Deferred Compensation Plan
BOARD REPORT 14-37

Date: September 5, 2014

To: Board of Deferred Compensation

From: Staff

Subject: Allocation of the FDIC-Insured Savings Account Option and Contract Update

<u>Recommendation</u>:
That the Board of Deferred Compensation Administration:

(a) Approve staff's recommendation to adopt a revised allocation of assets for the Deferred Compensation Plan FDIC-Insured Savings Account option beginning October 1, 2014, allocating an equal portion to Bank of the West and to East West Bank; and

(b) Receive and file additional information regarding the FDIC-Insured Savings Account option.

<u>Discussion:</u>

At its meeting on August 19, 2014, staff indicated to the Board that the contracts for the new providers of the Deferred Compensation Plan's FDIC-Insured Savings Account option with Bank of the West and East West Bank were being negotiated, to be effective October 1, 2014. Staff also reported that initial discussions had indicated Bank of America would continue to provide services until a third provider was identified; however, Bank of America subsequently indicated that upon review by senior management the Bank was not willing to extend its contract beyond the contract expiration date.

Given this development and the fact that the Plan is still reviewing options for potential third providers, staff recommends that the allocation of the FDIC account be split evenly between Bank of the West and East West Bank for the initial transition after the current provider contracts expire on September 30, 2014. Assuming a third provider is identified and approved by the Board, the allocation of the account will again be reviewed.

ACCOUNT ALLOCATION

The Plan's Investment Policy Statement (IPS) provides that the allocation of assets for the FDIC-Insured Savings Account will typically be split evenly between three providers. However, the IPS provides the Board with flexibility to adjust these allocations based on institutional viability as well as interest rate differentials (e.g., a larger allocation to a bank provider should it provide a demonstrable yield advantage over the others). Currently, the account providers and their allocations are: Bank of the West (50%), City National (25%), and Bank of America (25%). Moving forward, staff and the Plan's investment consultant, Mercer Investment Consulting (“Mercer”), do not believe that any bank will offer a significant yield advantage in the current interest rate environment. Consequently, it is expected that FDIC option assets likely will revert to an equal allocation across providers.

As of August 31, 2014, there was $295,920,307 in total assets in this option, with approximate holdings and crediting rates indicated as follows:

	Assets	Current Crediting Rate
Bank of the West	$147,960,153	0.75%
City National Bank	$ 73,980,076	0.15%
Bank of America	$ 73,980,076	0.08%
	Approximate blended rate:	*0.43%*

The contracts for the incumbent providers expire on September 30, 2014. Bank of the West was the only incumbent to submit a proposal during the most recent Request for Proposal (RFP) process and has been re-selected as a provider. Staff is negotiating a new contract and anticipates no gap in services. In addition, staff has been working closely with the other successful respondent, East West Bank, on negotiating its contract and is on track to finalize a contract by October 1, 2014.

Services will not continue under the other two providers:

> City National: Previously communicated their decision to not pursue another contract term, though it is willing, however, to offer a short-term contract extension through the end of the year (three additional months) until a third provider is secured, provided a lower interest rate is accepted (approximately 0.05% versus the current 0.15%).
>
> Bank of America: Has now confirmed that they are not willing to extend the contract.

Given present circumstances and limited alternatives available, staff recommends splitting the account between Bank of the West and East West Bank equally until a third provider is secured. Both banks have confirmed their willingness to assume this amount of deposits. The assets and projected crediting rates for the new proposed allocation are indicated as follows:

	Approximate Assets	New Projected Crediting Rate
Bank of the West	$147 million	0.25%
East West Bank	$147 million	0.20%
	Approximate blended rate:	*0.23%*

FDIC COVERAGE CHANGE & COMMUNICATION

With the change in allocation, the FDIC coverage for a participant invested in this account may change based on the amount of assets they invest in this option. While participants will continue to be FDIC insured dollar-for-dollar up to $500,000, accounts with balances above that amount in this option will see a decrease in FDIC coverage; however, it should be noted that any amounts not covered by FDIC insurance are still required to be collateralized by each bank (pursuant to the contracting agreement and California Government Code). Participants may also utilize the self-directed brokerage option should they wish to find another product that will provide additional FDIC insurance coverage.

Below is an overview of changes in FDIC coverage:

Assets Invested in the FDIC Account:	Old FDIC Coverage	New FDIC Coverage (as of October 1, 2014)	Reduction in FDIC Coverage?
Up to $500,000	*100% of balance*	100% of balance	No
$501,000 - $999,999	*$500,000 +50% of your balance over $500,000*	$500,000	**Yes**
$1,000,000 and over	*$750,000*		

As of August 28, 2014, of the 9,098 participants with balances in this option, there were 22 participants with account balances above $500,000 who would see a reduction in FDIC coverage based on the proposed new allocation. The Plan will be sending out notices to these participants advising them of the change in FDIC coverage, as well as participants with balances above $450,000 (another 11 participants). Additionally, notice of the change will be placed in the next participant newsletter (to mail near the end of October 2014) and a web bulletin will be posted on the participant website.

THIRD PROVIDER SEARCH – UPDATE

As reported to the Board at its August 2014 meeting, Mercer identified and reached out to a number of potential banking institutions to determine interest in becoming a third provider for the FDIC-Insured Savings account. These included JP Morgan Chase & Co., Wells Fargo, Bank of America, Huntington Bank, Regions Bank, Fifth Third Bank, PNC Bank, Comerica Bank, Union Bank, and U.S. Bank. Of these, only Union Bank has indicated substantial interest in being a provider with the City. At the time of the writing of this report, Union Bank is reviewing the City's contracting agreement, general contracting requirements, and trading agreement with the third-party-administrator. Assuming Union Bank can work within the City's parameters and they are deemed to be a viable provider, it is plausible that it would be added as a third provider by early 2015.

Additionally, at the August 2014 meeting, the Board asked whether Mercer had identified any interest from online banking institutions. Mercer subsequently reached out to Ally Bank and Capital One; both indicated they either provide services only on an individual basis and/or on accounts up to a certain dollar amount.

Submitted by: ____________________________________
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