

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

I. SUMMARY

Section 53F of Chapter 44 of the Massachusetts General Laws as amended by Chapter 218 of the Acts of 2016, *An Act Modernizing Municipal Finance and Government*, expressly authorizes a municipal or district treasurer or collector to enter into formal “compensating balance” agreements with banking institutions.

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 banking institution on the account balances compensate the bank for the services provided.

Section 53F of Chapter 44:

- 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.

Compensating balance agreements, if properly structured and administered, are an option available to municipal or district treasurers or collectors in the effective management of municipal and district funds. The statutory requirements promote the productive and cost-effective use of public monies and full disclosure and accountability in the procurement of banking services. The compensating balance law became effective on April 3, 1986.

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:

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.

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.

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. Treasurers or collectors, in general, are not responsible for the acquisition of such services and the responsibility 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. 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.

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 appropriate oversight individual or group and to the Office of the Inspector General in compliance with the requirements set forth below);
- Approval by the selectmen, town council, city council, or district governing body.

Compensating balance agreement reports should be submitted to the Office of the Inspector General by email to MA-IGO-General-Mail@mass.gov; Subject line: **53F Report**.

3. 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.
 1. 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 using M.G.L. c. 30B.
 2. 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.

4. REPORTING REQUIREMENTS

The law expressly requires that a treasurer or collector who has entered into a compensating balance agreement report annually to the collector or treasurer, the mayor and city council, the selectmen, the regional school committee, the prudential committee, if any, otherwise the commissioners, of the city, town, or district and the Inspector General.

The report shall include information to determine whether the funds maintained on deposit with the banking institution have exceeded the amount required by the agreement. You will need to obtain the following information at a minimum to complete the report:

- 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.

5. COMPETITIVE PROCUREMENT REQUIREMENT

In order to ensure the efficient acquisition of banking services through compensating balance agreements (or any banking services that impose fees), depending on the cost of the services to be provided, a treasurer or collector must enter into such agreements pursuant to M.G.L. c. 30B.

No agreement shall be split or divided for the purpose of evading any provision of Chapter 30B.

For banking services contracts of less than \$10,000, M.G.L. c. 30B requires that you use sound business practices. Sound business practices are defined as “ensuring the receipt of a favorable price by periodically soliciting price lists or quotes.” While the definition does not require a formal competitive process for small procurements of less than \$10,000, it requires you to ensure that you receive the needed quality of supplies and services at a reasonable price.

If the banking services contract value will be at least \$10,000 but not more than \$50,000, you must solicit at least three written quotes from banking institutions that customarily provide the services you are procuring, and award the contract to the responsible banking institution that gives you the lowest written quote that meets your purchase description. Under M.G.L. c. 30B, a responsible banking institution has the capability to perform fully the contract requirements and the integrity and reliability that assure good faith performance.

When you seek quotes, you are required to develop a written purchase description or scope of services for contracts of \$10,000 or more. (A bid or proposal process also requires a written purchase description.) A written purchase description will help ensure you adequately describe what you need to each banking institution that you contact for a quote. You then can easily read your description over the phone, email it or fax it to three banking institutions. You must make sure that each banking institution provides a written quote based on the *same* purchase description. You must record the names and addresses of all persons you contacted for quotes, the names of all persons who submitted written quotes, and the date and amount of each quote you received.

The written purchase description shall specify only one of the following two forms for the submission of cost information:

1. Costs shall be stated in terms of a fixed balance required to be maintained for the total volume of each service; or
2. Costs shall be stated in terms of the earnings credits required per unit of each service.

After you obtain quotes, you have to identify the lowest-priced quote from a responsible banking institution. When you have identified the lowest quote that meets your purchase description, and you have determined that the banking institution is responsible, you will award the contract to that banking institution.

In writing a purchase description and a rule for award, you also will need to consider:

- The required balances to be maintained by the municipality;
- The type and volume of services to be provided;

- The charges for such services;
- The interest rates used to calculate earnings credits;
- The surplus or deficit of such credits less service charges.

You also may want to obtain information on factors related to the financial record and stability of the banking institution. You should include all contractual terms and conditions applicable to the procurement and such other criteria as the municipality may deem appropriate.

If the value of your banking services will be more than \$50,000, you must advertise for sealed bids or proposals. The invitation for bids or request for proposals should incorporate all of the above information and obtain cost information in one of the two forms specified above. For detailed information on the Chapter 30B requirements for procuring supplies or services using an advertised process, please see the Office of the Inspector General's manual, *The Chapter 30B Manual: Procuring Supplies, Services and Real Property*, at the Office website: www.mass.gov/ig.

In general, the treasurer and/or collector is responsible for the evaluation of the quotes and bids. To use proposals, your jurisdiction must have a Chief Procurement Officer who may delegate authority to a treasurer or collector to use proposals. Whoever completes the evaluation may only use factors or criteria specified in the written purchase description.

6. RECORDKEEPING

You must retain a file of all written documents required by Chapter 30B for six years from the date of final payment under a contract. Also, you must retain monthly bank statements for three years in the event of a Department of Revenue audit.

III. PURPOSES

Chapter 218 changed certain provisions related to compensating balance account agreements. However, the primary purposes of the compensating balance law were not changed. Municipalities and districts have a responsibility to implement the law in accordance with the purposes, which 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.

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

(updated October 2018)