Deferred Compensation Plan
BOARD REPORT 14-33

Date: August 11, 2014

To: Board of Deferred Compensation

From: Staff

Subject: Selection of Third Provider for the FDIC-Insured Savings Account Option and Contract Update

Recommendation:
That the Board of Deferred Compensation Administration (a) receive and file this update regarding the search or a third provider, provider allocations, and the Responsible Banking Ordinance as these matters relate to the Deferred Compensation Plan FDIC-Insured Savings Account option; and (b) direct staff to seek extension of the contract with Bank of America for a one-year period, through September 30, 2015.

Discussion:

A. BACKGROUND AND SEARCH FOR A THIRD PROVIDER

At its meeting on July 15, 2014, the Board took several actions relative to a recently issued Request for Proposal (RFP) for the Plan's FDIC-Insured Savings Account option:

(a) Approved the selection of Bank of the West and East West Bank as two of the three providers for the FDIC-Insured Savings Account;
(b) Instructed staff to draft proposed contracts for these two providers and authorized the Board Chairperson to execute the contracts;
(c) Reached a finding that the use of competitive bidding for a third provider would be undesirable and impractical and directed staff and the Plan's investment consultant to perform a search for a third provider; and
(d) Directed staff to seek City Council authorization of any needed extensions required for this option's incumbent providers if new contracting deadlines were unable to be met, and authorized the Board Chairperson to execute any necessary contract amendment(s) with those providers to extend the contract(s).

Since the July 15th meeting, the Plan's investment consultant, Mercer Investment Consulting ("Mercer") identified and reached out to a number of potential candidates including the following banking institutions:

1. JP Morgan Chase & Co.
2. Wells Fargo
3. Union Bank

4. U.S. Bank
5. Bank of America

Mercer subsequently indicated to staff that JP Morgan and Wells Fargo replied that they did not have an interest in providing these services. Mercer further indicated that while Union Bank and U.S. Bank initially expressed an interest, presently they are indicating some level of reluctance or lack of responsiveness. However, Bank of America continues to indicate its willingness to provide services under an extended contract, notwithstanding the fact that it did not respond to the City's RFP. As a result, Mercer and staff are presently not in a position to make a recommendation with respect to a long-term contract for a third provider as of the time of submitting this report to the Board.

The Board previously authorized staff to seek Council approval for extension of contract terms of incumbent providers if that was necessary. However, given recent developments, staff recommends that the Board clarify its prior action relative to the Bank of America contract to specifically request authorization to extend the contract for up to one year. Extending the contract for up to one year provides the Plan with flexibility to address a number of potential scenarios:

Scenario A: Finding a viable and interested third provider takes longer than anticipated.

Scenario B: No viable and interested provider is identified for a long-term contract.

Scenario C: The Board develops an alternative approach for managing the assets in this option.

In the event the latter scenario is realized, staff will review options with Mercer and may return to the Board with some alternate strategies for addressing this option at a more structural level. Those options may include reducing the number of providers, replacing this option with a money-market fund, or other strategies.

As previously discussed, both staff and the consultant believe that a broader, distorted interest rate environment is the fundamental driver of low rates and lack of interest from the provider community. So long as this interest rate environment remains, it is likely that the City's Plan will face challenges with finding and maintaining interested providers.

For the present, however, staff believes that the Plan is still on track to maintain this option under a three provider structure:

- Bank of the West, an incumbent, will continue to be a provider;
- East West Bank will absorb the assets presently held by City National Bank; and
- Bank of America, upon extension of their contract, will continue to provide services.

B. INTEREST RATE DIFFERENTIAL AND PROVIDER ALLOCATIONS

The Plan's Investment Policy Statement (IPS) provides that normally the allocation of assets will be split evenly, by thirds, between the three providers of the FDIC-Insured Savings Option. However, the IPS further provides the Board with flexibility to permit a larger allocation to one of the bank providers should that provider offer a rate with a significant difference over the other providers.

Currently, Bank of the West has been allocated 50% of the total asset pool due to having a significantly higher interest rate than the other two providers, which are allocated 25% each. However, with the rates proposed by Bank of the West and East West Bank pursuant to the 2014 RFP, that rate differential no longer exists. However, Bank of America is presently indicating that it would not be willing to absorb more assets than it is currently holding.

Given the present uncertainties regarding this option, staff recommends that current allocations temporarily remain for the initial transition, with East West Bank taking over City National's 25% allocation, and that determination of the longer-term allocation of assets between the three banking institutions be deferred until staff can report back further at the Board's next meeting.

C. CITY CONTRACTING PROCESS & REQUIREMENTS

At the July Board meeting, there was some discussion regarding the applicability of the Responsible Banking Ordinance (RBO) to the contracts for the FDIC-Insured option. Upon researching the City ordinance and speaking with the Office of Finance and the Office of the City Administrative Officer (CAO), staff found that the ordinance is in fact applicable.

The RBO requires that covered institutions provide certain disclosures on an annual basis for the prior calendar year related to community reinvestment and lending activities. This information is uploaded to the Office of Finance website, where it is then provided as public information. A bank is only required to file this paperwork if it provides banking services to the City of Los Angeles. Bank of the West, East West Bank, and Bank of America have each indicated that they will comply with this ordinance.

Submitted by: ______________________________

Esther Chang

Approved by: ______________________________

Steven Montagna