

# THE IOLTA UPDATE

**TAKE A LOOK AT IOLTA ACCOUNT BASICS, WHAT'S NEW AND WHAT'S NEXT REGARDING THE IMPACT OF GOVERNMENTAL POLICY.**

BY ED POLL

Interest on Lawyer Trust Accounts (IOLTA) is one of the most fundamental financial and ethical concerns of any law firm, and any law firm administrator. Managing IOLTA accounts involves highly technical issues (many of which we discussed in a February 2009 *Legal Management* article), which center on depositing into the account a client's payment for work that will be performed, and withdrawing that payment from the account when the work has been performed. Funds in IOLTA accounts belong to the client, and must be strictly safeguarded until the lawyer and firm are entitled to them by virtue of services performed.

Two years ago, at the depths of the financial crisis, this safeguarding requirement was creating big worries for the legal profession. With many banks in danger of failing or actually being taken over by the government, IOLTA accounts that exceeded the Federal Deposit Insurance Corporation's (FDIC) guaranteed limit appeared to be at risk – and lawyers and law firms, with fiduciary responsibility for the acts of banks as their agents, could have been held responsible. That risk has passed thanks to specific action by the federal government. But new questions and new requirements continue to arise on IOLTA account management in today's complex financial environment, particularly in regard to electronic banking. In this article we'll take a brief refresher course on IOLTA account basics, and look at what's new and what's next regarding the impact of governmental policy and new Rules of Professional Conduct.



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#### WHAT IS IOLTA?

Interest on Lawyers Trust Accounts (IOLTA) is a unique and innovative way to increase access to justice for individuals and families living in poverty and to improve our justice system. Without taxing the public, and 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. Every state in the U.S. operates an IOLTA program. Learn more at [www.iolta.org](http://www.iolta.org).

#### AN IOLTA PRIMER

The foundation for IOLTA management is the engagement agreement, which should set forth in detail the circumstances under which funds may or must be transferred from the client's trust account to the lawyer's general account. When the lawyer is entitled to make the transfer, the lawyer must make the transfer or be guilty of commingling personal and client funds. The American Bar Association Rule of Professional Conduct 1.15 specifically addresses the impermissibility of commingling the lawyer's own funds with client funds, except when necessary to pay the normally small bank service charges on the trust account. Money earned by a lawyer for provision of services belongs to the lawyer and must be transferred immediately from the trust account to the general account when earned (except in those jurisdictions that require several days advance notice to the client before making any transfer).

The transfer process need not be complex. The engagement agreement can state that the client authorizes the lawyer to debit trust account funds after a reasonable time from the date of billing (for example, 15 or 30 days). The lawyer is a fiduciary who, working with the appropriate firm administrator, must keep accurate accounting records of such transfers under every State's rules of professional conduct. This fiduciary duty to properly account for clients' funds is intended to prevent misappropriation or negligence. Failure to maintain and provide accurate accounting records is to risk sanction or even loss of a license to practice law.

#### NEW BANKING SAFEGUARDS

Maintaining the safety of IOLTA funds prior to transfer is obviously paramount. The banking crisis raised such concerns over IOLTA account safety that, when Congress as part of its financial system rescue raised the FDIC's ceiling on bank accounts to \$250,000 rather than \$100,000, the FDIC itself issued a ruling that all amounts in a client's trust account would be protected, regardless of size. The account had to be identified as a trust account and lawyers had to maintain their clients' trust accounts

in accordance with generally accepted accounting principles and the trust rules of the jurisdiction for such accounts, including identification of the amounts held for each client. This was intended to be "temporary" protection through December 31, 2010.

Nothing that involves the government is ever simple, however. When Congress passed the Dodd-Frank financial reform act in the latter part of 2010, it extended the higher FDIC limits – but did not include IOLTA accounts. In November the House of Representatives approved adding IOLTA but it took the Senate until December 23 – virtually the end of the session – to do the same. The President signed the IOLTA extension on December 29, 2010, and on January 18, 2011, the FDIC issued a final rule revising its deposit insurance regulations to reflect this amendment to the Federal Deposit Insurance Act. The final rule requires that each insured depository institution that offers noninterest-bearing transaction accounts such as IOLTA accounts must post prominently an amended notice in its office lobbies and on its websites explaining that IOLTAs will be fully insured through December 31, 2012.

Lawyers and administrators should still make certain their IOLTA accounts have FDIC coverage. Be sure to identify in bank records the name of the client and the amount of dollars held for that client. An additional step might be to maintain a separate trust account for each client whose funds are likely to be held for an extended period of time. The interest on such a separate account will belong to the client. Because this increases trust fund accounting expense, consider providing in the engagement agreement for an administrative charge to cover the cost of account administration. The extra assurance for such an arrangement could be worth it.

#### NEW MODEL RULES

FDIC coverage removes one IOLTA account concern, but a broader issue involves account recordkeeping in the era of electronic banking. For example, Rule 1.15 had been interpreted to require that lawyers maintain original canceled checks drawn on IOLTA accounts. However, for nearly a decade, federal

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rules allowed banks to either convert checks into electronic images and destroy the originals or simply provide a statement listing checks drawn. This was just one issue that increasingly created ethical compliance problems in IOLTA management.

As a result, in August 2010 the American Bar Association's House of Delegates adopted the Model Rules for Client Trust Account Records to replace the Model Rule on Financial Recordkeeping, which had been in effect since 1993. That rule was adopted to help lawyers comply with Rule 1.15, requiring lawyers to maintain "complete records" with respect to client trust accounts and to render a "full accounting" for the receipt and distribution of client trust property. The new Model Rules provide comprehensive guidelines to lawyers for compliance with the complete-records and full-accounting requirements of Model Rule 1.15, by accommodating current standards of practice while maintaining protections for clients.

The new model rules encompass three key guidelines intended to bring IOLTA account management into line with current banking practices and business realities by:

- Permitting lawyers to meet recordkeeping requirements by using substitute checks or electronic images of checks as an alternative to pre-numbered canceled paper checks, with the proviso that detailed records must still be kept.
- Allowing a law firm employee, under the direct supervision of a lawyer, to authorize bank transactions from a client trust account, provided that the lawyer closely monitors and remains personally and professionally liable for all such transactions.
- Confirming that, in addition to paper copies, a lawyer or firm may maintain IOLTA account records in electronic, photographic, computer or other formats, either at the lawyer's office

or at an off-site storage facility, with the important stipulations that the records must be readily accessible, that printed copies are available upon request, and that client confidentiality is fully protected by any third-party electronic or Internet-based file storage arrangements.

#### **A SERIOUS RESPONSIBILITY**

These changes are obviously common-sense realizations of current practices, but the fact that they needed to be made explicit illustrates the point that IOLTA account management is taken very seriously as a professional responsibility by every state bar association. For any firm, and for any firm administrator with any account management responsibilities, to do anything other than use an effective software accounting program or an outside accountant to reconcile trust and bank account records each month is to invite error, inquiry and trouble. Banks are required to notify the appropriate bar authority of any suspected theft or negligence, and a bounced check from an IOLTA account brings bar examiners into the lawyer's office almost instantly. No matter how much activity there is in an IOLTA account (and some accounts in large personal injury, debt collection and real estate practices are very large), funds must be kept safe and records must be maintained accurately. Simple human error may be an explanation for trust account problems, but it is never an excuse so far as a lawyer's professional responsibility and liability are concerned. ✱

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