Lawyers' Trust Accounts Benefit From Unlimited Deposit Insurance

by
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The financial crisis that began in September 2008 and resulted in many bank failures caused some lawyers to reconsider the rules applicable to trust accounts. While frequent users of trust accounts are probably familiar with relevant developments during the financial crisis, other attorneys may benefit from a bit of background on these accounts.

When lawyers receive funds of clients, they must hold the funds separate from their own funds, and typically use trust accounts for this purpose. Client funds can include financial settlements or advance legal fees, for example. The funds of multiple clients can be held together in a single trust account, which is a fiduciary account. Combining the funds of multiple clients is customary if the net interest on the money would not be enough to compensate for the costs of maintaining separate accounts for the clients.

If a lawyer holds large sums for a single client, a specific trust account is usually established so the funds can earn interest for the client. Frequently, however, the amount of money a lawyer is holding for his client is either small or only to be held for a short time. Separate trust accounts may be impractical in this situation because the amount of interest earned would be less than the costs incurred to maintain the accounts. Traditionally, when client funds are pooled in trust accounts, they earned no interest because attorneys are not ethically permitted to derive a monetary benefit from funds belonging to their clients.

State laws and Supreme Court Rules created Interest on Lawyers Trust Accounts ("IOLTA"). IOLTA accounts were allowed to earn interest which is paid to the state IOLTA Program to fund charitable causes. IOLTA accounts must be held in financial institutions with FDIC insurance and must be capable of being withdrawn without delay. Mishandling IOLTA funds, such as by using the funds for improper purposes or failing to keep required records, can result in disciplinary action against a lawyer.

The interest on IOLTA accounts is used to benefit low-income persons and provide legal assistance to the poor. As stated on the IOLTA.org website, "at no cost to lawyers or their clients, interest from lawyer trust accounts is pooled to provide civil legal aid to the poor and support improvements to the justice system." Significant funds are generated by IOLTA accounts; one estimate of 2007 IOLTA is $212 million nationally. The California State Bar reported $12.2 million in IOLTA grants in 2008.

Despite the charitable purposes to which trust account interest is put, IOLTA Programs have faced legal challenges. Among other things, claims have been made that the taking of the interest earned violates the Compensation Clause of the Fifth Amendment and that the requirement that the client funds be placed in such an account was an illegal taking.

In *Brown et al. v. Legal Foundation of Washington, et al.*, 271 F.3d 835 (2003), the United States Supreme Court held that under the Fifth Amendment, the taking must be for public use and just compensation must be paid to the owner. The Court made it clear that the success of the IOLTA programs in providing legal services to the needy qualified the distribution of the funds as a public use. The Court further held that there was no violation of the Just Compensation clause because the owner had no pecuniary loss.

In the midst of the global financial crisis in November 2008, the FDIC created the Transaction Account Guarantee Program (TAG), which included (among other measures designed to boost confidence in the banking system) a provision for unlimited insurance coverage for non-interest bearing deposit transaction accounts. The TAG Program included IOLTA accounts. That provision was originally set to expire on December 31, 2009 and was extended by the FDIC until December 31, 2010.

President Obama signed the Dodd Frank Wall Street Reform and Consumer Protection Act into law on July 21, 2010. Dodd Frank extended unlimited FDIC insurance for non-interest bearing accounts until December 31, 2012, but through an oversight, it did not extend the unlimited coverage to IOLTA accounts. As a result, lawyers had to consider whether to deposit trust funds totaling more than the FDIC-insured limit in IOLTA accounts and face the consequences of possible bank failure, or alternatively, whether to potentially violate state ethics rules and use non-interest bearing accounts for the deposit of large sums to take advantage of unlimited deposit insurance. Either alternative had potentially unhappy consequences for lawyers, their clients, and IOLTA Programs.

The ethics rules of most bar associations further complicated the issue. A December 2010 ABA press release noted that lawyers must deposit client funds into IOLTA accounts in 42 states and the District of Columbia. In seven other states, lawyers may opt-out of participation in IOLTA accounts, and participation is voluntary in one state and in the U.S. Virgin Islands.

With the deadline of December 31, 2010 for the expiration of unlimited FDIC insurance for IOLTA accounts looming, the American Bar Association lobbied successfully for an amendment to include IOLTA accounts in the definition of “non-interest bearing” transaction accounts. President Obama signed H.R. 6398 on December 29, 2010, extending unlimited deposit insurance for IOLTA accounts through December 31, 2012. Thereafter, on January 18, 2011, the FDIC announced a rule redefining non-interest bearing transaction accounts to include IOLTA accounts, with the effect that IOLTA accounts are now insured without limit until December 31, 2012.

The legal change is good news for lawyers with IOLTA accounts, who might have had to withdraw funds from an account when it reached the otherwise-applicable deposit limits, or create multiple accounts to avoid balances higher than such limits. The ability to keep trust funds together in a single account also reduces required recordkeeping for lawyers and allows interest to continue to be earned for IOLTA Programs.

Not later than February 28, 2011, banks offering noninterest-bearing transaction accounts, *including IOLTA accounts*, must post a notice in their main and branch offices and on their websites, as follows:

> All funds in a "noninterest-bearing transaction account" are insured in full by the Federal Deposit Insurance Corporation from December 31, 2010, through December 31, 2012. This temporary unlimited coverage is in addition to, and separate from, the coverage of at least $250,000 available to depositors under the FDIC's general deposit insurance rules.
> The term "noninterest-bearing transaction account" includes a traditional checking account or demand deposit account on which the insured depository institution pays no interest. It also includes Interest on Lawyers Trust Accounts ("IOLTAs"). It does not include other accounts, such as traditional checking or demand deposit accounts that may earn interest, NOW accounts, and money-market deposit accounts.

For those wishing to delve further into the operation, regulation and uses of IOLTA accounts, the following are useful sources of information:

http://www.abanet.org/legalservices/iolta/ioltback.html

http://www.iolta.org/

http://www.law.cornell.edu/supct/html/01-1325.ZS.html

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