

Institutional Investor

Ash Williams Works to Restore Broken Trust At Florida SBA

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Ash Williams left a New York hedge fund to return to the Florida State Board of Administration and set things right.

On a Friday in late November 2007, Patsy Heffner was shocked to discover that the \$123 million she had invested in a state-run money market fund had been frozen. With the year fast drawing to a close, Heffner, the Osceola County, Florida, tax collector, had less than a month to distribute cash to the cities, school boards, fire districts and community development districts that relied on it to pay salaries and cover operating expenses. “Are we going to lose everything in there?” she recalls thinking. On Sunday, growing more and more anxious about the funds under her care, the Kissimmee-based executive jumped into her Oldsmobile Aurora and drove the four hours to the Tallahassee state capitol. On Monday morning, Heffner was on the front steps of the capitol before the doors opened at 8:00 a.m. — she wanted answers.

Osceola County was just one of 1,000 local government agencies with a total of \$33 billion invested in the Local Government Investment Pool, the money market fund managed by Florida’s public investment agency, the State Board of Administration. Investors’ faith was shattered in November 2007 when they learned that the LGIP had lost billions in the wake of the SBA’s decision to purchase risky structured-investment vehicles loaded with illiquid prime and subprime mortgages in the summer of 2007 — much of it from the now-defunct Lehman Brothers Holdings — as triple-A-rated paper.

Indeed, panic was setting in for investors across the U.S. as the worst financial crisis since the 1930s gathered momentum. Florida’s state investment agency, which managed \$193.3 billion in public funds at the time, wasn’t the only one under siege by angry clients, but it was one of the early casualties. News that the LGIP was holding \$2.1 billion in illiquid commercial paper sparked an old-fashioned run on the bank as frantic school officials and county clerks yanked billions — assets plummeted to \$14 billion in a few weeks, forcing trustees to freeze the fund. The remaining investors, including

Heffner, were left holding the bad debt, and beleaguered SBA executive director Coleman Stipanovich abruptly resigned.

While investors licked their wounds, the SBA's glaring leadership vacuum prompted an immediate nationwide search for a new executive director. The winning candidate, Ashbel Williams Jr., was plucked from his role as managing director of investor relations at New York-based hedge fund firm Fir Tree Partners and assumed both executive director and chief investment officer posts at the agency last October. Williams had one big advantage over his competition: He was returning to a job he had held in the mid-1990s.

But the challenges he faced were immense. The crisis exposed a slew of risk management and compliance deficiencies at the once-revered state agency, and it was up to Williams to restore the broken trust. The SBA's recovery would rest on his ability to convince hundreds of government officers such as Heffner and Hillsborough County school superintendent MaryEllen Elia to sink their districts' millions back in the pool.

"The trust issue is a big one," says Elia, who was appointed in 2008 along with Heffner by state CFO and SBA trustee Alex Sink to head a local government advisory council that represents investors. "Some people got hit in the back of the neck, and they're very reluctant to return."

One year into the job, Williams is working hard to restore the SBA's damaged credibility and win back investors. "Everybody understands that providing investment services is all about confidence," says Williams, 54, a natty dresser who sports a bow tie along with a Southern accent and the charm that goes with it. "It's the hardest thing to replace when it's broken."

Over the past 12 months, Williams has spearheaded the rebranding of the LGIP into the Florida Prime fund and improved its transparency, client focus, investment policy and operations. He has also made a serious dent in the backlog of outstanding audit recommendations, resolving roughly a quarter of the 350 issues raised by internal and external auditors. Williams and the strategic investment team took advantage of market conditions by committing \$2.9 billion in more than 20 credit-related and private equity funds; he is now one of the biggest buyers of private equity partnerships on the secondary market. Williams also beefed up the Hurricane Catastrophe Fund that he originally established in 1994, adding \$14.5 billion to its January 2009 level, and he built back the SBA's legal department to increase the agency's activist role.

Although some in Florida see Williams as a hometown hero and savior of the SBA, others wonder if his IR job on Wall Street qualifies him to turn around a tarnished multibillion-dollar asset management agency. For his part, Williams is keenly aware of the challenges. "The public's regard for financial institutions is probably at an all-time low," he said during one of a series of summer interviews with Institutional Investor at the SBA's Tallahassee offices. "Government in general tends to carry a negative perception, so if you happen to be delivering financial services through a government

agency, you are twice tagged.”

The SBA was established in 1942 to manage gas tax collection in Florida. It now has 36 mandates, everything from the Florida Retirement System, which accounts for 80 percent of total assets, to a hurricane catastrophe fund and the Florida lottery. As of mid-September total assets under management were \$133 billion, down from \$193.3 billion in October 2007 because of market losses, withdrawals from the LGIP and pension withdrawals, but up 58 percent from its March 2009 low of \$107.4 billion.

The market downturn led to the SBA’s worst performance in 60 years. The retirement fund was down 19 percent for the fiscal year ended June 30, 2009. Until the LGIP crisis erupted, the SBA had been coasting for years on its reputation for sound pension fund management. From 1998 to 2008 the FRS was one of the few state pension funds that could boast of having the assets to pay future defined benefits and then some.

The blowup put the spotlight on a glaring lack of oversight at the SBA, which is overseen by three trustees who also happen to be Florida’s highest elected officials — the governor, the attorney general and the CFO. All are currently running for office (two of them against each other). To augment the oversight that comes with having only three trustees, compared with a norm of five to ten at other large pension funds, the legislature created a nonfiduciary, six-member investment advisory council in 1983.

As is the case for more than a dozen state pension funds, the legislature controls changes to the SBA’s overall investment policy. After the LGIP cratered, the state hired two financial consultants, in February 2008, to perform due diligence on the damaged money market fund. One of them, Miami attorney Thomas Tew, says problems were immediately apparent: a lack of Securities and Exchange Commission regulation and oversight as well as the SBA’s dependence on three elected officials — who spend 15 minutes twice a month at the end of the state’s bimonthly cabinet meetings overseeing the agency’s business.

“If you don’t have auditors and you don’t have regulators, what have you got?” Tew says in disbelief. He also questions the ability of low-salaried, unlicensed civil servants to manage a multibillion-dollar portfolio of complex financial instruments, given that 40 percent of the funds are managed in-house. Adds Tanya Beder, Tew’s partner in the due-diligence task and founder of the Strategy Building and Crisis Control Group, a New York investment and risk advisory firm: “They are in the Dark Ages of risk management.”

After freezing the fund that Friday night in November, SBA signed BlackRock Financial Management to a 90-day emergency contract. A multidisciplinary team of nearly 50, headed by vice chairwoman Barbara Novick, worked through the weekend in New York, flew to Tallahassee on Monday and on Tuesday presented their idea of splitting the pool into two parts. “We wanted to create an economic incentive to drive the right behavior,” explains Novick. The untainted, liquid securities — 86 percent of the fund — would go into one fund, and the illiquid, toxic waste would get dumped into another. After the

funds were stabilized and the remaining investors received a partial-withdrawal schedule, BlackRock stepped aside. Pittsburgh-based Federated Investors was hired in February 2008 to run the two pools.

Robert Smith, head of fixed income at the SBA, was on the front lines in the days leading up to the run, and he accepts his role in the LGIP disaster. “I realized after the fact that I didn’t have a solid investment process in place, as we had in the long-term portfolio,” he admits. Florida Rivera-Alsing, chief of internal audit and former vice president of treasury services at HSBC in Asia, adds: “One of the findings was that fixed income was involved in pricing its own portfolio. Where I came from that was a big no-no.” When BlackRock entered, Smith folded the short-term fixed-income team into the long-term group. The exception: LGIP portfolio manager Michael Lombardi was ousted from fixed income and made a lateral move into the private equity and strategic investment group as a senior portfolio analyst without fund management responsibility. Today the SBA is still short one fixed-income professional.

Some observers say the state expected too much of the SBA. “When you have so many disparate things to manage, you’re a jack-of-all-trades and it’s hard to be a master of any of them,” says Dominic Calabro, head of Florida Tax Watch, a private, nonprofit watchdog organization in Tallahassee. Edward Seidle, a former SEC attorney who investigates public funds from his office in Lighthouse Point, Florida, is more blunt: “The fund is being mismanaged on a grand scale,” he asserts.

One trustee, state CFO Sink, a former president of the Florida operations of Bank of America Corp., agrees. In an open letter she sent to Williams in May, she asked for ten major changes to SBA governance, highlighting the fact that so much public money is overseen by so few — and such preoccupied — individuals. Sink also called for dedicated quarterly board meetings at SBA headquarters, regular reports from the audit and investment advisory committees and the addition of three more trustees, including at least two investment professionals.

Sink’s adversary in this debate, fellow trustee attorney general Bill McCollum — who also happens to be her opponent in the 2010 race for governor — disagrees. “We’re the three state officers accountable to the voters,” says McCollum. “I don’t think there’s anything wrong with that.” Trustee No. 3, Governor Charlie Crist, who is taking a run at the U.S. senate, says raising salary levels at the SBA is unlikely in the current environment. “I don’t think the populace would tolerate any dramatic increases in salary for me or anyone else,” he tells II. “A lot of people are out of work, period.”

James Dahl, manager of the convertible bond department at Drexel Burnham Lambert during the 1980s and one of the six investment advisers appointed by the trustees to review the SBA’s investment policies, agrees with Sink and said as much to Williams during a recent hike on Dahl’s 5,000-acre Tallahassee property. “The [council] isn’t empowered to demand accountability,” notes Dahl, who is also the founding partner of alternative-assets manager Rock Creek Capital in Jacksonville. “You need to create a new body.”

For his part, Williams says he's content to work with three trustees. "The level of delegated authority is one of the things that make the job appealing," Williams explains during a tour of the state capitol, where he once worked and met his wife of 27 years, Janet. "The most effective way to manage an institution like this is a partnership."

Headhunters agree that that may be the only way to get someone to run such an agency for the \$325,000 in annual salary (and a bonus of up to 8 percent of that salary) that Williams pulls in. "Some might not have investment experience, but rather exposure to investment management," says Michael Kennedy, a consultant specializing in public pension executive searches at Korn Ferry in Atlanta. "You are building and running an organization and strategy. It's a very attractive position." Others are less sanguine. "You're going to invest billions, you're going to be high profile, but you're going to get paid \$300,000 and answer to three people," notes Tew. "Take the job description, take what they were prepared to pay, and talk to your friends on the Street and see if they don't laugh you right out of the room."

When Thomas Wolfe said you can't go home again, he had it half right. Just ask fellow Southerner Ashbel Williams. The fifth-generation Floridian may be back at the helm of the State Board of Administration, but gone are the halcyon days of the 1990s, when he helped Florida roughly double its assets from \$36 billion to \$70 billion while adding new asset classes such as emerging markets and private equity.

Williams was born in Jacksonville in 1954. His family tree includes Marcellus Williams, a surveyor who worked for George Washington's nephew Lawrence, marking down the state boundaries on muleback in the years after Florida became a state, in 1845.

Williams found his *métier* in Florida politics while studying for a bachelor's degree in management at Florida State University, just a stone's throw from the capitol building, when a professor helped the young man land a paid assignment working on committee projects in the Florida House of Representatives. Williams put his dream of heading to New York after graduating in 1976 on hold when he met J. Hyatt Brown, speaker of the house from 1978 to 1980, who became a mentor. Brown convinced Williams to work for him while matriculating for his MBA, earned at Florida State University in 1978. For the next four years, Williams worked as a legislative assistant, and then dipped his toe in the private sector as a lobbyist for two years. His relationship with the SBA began in 1984 when, as deputy chief of staff for governor Bob Graham, he was assigned to rewrite its rules to allow equity investments.

Williams is no stranger to crisis management. He got his first taste as assistant state comptroller from 1985 to 1991, when, in the thick of the savings and loan crisis, he participated in stealth bank seizures, where state officials secretly lined up buyers and handed over the keys in the space of a weekend to avoid massive withdrawals by skittish depositors. During his first tenure as SBA head, from 1991 to 1996, following the \$26 billion in losses wreaked by Hurricane Andrew in 1992, the legislature gave Williams five months to create a state reinsurance fund to backstop an industry in crisis.

In 1996, Williams finally fulfilled his college dream when he got a job in New York as vice president (and later president) of Schroder Capital Management. He settled his wife and two daughters in Wilton, Connecticut, where a third daughter was born, and took on the life of a daily suburban commuter. Williams found time for passions outside of work and family — he became an Episcopal lay minister at the local church, joined the Wilton Riding Club and served on the board of the Lower East Side Tenement Museum after an emotional visit to the Manhattan landmark. “I’ve always been interested in the history of New York City,” he explains.

In 1999, Williams joined Fir Tree, where he spent almost a decade as managing director of client relations and business development. The opportunistic, value-oriented multistrategy hedge fund firm founded by Jeffrey Tannenbaum five years earlier gave Williams exposure to clients such as Duke University, the University of Notre Dame and the J. Paul Getty Trust. During Williams’s time with the firm, Fir Tree’s assets grew from \$450 million to \$4 billion.

“Ash’s talent for understanding and explaining complex situations helped our firm execute on its long-term investing mandate, which certainly helped our success,” says Tannenbaum.

At Fir Tree, Williams honed his skills soothing investors, first when the technology equity market bubble burst in 2000 and, more recently, during the credit crisis that began in 2007. However, by the following year, Williams says, he was ready to return home. His ability to put out fires and build bridges is now being put to the test.

“Ash couldn’t have picked a worse time to come back,” observes William Bell, who was chief of investment policy management at SBA from 1982 through 2000 and who worked closely with Williams.

On a sweltering July day in Tallahassee, Williams gazes at the dual computer monitors in his spacious, light-filled, modestly decorated office. One screen displays a prototype of a logo created to rebrand the maligned government investment pool. The newly dubbed Florida Prime will sport a buoyant sun-and-wave logo in tropical colors — as well as the triple-A rating from Standard & Poor’s that was obtained after BlackRock split the bad securities from the good.

The marketing campaign is part of a larger effort to reassure skeptical investors that it’s safe to wade back into the water, but Williams knows it will take more than a new look to win back the money investors pulled from the fund. (Prime sat at \$6 billion as of mid-September.) Not long after returning to the SBA, he began visiting key investors and speaking to industry groups in an attempt to mend fences directly.

It hasn’t always worked. In late May, Williams went to Tampa to visit Pat Frank, the Hillsborough County clerk who withdrew all but \$280 million of the \$871 million the county had invested in the pool.

“Ash was down here to say it’s a new day,” confirms Frank, who still has \$14.5 million in unrealized losses plus a missing \$3.4 million November 2007 interest payment. “I don’t feel good about it. They’ve asked us over and over to invest in it, and I won’t.”

Heather Fiorentino and Olga Swinson, the school superintendent and CFO, respectively, of the Pasco County School District, pulled out all of their district’s \$315 million investment save the \$20 million still left in the illiquid of the two funds. “We’ve been recording losses for two years,” says Swinson, who is still waiting for \$1.3 million in lost interest.

Some investors, including officials at the Palm Beach County Clerk & Comptroller’s office who manage \$2 billion in tax receipts, didn’t lose a dime, but they’re still not buying into the new regime. “We took the time to look at every one of their assets,” asserts investment manager Felicia Landerman, who questioned outside LGIP returns in early 2007. Unable to get an answer from SBA staff, clerk and comptroller Sharon Bock withdrew the county’s tax dollars, achieving a zero balance just before the run on the bank. With about \$70,000 in interest still owed to the county, Bock says it would take “a period of time [in which] they can demonstrate that it’s not just rebranding, but that the core of what they do matches what we do” before the SBA sees Palm Beach County’s tax dollars again.

It’s not all bad news. The Orange County school board invested \$300 million last month.

Williams is acutely aware of the public relations work needed to make reparations to 1,000 statewide government entities, some of which had special challenges during the fund freeze. “Jefferson County had to borrow money to make paychecks,” he acknowledges. “If I were the school board, I’d be very angry and resentful for a long time.” However, he says, the crisis has served to set the beaten-up agency on a new course: “Through the actions of the SBA and the legislature, you now have what is probably the most open, transparent and liquid investment vehicle anywhere.”

In terms of oversight, Williams; a Federated Investors senior manager, Amy Michaliszyn; and the SBA’s senior portfolio manager, Paige Wilhelm, now hold regular quarterly investor calls. The legislature-created Local Government Participant Advisory Council meets quarterly to monitor the SBA’s progress, and Florida law firm Lewis, Longman & Walker has been retained to provide annual compliance reviews.

“I’m responsible for reporting any material exceptions to the LGIP,” Williams says. “The SBA is directed to certify and report annually that we are in compliance with all requirements for openness with investors.”

He is also forging ahead with plans to move the SBA into new asset classes, including hedge funds and possibly real assets such as timber and infrastructure. Senior investment officer Jim Treanor, who also oversees the private equity portfolio, has reviewed half a dozen timber and infrastructure proposals but has so far held back because they’d require

pricey outside expertise.

“We are concerned about fees,” notes Treanor, a former Minneapolis-based airline finance executive. The SBA made its first move into hedge fund-like investments in March 2008, when it reallocated \$2 billion from three of its managers to 130-30 funds in the domestic and global equity portfolios.

The SBA might be late to hedge funds, but it has been a longtime investor in private equity and venture capital funds. The initial investments were set up in the domestic equity portfolio during Williams’s first administration in the mid-1990s; they were moved to their own portfolio in 1999. Today there are about 87 separate commitments, valued at about \$4.3 billion. And with the help of private equity advisory firm Hamilton Lane in Philadelphia, a new Florida Growth Fund was established in June to invest up to 1.5 percent of retirement system assets in statewide technology and growth investments. On the strategic side of the portfolio, Treanor bet early on distressed debt, resulting in losses of 34.6 percent for the year ended June 30, 2008. “In ’07 and ’08 we thought distressed was the place to be,” he explains. “It turned out January ’09 was better.”

One of Williams’s key challenges has been attracting top investing talent, particularly given Tallahassee’s relatively remote location in the Florida Panhandle, 12 miles south of Georgia, 28 miles north of the Gulf of Mexico, served only by a small regional airport. COO Gwenn Thomas recently commissioned a salary study by McLagan Partners in New York that revealed that the average salaries of investment professionals at the SBA in March 2009 were 40 percent lower than those of comparable professionals at large state pension funds. Tew, the Miami attorney who examined LGIP operations, asks, “How can you run this type of huge fund without buying the very best talent available?” Williams says it is possible more of the internal management will have to be outsourced. “We really have to look in the mirror and ask, Are we prepared to run money in-house and do it prudently?” Williams also has further to go in risk management and compliance improvements. In 2008 the SBA hired Deloitte & Touche to perform a compliance review of its front-, middle- and back-office operations, with the goal of providing recommendations for enhancing risk management and compliance. However, warns risk consultant Beder, this is just the latest in a long line of reviews, and improvements are still wanting. “Internal controls are not easy to implement,” notes internal audit chief Rivera-Alsing.

Although progress has been made, some wonder if it will be enough to regain the trust of investors like Patsy Heffner. “They’re moving in the right direction, and I’m willing to work with them,” says the Osceola County tax official, who’s now chair of the advisory council. The true test will be whether that willingness translates into cash.