the portfolio is in treasury and agency securities or in money market funds.

On slide four, the portfolio income return summary, 2.49% over the last 12 months and 2.55% over the last two years. And the portfolio total return summary, 8.62% over the last 12 months and 3.73% over the last two years. Behind this slide is an appendix that goes into more detail. And the very last slide of that appendix is where we had our legacy securities. On September 25th staff received Board approval to develop a strategy to sell the remaining legacy assets in Lehman Brothers' holding escrow. We worked closely with the financial adviser on the economic analysis of the legacy assets. We also consulted with Apollo Group who manages the underlying securities in the two structured investment vehicles, AFF and Issuer Entity. The market sale price of the SIV portfolio was expected to be approximately $14.3 to $17.8 million with a midpoint of approximately $16 million. On October 9th, 2019, Citizens sold Axon Financial Funding, LLC which is AFF, Issuer Entity, Ottimo and Lehman Brothers to Citi for a total of $16 million. The sale of these investments marks the end of the legacy of liquid securities and I will pause for any questions.

Chairman Rivard: Question? Governor Dunbar.

Governor Dunbar: On the last page, I guess it is page 13 of the Citizens' investment summary report appendix, the downgrading of Ford Motor Credit, it is showed there that chart. It says page 11 in the hard copy, but it is the last page that you referred to as a downgrade.

Jennifer Montero: Yes, page 11.

Governor Dunbar: Which one is the downgrading, the one that is highlighted? So, Moody’s downgraded them?

Kapil Bhatia: Yes.

Governor Dunbar: The other S&P and Fitch, their ratings have not changed?

Kapil Bhatia: Their ratings meet the criteria of our investment policies. The only ratings which don’t meet the criteria of our investment policies, the Moody's rating which is downgraded to Ba1 and that is why they’re highlighted. Under our investment policies they have to meet rating criteria of all three ratings agencies.

Governor Dunbar: So, all three of them downgraded?

Kapil Bhatia: Just Moody's downgraded and that is why Moody is highlighted.

Governor Dunbar: So Moody downgraded and it is still within our investment policies?

Kapil Bhatia: Moody downgraded but it is not in the investment policy guidelines. So, investment managers have suggested to hold on to securities. They will look for the right moment to exit out of the securities over the next couple of weeks. And as you can see, where the unrealized gains and losses are, the total market value of the securities is $9.1 million. That is what I was referring to and the market to market value is $1,000 below the Par amount.

Governor Dunbar: Right. I really was just trying to read the chart. So, when you show this and you highlight something, that is the downgrading event that you are trying to make sure we see.

Kapil Bhatia: Absolutely.

Chairman Rivard: Any other questions? Jennifer, anything else?

Jennifer Montero: That completes my report. The final tab is the Finance and Investment Committee Depopulation Clearinghouse update and that is for informational purposes only.

Chairman Rivard: Okay. Any other questions from Board members? All right, thank you, and with that we will stand adjourned.

Jennifer Montero: Thank you.

(Whereupon, the meeting was concluded.)