CITY OF MCKINNEY, TEXAS

Analysis of Bank Depository Service Proposals
April 2014

In March 2014, the City of McKinney has solicited proposals for banking services to serve the City with efficient and cost effective banking services. The City intended for its banking partner to provide cost effective state-of-the-art technology to assure that its current banking needs would be met and that it will be able to incorporate technological changes and improvements into its operations over the period of the contract. The contract is to be for a three year period with a potential two year extension with City Council approval.

The City received five proposals for banking services in response to the Request for Proposal (RFP). The proposals were made by America National Bank (the incumbent bank), Chase Bank, Legacy Bank, Prosperity Bank and Wells Fargo. All the banks have the necessary facilities and services within the City limits and are solid financial institutions which can provide the basic services required. The banks are all highly credit rated and have been shown to have contributed to the health of the community through their 'satisfactory' and 'outstanding' CRA ratings (Community Reinvestment Act).

The initial review placed two banks in close competition and the City asked for a "Final and Best" offer from both American National and Wells Fargo banks. There was a considerable difference on the services available at the two banks but the costs and resulting potential earnings placed the two banks in close contention.

The economic conditions have somewhat dictated how this evaluation reviews earnings capabilities in the banks. Normally, the best rates available to the City would be obtained through a 'sweep account' which moves funds out of the bank every night investing them into a higher yielding money market fund which also reduces collateral requirements and costs. During this contract period this situation may return and must be considered. However, with overnight rates hovering at zero percent the earnings in money market funds are effectively negative with fees applied. Therefore, the earnings potential has been focused on compensating balances and interest bearing accounts. Rates are anticipated to be low for at least the first year, and perhaps year-and-a-half, of the contract based on Federal Reserve statements.

As a result of the low rates none of the banks are offering a sweep mechanism currently but it is critical that the chosen bank has the option available for the higher rate environment when rates rise for the remainder of the contract period. Regardless of rate environment the fees for services and the earnings potential at the banks are critical to evaluating the net savings/earnings to the City.

The evaluation was guided by the City's guiding objectives in the RFP:

banking services costs and earnings potential,
responsiveness and ability to provide services and reports required,
earnings potential,
experience, references, and continuity of the bank and bank officials, and
creditworthiness and stability of the bank.

Since banks bundle services and price services differently, the evaluation of the proposals was made on several different levels to capture and evaluate those differences equitably.

(1) All services offered and recommended have been evaluated as to the level of service offered compared to the required specifics, the level of automation which can improve staff productivity, level of control, and availability of customer service on an on-going basis. The bank is also evaluated to determine its adaptability and capability to grow into new technologies as they become available.
(2) The cost of specific and overall services has been compared between all banks on an equal basis.
(3) The potential for earnings has been compared based on various account structures and based on historical data, rather than future projections.
(4) The proposals have been evaluated combining all these factors and netting earnings and costs to create a final, unbiased assessment through net impact.

These four levels of analysis have been completed through a detailed compilation of findings. The worksheets which were used to make these analyses are attached. The following report summarizes those findings highlighting key areas identifying differences between the banks. Comments here are not all-inclusive but are made to highlight specific differences by way of explanation and illustration of the recommendation.

REQUIRED SERVICES EVALUATION

The City's RFP outlined and requested detailed information on all the services which would be required under the contract to perform its current banking services and to meet its projected needs. The goal is to have the banks perform those duties in the most cost effective manner.

The analysis evaluated all services, along with their associated costs, for services which will be needed immediately or added during the term of the contract. Specific functional areas of required services are discussed briefly here noting significant differences in service levels or capabilities between banks. Neither the analysis nor recommendations automatically include all services available through the banks if the costs were prohibitive or if their use by the City was unlikely. It is imperative, however, that the bank be capable of providing the service should it be needed.

The banks were ranked on services by (a) weighting each question in the RFP by its relative importance to the City and to the performance of the service and (b) scoring each proposal's response. The total points received by each bank for service provisions are:

America National Bank	753
JPMorgan Chase	**909**
Legacy Bank	795
Prosperity Bank	584
Wells Fargo	**963**

The major differences in service scoring occurred in the areas of account structure, automation capabilities, reconciliation, safekeeping and collateralization. All the various category sections are shown with the subsection scores on the Service Summary Sheet.

Customer Service

All the banks strive for excellent customer service and have management review of problems. Chase and Wells not unsurprisingly have deep technical and specialist teams supporting the local representatives as well as feedback forums and escalation procedures for problems. Only American National and Wells enumerated new services planned. American National is planning to implement RCK and bill presentment through a third party (Govolution). Wells is increasing its mobile banking, introducing an Android application, adding composites and CD summaries, adding cash forecasting and enhancing EDI payment detail reporting. Chase does not release future plans.

Fraud control is a key concern in today's banking and all the banks have positive pay services and some filters and blocks for ACH transactions. Chase and Wells have multiple layers of security from digital signature controls to receivables which do not release routing numbers. Timed lockouts and vendor tracking are additional fraud controls at Wells. Legacy routinely screens transactions for fraudulent items and both Legacy and Prosperity use one-time use tokens for all money-movers use.

The agreements each bank is requiring for signature accompanied each proposal. American, Legacy and Prosperity had minor noted exceptions. Chase lengthened the termination allowance to 30 days, which is not unreasonable considering the account size, but it wants 10 and not 3 days on a default correction period which is not reasonable. Wells submitted its own collateral agreement which is straightforward but has two unreasonable clauses which would have to be removed before any award. The bank states that it follows PFIA and PFCA state statutes rather than the more restrictive City limits and it wants a 100% coverage on collateral instead. This is the bank's normal initial stance on collateral but one that would have to be changed to City limits and 102%. The bank also wants substitution without City approval. This sounds detrimental but the Bank is also providing for custody at Bank of NY which gives the City an online daily marked-to-market view of the collateral which is actually better for monitoring collateral.

Account Structure

The RFP required the ability to automatically sweep daily into an SEC regulated money market fund as an option. This is the most effective banking structure to maximize earnings when rates are higher than current historically low rates. The RFP also allowed for sweeps to an interest bearing account or stand-alone accounts to accommodate the current low rate environment. With current historically low interest rates the sweep structure is unavailable because it is ineffective. Any bank's internal rates (where funds are being loaned out) are better than those found in the money markets with overnight rates at zero to 0.01%.

Only Chase and Wells Fargo have a sweep mechanism. The other three banks have only the capability to leave funds in their bank. Both of these banks also provide for monthly sweep reports to aide in reconciliation and entries. All the banks have the ability to create a ZBA (zero balanced account) to consolidate funds. Chase and Wells also have the ability to accrue interest to either the Master or individual accounts.

With a large amount of money left in the bank at low rates to pay on a compensating balance the FDIC fee pass-through can be a major issue. American National, Legacy and Prosperity do not pass through the FDIC assessment through to the City. Chase and Wells will pass it through resulting in an approximate $4000 fee per month.

The analysis of the proposals did include the potential to utilize the earnings credit rate (ECR) when rates so dictate assuming continuous full investment.[1]During the current period, paying bank fees through a "compensating balance" (i.e. target balance) is recommended because it is extremely cost effective with the bank's ECR significantly higher than the pools or other liquid vehicles. The banks have been aggressive on their ECR rates which will be considered in detail below. Two of the banks have offered a floor rate on the ECR: American National at 0.30% and Wells Fargo at 050%. The use of this ECR and the account structures materially affect the net costs to the City.

[1]The City's reserved right to change between fee and compensating balance basis for compensation determines the level of the sweep on an ongoing basis.

Automation

All the banks have the basic reporting and transactional services needed and have very similar levels of basic automation and reporting capabilities. The capabilities and reporting customization is significantly different in the national banks however. All the banks utilize automated services which reduce time and effort required of City staff for standard banking functions (balance reporting, wires, ACH, stop pays, positive pay, etc.). All have dual or more levels of City controlled security administration. All have systems available by at least 8:00am for information processing.

Neither American National nor Legacy has any customization on their systems. These are basic online systems both offered through a third-party NetTeller. These systems also are focused on prior day activity and do not have current day reporting availability. Downloads are also limited with downloads geared to Microsoft Excel and Quick Books rather than file transmissions and straight downloads to City files. This is true of the Prosperity system also although it does have some limited ability to restrict reporting by dates, check numbers or category and some current day information. By comparison, Chase and Wells Fargo have extensive automation with customization from the home page for individual users to reports. Reports and transactions are real time for ACH, wires and transfers and daily postings are updated throughout the day on current day reporting. They both have direct links to images and have multiple formats for downloads. The supplemental services like lockbox, e-box and cash letters are all brought into the systems.

All the banks have imaging for checks and statements and allowing access for one year. All the banks retain detail and summary information on line for a stated period of time. American National retains remote deposit information for 60 days. Chase and Wells Fargo both retain balances and transactions for 60 days online and 7 years for images. Legacy retains statements on line for 14 months. Prosperity retains statements online for 2 years.

The major difference in automation is in the flexibility and customization allowed by the larger interstate banks and the customizable portals. These portals are the main entry point for each individual user and can address their particular needs. These larger banks have a larger footprint and have concentrated on developing the technologies. The Wells Fargo CEO and Chase ACCESS appear the most user-friendly formats.

Deposit/Collection Services

In the area of basic deposit and collection services the banks are essentially the same. All the banks can remotely capture checks for deposit which was included in the required services and should be considered by the City use because of reduced float, reduced collateral needs, and increased security. All the banks remote systems are web based and easy to use. Chase and Wells Fargo have linked their remote to additional receivables services moving to e-receivables and generally taking all transactions online or into an electronic format. American National has offered one free scanner, Chase has offered four free scanners and Legacy will supply scanners without indicating how many. Wells Fargo is offering $5,000 for transition supplies which could be used for scanners.

One major difference in deposit services is the use of vault services for Chase and Wells Fargo. These banks will not accept funds over $10,000 (due largely to Patriot Act limits) or more than 250 checks (which would be eliminated n any case with remote deposit). With these banks an armored car service to the respective vault would be needed with a 4:00 cut-off at Wells Fargo and a 5:00pm cutoff at Chase. The vaults are all in the DFW area. All the banks have local banking centers which can be used for deposits. All the banks use tamper proof poly bags (with possible canvas bags at American National, Legacy and Prosperity). Deadlines for deposits are shortest at American National and Legacy. Remote deposit deadlines are 9:00pm at Chase and Wells Fargo and 6:00pm at the other banks.

Location tracking on deposits aides on reconciliation. Location tracking is available at Chase and Wells Fargo only. Legacy can track by the branch at which the deposit is made.

In the area of assisting the City in moving its vendors to the use of electronic payments, Chase and wells Fargo again have full programs for vendor payments (Pay Connexion at Chase and e-Bill express) to encourage vendors and merge the information on receivables into City transactions.

Advices and returns on deposits can be handled electronically by all the banks except Prosperity. Wells Fargo has extensive decisioning on returns management as well as mobile handling.

Chase and Wells Fargo have highly developed systems for collection management using increased ACH and a receivables collection process. This is an important function for consideration in the next few years to have as services develop to decrease float and increases handling efficiencies.

A separate collection mechanism offered by Chase and Wells Fargo (and available in 2014 at American National is the re-presentment of checks through ACH. The process allows NSF checks received to be represented as a date targeted ACH direct debit to enhance the potential for initial collection.

E-box services are available only at Chase and Wells Fargo. Chase automatically aggregates the transactions (and can do debits also) with full transmission repair services as part of their Payment consolidation services. Chase's Host-to-host service sends all types of receipted information with the remittance detail by email. Wells Fargo brings all the payments together including remittance information confirms history online and allows for single transmission and posting. These payment consolidation services significantly reduce City staff time.

Disbursing Services

The provision of standard disbursing services is basically the same at all the banks. All the banks have positive pay services for safety and fraud control. In the area of disbursements, it is critical for any large institution/business to protect against fraudulent checks. The system designed by the banking industry to accomplish this is positive pay. It has been required in this RFP for all accounts to provide security. All the banks except Legacy and Prosperity have payee positive pay to also capture the payee name. In the area of positive pay an important consideration is the time available to City staff to review the check exceptions. These times and the time of the day for review vary which impacts staff time: Chase and Wells Fargo give six and five hours respectively, Legacy four hours, Prosperity three hours and American national two and one-half hours. Only Wells Fargo offers a third option on the positive pay decision which allows the City to "hold" an item for research which can be very helpful.

Payment management has become a more effective service over the past few years. The information processing is available at Chase (Receiver Services) and Wells Fargo (Payment Manager).

Another area of disbursements is stored value cards (debit cards) which can be used for payroll or other reimbursement or advance purposes. This presented as a service in the RFP. Prosperity does not have the service and Chase is no longer offering the service. American National and Legacy provide the service through a third party. Wells Fargo offers the option of a standard or instant card (prepaid) solution, online orders for cards, and cardholder reporting.

Account Reconciliation

The City currently uses partial reconciliation services. American National and Prosperity do not have reconciliation services and rely instead on simple listing of paid items for City use. Legacy does have basic reconciliation reporting. The use of cleared information only is not effective as a complete substitute for full reconciliation.

Chase and Wells Fargo have fully developed reconciliation services (partial and full services) providing for multiple formats and complete ARP reporting.

Wires and Internal Transfers
In the area of wires and internal account transfers the banks are very similar. All use online services to create and monitor pending wires and transfers. All, except American National, allow for future dating of wires. All have strict security provisions for use. Although the banks are all automated, American National requires a call-back on wires over $25,000. The others all report and confirm online. All the banks provide for template creation with Chase restricting *any* change of the template at use. Addenda for the wires are also available at all banks although Prosperity has to fax the information to the City. Chase and Wells Fargo incorporate the information from the transactions in to their payables reporting.

Only Prosperity requires a collected balance before the wire is sent. Chase aggregates account balances. The others automatically have a risk manager or local representative make the final call on whether to allow the outgoing wire.

ACH Services
ACH services are of paramount and growing importance as it represents the most cost efficient payment transfer system. Its use is undoubtedly going to increase in importance in the future as new services develop and use these mechanisms. For example, the remote check acceptance service depends on ACH and can save the City considerable fees over traditional check processing. All the banks must utilize the NACHA[2] formats and services and function through SWACHA so there is little difference in the basic service. All can future date ACH transactions.

All of the banks, except American National, give the City the ability to input by batch or individually online. All have the ability to establish blocks and/or filters on the accounts for City safety. The variety available for filters is greater at Chase, Legacy, Prosperity, and Wells Fargo. The addenda accompanying ACH transactions are critical for the staff to identify transactions. American National, Chase, and Wells Fargo all provide for electronic notification. Chase and Wells Fargo have superior ability to capture the entire addendum through standard reporting.

Investment Safekeeping
The City invests in securities for its portfolio so safekeeping is a required and critical service. The delivery versus payment (DVP) settlement and protective custody of the City's owned securities are paramount for safety and control. All of the banks, except Prosperity will offer safekeeping services. American National uses Northern Trust which delays all coupon distributions by one day without reimbursing the City. Legacy uses TIB as the safekeeping agent and confirms are delayed two days. Neither of these is an optimal situation considering the amount of money concerned.

Only Chase and Wells Fargo provide online tracking and reporting and Wells Fargo allows for customization on the reporting although the safekeeping for wells Fargo (without significant fees) is on the brokerage side of the bank. This major difference at Wells Fargo comes from it's two locations for safekeeping: the bank or the WF brokerage subsidiary. The bank safekeeping is prohibitively expensive. The brokerage safekeeping is not available unless the City uses the brokerage services. In order for the City to retain control of its trades and to obtain the statutory control of DVP the RFP stated clearly that the depository will <u>not</u> be used as a City broker. The bank does offer the use of a money fund in the brokerage to accommodate this situation as an accommodation.

[2]National Association of Automated Clearing House Association

Collateral Conditions
The RFP outlined specific conditions for the provision and safekeeping of required collateral which were directed to maximum safety of the City's funds. The banks were asked to confirm their compliance with each of these requirements. The requirements included the 102% margin level for collateral, authorized collateral types, and the provision for independent third party safe-keeping and reporting. The banks were required to accept the conditions as stated. Not all the banks confirmed agreement without exceptions.

- American National made only one exception and that is that receipts are received from the bank and not the independent custodian. The custodian (FHLB) does however send monthly reports directly to the City (which should be verified because this is rarely the practice of the FHLB).
- Chase has made several exceptions. The bank uses the Federal Reserve but wants one day advance notice on large deposits. The bank does not want liability but will take responsibility. Chase Bank has referenced a section of the law which "requires" the City to inform the bank of increased inflows rather than the longer standing section of the same law (PFCA) which allows the City to make a best effort at notifying the bank. Since this could involve some liability on collateral coverage it is a point, if the bank were chosen, to address before award of the contract.
- Legacy has made no exceptions.
- Prosperity makes no exceptions.
- Wells Fargo uses Bank of New York. It requests the right to release and substitute collateral without City approval. It wants the ability to pledge anything under Texas law and its agreement calls for 100% margin.

Only Wells Fargo has online monitoring of collateral at the custodian which includes daily mark-to-market.

Statements and Account Analyses
All the banks provide monthly statements online and make them available for downloads. All can provide a monthly CD. Availability of reports is very similar for all banks. Banks are generally trying to move from paper based reports and statements to downloadable but all will provide the statement if required. All have electronic versions of the account analysis.

Overdraft Protection
Although the City does not anticipate any overdrafts the potential exists. All the banks view overdrafts as an extension of credit and review each occurrence. Only American National has no fee for overdrafts unless it becomes excessive. Chase uses stand-alone evaluation and therefore does not allow overdrafts. Prosperity requires the amount in compensating balances or accounts. The charge varies for the other banks: Legacy at prime plus 2% and Wells Fargo at prime.

Stop Pays
Stop pays are placed on line at all the banks. American National, Legacy and Prosperity al have six month stop pays which are then renewed for successive six month periods. At Chase the stops start at one year and at Wells Fargo they start at six months but like Chase renew automatically out to seven years. Chase is the only bank which does not encourage or permit stops through the positive pay system. All the banks have online information for current stop pays but Chase and Wells Fargo also keep the history online with reporting.

Ambulance Lockbox
All the banks suggest a wholesale lockbox for the ambulance payments collected by the City and every bank except Prosperity will provide remittance design assistance. Both Chase and Wells Fargo consolidate the information into their receivables reporting and consolidation platforms.

Merchant Services

The City simply asked in the RFP whether the banks had merchant services available. American National states that by mid-2014 they will partner with Automated Merchant Services to provide the service. Prosperity will also start through Automated Merchant Services in mid-2014. Legacy had no comment on the service. Chase and Wells Fargo are two of the largest and longest tenured merchant services providers. Both have expressed interest in talking to the City for this service.

Stored Value Cards

Stored value cards were mentioned briefly above in the disbursement discussion. The service is not available at Chase or Prosperity. American National has a limited service. Legacy provides the service through TIB. Wells Fargo has an extensive program with instant and re-load cards, online reporting and enrollment and card holder reporting.

Company Banking

All the banks have standard company banking programs for City employees. Direct deposit is not required at American National or Wells Fargo. It is not required but with it employees receive a higher interest rate at Legacy.

Check Printing

The use of the banks for the printing and mailing of City checks was included in the RFP as an optional service. Only Chase and Wells Fargo provide the service. Chase receives the transmission and processes via their PaySource programs with fraud control paper and reporting. Wells Fargo uses its Payment Manager module. They print checks and the associated documents complete zip routing for lower postage fees, provide fraud paper and include an on-boarding program for vendors to help move them to ACH.

Alternative Services

All the banks except Legacy presented alternative or advanced services. All of American National's suggestions however had already been included in the required services sections. Prosperity suggested Prosperity suggested pay cards which are the same as stored value cards which were in the required services. Chase discussed single use accounts, municipal leasing options, smart safes and mobile ACCESS use. Wells Fargo discussed their receivables manager.

Services Summary

Clearly the interstate banks have invested significantly in technology and provide the tools to move as much data and information electronically as possible. The systems are more flexible and customization is built in throughout the systems. These are the banks which will continue to move quickly as new services and technologies are made available because of their large service foot print. The service scores received reflect their capabilities and scope.

<u>BANKING COSTS EVALUATION</u>

In its RFP the City has reserved the right to pay for services on either a fee or compensating balance basis dependent upon the interest rate environment[3]. Regardless of the method of compensation used, the total cost of the contract starts with the individual service fees in each bank. Both fees and compensating balances are based on these fees and the volumes of those services used. An attachment of the RFP was used to capture unit costs for each services and levels of service.

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[3] In very low interest rate environments the ECR may exceed the interest paid in accounts or money funds. Rates rise however the ECR usually earns half of Fed Funds (i.e. overnight rates).

Using the historical volumes for services from the City, a gross estimated monthly price level was calculated for each bank. These include FDIC fees which are charged by Chase and Wells Fargo.

	Gross Fees	w/out Paycards/safekeeping
American National	$ 4,855	$ 4,121
JPMorgan Chase	$ 8,384	$ 8,034
Legacy Bank	$ 367	$ 0
Prosperity Bank	$ 55	$ 30
Wells Fargo	$ 8,378	$ 8,328

The second column which removes the charges for both stored value cards (paycards) and safekeeping which are not offered by all the banks shows an apples to apples comparison. However, it is extremely difficult on straight fees to compare these five banks. Two of the banks, Legacy and Prosperity have made their proposals on a "no fee" basis. Obviously no bank offers their services for free. Most often banks which offer free services are earning their fees by lowering the interest rate available to the City while the funds are in the bank. All these banks know that for straight operational reasons the City will probably maintain funds in the bank and not invest it outside. Because of the large compensating balances required during the last five years of low interest rates the City has been leaving an average of $36 million in the bank. Therefore a superficial look at only fees does not fully or fairly judge the true cost of – or benefit to - the City. We will compare the banks again utilizing the earnings rates that they are making available to the City on a historical and future looking basis.

Another factor influencing the true cost of service at each bank is the value of incentives each has offered the City. The RFP asked what transition or retention each bank was offering in their proposal.

Transition Incentives

The cost of the contract is directly impacted by the transition incentives being offered by the banks. Those incentives *from the initial proposals* are listed here and translated into their monetary worth on the combination sheet attached as part of this evaluation.

- **American National Bank, as the incumbent depository, is offering a floor on the ECR rate of 0.20% and a floor on the interest bearing accounts of 0.20%. They are also offering one free remote scanners and a safe deposit box. They will offer a no fees program with $18 million left in the bank. The waived fees do not include paycards or merchant services.**
- **Chase is proposing to waive the first six months of service fees and is offering four free scanners. The bank will also give an analysis credit for the initial supplies (bags, check stock and stamps).**
- **Legacy is offering the "needed" scanners which are assumed to be four.**
- **Prosperity Bank is offering an interest bearing floor rate of 0.25% and a floor money market account rate of 0.25%.**
- **Wells Fargo is offering an ECR floor rate of 0.50% and an account analysis credit of $5,000 for supplies. They are waiving all set up fees for services started the first year. In addition, the bank is offering to waive three months of analysis charges the first year, two months of analysis charges the second year and one month the third year.**

Using each bank's estimated gross cost per month these incentives have been included to measure the impact on the monthly cost of service over a three and five year period. The average adjusted monthly charge over a three and five year periods are shown below. Again, just the level of fees is indicative but is not the full picture of the price of services as will be explained below.

	Gross Fees	Adjusted Fee/3 Yrs	Adjusted Fee/5 Yrs
American National	$ 4,855	$ 4,857	$ 4,856
Chase Bank	$ 8,384	$ 6.760	$ 7,410
Legacy Bank	$ 367	$ 279	$ 314
Prosperity Bank	$ 55	$ 55	$ 55
Wells Fargo	$ 8,378	$ 6,843	$ 7,457

Best and Final Proposals

Only the two leading banks from the initial evaluation were asked to offer a Best and Final Proposal. Those proposals are summarized below.

American National Bank of Texas

The bank offered four pricing options.

#1 An ECR of 0.30% on non-interest bearing accounts. Money market account rate of their normal rate plus 0.15% - currently 0.20%.

#2 No set fees by service level with a balance of $18 million and money market account rate of their normal rate plus 0.15% - currently 0.20%.

#3 An ECR of 0.28% on non-interest bearing accounts. Money market account rate of their normal rate plus 0.15% - currently 0.20% with allowances per year of $7,000, $6,000 and $6,000 per year.

#4 No set fees by service level with a balance of $19 million and money market account rate of their normal rate plus 0.15% - currently 0.20% with allowances per year of $7,000, $6,000 and $6,000 per year.

Additionally they offered on remote deposit scanner, one safe deposit box.

Wells Fargo Bank

Wells Fargo offered to reduce the fees on several of their service categories including:

- Debits posted
- Deposited checks (all types)
- Batch transmission on ACH
- Stop pays
- Incoming wires
- Lockbox Maintenance and Transmissions

The proposal also waived all set-up fees for services added during the first year. Based on the assumptions for services to be used this would save approximately $4,400 in the first year.

The **best and final** effect on fees resulted in.

	Gross Fees	Adjusted Fee/3 Yrs	Adjusted Fee/5 Yrs
ANBT #1	$ 4,855	$ 4,879	$ 4,809
ANBT #2	**$ 4,855**	**$ 4,879**	**$ 4,870**
ANBT #3	$ 4,855	$ 4,352	$ 4,553
ANBT #4	$ 4,855	$ 4,352	$ 4,553
Wells Fargo	**$ 4,991**	**$ 4,020**	**$ 4,409**

There were some material fee differences on high volume items between banks initially which create these differences as shown below a major factor being the FDIC assessment charge that is being charged at Chase and Wells Fargo. This is key to remember because as rates rise the City will naturally move more funds out of the bank for higher interest rates. As this happens the FDIC charge will drop materially. For example, when funds totaling $36 million are being maintained in the bank the FDIC charge averages $4,000 to $4,500 a month. However, when funds are reduced to a more historical average of $18 million the fee will be cut in half or approximately $2,000 a month. In that case the Chase and Wells Fargo fees are adjusted to $2,760 and $2,843 respectively. This is significant because with the economy righting itself and rates already beginning to rise this change could be expected in the third or fourth year of the contract. Since it is in the future it is a speculative factor which can only be considered within the reader's call on interest rates. We believe this will be a major factor in the fourth year of the contract and perhaps the third year.

Major fee differences between the banks proposing on a fee basis are shown below:

Service Category	American N.	Chase	Wells
Account costs	15.00	5.00	5.00
Debits Posted	0.15	0.07	0.03 *
Credits Posted	0.35	0.40	0.50
Check Clearing/Encoding	0.12	0.06	0.03 *
ZBA Subsidiary accts	25.00	10.00	5.00
ACH Detail	0.25	0.05	0.02
Stop Pays	32.00	5.00	1.00 *
Incoming Wire	10.00	3.00	0.50 *
Outgoing Wire	10.00	3.00	10.00
Image Capture Detail	0.00	0.02	0.03
Safekeeping/Mo	208.	350.	50.
Ambulance Lockbox	426.	228.	75. *

** Indicates best and final pricing*

With the exception of image capture (detail) American National has higher fees across the board.

Compensating Balance Calculations

When a compensating balance basis is used to pay bank fees, a target balance sufficient to generate interest equal to the fees (at a specific rate) must be maintained in the bank as the target or compensating balance. The interest rate used to generate funds to pay the fees is called the ECR (Earnings Credit Rate). It is a unique and bank managed rate applied only for this purpose. The higher the ECR the higher the earnings and the lower the target balances required.

With a higher ECR and therefore higher earnings the City needs to maintain a smaller target and has more funds to be used to invest otherwise – either inside or outside the bank. (The target balance is calculated from the fees to be charged and the ECR proposed.) The floor ECR rates offered by American National and Wells Fargo banks are particularly helpful when rates are low. The floor rates are helpful especially when rates are projected t go lower. But It is unlikely now that the rates will go lower.

Based on the ECR and fees estimated, the **initial** target balances required are:

	ECR %	Target Balance	
American National	0.30 %	$ 19,425,013	(floor rate)
Chase Bank	0.30 %	$ 29,639,189	
Legacy Bank	0.48 %	$ 1,508,000	
Prosperity Bank	0.32 %	$ 220,000	
Wells Fargo	0.50 %	$ 17,896,761	(floor rate)

Applying the **Best and Final** Proposals the target balances change to:

	ECR %	Target Balance
ANBT #1	0.30 %	$ 19,478,347 (floor rate)
ANBT #2	0.30 %	$ 18,000,000
ANBT #3	0.28 %	$ 19,512,500
ANBT #4	0.30 %	$ 19,000,000
Wells Fargo	0.50 %	$ 12,245,726 (floor rate)

American National had initially stated that if a compensating (target) balance of $18,000,000 was maintained at the bank there would be no fees. This was modified in the Best and Final. The City has been maintaining a large balance in the bank averaging $36 million over the past year meaning it left $18million over the necessary target balance for the bank. The remainder of the funds (because the compensating rate can only be applied to the actual target computation) would have been in interest earning accounts.

This discussion though difficult to understand is key to the evaluation. The key here is the compensating balance required by the banks. Of the two final banks Wells Fargo's higher ECR clearly shows that it requires a lower balance by the City which gives the City more alternatives for higher rates outside the banks – especially as rates rise which they are forecast to do starting in 2015. In fact, if the balance maintained by the City in the bank were lowered to the ANBT lowest required level the view changes considerably. With only $18 million in the bank as an average (which is all that would be required) the balance for interest through the bank actually turns <u>negative for ANBT</u> and jumps to $240/month for Wells Fargo which would equivalently still have $5 million available for investment anywhere. If you reduced the balance at Wells Fargo in accordance with their balance requirement at the higher ECR it releases an additional $6 million for alternate investments.

Critically, as mentioned above, a critical factor in the fees anticipated from Wells Fargo hinge on the amount of FDIC assessment (recoupment). If the City continues to maintain a large balance at the bank (averaging $36 million in the past year), the FDIC charge at Wells equates to over $4,600 a month. If however the amount at the bank were reduced to accommodate the $18 million discussed above the FDIC fee is reduced significantly to $1,912 a month (more than half). The reduction occurs however only if the City uses the funds to invest outside either bank. This is difficult currently because of historically low rates. That gives an advantage to American National – but only until rates start to rise. When equitable rates exist outside Wells with the higher ECR and actual lower costs will definitely be the superior choice for the City – even before considering the superior services offered by Wells Fargo.

The interest bearing rates at the banks also have a material influence on the effectiveness of the entire relationship. The historical rates provided by the banks for the last year in interest bearing and money market accounts were:

	IB Accounts	MM Accounts
American National	0.20%	0.20% (all options)
Chase Bank	0.07%	0.10%
Legacy Bank	0.10%	0.00%
Prosperity Bank	0.25%	0.25%
Wells Fargo	0.05%	0.02%

During a period of low interest rates, it is wiser to use the higher ECR rates (versus an average 0.10% in the pools for example for liquid funds) and pay on a compensating balance basis. When Fed Funds reach approximately 3% the City must review the ECR and alternative rates because normally the ECR will be half the available outside rates for example in a sweep or individual investments. The City would then switch to a fee basis and sweep the daily funds to a money market mutual fund and invest outside for funds above this rate. In this manner the City is most effectively using the alternative rates in the marketplace.

The interest rates at American National and Prosperity are the highest. Obviously these banks want the funds kept in the banks whereas a Chase and Wels Fargo are not as interested in internal interest bearing accounts. But, the City would more than likely be investing outside at the point in time that these rates come into play.

Chase has eliminated itself from the analysis because the fees are higher without a high ECR rate to compensate. Legacy and Prosperity are basically eliminated because of the lack of required services. Therefore the decision comes down to American National and Wells Fargo. These two reflect the high service scores and the high ECR offered on a compensating balance basis payment methodology.

Fee Basis

During the next three to five years of the contract it can be reasonably expected that the market rates will rise (as they have already begun to do.) It is expected that the fed Funds rates will begin to rise sometime in mid-2015.

On a fee basis (which should be evaluated and used when Fed Fund rates rise to about 3% which could be in 2016), no compensating balance would be maintained. At that time no compensating balance would be maintained and funds would be better swept to a MMMF or invested in interest bearing accounts – or more likely invested outside the bank. Judging simply on the interest bearing account options available historically the best earnings come from the lowest fees.

It is the potential for a quite different interest rate environment during the contract period that makes this analysis and recommendation difficult.

(a) If rates were expected to stay low and a compensating balance basis to be used throughout the contract period, the choice on a cost basis of American National would be suitable. The lower rates (primarily because of the FDIC charge at Wells Fargo) would allow the City to maintain a slightly higher target balance than Wells Fargo($18,000,000 versus $17,896,761) without paying fees (i.e. a set fee amount equating to $18 million balance). The $18 million would also be a lower target balance than calculated for the real fees being charged by American National.

(b) If the general rates were expected to go higher, the ECR ultimately becomes irrelevant. In that case, the fees are very similar at American National and Wells but the interest rates are higher. Although higher rates would also undoubtedly be found outside the banks. If the City stayed with the compensating balance basis and the $18 million balance at American National they would be paying more than necessary because the balance should be lowering as the rates rise. The City could move at that time to a fee basis and enjoy lower fees than Wells Fargo. However, at a higher market rate level the City would not be keeping the funds necessarily in the bank and therefore the FDIC charge would be significantly lower.

    For example, if the City only maintained $18million in the bank (as opposed to the $36million which has been maintained) the fees at Wells Fargo are only $239/month higher ($2,868 per year). This is a result of reducing the FDIC assessment charge being passed through at Wells Fargo.

Therefore, if the City were to reduce the amount of funds it maintains in either bank, American National and Wells Fargo become very close in fees and as a result the compensating balance required at Wells Fargo comes in lower than American National and because the fees are cut in half at Wells when the balance requirement is considered with the City maintaining a lower balance (of for example $18 million as discussed above). The caveat in this scenario is that the City would have to forgo the higher interest bearing rates at American National which currently higher than other outside rates such as the pools (0.20% versus 0.05%).

SUMMARY AND RECOMMENDATION

An original recommendation was made based on the initial proposals by all the banks. The evaluation was very close on the benefits and potential earnings in the two top banks. By asking for a "Best and Final Proposal" from American National and Wells Fargo the City has effectively reduced the final decision to one of these two banks. This summary and recommendation is therefore based on the best and final proposals only.

As shown, the banks on a cost basis are almost the same. It is the impact of the FDIC fee and the interest bearing account rate differences between the two that makes the choice difficult.

- If the City retains excess funds in ANBT for ease and to capture its higher interest rates (for example sake $25 million) in the money market accounts (MMA) and uses the best Option (#2) proposed by ANBT the balance required would be $18 million and the potential earnings on the remaining $7 million would be $1,167/month.
- If the City retains only $18 million in ANBT and secures equal or better earnings outside the balance required would be $18 million and additional earnings would be $ 00.

- If the City retains $25 million in Wells Fargo and uses the bank's interest bearing accounts the balance required is $7.9 million and the earnings $709 with outside potential earnings at 0.20% of $2,834.
- If the City retains only $18,00,000 in Wells (reducing the FDIC fee) and secures equal or better earnings outside the balance required would be $6.3 million and additional bank earnings would be $ 484 in the bank and potentially $1,935 outside.
- If the City retains only $12,50,000 in Wells (further reducing the FDIC fee) and secures equal or better earnings outside the balance required would be $5.1 million and additional bank earnings would be $ 307 in the bank and potentially $1,535 outside.

Therefore the best option at ANBT is Option #2 but this would not be as good as leaving only $18 million at Wells Fargo (reducing the fees because of the FDIC fee). This is also based on the fact that as rates rise and alternative rates are found and used by the City in its portfolio at American National the City is still required to maintain the $18 million balance regardless of whether better rates are available outside the bank thereby resulting in a material opportunity cost.[4]

And, as shown, the detail costs for large volume items at American National are higher than Wells Fargo. In addition, when rates rise there is no sweep available at American National to provide the City with additional and functional investment options.

There is a definite difference in the services provided and the advanced technology at Wells Fargo as discussed above. Wells Fargo and Chase both have the technologies and services to enhance the City's capabilities and reduce staff time to be focused on other directions. These are not found at American National. The move to e-payables and e-receivable, even using check printing as a first step, will probably not be available at state chartered banks for several years.

The purpose of this analysis was to find the most cost effective and efficient banking situation for the City which provided all the necessary services. Initially the evaluation looked at service levels. Between the two final banks Wells Fargo outperforms American National in the service area.

[4] As overnight interest rates rise above 3% generally the ECR in the banks is historically half of the outside fed funds rates therefore it is better to move funds out of the banks. The RFP does allow for this choice but not if the ANBT option for a set balance is utilized.

The cost and potential earnings makes this a very close analysis. The decision will hinge on the City's use of its funds. This analysis has to assume that the City will continue to manage the portfolio with a large balance at the bank as it has done so for the past year when rates were essentially the same as now. That means we have to assume at least a $25 million (and potentially higher) balance in the bank for the required balance and the operational funds. In this case the higher rates on the American National Bank interest bearing accounts would produce the best earnings potential.

If the City wanted to take a more aggressive position and invest outside resulting in an equal rate (0.20%) then the best solution would be Wells Fargo because the fees would be reduced and the earnings increased – although outside the bank.

As mentioned, this analysis has to assume that the investment parameters will not change. Therefore, it is recommended that the City take advantage of the set $18,000,000 compensating balance – Option #2 - for an initial period at American National and monitor rates carefully.

It is further recommended however that if, overnight rates rise quickly during the period and the ECR parallels that increase, the City should move to a fee basis and utilize the higher interest bearing account rates.

It is further recommended that the City award this contract for only three years as was the option given in the RFP. This recommendation is based on the expected rise in interest rates. When rates rise, the then lower fees at Wells Fargo, on either an ECR, or fee, basis and the higher bank and outside rates will lower the City costs and increase the earnings potential. This would additionally allow the City to utilize the higher level of service at Wells Fargo or other banks which might make a proposal at that time. The City is foregoing a higher level of service at American National and – because of the current rate environment - the situation will change considerably with a change in rates. At the end of three years, the cost/benefit ratios will quite possibly favor banks with higher service potential and use of technological advances.

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