

March 30, 2022

Finance and Audit Committee Meeting Minutes

A Finance and Audit Committee meeting for the Surplus Lines Stamping Office of Texas was held in-person at the Surplus Lines Stamping Office of Texas, 805 Las Cimas Parkway, Suite 300, Austin, TX 78746.

Agenda

- Item 1. Call to Order & Establishment of a Quorum
- Item 2. Discussion and Appropriate Approval of December 14, 2021 F&A Meeting Minutes
- Item 3. Discussion and Appropriate Action – 2021 Annual Financial Audit Review
- Item 4. Discussion and Appropriate Action – 2022 Finance YTD Update, Reserve Balance Review, Investment and Cash Management Policy Annual Review
- Item 5. Discussion and Appropriate Action – Annual Stamping Fee Analysis
- Item 6. Adjournment

Item 1. Call to Order | Charles Gillenwater, Committee Vice Chair

Charles Gillenwater, Vice Chair of the Finance and Audit Committee, called meeting to order on March 30, 2022, at 3:01 p.m.

Meeting was held in-person a conference call-in number was provided in the Public Meeting Notice. Written notice of this meeting proposed agenda, and all related meeting materials were provided to the Texas Department of Insurance Deputy Commissioner of the Financial Regulation Division and designees on March 21, 2022, in accordance with the Plan of Operation, Section 2(c)(2).

Notice of this meeting and related agenda was provided to the Finance & Audit Committee and submitted for publication to the Office of the Secretary of State on March 24, 2022, in accordance with the Plan of Operation, Section 2(c)(1) and the Chapter 551 of the Tex. Gov't Code. Gillenwater called roll to determine participating members pursuant to the Plan of Operation Section 2(c)(6):

COMMITTEE MEMBERS PRESENT

Charles Gillenwater	Vice – Chair
Jeffrey Klein	Secretary

NON-COMMITTEE MEMBERS PRESENT

Penni Chambers, Chair of the SLTX Board – Term Expiration: 12/31/2023
Leslie Milvo, SLTX Board Member – Term Expiration: 12/31/2024
Garrett Spowls, SLTX Board Member – Term Expiration: 12/31/2024

ALSO PRESENT

Greg Brandon, Executive Director, SLTX
Donna Aug, Director of Finance, SLTX
Cheyenne Herrera, Director of Operations, SLTX
Sholonda Stone, Director of IT, SLTX
Denisse Orellana, Director of Human Resources, SLTX
Christian Robinson, Data Analyst, SLTX
Marissa Gamez, Administrative Assistant, SLTX

Marcelina Gutierrez, Communication and Education Coordinator, SLTX
Marie Musalem, Senior Audit Manager, Calhoun, Thompson, & Matza LLP - Financial Auditors
Stanton Strickland, General Counsel, Mitchell, Williams, Selig, Gates & Woodyard, P.L.L.C
Courtney Williams, Attorney III, TDI – *Participated via Teams phone call*

SLTX staff members also in attendance

Sharmila Subedi, Business Analyst, SLTX
Toby Pick, Operations Manager, SLTX – *Participated via Teams phone call*

Minutes were taken by SLTX staff.

Gillenwater made the following administrative housekeeping announcements before moving forward with agenda items:

1. Antitrust activity or discussion are prohibited at all Stamping Office functions. This prohibition includes exchange of information concerning individual company rates, coverages, market practices, claims settlement practices, expenses, or any other competitive aspect of an individual company's operation.
2. We will not have a public comments session. Public and media attendees listening by telephone should always mute lines.
3. Representatives of state agencies and public members are welcome to observe or record this Board meeting but refrain from asking questions or interjecting comments during the Board's deliberations.
4. State agency personnel present may be asked questions about agency policies if those questions relate to an agenda item.
5. Members, counsel, and staff participating by conference call should identify themselves when speaking. Please mute lines when not speaking.

Item 2. Discussion and appropriate approval of December 14, 2021, F&A Meeting Minutes

Presenter: Charles Gillenwater, Committee Vice Chair

Gillenwater asked if there were any questions or corrections to minutes. Hearing none, Gillenwater motioned to accept minutes as presented.

MOTION: Charles Gillenwater

SECOND: Jeffrey Klein

TEXT OF MOTION: Approve December 14, 2021, F&A Meeting minutes as presented.

Gillenwater asked if there were any further discussion or questions, hearing none.

All committee members in favor.

Motion carries.

Item 3. Discussion and appropriate action – 2021 Annual Financial Audit Review

Presenter: Donna Aug, Director of Finance; Marie Musalem, Calhoun, Thomson, & Matza

Marie Musalem began presentation by reviewing the Audit Wrap Up letter. Audit was conducted in accordance with highest auditing standards generally accepted in the United States. Full access to requested records and information was readily available. Management provided excellent cooperation. Audit did not identify any material inconsistencies. No significant changes to process or significant assumptions were used to develop 2021 estimates. Methods used to account for significant or unusual transactions, and related disclosures, are considered appropriate. There were three corrected misstatements: (1) To record fiduciary fund activity for year ending December 31, 2021. (2) To reclassify

all securities maturing in over one year as of December 31, 2021, as noncurrent investments. (3) To record December 2021 SMART Release from internal software work in progress. No material weaknesses were found in conjunction with audit of financial statements which is highest classification allowed.

Musalem asked if there were any questions, hearing none. Gillenwater asked if there were any questions regarding audit, hearing none. Gillenwater recommended per text of motion below.

MOTION: Charles Gillenwater

SECOND: Jeffrey Klein

TEXT OF MOTION: Accept 2021 Annual Financial Audit Review as presented and recommend it to the full board for consideration and submission to TDI in accordance with section 2(b)5 and 2(c)5(c) of the Stamping Office Plan of Operation.

Gillenwater asked if there were any further discussion or questions, hearing none.

All committee members in favor.

Motion carries.

Item 4. 2022 Finance YTD Update, Reserve Balance Review, Investment and Cash Management Policy Annual Review

Presenter: Donna Aug, Director of Finance

Donna Aug began by providing February 2022 financial results. Aug reported stamping fees were under budget 34% for February; 25% YTD due to premiums reported being less than budgeted this year. Investment income was over budget 1% for February; under budget 4% YTD. Total Expenses category were under budget for February \$29,400 or 5%; under \$46,000 – 3% YTD. Salaries and Benefits were under budget 10% in February; 3% YTD. Professional Services category was over budget by 53% for February; 12% YTD in ITS due to extension of Cloud Optimization SOW by Headspring, through April, not being anticipated when 2022 budget was finalized. Conference and Education category were under budget 100% for February; 73% YTD.

Aug continued February finance update: Travel and Entertainment, which includes Board Expenses were under budget by 100% February; 94% YTD. Occupancy & Operating Expenses are under budget \$3,000 or 4% for the month; \$4,000 or 3% YTD due to savings in internet expense due to co-location from RSI being cancelled. General & Administrative expenses were under budget \$2,500 or 1% for February and even for year to date. Contingency Expense, which was not used, resulted in over \$3,100 savings for February; \$7,400 YTD. Operating loss in February was almost \$163,000; \$452,000 YTD. There was a budgeted gain of \$25,000 for February; loss of \$180,000 YTD. Fair Market Value of investments decreased approximately \$135,000 for February; \$302,000 YTD.

Gillenwater asked committee if there were any comments or questions regarding Aug's report, hearing none. Aug stated there is no recommended motion for the committee at this time.

Unrestricted, Undesignated Funds –SLTX went into 2022 with a fund balance of \$28.8 million which was \$20 million over the maximum for 2022, which is \$8,806,266. February's year to date net loss of \$754,000 resulted in a fund balance of \$28 million, which is \$19.2 million over our current maximum. At our current pace, our year ending fund balance is projected to be \$27 million; \$18.2 million over our maximum.

Gillenwater asked if there were any questions, hearing none. Gillenwater asked committee if there were any comments or questions regarding Aug's report, hearing none. Aug recommended per text of motion below.

MOTION: Charles Gillenwater

SECOND: Jeffrey Klein

TEXT OF MOTION: Motion for Finance and Audit Committee to make a recommendation to the board for reducing amount of actual reserves of the stamping office in accordance with section 2(b)(7)(b) of the Stamping Office Plan of Operation.

Gillenwater asked if there were any further discussion or questions, hearing none.

All committee members in favor.

Motion Carries.

Donna Aug begins Annual Review of Investments and Cash Management Policy presentation. Aug states CDs are currently at 54.7%, above 25% target; within 10-60% range. Fixed income is currently at 45.3%, right on target of 45%; within 10-60% range.

Gillenwater asked if there were any questions regarding annual review of investment in cash management policy. Committee member, Jeffrey Klein, asks if any investments are in non-domestic or in international certificates of deposits. Aug clarifies that they are not. Gillenwater asked Aug if there were any recommendations regarding annual review. Aug recommended per text of motion below.

MOTION: Charles Gillenwater

SECOND: Jeffrey Klein

TEXT OF MOTION: Motion to recommend to the board that no revisions to be made to the Stamping Office Investment and Cash Management policy in accordance with section 2(b)(6) of the Stamping Office Plan of Operation.

All committee members in favor.

Motion Carries.

Item 5. Annual Stamping Fee Analysis

Presenter: Cheyenne Herrera, Director of Operations; Christian Robinson, Data Analyst

Cheyenne Herrera passes floor to SLTX's Data Analyst, Christian Robinson, to discuss item. Herrera will provide recommendation. Robinson provides introductions moved to item of discussion, the Stamping Fee Rate and Undesignated Fund Balance. Reasoning for discussion is due to Plan of Operation. It requires board to submit written recommendation to Commissioner of Insurance to lower, raise or take no action on fee. Due to current state of fund balance, SLTX did not take time to analyze raising fee, but is an option. Regarding undesignated fund balance, Plan of Operation defines maximum the reserve balance can hold (2 times the 5-year average audited expenses). If we predict fund will reach well over maximum threshold, board will need to provide a written plan to reduce fee within reasonable time. Robinson provides visual depicting YTD for SLTX. For 2021, fund balance was around 28.8 million which is over maximum \$8.8 million-dollar amount. When we compare this to previous discussion in 2020, undesignated fund balance was around \$22 million; maximum was \$7.3 million. To review, 2020 is when we decided to reduce existing stamping fee to .075% from .15%, and we predicted maximum fund balance would return to normalcy in 2034. Furthermore, from this presentation, you can see fund balance does not decrease for a few years. This takes account for hard market conditions currently ongoing.

Robinson further states 20-year projections may have uncertainties due to expansion of time. Moving forward, Robinson provides updated points on projection slide from 2020. Hard market conditions were apparent in 2019 and has continued to stay stable through this period.

Robinson provides three different projections for stamping fee, .075%, .05%, and .03%. Current fee allows SLTX to reach maximum by 2029, while .05% allows to reach maximum by 2025. Lastly, a .03% rate would allow us to reach maximum by 2024. However, funds will become negative by 2026 if rate is decreased to .03%. Robinson clarifies timeline has nothing to do with premium we are experiencing, for it is more to do with expenses. For these projections, we considered 2022 budget expenses, and accommodates for accelerated timeline since expenses have an impact on both reserve and maximum balances. Moving onto pros and cons of these projections, biggest pro for current projection is lack of impact on industry. To clarify, when SLTX makes stamping fee rate change, agents and brokers of market go through significant changes. Current rate also has greatest long-term sustainability since it's relatively close to break-even rate. We can operate with this rate without worrying about negative funds once undesignated fund balance has reached its maximum. Cons for this rate are it reaches maximum balance at slowest rate, so if there is a legislative change which impacts volume of business in market, it's possible current rate would not allow us to reach maximum. However, it will take an unprecedented change which does not include climate we have seen over past couple of years. Moderate reduction to .05% is good due to flexibility it provides regarding Surplus Lines market. However, if rate does not work, there may be necessity for a rate increase. This is a con to .05% rate. Lastly, .03% rate provides quickest way for max fund balance to decrease, but a rate increase may be required. Committee member, Jeffrey Klein, asks how much lead time is given to industry before a change is made. Cheyenne Herrera clarifies that if a change were to be made to the stamping fee, historically has been 90 days. Herrera also clarifies that stamping fee rate is not based on change made but based on policy inception date, we would see a significant amount of runoff almost nine months to a year of premiums being reported with old rate before we get renewals and subsequent business on new rate.

Robinson provides a break-even analysis. Given premium which we have seen in market, this is rate that would need to be charged to break even. After stamping fee rate was changed January 1, 2021, realized rate and stamping fee rate differ. He reviewed previous occurrences in which stamping office made a fee change and found it takes three to six months for true impact of rate change. It wasn't until June 2021, majority of policies which come into office have new stamping fee rate.

In terms of cashflow process, SLTX does not require agents to pay their fees until balance reaches at least \$15 dollars. The lower we make stamping fee; more agents will not pay fees until they reach \$15 dollars. Although premium is being realized, we do not see cash coming into office. During hard market conditions over last three years, items have stayed relatively flat through time while premium has increased. This means there are companies in market who are charging at higher price. From 2017 to 2019, we were operating under a different climate. SLTX had less employees than usual; expenses reflected this. When we look at max fund balance for 2022, it includes expenses from 2017-2019. As we operate under conditions we are currently in, you see max fund balance increase as well. Balance is projected to increase \$10 million dollars over next five years. In terms of hard market condition predictions, they have remained strong –Robinson does not expect industry to exit in near future. We also see new market entrances in Texas. There are 5-6 new companies every year, but last four years we are averaging 16-17 per year. As new companies enter market, there will be competition for price, and could have a negative impact on premium.

Robinson asks committee if there are any questions. Stan Strickland, General Counsel, comments on committee member, Jeffrey Klein's question regarding timing of a stamping fee change and how long after the board approves a change, it goes to TDI. Strickland states that TDI is obligated by rule to put it out for comment for 20-day comment period. At that time, TDI can choose to have a hearing or a public forum to collect more comments or do it all by written form. Strickland adds that there's no deadline as to when they actually approve it.

Gillenwater thanks Robinson for his presentation and asks if there is any recommendation to be made. Cheyenne Herrera recommended per text of motion below.

MOTION: Charles Gillenwater

SECOND: Jeffrey Klein

TEXT OF MOTION: Gillenwater motions that the Finance and Audit Committee recommends to the board that no change be made to the current stamping fee rates in accordance with Section 2(b)(7)(C) of the Stamping Office Plan of Operation.

All committee members in favor.

Motion Carries.

Item 6. Adjournment

Gillenwater motioned to adjourn meeting.

MOTION: Charles Gillenwater

SECOND: Jeffrey Klein

TEXT OF MOTION: Adjournment

All Committee Members present in favor.

Motion carries.

Meeting adjourned at 3:51 p.m. on Wednesday, March 30, 2022.

Jeffrey Klein, Committee Secretary