



Florida PRIME™ Best Practices Review

Florida State Board of Administration (SBA)

June 2016

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Executive Summary

Aon Hewitt Investment Consulting (AHIC) conducts a Best Practices Review of Florida PRIME™ on an annual basis. In this report, we review the responses to the annual participant survey, provide information on finalized Governmental Accounting Standards Board (GASB) Statement 79, review the Florida PRIME™ Investment Policy Statement (with particular consideration paid to the impact stemming from GASB 79), and provide a peer comparison analysis.

Based on our most recent 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.

2016 Recommendations

- SBA can continue to manage Florida PRIME™ in a similar capacity (i.e., “2a-7 like” status) given its compliance with the finalized GASB 79. However, we do suggest modest investment policy changes in light of recent GASB guidance (as outlined below and further detailed later in this report) which we believe will further ensure SBA’s continued “2a-7 like” status. In the spirit of keeping participant needs and best interests secure, a finalized GASB Statement 79 puts forth rules on how external investment pools shall interpret and apply the SEC’s 2a-7 money market reforms. More specifically, AHIC recommends SBA maintain current amortized cost practices as well as the fixed (\$1.00) net asset value (participant survey data shows strong support for this approach).
- AHIC reviewed the Investment Policy Statement (IPS) with an eye to GASB 79. In doing so, AHIC worked with Staff and investment manager, Federated, to identify changes to the IPS. Below we summarize major recommended changes:
 - Added language regarding the issuance of GASB 79 and Florida PRIME™’s commitment to operate in a manner consistent with the criteria and requirements as stated in GASB 79
 - Specifically state that 100% of Florida PRIME™ assets will be U.S. dollar denominated
 - Clarifying language regarding Nationally Recognized Statistical Ratings Organizations (NRSRO) criteria
 - New language regarding the need to hold liquid assets sufficient to meet reasonably foreseeable redemptions
 - Soften the current strict nine month maturity limit on commercial paper
 - Clarifying language regarding bank instruments such that it better conforms to GASB 79
 - Change definition of illiquid asset to reflect five business days instead of seven days (until such security can be sold)
 - Clarifying language on repurchase agreements such that it better conforms to GASB 79

2016 Participant Survey Results

The SBA conducts a survey of Florida PRIME™ participants every year to gain a better understanding of the participant base, overall investor satisfaction, gauge interest in various enhancements, and obtain information on investors' usage of the website and other resources. The 2016 survey attracted 73 respondents (although not all respondents answers all questions), which is a slightly lower turnout than what was experienced last year.

A diversified group of governmental units responded to the survey, with approximately 64% indicating that they employ less than 1,000 employees and 51% indicating a level of cash assets available for short-term investment being greater than \$10 million. Of the 73 respondents, 42% indicated having a balance with Florida PRIME™ of over \$10 million. 32% of respondents indicated they have maintained less than 25% of their surplus in Florida PRIME™ and 32% indicated they have maintained between 25% and 50% with Florida PRIME™.

Respondents continue to provide strong feedback related to the Florida PRIME™ website, with 76% indicating that they visit the website at least once a month, and 67% responding that they find its functionality very easy to use and 32% of respondents finding it somewhat easy to use. The survey indicated that participants continue to utilize the website primarily to access account balances and statements, to make transactions and to access the Monthly Summary Reports. Though phone representatives are seldom used, customer service continues to receive strong feedback with over 90% of respondents rating them very courteous, knowledgeable and responsive.

When asked about the usefulness of multiple communication pieces, 88% of respondents noted that they find the monthly account statements very useful and 83% indicated that they find the email Notifications of Withdrawals & Changes to Bank Instructions very useful. Over 90% found the Periodic eNotices and Monthly Summary Reports to be either very useful or somewhat useful. The Education Center continues to see weak participation, as only 3 of 71 responders indicating that they routinely access this service.

The survey also posed questions related to how and why participants utilize other competing and complementary liquidity vehicles. The survey indicated that the most commonly used vehicle in addition to Florida PRIME™ are Certificates of Deposit offered by a bank, with approximately 33% indicating their use over the past 12 months, and consistent with previous surveys, roughly 35% have also used an SEC-registered money market fund (not offered by Federated, Florida PRIME's investment manager). When asked how competing investment services have added value to the respondent organizations' investment goals, 39% indicated that the yield level added value and 27% indicated value was added through offering other complimentary investment vehicles to choose from. When asked what is preventing an organization from using Florida PRIME™ as the primary source of cash management, 44% responded that a major or moderate reason was an unattractive yield level; however, 41% responded that the yield was not a reason at all. Approximately 44% responded that diversification needs of the cash portfolio were a major or moderate reason for not utilizing Florida PRIME™ as a primary source of cash, though

42% also responded this was not a reason at all. Further, approximately 84%, 88% and 91% of respondents indicated that costs being too high, participant disclosures not being adequate and poor client service, respectively, were not at all reasons for not using Florida PRIME™ as a primary source of cash management.

Overall, the survey results continue to be favorable regarding the operational and service related questions. Respondents indicated that they utilize the website fairly frequently and find it easy to use. Further respondents indicated the communications issued by the SBA are mostly useful as well.

SEC Rule 2a-7 / GASB 79 Reform Update

The Florida PRIME™ investment pool is managed as a “2a-7 like pool” in accordance with the accounting and financial reporting guidelines established by the Governmental Accounting Standards Board (GASB). “2a-7 like pools” are defined as external pools that satisfy the requirements of SEC Rule 2a-7 of the Investment Company Act of 1940 without actually being registered with the SEC.

Recently issued GASB 79 guidelines state that “2a7-like pools” are permitted to report their investments at amortized cost if they have a policy that they will, and do, operate in a manner consistent with the new guidelines set forth by GASB 79. These guidelines are very similar to Rule 2a-7 with a few differences, which are highlighted throughout this and the following section of the report. Federated and SBA Staff have managed Florida PRIME™ in a manner consistent with SEC Rule 2a-7 as is laid out in Florida PRIME™’s Investment Policy Statement, and therefore, there are only a few changes required in the way the pool is managed to ensure compliance with GASB 79. We note that Federated is meeting with all clients (including Florida SBA staff), to go over GASB 79 changes in more detail to ensure a full understanding.

In the following section we show pertinent criteria and guidance from GASB 79 compared to the current language in the investment policy statement. Florida PRIME™ is compliant with almost all of the GASB guidance; however, we have a few recommendations for changes that should be made to the investment policy statement.

GASB Guidance	Relevant IPS Language	Compliant?	Commentary
Maximum maturity of a portfolio asset is 397 days	The remaining maturity of securities purchased by the Investment Manager shall not exceed 762 days for government floating rate notes/variable rate notes and will not exceed 397 days for all other securities.	Yes	GASB treats government floating rate/variable notes as having a maturity of 1 day
Maximum Weighted Average Life is 120 days and Maximum Weighted Average Maturity is 60 days	The Investment Manager will exercise reasonable care to maintain (i) a dollar weighted average maturity (“DWAM”) of 60 days or less; and (ii) a maximum weighted average life (WAL) within the range of 90-120 days	Yes	None
Daily liquid assets of at least 10% (plus foreseeable cash flows) and Weekly liquid assets of at least 30% (plus foreseeable cash flows)	The Investment Manager will exercise reasonable care to not acquire a security, other than (i) a Daily Liquid Asset, if immediately after the acquisition Florida PRIME would have invested less than 10% of its total assets in Daily Liquid Assets; (ii) a Weekly Liquid Asset, if immediately after the acquisition Florida PRIME would have invested less than 30% of its total assets in Weekly Liquid Assets.	Yes	Adding language regarding foreseeable cash flows to the IPS

Maximum illiquid assets is 5%	The Investment Manager will exercise reasonable care to not acquire securities that cannot be sold or disposed of in the ordinary course of business within seven days at approximately the value ascribed to them by Florida PRIME if, immediately after the acquisition, Florida PRIME would have invested more than 5% of its total assets in such securities.	Yes	GASB defines an illiquid investment as an investment that cannot be sold or disposed of in the ordinary course of operations at its amortized cost value within five business days. AHIC recommends changing the IPS to reflect five business days (as opposed to seven)
Diversification – 5% max per issuer and 10% max per guarantor	Exposure to any single non-governmental issuer will not exceed 5% and exposure to any single money market mutual fund will not exceed 10% of Florida PRIME assets.	Yes	None
Credit Quality – must be highest credit rating at purchase	<p>The Investment Manager will manage credit risk by purchasing only high quality securities. The Investment Manager will perform a credit analysis to develop a database of issuers and securities that meet the Investment Manager's standard for minimal credit risk. The Investment Manager monitors the credit risks of all Florida PRIME's portfolio securities on an ongoing basis.</p> <p>In buying and selling portfolio securities for Florida PRIME, the Investment Manager will comply with (i) the diversification, maturity and credit quality conditions imposed by Rule 2a-7 under the 1940 Act</p> <p>In the event that a security receives a credit rating downgrade and ceases to be in the highest rating category, or the Investment Manager determines that the security is no longer of comparable quality to the highest short-term rating category (in either case, a "Downgrade"), the Investment Manager will reassess whether the security continues to present minimal credit risk and will cause Florida PRIME to take any actions determined by the Investment Manager to be in the best interest of Florida PRIME</p>	Yes	GASB relies on SEC 2a-7 regarding various procedures in the event of a downgrade or default. The focus of GASB in this regard is that a process is documented and followed in the event of a security downgrade. AHIC believes current IPS language satisfies this requirement.
Use of repurchase agreements – counterpart and collateral must	Florida PRIME will enter into repurchase agreements only with banks and other recognized financial institutions, such as securities dealers, deemed creditworthy by the	Yes	None

meet credit quality tests	<p>Investment Manager.</p> <p>Each repurchase agreement counterparty must have an explicit issuer or counterparty credit rating in the highest short-term rating category from Standard & Poor's.</p>		
100% dollar denominated assets	<p>The Investment Manager will invest Florida PRIME's assets in short-term, high-quality fixed income securities.</p>	No	<p>In multiple instances within the IPS, dollar denominated securities are mentioned as allowable assets. AHIC recommends adding specific language related to this criteria to the IPS.</p>
Bank deposits – credit evaluation or rating required	<p>Bank instruments are unsecured interest bearing deposits with banks. Bank instruments include, but are not limited to, bank accounts, time deposits, certificates of deposit and banker's acceptances.</p> <p>Florida PRIME will not invest in instruments of domestic and foreign banks and savings and loans unless they have capital, surplus, and undivided profits of over \$100,000,000 or if the principal amount of the instrument is insured by the Bank Insurance Fund or the Savings Association Insurance Fund which are administered by the Federal Deposit Insurance Corporation.</p>	No	<p>While the current IPS does include language related to the evaluation of bank deposits, AHIC recommends adding specific language related to this criteria to the IPS.</p>
Monthly shadow pricing required	<p>When the deviation between the market value and amortized cost of Florida PRIME exceeds 0.25%, according to pricing information provided by the Custodian, the Investment Manager will establish a formal action plan. The Investment Oversight Group will review the formal action plan and prepare a recommendation for the Executive Director's consideration.</p> <p>When the deviation between the market value and amortized cost of Florida PRIME exceeds 0.50%, according to pricing information provided by the Custodian, the Executive Director will promptly consider what action, if any, will be initiated. Where the Executive Director believes the extent of any deviation from Florida PRIME's amortized cost price per share may result in material dilution or other unfair results to investors or existing shareholders, he will cause Florida PRIME to take such action as he deems appropriate to eliminate or reduce to the extent</p>	Yes	<p>A primary concern stated with SEC Rule 2a-7 and GASB 79 is that a process is documented and followed in the event of deviation between market value and amortized cost. AHIC believes current IPS language satisfies this requirement.</p>

	reasonably practicable such dilution or unfair results.		
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Investment Policy Review

Included in the annual best practices review is a periodic assessment 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 Florida PRIME™ IPS was last formally approved by the SBA Trustees in June of 2015. AHIC last reviewed the IPS then as well. At that time, AHIC believed it prudent to wait to make modifications to the IPS until GASB issued its final Statement (GASB 79). Our rationale was that by potentially enacting changes to Florida PRIME™’s IPS it could result in unnecessary disruptions to the management, reporting and overview of the portfolio (pending final opinion from GASB).

Here we summarize the recommended changes to the IPS resulting from AHIC’s annual review.

GASB Guidance	Relevant IPS Language	Commentary
Notice of the issuance of GASB 79	In December 2015, GASB issued Statement 79, which de-links the accounting treatment of external investment pools from Rule 2a-7, and establishes criteria for the use of amortized cost to value portfolio assets of an external pool. GASB 79 also made clear that rounding unit value up or down to the nearest penny to maintain a stable NAV of \$1.00 per share for issuances and redemptions of units is an operational decision for an external investment pool, rather than accounting matter. GASB 79 also specifies, however, that seeking to maintain a stable price of \$1.00 per share is one of the criteria that an external investment pool must meet as a condition to valuing all portfolio assets at amortized cost for financial reporting purposes.	There are multiple minor changes to the IPS as a result of the issuance of GASB 79; these instances typically note that Florida PRIME will operate in a manner consistent with GASB 79 instead of Rule 2a-7
100% U.S. dollar-denominated assets	. All Florida PRIME™ assets (100 percent) will be U.S. dollar-denominated.	A clarifying statement, not previously found in the IPS
Nationally Recognized Statistical Ratings Organizations (NRSRO) criteria	In order to meet the investment grade ratings criteria of Standard & Poor’s for a pool, the remaining maturity of securities purchased by the Investment Manager shall not exceed 762 days for government floating rate notes/variable rate notes and will not exceed 397 days for all other securities; provided, however, that if not required by the ratings criteria of the applicable NRSRO that is providing an investment grade rating to the pool and to the extent consistent with the portfolio criteria of GASB 79, longer term floating rate/variable rate notes that are U.S. government securities may be owned by Florida PRIME.	Clarifying statement

Retain liquidity to meet reasonably foreseeable redemptions	Florida PRIME™ shall seek to hold liquid assets sufficient to meet reasonably foreseeable redemptions, based upon knowledge of the expected cash needs of participants.	The key change is the addition of GASB 79 guidance pertaining to “meeting reasonably foreseeable redemptions”
Commercial paper maturity	Commercial paper is an issuer’s obligation with a maturity of generally less than 270 days (and typically with a maturity of 30 days or less).	This revised statement softens the previous language regarding a strict nine month maturity limit
Bank instruments	Florida PRIME™ shall further limit its investments in bank instruments consistent with the requirements of GASB 79.	A new clarifying statement as a result of GASB 79
Definition of illiquid assets	The Investment Manager will exercise reasonable care to not acquire securities that cannot be sold or disposed of in the ordinary course of business within five business days at approximately the value ascribed to them by Florida PRIME if, immediately after the acquisition, Florida PRIME would have invested more than 5% of its total assets in such securities.	The pertinent change is that an illiquid asset is now defined as a security not able to be sold within five business days (previously it was seven days)
Repurchase agreements	The securities that are subject to the repurchase transactions are limited to securities in which Florida PRIME™ would be permitted to invest, except that such securities may have a maturity longer than would otherwise be permitted for Florida PRIME to own.	Clarifying statement

Under separate attachment is a red-line version of the IPS and all recommended language changes.

Peer Review

We compare the structure and practices of Florida PRIME™ to peer pools serving the short-term investment needs of state and local agencies and other public entities in the United States. We make the following broad observations about the characteristics of Florida PRIME™. In general, we find that Florida PRIME™ is comparable or compares favorably to peers in nearly all areas.

- *Participant Base:* Whereas peer pools may be tailored to a specific participant base, Florida PRIME™ partners with a diversified group of Florida public entities, including, but not limited to, colleges and universities, constitutional officers, counties, municipalities, school boards, and school districts.
- *Common Structure:* Florida PRIME™ is structured as a money market fund with a \$NAV, among the most commonly offered structures offered by local government investment pools. Pools managing assets on a total return basis will inherently exhibit different profiles and attract investors with different risk and return objectives.
- *Risk-Controlled Investment Objective:* Florida PRIME™ operates as a “2a-7-like” fund, being managed in a manner consistent with the diversification, credit quality and maturity conditions of SEC Rule 2a-7. AHIC believes the inclusion of this language in the Florida PRIME™ Investment Policy Statement provides investors with added comfort that the pool will be managed at least in line with industry standards.
- *Use of a Common External Adviser:* The vast majority of pools surveyed utilize external advisers to handle investment decisions. Florida PRIME employs Federated Investment Management’s services. Federated is experienced in the local government investment pool (LGIP) business and advises other similar large pools.
- *Highest Credit Rating:* Florida PRIME™ holds the highest money market fund rating from S&P, an AAAM principal stability fund rating, which is consistent with a large majority of peers. A very small minority of pools are rated by more than one agency.
- *Easily Accessible Information:* Florida PRIME™ has put a significant amount of effort into ensuring the Florida PRIME™ website is meeting and exceeding the needs of its participants. The large majority of respondents to the Florida PRIME™ Annual Participant surveys indicate that they access the website at least monthly and that they find it very easy to use.
- *Investment Return:* Florida PRIME™’s 12-month total return falls at the lower end of the range of returns when compared across a wide range of local government investment pools, which can be expected given the pool’s conservative positioning illustrated by its extremely low weighted average maturity. However, when compared to those that have similar guidelines related to the weighted average maturity (60 days), Florida PRIME™’s 12-month total return is comparable or higher.

- *Reasonable Benchmark:* While there is no universally accepted practice for benchmarking, the S&P Rated GIP All/30-Day Net of Fees Index that Florida PRIME utilizes is a commonly used benchmark.
- *Commonly-Used Custodian:* BNY Mellon, a commonly used custodian among peer funds, acts as Florida PRIME's custodian.
- *Fees:* Over the last five years, the Florida PRIME™ fee has averaged less than 2.0 basis points. Since January 2016, participants have received the benefit of having all pool expenses offset (i.e., fee holiday) and this offset is expected to continue through early 2017. Monthly pool expenses are currently being paid with monies originally accumulated in 2008 stemming from liquidity fees paid by participants.

In the table below, we show the top 25 largest local government investment pools in the country by assets under management. As of December 2014, Florida PRIME™ was the 8th largest pool. The Fund's total effective fee of 3.0 basis points (bps) is among the lowest of the group, which ranges from 0.3–24.0 bps. Florida PRIME™'s 0.16% 12-month total return is below median among this group, and can be attributed to the pool's absolute and relatively low weighted average maturity.

Rank	Name of Pool ¹	State	Assets (\$ mm)	12 Mo. TR (%)	Total Fee (bps)	Max WAM (days)	Pool Category ²
1	Local Agency Investment Fund	CA	19,493	0.25	--	120-540	Ultrashort
2	TexPool	TX	13,847	0.03	4.2	60	MMF
3	State of New Jersey Cash Management Fund	NJ	11,362	0.06	--	365	MMF Plus
4	Utah Public Treasurers Investment Fund	UT	11,324	0.49	--	90	MMF Plus
5	Georgia Fund 1	GA	10,733	0.17	3.3	60	MMF
6	(Washington State) Local Government Investment Pool	WA	8,956	0.10	3.5	60	MMF
7	San Diego County Treasurer's Pooled Money Fund	CA	7,922	0.45	13.0	1.5 Years	Ultrashort
8	Florida PRIME™	FL	7,881	0.16	3.0	60	MMF

¹Data provided by iMoneyNet Special Report: Government Investment Pools: Investment Strategies, Facts, Figures, and Trends; December 2015

²iMoney defines as follows: MMFs - stable \$1 NAV with max WAM of 60 days; MMF Plus - stable \$1 NAV with WAM of 61 days – 1 year; Ultrashort - variable NAV with investment horizon from 1-3 years; Enhanced Cash pool - variable NAV with duration of one year or shorter.

9	(Tenn.) Local Government Investment Pool	TN	7,611	0.08	5.0	120	MMF Plus
10	LGIP/Oregon Short-Term Fund	OR	7,326	0.50	0.3	--	Ultrashort
11	Mass Municipal Depository Trust-Cash Portfolio	MA	7,038	0.18	5.0	60	MMF
12	(Riverside) Treasurer's Pooled Investment Fund	CA	5,896	--	--	541	Ultrashort
13	The Illinois Funds – Money Market Fund	IL	5,371	0.01	--	60	MMF
14	King County Investment Pool	WA	5,241	0.69	--	541	Ultrashort
15	TexSTAR Cash Reserve Fund	TX	5,158	0.04	--	60	MMF
16	Orange County Extended Fund	CA	4,997	0.50	7.6	549	Ultrashort
17	San Bernardino Investment Pool	CA	4,907	--	5.0	541	Ultrashort
18	Maryland Local Government Investment Pool	MD	4,713	0.05	2.5	60	MMF
19	(Conn.) State Treasurer's Short-Term Investment Fund	CT	4,177	0.15	2.0-3.0	60	MMF
20	San Mateo County Investment Pool	CA	4,115	0.90	11.5	3 Years	Intermed. Bond
21	LOGIC I-Class A	TX	3,940	0.09	--	60	MMF
22	PFM Funds: Prime Series/SNAP Fund Class	VA	3,773	0.13	8.0	60	MMF
23	North Carolina Capital Management Trust: Cash Portfolio	NC	3,743	0.01	24.0	60	MMF
24	Sacramento County Pooled Investment Fund	CA	2,915	--	--	3 Years	Ultrashort
25	TEXAS CLASS (TEXAS COOPERATIVE LIQUID ASSETS SECURITIES SYSTEM)	TX	2,881	0.10	8.9	60	MMF

While it is important and informational to compare Florida PRIME™ to other local government investment pools nationwide, it is also prudent to review the short-term investment solutions that serve as direct alternatives for Florida PRIME™'s current and potential participants. These alternative options include other short-term funds within the state of Florida and registered institutional money market funds.

As shown in the table below, relative to the five alternative products offered in Florida, Florida PRIME™ is the largest fund according to assets and number of investors, and is offered at the lowest total fee. Similarly, Florida PRIME™ compares favorably to a universe of money market funds provided by Morningstar. The Morningstar universe is comprised of 140 money market funds with an average 12 month total return of 0.03% and a median annual fee of 33 basis points.

Florida Peer Funds (Data as of 12/31/2014)	Assets (\$ b)	# of Investors	Total Fee (bps)	Pool Category	Rated	12 Mo. TR (%)	Max WAM (days)	Investment Manager	Benchmark
Florida PRIME™	7.9	803	3.0	2a-7 Like	AAAm	0.16	60	Federated Investors	S&P Rated GIP All/30-Day Net of Fees Index
Florida Trust (Day to Day Fund)	0.5	--	13.6	Non-2a-7	AAAm	0.08	60	Payden & Rygel	3-Month Treasury Bill
Florida Trust (Short Term Bond Fund)	1.0	--	25	Non-2a-7	AAAf/S 1	0.57	1-5 Years	Payden & Rygel	BofA ML 1-3Yr U.S. Treasury Index
Florida Education Investment Fund (FEITF)	0.3	--	14	2a-7 Like	AAAm	0.10	60	PFM Asset Management LLC	--
Florida Surplus Asset Fund Trust (FLSAFE)	0.1	--	--	Non-2a-7	AAAm	--	60	Prudent Man Advisors, Inc.	--
FL Municipal Investment Trust HQ Bond Fund	0.2	--	23	Non-2a-7	AAA/V1	0.12	6mo-1.25 Years	Eaton Vance	BofA ML 1-Year Treasury Note

It is also worth noting that Florida PRIME™ maintains a yield advantage (Federated estimates this to be 3-8 basis points) relative to registered money market funds, another source of comparison for the pool. The reasoning behind this is that registered prime institutional portfolios generally maintain shorter weighted average maturities (i.e., greater liquidity) relative to Florida PRIME™, in anticipation of SEC reforms coming in October 2016. These reforms, specifically the adoption of fluctuating net asset values for registered funds, and the corresponding apprehension within the investment management industry

that investors will exit these funds is the primary reason for shorter weighted average maturities (relative to Florida PRIME™). The longer maturity profile of Florida PRIME™ (35-40 days versus 30-35 days on average for registered prime funds) allows for this estimated 3-8 basis point yield advantage.