

*Reply To: Tallahassee*

June 4, 2020

## LOCAL GOVERNMENT SURPLUS FUNDS TRUST FUND STATUTORY COMPLIANCE REVIEW

The Local Government Surplus Funds Trust Fund (Trust Fund or Fund) administered by the State Board of Administration (Board) was created in 1977, is governed by Part IV of Chapter 218, Florida Statutes, titled Investment of Local Government Surplus Funds, and is now known as Florida PRIME™.

### THE STATUTE

Pursuant to section 218.405(3), the trustees (meaning the trustees of the State Board of Administration, section 218.403(10), constituted per section 215.44(1)) must make a two part annual certification:

**The trustees shall annually certify to the Joint Legislative Auditing Committee that the trust fund is in compliance with the requirements of this part and that the trustees have conducted a review of the trust fund and determined that the management of the trust fund is in accord with best investment practices.** (Emphasis added.)

This is the eleventh annual statutory review of the Fund under section 218.405(3). There were no substantive amendments to Part IV, Chapter 218, Florida Statutes, during the 2020 Legislative session.

### SCOPE OF REVIEW

This review addresses the first part of the annual certification and examines whether the Trust Fund, defined at section 218.403(9) as “the pooled investment fund created by Section 218.405 and known as the Local Government Surplus Funds Trust Fund,” is “in compliance with the requirements of this part.” “This part” refers to Part IV of Chapter 218, Florida Statutes, which includes sections 218.40 – 218.415, Florida Statutes.

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The scope of this review is compliance with sections 218.40 – 218.412, Florida Statutes during the time period May 16, 2019 through May 15, 2020. The remainder of Part IV, Chapter 218 covers local government investment policies, which are not within the scope of this review.

The second part of the certification required by section 218.405(3), the determination that the Fund is in accord with best investment practices, is being performed separately by Aon Hewitt Investment Consulting, Inc.

## **PURPOSE**

As set out at section 218.401, Florida Statutes, the intent of Part IV of Chapter 218 is:

**[T]o promote, through state assistance, the maximization of net interest earnings on invested surplus funds of local units of government, based on the principles of investor protection, mandated transparency, and proper governance, with the goal of reducing the need for imposing additional taxes.**

The definition of surplus funds, found at section 218.403(8), includes:

**[A]ny funds in any general or special account or fund of a unit of local government, or funds held by an independent trustee on behalf of a unit of local government, which in reasonable contemplation will not be immediately needed for the purposes intended.**

By its terms, the Fund is limited to units of local government, defined at section 218.403(11) as:

**... any governmental entity within the state not part of state government and shall include, but not be limited to, the following and the officers thereof: any county, municipality, school district, special district, clerk of the circuit court, sheriff, property appraiser, tax collector, supervisor of elections, authority, board, public corporations, or any other political subdivision of the state.**

This broad definition covers not just “any governmental entity...not a part of state government,” but includes also authorities, boards and public corporations, and is specifically not limited to the enumerated bodies.

Fund participants are charged by statute with determining whether it is in their interest to participate in the Fund. §218.407(2). The enrollment materials require the participant to certify that it has determined it is authorized to invest in the Fund. They also state that the SBA is not responsible for independently verifying that the participant is so authorized.

## **CREATION, OBJECTIVES**

The Trust Fund is created at section 218.405, Florida Statutes,

**(1) There is hereby created a Local Government Surplus Funds Trust Fund to be administered by the board and to be composed of local government surplus funds deposited therein by units of local government under the procedures established in this part. The board may contract with a professional money management firm to manage the trust fund.**

The Board has contracted with a professional money management firm, Federated Investment Counseling, Inc. (Federated), to manage the Trust Fund.

- (2) The primary objectives, in priority order, of investment activities shall be safety, liquidity, and competitive returns with minimization of risks.**
- (3) (Certification requirement, cited above)**
- (4) The board may adopt rules to administer the provisions of this section.**

## **RULES**

Both sections 218.405(4) and 218.412 make rulemaking to administer the Trust Fund permissive rather than mandatory. The Board has adopted rules for the Fund at Chapter 19-7, Florida Administrative Code. The majority of these rules were enacted in 1982, with substantial revisions in 2002 and 2010. Rule 19-7.002 was amended to adopt the current Investment Policy Statement for the Fund on April 8, 2020 as approved by the Trustees effective July 25, 2019.

## **INTERACTION WITH LOCAL GOVERNMENT AUTHORITIES**

Section 218.407 sets out the requirements that must be met before a unit of local government may deposit surplus funds in the Trust Fund:

- (1) Prior to any determination by the governing body that it is in the interest of the unit of local government to deposit surplus funds in the trust fund, the board or a professional money management firm must provide to the governing body enrollment materials, including a trust fund profile containing impartial educational information describing the administration and investment policy of the trust fund, including, but not limited to:**
- (a) All rights and conditions of participation, including potential restrictions on withdrawals.**

- (b) The historical performance, investment holdings, credit quality, and average maturity of the trust fund investments.**
- (c) The applicable administrative rules.**
- (d) The rate determination processes for any deposit or withdrawal.**
- (e) Any fees, charges, penalties, and deductions that apply to the account.**
- (f) The most recently published financial statements or independent audits, if available, prepared under generally accepted accounting principles.**
- (g) A disclosure statement for signature by the appropriate local government official.**

The Board, with Federated, has created enrollment materials which include a Trust Fund profile and education information which appear to be impartial and to accurately describe the administration and investment policies of the Trust Fund and which meet the specific requirements of the above section.

All materials are provided to participants and potential participants at the Board's web site: [www.sbafla.com](http://www.sbafla.com) at the Florida PRIME link, or directly at [www.sbafla.com/prime](http://www.sbafla.com/prime). The New Participant Enrollment Guide, the current Investment Policy Statement, the Earnings Allocation description and the applicable rules are included under the "Enrollment Materials" tab, as are two form documents that must be executed by a new participant: the Disclosure Statement and the Authorizing Resolution. These materials track the statutory information required by section 218.407(1) cited above, and were last updated on April 7, 2018 to reflect the most recent statutory changes.

**(2) Upon review of the enrollment materials and upon determination by the governing body that it is in the interest of the unit of local government to deposit surplus funds in the trust fund, a resolution by the governing body and the signed acceptance of the disclosure statement by the local government official, who may be the chief financial or administrative officer of the local government, shall be filed with the board and, if appropriate, a copy shall be provided to a professional money management firm authorizing investment of its surplus funds in the trust fund established by this part. The resolution shall name:**

- (a) The local government official, who may be the chief financial or administrative officer of the local government, or**
- (b) An independent trustee holding funds on behalf of the unit of local government, responsible for deposit and withdrawal of such funds.**

Section 218.407 was substantially amended in 2008 to include the safeguards set forth in paragraphs (1) and (2) above. Most of these requirements are intended to assure that the participant is fully informed about the nature, purpose, stability and processes of the Fund. Signed disclosure statements are on file for all participants in the Fund who have enrolled since the 2008 amendment; and all Fund participants have putative and actual knowledge of the information included in the disclosure statement, through the Monthly Summary Reports and materials posted to the website.

**(3) The board or a professional money management firm shall, upon the filing of the resolution, invest the moneys in the trust fund in the same manner and subject to the same restrictions as are set forth in s.215.47. All units of local government that qualify to be participants in the trust fund shall have surplus funds deposited into a pooled investment account**

Section 215.47, Florida Statutes details the types of investments permitted for all Board funds, including Florida PRIME. Pursuant to section 218.409(2)(a), the Fund also must be invested in accordance with the current written investment policy, which must be updated annually. Part two of the certification required by section 218.405(3), being conducted by Aon Hewitt Investment Consulting, Inc., determines whether the Fund's management is in accord with best investment practices and whether the specific holdings of the Fund are in accord with all statutory requirements including section 215.47 (cross-referenced in 218.405(3)) as implemented in the current PRIME Investment Policy Statement, adopted in rule 19-7.002.

#### **ADMINISTRATION OF THE TRUST FUND, ADVISORY COUNCIL**

**218.409 Administration of the trust fund; creation of advisory council.—**

**(1) Upon receipt of the items specified in s. [218.407](#) from the local governing body, the board or a professional money management firm shall accept all wire transfers of funds into the trust fund. The board or a professional money management firm shall also wire-transfer invested local government funds to the local government upon request of the local government official named in the resolution.**

A clearing account maintained by Bank of America, which is a qualified public depository, accepts money transmitted to the Board and transfers to BNY Mellon, as the custodian, as discussed further below.

**(2)(a) The trustees shall ensure that the board or a professional money management firm administers the trust fund on behalf of the participants. The board or a professional money management firm shall have the power to invest such funds in accordance with a written investment policy. The**

**investment policy shall be updated annually to conform to best investment practices. The standard of prudence to be used by investment officials shall be the fiduciary standards as set forth in s. 215.47(10), which shall be applied in the context of managing an overall portfolio. Portfolio managers acting in accordance with written procedures and an investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and the liquidity and the sale of securities are carried out in accordance with the terms of this part.**

The Board administers the Trust Fund on behalf of the participants and handles accounting, statements, monthly reporting and compiling and maintaining enrollment materials, and has contracted with professional money management firm Federated to act as the Investment Manager and to invest the Trust Fund funds in accordance with the Investment Policy Statement. Federated also interacts with participants to answer inquiries and facilitates Standard and Poor's ratings. BNY Mellon acts as custodian of all assets of the Fund, processes all trades made by Federated, and does valuation and pricing for the Fund. The Investment Policy Statement has been updated and approved by the Trustees effective July 25, 2019. It is posted at the Fund website tab "Risk Management and Oversight," and at the "Enrollment Materials" tab as a separate item and as part of the New Participant Enrollment Guide.

**(2)(b) Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program or that could impair their ability to make impartial decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business on behalf of the trust fund. They shall further disclose any personal financial or investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the board.**

All Board employees are required to complete training sessions to assure that Board officers and employees involved in the investment process are not engaged in personal business activity that could conflict with the Trust Fund program or impair their ability to make impartial decisions. The SBA Inspector General monitors completion of all mandatory policy courses and confirms that all courses required in the applicable fiscal year rotation have been completed.

A course cycle, which was updated in October 2018, sets out when the mandatory courses must be completed. For 2020, the following mandatory course cycle applies: Cybersecurity Awareness, Ethics, Harassment Prevention, Incident Management Framework, Insider Trading, and Personal Investment Activity are required every year; Public Records and Sunshine Law are required every two years; and Fiduciary Duties is required every four years. All training is done

on line and all new employees are required to take all 9 mandatory courses at the time they start working for the SBA. Human Relations notifies the Inspector General of any training non-compliance and he then follows up to assure that training is complete.

Employees and investment officials are required to disclose material interests in financial institutions with which they also conduct Trust Fund business, and any personal financial or investment positions that could be related to performance of the Trust Fund portfolio. Policy 10-041 on Personal Investment Activity, as updated February 26, 2020, guides the Board on these issues. The Inspector General assures that any trading or investment activity by individual employees is in compliance with applicable policies.

The Board has developed a process and document to be used by professional money manager Federated to certify that it is in compliance with statutory ethics requirements. Federated Vice President M. Cole Dolinger executed a certification of accredited investor/qualified purchaser status on April 21, 2020, and Federated Chief Compliance Officer, Stephen Van Meter executed an annual Compliance Certification for the period January 1, 2019 through December 31, 2019.

**(2)(c) The board or a professional money management firm and all employees have an affirmative duty to immediately disclose any material impact to the trust fund to the participants. To ensure such disclosure, a system of internal controls shall be established by the board, which shall be documented in writing as part of the investment policy. The controls shall be designed to prevent the loss of public funds arising from fraud, employee error, and misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by employees and officers of the board or a professional money management firm. The controls shall also include formal escalation reporting guidelines for all employees. The guidelines shall establish procedures to address material impacts on the trust fund that require reporting and action.**

Policy 10-040, Ethics, as revised February 26, 2020, sets out comprehensive ethical requirements for all employees of the SBA, including PRIME, which are more stringent than the statutory requirements under Chapter 112, Part III, Florida Statutes. SBA management and staff have an affirmative duty to immediately escalate and report directly to the Executive Director & CIO, the Inspector General, or the General Counsel any “employee or contractual party fraud or misconduct (whether actual or suspected), employee or contractual party material error that adversely affects SBA or client assets or interests, misrepresentation or omission of material information in internal and external reporting and client communications, and violations of laws, rules or SBA policies.” The Inspector General then is required to investigate.

The Board internet and intranet home pages include an employee toll-free fraud hotline number which allows all employees to anonymously report any concerns with regard to any aspect of Board functions, including the Trust Fund. This number also is provided in all contracts with

external service providers, in order to reach any potential problems in these relationships. The hotline is operated by an independent company and is available 24 hours a day, 7 days a week. The Inspector General receives any reports from the hotline and copies these to the Chief Risk and Compliance Officer. There were no fraud reports to the hotline number during the review period.

The Investment Policy Statement at Section IX, Controls and Escalation Procedures, imposes extensive reporting, monitoring and escalation requirements on the executive director, all employees, the Fund custodian, the Investment Manager, an independent investment consultant and any third party used to materially implement the Fund.

The IPS requires the Executive Director to develop policies and procedures to maintain an appropriate and effective risk management and compliance program, which identifies, evaluates and manages risks within business units and at the enterprise level. The Executive Director is required to appoint a Chief Risk and Compliance Officer, whose selection, compensation, and termination are to be affirmed by the Board. This position assists the Executive Director in fulfilling the Controls and Escalation Procedures, and has been staffed.

Also in accordance with the IPS, the executive director of the Board has organized an Investment Oversight Group (IOG) to regularly review and formally escalate exceptions or events that might have a material impact on the Trust Fund. The minutes of its meetings, with a list of participants, are posted to the Fund website. The IOG meets and reports monthly to the Executive Director.

As discussed below, the Auditor General conducts an annual financial audit of PRIME, and the IPS states that this audit “will include testing for compliance with this Policy,” (the IPS.)

The IPS also requires the Trustees to review and approve management summaries of material impacts on the Fund and any actions or escalations, along with any required actions thereon. The Monthly Summary Reports, which are provided on the website, constitute these management summaries. (See further discussion on the contents of this Report under section 218.409(6).) As reflected in the quarterly reports to the Joint Legislative Auditing Committee, the Trustees have reviewed and approved the monthly summary reports.

The above safeguards assure that the administration of the Trust Fund is in accordance with stringent standards of disclosure designed to prevent the loss of funds from fraud, error, misrepresentation, market changes or imprudent actions by the Board or a money manager, and in some aspects exceed what is required by statute.

**(2)(d) The investment policy shall be reviewed and approved annually by the trustees or when market changes dictate, and in each event the investment policy shall be reviewed by the Investment Advisory Council.**

As set out above, the Investment Policy Statement was readopted, endorsed by the Investment Advisory Council and approved by the Trustees on July 25, 2019.

**(3) The board or a professional money management firm may purchase such surety or other bonds as may be necessary for its officials in order to protect the trust fund. A reserve fund may be established to fulfill this purpose. However, any reserve must be a portion of the management fee and must be fully disclosed, including its purpose, in the enrollment materials at the time a unit of local government considers participation. Further, any change in the amount to be charged for a reserve must have a reasonable notice period to allow any participant to withdraw from the trust fund prior to the new reserve charge being imposed.**

No surety or other bonds have been purchased to protect the Trust Fund, and there is no reserve fund.

**(4) The board or a professional money management firm shall purchase investments for a pooled investment account in which all participants share pro rata in the capital gain, income, or losses, subject to any penalties for early withdrawal. Any provisions for penalties, including their purpose, must be disclosed in the enrollment materials. Any change in the amount to be charged for a penalty must have a reasonable notice period to allow any participant to withdraw from the trust fund prior to the new penalty charge being imposed. A system shall be developed by the board, and disclosed in the enrollment materials, subject to annual approval by the trustees, to keep account balances current and to apportion pooled investment earnings to individual accounts.**

All participants in the Trust Fund share pro rata in all capital gains, income or losses, as set out in the Description of Investment Pool Earnings Allocation, posted to the website. This system is designed to keep account balances current and to apportion pooled investment earnings to individual accounts.

**(5) The board shall keep a separate account, designated by name and number of each participating local government. A maximum number of accounts allowed for each participant may be established by the board. Individual transactions and totals of all investments, or the share belonging to each participant, shall be recorded in the accounts.**

Separate accounts are kept for each participant. The Board has not established a limit on the number of accounts a participant may have

**(6)(a) The board or a professional money management firm shall provide a report, at a minimum monthly or upon the occurrence of a material event, to every participant having a beneficial interest in the trust fund, the board's executive director, the trustees, the Joint Legislative Auditing Committee, and the Investment Advisory Council. The report shall include:**

**1. Reports of any material impacts on the trust fund and any actions or escalations taken by staff to address such impacts. The trustees shall provide quarterly a report to the Joint Legislative Auditing Committee that the trustees have reviewed and approved the monthly reports and actions taken, if any, to address any impacts.**

**2. A management summary that provides an analysis of the status of the current investment portfolio and the individual transactions executed over the last month. This management summary shall be prepared in a manner that will allow anyone to ascertain whether investment activities during the reporting period have conformed to investment policies. Such reporting shall be in conformance with best market practices. The board or a professional money management firm shall furnish upon request the details of an investment transaction to any participant, the trustees, and the Investment Advisory Council.**

A document titled Monthly Summary Report is produced monthly to address the above requirements and made available at the Florida PRIME website. The most recent Monthly Summary Report was posted for April 30, 2020.

The quarterly reports of the Trustees to the Joint Legislative Auditing Committee showing that the Trustees have reviewed and approved the monthly reports and taken responsive action, per the above, are memorialized in the agendas of the meetings of the Trustees of the State Board of Administration, posted to the SBA website.

**(6)(b) The market value of the portfolio shall be calculated daily. Withdrawals from the trust fund shall be based on a process that is transparent to participants and will ensure that advantages or disadvantages do not occur to parties making deposits or withdrawals on any particular day. A statement of the market value and amortized cost of the portfolio shall be issued to participants in conjunction with any deposits or withdrawals. In addition, this information shall be reported monthly with the items in paragraph (a) to participants, the trustees, and the Investment Advisory Council...**

The market value of the Fund portfolio is calculated daily by BNY Mellon and posted on the website the next day. The Information Statement and Operating Procedures, posted to the

website as part of the New Participant Enrollment Guide, sets out the operating procedures for the Fund, including hours of operation, holidays and timing of transactions. These procedures are transparent and appear to ensure, to the extent possible, that disadvantages do not occur to parties making deposits or withdrawals on particular days, as each participant has equal access to the transaction system. A statement of the market value and amortized cost of the portfolio is available at all times to participants on the website, and participants receive monthly individual account statements.

**...The review of the investment portfolio, in terms of value and price volatility, shall be performed with practices consistent with the GFOA Recommended Practice on "Mark-to-Market Practices for State and Local Government Investment Portfolios and Investment Pools." In**

Compliance with the above part of section 218.409(6)(b) will be determined in part two of the annual certification, conducted by Aon Hewitt Investment Consulting, Inc.

**...Additional reporting may be made to pool participants through regular and frequent ongoing multimedia educational materials and communications, including, but not limited to, historical performance, investment holdings, amortized cost and market value of the trust fund, credit quality, and average maturity of the trust fund investment**

Additional materials are available on the Trust Fund website and are provided through the monthly reports. Board staff are available for direct communication with participants for any questions regarding their accounts.

**(7) Costs incurred in carrying out the provisions of this part shall be deducted from the interest earnings accruing to the trust fund. Such deductions shall be prorated among the participant local governments in the percentage that each participant's deposits bear to the total trust fund. The remaining interest earned shall be distributed monthly to participants according to the amount invested. Except for costs, the board or a professional money management firm may not transfer the interest or use the interest for any other purpose, including, but not limited to, making up investment losses.**

The above statutory requirement was present in the law before the 2008 revisions and has been discussed in previous reviews because it is theoretically problematic: If fund investment values were to decline sufficiently in a given month, there would be no interest from which to pay costs, and the literal requirements of this provision could not be met within a given month. Staff have reviewed this issue and updated last year's analysis in the following statement:

The Florida PRIME total expense ratio is approximately 3.23 basis points (or 0.0323%), with the SBA's portion of the total fees equal to 1.0 basis point (or 0.01%). Historical asset levels with an average annual balance of \$8.9 billion over the last 5 years have been more than sufficient to generate adequate fees to cover all administrative, operational, compliance and investment management charges. All pool charges have continued to be reported within the Monthly Summary Report, including the actual monthly line-item fees.

**(8)(a) The principal, and any part thereof, of each and every account constituting the trust fund shall be subject to payment at any time from the moneys in the trust fund. However, the executive director may, in good faith, on the occurrence of an event that has a material impact on liquidity or operations of the trust fund, for 48 hours limit contributions to or withdrawals from the trust fund to ensure that the board can invest moneys entrusted to it in exercising its fiduciary responsibility. Such action shall be immediately disclosed to all participants, the trustees, the Joint Legislative Auditing Committee, and the Investment Advisory Council. The trustees shall convene an emergency meeting as soon as practicable from the time the executive director has instituted such measures and review the necessity of those measures. If the trustees agree with such measures, the trustees shall vote to continue the measures for up to an additional 15 days. The trustees must convene and vote to continue any such measures prior to the expiration of the time limit set, but in no case may the time limit set by the trustees exceed 15 days.**

In the time period covered by this review, the principal of all accounts in the Trust Fund has been paid at any time requested by a participant and there have been no events causing the Executive Director to limit contributions or withdrawals.

**(8)(b) An order to withdraw funds may not be issued upon any account for a larger amount than the share of the particular account to which it applies; and if such order is issued, the responsible official shall be personally liable under his or her bond for the entire overdraft resulting from the payment if made.**

In the time period covered by this review, there have been no orders to withdraw funds for a larger amount than the share of a particular account.

**(9) The Auditor General shall conduct an annual financial audit of the trust fund, which shall include testing for compliance with the investment policy. The completed audit shall be provided to the participants, the board, the trustees, the Investment Advisory Council, and the Joint Legislative Auditing Committee. As soon as practicable, but no later than 30 days after**

**completion of the audit, the trustees shall report to the Joint Legislative Auditing Committee that the trustees have reviewed the audit of the trust fund and shall certify that any necessary items are being addressed by a corrective action plan that includes target completion dates.**

The Auditor General annual financial audit of the Trust Fund, Report No. 2020-064, for the fiscal years ended June 30, 2019 and June 30, 2018, was completed in November 2019. The audit did not disclose any deficiencies in internal control over Florida PRIME's financial reporting that were considered to be material weaknesses. The report noted no instances of noncompliance or other matters required to be reported under Government Auditing Standards, and included as audit objectives determining if the SBA had complied with various provisions of laws, rules, contracts, the IPS, and other guidelines that are material to the financial statements.

#### **AUTHORIZATION TO PROVIDE ASSISTANCE**

**218.411 Authorization for state technical and advisory assistance.**

**(1) The board is authorized, upon request, to assist local governments in investing funds that are temporarily in excess of operating needs by:**

**(a) Explaining investment opportunities to such local governments through publication and other appropriate means.**

**(b) Acquainting such local governments with the state's practice and experience in investing short-term funds.**

**(c) Providing, in cooperation with the Department of Economic Opportunity, technical assistance to local governments in investment of surplus funds.**

**(2) The board may establish fees to cover the cost of such services, which shall be paid by the unit of local government requesting such service. Such fees shall be deposited to the credit of the appropriation or appropriations from which the costs of providing the services have been paid or are to be charged.**

The education offerings of the Fund have been discontinued, and there have been no instances of the SBA providing technical assistance to a fund participant in this review period.

**218.412 Rulemaking authority.—**

**The board may adopt rules as it deems necessary to carry out the provisions of this part for the administration of the trust fund.**

As noted above, the Board has adopted rules for the administration of the Fund at Chapter 19-7, Florida Administrative Code, which are up to date.

#### **OTHER SECTIONS OF PART IV, CHAPTER 218**

Part IV of Chapter 218, Florida Statutes covers other facets of investment of local government funds, such as local government investment policies (Section 218.415.) Because this review, as mandated by Section 218.405, is of the pooled investment fund created by 218.405 only, these sections are not a part of this review.