Finance and Investment Committee Minutes

☒ ACTION ITEM

☐ New Contract

☐ Contract Amendment

☒ Other - Committee Charter

☐ CONSENT ITEM

☐ Contract Amendment

☐ Existing Contract Extension

☐ Existing Contract Additional Spend

☐ Previous Board Approval______________

☐ Other______________________________

Action Items: Items requiring detailed explanation to the Board. When a requested action item is a day-to-day operational item or unanimously passed through committee it may be moved forward to the board on the Consent Index.

☐ **Move forward as Consent**: This Action item is a day-to-day operational item, unanimously passed through committee or qualifies to be moved forward on the Consent Index.

Consent Items: Items not requiring detailed explanation to the Board of Governors. Consent items are contract extensions, amendments or additional spending authorities for items previously approved by the Board.

Item Description	The Finance and Investment Committee meeting Minutes April 9, 2024
Purpose/Scope	Review of the April 9, 2024, Finance and Investment Committee to provide opportunity for corrections and historical accuracy.
Contract ID	N/A
Budgeted Item	☐Yes ☒No
Procurement Method	N/A
Contract Amount	N/A
Contract Terms	N/A
Committee Recommendation	Staff recommends the review and approval of the April 9, 2024 Finance and Investment Committee minutes.
Contacts	Jennifer Montero, Chief Financial Officer

CITIZENS PROPERTY INSURANCE CORPORATION

MINUTES OF THE
FINANCE AND INVESTMENT COMMITTEE MEETING
Tuesday, April 9, 2024

The Finance and Investment Committee (FIC) of Citizens Property Insurance Corporation (Citizens) convened at The Westen Lake Mary, Lake Mary Tuesday, April 9, 2024.

The following members of the FIC were present:

Chair Erin Knight
Charlie Lydecker
LeAnna Cumber

The following Board members were also present:

Robert Spottswood

The following Citizens staff members were present:

Jennifer Montero
Barbara Walker
Tim Cerio
Michael Peltier
Jeremy Pope
Jay Adams
Joe Martins
Mark Kagy
Brian Donovan
Andrew Woodward

The following people were present:

Kapil Bhatia	Raymond James
Sasha Stipanovich	Raymond James
Duane Draper	Bryant, Miller, Olive
Mark Weinberg	JP Morgan
Matthew Sansbury	RBC Capital Markets
Jim Cook	JP Morgan
Nathaniel Johnson	Bank of America
Doug Draper	Bank of America

Call Meeting to Order

Barbara Walker: Good afternoon, and welcome to Citizens' April 9, 2024, Finance and Investment Committee Meeting that is publicly noticed in the Florida Administrative Register to convene immediately following the Audit Committee Meeting and will be recorded with transcribed Minutes available on our website. For those attending today's session through the public link, you are automatically in listen-only mode. Panelists, thank you for identifying yourself prior to addressing the Committee. May I proceed with the official roll call?

Chair Knight: Yes.

Roll was called and quorum established with Chair Knight, Governor Lydecker and Governor Cumber.

Barbara Walker: Chair Beruff is not here today, but Chair Knight, you have a quorum.

a. Approval of Prior Meeting's Minutes

Chair Knight: Thank you. I'd like to call the April 9th, '24, FIC meeting to order, with our first item of business being **approval of the minutes from December 5, 2023.**

Governor Lydecker: **So moved**. Lydecker.

Governor Cumber: **Second.**

Chair Knight: Okay. We will **adopt the minutes from the December meeting.** And welcome, Mr. Bhatia. We look forward to hearing your market update.

b. Raymond James - Financial Advisor

a. Market Update

Kapil Bhatia: Thank you. Good afternoon, Madam Chair, Board of Governors. I'll briefly go through the market update, but please stop me at any point of time. For the record, Kapil Bhatia from Raymond James and Associate. We are your financial advisers. Inflation increased in February by .4%, and over the last 12 months, the all-item index increased by 3.2%. The increase was driven primarily by the increase for housing and gasoline. The gasoline index rose 2.3% for the month of February, as housing and gasoline account for approximately 60% of the monthly increase in February. The all-items, less food and energy, rose by 3.8% over the last 12 months. So, inflation is still increasing, but not at the same level as compared to last year. Total nonfarm payroll employment increased by 303,000 in March, and the unemployment rate decreased to 3.8% with

6.4 million unemployed persons. A year ago, the unemployment rate was 3.5% and the number of unemployed persons totaled 5.8 million. The average monthly gain in employment has been 244,000 over the past 12 months. The labor force participation has marginally increased to 62.7%. So even though the unemployment rate is very low, it is still seeing an uptick marginally as number of unemployed people are increasing. The fed has not increased its benchmark rate almost over the last eight months. The last increase was in July 2023. But at the March 2024 board meeting, after raising it 11 times, they left the rate unchanged. The market is currently expecting three rate cuts in the second half of 2024, which would put the fed fund rate at approximately 4.50% to 4.75% by the end of 2024. But economic data between now and the June meeting will drive the fed to either stay put for longer or start cutting starting either in June or July. One of the key data points that fed always looks for is the PCE inflation index, which has slowed down significantly, and it was .3% in February compared to .4% in January or 2.5% on an annual basis. So fed is getting close to its inflation target of 2% because they look at the PCE index.

The fed has indicated that may also slow the process of letting its balance sheet run off, which has seen approximately $1.5 trillion of bonds roll off to a current level of approximately $7.5 trillion. Since the fall of 2022, the fed has allowed up to $60 billion per month in treasuries and additionally $35 billion per month in mortgage bonds to mature and not to be replaced. The fed is projecting inflation to steadily cool while the labor market remains historically strong. Personal consumption remains high and energy prices have recently increased. We expect GDP to increase by 2.5% this year and 1.9% in 2025. While we believe the U.S. economy will grow relatively slow this year compared to where we were last year, but we do not believe the slowdown is going to be enough to bring economic growth to negative territory or to recession. The reason for an expected soft landing and not a recession is resiliency in housing market, continued nonresidential investment, and, of course, we all know about the government spending since the COVID relief funds, as well as the impact from CHIPS Act and the Inflation Reduction Act, which increased the construction of manufacturing plants in the U.S. with additional government spending.
Customers who make up about two-thirds of all economic activities have slowed spending but continue to remain engaged in the economy with no signs of stopping anytime soon. Personal saving rates have plummeted down to 3.6% as compared to 7.4% in 2019. And credit card debt has increased, and for the first time ever, it is approaching $1.1 trillion. The continuous consumer spending can be attributed to the strength in the labor market, which has given consumer confidence to keep spending. Based on the projection of maintaining current fed rate levels through the first half of 2024, and with less rate cuts projected in the second half of 2024 than market expectations earlier, the rates have marginally increased in the first quarter, as Jennifer mentioned earlier, our unrealized losses have also marginally increased. However, the yield curve remains inverted, but getting flatter with the spread between the 3-month and 10-year treasury at negative 106 basis point, and the spread between two and ten-year treasury is at negative 32 basis point. Since the beginning of the year, one-year treasury has increased by 20 basis points to 5% and 2-year treasury has increased by 35 basis point to 4.7% and 10-year has increased by another 40-basis point to 4.35%. The current unrealized losses in our portfolio are over $600 million but continue to decrease. These negative mark-to-market value are noneconomic and noncash as these values pull to par as securities mature, and our portfolio is relatively shorter today than it was a year ago. So, the evaporation pace has significantly accelerated. Lastly, our income return is stable. Historically, high interest rates are economically beneficial for us. Currently, the book yield for the portfolio is 3.4% with $2.5 billion maturing, or approximately 25% of the portfolio, over the next 12 months, and if these maturities are invested at a higher

rate, we expect our investment income to be closer to 4% for the year, or $450 million, which is close to five-year treasury; however, we are also maintaining liquidity for any events. And, lastly, the global reinsurance market, especially the capital markets, have a positive undertone with an increase in capacity and demand with rates are projected to remain flat to negative 5%, depending on the season. So, the reinsurance markets are finally stable. After four years of hardening, we are seeing not really softening, but relatively less hard. So, we expect reinsurance market to behave better for us as we place our program for the upcoming season. With that, I'll stop and be happy to answer any questions.

Chair Knight: Any questions? No? Okay. Thank you very much.

c. Chief Financial Officer Report

a. Risk Transfer Program Update/2024 Preliminary Program Layer Chart

Jennifer Montero: Thank you. Behind Tab 3, we have a preliminary risk transfer program for 2023 and a quick overview and update.

Governor Lydecker: Wait, wait a second. I'm sorry. What –

Jennifer Montero: Sure. Behind Tab 3, it's the reinsurance, it's 2024 preliminary risk transfer program. It's the –

Governor Lydecker: I was looking at it earlier.

Jennifer Montero: -- executive summary and the layer charts.

Governor Lydecker: Is this it? I was looking at it earlier, so I know it's in here. Oh, I pulled it out. That's how excited I was to see you.

Jennifer Montero: And if you'll put the layer charts on the screen, that would be great. Thank you. So as of January 1, 2024, Citizens is operating under a combined account. This account is the combination of the personal lines account, the commercial lines account, and the coastal account. The combining of the accounts does enhance Citizens' ability to pay claims for future storms and minimizes the potential for assessments. Citizens is aiming to secure private reinsurance coverage of approximately $5.5 billion. Last year, we had $5.38 billion, so it's not that big of a difference. This would be comprised of $500 million of existing private reinsurance remaining from 2023 and $5 billion of new, private reinsurance with budgeted premiums of approximately $700 million. Under this scenario, Citizens would expose all of its surplus for a 1-in-100 year event and would have a potential Citizens policyholder surcharge of $567 million for a 1-in-100 year event, which would actually attach around the 1-in-96 year event. So, the sliver layer which sits alongside the Florida Hurricane Catastrophe Fund, and it would provide approximately $630 million of coverage, of annual per occurrence coverage. This layer is to be placed in the traditional market and would work in tandem with the mandatory coverage provided by the Florida Hurricane Catastrophe Fund. Layer one will sit above the sliver layer in the CAT fund. This layer would provide approximately $409 billion of coverage from the capital markets and the traditional reinsurance markets, of which includes the capital markets renewal risk transfer, placement of $500 million through Lightning Re in 2023 -- this is the second year of the multi-year notes -- as well as approximately $4.4 billion of new coverage from the traditional capital markets.

Governor Lydecker: So, when you say traditional -- are you calling it traditional capital markets, or are you saying there's traditional and then there's capital markets?

Jennifer Montero: So, there's traditional, and that's the typical reinsurance that you get in the traditional –

Governor Lydecker: And combined, that's $4.4 billion?

Jennifer Montero: Excuse me?

Governor Lydecker: And combined, traditional and capital markets is $4.4 billion?

Jennifer Montero: That's correct. And then, capital markets are CAT bonds.

Governor Lydecker: Got that, yeah.

Jennifer Montero: And so right now, you're seeing a diagonal line because when we go to the market, it really depends on market conditions of how much we get of each that makeup. They're typically in the same layers so they can compete, and we can use the market to see -- to help fill the layers when the capacity is high and also to, you know, use market conditions to stack it based on pricing.

Governor Lydecker: Do you mind if I ask another question? Because I think you do a really good job of showing this and illustrating this as you're showing on the screen. Could you give us just a little bit of context on this year's placement based on this layering chart? What the recent storms would have meant here in terms of -- and I'm really interested more in terms of any type of Citizens policyholder surcharge. When do citizens get charged when they're not expecting it because of a storm? What does this layout do for us? Maybe just give some context.

Jennifer Montero: Sure. So if you look at the chart and you see the purple line at the very top, so that is -- the green is the surplus, the yellow and the blue are all kinds of reinsurance coverage, and as the storm -- as a storm occurs, we would have to go through all of the green, yellow, and the blue before we'd have a Citizens policyholder surcharge. That would kick in near the top at a 1- in-96 year event. So, to put it in reference, like for Citizens, Andrew was about a 1- in- 43.

Governor Lydecker: How about Southwest Florida two years ago when the storm hit?

Jennifer Montero: Ian?

Governor Lydecker: I can't ever remember the names. I think it's Hurricane Ian.

Jennifer Montero: Irma?

Kapil Bhatia: No, Ian was southwest.

Jennifer Montero: Oh, yeah, Ian -- so Ian was – I just had the number –

Governor Lydecker: Just roughly.

Kapil Bhatia: Yeah, about a 1- in 25-year event.

Jennifer Montero: Yeah, about a 1- in 25 year.

Governor Lydecker: And what would that do to consumers in the state of Florida who are policyholders of Citizens? My sense is –

Jennifer Montero: Absolutely nothing.

Governor Lydecker: -- it would not affect them.

Jennifer Montero: No, it would not affect them. We would have to have either lots of multiple storms to get to the 1- in 96-year event, or we'd have to have one hellacious, huge, monstrous storm.

Governor Lydecker: Okay. And then, finally, multiple storms in one year, which we had -- I'm guessing 10 years ago, but we –

Jennifer Montero: '04 and '05.

Governor Lydecker: Yeah, four storms in one year. Does this just keep drawing down on this existing program, or is there a -- are the aggregates renewed automatically in any case?

Jennifer Montero: So, the -- typically, the CAT bonds are multi-year. They would continue for either two or three years. The traditional placements that we have are single year. Some of it's per occurrence, so each storm has to –

Governor Lydecker: Got it. Okay.

Jennifer Montero: -- on its own get there, or we have aggregate, which is annual aggregate. So, all the storms in one year, one season, added together could attach to the reinsurance program.

Governor Lydecker: And in the last four years, you know, as Kapil was talking about, you know, it was a hard market, and now the market is softening a little bit, not necessarily from a pricing standpoint, but from a capacity standpoint. Is Citizens in a better position today than it was the last couple of years?

Jennifer Montero: Absolutely.

Governor Lydecker: Thank you.

Jennifer Montero: So as far as -- any other questions? So as far as next steps, staff will work with our traditional and our capital market teams, as well as our financial adviser, to evaluate available options relating to structuring terms, pricing, other relevant matters with regards to the '24 program. Staff will present recommendations to the board at the May 14th special board meeting for final approval of the risk transfer program. And I did mention earlier this program is – this illustrated program is created using the budgeted $700 million, and we think that that is probably a good number. As Kapil mentioned, we're looking at risk-adjusted pricing pretty flat. We will know more once we get quotes in. The submission was supposed to go out yesterday for the traditional market, and after the bonds are announced, we go to the market with that, we'll start getting a demand curve with that. We'll have much better pricing to come to the board with.

Governor Lydecker: So, it's a $700 million budget versus -- was it -- weren't we in the five hundred plus -- $575 million last time?

Jennifer Montero: Oh, $650 million was last year, and now -- and right now, the placeholder is $700 million. Typically, we have a placeholder when we do the budget because it's so far in advance, we don't know what the market conditions are. If the market conditions remain the way that they are today, then I think that will be fine with the $700 million, but we'll come back at the May board meeting –

Governor Lydecker: But is that $700 million reflective of rate, or is that really more a reflection of expose unit changes on Citizen?

Jennifer Montero: It's a little bit of both, mostly rate, but sometimes when you have large capacity to get huge chunks –

Governor Lydecker: But it should be exposing it, isn't it? Because Citizens has grown this past year.

Jennifer Montero: Correct. And the thing that's happened is the commercial residential that is covered under our reinsurance program for the commercial lines account has never been reinsured. That is being added to our subject business now. So, it's about 1 and a half to 2% of the programs. So that is an additional amount of – of the reinsured - subject business. So that has increased by the CLA being added in, but not the commercial nonresidential. That's the sliver along the side, and we haven't reinsured commercial nonresidential in many years. So, the CLA, the commercial lines account portion of the CNR, would not go to the program, just the commercial residential.

Governor Lydecker: And do you think the combining of the accounts that you've been working on for two years now is done, is that helping you in the placement in the marketplace?

Jennifer Montero: We hope that it will. We hope it'll simplify it. There are a few reinsurers that -- you know, they favored one account over the other. Most are indifferent, they don't have a preference that it's combined. But there were some that liked the pricing on the personal lines account because it was a riskier account and had higher pricing, and some like to stay away from that risk and preferred the coastal account for that reason.

Governor Lydecker: And this is my last question.

Chair Knight: (Inaudible)?

Governor Lydecker: I'm sorry?

Chair Knight: Do you have another one about fraud?

Governor Lydecker: She asked if I have another one about fraud. Fraud's a hot topic in my world. I really take an anti-fraud position on things. Yeah, yeah. It's -- I've staked out a very clear path. $700 million. I understand why there was a budget process, approval from this board for identifying the spend on reinsurance, but by identifying the spend on reinsurance today, as both accounts have combined, it just feels a little bit to me that we're projecting to the marketplace our budget where maybe -- I wonder if almost that should be an executive committee conversation. My question is going to be, are we looking fat and happy when we go into the marketplace as the market pricing is changing? And the -- you know, to the point that was made earlier, the pricing is -- it's only around the corner before the pricing softens, assuming we don't have a hurricane, you know, pop this year. Should there be a thought process or some consideration for not projecting that number, softened market, and the combining of the accounts, so that when you go into the marketplace, or your team goes into the marketplace, that, you know, maybe we create a more competitive process and a -- because there's an air of uncertainty? They know there's a big spend, but there's an air of uncertainty. It just feels like we're projecting ourselves too much.

Jennifer Montero: So, when we do the budget, we do call it a placeholder because we don't know what the market conditions are. And what -- how it works on the traditional side is once we get the quotes back, we'll look at the quotes and we'll compare it to the internal analysis that we did, the internal analysis Raymond James did, and the internal analysis that Gallagher Re as our broker did, and we all compare where we think that those prices should be based –

Governor Lydecker: This is not my question.

Jennifer Montero: But we go out -- give me just a second. I'll get there.

Governor Lydecker: Okay.

Jennifer Montero: So, what happens, though, is for each layer that we have, we go out with – after you -- the board approves us for a certain spend, we go out with what's called firm order terms. So, for each layer, we say this rate online is going to be 10, this will be 11, this will be 12, whatever, and that's what we think the price is, and it's not negotiable anymore, that's what it is. They either come on it for that price or they don't.

Governor Lydecker: Okay. I get your point.

Jennifer Montero: So, we're setting the price kind of, but based on what we think the market prices are –

Governor Lydecker: Fair enough.

Jennifer Montero: -- not on our budget.

Governor Lydecker: Fair enough. So that's -- so what you're describing to me requires a pretty high level of sophistication, which the Citizens team has. So, hats off. I would just add one other element because my question -- I did not want you to defend where we've been, because I know how painful it's been to get to where you are now, but do you want to consider another layer of competition into that thought process? Because you go into the you have to be one of the most sophisticated purchasers of reinsurance in the marketplace today. You just gotta be. And I know two years ago, this board passed software that helped you become even more quick and sophisticated in terms of how you price and how you layer. But given some of the changes that are occurring right now, and the marketplace is changing to our advantage, and because of the combination that you have now, and Citizens is a cleaner presentation. I'm just throwing it out there. You don't have to defend it or anything, just throw it out there, like maybe we ought to consider as a -- because as a public body, we project all this, but maybe there's some of this stuff that we should use in executive session, so you have a little bit -- some more cards to play. But I still take your point in terms of how you set the market. So, thank you for that clarification.

Jennifer Montero: Sure. Thank you.

Governor Spottswood: Madam Chair?

Chair Knight: Yes.

Governor Spottswood: Could you provide us -- not now, but at some point, in time and maybe send it to us, a more detailed description of our investment portfolio and the way it's performing?

Chair Knight: We're going to actually have a piece on that.

Governor Spottswood: Is it here?

Chair Knight: Uh-huh.

Governor Spottswood: Okay.

Kapil Bhatia: The $700 million is really at a very macro level. And we have so many layers, so many pieces, aggregate occurrence, multi-year, single year, that nobody can put the puzzle together, even though everybody knows it and nobody is going to participate for $5.2 billion. So, there is no way to reverse engineer that product to get to the pricing level as long as we feel comfortable where we are. So, we can slice and dice it into the micro components to get to it. And we can go through the details offline and see how we do it.

Chair Knight: Thank you. Does that conclude the layer chart?

Jennifer Montero: That does.

Chair Knight: Okay. Thank you. Moving into the investment policy changes.

b. Investment Policy Changes [AI]

Jennifer Montero: Thank you. So, each year, Citizens comes to the board with our recommended investment policies, if any. So, Citizens had five separate investment policies that are being reduced to three investment policies as the two tax-exempt policies are being eliminated. We defeased the pre-event debt in 2023, and, therefore, we do not have any funds invested in the tax-exempt liquidity fund or the tax-exempt claims paying fund. The assets in the three remaining taxable investment policies are only invested in high-quality, fixed income securities with an overall investment strategy that prioritizes goals as safety of principle, liquidity so that operating expenses and claims can be paid in a timely manner, and competitive returns. However, each of the policies provides for different portfolio duration, credit quality, and other parameters consistent with these broad goals and the specific purposes of the underlying fund. So, the taxable liquidity fund generally governs the investments of funds in surplus that will be the first monies used to pay claims after an event that can be used to pay operating expenses on an ongoing basis. The amount of the liquidity fund is reset each year to equal the approximate amount of funds needed to reach the attachment point of the Florida Hurricane Catastrophe Fund. So, this is the green layer that's right under the CAT fund in the layer charts. The taxable claims-paying fund generally governs the investment of funds that are up to the 1-in-100 year probable maximum loss and will be used to pay claims post-event after Citizens has expended all monies in the liquidity fund. So that would be from the CAT fund to the top of the chart at the 1-in-100 year event.

And then, the taxable claims-paying long duration fund generally governs the investments of funds that are above the 1-in-100 year probable maximum loss and will be used to pay claims post-event after Citizens has expended all monies in the taxable claims-paying fund. As money is invested, pursuant to this policy, will be Citizens' last source of available funds. Duration limits of the policy are longer than the duration of the taxable claims-paying fund and allows for maximum return as this is where our preserved surplus is retained. The policy is currently not funded, but we will build surplus, and then, the policy will be funded. The surplus is projected up to the one in 96-year event for 2024. So as part of the annual review of the investment policy, Citizens' staff worked with its financial adviser and investment managers to make proposed changes to the policies. The recommended changes are slightly more conservative to preserve the surplus and to adjust for market conditions. For the taxable liquidity fund, decrease the maximum limit for security ratings of Baa3 or BBB- from 10% to 5%, and decrease the maximum issuer limit from 1.5% to .5%. For the taxable claims-paying fund, decrease the maximum limit for securities with ratings of Baa3 or BBB- from 10% to 7.5%, and decrease the maximum issuer limit from 1.5% to 1%. For the taxable claims-paying long duration fund, we want to increase the minimum treasury and U.S. agency composition from 20% to 25% and decrease the maximum allowable corporate securities from 80% to 75% and decrease the minimum tranche size for asset-backed securities from $75 million to $50 million. And, then, for all three funds, require written notice from the investment manager within one business day of an event where the security is downgraded by one notch to BBB-, require an action plan from the investment manager within five business days of an event where the security is downgraded by one notch to BBB+, or if a negative watch falls outside the investments policy standard, decrease the maximum issuer limit for asset-backed securities from 1.5% to 1%, exclude treasury and agency money market funds from limitations regarding the money market funds, and, then, include portfolio management language regarding the investment strategy being based solely on the pecuniary factors to comply with recent statutory changes from HB3. This last one, we are just codifying this. We are actually already doing this. We just wanted to codify that. These changes will allow Citizens to be more proactive with adverse rating actions, reduce exposure to individual issuers that have minimum rating levels, and reduce issue exposure for asset-backed securities. So, I will stop there for any questions.

Chair Knight: Any questions?

Governor Lydecker: Madam Chair, I would be happy to help with a motion.

Chair Knight: Thank you.

Governor Cumber: Second.

Governor Lydecker: I'm sorry, let me just put the motion out first. **I'd like to recommend the approval of the changes to Citizens' investment policies. These changes will allow Citizens to be more proactive with adverse rating actions, reduce exposure to individual issuers, and have minimum rating levels and reduces issuer exposure for asset-backed securities, so authorized staff to take any appropriate or necessary action consistent with this action item.**

Governor Cumber: **Second**.

Governor Lydecker: **Second.**

Chair Knight: Okay. **The motion passes.** Thank you.

Governor Lydecker: I was reserving the right to oppose it, even though it was my motion, but...

Chair Knight: And just, also, if the record can reflect that at the December 5th meeting, Governor Lydecker and Chair Beruff asked to have a look at the investment policy statement, which we do and did, and just let the record set forth that.

Governor Lydecker: And I thought it was a really thoughtful presentation. Using the circumstances that we find ourselves in today with the returns that we're enjoying, I think I was hearing $450 million during Kapil's presentation, that here's an opportunity to scale back, be a little bit more conservative on how we look at it, I think it's a really good thing. So –

Chair Knight: Okay.

Governor Lydecker: -- well done.

Chair Knight: Okay. Leading right into our investment portfolio update.

c. Investment Portfolio Update

Jennifer Montero: Sure. And it's behind the tab that says, "Investment Portfolio." So, on Slide 1, the total portfolio is $9.45 billion with approximately $8.36 billion, or 88%, externally managed by 10 investment managers. The remaining $1.09 billion, or approximately 12%, is internally managed and is primarily consists of liquidity for claims, operating fund, debt service funds, and debt service reserve funds. Internally managed funds are invested in short-term U.S. Treasury securities or money market funds. The portfolio is very conservative and stable with sufficient liquidity to pay any current or potential future claims. The total portfolio average duration is stable and is currently just over 2.87 years. As of February 2024, the one-year net income and total income return is 3.11% and 5.37%, respectively. The annualized net income return for the last four years is approximately 2.75%. The 2023 net income return was 3.0%, and the 2024 net income return is expected to be approximately 3.6%. On Slide 2, treasury rates have increased over the last 24 months, but have stabilized over the last four months. The increase in rates reflects the feds' 11 rate increases to the current rate fund rates of 5.25% to 5.5%. The fed is done with increasing rates as inflation has started to come down and interest rates have stabilized at relatively higher levels. The yield curve is still inverted. The current two to ten-year spread is negative 32 basis points, and the three-month to ten-year spread is negative 106 basis points. Both spreads are still at significantly negative levels as the financial markets are either expecting a soft landing or slowdown.

On Slide 3, the portfolio has very strong credit quality. Over 77 percent of the taxable portfolio is in money market funds or rated A or higher. Approximately 43% of the total portfolio is in treasury and agency securities or money market funds. And Slide 4. The portfolio income return is stable and net income for 2024 is expected to be approximately 3.6%. We continue to receive the incremental interest income from rising interest rates with increased investment in short-duration securities. And, lastly, the portfolio continues to have negative mark-to-market values, but it is declining as interest rates come down and the portfolio matures with declining duration. We expect the 2024 total return to be over 4.5% as existing securities mature. And I will pause for any questions. And there is an appendix after the summary report that has -- goes into some more detail behind that tab.

Governor Spottswood: Madam Chair?

Chair Knight: Yes.

Governor Spottswood: You're showing the current market value at $9.4 billion?

Jennifer Montero: Yes.

Governor Spottswood: And that compares to book value how?

Kapil Bhatia: We have approximately negative $600 million or unrealized mark-to-market right now, so the book value is approximately $10.1 billion.

Governor Spottswood: And that's mainly in the five years and over?

Kapil Bhatia: It's basically -- no, it's distributed quite evenly. We have -- sorry, I have the number (inaudible). So, we have approximately $1 billion maturing – $2.5 billion maturing over the next 12 months, and then, another billion maturing each in Year 1 to 2 and 2 to 3. Most of the negative value are in the first three years because yield curve is inverted, so more than half of it. Over the next 24 months, three-quarters of the unrealized losses will evaporate because our portfolio is so short to the 2.87.

Governor Spottswood: But when you talk about a one-year income and total return, 3.11% and 5.37%, respectively –

Kapil Bhatia: Yeah, the 3.11 %

Governor Spottswood: -- the 3.11% is net. That's the current earnings –

Kapil Bhatia: Yes.

Governor Spottswood: -- less the decrease in market value?

Kapil Bhatia: The 5.37% is basically what reflects the evaporation of negative mark to market value. So over $230 million on a $10 billion portfolio will evaporate over the next 12 months as we project.

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Governor Spottswood: Okay. Thank you.

Chair Knight: Thank you. There's no other Any new business?

Kapil Bhatia: Can I just add one more additional comment?

Chair Knight: Yes.

Kapil Bhatia: That's based on the current market rates with no reduction. If the interest rates, as Fed is planning to reduce, whether it's 25 or 50 basis point, that unrealized will evaporate at a much faster pace. But for simplistic reason, we are assuming no change in the interest rates.

Governor Spottswood: But to be strictly invested in fixed income securities, that's not bad performance, that's pretty good performance over the past couple of years, isn't it?

Kapil Bhatia: Thank you. And we were able to monetize some of the gains a few years ago as the interest rates were coming down, and that's one of the reason -- So in 2021, we had a positive $90 million, and we took the gains off the market to pay some of the claims. Thank you.

Governor Lydecker: As a general rule of thumb, though, we try not to be complimentary of Kapil, you know. We like to keep our finger on them.

Governor Spottswood: You should have told me that before the meeting.

Kapil Bhatia: I'm used to it, Governor Lydecker, so thank you.

Chair Knight: Thank you both. The meeting is adjourned, and we look forward to our next meeting on July 9th.

(Whereupon, the proceedings were concluded.)