



Florida PRIME™ Best Practices Review

Florida State Board of Administration (SBA)

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Executive Summary

Aon Hewitt Investment Consulting (Aon) conducts a Best Practices Review of Florida PRIME on an annual basis. In this report, we review the 2019 Participant Survey responses, review updates from the Governance, Risk Management, and Compliance Assessment, cover the annual Investment Policy Statement Review, provide an overview of the upcoming Florida PRIME Strategic Plan and provide a brief update on the discontinuation of the Participant Local Government Advisory Council.

Based on our review, we continue to believe that Florida PRIME is being managed in a manner consistent with best practices and in consideration of participants' best interests and do not have any recommendations at this time.

2019 Participant Survey Results

On a regular basis, the SBA conducts a survey of Florida PRIME participants to gain a better understanding of the participant base, current usage of available services, and overall satisfaction. The survey also seeks to gauge interest in various enhancements and to ensure awareness of participant needs and preferences. The 2019 survey attracted 83 respondents which is in line with the previous rate of response.

A diversified group of governmental units responded to the survey, primarily representing counties, municipalities, school boards and special districts, with over half (61%) representing investment decision-makers and the remaining functioning in an account operations role. Of the respondents, 46% have one account with Florida PRIME and 36% have either 2 or 3 accounts. Half of respondents have over \$10 million of cash assets available for short-term investment, with another 21% having between \$1 million and \$10 million of cash assets available. The survey indicated that approximately 60% of respondents indicated having a balance of over \$10 million with Florida PRIME, and 23% indicated having between \$1 million and \$10 million with the pool. The survey revealed that 19% of respondents maintained greater than 75% of their cash surplus in Florida PRIME over the past year, which is slightly down from the previous survey. However, 23% indicated they have maintained less than 25% with Florida PRIME, which is an improvement of approximately 10 percentage points from the previous survey response (34%).

The survey includes questions that relate to how and why participants utilize other competing and complementary liquidity vehicles. Of the respondents, 38 indicated that their organization has a policy that dictates a maximum allowable allocation to Florida PRIME and 25, or 71% of those with policies, are restricted to allocating 50% or less to any single governmental investment pool or money market fund. Relatedly, when asked what prevents an organization from using Florida PRIME as the primary source of cash management, 49% of the 72 respondents to this question indicated that investment policy restrictions were a reason for not using Florida PRIME as a primary source of cash management. The next greatest response was 52% of respondents indicating that diversification needs of the cash portfolio was a major or moderate reason. Consistent with the previous survey, current yield level and costs were highly selected as not reasons at all for not using Florida PRIME as a primary source of cash management, at 67% and 74% response rates, respectively.

When asked about other investment vehicles used in the past 12 months for cash management, respondents indicated the most commonly used vehicles aside from Florida PRIME are Certificates of Deposits at 33% of respondents, followed by peer funds, and specifically the Florida Education Investment Trust Fund and the Florida Local Government Investment Trust at 27% and 25%, respectively. Diverging from the previous survey, SEC registered money market funds were indicated as used by only 5% of respondents in the past 12 months. This is in large contrast to the 37% of respondents in the 2017 survey who indicated using a SEC registered money market fund and is likely due to the SEC's Rule 2a-7 Reforms that went into effect. The survey also asked respondents to rank how competing investment services have added value to the respondent organizations' investment goals

from the following list: yield, cost, risk, client service, available funds, and ease of use. Respondents indicated that yield was the most appealing feature, followed by risk, defined as perceived risk levels adjusted for the level of return. Client service and ease of use were ranked the lowest in terms of value add from competing investment services.

The survey questions surrounding current services related to Florida PRIME continue to receive strong feedback. Related to the Florida PRIME website, 82% of respondents indicated that they visit the site at least once a month and 99% responded that they find the website functionality as very easy to use. The survey also indicated that the clear majority (100%) of participants continue to utilize the website primarily to access account balances and statements, and approximately 74% and 45% of respondents utilize the website to make transactions and to access the Monthly Summary Reports, respectively. When asked about the usefulness of multiple communication pieces, the responses also continue to be favorable. The survey indicated that over 70% of respondents rated the following communications as very useful: monthly account statements (94%), e-mail notifications of withdrawals (82%) and changes to bank instructions (79%). Further, over 75% of respondents found the following to be at least somewhat useful: Periodic eNotices (91%), Monthly Summary Reports (95%), and Weekly Market Commentary (78%). Lastly, respondents indicated great satisfaction with the Florida PRIME representatives, with over 90% indicating the representatives were very courteous, very knowledgeable and very responsive.

Overall, the survey results continue to be positive from both operational and service-related perspectives. Responses related to the use of competing investment vehicles continue to be mixed, with indications of yield and risk being top of mind, but notably, that a large percentage of respondents' organizations have investment policies limiting available funds to invest in a single entity and/or seek diversification from a single cash management source. Generally, the survey indicates a strong level of satisfaction with the management of the Florida PRIME portfolio. Over 80% of respondents indicated that they are very likely or extremely likely to recommend Florida PRIME to a colleague or other governmental investor. We continue to believe the survey is a great mechanism to obtain feedback from Florida PRIME participants, as well as to express the SBA's awareness and receptiveness to the participant's needs and wants.

Compliance Review Follow-up

In 2018, the SBA completed its triennial Governance, Risk Management and Compliance Assessment conducted by a third party consultant. This Assessment covered all major mandates managed by the SBA, including Florida PRIME. The Assessment identified the SBA as a high performing organization with strong governance and compliance practices and did not find any material issues. The assessment also provided some suggestions for the SBA to consider surrounding its compliance structure and practices. One of the topics that was discussed was the role and mechanics of the SBA's Investment Oversight Groups (IOGs).

The SBA's IOGs play an important risk management role across all the major mandates the SBA oversees. At a high level, the IOGs are categorized by asset class and are responsible for reviewing and ensuring compliance with the appropriate policies and procedures. Florida PRIME had been covered by the fixed income IOG until recently when it split off and is now covered by a Florida PRIME-specific IOG. The Florida PRIME IOG currently meets monthly to review the regular risk and compliance reporting that is required for the portfolio. The main purpose of the monthly meetings is to review any compliance exceptions or elevated risk concerns that may have occurred over the previous period. However, given the exceptionally strong governance practices surrounding investment and risk management of Florida PRIME, there have been an immaterial number of exceptions or issues to address during these meetings over the past several years. One of the resulting suggestions from the Governance, Risk Management and Compliance Assessment was to consider conducting the physical IOG meetings for Florida PRIME on an exception-basis, rather than required monthly. The SBA's fixed income IOG has successfully transitioned to a meeting-by-exception basis and has not experienced any disruption or impact on its compliance or risk management practices.

Importantly, this suggested change would also not impact the level of compliance oversight or reporting on Florida PRIME. The monthly compliance and risk reports will continue to be performed and disseminated to the appropriate parties at the same intervals. The only difference is that a physical meeting would only be called if an exception was reported or an issue arose. Additionally, the Florida PRIME IOG would still meet quarterly to review the regular stress testing.

In Aon's 2017 Best Practices Review, we conducted a comprehensive review of the compliance procedures and policies that govern the management of Florida PRIME. The review included an evaluation of the compliance practices followed by Federated, S&P, and the SBA. In addition to finding that the SBA has developed a very comprehensive compliance program that is in line with best practices, we suggested there were a few areas where efficiencies could be gained across the governance system. Aon believes that moving the IOG monthly meetings to exception-based meetings is in line with the goal of enhancing efficiencies across the governance system and encourages a more effective use of the SBA's time and resources without impacting the actual level of compliance or risk management of Florida PRIME.

Importantly, we reiterate that the compliance policies that govern the Florida PRIME investment pool and corresponding compliance procedures represent a robust, multilayered approach to ensuring the portfolio remains in compliance with the criteria contained in the Investment Policy Statement and we do not foresee this change impacting that assessment.

Investment Policy Review

As part of Aon's Best Practices review of Florida PRIME we conduct a review of the Florida PRIME Investment Policy Statement (IPS). The objective of the IPS is to set forth the objectives, strategy, guidelines, and overall responsibilities for the oversight and prudent investment of Florida PRIME assets. The purpose of the periodic review is to ensure the document reflects the evolving investment portfolio, current legal and regulatory developments, and best practices. A well-written and unambiguous document is critical to the success of any investment program

Over the past several years there have been modest updates to the IPS that have kept it up-to-date with the current regulatory, legal, and investment environments. The most significant updates occurred in 2016 when the GASB 79 guidelines were released. The SBA is prudent with staying current with overall best practices in managing the Florida PRIME assets and thus the updates to the IPS had been seamless.

Overall, Aon continues to find the IPS to be comprehensive and appropriate for the management and oversight of Florida PRIME. The topics covered continue to be relevant and critical to the success of the management of Florida PRIME assets. The investment objective of the pool and the roles and responsibilities are clearly defined. The IPS provides the necessary specifics and supplemental guidelines for a clear understanding of the investment strategy, making direct and clear reference to the appropriate GASB guidelines for appropriate fiduciaries to follow and understand. We believe the IPS thoroughly defines the risks that are associated with investing in Florida PRIME and find the detailed control procedures provide the comfort of prudent safe-keeping and oversight of assets.

The 2019 review identified one reference update and one update related to the updated mechanics of the Investment Oversight Group. We highlight both below:

1. Section III. Roles and Responsibilities: Remove reference to the Participant Local Government Advisory Council (PLGAC). The PLGAC was repealed in 2018 and therefore no longer relevant going forward.
2. Section IX. Controls and Escalation Procedures: Update language surrounding the Investment Oversight Group's (IOG) function from a mandated monthly meeting to the adopted meeting-by-exception basis. As discussed earlier in this report, there will be no changes to the reporting, risk management or compliance oversight of the pool because of this change.

While it is not expected that the IPS will change frequently, it is a living, breathing document that should be reviewed periodically to ensure it remains appropriate and relevant. Overall, we continue to believe the Florida PRIME IPS is robust and in line with the goals and objectives of the investment pool, and continue to find the Policy to be an effective guiding document for the management of Florida PRIME.

Review of the Florida PRIME Business Case

The Florida PRIME Strategic Plan includes three main goals and objectives for the five-year period beginning in 2019. One of these objectives is to “*evaluate the business case for insourcing and/or outsourcing of pool operations, investment management, user interface (web), need for additional funds, and other general administrative issues.*”

- *Conduct a review of pool operations, evaluating scope and change for potential changes to investment operations*
- *Undergo review and evaluation of the business case for internal/external management.”*

Currently, Florida PRIME utilizes Federated Investment Counseling (“Federated”) as the investment manager to invest the Florida PRIME assets in accordance with the Investment Policy Statement. Federated also conducts investment related risk management procedures and reporting to ensure compliance and the safety of pool assets.

The Florida SBA provides the other services for managing the Florida PRIME program. These responsibilities and services are broadly defined below:

- *Administration*: recordkeeping, trade execution, position monitoring and reporting
- *Client Service*: call center, website/user interface, participant communication and experience
- *Risk Management and Compliance*: policies and guidelines, monitoring, reporting, escalation procedures, participant communication, business continuity

The Florida SBA will be conducting a comprehensive evaluation of changing or maintaining the current management structure of Florida PRIME to evaluate the business case for insourcing or outsourcing each of these functions. This review is intended to include a full assessment of the merits and drawbacks across 100% outsourcing to 100% insourcing, and the potential hybrid approaches in between.

The following discussion is intended to highlight the main services required to manage and run Florida PRIME and the main factors we believe should be evaluated that will help inform the ultimate conclusions on the best management approach.

Service	Evaluation Factors*
Investment Management	<ul style="list-style-type: none"> • Portfolio management • Competitive returns and risk management • Investment, operational and risk-related reporting • Capital market, regulatory and legal awareness and responsiveness • Performance/management evaluation • New fund offerings
Administration	<ul style="list-style-type: none"> • Custody, banking services and accounting • Trade execution • Recordkeeping and reporting • Technology
Risk Management and Compliance	<ul style="list-style-type: none"> • Maintaining and updating investment and operational policies and procedures • Monitoring and reporting requirements, including Fund rating • Trade execution • Information security and business continuity • Regulatory and legal awareness and responsiveness
Client Service	<ul style="list-style-type: none"> • Participant communication/reporting and client experience • Website/User-interface updates, maintenance and offerings • Call center and other participant services
Marketing / Education	<ul style="list-style-type: none"> • Marketing capabilities and effectiveness • New fund offerings • Training and education sessions

*Not intended to be a complete list of factors to be considered. Intended to highlight the main factors.

Surrounding each factor are a range of considerations that will help inform the most appropriate course for the Florida SBA as it relates to managing Florida PRIME. In the table below, we have identified the common considerations we believe are important to evaluate across the range of service options and evaluation factors listed above. As an example, what is the anticipated cost impact on the SBA and on the participants for outsourcing the administrative and client service functions? Are there any cost savings to outsourcing everything, rather than on a piecemeal basis?

Considerations	
Cost	<ul style="list-style-type: none"> • Impact on SBA, revenues earned and cost of providing services • Impact on participant-paid fees
Efficiency	<ul style="list-style-type: none"> • Improved or weakened efficiencies across services • Technological enhancements
Control	<ul style="list-style-type: none"> • Ability to proactively affect change and level of responsiveness
Responsibilities	<ul style="list-style-type: none"> • Ability to provide quality services, including staffing, and the trade-offs in time, expenses and opportunity cost
Accountability	<ul style="list-style-type: none"> • Ability to provide and maintain best in class service, including personnel, systems/technology, client service, etc.
Customization	<ul style="list-style-type: none"> • Ability and ease of tailoring services to specific needs and desires
Disruption	<ul style="list-style-type: none"> • Impact of change on participants and current Fund operations

A similar business case analysis was considered back in 2010 and at that time it was determined that the current servicing model was appropriate and satisfactory to participants. Additionally, it was determined that the alternative approach was comparable to the current offerings and thus did not justify the added cost and disruption to participants to make a change.

We anticipate the forthcoming review to be comprehensive and insightful and will provide the necessary support for the continued management of Florida PRIME in whatever capacity is determined as best. As the above considerations are contemplated, it is important that they are not evaluated in silos. There are trade-offs that must be factored in, such as, are potentially higher fees bringing additional and beneficial services to participants that they otherwise would not have access to? Ultimately, the key consideration across each of these factors and trade-offs should be whether the decision will make the pool more or less valuable to current and future participants.

Participant Local Government Advisory Council

The Participant Local Government Advisory Council (PLGAC) was formed in 2009 to provide additional oversight to the Florida SBA on Florida PRIME and was statutorily repealed on March 30, 2018. The PLGAC consisted of members from local governments appointed by the Board of Trustees and advised the SBA on matters related to Florida PRIME including participant communication, investment policy statement, investment approach, compliance policies and procedures, and other matters that need their attention. In 2018, the recommendation by the existing members of the PLGAC was to repeal the Council and instead rely on the oversight and advice provided by the Investment Advisory Council (IAC). The IAC continues to review Florida PRIME performance and risk on a quarterly basis and the Best Practices Review on an annual basis, as they did historically. Aon agreed with this approach and noted that since beginning our Best Practices Reviews, the Florida PRIME has implemented many changes and enhancements to ensure that participants are receiving the best a local government investment pool can offer in terms of investment strategy, investment risk, oversight and compliance, education, communication, and technology. We had made very few recommendations in the past couple years as a result of our reviews, which is an indication that Florida PRIME has reached a target state wherein it is functioning at the very highest level, performing well, and delivering to participants what they need. For all these reasons, Aon was supportive of the repeal of the PLGAC and the suggested continued reliance on the IAC for continued oversight and council to the SBA on Florida PRIME.

As a follow-up to the one-year anniversary of the repeal of the PLGAC, we are reporting that the management and oversight of Florida PRIME has continued seamlessly and has not experienced any disruptions as a result of the PLGAC repeal. The IAC, SBA, Aon and Federated have all continued in their specific risk management and oversight roles and Florida PRIME has continued to function as a best in class local government pool for its participants.