CITY OF Los Angeles
DEFERRED COMPENSATION PLAN

Board Report 23-16

Date: April 18, 2023

To: Board of Deferred Compensation Administration

From: Staff

Subject: FDIC-Insured Savings Account

Recommendation:

That the Board of Deferred Compensation Administration approve proposed amendment to the contracts between the City of Los Angeles Deferred Compensation Plan and (1) East West Bank and (2) Bank of the West, in order to reflect a change to the benchmark used and interest crediting rate calculation methodology for the FDIC-Insured Savings Account; and authorize the Board Chairperson to execute the amendments, subject to final modification as to form by the City Attorney.

Background:

The FDIC-Insured Savings Account has two underlying bank providers, East West Bank and Bank of the West, each having 50% allocation of the funds. As a capital preservation option, the account offers FDIC insurance on the first $500,000 (combining protection of $250,000 offered by each of the providers) and any amounts in excess are to be collateralized by the banks. Deferred Compensation Plan (DCP) participants benefit from having more than one bank as the underlying provider, as it provides incremental FDIC protection (up to $250,000 held by each bank is FDIC insured) and to better bolster the option against singular bank failure.

Additionally, each bank provides a crediting interest rate that is currently set every quarter and credited daily, utilizing a methodology that is based on 3-month LIBOR. This reference rate will be sunsetting in June 2023, and as such, an alternative crediting methodology is required.

Discussion:

A. FDIC-Insured Savings Account (Capital Preservation)

The FDIC-Insured Savings Account is part of the DCP's core investment menu, and it is communicated as a capital preservation option. Both Bank of the West and East West Bank were selected as a result of a procurement process and were awarded contracts for the term of October 1, 2019 through September 30, 2024.

As mentioned before, deposits under each bank are FDIC-insured up to $250,000. Participants electing to contribute to the FDIC-Insured Savings Account have up to $500,000 insured by the FDIC, as total deposits are split evenly between East West Bank and Bank of the West. For participant balances above $500,000 that are not FDIC insured, each bank is further contractually required to collateralize these amounts with high quality securities. At the beginning of 2023, a little under $590 million or about 7% of total participant assets were invested in the FDIC-Insured Savings Account and is one of the top five investment options in the DCP. As of March 10, 2023, there were 13,159 participants with balances in the FDIC-Insured Savings Account. Of these:

- # of Participants with balances up to $500,000: 12,951
- # of Participants with balances over $500,000: 208

It should be noted that subsequent to the Silicon Valley Bank collapse in early March 2023, both East West Bank and Bank of the West have reiterated they are well positioned from a liquidity and collateralization standpoint.

- East West Bank[1] indicates it has a diverse base of consumer, small business, and commercial customers, with a deposit base that is well spread by geography and diversified by industry and depositor type. There is no exposure to cryptocurrency and venture deposits were less than 2% of its total deposit base. East West Bank indicates robust capital with a prudent balance sheet and strong liquidity.
- Bank of the West is now part of the Bank of Montreal (BMO) Financial Group. BMO is a 205 year old bank with a strong, stable deposit base that has been significantly enhanced by the recent merger of Bank of the West into BMO Harris Bank. Bank of the West is now a top 10 bank in the U.S., and a top 5 Commercial Bank in North America. Bank of the West indicates a well-diversified business model with diversified industry focus and diversified deposit and loan base, with no industry exceeding 20% of its book.

Staff will work with Mercer to continue to monitor the banking industry situation and report back to the Board should any action need to be taken.

B. Crediting Rate Methodology

The crediting rate methodology under both banks is currently based on 3-month LIBOR, which will be sunsetting in June 2023. Mercer has previously provided the Board with information related to the end of LIBOR and has been further working with both banks to identify the appropriate replacement reference rate and spread to provide similar rates moving forward. Mercer has provided a report to the Board with additional information (**Attachment A**). Staff recommends proceeding with the use of SOFR as the replacement rate.

The proposed crediting rate methodology is included as part of **Attachment B**, which is an amendment to the contracts with East West Bank and Bank of the West. Staff recommends the Board approve the draft amendments to the contract, and authorize the Board Chairperson to execute the amendments, subject to final modification as to form by the City Attorney. It should

[1] East West Bank Message, March 12, 2023: https://www.eastwestbank.com/en/newsroom/pr_031223

be noted that the rate from Bank of the West, now BMO, is under review with its new management structure. Staff will return to the Board with an updated rate, should it change from the recommendation as noted in Mercer's report (**Attachment A**).

Submitted by: ______________________________

Esther Chang, Sr. Personnel Analyst II

Attachment A

Mercer

welcome to brighter

Devon Muir
Principal

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www.mercer.com

Memo

To:	Board of Deferred Compensation Administration, City of Los Angeles Deferred Compensation Plan
Date:	April 18, 2023
From:	Devon Muir, CFA and Ana Tom-Chow
Subject:	FDIC-Insured Bank Deposit Account – USD 3 Month LIBOR Sunset and Replacement
Copy:	Staff

Background: The Deferred Compensation Plan's FDIC-Insured Bank Deposit Account comprises savings accounts from two banks, Bank of the West and East West Bank, with each offering FDIC protection up to the maximum allowable threshold of $250,000 per participant ($500,000 in total when combining protection offered by both providers).

Per contract, the Plan's FDIC providers use the three-month London Interbank Offered Rate (LIBOR) to credit interest to the FDIC-insured accounts; however, the LIBOR benchmarks will sunset in mid-2023. LIBOR was designed to reflect the rate at which banks lend to one another, and it has served as the reference rate for countless financial transactions. LIBOR is set in different currencies and maturities. As we have discussed with the Board over the last several years, LIBOR has been the subject of much controversy. A well-publicized scandal in 2012 involved several bankers engaging in price-fixing, artificially manipulating LIBOR to profit from trades. Ultimately in 2017, the Financial Conduct Authority (the financial services regulator in the UK) and the Bank of England's Financial Policy Committee announced plans to end use of LIBOR. Later it was announced that LIBOR would be phased out beginning 2021, with an ultimate target sunset at the end of June 2023. This has broad implications for the trillions of dollars of financial transactions based in LIBOR which will now need to reference an alternative interest rate.

An alternative to LIBOR: In the U.S., the Federal Reserve's (the Fed's) recommended alternative reference rate is the Secured Overnight Financing Rate, or SOFR[1]. SOFR is the borrowing rate for overnight loans collateralized by Treasury securities. The transition to SOFR is being led by the Alternative Reference Rate Committee, an industry group established by the Fed. **There are other alternatives to LIBOR such as the Federal Funds Rate[2], American Interbank Offered Rate**

[1] SOFR is a benchmark interest rate for dollar-denominated derivatives and loans. It is computed from transactions in the Treasury repurchase (repo) market and it is based on data from many observable transactions.

[2] The federal funds rate is the rate at which large U.S. commercial banks lend to one another. Its target is set by the Federal Reserve's Federal Open Market Committee (FOMC), but the actual rate is determined in the market. However, this rate is capped by the Fed's discount rate, the interest rate at which it charges commercial banks to borrow from it directly.

(Ameribor)[3], and Bloomberg Short-Term Bank Yield Index (BSBY)[4] but based on our discussions with the DCP's bank providers, numerous asset managers, and other financial institutions, we believe SOFR is the preferred reference rate alternative for the DCP's FDIC option as we look beyond June 2023. Likewise, it bears noting that LACERS and DWP also indicated they will use SOFR, where applicable, in place of LIBOR going forward.

SOFR implementation considerations: A major issue in the transition from LIBOR to SOFR is that there are meaningful differences between the two that should not be ignored. Whereas LIBOR represents the average borrowing rates reported to be available by participating banks over various tenors (i.e., lengths of time), SOFR is based on actual overnight money market transactions. Further, while LIBOR rates have been published for a number of tenors, SOFR tenors are derived from futures prices for the overnight rate. Finally, and perhaps most importantly, LIBOR rates represent unsecured loan rates; meanwhile, SOFR applies to collateralized transactions. Due to this latter point, in general SOFR should be lower in yield. Because of this, **we believe it is appropriate to apply an added basis point premium (or spread) to SOFR in order to put the future reference rate in parity with the prior LIBOR-based rate.**

In determining such an appropriate spread to apply to SOFR, it is useful to revisit the current interest rate methodologies for both FDIC providers to ascertain what to use going forward.

Current Interest rate methodologies by bank: The Plan's FDIC providers currently credit interest to the FDIC insured accounts according to the following methodologies for interest rates which were established in their respective agreements with the Plan.

- ***Bank of the West uses 3-Month LIBOR minus 0.15% (15 basis points)***
- ***East West Bank uses 3-Month LIBOR minus 0.03% (3 basis points)***

The Plan currently implements an equal weight allocation policy of 50% to each provider to calculate blended yield for the FDIC-insured option. The interest rate is reset on a quarterly basis, the calculation is based on actual days and credited monthly. Rates are reset two business days prior to the quarter in which the interest rate will apply.

Determining new SOFR rate alternatives: *S*taff and Mercer held a series of discussions over the past eighteen months with both FDIC providers to arrive at appropriate crediting rate alternatives which were based on SOFR. Each provided their analysis and in summary:

- ***Bank of the West is recommending 3-Month Term SOFR plus 0.13% (13 basis points), subject to final approval by new ownership[5]***
- ***East West Bank has proposed 3-Month Term SOFR plus 0.18% (18 basis points)***

[3] Ameribor is a benchmark interest rate that reflects the true cost of short-term interbank borrowing. It tracks unsecured dollar-denominated interbank yields, and it is intended to aid small and midsize regional banks.
[4] The Bloomberg Short-Term Bank Yield (BSBY) Index provides a series of short-term rate benchmarks for banks to use in maturities of overnight, three-month, six-month, and 12-month. It looks at unsecured lending in a range of products such as commercial paper, certificates of deposit (CDs), demand deposits, and short-term corporate bonds. The index is constructed from observed transactions on Bloomberg's proprietary trading platforms as well as from feeds from the Financial Industry Regulatory Authority (FINRA).
[5] On February 1, 2023, Bank of Montreal (BMO) acquired Bank of the West from BNP Paribas.

Historical annualized rate comparison (current versus proposed)

Provider and rate	7-day average (3/27/2023)	YTD average	12M average	24M average	36M average
Bank of the West current	4.91	4.76	3.30	1.68	1.18
Bank of the West proposed	4.98	4.91	3.38	1.80	1.26
East West Bank current	5.03	4.88	3.42	1.80	1.30
East West Bank proposed	5.03	4.96	3.43	1.85	1.31

Note: green font indicates proposed rate higher than current methodology for a given period

Conclusion: As the above table displays, on a historical basis the proposed rates for each provider are generally in proximity, or modestly better than the current rate structures. It should also be noted that the normal RFP process for FDIC bank providers will occur once again in early 2024, at which point, a comprehensive review of market pricing for the account will occur once again. **In the immediate term, however, we recommend adopting these new proposed rate structures.**[6]

Should the Board approve them, we will work with Staff and Voya to ensure that appropriate administrative details are in place for an orderly transition. Transition steps we envision are the following:

Transition steps

Step 1: The Board approves the new benchmark and interest calculation methodology

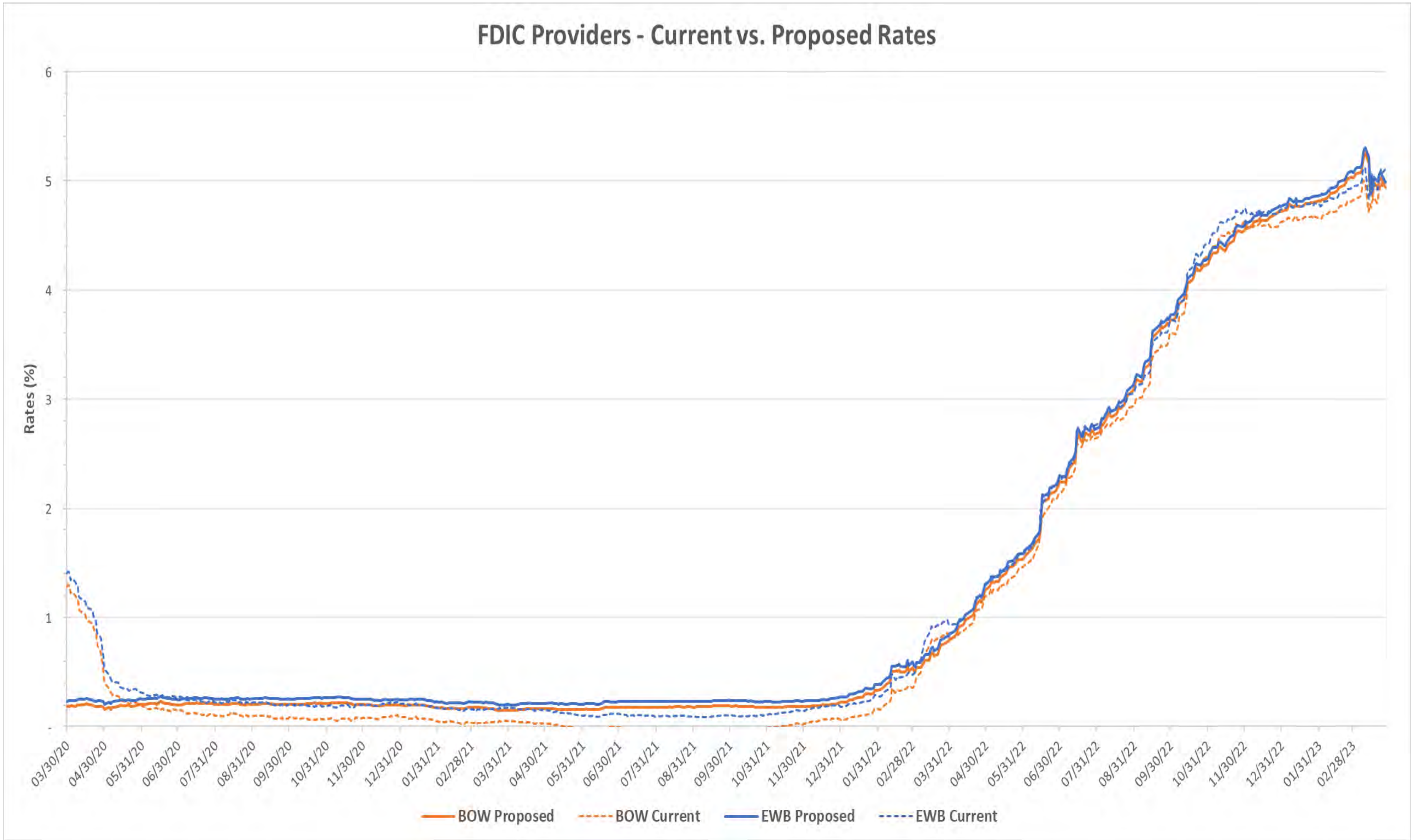
Step 2: Board directs Staff to perform an amendment to the contracts with the FDIC providers

Step 3: Board delegate Staff to notify such directive to the TPA

Step 4: The TPA will implement the Board's directive and take necessary steps from an administrative perspective in coordination with the bank providers to ensure a seamless transition

[6] Subject to final confirmation from Bank of the West

APPENDIX



FDIC Providers - Current vs. Proposed Rates
Rates (%)
6
5
4
3
2
1
-
03/30/20
04/30/20
05/31/20
06/30/20
07/31/20
08/31/20
09/30/20
10/31/20
11/30/20
12/31/20
01/31/21
02/28/21
03/31/21
04/30/21
05/31/21
06/30/21
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12/31/21
01/31/22
02/28/22
03/31/22
04/30/22
05/31/22
06/30/22
07/31/22
08/31/22
09/30/22
10/31/22
11/30/22
12/31/22
01/31/23
02/28/23
BOW Proposed
BOW Current
EWB Proposed
EWB Current

FIRST AMENDMENT TO THE PROFESSIONAL SERVICES AGREEMENT (CONTRACT NO. C-135431) BETWEEN THE CITY OF LOS ANGELES AND BANK OF THE WEST

This First Amendment to the Professional Services Agreement (Contract No. C-135431) ("**Original Agreement**") is made and entered into by and between the City of Los Angeles, a municipal corporation, by and through the Board of Deferred Compensation Administration (hereinafter referred to as "**City**") and Bank of the West, a [state] corporation, acting by and through its subsidiary [name] (hereinafter referred to as "**Contractor**"), with reference to the following:

RECITALS

1. On June, 4, 2020, the City entered into that certain Original Agreement for FDIC Savings Account Services ("**Account Services**") with a commencement date of October 1, 2019 ("**Commencement Date**") and an ending date of September 30, 2024; and

2. In rendering of Account Services, any interest credited to the assets administered by the Contractor would be at the three-month London Interbank Offered Rate ("**LIBOR**") less three basis points under the terms set forth in the Interest Crediting Agreement, which was included and incorporated as Attachment A of the Original Agreement; and

3. On December 16, 2022, the Federal Reserve board adopted a final rule to replace the LIBOR benchmark rate with a new benchmark based on the secured overnight financing rate ("**SOFR**") for certain contracts using one-month, three-month, six-month, and 12-month LIBOR after June 30 2023; and

4. With the replacement of LIBOR after June 30, 2023, the parties desire to supplement the crediting methodology in accordance with Paragraph K of the Original Agreement.

NOW, THEREFORE, the City and Contractor, in consideration of the promises and of the recitals, agreements, covenants, and representations set forth herein, hereby covenant, represent, and agree as follows:

1. The terms and conditions of the Original Agreement and its attachments, together with this First Amendment and its attachment, shall be read and construed as one document and references to "this Agreement" or "the Agreement" shall from effective date hereof (but not for any purpose prior to the effective date hereof) incorporate references to this First Amendment.

2. Section H of Article III of the Original Agreement, entitled "Interesting Crediting Agreement," is hereby deleted in its entirety and replaced with the following:

> "From the Commencement Date through June 30, 2023, the assets administered by Contractor in the Account shall be credited with interest according to the terms of the Interest Credit Agreement, attached hereto as **Attachment A** and incorporated by reference. Beginning July 1, 2023, the assets administered by Contractor in the Account shall be credited with interest according to the terms of the Supplemental Interest Credit Agreement, attached hereto as **Attachment B** and incorporated by reference."

3. Section K of Article III of the Original Agreement, entitled "Regular Review of Crediting Methodology," is hereby deleted in its entirety and replaced with the following:

> "Contractor shall regularly confer with City staff and/or Plan consultants as necessary but on no less than a six-month basis to review potential changes to the Interest Crediting Agreement. If for any reason a change to the crediting methodology is agreed upon by both the Contractor and the City staff, the proposed change will be brought to the Board for approval. Changes to the crediting methodology approved by the Board will be memorialized by a contractual amendment to Attachments A and/or B."

4. Section A of Article V of the Original Agreement, entitled "Standard Provisions for City Contracts," is hereby amended to replace any reference to "Attachment B" with the reference "Attachment C."

5. In the event of any inconsistency between the provisions of this First Amendment and any attachments and exhibits attached thereto, said inconsistency shall be resolved by giving precedence to the documents in the following order, except as required by applicable ordinances and law:

   A. This First Amendment;
   B. The other attachments/exhibits to the First Amendment;
   C. The Original Agreement;
   D. The other attachments/exhibits to the Original Agreement; and
   E. Standard Provisions for City Contracts (Rev. 10/17).

6. This First Amendment shall be deemed executed upon the occurrence of all of the following events:

   A. This First Amendment has been signed on behalf of Contractor by the person or persons authorized to bind Contractor hereto;
   B. This First Amendment has been approved by the Chairperson of the Board of Deferred Compensation Administration;
   C. The Office of the City Attorney has indicated in writing its approval of this First Amendment as to form; and
   D. This First Amendment has been signed on behalf of the City by the person designated to so sign by the City's Council or by the board, officer or employee authorized to enter into this First Amendment.

7. Except as amended by this First Amendment, all other terms and conditions of the Original Agreement shall remain in full force and effect.

8. Capitalized terms not otherwise defined herein shall have the meaning ascribed to them under the Original Agreement.

9. This First Amendment may be executed in one or more counterparts, and by the parties in separate counterparts, each of which when executed shall be deemed to be an original but all of which taken together shall constitute one and the same agreement. The parties further agree that facsimile signatures or signatures scanned into pdf (or signatures in another electronic format designated by City) and sent by e-mail shall be deemed original signatures.

(REMAINDER OF PAGE INTENTIONALLY LEFT BLANK. SIGNATURE PAGE FOLLOWS)

IN WITNESS THEREOF, the parties, hereto have caused this First Amendment to be executed by their respective duly authorized representatives.

THE CITY OF LOS ANGELES

By: ___________________________________ Date: __________________________

THOMAS MOUTES
Chairperson, Board of Deferred
Compensation Administration

BANK OF THE WEST

By: ___________________________________ Date: __________________________

[INSERT]

APPROVED AS TO FORM:

HYDEE FELDSTEIN SOTO, City Attorney

By: ___________________________________

CHARLES HONG
Deputy City Attorney

Date: __________________________

ATTEST:

HOLLY L. WOLCOTT, City Clerk

By: ____________________________

Deputy City Clerk

Date: __________________________

*Approved Signature Methods:

1) Two signatures: One of the Chairman of the Board of Directors, President, or Vice-President, and one of the Secretary, Assistant Secretary, Chief Financial Officer, or Assistant Treasurer.
2) One signature of a Corporate-designated individual together with a properly attested resolution of the Board of Directors authorizing the individual to sign.

City Business License Number: _________________
Internal Revenue Service Taxpayer Identification Number: _________
Agreement Number:___________

Attachment B

Supplemental Interest Crediting Agreement

Effective July 1, 2023

The rate structure will be the Secured Overnight Financing Rate (SOFR) plus 0.0013 (13 basis points). Interest will be calculated based on actual days (actual/actual) and credited monthly. The rate will be adjusted quarterly and will be reset two business days prior to the quarter in which the interest rate will apply.

FIRST AMENDMENT TO THE
PROFESSIONAL SERVICES AGREEMENT (CONTRACT NO. C-135729)
BETWEEN THE CITY OF LOS ANGELES
AND
EAST WEST BANK

This First Amendment to the Professional Services Agreement (Contract No. C-135729) ("**Original Agreement**") is made and entered into by and between the City of Los Angeles, a municipal corporation, by and through the Board of Deferred Compensation Administration (hereinafter referred to as "**City**") and East West Bancorp, Inc. a Delaware corporation, acting by and through its subsidiary East West Bank (hereinafter referred to as "**Contractor**"), with reference to the following:

RECITALS

1. On June, 4, 2020, the City entered into that certain Original Agreement for FDIC Savings Account Services ("**Account Services**") with a commencement date of October 1, 2019 ("**Commencement Date**") and an ending date of September 30, 2024; and

2. In rendering of Account Services, any interest credited to the assets administered by the Contractor would be at the three-month London Interbank Offered Rate ("**LIBOR**") less three basis points under the terms set forth in the Interest Crediting Agreement, which was included and incorporated as Attachment A of the Original Agreement; and

3. On December 16, 2022, the Federal Reserve board adopted a final rule to replace the LIBOR benchmark rate with a new benchmark based on the secured overnight financing rate ("**SOFR**") for certain contracts using one-month, three-month, six-month, and 12-month LIBOR after June 30 2023; and

4. With the replacement of LIBOR after June 30, 2023, the parties desire to supplement the crediting methodology in accordance with Paragraph K of the Original Agreement.

NOW, THEREFORE, the City and Contractor, in consideration of the promises and of the recitals, agreements, covenants, and representations set forth herein, hereby covenant, represent, and agree as follows:

1. The terms and conditions of the Original Agreement and its attachments, together with this First Amendment and its attachment, shall be read and construed as one document and references to "this Agreement" or "the Agreement" shall from effective date hereof (but not for any purpose prior to the effective date hereof) incorporate references to this First Amendment.

2. Section H of Article III of the Original Agreement, entitled "Interesting Crediting Agreement," is hereby deleted in its entirety and replaced with the following:

> "From the Commencement Date through June 30, 2023, the assets administered by Contractor in the Account shall be credited with interest according to the terms of the Interest Credit Agreement, attached hereto as **Attachment A** and incorporated by reference. Beginning July 1, 2023, the assets administered by Contractor in the Account shall be credited with interest according to the terms of the Supplemental Interest Credit Agreement, attached hereto as **Attachment B** and incorporated by reference."

3. Section K of Article III of the Original Agreement, entitled "Regular Review of Crediting Methodology," is hereby deleted in its entirety and replaced with the following:

> "Contractor shall regularly confer with City staff and/or Plan consultants as necessary but on no less than a six-month basis to review potential changes to the Interest Crediting Agreement. If for any reason a change to the crediting methodology is agreed upon by both the Contractor and the City staff, the proposed change will be brought to the Board for approval. Changes to the crediting methodology approved by the Board will be memorialized by a contractual amendment to Attachments A and/or B."

4. Section A of Article V of the Original Agreement, entitled "Standard Provisions for City Contracts," is hereby amended to replace any reference to "Attachment B" with the reference "Attachment C."

5. In the event of any inconsistency between the provisions of this First Amendment and any attachments and exhibits attached thereto, said inconsistency shall be resolved by giving precedence to the documents in the following order, except as required by applicable ordinances and law:

   A. This First Amendment;
   B. The other attachments/exhibits to the First Amendment;
   C. The Original Agreement;
   D. The other attachments/exhibits to the Original Agreement; and
   E. Standard Provisions for City Contracts (Rev. 10/17).

6. This First Amendment shall be deemed executed upon the occurrence of all of the following events:

   A. This First Amendment has been signed on behalf of Contractor by the person or persons authorized to bind Contractor hereto;
   B. This First Amendment has been approved by the Chairperson of the Board of Deferred Compensation Administration;
   C. The Office of the City Attorney has indicated in writing its approval of this First Amendment as to form; and
   D. This First Amendment has been signed on behalf of the City by the person designated to so sign by the City's Council or by the board, officer or employee authorized to enter into this First Amendment.

7. Except as amended by this First Amendment, all other terms and conditions of the Original Agreement shall remain in full force and effect.

8. Capitalized terms not otherwise defined herein shall have the meaning ascribed to them under the Original Agreement.

9. This First Amendment may be executed in one or more counterparts, and by the parties in separate counterparts, each of which when executed shall be deemed to be an original but all of which taken together shall constitute one and the same agreement. The parties further agree that facsimile signatures or signatures scanned into pdf (or signatures in another electronic format designated by City) and sent by e-mail shall be deemed original signatures.

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IN WITNESS THEREOF, the parties, hereto have caused this First Amendment to be executed by their respective duly authorized representatives.

THE CITY OF LOS ANGELES

By: ___________________________________ Date: __________________________
THOMAS MOUTES
Chairperson, Board of Deferred
Compensation Administration

EAST WEST BANK

By: ___________________________________ Date: __________________________
[INSERT]

APPROVED AS TO FORM:

HYDEE FELDSTEIN SOTO, City Attorney

By: ___________________________________
CHARLES HONG
Deputy City Attorney

Date: __________________________

ATTEST:

HOLLY L. WOLCOTT, City Clerk

By: ____________________________
Deputy City Clerk

Date: __________________________

*Approved Signature Methods:
1) Two signatures: One of the Chairman of the Board of Directors, President, or Vice-President, and one of the Secretary, Assistant Secretary, Chief Financial Officer, or Assistant Treasurer.
2) One signature of a Corporate-designated individual together with a properly attested resolution of the Board of Directors authorizing the individual to sign.

City Business License Number: _________________
Internal Revenue Service Taxpayer Identification Number: _________
Agreement Number:___________

Attachment B

Supplemental Interest Crediting Agreement

Effective July 1, 2023

The rate structure will be the Secured Overnight Financing Rate (SOFR) plus 0.0018 (18 basis points). Interest will be calculated based on actual days (actual/actual) and credited monthly. The rate will be adjusted quarterly and will be reset two business days prior to the quarter in which the interest rate will apply.