



Florida PRIME™ Best Practices Review

Florida State Board of Administration (SBA)

June 2022

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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 2022 Participant Survey responses, provide an update on the Business Case Review, highlight proposed money market reforms 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. We do not have any recommendations at this time.

2022 Participant Survey Highlights

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.

During the release of the 2022 survey, the building the SBA resides in went through a server migration which disabled the automatic listserv that automatically sent reminder emails to participants to take the survey. As a result of the reminder emails not being sent, the 2022 survey received only 11 responses which is significantly lower than the typical response rate (for reference, 70 participants responded to the 2021 survey).

Aon reviewed the 11 responses from the 2022 survey and while they are generally in line with historical responses, we do not feel it is appropriate to summarize the responses from the low sample size as representative responses of the broader FL PRIME participant group. The SBA plans to re-launch the survey in the Fall of 2022 to seek a greater response rate.

The FL PRIME survey results have historically been positive from both operational and service-related perspectives. Generally, the past surveys have indicated a strong level of satisfaction with the management of the Florida PRIME portfolio with the majority of respondents over time having indicated that they are very 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. An update to the survey responses will be provided in the next annual review.

Florida PRIME Business Case Review Update

The SBA initiated a business case review of FL PRIME as described in the Florida PRIME Strategic Plan in 2019. 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.

Business Case Review Status Update

As a reminder, the pandemic that hit in 2020 put the FL PRIME Business Case Review on pause for a period of time as the SBA prioritized other critical functions and needs. The FL SBA re-engaged with the Review in the Fall of 2021. During the October 2021 meeting, it was identified that the commercial banking relationship that the SBA has with Bank of America, which provides banking and custody services for FL PRIME, among other asset pools, needed to be re-bid. Given that the banking relationship is central to the FL PRIME operations, it was determined that the intent to negotiate (ITN) for these services should be prioritized in fiscal year 2022, and before additional servicing reviews are evaluated. Following completion of the commercial banking selection, the SBA plans to re-visit potential outsourcing opportunities as part of the Business Case Review.

Intent to Negotiate (ITN) for Treasury/Banking Services and/or Custody/Safekeeping Update

The ITN was drafted and issued in mid-March 2022. The SBA's timeline indicated finalists would be selected before the end of April. At the time of this report, the SBA had plans to meet with respondents during the second week of June with plans for the Evaluation Team to announce their recommendation as a result of the ITN later in the week.

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. It was during these discussions that the SBA identified the need to re-bid the existing commercial banking relationship prior to drafting potential solicitation documents for additional outsourcing services.

Money Market Reforms

Background

As a result of the global financial crisis and the run on money market funds in 2008, there have since been two significant and much-debated reforms to the Securities and Exchange Commission's (SEC) Rule 2a-7, which is the principal rule covering registered U.S. money market funds. The two rounds of reforms were approved by the SEC in 2010 and 2014. The goal of the reforms was to provide additional protection and transparency to industry participants and ultimately avoid another 2008 event. In December 2021, the SEC announced a third round of proposed amendments to Rule 2a-7 in light of market events in March of 2020 due to the onset of the COVID-19 pandemic.

The SBA manages the Florida PRIME portfolio in accordance with guidelines set forth by the Governmental Accounting Standards Board (GASB), which is the source of generally accepted accounting principles used by state and local governments. The money market reforms are relevant to the Florida PRIME portfolio as the pool has historically been managed as a "2a-7 like" pool, defined by GASB as an external pool that satisfies the requirements of SEC Rule 2a-7, without actually being registered with the SEC. The most recent guidance from GASB was in December 2015, when it released guidance (GASB 79) for local government investment pools related to the 2014 reforms. Most notably the guidance removed the direct reference to "2a-7-like" pools in an effort to recognize differences between LGIPs and money market funds and the appropriateness of certain reforms on these investment pools.

2021-2022 Proposed Money Market Reforms¹

In December 2021, the SEC released additional 2a-7 proposed reforms with the goal of further improving the resilience and transparency of money market funds in light of market behavior following the events in March of 2020 due to the onset of the COVID-19 pandemic.

¹ [SEC.gov | SEC Proposes Amendments to Money Market Fund Rules](https://www.sec.gov/news/press/2021/20211201secprop2a7.htm)

The table below provides a high-level summary of the proposed reforms.

Summary of Proposed Reforms ²	Details
Increase Liquidity Requirements	<ul style="list-style-type: none"> • Increase daily liquid assets from 10% to 25% of total assets • Increase weekly liquid assets from 30% to 50% of total assets
Remove Liquidity Fee and Redemption Gate Provisions	<ul style="list-style-type: none"> • Proposed amendment would remove the fee and gate provisions from rule 2a-7 • Current rules allow MMFs to impose a liquidity fee of up to 2% or temporarily suspend redemptions (i.e., impose a “gate”), if the fund’s weekly liquid assets fall below 30% of its total assets and the board of directors determines it is in the fund’s best interests. • Current rule also includes a default liquidity fee if a non-government fund’s weekly liquid assets fall below 10%, unless the board determines that is not in the best interests of the fund
Adopt Swing Pricing Requirements	<ul style="list-style-type: none"> • Swing pricing would adjust a MMF’s current NAV such that the transaction price effectively passes on costs stemming from shareholder redemptions to redeeming shareholders. • Proposal would require institutional prime and institutional tax-exempt MMFs to adopt swing pricing policies and procedures to adjust a fund’s current NAV per share by a swing factor when the fund has net redemptions. • Currently, redemption and trading costs are borne by the remaining investors in the MMF
Other Proposals	<ul style="list-style-type: none"> • Stable NAV funds must convert to a floating share price if future market conditions result in negative fund yields • Require amendments to certain reporting requirements on Forms N-MFP, N-CR and Form N-1A to improve the availability of information about MMFs

The proposed rules were released on the SEC website in December 2021 and officially posted on the Federal Register in early February of 2022. Following publication by the Federal Register was a 60-day comment period that closed on April 11, 2022. Several industry participants have submitted comment letters, including Federated Hermes, the investment manager for the FL PRIME portfolio. We expect the

² [ic-34441-fact-sheet.pdf \(sec.gov\)](#)

SEC to take time to digest the market reactions before issuing further guidance or decisions. Further, we expect once the final rules are released that GASB will offer guidance on applicability to LGIPs. We also note that Fitch Ratings, one of the big three credit agencies in the U.S., issued an article indicating their opinion that LGIPs are unlikely to be impacted by these 2021-2022 proposed reforms³. The basis for their opinion centers on LGIP's having differing cash flow and liquidity characteristics than most prime institutional money market funds. Specifically, the article calls out that LGIPs generally have more stable cash flows and had adequate liquidity during the 2020 market turmoil, compared to some prime MMFs' which had notable outflows and liquidity concerns during this period.

Importantly, the SBA, Federated and Aon have monitored and updated Florida PRIME's investment policies and procedures to maintain compliance with the GASB guidance and best practices for external government investment pools over the course of the past 10+ years and through multiple periods of MMF reforms. Given the pool's practice of staying up to date with best practices, we are confident any additional reforms impacting the FL PRIME will be incorporated seamlessly. Aon, the SBA and Federated continue to stay apprised of the 2021-2022 proposed rules and will update the IAC and FL PRIME participants as needed.

³ [U.S. LGIPs Unlikely to be Affected by Money Market Fund Reform \(fitchratings.com\)](https://www.fitchratings.com/web-content/2021/09/21/US-LGIPs-Unlikely-to-be-Affected-by-Money-Market-Fund-Reform)

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. Modest changes have been made over time, the most notable ones being after money market reforms are passed and GASB has offered guidance for LGIPs. As noted in the previous section, Aon, the SBA and Federated continue to monitor the progress of the recently proposed 2a-7 rule reforms and will provide an update on any potential implications on the investment policy statement of the FL PRIME as necessary.

Following the 2022 review, 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.