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Correspondence Memorandum

Date: February 9, 2021

To: Deferred Compensation Board

From: Shelly Schueller, Director
Wisconsin Deferred Compensation Program

Subject: Proposed Amendment to FDIC Bank Option Contract

The Department of Employee Trust Funds (ETF) recommends the Board amend the FDIC bank option contract (ETJ0050) to provide an interest rate floor of 15 basis points.

After a successful Request for Proposal process, the Board approved a contract with Johnson Bank to provide the FDIC bank option for the Wisconsin Deferred Compensation Program (WDC) in June of 2020. As of December 31, 2020, nearly 7,000 WDC participants held approximately $148,419,000 in the FDIC bank option.

In late 2020, Johnson Bank approached ETF staff regarding the FDIC bank option contract, noting that the changes in the financial markets caused by the pandemic have resulted in more cash being deposited than loaned out, and lower interest rates for much longer than anticipated. Johnson Bank believes the current contract terms are unsustainable for the bank. They are respectfully requesting the Board consider a contract amendment to lower the FDIC bank option interest rate floor from 30 basis points to 15 basis points. Johnson Bank can provide additional details on how the market has changed since the contract was signed

Johnson Bank staff will attend the meeting to discuss this request with the Board. Their presentation is attached to this memo. The current contract requires Johnson Bank to pay out 30 basis points on the FDIC bank option deposit floor while the account only earns 7 basis points[1]. As noted in the presentation, the Federal Reserve Board's economic projections suggest short-term interest rates will remain low for at least the next three years, and thus excess liquidity will remain in the banking system.

[1] Johnson Bank states it is earning 10 basis points on cash and pays a fee of 3 basis points for FDIC insurance, netting a rate of 7 basis points.

Reviewed and approved by Matt Stohr, Administrator, Division of Retirement Services

Matt Stohr Electronically Signed 2/22/21

Board	Mtg Date	Item #
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Staff recommends the Board amend the FDIC bank option contract (ETJ0050) as shown to provide an interest rate floor of 15 basis points. If approved, the change to the interest floor would be reflected in revisions to the contract, as shown below:

A.2. Contractor will provide an FDIC-insured liquid deposit alternative (“Deposit Account”) for the benefit of participants in the Program. The funds will be held in two (2) omnibus Deposit Accounts: one (1) Pension Now omnibus transaction account and one (1) Liquid Savings omnibus account, both titled for the benefit of the Program’s participants that provide pass-through FDIC insurance coverage for each participant. Contractor will work directly with the Board’s designated entity(s) that provides recordkeeping and trustee services for the Program.

Contractor agrees that interest rates set for the Deposit Accounts under the terms of this Contract are generally subject to a guaranteed interest rate floor equal to the current applicable rate for the 30-day U.S. Treasury bill from the US Department of Treasury website, two business days prior to the end of the month, less a spread of 5 basis points, but at no time will the rate be less than ~~30~~ 15 basis points ~~(0.30%)~~(0.15%). The yield for the entire pool of FDIC-insured liquid deposits will change beginning on the first day of each month and the yield will remain in effect until the last day of that month. Interest will be accrued daily using the 365/365 method and be credited on the last day of each month. During leap year, interest will be credited for a total of 366 days.

Contractor will work with the Board’s record keeper to act upon the net daily withdrawal or deposit instructions.

Individual Deposit Account balances will be insured under the existing FDIC coverage levels. The FDIC coverage levels may change and are not set by the Contractor or affiliates of Contractor.

Upon 30-day written notice from the Board, or its record keeper, of the aggregate total of individual participants’ Deposit Accounts that exceed the maximum applicable FDIC insurance coverage, Contractor shall collateralize, with U.S. Government-backed securities such as, but not limited to, Treasury Bills, Treasury Notes, Fannie Maes and/or Freddie Macs, at a rate of 110% of such amounts. If at any time, the total deposits held in Deposit Accounts exceeds $200 million, Contractor and Board agree to negotiate in good faith changes to this Contract’s terms to appropriately manage the risk of additional deposits. Based on such negotiations, and in Contractor’s sole and absolute discretion, Contractor may allow additional deposits.

If the Board approves this contract change, staff will work with Johnson Bank and the WDC's record keeper to implement the contract changes by mid-2021, including developing a communication plan to notify participants of the change. If this change is not approved, it appears likely that Johnson Bank will seek to terminate the contract early. This would necessitate a search for a new FDIC option provider.

Staff from ETF and Johnson Bank will be at the meeting to answer any questions.

Attachment: 2021 Proposed FDIC Floor Reset

JOHNSON FINANCIAL GROUP®

BANKING WEALTH INSURANCE

WDC Board Investment Committee
FDIC Provider Contract Discussion

11 March 21

Introduction

- Johnson Bank is pleased to have been the provider of the FDIC-Insured Investment Option for the State of Wisconsin’s Deferred Compensation Program since December of 2018.

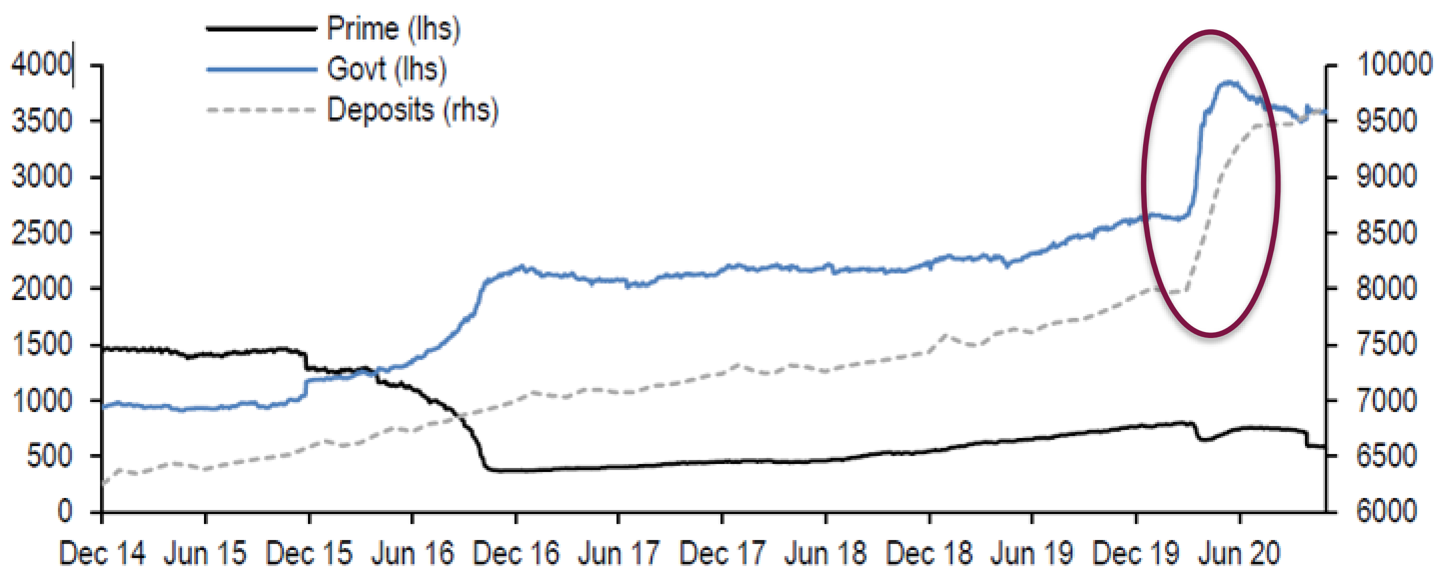
- We appreciate the working relationship with Shelly and the Deferred Compensation Team out of Madison along with Empower and Great West and believe ongoing operations have been clean and efficient on all sides.

- Unfortunately, our Bank and the industry have been surprised by the depth and length of the covid-19 induced changes in the financial markets. This presentation seeks to provide background and concludes with a request to lower the floor rate on the FDIC option without changing any of the other terms.

Developments in 2020

- The Fed cut short-term rates 150 basis points in March of 2020 and stepped-up efforts to buy securities.
- The yield curve moved materially lower and uncertainty spiked with covid-19 related concerns.
- As shown in the chart below, deposits in the banking system increased dramatically along with balances in government money market funds.

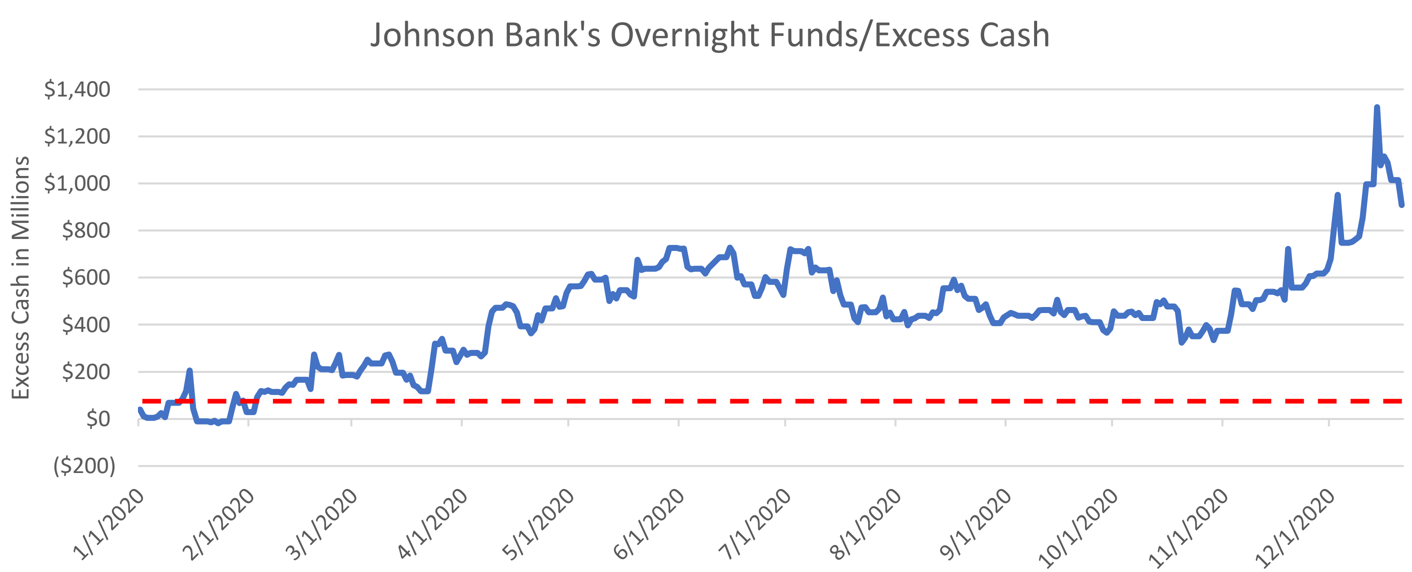
Prime and government MMF AUM (lhs, $bn) vs deposits at large commercial banks in the U.S. (rhs, $bn)



Source: iMoneyNet, Federal Reserve, J.P. Morgan

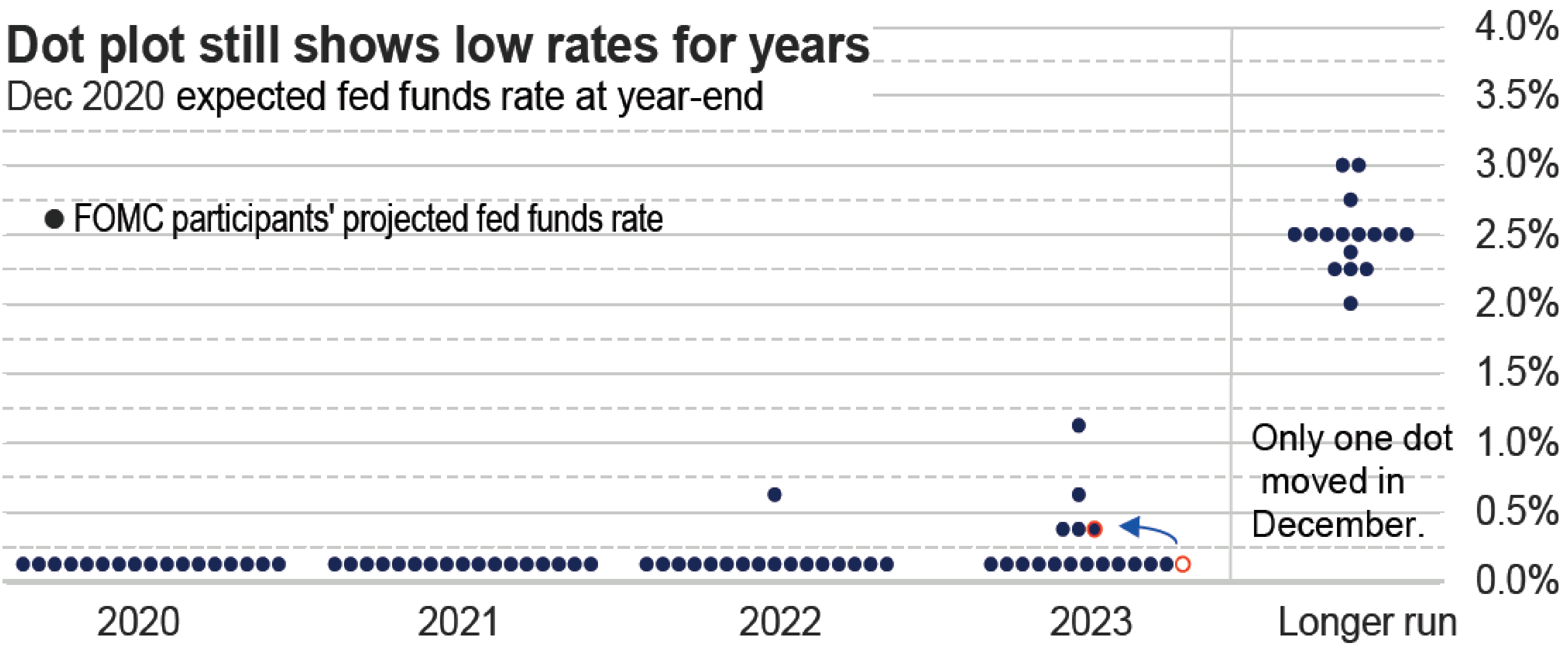
Developments in 2020

- Like many financial institutions, Johnson Bank's cash in excess of loans and investments increased in 2020 as shown by the chart below.
- Though our Bank participated heavily in the Paycheck Protection Program (PPP), clients taking advantage of these loans generally deposited the money back in the Bank. Loan forgiveness has the government paying the Bank for the principal while many of the clients do a combination of retaining some deposits, paying down borrowings and meeting payroll obligations.
- This has contributed to cash in excess of our preferred target (the red dotted line below). On this cash, the Bank earns 0.10% and pays a fee for FDIC insurance of 0.03%, netting a rate of 0.07%



Developments in 2020

- Johnson Bank entered the FDIC relationship with the State in the hopes of making loans to customers at rates above the deposit rate or, if we were in an excess cash position, of keeping the cost of our funds close to or below the rate we earned on excess cash.
- Presently, we are paying out 0.30% on the deposit floor and earning 0.07% as noted on the prior page.
- If one believes the Fed's forecasts as evidenced by their "Dot Plot" below, short-term rates will likely be low for the next three years or longer and the excess liquidity in the system will likely remain.



Note: Each dot represents the expectations of one FOMC member. Median projections for 2020 - 2023 is 0.125%. The longer run median is 2.5%. One member did not submit projections for the longer run.

Source: Federal Reserve Board of Governors

Recommendation

- The current terms of the contract call for a monthly reset to the 30-day T-Bill less five basis points with a floor of 0.30%.
- We are asking to adjust the floor only to be lowered to a rate of 0.15% while retaining the 30-day T-Bill less five basis point calculation.
- Thank you for your consideration.