An Introduction to Treasury Agreements for State and Local Governments

by Linda Sheimo
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and Local Governments

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Foreword

Governments use various banking services to carry out their treasury management functions. Banking services, as with other contractual services, should be governed by written agreements. This publication offers guidance on the makeup of those agreements.

Banks and other financial institutions typically offer standard agreements for services that they provide to governments and other customers. These standard agreements can save time and resources that otherwise governments would have to spend on the creation of an original agreement. Standard contracts, however, do not relieve public officials of the duty to protect the interests of their government. They must carefully review, and as needed, modify treasury agreements to meet their government’s needs.

This publication is intended to assist public officials with the review and revision of frequently used treasury agreements. It describes the key provisions commonly found in banking services, wire transfer, lockbox, trust account, and escrow account agreements. It also presents examples of actual language used in some provisions. Because each government has its own unique needs and concerns, it does not offer model language.

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Jeffrey L. Esser
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Introduction

Public officials must become more proficient than ever at assessing risks involved in contracting for banking services that are subject to frequent regulatory and technological change. By developing a publication of frequently used agreements, GFOA aims to help public officials analyze, revise and monitor treasury agreements to protect public funds and other assets.

Intended to serve as a reference guide for public officials entering into or reviewing existing treasury agreements, this publication includes chapters on services that require formal written agreements such as general banking, wire transfers, lockbox, escrow and trust account maintenance. These services cover a broad range of responsibilities that are carried out by treasury professionals. These agreements are especially worthy of care and due diligence because they involve the direct transfer and safekeeping of public monies and properties.

Banking Services Agreements. The banking services agreement is the master agreement to which other agreements should be linked to ensure consistency and continuity. Master banking services agreements should be flexible enough to allow for future amendments and should be negotiated at the time a contract is awarded.

Banking services agreements have become increasingly important as mergers and acquisitions of financial institutions have changed the nature of banking relationships. Through downsizing and reorganizing of corporate staff, bank representatives may be unfamiliar with public officials and the types of service the "old bank" had provided. Similarly, public officials may be uncomfortable dealing with unfamiliar banking representatives or may find the new financial institution unwilling or unable to provide the same services for the same price. Because of the dynamic nature of banking today, public officials must put in writing the agreed upon banking services and the manner of compensation. Many problems can be avoided if both parties have a clear idea of what services are needed by the government entity and how the bank is to be compensated for providing those services.

Wire Transfer Agreements. Many treasury professionals advise public entities to have a separate wire transfer agreement either as an addendum to the banking services agreement or as a stand-alone document. Since wire transfers can involve large sums of money, the financial institution's methods and policies for handling transfers should be clarified in writing to prevent any misunderstandings.

Lockbox Agreements. Lockbox agreements on the surface deal with how financial institutions will handle remittances to public entities, but also deal with broader issues of safety. While a lockbox service is intended to replace in-house processing, agreements for these services should address control issues of how the financial institution will handle public funds and what steps will be taken to ensure the safety of those funds. Public officials must recognize that a lockbox operation may involve funds in excess of the $100,000 on deposit insurance set by Federal Deposit Insurance Corporation.

Collateral agreements must be in place and regular reviews performed to monitor the financial condition of the financial institution. When contracting for lockbox services, public officials should ask very specific questions to secure the best service available. A government may choose to amend the standard bank agreement to ensure safety, security and timely processing.

Trust and Escrow Account Agreements. Trust account agreements generally address how property interests, such as securities and funds, should be held by a bank for a third party. Trust account agreements spell out what arrangements have been made with a financial institution concerning responsibilities of trustees and obligations of the bank to perform specified duties, such as investing reserve funds.

Escrow account agreements, on the other hand, are a subset of trust account agreements and generally govern the management of funds or properties. Escrow account agreements terminate when the "fulfillment of a condition" is met. Escrow account agreements are normally used in public works projects or refunding of municipal bonds. Deeds, bonds, funds or properties may be held until a contract is complete.
Evaluating Agreements

When evaluating agreements, public officials must identify the worst case scenario and include provisions within the agreement to protect against that scenario. Who has liability for a failed wire? What happens to public funds if a financial institution fails while holding funds in a trust account? Does the agreement favor the institution? Are there issues that have not been addressed? These and other questions should be answered before entering into any treasury agreement.

Financial institutions frequently offer standard "boilerplate agreements" to their customers. Pre-printed or standard agreements can be time-savers but do not have to be adopted in their entirety. Whether a standard or customized agreement is used, public officials must understand its terms and conditions as well as the long-range consequences if the agreement proves to be inadequate. Public officials then have the added responsibility of ensuring that the final agreements is faithfully executed.

When evaluating treasury agreements, public officials must work with service providers to tailor agreements to fit the needs of their government. Public officials should begin the negotiating process by reviewing the bank's standard contract and asking specific questions where ambiguities might exist. Financial institutions often will amend their standard agreements to address their customers' concerns. If too many amendments are needed or if the existing agreement appears inadequate, the government then may wish to draft its own agreement. Regardless of how documents are prepared, the end result should be a concise document that addresses the concerns and protects the interests of all involved parties.

Purpose of this Publication

This publication is intended to assist public officials with the evaluation and drafting of common treasury agreements. Organized so that each chapter covers a single, frequently used treasury agreement, it also delineates the responsibilities and liabilities of the principal parties.

Within each chapter, there is a brief introduction explaining the purpose and nature of the agreement. The remainder of the chapter is devoted to enumerating the essential provisions of each agreement. Readers will find useful tips and information on what to look for and what to look out for when entering into various agreements. Sample language from actual agreements is included to illustrate how various sections may be worded.

While this publication is not a substitute for proper legal advice, it can serve as a guide to well-written, comprehensive contracts that not only protect public funds, but also ensure cost-effective services. As with any legal document, legal counsel should be involved in the development and execution of all treasury agreements.
Banking Services Agreements

The purpose of the all-encompassing banking services agreement is to combine all facets of the total banking relationship into a single document. Depending on the nature and scope of the requested banking services, the banking services agreement may include any number of provisions. The banking services agreement should be developed at the time the request for proposals is issued.

The agreement should be worded in such a way that it can accommodate situations, such as staff changes, without having to be amended. In addition, the banking services agreement should be able to incorporate other agreements such as trust account and escrow agreements.

The remainder of the chapter describes provisions commonly found in banking services agreements and in some cases, offers suggested language.

What to look for

Introduction. Introductory paragraphs in banking services agreements should include the effective date of the agreement and the parties between whom the agreement exists. The first paragraph also defines how the parties will be referenced for the remainder of the agreement (e.g., hereinafter referred to as the "Bank"). Additional provisions, such as the length of the agreement (e.g., for banking services from March 1, 1991 through February 28, 1993), should be included.

Some agreements list the parties in one section of the introduction and the effective date in another. If this is done, wording such as the following is commonly used:

This Agreement goes into effect upon the earlier of (1) the date when the City makes its first deposit into the Account(s), or (2) the date upon which the City signs the Agreement.

Purpose. All requests for proposals will list a description of services to be provided to the government. Therefore, the banking services agreement should restate in broad terms the list of banking services expected, as illustrated in the following example.

The Port Authority of New York and New Jersey (hereinafter referred to as the "Authority") is a municipal corporate instrumentality and a political subdivision of the States of New York and New Jersey, and the Authority's funds are public funds expended only for governamental purposes. The purpose of this Agreement is to guard against loss to funds now or hereafter on deposit with the depository signing this Agreement, whether deposited as principal, trustee or agent, in checking accounts, on time deposits, pursuant to certificates of deposit, in trust, or otherwise.

Checking Accounts. Checking accounts may be referred to as "deposits" or divided into interest-bearing accounts and regular checking accounts. If the government has various types of checking accounts, this section should document both the types of accounts as well as the purpose of these accounts.

Transfers. The government may want to either address the transfer of monies in this section or incorporate, by reference, a wire transfer agreement, if one exists. For example, this section might include a list of positions authorized to transfer money.

Collateral. If the government entity requires collateral to be pledged for deposits, the procedure should be itemized in this section. For example:

The Depository represents that it is insured by the Federal Deposit Insurance Corporation and designates the securities listed on the annexed schedule and any other securities added thereto or substituted therefor in accordance with the provisions of this Agreement as security for and a pledge of the faithful performance of all its obligations, heretofore or hereafter assumed, in regard to monies of the Authority on deposit with the Depository and for such purpose and for other valuable consideration the Depository hereby grants a security interest in the Collateral to the Authority.

For further clarification, the government may want to specify the types of collateral required as well as the
amount of collateral needed. An example of a reference to collateral type follows:

The collateral shall consist solely of any of the following:

(a) lawful money of the United States of America and other direct obligations of the United States of America, (b) direct obligations of the City, and (c) direct obligations of the State of Minnesota.

Additional language regarding the care and safekeeping of the collateral agreement should be discussed to ensure security and safety. The government also may wish to add a statement on substitution and/or sale of collateral.

**Authorization.** There should be provision in the agreement identifying the individuals or positions authorized to do business with the financial institution. For example:

The City shall provide the Bank with a list of its officials duly authorized to act on behalf of the City in connection with the City’s use of the services, and the City hereby authorizes the Bank to act in reliance on the instructions of such officials.

The person(s) shown on your Account Signature Card (or Letter of Authorization) filed with us are authorized by the City to make arrangements and issue instructions concerning the Account(s).

**Notices.** Mailing and street addresses of the parties should be included to ensure accurate and timely delivery of notices. A contact person for each party should be listed as well.

The manner in which the notification is given might be specified, such as:

... if in writing and delivered personally, mailed by first class (postage prepaid), registered or certified mail, or facsimile with written follow-up.

**Termination.** The issue of termination may be handled in one of two ways. The first would specify the beginning and ending date of the agreement. For example:

This agreement is made and entered into ... for banking services from March 1, 1991 through February 28, 1993.

The second circumstance would be one in which the financial institution gives notice to the government.

The Bank shall have the right to terminate this Agreement at any time upon ninety (90) days prior written notice to the City.

**Reports.** The banking services agreement should specify what reports the government entity will receive as well as the frequency of the reporting.

**Validity and Interpretation.** Some governments cite the governing laws by which compliance to all provisions are determined (e.g., "This Agreement shall be governed by and construed in accordance with the laws of the State of Texas.").

**Fees.** Agreements should stipulate how fees are to be handled (i.e., compensating balances, fees or other arrangements). If a pricing schedule is used, the government entity may wish to include this as an attachment to the agreement (e.g., "The amount and manner of payment of fees due to the Bank for its services hereunder shall be as stated in Exhibit A.").

**Amendments.** If any part of the agreement is modified or amended, it should only be done by all parties receiving a written notice as well as all parties accepting the amendment in writing. Two types of wording that are typically found are:

This Agreement may be amended by the City by written notice and delivered and acknowledged by the Bank.

or

This Agreement may not be amended except by written modification signed by both parties hereto.

**Assignments to Successors.** The government’s financial institution should promptly notify it of any takeovers, mergers, or acquisitions. Notification
should be mandatory and should take the form of a written announcement. The banking services agreement should ensure notice is given in a timely manner. For example:

The substitution of another person or firm to act as Bank under this Agreement may occur by agreement of the City. The party serving as Bank shall, upon 60 days written notice to the City, resign and be replaced by a successor Bank. Such successor Bank shall execute a copy of this agreement.

As an alternative, the government could include language which would provide an automatic continuation of all terms of the agreement in the event of a merger, takeover or acquisition as long as the financial institution can continue to meet all required terms of the agreement.

If there are any special concerns regarding successor requirements (e.g., size, assets, location), this section should address those issues. This section also should allow the government to terminate the contract if a merger, takeover or acquisition occurs.

**Liability.** The agreement should indicate that the financial institution is only responsible for the duties set forth in the agreement and that there should be no implied duties. The financial institution's standard of care is an important and potentially divisive issue. Generally, it is stated as a proviso in an indemnity clause:

The Government shall indemnify the Bank against any loss or liability incurred by it, except in the case of the Bank's (negligence/gross negligence) or willful misconduct.

The difference between a "negligence" and "gross negligence" standard of care is a legal concept to be discussed with legal counsel. The appropriate standard of care needs to be determined in each agreement based upon an assessment of the following relevant factors:

- experience and past practice of the parties
- risk inherent in the duties/responsibilities
- alternative remedies agreed upon to cover errors
- compensation level versus potential risk

The liability of the various parties in an investment (e.g., investment manager, broker) regarding delays, inaccuracies, loss of interest, trade/settlement failure or discrepancies in records might also be addressed in this section. The agreement also should contain a hold-harmless clause addressing the reimbursement of fees and expenses for processing claims, recovering damages or defending litigation. It is always best to consult legal counsel concerning any indemnity or liability provisions.
Wire Transfer Agreements

Wire transfers are a form of electronic funds transfer (EFT), and provide an excellent means of accelerating the receipt of large dollar payments. Wire transfers also are effective in timing the disbursement of funds more precisely, thereby reducing float. These transfers involve the electronic transmission of funds from one bank to another via a bank wire system or, more often, via the Federal Reserve Communications System (Fedwire). By 1990, the annual volume of wire transfers reached a total of more than 96 million transactions.

When using wire transfers, there are some precautions that should be taken. First, the Fedwire system is the most efficient, albeit most expensive, method of transferring funds, and thus should be reserved for transferring large dollar amounts—usually in excess of $100,000. The second and more important reason for caution is the finality of a wire transfer. When money is transferred via the Fedwire system, the transaction is final. The wire transfer is unlike a check where the customer has sufficient time to initiate a stop payment. There is no way to reverse a wire. The only alternative is for the receiving party to return the funds. The risk then is that the receiving party may refuse or may send the funds by a less expedient means. The initiating party then would risk losing interest on its own funds.

Many banks require an executed Wire Transfer Agreement from their commercial customers—those who utilize the Fedwire system as a means for transferring large amounts of funds on a regular basis. The wire transfer agreement and other supplemental agreements (such as a Master Repurchase Agreement) should all tie back to the Master Banking Services Agreement and include language that specifies that, in case of conflict, the Master Banking Services Agreement governs. Investors should be careful about adding agreements to the master agreement as supplemental agreements because the original intent of the RFP may be modified.

If the wire transfer agreement is included as part of the Master Banking Services Agreement, governments should acknowledge that there may be a need to negotiate this section of the agreement with the awarded financial institution. In selecting a financial institution, governments should inquire how each institution would handle non-repetitive wire transfers, both with an agreement and without a written agreement. In the absence of a written agreement, callback procedures and other security controls should automatically be placed in effect.

In most cases, financial institutions will provide their customers with a wire transfer agreement to complete and return to the bank. Upon receipt of the standard bank agreement, the government should read it thoroughly and understand all provisions of the document. Usually the document is a pre-printed bank form. The government may wish to have legal counsel review all agreements received from its financial institution.

Within certain limitations, financial institutions generally are receptive to modifications that governments wish to make. Certain sections of the agreement, for instance, may need further clarification or expansion. The wire transfer agreement was created using banking expertise, but the purpose of the document should be to meet the "mutual" needs of both the financial institution and the government.

This chapter presents key provisions usually found in a wire transfer agreement. These points are explained in detail and are intended to assist the public officials in the review, modification and execution of these agreements. Government officials may pick and choose the topics they negotiate. It is the government official’s responsibility to request a review, not the financial institution’s responsibility. Finally, government officials should always have their attorney review the final agreement.

What to look for

List of Accounts. All accounts for which wire transfers may be used, such as debt service accounts, general accounts and payroll accounts, should be listed in the agreement. The agreement may specify, "including but not limited to the following accounts" or "additional accounts may be included only upon written authorization and/or amendment to the agreement." For governments without multiple types of accounts, the wire transfer agreement merely may cite the name of the entity or political subdivision.

If the wire transfer agreement is a component of the Master Banking Services Agreement, account specifi-
cations may be covered by referencing the appropriate section of the Master Banking Services Agreement. The specific itemization of accounts by the government, however, will guide the financial institution in enforcing restrictions or special instructions.

Custodial Functions. The agreement may specify a safekeeping agent, the ownership of assets, the direct commingling and separate identification of securities as well as specify the duties of the financial institution to collect, sell and purchase securities.

Many contracts include this provision only as a reference if it is already included in the "repetitive wire transfer" section.

Transfer of Requests/Authorized Representatives. The agreement should include an "Authorized Representatives List" which, for internal control purposes, may include dollar limits for wires and methods of verification for each authorized representative on the list for internal control.

It is the responsibility of the government to determine who will be authorized to initiate wire transfers. It is also the government's responsibility to communicate this information and any changes to the financial institution. It is the institution's responsibility, in turn, to verify that a person is authorized prior to allowing him/her to initiate a transfer.

Governments may wish to expand this section and place limitations on authorized representatives in terms of destination of funds and use of repetitive wires (e.g., Person A may transfer up to a certain amount, to a specific destination or Person B may only initiate repetitive transfers).

Inclusion of this list in the agreement itself ensures that the finance officer or governing body in charge has approved the list of authorized positions/individuals.

In setting these restrictions, the government must realize that monitoring such restrictions places a burden on the financial institution which may result in increased costs. As an alternative, a list of repetitive wire transfers may be set up with the institution and included as an attachment.

Form of Request. Agreements should list the types of communications, such as telephone, written authorization, fax, or electronic communication, that may be used to initiate transfers. Most institutions accept telephone instructions. If written confirmation is required, this should be specified in the agreement.

Financial institutions often record all verbal wire transfer requests for subsequent review by the institution and/or the customer. If the institution regularly records telephone instructions, this practice should be acknowledged in the agreement.

Confirmation. Some form of notification should be required by the agreement. Immediate call back may be requested; next-day confirmation and wire transfer activity included on monthly statements are a must. From an audit standpoint, this information should be distributed in a timely manner by the financial institution and reviewed by the appropriate government official. Initiation and review of wire transfers should be conducted separately by different government officials or departments.

If the financial institution has automated most of its procedures for executing wire transfers, the government entity may establish a time period for execution of the transfer as well as require a wire transfer reference number during the transaction. The written confirmation also should include the wire number and time it was sent. In addition, the agreement should specify a time limit for resolution of discrepancies.

Information Requests. If additional information is requested or required by either party, this should be specified in the agreement. Language should address the "exchange of special information by either party." Titles and addresses of both financial institution and government contacts should be included (e.g., "Whenever the Government requests a transfer exceeding a certain dollar amount, the Bank will ask for a written, rather than verbal, request.").

Also, many trust departments require written confirmation on all transfers by customers for their internal and external auditors. The nature and timing of those confirmations should be spelled out.

Methods of Authorization. The method of authorization will vary depending upon whether it is a "repetitive" or "non-repetitive" transfer.
Repetitive Transfers. A repetitive wire transfer is a transfer that is conducted more than once and for which all transfer information is identical except for the transfer amount and date of transfer. Repetitive transfers should be included in the agreement as an option offered by the financial institution. The agreement should reference a listing of repetitive wire transfers that will be provided to the institution by the government.

Only a reference should be made here, not the actual listing. The actual listing could, but would not necessarily, specify the authorized representatives, destination, code and dollar ranges for each of the repetitive wire transfers.

Non-Repetitive Transfers. In selecting a financial institution, governments should inquire how the institution would handle non-repetitive wire transfers. If the institution offers repetitive transfers, the use of non-repetitive transfers should be limited.

For security reasons, if funds are wired on occasion to an account other than the government’s own (e.g., to a third party for payment of a large security transaction), the specific process or instructions should be listed in the agreement. Any specific guidelines regarding communication, designated individuals and financial intermediaries, callbacks, or time requirements should be specified in this section as well.

Methods of Money Movement. Because there are several wire services available, the agreement should specify the government’s preference. Use of the Fedwire is often recommended because there are guarantees with the Fedwire that are not evident with other wire services.

As a matter of procedure, governments should specify and confirm with broker/dealer or banker the method of payment for both the purchase and sale of investments at the time an investment is made. If unspecified, funds may be sent and received as clearinghouse funds.

Security/Confidentiality. All agreements should emphasize security as it relates to the confidentiality of the bank/customer relationship. The financial institution should agree to some sort of statement of confidentiality. This section should limit access of financial institution personnel to codes, identification numbers, callbacks and other items.

The institution may refer to "commercial reasonableness" to limit their liability for breaches of security. Public officials should not sign off on the use of this term in the agreement unless they consider it reasonable.

Compensation. The agreement should not grant financial institutions authority to deduct funds for any reason "except as otherwise specifically authorized in the agreement."

Transaction Payment. The fees for transactions are generally left open in the wire transfer agreement, but are incorporated by reference to the overall master banking agreement. If a formal contract does not exist, terms of the fee amounts should be specified in the wire transfer agreement.

Account Overdraft. Any overdraft issues should be addressed in the section on compensation. A distinction should be made between the government's regular bank account overdraft and the financial institution's intraday [within the same day] overdraft position with the Federal Reserve Bank (see section below).

Many wire transfer agreements prohibit or are silent on overdrafts. If the government has negotiated specific provisions for account overdrafts (i.e., line of credit and remedies), these provisions should be addressed in this section.

Bank Net Overdraft. Since May 1985, the Federal Reserve has been slowly reducing banks' net intraday overdrafts through implementation of its "Policy Statement Regarding Risks on Large-Dollar Wire Transfer Systems." Some banks are now charging customer fees to cover Fed penalties for intraday overdrafts.

The procedures and charges for daylight overdrafts should be addressed in the wire transfer agreement. With regard to fees charged by the financial institution to cover Fed penalties and for incurring overdrafts, this section should either spell out those provisions or reference the master banking agreement.

Interest payment for failed transfers. Failed transfers should be reimbursed at the prevailing Fed Funds rate,
not less reserves. Outgoing wires (the only wires the bank has any effective control over) are intended to be outgoing funds, either for investment or disbursement purposes. Because these funds are outgoing, a failed wire should not be penalized with a reserve requirement; these funds should not have stayed on deposit overnight at the financial institution.

Transfer/Implementation. The agreement should specify a time limitation for execution of the wire transfer request according to the government entity's reasonable expectations.

The agreement may specify a time deadline for transfers that is earlier than the institution's cut-off times. A reasonable deadline would be 2:30 p.m. Eastern Standard Time. Treasury staff may choose to send wires out early in the day as well as several other times during the day. By initiating wires as early as possible, the government will have time to correct any problems that may arise and still meet the wire deadline, and give the bank flexibility in managing the overdraft.

Bank Liability. Agreements drafted by financial institutions often place the bulk of liability on the customer. This section of the agreement, however, should more equitably distribute this burden of liability. Although Uniform Commercial Code No. 4A (UCC 4A) has not yet been adopted as law in many states, it does offer some guidance with respect to the distribution of liabilities.

UCC 4A clarifies the disposition of a vast range of errors, but the code is silent with respect to consequential damages. In the event of a failure with consequential damages, such damages may only be recovered if the government had been able to negotiate a pre-arranged contract with the institution prior to initiation of the wire transfer.

In general, financial institutions avoid liability for all but "gross negligence." While most agreements now refer to "gross negligence" and "willful misconduct," which are difficult to prove, investors should instead refer to the term "simple negligence" in the agreement. Simple negligence references the omission to do something which a reasonable person under ordinary considerations would do. The negligence is the failure to exercise such reasonable prudence or care. However, "gross" negligence is the intentional failure to perform in reckless disregard of the consequences. Gross negligence is often very difficult to prove.

Additional topics that may be of concern to certain investors include: financial institution's and purchaser's obligations regarding delays, inaccuracies, loss of interest, failure, discrepancies in records, international transfers and overdrafts. Sample language that generally covers these situations follows:

Notwithstanding any provisions to the contrary contained herein, the Bank shall only be liable to the Customer under this agreement for its negligence or misconduct. The Bank shall not be responsible for delays or failure in performance caused by, or resulting from, any act or omission by any third-party data processor, any other financial institution or any other person; acts of God, strike, lockout, riot, epidemic, governmental regulation, fire, communications line failure, power failure, equipment malfunction, emergency conditions or circumstances beyond the Bank's control.

Operating Instructions. It should be noted in the agreement that any changes in operating instructions imposed by either party should be in writing and be in accordance with all sections of the main agreement with sufficient time to implement changes.

If the institution changes its operations, it should amend the agreement to reflect those changes or exempt the government entity from those changes. This provision should be included to preclude unexpected changes in either services or fees. Governments should be given notification of change in a timely manner to ensure that there is adequate time to implement the change.

Modification and Severability. Any modifications by either party to the agreement should be made in writing.

If any part of the contract is rendered invalid, then the rest of the contract is still valid. For example, if a government initially lists a fax machine as an acceptable form of communication but that method is not available, the government may wish to alter that section of the agreement. All other provisions of the
agreement, however, would remain valid until the acceptance of an amended agreement.

Assignment to Successors. The financial institution should promptly notify the government of any takeovers, mergers, acquisitions or similar events that may occur. Notification to the government should be mandatory and should take the form of a written announcement. Such notice should be given in a timely manner.

Length of Agreement. The agreement should state the period of time covered by the agreement and give both parties a sufficient amount of time to cancel should the need arise. The normal length of an agreement is from one to three years and should coincide with the period covered by the Master Banking Services Agreement. Provision may also be included for continuation of the agreement if written notice is given (e.g., "Upon ninety (90) days of notice, this agreement shall remain in effect beyond the period covered by this agreement until written notice is given by either party.").

Civil Rights/Affirmative Action. Local laws may require non-discrimination and affirmative action provisions within the agreement. Purchasing requirements should be consulted to determine if the government must include these provisions in service contracts.

Tax Exemption. Either the master agreement or the banking services agreement should specify that the investor is a tax-exempt entity.

Records Retention. The financial institution should retain records associated with municipal wire transfers for a specified period of time. This provides necessary back-up to the government’s own records. Independent auditors can be consulted regarding how long these records must be kept.
Lockbox Agreements

A lockbox is one of many services provided by financial institutions to improve the processing of funds. Lockbox systems reduce mail and internal processing time delays and, consequently, increase availability of funds. Depending on the volume and size of payments, the government may enter into a "retail" or "wholesale" lockbox arrangement. Retail lockboxes are used more often by governments and are ideal for large-volume, small-dollar payments such as utility payments. Wholesale lockboxes are used for large-dollar, low-volume payments or for remittances requiring manual processing.

In providing a lockbox service, the financial institution will arrange a post office box in the government’s name, collect remittance checks from the box according to a pre-determined schedule and process checks received for deposit on a continuous basis. The benefit of such a service to a government is increased availability of funds by reducing mail float, processing time and collection float. Other benefits include reduced clerical and cyclical workloads in the government’s treasury operations, improved internal control and possibly faster updating of accounts receivable records.

In choosing a lockbox service provider, the government must analyze its needs and require responses to the following questions in the Banking Services Request for Proposals (RFP) or a separate RFP for lockbox services:

- What are the hours of processing shifts?
- What is your bank’s average turnaround time?
- What is your availability schedule?
- How many times per day will the contents of the post office box be collected?

Treasury officials also will want to visit the lockbox processing site personally to see how each system works. Once a financial institution is chosen, the government can enter into a lockbox agreement.

While the financial institution may offer a standard lockbox agreement, many items are negotiable. The government should review its lockbox needs, identify any special circumstances and negotiate a contract that addresses the needs and circumstances. If any customized services can be arranged or if any special instructions are required, the lockbox agreement should itemize those services and instructions along with agreed-upon pricing.

A lockbox agreement primarily covers remittance processing procedures and fees. This chapter describes key provisions commonly found in a lockbox agreement.

What to look for

Introduction. The introductory paragraph of a lockbox agreement should include the date of the agreement and should identify the parties to the agreement. The first paragraph also specifies how the parties will be referenced for the remainder of the agreement (e.g., hereinafter referred to as the "Bank"; hereinafter referred to as the "Government").

Purpose. Following the introduction, the purpose of the agreement should be stated. This might entail a simple and concise overall statement such as: "The Bank shall perform specialized lockbox services for the Government under the following terms and conditions." Or it could further explain:

... to provide the Government the earliest possible collection of certain remittance checks or other items payable to the Government by having such checks and items mailed to the Government remittance address and processed by the Bank as hereinafter described and in the Operating Instructions attached hereto and incorporated herein by their reference.

This also would be an appropriate place to reference the government’s RFP which resulted in the lockbox agreement.

Lockbox Set-up. This first section authorizes the financial institution to collect the contents of a post office box with "unrestricted and exclusive" access. A post office box is set up at the institution’s collection point to allow faster pick-up and processing of remittance items. This box should be used only as a remittance address and not for general correspondence. The post office box number should be referenced in this section of the agreement.
Mail Collection. This section states that the financial institution will collect the contents of the post office box according to a set collection schedule. The financial institution normally has several collection schedules. The institution and the government will decide on the schedule to be used and reference it in the agreement. For example:

... in accordance with the Bank’s multiple pick-up schedule, as such schedule may change from time to time with notification;

or

... according to the schedule attached as Exhibit A;

or

... at least twice a day at times that allow for maximum mail and processed funds availability.

Processing Instructions. This section describes the procedures that the financial institution will follow in processing the government’s remittance items.

Inspection of Checks. This section describes how envelopes should be opened, inspected and handled. Some agreements state contents will be examined only for the correct payee and check date. Some agreements are very detailed and include provisions for handling items such as:

- acceptable payee
- missing date
- post-dated checks
- stale-dated checks
- differing amounts
- missing signatures
- foreign banks/foreign currency
- restrictions and conditional notations (e.g., paid-in-full)

The government should be very specific in its instructions to the institution regarding the above items. For example, the instructions may specify a course of action as follows:

<table>
<thead>
<tr>
<th>IF:</th>
<th>ACTION:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Missing date</td>
<td>1. Process check</td>
</tr>
<tr>
<td>2. Post-dated check</td>
<td>2. Accept if the check will clear the drawee bank on or after the check date; otherwise, reject the check</td>
</tr>
<tr>
<td>3. No remittance advice</td>
<td>3. Photostat check and process</td>
</tr>
</tbody>
</table>

Procedures are also specified in the agreement for handling checks once they have been inspected and found acceptable for deposit.

Endorsement. The agreement should specify that checks should be endorsed also in the manner in which they should be endorsed (e.g., “credited to the account of the government; absence of endorsement guaranteed by (bank name”)).

Deposit. In this section, the financial institution is instructed to credit (deposit) checks received to a specified account or simply indicate “the demand deposit account as described in the Operating Instructions.” Any special instructions such as providing a copy of each deposit slip and check listing should be included in this section. Instructions on the frequency of deposits should also be included (e.g., “all acceptable checks will be deposited within ________ hours after they are collected from the post office box” or “all payments shall be processed on the day received”).

Remittance Material Deposition. Most lockbox agreements specify which materials should be forwarded to the government. The most common types are:

- photocopies, accompanying documents, envelopes, adding machine tapes and deposit advices;
- checks not deposited for any reason along with any accompanying papers and envelopes;
- customer correspondence; and
- other supporting documents

If there are special instructions (e.g., staff pick-up, sorting) on how those materials should be forwarded, they should be included in this section as well.

Returned Checks. Procedures for handling returned checks should be included in the agreement. A government entity may choose to handle returned checks for non-sufficient funds, closed accounts or stop payments in different ways. If so, they should be specified in this section to avoid confusion.
Record Retention. Most agreements deal with two issues of record retention. The first issue involves the length of time the financial institution will be required to keep microfilm records. At a minimum, microfilm records of processed checks should be kept for a period of not less than two years. The second issue involves retrieving information from microfilm records. The government will be required to provide the financial institution with sufficient information to locate requested checks (e.g., deposit date, adding machine tape totals and deposit total). It also may include a statement that such records are deemed public records and copies of filmed checks will be provided to the government at their request.

Compensation and Method of Payment. Payment in lockbox services may be in the form of compensating balances or through a monthly fee that may be directly billed or debited from a specified account. This information may be included in the agreement or as an attached exhibit.

Termination of the Agreement. The most common language for this section is:

This Agreement may be terminated by either party at any time by giving 30 days prior written notice to the other party.

Alternatively, the government may wish to specify a termination date, such as:

The term of this Agreement is to be for the period of two years, unless sooner termination is provided herein.

Inquiries. The agreement should address how and where inquiries concerning lockbox processing should be directed. It should list names, addresses and telephone numbers of staff contacts at both the financial institution and government.

Successors and Assignments. This section should state that neither the financial institution nor the government may assign their interest in the agreement or transfer any interest in the agreement without prior written consent of the other party.

Indemnification. The following are examples of alternative language for indemnification issues:

The Bank shall not be liable for any claim, loss or damage suffered by the Government or any third party under this Agreement or otherwise relating to the services provided hereunder, except as caused by the negligence of the Bank, its agents or employees acting within the scope of their employment. The Government shall indemnify and hold the Bank harmless against all such claims, losses or damages of the Government and third parties, except as caused by such negligence. The Bank shall be deemed to be free from negligence if it exercises the same degree of care in performing the services provided hereunder as it uses in processing items and data and compiling reports for its own use.

or

The Government agrees that the Bank shall not be liable to the Government for any error of judgment, or for any act done or step taken or omitted by it: in good faith, or for any mistake in fact or law, or for anything which it may do or refrain from doing in connection with this Agreement, except for negligence or willful misconduct.

or

The Government agrees to indemnify, defend and hold, within the limits and subject to the restrictions of the Tort Claims Act, the Bank, its agents and employees harmless from and against any and all damages, liabilities, actions and claims resulting, directly or indirectly, in whole or in part, from any negligence of the Government or of any agent or employee of the Government that may result from or arise out of the Government performance and administration of this Agreement.

Normally, boilerplate language is used in this section. This language is negotiable, nonetheless, and should be discussed with legal counsel.
Trust Account Agreements

A Trust Account Agreement, sometimes entitled an "Indenture of Trust," is a contractual document wherein a banking authority accepts and administers the trusts created for a specific purpose within a banking relationship. The purpose of the contract is to outline and itemize the counterparty responsibilities, limitations of liability and terms of the arrangement. Trust accounts may be defined as a property interest held by one person or party for the benefit of another. Properties (securities or funds) held in trust are committed or entrusted to an entity (i.e., the "City," "Lesssee," the "Government", etc.) as the case may dictate.

Trust account agreements are longer, more formal documents than are escrow agreements. Escrow accounts are a subset of trust accounts. In standard bank-prepared trust account agreements, the specified responsibilities of trustees are expressly limited. In fact, some trust account agreements effectively limit the obligation of the bank to perform even the specified duties outlined in the agreements.

In establishing a trust account, a government must be concerned with the legal assignment of properties to the trustee, the investment of reserve funds, the establishment and timing of the reserve fund, fees and timeliness of trustee's execution of responsibilities. The government entity also should ascertain that the existence of the trust account is mentioned in related documents, such as in related lease agreements or official statements.

Although a standard trust account agreement may be offered by the trust agent (bank) as a starting point, there are several items which the government may wish to negotiate. These items include but are not limited to reporting, timeliness, performance of duties and investment of funds. These and other standard provisions of trust account agreements are described below.

What to look for

Parties. Trust account agreements are preceded by a statement which dates the agreement, identifies the parties to the agreement and includes a description of the parties (e.g., "Pompano Beach Finance Corporation, a not-for-profit corporation duly organized and validly existing under and pursuant to Chapter 617, Florida Statutes"). In addition, this section also specifies how the parties will be referenced for the remainder of the document (e.g., City of Smithville will hereinafter be referred to as "City").

Preambles. A preamble should describe in general terms the background and purpose of the trust account. Preambles are most often labeled "witnesseth," and are constructed with several "whereas" statements.

Sections of the agreement often are grouped together under the following major headings (formally referred to as "Articles"): definitions; bonds or certificates of participation; funds and accounts; and investments.

Definitions. The first article (Article I) of trust account agreements always includes a comprehensive list of definitions which will be used in the document. For example, the agreement may state:

The terms, words and phrases defined in this section shall have the meanings ascribed to them for all purposes within the Agreement unless the context clearly indicates some other meaning.

Other provisions under this heading include one or more of the following.

Definition's Appointment of Trustee. The first article sometimes provides official recognition of the trustee. For example, the following language might be included:

Said trustee is hereby appointed to act solely as set forth herein, to receive, hold and disburse in accordance with the terms hereof the money to be paid to it, to execute and deliver Certificates representing undivided proportionate interests in Sublease, to apply and disburse payments received pursuant to the Sublease to Owners of such Certificates, and to perform certain other functions, all as hereinafter provided. By executing and delivering this Trust Account Agreement, the Trustee accepts the duties and obligations provided herein, but only upon the terms and obligations herein set forth.
Definitions and Interpretations. For purposes of the agreement, this section may separate clear-cut definitions from those which involve some discretion or assumptions on the part of either party.

Definitions and Certificates. Whether identified separately or included in an "Interpretations" section, a "Content of Certificates and Opinions" section states that any person who presents an opinion regarding compliance with any provision in the agreement will have read the applicable provisions and definitions. In addition, it states that the same person will have conducted all necessary and sufficient research to be able to provide said certificate or opinion, and will specify whether, in the opinion of such person, the condition or covenant has been complied with.

The Bonds or Certificates of Participation. This article may also be referred to as: "Certificates, Terms, and Provisions." In conjunction with setting up a trust account, bonds or certificates (notes) of participation often are issued to obtain monies to carry out desired programs or asset acquisitions.

Authorization/Designation/Preparation of Certificates of Bonds. The agreement should explain what types of securities will be issued in conjunction with the trust account. It may also identify the structure (e.g., coupon or discount securities), method of payment and denominations of the securities. This section also may present the aggregate principal amount of bonds or certificates to be issued. Further, the section should authorize and direct the trustee to execute the certificates (or bonds) and deliver them to the original purchaser or purchasers. The section should include a maturity schedule for the certificates of bonds including: dates of maturity, principal amounts and interest rates for different maturities.

This and other sections may describe the reasons for possible additional issuances, as well as the terms, limitations and additional documentation needed for future issues. Additional documentation may include but is not limited to the following:

- a supplemental Trust Account Agreement;
- an executed counterpart of an amendment to or supplement of the lease purchase agreement;
- an executed counterpart of an assignment agreement;
- an executed counterpart of an amendment to or supplement of the reimbursement agreement;
- a credit facility securing all certificates outstanding;
- opinion of counsel that all conditions preceding delivery of the securities have been fulfilled and that tax exemptions allowed by certificates will not be affected by the issuance of additional securities;
- written order to the trustee to authenticate and deliver the additional certificates (or bonds) to the purchaser or purchasers; and
- legal opinions that the issuance of additional securities have been duly authorized.

Execution of Bonds. Bonds should be executed in the name of and on behalf of the government. This section specifies who shall sign the bonds and how they shall be sealed. The section also may specify how the bonds or certificates are to be executed, authenticated and delivered.

Limited Obligation/Limitation of Liability. This section may identify the purchaser's rights to certain revenues. The section should identify the source(s) of revenue and limitations of the obligation for the issuer/lessee. For example:

Each certificate shall evidence the assignment of a proportionate undivided interest in the right to receive revenues under the Lease. The Certificates are payable solely from revenues as, when and if the same are received by the Trustee, which revenues are to be held in trust by the Trustee for such purposes... The Certificates do not constitute a debt of the Lessee or any assignee of the Lessee under the Lease, but the amounts payable under the Lease constitute a limited obligation of the Lease payable from the sources pledged in the Lease to the discharge of the obligation.

Registration/Ownership of Bonds. Typically, the person in whose name a certificate is registered is the absolute owner of said certificate.

Transfer of Bonds/Certificates. Ownership of bonds may be transferred to another person if the original bond is surrendered for cancellation and a new fully registered bond or bonds are issued. Transfers gener-
ally cannot be made within a specified number of days prior to interest payments.

Other Sections. Other sections regarding the management of outstanding bonds may cover the following topics:

- exchange of bonds;
- bond register (records for the registration and transfer of the bonds);
- temporary bonds;
- disposition of bonds mutilated, destroyed or stolen;
- prepayment and prepayment price;
- selection of certificates to be prepaid;
- notice of prepayment; and
- cancellation and destruction of certificates.

Funds and Accounts. Establishment of a trust account may involve two very different types of activities. One activity has to do with the issuance and use of bonds or certificates to raise money for some specified purpose. The other activity has to do with placing either funds or fixed assets in trust until either such funds are needed for disbursement, or the fixed assets are either purchased or completed. Each of these activities requires different funds and accounts.

Application of Proceeds of Sale of Certificates. In trust account agreements involving an initial issuance of securities, the trustee first must manage the Sale of Certificates and the Application of Proceeds from such issuances. The agreement, therefore, establishes several accounts and subaccounts into which the proceeds are deposited. This section of the agreement may direct the trustee regarding specific amounts to be deposited into various accounts and subaccounts upon trustee’s receipt of bond or certificate proceeds. This section is included to ensure proper distribution of the proceeds among program expenses, construction funds, acquisition accounts, reserve funds and other finances.

Allocation of Revenues/Sources of Payment. This section may identify the source(s) of payment for certificate requirements and may allocate revenues which come from these source(s). For example:

On each April 1 and October 1 after making any transfer required under Section x,

the Trustee shall transfer from the Revenue Fund and deposit into one or more of the following respective separate funds or accounts, the following amounts in the following order of priority...

This provision would be followed by a listing of funds into which money should be deposited, as well as an explanation of the needs and cash restrictions of each respective fund. For example:

Deposit into the interest account in the Bond Fund, the amount, if any, needed to increase the amount in such account to the aggregate amount of interest becoming due and payable on such interest payment date upon all Bonds then outstanding.

In this or a separate section, a Certificate Fund (or Bond Fund) should be created. The fund should be used to pay principal, premium, if any, and interest on the certificates. Within the Certificate Fund, an Interest Account and Principal Account should be created to ensure the availability of funds for specific payment needs.

In some cases, an Interest Reserve Account as well as a Capital Reserve Account are created and established for the purpose of making up any deficiencies in the Certificate Fund or in the Rebate Fund. Instructions to transfer funds in the event of a deficiency may be specified in this or a separate provision. Provision should be made to transfer money to a Redemption Fund upon maturity of the Certificates or Bonds.

In the case of lease-purchase or construction arrangements, the trust account agreement often will provide for the establishment of a Facility Fund. Where the Certificate Fund takes care of payment requirements to certificate holders, the Facility Fund assumes a parallel role in paying for the project or assets under lease-purchase arrangements. Within the Facility Fund, many accounts are created and established for a sundry of purposes.

Acquisition Account. The Acquisition Account (sometimes established as a "Construction Account") initially is a very active account, serving as depository for the following monies and purposes:
proceeds of any insurance maintained against physical loss or damage, pursuant to the lease-pur-
chase agreement;
• cost of the facility which shall be paid from amounts on deposit in the acquisition account; and
• costs of issuance of the certificate.

After properly documenting the completion of the acquisition and construction of the facility, any amounts remaining in the Acquisition Account should be transferred to the Lease Payment Account and applied as a credit to basic lease payments due under the lease purchase agreement.

lease payment account. A Lease Payment Account should be created with the stipulation that all funds and receipts shall be deposited immediately. The trustee should be responsible for paying out from this account interest payments when they become due, principal payments, additional lease payments to payee and prepayment amounts in the event of termination of the lease term.

Credit Facility Account. To use or advance its own funds in the execution of the trust account agreement, the government may provide for a credit facility (i.e., letter of credit or other credit back-stop) to be used in the event of an account deficiency. Amounts drawn under the credit facility to make payments of interest, principal or prepayment should be deposited in the Credit Facility Account.

Prepayment Account. The government should place a limit on the number of days within which deposits may be applied to the prepayment of certificates or to the reimbursement of the credit facility issuer for drawings taken from the credit facility for prepayment.

Reserve Account. A Reserve Account should be maintained by the trustee for the effective duration of the trust account agreement. If for any reason the lease payment account falls short, a transfer will be made from the Reserve Account.

Surplus Account. This account is established to ensure that all surplus funds, amounts in excess of what is needed to pay certificate holders or the trustee, will be remitted to the government to be used for lawful purposes. The following is an example of such a provision:

After payment or prepayment or provision for payment or prepayment of all amounts due with respect to the Certificates and payment of all fees and expenses to the Trustee, or satisfactory provision for such payments have been made, any amounts remaining in any of the funds or accounts established hereunder and not required for such purposes shall be remitted to the County and used for any lawful purpose thereof.

Additional Rental. If the trustee receives any additional rental, the trustee may or may not establish a separate fund for such additional rental. The trustee, however, should not apply these funds to any other purpose than payment of rental and should not commingle these monies with other funds received in conjunction with the agreement, or as defined under the terms of the contract.

Repair or Replacement/Application of Insurance Proceeds. The proceeds of any insurance (other than any rental interruption insurance), including the proceeds of self-insurance, should be deposited as directed in the agreement. No matter where such funds are deposited, the trustee should make such funds available for repair or replacement upon written notice by the government.

The responsibilities of the government are defined to notify the trustee in writing of the government’s intent to replace or repair the project or the portions of the project which were damaged or destroyed. Some agreements stipulate the following:

If the Project or any portion thereof shall be damaged or destroyed, the County shall ... continuously and diligently prosecute or cause to be prosecuted the repair or replacement thereof, unless the Government elects not to repair or replace the Project or the affected portion thereof in accordance with the provisions of this section.

Investments. The following sections typically are found under this fourth major heading (article):

Deposit of Monies. All monies deposited under the provisions of the agreement should be held in trust and
applied only in accordance with the provisions of the trust account agreement. It typically states that the trustee may invest funds held in trust, but that the funds are not subject to collateralization requirements that may be required by statute for other governmental deposits.

Investment of Certain Accounts/Direction of Investments. Monies held in each of the accounts are to be invested and reinvested by trustee in securities which mature no later than when funds are needed for payments to be made from such accounts. The government should determine desired maturities for the investment of reserve account monies which, in any event, may not be invested longer than the final maturity date of the certificates.

The trustee should make investments in accordance with standing instructions from the government (e.g., "Credit Facility Account and Prepayment Account monies may only be invested in United States Government Obligations") or other instructions, confirmed in writing, and received from an authorized city representative.

Interest earnings from the investment of monies in various accounts may be assigned for transfer to other specific accounts. Sample language might be: "Interest earned on monies in the Acquisition Account or in the Reserve Account may be transferred to the Lease Payment Account to be applied toward the next basic lease payment."

Valuation and Sale of Investments. Investment holdings as well as accrued interest earnings should be valued at the amortized cost of such securities plus accrued interest. If the accounting will be done another way, this section should specify how the investment holdings and accrued interest will be valued.

Arbitrage Rebate Account. If the average weighted yield on investment of bond proceeds exceeds the true cost of issuance, the government is mandated to pay a rebate to the Internal Revenue Service.

The trustee is directed to deposit to the Rebate Account any monies delivered to it by the government for that purpose or to transfer amounts from other accounts held by the trustee as directed by the government.

This section must specify who is to perform rebate calculations, how often they are to be calculated, and how the trustee is to collect, transfer from other accounts, and pay rebate to the U.S. Government upon instruction from an authorized government representative.

Events of Default. What constitutes a "default" and what actions should be taken in the event of default should be spelled out. The following events may be identified as a default situation in this section:

- government's failure to make installment payments;
- government's failure to make any transfer payments at the time required;
- government's failure to comply in any material respect with any covenant, condition or agreement for a specified period (normally thirty days after notice by trustee);
- any representation or warranty made by the government which is untrue in any material respect as of the date made; and
- government becomes insolvent or admits in writing an inability to pay its debts.

Remedies or actions that the trustee may take to satisfy the government's obligations should be enumerated.

Indemnification. The trustee may not be held liable for any event of default by the government. The following language is commonly used:

The Trustee shall not be required to do any act or pursue any remedy or exercise any diligence whatsoever to mitigate the damages to the Government if an Event of Default shall occur hereunder EXCEPT in the case of the Trustee's negligence or willful misconduct...

Lastly, an agreement to pay attorney's fees in the event of any suit or proceeding involving the parties may be specified.
Escrow Account Agreements

Escrow account agreements govern the management of funds or property which are held in trust by a third party and which are to be turned over to the grantee only upon the fulfillment of a condition. It is this latter provision which distinguishes an escrow account agreement from the broader class of trust account agreements.

Technically, an escrow account agreement may apply to a deed, bond, money or piece of property held in trust. The most common uses of escrow account agreements in public treasury management are for the escrow of either a) properties or funds involved in a public works project, or b) funds and securities for the advance refunding of municipal bonds.

This chapter describes the key provisions frequently found in escrow account agreements. Because they differ significantly, the provisions for bond related escrow accounts and non-bond related escrow accounts are presented separately. The introductory sections common to both types are presented below.

What to look for

Introduction. Introductory paragraphs in escrow account agreements should include the date of the agreement and identify the parties to the agreement. The first paragraph also specifies how the parties will be referenced for the remainder of the agreement (e.g., hereinafter referred to as the "Bank").

If the escrow account agreement is prepared as part of a trust agreement, the introduction will also include a reference to the first agreement (e.g., "as Trustee under that certain Trust Agreement dated as of __________, by and between Bank and Municipality").

Background. Background sections may be as brief as one paragraph or as long as several paragraphs or pages. They may describe events leading to the development of the agreement such as prior bond issues, former leasing agreements, construction plans and cash contributions. Background data may be either listed in the body of the agreement or included as an attachment. The background section also may list or reference authorization or enabling legislation which legally permits the formation of the escrow account.

Purpose. Following the background section, the purpose of the escrow account agreement should be stated. Several examples follow:

The Local Sponsor and the Government have agreed that the required contribution may be deposited into an escrow account and held there-in until the Government withdraws the funds in accordance with the local cooperation agreement. . . . in lieu of immediate total cash payment, to D.O.T. by the Municipality, the D.O.T. has agreed for such amount to be paid into an escrow account . . .

or

. . . on condition that LCRA set aside in escrow certain securities to secure LCRA's refund obligation pursuant to . . .

or

The 1990 Trustee shall establish and administer an escrow account as provided... and the amounts are irrevocably pledged and shall be applied solely for the purpose set forth. . .

or

. . . in order to provide for the proper and timely application of the monies deposited in the trust created hereby, the maturing principal amount of the Government Obligations purchased there-with, and investment income and earnings derived there-from to the payment of the Refunded Bonds . . .

Operating Instructions. The remainder of the document gives detailed operating instructions and direction to all parties. Because the provisions for bond-related and non-bond related agreements differ, they are presented separately.

Non-Bond Related Escrow Account Agreements

The following operating instructions are commonly found in non-bond related escrow account agreements.
Set Up Account. The account into which funds may be deposited and disbursements made should be set up and listed in the agreement; there should always be a provision or authorization for the establishment of the Account. This section can also include a reference to the escrow account title and number as well as the date by which the account should be set up.

List of Authorized Representatives. A list of authorized government representatives by name and title should be inserted here. It should state who is authorized to direct investments as well as how the authorization is to be given (e.g., written confirmation by letter or facsimile with hard copy to follow).

Receiving Monies. In many types of escrow account agreements, the receipt of the principal amount by the "escrow agent" is the informal beginning of the agreement. All agreements should specify the original amount of the funds to be transferred to the escrow account. If additional monies are to be transferred at a later date and the amounts are known, that information should be disclosed in the agreement.

Where the original amount or subsequent amounts may not be known, agreement may merely state that funds will be deposited into the escrow account (e.g., "The Bank shall establish an Escrow Account into which shall be deposited the funds delivered by the Local Sponsor") and should be receipted as the original sum.

Disbursement of Money. This section should list disbursement procedures to be used for paying funds out of the account. The government may also want to place limitations on either the form of payment or timeliness of payment such as provided in the following examples:

Payment shall be made for such equipment upon presentation to Bank of one or more properly executed Acceptance Certificates and properly executed Payment Request Forms, together with an invoice for part or all of the equipment.

or

The D.O.T. will submit periodic billings to the Municipality not more frequently than semimonthly, and the Municipality agrees to pay said billings in full within ten (10) days of receipt of same.

or

Within ten (10) days of receipt of the demand, the Bank shall pay to the Government the amount requested to the extent such amount does not exceed the balance available in the Escrow Account.

Notifications and Accounting Statements. Some form of notification to all parties involved should be required when disbursements are to be made from the escrow account, such as:

A written demand for withdrawal shall be made to the Bank on the form set forth as Exhibit A to this Agreement, with a copy of said demand provided to the Local Sponsor.

Agreements should list the frequency with which government and others receive statements (e.g., monthly, quarterly). Most bank statements should be received within fifteen (15) days after the end of the month or quarter. From an audit standpoint, this information should be distributed in a timely manner by the escrow agent and received and reviewed by the appropriate government officials.

Normally, the government would receive statements showing, at a minimum, income, disbursements and balance data. It may request, however, additional information such as:

The Escrow Agent shall confirm, based on generally accepted market practices, methods and procedures and to the satisfaction of the Government, the market value of such obligations, net of any commissions or service charges resulting from the sale or redemption of the securities or service fees charged by the Escrow Agent, prior to the demand dates.

Notices. Addresses of all parties and contact persons should be provided to ensure accurate and timely delivery of notices. The method of notification can also be specified (e.g., "... if in writing and delivered personally, given by prepaid telegram, or mailed by
first class (postage prepaid), registered or certified mail.

**Vesting Title.** There is normally a statement in the escrow account agreement stating that the financial institution is only the escrow agent in the transaction and is responsible for safekeeping the securities. The language most frequently used is as follows:

Nothing in this Agreement shall be considered as vesting title in the Bank to the amount deposited, except as Trustee for the Local Sponsor and the Government for the purposes set forth herein.

**Termination.** Termination of the agreement can be dealt with in one of four ways. One way is to refer to the dissolution, such as:

The Escrow Account shall be deemed dissolved and this Agreement shall terminate upon payment of the last amount remaining in the Escrow Account to _____ or _____ as the case may be, or upon transfer of all amounts in the Escrow Account to a court of competent jurisdiction to the terms of this Agreement.

A second option is to refer to early termination of the agreement (e.g., unless earlier terminated by the written mutual agreement of the Local Sponsor and the Government”). A third way is to include a drop dead date if certain events fail to take place (e.g., ”If the conditions of the Escrow Account Agreement are not satisfied by _____, then the remainder of this contract becomes null and void”). Lastly, if there is no termination provision, at the very least, there should be a clear statement indicating what specific actions should be taken and where the remaining monies should go upon termination.

**Amendments.** If any part of the agreement is modified or amended, all parties should receive a written notice and all should accept the amendment in writing (e.g., ”This Agreement may not be amended except by written notification signed by the parties hereto.”).

**Assignment to Successors.** The financial institution (escrow agent) should promptly notify the government of any takeovers, mergers, acquisitions and other such events that may occur. One example of such notification is as follows:

The substitution of another person or firm to act as Bank under this Agreement may occur by agreement of Group and the City. The party serving as Bank shall, upon 30 day written notice to Group and the City, resign and be replaced by a successor Bank. Such successor Bank shall execute a copy of this Agreement.

As an alternative, the government might include language which would contain an automatic continuation of all terms of the agreement in the event of a merger, etc., as long as the escrow agent maintains the ability to meet all required terms of the original agreement. If there are any special concerns regarding successor requirements (e.g., size, assets, location), those items should be addressed as well.

**Effective Date of the Agreement.** This section should state whether the agreement becomes effective when it is dated, when it is signed or when the first monies are received by the escrow agent.

**Signatures.** To be a binding document, the agreement must have appropriate signatures representing all concerned. Some governments require dates, witnesses and notarized signatures. Other governments allow only one signature with the title of the individual listed. It is important that the agreement be signed properly. As added protection, the government may add "Authorized Signature" underneath the signature line on the agreement. This may be an appropriate place to include addresses and telephone numbers of all parties as well.

**Liability of Bank/Escrow Agent.** The agreement should ensure that the escrow agent is only responsible for the duties set forth in the agreement; there should be no implied duties. The agreement should make reference to other agreements which are subject to revision by the other parties, since this would subject the parties to uncertainty and changes beyond their control. The escrow agent’s standard of care is an important and potentially divisive issue. Generally, it is stated as a proviso in an indemnity clause, such as:

The Government shall indemnify the Escrow Agent against any loss or liability in-
curred by it, except in the case of the Escrow Agent's negligence, gross negligence or willful misconduct.

The difference between a "negligence" and a "gross negligence" standard of care is a concept that should be discussed with legal counsel. The appropriate standard of care should be determined in each agreement based upon an assessment of the following relevant factors: experience and past practice of the parties, risk inherent in the duties and responsibilities, alternative remedies agreed upon to cover errors, and compensation level versus potential risk.

Additional topics concerning the liability of the various parties (i.e., investment manager, broker, escrow agent) in an investment transaction include inaccuracies, loss of interest, trade/settlement failure and discrepancies in records. The agreement also should contain a "hold harmless" clause addressing the reimbursement of fees and expenses for processing claims, recovering damages or defending litigation. Once again, it is best to consult legal counsel concerning any indemnity or liability provision.

**Type and Directing of Investments.** An authorized list of investment securities that may be used for escrow account founds should be a part of or an addendum to the agreement. Reference to relevant state statutes and local laws may also be added.

**Type.** All types of permissible investments should be listed. The most common types are:

- direct obligations of the U.S. Government;
- obligations of agencies or instrumentalities that are fully guaranteed by the U.S. Government;
- certificates of deposit (a minimum rating standard of "AA" by Moody's or Standard & Poors could be stipulated); and
- money market securities of the highest quality. (A specific list of these instruments, such as banker's acceptances, prime commercial paper, money market mutual funds, etc. would be preferable; however, in practice, "money market securities of the highest quality" is common usage.)

Again, to be precise, the government may cite specific state statutes (as amended) but only as a reference as statutes do change over time.

**Directing.** The directing of investments is a negotiable issue among all the parties. Examples of language to deal with directing of investments follows:

- "City authorizes Bank to invest in..."
- "invested by Bank at the direction of City..."
- "investments chosen by Contractor and approved by City..."
- "City directs the investments..."

It is important that all parties 1) agree up front as to the wording as well as the actual enactment of security purchases, 2) agree on how to apply the earnings, and 3) understand that the agreement states what is going to occur and how it is going to occur (always at the written direction of the authorized representative).

**Fees.** This section should specify how fees will be handled (e.g., "fee paid to Bank shall be the sole responsibility of the City" or "Contractor agrees to pay Bank as compensation for services hereunder an initial fee of $____ and an annual fee of $____") and give a sufficient description of recourse to the escrow agent (e.g., "and if not so paid shall constitute a lien on the interest accruing").

If a pricing schedule is used, the government may wish to include this as an attachment to the agreement. Usually the fee is paid by the government to the escrow agent at agreed upon intervals, or may be paid up front. For example:

...agrees to pay the Escrow Agent its agreed upon compensation, as set forth in the attached schedule, for its services as Escrow Agent hereunder promptly upon request therefor, and to reimburse the Escrow Agent for all expenses of or disbursements incurred by the Escrow Agent in the performance of its duties hereunder, including reasonable fees, expenses and disbursements of counsel to the Escrow Agent.
The Escrow Agent shall have a lien upon the Escrow Account of its costs, expenses and fees which may arise hereunder and may retain that portion of the Escrow Account equal to such unpaid amounts until all such costs, expenses and fees have been paid.

**Refunding Bond Related Escrow Account Agreements**

The following operating instructions are typically found in refunding bond escrow account agreements.

**Creation of Account(s) Within Escrow.** An account into which the government shall deposit all government obligations and cash to be used in refunding bonds should be set up and listed in the agreement. There should always be a provision or authorization for the establishment of the account(s). The government may want to expand this area by adding the escrow account title and number as well as the date by which the account or accounts should be set up.

In some instances the deposit of cash is viewed as creating an irrevocable trust for the benefit of the holders of the refunded bonds. Accordingly, there may be a special section devoted to refunding of bonds which should be examined carefully.

**Delivery of Money to Escrow Agent.** The agreement should specify the date(s) on which funds will be delivered to the escrow agent as well as the dollar amount to be delivered. The following confirmation is sometimes included: "Execution of this Escrow Account Agreement by the Escrow Agent shall constitute written acknowledgement of receipt of funds."

**Investment of Money.** The escrow agent should be given authority to invest delivered funds as directed. The government may want the escrow agent to make investment decisions or (depending on staff capacity) may choose to direct the investments themselves. Responsibility for the direction of investments must be specified in the agreement. If authority is assigned to the escrow agent, a list of permissible investments should be included as an attachment to the agreement. For example:

The Escrow Agent shall at the written direction of [ ], invest and reinvest from time to time all amounts held in the Escrow Account in (i) obligations issued or guaranteed by the United States Government, its agencies or instrumentalities, or (ii) Certificates of Deposit issued by any bank, trust company or national banking association (including the Escrow Agent) authorized to do business in the State of New York, provided the capital stock, surplus and undivided profits of such institution are not less than $500 million which, in each case, shall mature not later than the date amounts are to be paid under this Agreement, as the Escrow Agent shall be advised from time to time in writing by [ ] or (iii) a money market account with a stated investment objective of investing only in the foregoing. All interest accruing on monies held in the Escrow Account and any earnings realized from investments permitted hereunder shall be credited to the Escrow Account and any loss resulting from investments permitted hereunder shall be similarly charged. The Escrow Agent shall not be accountable or liable for any losses resulting from the sale or depreciation in the market value of such investments thereof. Any income earned on investments held hereunder shall be accumulated and added to the Escrow Account and subject to distribution as set forth herein.

If the specified securities are unavailable, temporary substitution of comparable securities may be expressly permitted. The escrow agent should supply detailed information on a monthly basis regarding investments to the government entity no matter who directs the investment. The government entity may also want to retain the right of substitution. In many cases, the underwriters actually structure the investment portfolio.

**Sufficiency of Funds and Investments.** At all times, the total market value of investments at maturity and accumulated funds must be sufficient to fulfill the refunded bonds’ debt service requirements. The following language may be appropriate:
Any temporary advancement of monies to the Escrow Account to pay designated requirements of refunded bonds, because of a failure to receive promptly the principal of and interest on any federal securities at their respective fixed maturity dates, or otherwise, must be repaid to the person advancing such monies upon the receipts by the Escrow Bank of such principal and interest payments of such federal securities.

The government should work closely with bond counsel as well as the financial advisor to understand the sufficiency of principal and interest, if any, to be received on the securities (investments) deposited in the account. Actions and reports of the escrow agent should be closely monitored.

Notice of Insufficiency/Possible Deficiencies. Periodic assessments and/or valuations of investments and other funds should be made by an independent auditor. To protect all parties, a sufficiency report prepared by the auditor is always required for refundings.

If, at any time, it appears that the money as well as interest on the principal of securities in escrow are insufficient to make required payments, the escrow agent (or auditor) should immediately notify the government in writing. Such notice should include the amount and explanation of the deficiency. Should deficiencies occur, legal counsel should be notified promptly and immediate action taken to avoid potential Internal Revenue Service penalties.

Some agreements state that the escrow is not responsible for advancing additional funds to meet refunding requirements. As a consequence, the government would be required to deposit additional money as specified in the escrow agent’s notice of insufficiency. Responsibilities in this area should be made clear in the agreement.

Status Reports. The government should require that the escrow agent submit a report detailing all monies which the escrow bank received and all payments which the escrow bank has made in accordance with the agreement. Such reports also should list investments held and/or investment transactions as well as the disposition of any uninvested monies. This report should be submitted no less than quarterly.

Collection of Proceeds. This section specifies that the escrow agent shall be responsible for the immediate collection and receipt of all interest and principal payments made from purchased securities. The agent should be responsible for the immediate deposit of such funds into the escrow account.

Application of Proceeds and Money. In this section the escrow agent should be assigned responsibility for making transfers to the paying agent (via bank or government) on specified dates or intervals.

Bank as Escrow Agent/Segregation of Accounts. All securities and monies to be held in the escrow account(s), to the extent possible, should be registered under the name of the government. Oftentimes, however, securities are registered in the name of the financial institution for the benefit of the escrow account. This allows for efficiency in processing. Such funds and investments should not be commingled, however, with other accounts managed by escrow agent.

Reinvestment of Bond Proceeds and of Other Government Obligations. Reinvestment of proceeds must be conducted in conformance with arbitrage rebate and yield restriction requirements of the Internal Revenue Service.

In conjunction with these requirements, the agreement should specify any limitations on the yield of individual investments (e.g., "must be U.S. Obligations of less than _%,"). If this limitation is not met by a prospective investment, a bond counsel letter should be required to verify the composite weighted average yield of reinvestment holdings. Purchased securities must mature no later than the date upon which funds are required to meet refunded bond requirements. For example:

Except as otherwise provided in sections x and y of this Agreement, there shall be no sale of any federal securities held hereunder, and no federal securities held hereunder and callable for prior redemption at the option of the City shall be called at any time for prior redemption except if necessary to avoid a default in the payment of the refunded bond requirements.

In order to meet arbitrage requirements, some escrow account agreements provide for specified reinvestment
of earnings. Clients with the automatic reinvestment provision should have language in the agreement to ensure strict compliance.

**Excess Money in Escrow.** If the total value of investments and funds held in escrow exceed the amount necessary to make required payments, the government may request that surplus obligations, proceeds thereof, or other funds be returned to the government, or that the excess be applied toward fees of the escrow agent. Upon request, the agent would require a sufficiency report and/or counsel opinion to ensure that a shortfall would not occur.

**Ownership of Deposits.** Securities should be registered in the name of the financial institution as escrow agent. In the case of book-entry securities, an agent of the government or of the escrow bank should make arrangements with an agent of the federal government for interest payments to be directed to the escrow account.

**Amendments to Agreement.** Agreements may not be revoked or amended except to clarify an ambiguity, and then only if the revocation or amendment is accompanied by legal opinion that the change will not detrimentally affect the owners of the refunded bonds or tax-exempt status of the refunded bonds.

In some instances, amendment procedures may require public and court hearings. Some enabling legislation requires that notice of such hearings be placed in the print news media. In such cases, the government typically pays all costs of the escrow bank, including attorney's fees, in connection with any such proceeding. A statement should be included in the agreement that says all parties must sign the amendment before it becomes effective.

**Limitations of Escrow Agent Duties.** Many agreements specify that none of the provisions contained in the escrow account agreement shall require the escrow agent to use or advance its own funds in the performance of its responsibilities. An example of such language follows:

The Escrow Agent's liabilities and obligations in connection with this Escrow Account Agreement are confined to those specifically described herein. The Escrow Agent is authorized and directed to comply with the provisions of this Escrow Account Agreement and is relieved from all liability for so doing despite any demand or notice to the contrary by any party. The Escrow Agent shall not be responsible or liable for the sufficiency, correctness, genuineness or validity of the Government Obligations or the substitute obligations; the performance or compliance by any party other than the Escrow Agent with the terms or conditions of any instruments; or any loss which may occur by reason of forgeries, false representations or the exercise of the Escrow Agent's discretion in any particular manner unless the exercise is negligent or constitutes willful misconduct. If any controversy arises between the Government and any third party, the Escrow Agent shall not be required to take any action, but may, in its discretion, institute an interpleader or other proceedings as it may deem proper.

The parties to the agreement should assess the reasonableness of these and other provisions in light of the following factors: experience and past practice of the parties, risk inherent in the duties/responsibilities, alternative remedies agreed upon to cover errors, and compensation level versus potential risk.

**Termination of Escrow Account.** When all requirements of outstanding refunded bonds are met, the escrow agent should remit to the government any funds or securities remaining in the escrow account and the agreement will be considered terminated in an agreed-upon timeframe.

**Compensation of Escrow Agent.** The section may either specify escrow agent's fee or may refer to an attachment or a prior agreement. This section often goes beyond compensation for ordinary services and includes a provision for other services as provided in the example below:

In the event the Escrow Agent renders any service not provided for in this Escrow Account Agreement, or the Escrow Agent is made a party to or intervenes in . . . litigation . . . or institutes interpleader proceedings.
This section may explicitly state that these additional services will be provided at a reasonable cost.

Successor Escrow Agent. The obligations pursuant to an escrow account agreement may be assumed by a successor if certain conditions are met. Thus many agreements provide that a successor will assume all obligations of the escrow agent under this agreement: and all government obligations, substitute obligations and money then held by the escrow agent pursuant to the agreement will be duly transferred to the successor.

In addition, the agreement might require sixty (60) days written notice before the new escrow agent is appointed as well as set and establish minimum qualifications for a successor.

Notices. Addresses and contact names (and title) for both the government and the escrow agent should be included.

Severability. If any section of the agreement is rendered invalid for any reason, the protection and direction of the agreement should be retained until a new agreement is drafted (e.g., "If any section of this Agreement shall be rendered invalid for any reason, then the remainder of the Agreement shall remain in full force and effect").

Governing Law. Some governments list the governing law by which compliance to all provisions are assessed, evaluated or determined (e.g., "This Agreement shall be governed by and construed in accordance with the laws of the State of Texas."). If the government’s escrow agent is located in another state, the "dual law" should be mentioned.

Purpose of Escrow. Some agreements restate the purpose of the escrow that appears in the introductory section of the agreement.

Defeasance and Redemption Notice. Provisions should be made to give public notice of defeasance and/or redemption of the refunded bonds. For example:

Provision is made to give notice of prior redemption of the Refunded Bonds. Such notice shall be substantially in the forms set forth in the document. The Escrow Agent shall, not more than sixty (60) nor less than forty-five (45) days prior to the respective redemption dates of the Refunded Bonds a) notify the Treasurer and the Board’s Director of Finance by registered mail that the Treasurer is required to give published notice of prior redemption of the Refunded Bonds in a newspaper of general circulation in the City and in the Daily Bond Buyer or a financial newspaper or periodical in New York, b) notify the Treasurer and the Board’s Director of Finance by registered mail that the Treasurer is required to give certified first-class, postage prepaid mailed notice of prior redemption to the various managers of the purchasing account of the purchaser, and c) notify the Bank by registered mail that the Bank is required to give first-class, postage prepaid mailed notice of prior redemption to the registered owners of such bonds.

Disposition of Uninvested Funds. The agreement should specify where the escrow agent may place funds prior to disbursement for bond requirements (e.g., repurchase agreements). This agreement also may specify capital requirements, geographic location, bank membership, master agreements and other items. Also, the parties may have agreed to hold funds uninvested for periods of time and the fee structure should be adjusted accordingly. It is very important to detail this type of arrangement in this section.

Purchaser’s Responsibility. The escrow account agreement should free bondholders from responsibility for disposition of bond proceeds. Commonly used language follows:

The purchasers and registered owners from time to time of the refunding bonds shall in no manner be responsible for the application or disposition of the proceeds thereof or any monies or federal securities account for in the Escrow Account.

Timeliness. The government should provide for some form of recourse for late disbursement of funds to paying agent. Further, there should be some recourse specified for escrow agent’s failure to perform specified responsibilities in a timely manner.