



# ***Florida PRIME™ Best Practices Review***

Florida State Board of Administration (SBA)

*June 2021*

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## Executive Summary

Aon Investments (Aon) conducts a Best Practices Review of Florida PRIME on an annual basis. In this report, we review the 2021 Participant Survey responses, provide a data security update, discuss environmental, social and governance investment integration, provide an update on the Business Case Review and recap the annual Investment Policy Statement Review.

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.

## 2021 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 2021 survey attracted 70 respondents which is in line with the previous rate of response.

A diversified group of governmental units responded to the survey, primarily representing counties, special districts, municipalities, and school boards, with respondents roughly evenly split between investment decision-makers and personnel in account operations. Of the respondents, 56% have one account with Florida PRIME and 19% have 2 accounts. The survey indicated that approximately 50% of respondents indicated having a balance of over \$10 million with Florida PRIME, and another 31% indicated having between \$1 million and \$10 million with the pool. The survey revealed that 17% of respondents maintained greater than 75% of their cash surplus in Florida PRIME over the past year and 22% maintained between 50% and 75% in FL PRIME. On the other end of the spectrum, 32% indicated they have maintained less than 25% with Florida PRIME. These numbers are generally in line with previous surveys.

The survey includes questions that relate to how and why participants utilize other competing and complementary liquidity vehicles. Of the respondents, over half (55%) indicated that their organization has a policy that dictates a maximum allowable allocation to a single investment pool or money market fund. Of those with a policy limit, 64% 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, 34% indicated that investment policy restrictions are a major reason and another 14% indicated it is a moderate reason. The next greatest response was 47% of respondents indicating that diversification needs of the cash portfolio was a major or moderate reason. We did see a modest uptick in respondents indicating that an unattractive yield as a major reason (20%) and a minor reason (22%) for preventing use of FL PRIME as the primary source for cash management services. Inadequate participant disclosures, costs, functionality/operational features and lack of additional investment product offerings were all highly selected as not reasons at all for not using Florida PRIME as a primary source of cash management.

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 SEC registered money market funds at 40%. This number has increased over the past few years and reverted back to previous levels, we suspect from the growing familiarity and comfort with the reforms that went into effect. The next most common vehicles were peer funds, and specifically the Florida Education Investment Trust Fund at 26%, followed by Bank Certificates of Deposits at 21% of respondents. 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. Consistent with last year, 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, 76% 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 of participants continue to utilize the website primarily to access account balances and statements, and approximately 74% and 31% 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 respondents rated the following communications as very useful: monthly account statements (93%), e-mail notifications of withdrawals (91%) and changes to bank instructions (83%). Further, respondents found the following to be at least somewhat useful: Periodic eNotices (94%), Monthly Summary Reports (88%), and Weekly Market Commentary (80%). Lastly, respondents indicated great satisfaction with the Florida PRIME representatives, with over 96% 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. The large majority (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.

## Data Security Enhancements

The growth in frequency, cost and consequences of data breaches or cybersecurity incidents is undeniable over the past several years. The indiscernible reach of cyber threats has caused institutions across functions and sectors around the globe to prioritize cyber security. While not directly applicable to FL PRIME, it is worth noting that the U.S. Government Accountability Office (GAO) recently issued a report regarding the fiduciary issues involving cybersecurity and defined contribution plans (GAO Report). Additionally, the Department of Labor (DOL) followed with guidance relating to how plan sponsors (of private plans) should address their risks relating to cyber security threats, noting that responsible plan fiduciaries have an obligation to ensure proper mitigation of cybersecurity threats. Again, while the GAO Report and DOL guidance is not directly applicable to FL PRIME, they do reinforce the growing responsibility and focus on ensuring proper data security.

### *Florida PRIME Data Security Enhancement*

The SBA has been proactive in furthering the data security of FL PRIME participants by implementing additional authentication requirements when accessing FL PRIME information online.

Effective May 5, 2021, the SBA requires all Florida PRIME account users to use the DUO multi-factor authentication (MFA) for online access. This process creates a multi-layered approach by requiring two forms of verification when logging into the FL PRIME website, making it more difficult for unauthorized persons to gain access to the FL PRIME system. The DUO MFA application is being provided at no cost to FL PRIME participants and communication was sent to participants well-ahead of the effective date, providing instructions for participants to set up the DUO MFA. Thus far, the set up and MFA login process for account users has gone smoothly and without incident.



## Environmental, Social, and Governance (ESG) Integration

Accelerating environmental, social, and governance (ESG) trends, such as climate change, transforming technology and changing socio-demographics, have institutional asset allocators, investment managers, corporate boards and executives, and investors all increasingly aware of ESG issues. As the global economy and society transform, these trends will pose increasing challenges and opportunities for investors over coming decades.

ESG risks are commonly defined to include those related to climate change, environmental management practices and duty of care, working and safety conditions, respect for human rights, anti-bribery and corruption practices, and compliance with relevant laws and regulations. Also important, we believe, are the impacts from these ESG trends, emerging regulations and guidelines, and the disclosure and transparency requirements placed on wider stakeholders. This is leading to growing pressures on investors and companies to consider ESG issues in their decision-making, to safeguard long-term investment objectives and the long-term value of portfolios and companies.

ESG Integration within investing, formally defined as “the explicit and systematic inclusion of Environmental, Social and Governance (ESG) issues in investment analysis and investment decisions<sup>1</sup>,” is becoming increasingly important, and if implemented appropriately, may ultimately benefit investors and companies. Given the importance of these topics, Aon and SBA Staff met with Federated to understand their views and processes for incorporating ESG factors into their investment management practices and we highlight them below.

### **Federated and ESG Integration<sup>2</sup>**

Federated has long incorporated ESG factors into their liquidity investment process when determining internal credit ratings. They believe that relevant and material environmental, social and governance (ESG) factors can help identify business opportunities and operational risks and add a contextual dimension to the overall evaluation of a security. Additionally, Federated acquired a majority interest in Hermes Investment Management in 2018. Hermes is a London-based asset manager that is considered a pioneer in the ESG and Responsible Investment space. This acquisition provided Federated with additional resources to bolster its ESG integration efforts.

#### *Federated Internal Credit Rating Factors*

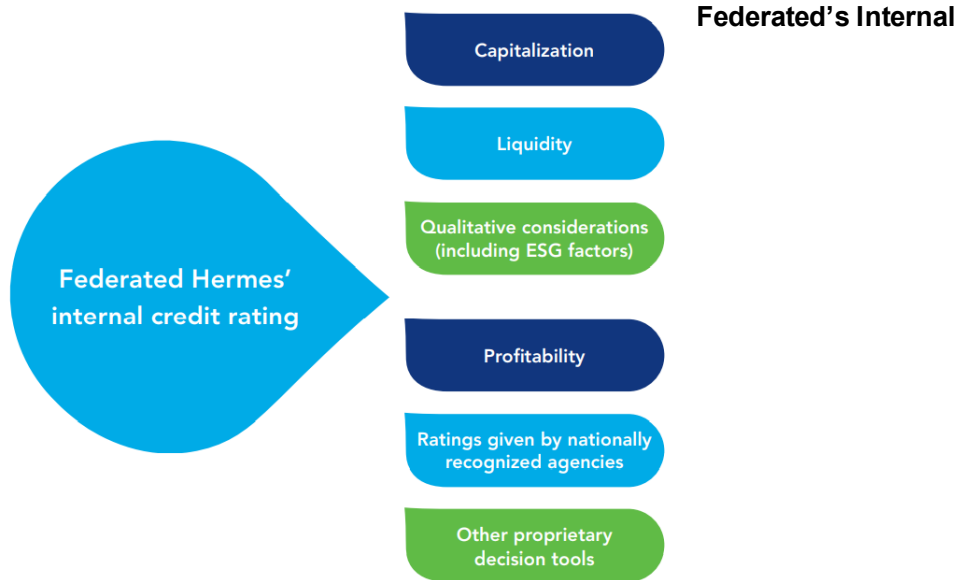
Every issuer considered for Federated’s approved list is assigned an internal credit rating that is determined by a collection of various factors. Inclusion of ESG factors, among all qualitative considerations, may affect Federated’s internal credit rating positively, negatively, or not at all, and does not automatically result in excluding or screening out sectors or specific issuers.

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<sup>1</sup> Principles for Responsible Investment (PRI)

<sup>2</sup> Information provided by Federated

## Summary of Credit Factors<sup>3</sup>



The acquisition of Hermes offered additional resources to Federated to incorporate into their credit analysis, particularly as it relates to ESG factors. This acquisition also initiated a cross check of Federated's ESG rankings with Hermes' ESG rankings across Federated's approved security list. The results of this exercise confirmed Federated's existing ESG rankings, offering additional validation to Federated's existing ESG evaluation and integration into its investment process.

We note that given the nature of the FL PRIME portfolio, being of the highest quality and very short-term in nature, the commonly discussed ESG factors may be less impactful to the evaluation of securities held in the FL PRIME portfolio compared to other fixed income and equity securities that are held for longer time horizons with varying investment objectives. That said, these factors can have material and pecuniary impacts on investment performance and therefore it is prudent for ESG integration to be part of any investment strategy.

We believe the incorporation of ESG factors into Federated's credit analysis to be prudent and believe the acquisition of Hermes and the resources they bring to be additive to this initiative. Importantly, Federated is dedicated to incorporating ESG with the objective of improving portfolio risk/reward characteristics and the sole prospects for long-term out-performance.

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<sup>3</sup> Provided by Federated

# Florida PRIME Business Case Review Update

The SBA initiated a business case review of FL PRIME as described in the Florida PRIME Strategic Plan. The business case review is intended to evaluate the case for insourcing and/or outsourcing all or a portion of the pool's administration, management and investment services. The ultimate goal of the Business Case Review is to ensure that the FL PRIME program is being administered in the most efficient way possible while providing the greatest security and value to current and potential participants.

## Status Update

The 2020 update on the Business Case Review was provided last year at the start of the pandemic. At that time, the SBA was meeting monthly to evaluate the merits for outsourcing different functions of FL PRIME and was beginning to draft an RFI. Given that the next several quarters were through the depths of the pandemic and there were other priorities the SBA Review Team was pulled towards, it was decided to put a pause on the FL PRIME Business Case Review during the first half of 2021. The intention is to pick this project back up in the Fall of 2021. In the meantime, FL PRIME continues to be managed seamlessly and aligned with best practices.

## Background

Florida PRIME currently outsources the investment management to Federated Investment Counseling ("Federated") to manage the pool's 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 handles all other services in house for administering the FL 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

## Business Case Review Progress

The SBA began the Business Case Review (the Review) in the fall of 2019. The initial work was largely an information gathering exercise. The SBA gained insight into full service outsourcing models, connecting with various providers to better understand the mechanics and the pros/cons of that path, as well as identify potential challenges and areas of concern for the SBA. The group also connected with peer local government investment pools to gain an understanding of what models have worked and what aspects have proven more challenging. This information allowed the SBA to identify areas that needed additional research and vetting.

The SBA also initiated an internal risk assessment with the objective of clearly understanding and defining the risks that the FL PRIME program presents to the SBA. The risk assessment evaluates the administration, client service and risk management functional areas on whether the risk of outsourcing is neutral, lower or higher than the current state.

Through the information gathering phase, the SBA identified some challenges that outsourcing certain functions could present. Therefore, the SBA is also investigating potential approaches to improve existing internal operations. The next phase of the business case review, should the SBA determine to outsource one or more functions, is drafting and sending either a Request for Information (RFI), an Invitation to Negotiate (ITN) or a similar competitive solicitation document. Given the desire to evaluate a full outsourcing model, as well as various hybrid models and potential enhancements to internal operations, the competitive solicitation document needs to be carefully drafted. The SBA Review Team had been meeting monthly as they sifted through the information and evaluated each functional area of FL PRIME management. The goal is to have a clear understanding of the best outsourcing options available to the SBA, potential internal improvements and draft a competitive solicitation document that allows for clear evaluation of the respondents.

## 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.

The SBA has been diligent with staying current with overall best practices in managing the Florida PRIME assets and has consistently ensured the IPS is up-to-date with the current regulatory, legal, and investment environments. Most recently, the FL PRIME IPS was reviewed and approved at the March 30, 2021 Investment Advisory Council meeting. The 2021 review identified a modest update to the definition of allowable fixed income securities. This edit was a result of regulatory changes by the Securities and Exchange Commission (SEC) to expand the definition of "accredited investor" in Rule 215 and Rule 501(a) as well as the definition of "qualified institutional buyer" (QIB) in Rule 144A.

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.

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.