DEFERRED COMPENSATION PLAN
BOARD REPORT 09-46

Date: October 2, 2009

To: Board of Deferred Compensation Administration

From: Staff

Subject: Washington Mutual Certificates of Deposit

Recommendation:
That the Board of Deferred Compensation Administration direct staff to work with the Board's consultant and legal counsel to generate a finding as to whether and under what conditions the offer by J.P. Morgan to provide prorated interest for terminated Certificates of Deposit would be negative, neutral, or positive for the affected participants.

Discussion:
The following information is provided regarding Certificates of Deposit (CDs) held by former Washington Mutual Bank subsequent to that firm's acquisition by J.P. Morgan/Chase Bank (J.P. Morgan). J.P. Morgan has indicated that its conversion of Washington Mutual CDs to J.P. Morgan CDs will create certain operational impacts and, in connection with that, is proposing to liquidate the CDs early and provide prorated interest on the accounts. Staff will discuss each of these issues separately.

Conversion of CD Accounts
To help facilitate consideration of issues related to conversion of the CD accounts, staff will provide background in the form of a timeline:

> *September 25, 2008: J.P. Morgan Acquires Washington Mutual Bank* – Washington Mutual Bank was acquired by J.P. Morgan on September 25, 2008. Washington Mutual had been the provider of two investment options in the City's Deferred Compensation Plan: the Liquid Account and CDs (with terms for the latter ranging from 1-5 years). The acquisition was brokered by the Federal Deposit Insurance Corporation (FDIC) via an agreement to which J.P. Morgan, Washington Mutual and the FDIC were each parties.
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> *November 18, 2008: Board Approves Changes to FDIC Insured Options* – On November 18, 2008, the Board approved a recommendation from its Investments Committee to restructure the Plan's FDIC insured savings options to (a) create a blended multi-vendor savings option to replace the single vendor Liquid Account and (b) grandfather the Washington Mutual CDs out of the City's Plan. Final CD purchases by participants were permitted until June 2009, will all CDs to be eliminated from the Plan by June 2014. The Board further directed staff to issue an RFP for the blended multi-vendor savings option.

January 25, 2009: Release of RFP for FDIC-Insured Savings Option - The Deferred Compensation Plan released a Request for Proposal (RFP) on January 25, 2008, seeking providers for its blended multi-vendor savings option.

March 2, 2009: J.P. Morgan Declines to Respond to RFP - On March 2, 2009, J.P. Morgan indicated that it would not be responding to the City's RFP and, further, would no longer support the Liquid Account effective 09/30/09. In addition, its initial correspondence suggested that it intended to exit its position with the CDs as well. Staff, working together with the City Attorney and its consultants at Mercer Investment Consulting, contacted and received confirmation from the Federal Deposit Insurance Corporation (FDIC) on 03/11/09 that J.P. Morgan was obligated to continue the existing CDs under the terms of the FDIC brokered acquisition. J.P. Morgan acknowledged in correspondence dated 03/27/09 that CD participants "will continue to earn the original interest rate throughout the term of the certificate" but indicated that the Washington Mutual CDs would convert to J.P. Morgan CDs at approximately the time that Liquid Account holdings would be terminated. No information was provided at this time indicating any operational impact of converting the CDs from Washington Mutual to J.P. Morgan.

September 2, 2009: J.P. Morgan Offers to Terminate the City's CDs - Staff received emailed correspondence from J.P. Morgan representative ostensibly indicating that it would "close out the CDs." The correspondence further stated that, "We have made this decision based on the fact that the new CDs will not have the same flexibility and services as currently offered through Washington Mutual." J.P. Morgan offered to pay prorated interest on the CD accounts as part of closing them out. Staff immediately contacted representatives of the firm and as a result of those conversations staff was informed later that same day, verbally and via email, that J.P. Morgan could not liquidate the CDs without the City's consent. J.P. Morgan indicated, "if you do not send us forwarding instructions for the CDs, they will convert to standard J.P. Morgan Certificates of Deposit at your current rate and term…" On 09/04/09 revised correspondence was provided to staff which again confirmed that the CDs would continue to be honored, although the tone of the letter appeared to assume that the City would accept the offer and implied negative consequences for failing to accept it (by suggesting that J.P. Morgan CDs would not include the same operational support as the Washington Mutual CDs.

September 22, 2009: Conference Call with J.P. Morgan – On 09/22/09 a conference call was held including J.P. Morgan executive staff and legal counsel, City staff and legal counsel, the Board's consultants at Mercer Investment Consulting, and Great-West Retirement Services operational staff. Staff initiated the discussion by requesting clarification of the operational impact of having the Washington Mutual CDs convert to J.P. Morgan CDs. J.P. Morgan indicated two areas where it believed its operational practices would differ from those used by Washington Mutual: (1) wire redemptions vs. payments issued by check; and (2) reporting frequency and willingness to initiate reporting to Great-West for the purposes of reconciliation. Great-West Retirement Services is presently reviewing both of these issues and, as of the time of writing of this report, has not indicated what the operational impact of these changes would be. Further discussions may be required in order to resolve outstanding issues, but based on preliminary discussions with Great-West it appears that the conversion of Washington Mutual CDs to J.P. Morgan CDs can be accommodated operationally.

Early CD Liquidation

J.P. Morgan is offering to terminate the Washington Mutual CDs and pay prorated interest on the accounts. Depending on the term of the CD, early cash-out could provide certain participants with opportunities to reinvest the proceeds and earn higher rates of return than they would earn by leaving the CDs where they are currently held. There are two important caveats to this, however.

First, reinvesting the CDs requires either that a replacement CD provider is made available within the Plan's core options or that affected participants find a replacement CD provider through the Plan's Self-Directed Brokerage Option (SDBO). In staff's view forcing CD participants to find a replacement through the SDBO is not a viable option due to the additional logistical burdens and fees it would impose on the affected participants, many of whom can be presumed to be more conservative investors who are unlikely to be otherwise interested in participating in an SDBO. As a result, if the only viable option is installing a replacement core menu CD provider, a determination would need to be made as to whether that replacement would be permanent or temporary (through the final term of the existing CDs) and the form of an investment provider search (through a Request for Proposal or consultant-led manager search). In either event, selecting and installing a new CD provider could not happen within the short time-frame (prior to the end of 2009) proposed by J.P. Morgan.

Second, before proceeding on the above, the Board would need to reach a finding that accepting the offer from J.P. Morgan was appropriate. This would require analysis of the offer by the Board's consultant to determine whether and under what conditions the offer would be negative, neutral, or positive for participants in each of the CD terms, and a finding from the consultant and the Board's legal counsel as to whether it would be appropriate for the Board to take an action of this type in any event.

The Board has the option of rejecting the J.P. Morgan early cash-out offer without proceeding to further review. However, it can pursue this matter further by directing staff to work with the consultant and legal counsel to generate a finding as to whether and under what conditions the offer from J.P. Morgan would be negative, neutral, or positive for the affected participants. Staff believes the latter represents the most appropriate course of action given the circumstances and therefore recommends that the Board so direct staff.

Submitted by: ___________________________
Steven Montagna

Approved by: ___________________________
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