



Board Report 24-16

Date: April 16, 2024

To: Board of Deferred Compensation Administration

From: Staff

Subject: Investments Committee Update and Recommendation for Government Money Market Option Mutual Fund Search and Request for Information related to the FDIC-Insured Savings Account Option

Board of Deferred Compensation Administration

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Recommendation:

That the Board provide approval to: (1) conduct a mutual fund search to review government money market funds; (2) release a Request for Information (RFI) to evaluate the depth and attractiveness of the FDIC bank provider market; and (3) authorize staff to negotiate contract extensions with the current underlying bank providers of the FDIC-Insured Savings Account as needed to ensure continuity of services, as forwarded from the Investments Committee for consideration.

Background:

The Investments Committee (“Committee”) has held several meetings to review the investment menu options and structure for the Deferred Compensation Plan program, as recommended by the plan’s investments consultant, Mercer, as a best practice to periodically conduct. The Committee has thus far met on September 22, 2023, December 19, 2023, and April 2, 2024¹. Following is a summary of what has been discussed thus far and recommendations related to the Capital Preservation options for the plan.

Discussion:

On September 22, 2023, the DCP investments consultant, Mercer, provided a presentation (Investments Committee Report [23-01](#)) to the Investments Committee to review the investment options structure for the DCP. The presentation included:

- a) Investment options array “Clean Sheet” relative to Mercer’s best practices and market trends for defined contribution plans

¹ For meeting agenda and reports, please go to: <https://la457.com/investments-committee-materials>

- b) Overview of DCP participant demographics
- c) Analysis of the DCP's investment structure including:
 - i) A review of the Committee's philosophy regarding Target Risk Funds versus Target Date Funds
 - ii) Consideration of a dedicated passive suite of options
 - iii) Appropriateness of offering an FDIC-insured savings option versus Money Market fund and affirmation of the Stable Value Fund
 - iv) Consideration of a combined US Small and Mid Cap (SMID) Equity option
 - v) Education on mandates such as Diversified Inflation Hedge (DIH), real assets, and Environmental, Social, and Governance (ESG) options

The Committee indicated that there was not a strong interest to pursue a diversified inflation hedge or ESG options as these could be available in other ways (provided by the cost-of-living adjustments from the defined benefit plans or through the self-directed brokerage) and the recommendations regarding a passive suite of options or a combined SMID option could be considered at a later meeting. The Committee requested to first delve further into certain recommendations and requested additional information regarding:

- **Asset Allocation Options** - In considering Target Risk Funds versus Target Date Funds, the Committee requested additional data be identified related to participant investment activity and whether having a defined benefit might impact the risk tolerances of DCP participants.
- **Capital Preservation Options** - As the current contracts with the two bank providers of the DCP FDIC-Insured Savings Account option are expiring at the end of September 2024, the Committee requested follow-up discussion regarding the consideration for a money market fund versus an FDIC savings option.

On December 19, 2023, Mercer provided a presentation (Investments Committee Report [23-02](#)) in order for the Committee to further consider:

- a) Capital Preservation Options
 - i) Affirm retention of the Stable Value Option
 - ii) Comparison of FDIC-insured savings option vs. Money Market
- b) Asset Allocation Options
 - i) Target Risk Funds vs. Target Date Funds
 - ii) Managed Account Education

During this meeting, the following was discussed:

- **Stable Value Fund**: A review of the Stable Value Fund and its performance was provided. The fund is managed by Galliard, remains highly rated by Mercer, and is being recommended to be retained as an option in the DCP investment menu. At its April 2, 2024 meeting, the Committee reaffirmed this option.
- **FDIC-Insured Savings Account**
Currently, two banks serve as the underlying providers of the FDIC-Insured Savings Account option, East West Bank and BMO (formerly Bank of the West), with assets in this option allocated equally. The current contracts are set to expire September 30, 2024.

As previously discussed by the Committee, it is recommended that the DCP investment menu option alternatively offer a government money market option. While the FDIC-Insured Savings Account option has produced slightly higher yield compared to a government money market option, Mercer previously indicated the difference may be attributable to fees. The yield difference may possibly be further narrowed in the future as the reference rate used by the banks to establish the interest crediting rate for the option was changed from LIBOR (more speculative) to SOFR (borrowing rate for overnight loans collateralized by Treasury securities). The consideration of yield may be offset by the fact that banks are subject to credit risk and failures can happen very quickly, as seen in early 2023, which caused unease with participants. Though FDIC backed, the insurance could take time to make investors in the option whole, with maximum coverage of \$500,000 (or \$250,000 per underlying bank in the FDIC-Insured Savings Account option). Further, Mercer does not generally monitor banks in the same way as they might monitor and assess investment funds. A government money market option also offers more transparency to participants and is administratively less burdensome (a mutual fund search compared to a full City procurement and contract negotiation process).

At the April 2, 2024 meeting, Mercer provided follow-up information in the Investments Committee Report [24-01](#), which detailed a proposed transition plan for replacing the FDIC-Insured Savings account with a government money market option:

1. Seek Board approval
2. Conduct a formal mutual fund search for a government money market option
3. Reconvene with the Investments Committee to identify the optimal fund
4. Communicate the change to the Plan's TPA so the necessary notices can be provided to participants and an effective date for implementation is set
5. Communicate the change and effective date to both bank providers
6. Devise a transition plan in collaboration with TPA, the legacy providers and the future money market fund provider
7. Implement the transition

During the discussion, Mercer indicated that, barring the potential risk considerations and administrative challenges, procurement for FDIC-Insured Savings Account providers is also subject to timing of when the procurement is conducted. Currently, Mercer indicated the environment could be more favorable for attracting providers, as compared to a previous procurement cycle when Mercer had to source proposals to attempt to secure a third underlying bank (which ultimately failed due to inability to agree on City contract requirements).

The Committee expressed its interest in transitioning to a government money market option. With consideration to the success of the FDIC-Insured Savings Account and of the current market environment, the Committee expressed that it would also wish to concurrently determine whether there might be interest from any potential banks at this time. It was requested that rather than a full Request for Proposal or RFP process, perhaps an abbreviated process to identify interest could be first conducted.

Staff requests the Board approve a mutual fund search for a government money market fund and release of an RFI as forwarded for consideration by the Investments Committee and by the plan's investment consultant, Mercer (see **Attachment A**). Should the Committee and Board decide to release a fuller RFP or to transition to a government

money market option, and if the timeline for either process is anticipated to go beyond September 2024, staff further requests the Board direct staff to draft contract extensions with the two current banks to provide adequate time to transition to a new contract or otherwise to the new government money market option. Any contract extension will be brought back to the Board for its final consideration.

- Asset Allocation Options

The Committee continues to consider the plan's target risk funds and their allocations, insights gleaned by Mercer from participant investment election behavior and demographics, and the merits of an off the shelf target date fund or a hybrid target risk/target date fund approach. It is imagined that the latter would utilize the plan's existing fund options to continue to leverage the plan's asset size for lower fees. At its April 2, 2024 meeting, the Committee requested additional information to consider further details on a potential hybrid target risk/target date fund and review of the current fund allocation percentages to optimize the target risk funds.

Submitted by: Esther Chang, Defined Contribution Plan Manager



welcome to brighter

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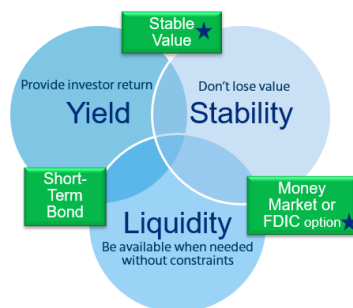
Memo

To: Board of Deferred Compensation Administration
Date: April 16, 2024
From: Devon Muir, Ana Tom-Chow, and Lauren Hansen
Subject: Recommendation to conduct a government money market search and FDIC bank provider RFI
Copy: Esther Chang

Background: Over the past several months, the Investments Committee has been diligently conducting its periodic review of the DCP Investment Structure (i.e., the broad categories of investment options offered in the menu) to ensure it remains competitive relative to peers and meets the unique needs of DCP participants. During this review, the Committee has examined Plan demographics, Deferred Compensation peer analysis, the DCP line-up including its managed allocation funds (i.e., Risk Profile funds), the core menu, and capital preservation options.

The latter was a particular focus of the April 2, 2024 Investments Committee meeting, in which we reviewed the spectrum of capital preservation options available including a money market fund (not currently utilized in the menu), an FDIC-based option (currently in the Plan), and Stable Value (currently in the Plan). The Committee affirmed retaining the Stable Value as a primary capital preservation vehicle given its strong historical track record and forward-looking return enhancement over other capital preservation options.

Capital Preservation Objectives and Investment Types (star indicates DCP category)



- No solution provides all three objectives
- Capital preservation option not meant to serve as a long-term investment
- Stability and liquidity should be primary objectives; yield should be secondary. However, yield becomes more important if retirees stay in the plan.

With regards to the continued use of an FDIC option, Mercer noted that this is a relatively uncommon investment type within the DC landscape. Although it has been a successful DCP option historically, it introduces additional operational complexities in terms of procurement, administration and oversight. Further, the FDIC option brings modestly higher risk relative to a government money market option inasmuch that individual banks must be selected by the Board. Conversely, government money market options offer similar government-backing but are more operationally straightforward due to their mutual fund vehicle structure. While returns for the DCP FDIC-backed option have been slightly better than government money market funds historically, both are generally aligned with the short-term Fed Funds rate.

After much discussion, the Committee expressed an interest in further evaluating government money market options by conducting a mutual fund search (as outlined in the DCP Investment Policy Statement) for this investment type. This would aim to compare leading alternatives to the FDIC option. Concurrently, the Committee would like to proceed in alignment with the normal search process for FDIC providers which is set to occur later this year. In the interest of expediency and in recognition that past FDIC procurements have had mixed results, the Committee suggested that Staff and Mercer develop an RFI to assess the current level of bank demand for deposits as well as the attractiveness of these offerings from the DCP's perspective.

Recommendations: Based on our discussions with the Investments Committee, Mercer recommends that the Board approve:

- 1) a mutual fund search to review government money market funds¹ and
- 2) an RFI be created by Staff and Mercer to evaluate the depth and attractiveness of the FDIC bank provider market. Sample RFI questions are provided following.

¹ Assuming the Board is in agreement, Mercer will return at the next meeting with mutual fund search evaluation criteria which we believe should be considered in determining top candidates.

Sample RFI questions

- Indicate the vehicle type
- Are you able to accommodate daily valuation of the account?
- Are there explicit fees charged on deposits?
- Describe your proposed interest rate structure.
- Is the interest rate structure based on an observable reference rate? If so, describe.
- Describe the frequency of interest rate crediting and methodology.
- Provide historical rates under this methodology for the past 10 years or longest available period.
- Indicate your institution's total value of assets.
- Indicate total deposits with your institution.
- Provide your short-term credit ratings from Fitch/Moody's and S&P.
- Provide your long-term deposit credit ratings from Fitch/Moody's and S&P.
- Provide your total risk-based capital ratio.
- Provide your tier I risk-based capital ratio.
- Provide your common equity tier 1 capital.
- Provide your leverage ratio.
- Provide the number of physical branches of your institution.
- Do you provide FDIC-backed deposit accounts for other defined contribution plans? If so, provide detail on the number and average deposit size by plan.
- Is there a limit to the amount of deposits your institution could take from the City of LA Deferred Compensation Plan? If so, describe.
- Are you able to collateralize deposits beyond maximum FDIC coverage limits pursuant to California governmental code? Please describe the collateralization process.