

AGENDA ITEM

JANUARY 114

Interest on Lawyers Trust
Accounts (IOLTA) Rules and
Regulations and Proposed
Rule of Court to Implement AB
1723 – Return following Public
Comment

DATE: December 18, 2007

TO: Members, Committee on Board Operations
Members, Board of Governors

FROM: Stephanie L. Choy, Managing Director, Legal Services Trust Fund
Program; Mary Lavery Flynn, Director, Legal Services Outreach

**SUBJECT: Interest on Lawyers Trust Accounts (IOLTA) Rules and Regulations
and Proposed Rule of Court to Implement AB 1723 – Return following
Public Comment**

EXECUTIVE SUMMARY

In October of 2007, AB 1723 was signed by the Governor. The bill is designed to increase the yield on Interest on Lawyers Trust Accounts (IOLTA) by requiring attorneys to hold IOLTA accounts at financial institutions that offer rates comparable to those paid to other depositors with similar accounts. The bill also expands the range of investment vehicles in which IOLTA accounts may be held. At its November 2007 meeting, the Board Committee on Stakeholder Relations approved releasing for public comment proposed amendments to IOLTA Rules and Regulations as well as a Proposed Rule of Court. The Board Committee approved a 45-day comment period in order to implement AB 1723 as expeditiously as possible, given the effective date of January 1, 2008.

This agenda item seeks approval of proposed modifications to the IOLTA Rules and Regulations, as well as approval to submit a proposed Rule of Court to the Supreme Court. The comment deadline is December 31, 2007; therefore, this agenda item includes a review of the public comment received to date. At your board meetings, you will be updated about any other public comment received, and a revised agenda item will be submitted, if subsequent public comment results in any further recommended modifications.

Questions regarding this agenda item should be directed to Stephanie Choy, Managing Director, Legal Services Trust Fund Program (415) 538-2249.

BACKGROUND

The Legislature created California's IOLTA program in 1981, which was codified at Business & Professions Code §§6210-6228. Section 6211 provided,

“(a)n attorney or law firm, which in the course of the practice of law receives or disburses trust funds, shall establish and maintain an interest bearing demand trust account and shall deposit therein all client deposits that are nominal in amount or are on deposit for a short period of time. All such client funds may be deposited in a single unsegregated account.”

The Legal Services Trust Fund Program receives interest on these accounts, and distributes those funds to approximately 100 programs statewide that provide free legal services in civil matters to indigent Californians.

The purpose of the IOLTA Program is to expand the availability and improve the quality of existing free legal services in civil matters to indigent persons, and to initiate new programs that will provide services to them. The amount of funds annually remitted to the Trust Fund Program varies depending on interest rates, historically resulting in a high distribution of over \$22 million in 1992-1993 to a low distribution of less than \$6 million in 1994-1995. Over the years, the LSTF Commission and its staff have worked diligently to increase revenue, including through earlier efforts to expand the types of accounts in which IOLTA funds may be held.

- **History of AB 1723:** On November 16, 2006, the Legal Services Trust Fund Commission requested that the Board of Governors support legislation to amend relevant sections of Business & Professions Code §§6210-6228 drafted in 1981. AB 1723 was signed into law on October 10, 2007. To allow IOLTA accounts to benefit from the range of secure deposit vehicles that are now on the market, the amended statute permits attorneys to hold IOLTA funds either in interest-bearing demand trust accounts or in cash management accounts that permit overnight investment into higher-yield investments backed by U.S. Government securities or other comparably conservative debt securities.
- **Impact of Implementation of AB 1723:** The implementation of comparability has significant support, as evidenced by the fact that dozens of organizations and individuals wrote to Governor Schwarzenegger requesting that he sign the bill into law, including both the Chamber of Commerce and Chief Justice Ronald George himself.

With successful implementation, California will join more than a dozen states that have established IOLTA comparability. Based on our initial analysis of currently comparable rates among the California banks that hold the most IOLTA funds, the LSTFP stands to increase revenue by close to \$2 million in important legal services funding for every month following implementation of comparability.

Prior Board of Governor Action - At its November 2007 meeting, the Board Committee on Stakeholder Relations approved releasing for public comment the proposed amendments to IOLTA Rules and Regulations and a Proposed Rule of Court. The Board Committee approved a 45-day comment period in order to implement AB 1723 as expeditiously as possible, given the January 1st effective of the new legislation.

The previous agenda item of November 2007, seeking public comment before the Board Committee on Stakeholder Relations, is available at:

<http://bog.calbar.org/pages/Agenda.aspx?id=10041&tid=0&show=100000603#10000603>

This agenda item seeks approval of proposed modifications to the IOLTA Rules and Regulations, and approval to submit a proposed Rule of Court, following public comment. The comment deadline is December 31, 2007; therefore, this item includes a review of the public comment received to date. At your board meetings, you will be updated about any other public comment received, and a revised agenda item will be submitted, if subsequent public comment results in any further recommended modifications.

PART I – PROPOSED MODIFICATIONS TO IOLTA RULES AND REGULATIONS

Implementation of the comparability bill requires revision of the State Bar Rules Regulating Interest-Bearing Trust Fund Accounts for the Provision of Legal Services to Indigent Persons to bring those Rules in line with the legislation. At the same time, the proposed Rules have been organized and restructured to fit within the new organizational structure adopted by the Board of Governors July 2007 under the State Bar rules revision project. Enactment of these rules would repeal existing Rules 1-1.5 of the State Bar Rules Regulating Interest-Bearing Trust Fund Accounts for the Provision of Legal Services to Indigent Persons.

Attachment 1: Proposed rules implementing comparability, can be found at this link: <http://calbar.ca.gov/calbar/pdfs/public-comment/2007/IOLTA-Amended-Rules.pdf>

Attachment 2: Redlined rules showing changes from prior rules, can be found at this link: <http://calbar.ca.gov/calbar/pdfs/public-comment/2007/IOLTA-Revised-Rules.pdf>

PART II – PROPOSED REQUEST FOR RULE OF COURT

The initial IOLTA legislation sought action by the Supreme Court, under §6212(a): “...the interest bearing trust account must be established with a bank or such other financial institutions as are authorized by the Supreme Court.” Following adoption of the statute, the Board of Governors recommended, and the California Supreme Court adopted, an order authorizing members to establish a federally-insured, interest-bearing trust account with a depository that has a notice of withdrawal requirement not exceeding 30 days.

The Order currently provides:

“...[pursuant to 6212(a)]... members of the State Bar, law firms or law corporations of which they are members are authorized to establish interest-bearing trust

accounts with a bank, savings and loan, or other financial institution regulated by a federal or state agency, which can accept such deposits, pay interest thereon, and insure such deposits by an agency of the federal government. . . .” (Supreme Court Order pursuant to Statutes 1981, Chapter 789)

This Order needs to be rescinded to remove criteria that the depository needs to be able to “insure such deposits by an agency of the federal government,” to avoid conflict with the legislative mandate.

At its November 2007 meeting, in order to accomplish the legislative intent of AB 1723, the Board of Governors approved submission of a petition to the Supreme Court to rescind the Order it issued to support the 1981 statute. The rescission of the existing Order will enable immediate implementation of comparability, and that petition is now pending with the Supreme Court. The proposed Rule of Court that is part of this agenda item would ultimately replace any interim order of the Supreme Court.

Attachment 3: Proposed Rule of Court, can be found at this link:

<http://calbar.ca.gov/calbar/pdfs/public-comment/2007/IOLTA-Prop-RofC.pdf>

PART III - OVERVIEW OF PUBLIC COMMENT RECEIVED

The request for public comment was widely disseminated, particularly within the financial institutions and legal services communities. The deadline for written comment is December 31st, and you will be updated at your meeting on public comment received prior to the preparation of this agenda item. There were two public hearings held – one in San Francisco on December 4th, and one in Los Angeles on December 13th.

Attachment 4: Notice of Public Comment can be found at the following link:

http://calbar.ca.gov/state/calbar/calbar_generic.jsp?cid=10145&n=89363

Speakers at the public hearings stressed the importance of legal aid to provide access to justice for those who otherwise would have nowhere to turn for help, and emphasized how implementation of comparability rules in other States has increased funding for legal aid, while protecting the security of the IOLTA funds.

Additionally, the California Bankers Association (CBA) has submitted comments summarized below. As of the time of submission of this agenda item, the Legal Services Trust Fund Commission is working with CBA to discuss their concerns and determine how best to respond, both with respect to these rules as well as to the Guidelines for Financial Institutions adopted by the Trust Fund Commission. We will supplement this agenda item, if necessary, after those discussions.

- **Fees.** The CBA states that they would like Rule 2.100 to be clarified with respect to the scope of reasonable monthly fees and that they would like Rule 2.113 to clarify that the institution has no responsibility to pay fees owed by the member. The Trust Fund Commission is working with CBA to discuss possible clarification of these rules with respect to the scope and handling of fees (Rules 2.100 and 2.113), and will submit any proposed modifications at your January meeting.

- **A Set Compliance Rate.** While CBA supports establishing a compliance rate (called a “benchmark” rate in the proposed rules), the CBA seeks clarification on how that rate will operate. The Trust Fund Commission will provide clarification, and among other things, is considering a recommendation to use another term for “Benchmark,” which term incorrectly connotes that it is a minimum criteria. A final recommendation will be available by the time of your meeting. Also, it is important to note that this proposed Rule would merely allow banks to choose to pay a specific compliance rate in lieu of the bank’s comparable rate as an accommodation to banks that choose to avoid administration of comparable rates. There is no requirement that banks choose to pay the “benchmark” rate and no harm to banks that opt to pay their actual comparable rate. This is merely an accommodation to help achieve the most efficient compliance, which allows savings for both financial institutions and the Trust Fund Program.
- **Government Sponsored Entities.** Finally, the CBA contends that Government Sponsored Entities (GSEs) should not be included in the range of comparable investment products, arguing that GSEs are subject to market forces different from securities issued by the U.S. Government and citing the fall in stock prices of Fannie Mae and Freddie Mac as evidence of this fact. However, the stock price of the entities themselves is not tied to the security of the stocks that these entities issue. In addition, banks only are obligated to treat IOLTA accounts as they do their accounts that meet similar minimum deposit and other requirements. If the banks do not offer GSE backed securities to other customers, they need not offer those investment options to the IOLTA account. In fact, banks continue to include such securities in their sweep products and attorneys already use them for their non-IOLTA trust accounts. Excluding these investment vehicles from IOLTA accounts would make many sweep products unavailable to IOLTA accounts – which would greatly reduce IOLTA revenue available to fund legal aid for indigent people. The security of these funds was addressed in public comment, and we will provide supplemental information about these funds at your meeting.

PERSONNEL/BUDGET IMPLICATIONS

This recommendation does not affect the general fund budget. No additional staff or other expenses will be incurred as a result of this recommendation.

BOARD BOOK/ADMINISTRATIVE MANUAL IMPACT

None.

RULE AMENDMENTS

If approved, this item would add Rules 2.100-2.118, 2.130 and 2.131 and would repeal existing Rules 1-1.5 to the State Bar Rules Regulating Interest-Bearing Trust Fund Accounts for the Provision of Legal Services to Indigent Persons.

STRATEGIC IMPACT

This proposal helps implement Long-Range Issue 3, Equal Access to Justice, Goal 3,

that all people have access to high quality legal services regardless of financial or other circumstances.

RECOMMENDATION

The Legal Services Trust Fund Commission and staff recommend the Committee on Board Operations and the Board of Governors approve the proposed changes to the Interest on Lawyers Trust Accounts (IOLTA) Rules and Regulations and approve submitting the Proposed Rule of Court to the Supreme Court to Implement AB 1723.

RESOLUTION

Should the Committee on Board Operations agree with the above recommendation, the following resolution is suggested:

RESOLVED, that the Committee on Board Operations recommends that the Board of Governors add Rules 2,100-2.118, 2.130 and 2.131 and would repeal existing Rules 1-1.5 to the State Bar Rules Regulating Interest-Bearing Trust Fund Accounts for the Provision of Legal Services to Indigent Persons in the form attached to this agenda item;

FURTHER RESOLVED, that the Committee on Board Operations recommends that the Board of Governors approve submission of the Proposed Rule of Court to the Supreme Court to Implement AB 1723, in the form attached.

Should the Board of Governors concur with the recommendation of the Committee on Board Operations, the following resolution is suggested:

RESOLVED, that upon recommendation of the Committee on Board Operations, the Board of Governors add Rules 2,100-2.118, 2.130 and 2.131 and would repeal existing Rules 1-1.5 to the State Bar Rules Regulating Interest-Bearing Trust Fund Accounts for the Provision of Legal Services to Indigent Persons in the form attached to this agenda item;

FURTHER RESOLVED, that upon recommendation of the Committee on Board Operations, the Board of Governors approves submission of the Proposed Rule of Court to the Supreme Court to Implement AB 1723, in the form attached.

LIST OF ATTACHMENTS:

1. **Proposed rule changes:** <http://calbar.ca.gov/calbar/pdfs/public-comment/2007/IOLTA-Amended-Rules.pdf>
2. **Redlined rule changes:** <http://calbar.ca.gov/calbar/pdfs/public-comment/2007/IOLTA-Revised-Rules.pdf>
3. **Proposed Rule of Court:** <http://calbar.ca.gov/calbar/pdfs/public-comment/2007/IOLTA-Prop-RofC.pdf>
4. **Notice of Public Comment:** http://calbar.ca.gov/state/calbar/calbar_generic.jsp?cid=10145&n=89363