

# **GUIDELINES RELATING TO THE MAINTENANCE OF COMPENSATING BALANCE AGREEMENTS BY MUNICIPALITIES AND DISTRICTS**

## **I. SUMMARY**

Massachusetts General Laws (M.G.L.) relating to municipal finance expressly authorizes a municipal or district treasurer or collector to enter into formal “compensating balance” agreements with banking institutions. The statutory provision, inserted by §1 of Chapter 740 of the Acts of 1985, is found in M.G.L. Chapter 44 §53F.

A compensating balance is an agreement by which a city, town or district maintains municipal funds on deposit in return for designated banking services. Under such an arrangement, the earnings retained by the bank on the account balances compensate the bank for the services provided.

Prior to the enactment of Chapter 740, there was no statutory authority for a municipality or district to utilize a compensating balance arrangement to acquire banking services.

With the advent of M.G.L. Chapter 44 §53F, a municipal or district treasurer or collector is permitted to enter into such an agreement. It should be noted, however, that the law also:

- Requires that any such agreement be in writing and not exceed three years;
- Provides for specific limitations on the types of services which may be procured under a compensating balance agreement;
- Establishes a local approval process for all such agreements;
- Sets in place annual reporting requirements relating to such agreements and requires the Commissioner of Revenue to publish a yearly evaluation report on the use of compensating balances.

By enacting this law, the General Court of the Commonwealth clearly acknowledged that compensating balance agreements, if properly structured and administered, could assume a useful role in the effective management of municipal and district funds. By including the additional statutory requirements, the Legislature sought to ensure the productive and cost-effective use of public monies, and promote full disclosure and accountability in the procurement of banking services.

The Commissioner of Revenue is empowered to issue such reasonable rules, regulations, standards and guidelines as are necessary to promote prudent fiscal management and ensure that compensating balance agreements are not utilized to circumvent the appropriation process or other provisions of law.

The primary purposes of the compensating balance law are:

- To promote the productive and efficient use of municipal funds;
- To ensure that the process by which banking services are procured by a municipality is open to public scrutiny;
- To introduce an appropriate degree of accountability to the use of compensating balance arrangements, and
- To establish a process by which the use and cost-effectiveness of compensating balance agreements can be readily evaluated.

## **II. GUIDELINES**

### **1. DEFINITIONS**

For purposes of these Guidelines, the terms “Compensating Balance Arrangement” and “Banking Services” will have the following meanings:

#### “Compensating Balance Arrangement”

Any arrangement whereby a municipality or district obtains banking services (as defined in these Guidelines) based upon the balances maintained in specified bank accounts.

The disbursement float, i.e. amounts in an account against which checks have been drawn but not yet presented for payment, is a compensating balance.

#### “Banking Services”

- a) Services such as the following provided in connection with the maintenance of a collection and deposit account are banking services for purposes of this law.
- Deposit of cash;
  - Deposit of checks for collection;
  - Billing, collection and lock-box services;
  - Acceptance of over-the-counter payments on behalf of the municipality;
  - Night depository services;
  - Computer services incidental to the above accounts.

b) Services such as the following provided in connection with the maintenance of a disbursement account are banking services for purposes of this law.

- Regular checking accounts (including ordinary NOW accounts);
- Concentration/zero balance and sweep accounts;
- Wire transfers;
- Payroll and vendor payables services and accounting;
- Daily account notification;
- Check sorting and account reconciliation;
- Computer services incidental to the above accounts.

## EXCEPTIONS

A collection and deposit account for the deposit of miscellaneous receipts such as license and permit fees will be exempted from the requirements of a formal written agreement and competitive procurement, if no large volume of deposits such as taxes, motor vehicle excise, utility or hospital receipts are deposited in the account, provided that the total estimated cost of the services is less than \$500. A written statement of the activity in the account must be filed annually with the Director of Accounts.

A disbursement account for miscellaneous payments will also be exempted from the requirements of a formal written agreement and competitive procurement, if regular payroll checks, vendor disbursements or similar large volume payment items are not disbursed through the account, provided the total estimated cost of the services is less than \$500. A written statement of the activity in the account must be filed annually with the Director of Accounts.

For accounts that qualify for the above exception in every respect for the dollar amount of the services to be provided, a treasurer or collector may, with the approval of the selectmen or council, apply to the Director of Accounts in writing to have such accounts excepted; the application to the Director must include the purpose of the account, a description and estimate of the volume and cost of transactions, the volume of transactions for the municipality's major disbursement or collection accounts, and any other information which may be useful in reaching a determination.

Minimal privileges for transferring funds, such as those customarily provided in connection with money-market accounts or other investment vehicles, will be considered investment rather than banking services, even if they fall within one of the categories listed above.

**EXAMPLES:** An investment account which permits the account holder at no charge to write a limited number of NOW drafts per month in amounts greater than a specified minimum amount, or to make a small number of wire transfers per month, will not be considered a compensating balance account, and will need no written agreement.

Advisory and investment banking services such as underwriting, certification of bonds, placements, financial and management consulting, and portfolio management services cannot be provided on a compensating balance basis.

Note that non-banking services such as the purchase or lease of equipment or computer hardware or software cannot be provided on a compensating balance basis, and must be paid for through a direct appropriation. The acquisition of such services are not an integral part of a treasurer's or collector's responsibility and should remain within the discretion of the appropriating authority. Use of a dedicated terminal provided by a bank to a treasurer or collector for use in connection with an account maintained with that bank, shall not be considered a lease of equipment for purposes of this paragraph.

Contracts entered into directly between municipalities and data-processing companies or other non-banking institutions cannot be paid for through a compensating balance.

## **2. EFFECTIVE DATE**

The compensating balance law became effective on April 3, 1986. For fiscal years beginning after that date, compensating balance agreements entered into by a municipal or district treasurer or collector must be in full compliance with the provisions of the new law and these guidelines.

Written agreements in full compliance with the contractual and competitive procurement requirements of these Guidelines must have been approved and have been in effect by September 30, 1986 at the latest.

## **3. AGREEMENT**

The proper parties to a compensating balance agreement are a treasurer or collector of a city, town, district or regional school district, and a banking institution which has its principal offices in Massachusetts.

All compensating balance agreements must be in writing. The duration of any such agreement must not exceed three years. Municipalities may not appropriate money to maintain the balances called for by a compensating balance agreement, but may appropriate to pay for services to the extent that the earnings credits on the balances were insufficient under the terms of the agreement to pay for said services.

The Commissioner of Revenue must approve all such agreements as to form. Any compensating balance agreement must include at least the following terms:

- The duration of the agreement (ordinarily agreements should begin July 1 and terminate on June 30 to coincide with the fiscal year);
- A detailed description of the services to be provided;
- A schedule of charges for each service;
- The amount of the collected balance required to be maintained, or the formula for determining such balance, and the method of calculating the earnings credits to be applied against the charges for services;
- Termination provisions;
- Reporting requirements (these should be adequate to permit the treasurer or collector to report to the Commissioner in compliance with the requirements set forth below);
- Approval by the selectmen, town council, city council, or district governing body.

Compensating balance agreements should be submitted to the Bureau of Accounts, P.O. Box 9569, Boston, Mass. 02114-9569. Any agreement submitted shall be deemed approved unless it has been disapproved within thirty days of its receipt by the Bureau. All agreements should be received by the Bureau at least thirty days before their effective dates.

#### **4. LOCAL APPROVAL PROCESS**

A compensating balance agreement between a municipal or district treasurer or collector and a banking institution should be reviewed by the municipality's chief executive officer and by the town counsel or city solicitor. In order for the agreement to become effective, certain approvals are required.

In a city, a compensating balance agreement must be approved by the city council (and the mayor if required by law) in order to become effective.

In a town having a town council form of government, such an agreement must be approved by the town council.

In all other towns (those without a town council), a twofold requirement must be satisfied in order for a compensating balance agreement to become effective.

First, the town meeting must vote to authorize its treasurer or collector to enter into such agreements for a specified period. The treasurer or collector may then solicit a provider of banking services on such a basis.

After a compensating balance agreement has been finalized, approval of the board of selectmen is required in order for the agreement to become effective.

In a regional school district, the regional school district committee must approve the compensating balance agreement. In any other district, the approval of the district meeting or other governing body of the district is required.

Approval of the agreement must be by a majority vote, evidenced by a certification by the clerk of the city or town council and the signature of the presiding officer of the council, or by the signature of a majority of the board of selectmen, or by a certified vote of the district meeting or other governing body of the district.

#### Town Meeting Warrant Article

The following article should be inserted in the warrant of a town meeting to authorize compensating balance agreements:

To see whether the town will authorize the treasurer (collector) to enter into compensating balance agreements during fiscal year (enter fiscal year), as permitted by Massachusetts General Laws Chapter 44 §53F.

## **5. REPORTING REQUIREMENTS**

The law expressly requires that a treasurer or collector who has entered into a compensating balance agreement file annually with the Commissioner of Revenue such information as is required to determine whether the funds maintained on deposit with the bank have exceeded the amount required by the agreement. The first reporting period will be the year ending June 30, 1987 and the nature and form of the required report, along with detailed instructions, will be provided prior to the filing date. The information that will be required will include at a minimum the following:

- The balances maintained by the municipality;
- The type and volume of services provided;
- The charges for such services;
- The interest rates used to calculate earnings credits;

- The surplus or deficit of such credits less service charges.

Based upon such information, the Commissioner will annually prepare and issue a report on the use of compensating balance agreements. By law, such report must identify for each city, town or district using such agreements, and by banking institution, the average daily amounts maintained on deposit which are in excess of the amounts necessary to fulfill the terms of the compensating balance agreements.

A copy of the Commissioner's report on compensating balances will be sent to the treasurer or collector, the mayor and city council, the selectmen, the regional school district committee, the prudential committee, if any, otherwise the commissioners of each city, town or district named in the report. A copy of the report must also be provided to the Inspector General of the Commonwealth.

## **6. COMPETITIVE PROCUREMENT REQUIREMENT**

In order to insure the efficient acquisition of banking services through compensating balance agreements, such agreements must be entered into pursuant to a competitive procurement process, if the estimated cost of the services to be provided exceeds \$5,000. A compensating balance agreement for the provision of services worth \$5,000 or less is exempt from the procurement requirement of these Guidelines.

No agreement shall be split or divided for the purpose of evading any provision of this section.

Where the estimated amount of the services to be provided is more than \$500, but less than \$5,000, a treasurer or collector should solicit proposals orally or in writing from at least three banking institutions and make a written memorandum of the institutions solicited and the proposals made.

A compensating balance agreement may only be entered into after proposals for the agreement have been invited by direct solicitation of at least three banking institutions, and by advertisement in at least one newspaper, if any, published in the city, town or district, otherwise in at least one newspaper of general circulation in the city, town or district, such publication to be at least one week before the time specified for the opening of said proposals. The advertisement shall state the time and place for opening the proposals and shall reserve to the city, town or district the right to reject any or all such proposals. Proposals shall be opened publicly, but shall be opened in the presence of at least two officials at the time specified in the request for proposals.

The request for proposals should include a description of the services to be purchased, the time and date for receipt of proposals, the address of the office to which proposals are to be delivered, the maximum time for acceptance by the governmental body, evaluation criteria such as compliance with all applicable General Laws, completeness of the proposal, ability of the bank to meet service requirements, the financial record and stability of the proposer, the level of compensating balance or credit required, all contractual terms and conditions applicable to the procurement, and such other criteria as the municipality may deem appropriate.

The request for proposals shall specify only one of the following two forms for the submission of cost information:

Costs shall be stated in terms of a fixed balance required to be maintained for the total volume of each service

or

Costs shall be stated in terms of the earnings credits required per unit of each service.

The treasurer and/or collector is responsible for the evaluation of the proposals and may designate additional individuals to participate. No other factors or criteria can be used in the evaluation other than those contained in the Request for Proposal.

The evaluation must be in writing and specify for each evaluation factor, a rating of each proposal and a composite rating for each proposal and the reasons therefore.

These Guidelines may be amended from time to time as required.

(updated July 2004)