



THE STATE BAR OF CALIFORNIA

LEGAL SERVICES TRUST FUND PROGRAM

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DATE: October 27, 2008

TO: Members, Board Committee on Stakeholder Relations

FROM: Stephanie L. Choy, Managing Director
Legal Services Trust Fund Program

SUBJECT: Legal Services Trust Fund Program - Request to Release for
Public Comment Proposed Supreme Court Rule Defining "Eligible
Institutions"

EXECUTIVE SUMMARY

AB 1723 (the "comparability bill") was signed into law on October 10, 2007. The resultant legislation, codified in Business & Professions Code §§6091.2, and 6211-6213, requires attorneys to hold IOLTA accounts at financial institutions that offer rates comparable to those paid to other depositors with similar accounts, and expands the range of investment vehicles in which IOLTA accounts may be held. In November 2007, the Board petitioned the Supreme Court for an order rescinding its 1981 interim order (which included a FDIC insurance requirement that was inconsistent with the new statute) and requested a new interim order authorizing financial institutions other than banks to hold IOLTA accounts. At that time, the Board Committee on Stakeholders Relations also released for comment a proposed new rule of court mirroring the interim order.

The Supreme Court approved the petition with respect to rescission of the 1981 order, but requested additional information on the need for any additional order or rule of court to implement the comparability legislation. B&P Code §6213(k) provides that "Eligible Institution" means a bank or any other type of financial institution authorized by the Supreme Court." Based on LSTFP experience implementing the legislation, we find a new rule is necessary to identify financial institutions, other than banks, that may hold IOLTA accounts. This agenda item requests release for public comment of a proposed rule to identify those financial institutions. Upon return from a 45-day public comment period, the Legal Services Trust Fund Commission ("LSTFC") will seek BOG approval of a petition to the Court at its January 2009 meeting.

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

BACKGROUND

Since the 1980's, Business and Professions Code §§6210 et seq. [Funds for Provision of Legal Services to Indigent Persons] has required that funds held in trust by California attorneys be held in interest bearing trust accounts ("IOLTA accounts"); that the interest earned by the financial institution be paid to the State Bar; and that the State Bar distribute those funds to nonprofit organizations that provide free legal aid to indigent people. The purpose of the IOLTA Program is to expand the availability and improve the quality of free legal services in civil matters to indigent persons.

In 2006, the Board of Governors supported legislation to amend relevant sections of B&P Code §§6210-6228 drafted in 1981. AB 1723 was signed into law on October 10, 2007 and went into effect on January 1, 2008. In brief, the statute was amended to provide that: 1) IOLTA accounts should earn no less than the interest rate or dividend generally available to non-IOLTA depositors at the same institution when the IOLTA account meets or exceeds the same minimum balance or other account eligibility requirements; and, 2) IOLTA accounts may benefit from the range of secure deposit vehicles on the market, including cash management accounts that permit overnight "sweep" into higher-yield investments backed by U.S. Government or comparably conservative securities. (Attachment 1 is the text of B&P Code §§6091.2, 6211-6213.)

In November 2007, in order to accomplish the legislative intent of the new law, the LSTFC requested the Board authorize a petition to the Supreme Court to: 1) rescind its 1981 Order (issued to support the 1981 statute) to remove criteria that the depository "insure such deposits by an agency of the federal government"; and, 2) issue an interim order to implement the new statutory requirements. The rescission was necessary because cash management accounts that permit overnight investment are not generally covered by federal insurance during the period they are invested in or secured by U.S. Government securities. Because B&P Code §6213(k) defines "eligible institution" as "a bank or any other institution authorized by the Supreme Court," the interim order also included a definition of "eligible institutions" and other wording to support the IOLTA program. (Attachment 2 is the 1981 Order.)

At the November 2007 meeting of the Board Committee on Stakeholder Relations, the LSTFC also submitted a parallel agenda item with a request that a proposed rule of court mirroring the contents of the interim order be sent out for public comment so that upon return, the State Bar could petition the Supreme Court to adopt that rule. (Attachment 3 is the proposed rule wording released for public comment in November 2007.)

On January 3, 2008, the Supreme Court rescinded its 1981 order, but rather than implement the interim order, the court ordered the State Bar to assist the court in evaluating the necessity for a rule of court to implement the legislative changes to

the IOLTA program. (Attachment 4 is the Supreme Court order rescinding its 1981 order.)

The Legal Services Trust Fund Program (LSTFP) is charged with administering the IOLTA program -- assisting both attorneys and financial institutions with complying with the statute. In the months since the statute went into effect, the LSTFP has qualified almost 300 institutions that hold IOLTA accounts, most of which held IOLTA accounts prior to implementation of the new statute, but not all of which are “banks” as identified in B&P Code §6213(k). Therefore, the LSTFP has determined the need for the attached Rule of Court (“Rule”), which clarifies and expands the types of financial institutions that are eligible to hold IOLTA accounts.

The proposed Rule defines “eligible institution” under Business & Professions Code §6213(k) to include “a bank, savings and loan, or other financial institution regulated by a federal or state agency that (a) can pay interest or dividends, and (b) carries deposit insurance from an agency of the federal government. This agenda item proposes the Rule be released for public comment. Upon return from a 45-day public comment, at its January 2009 meeting, we will seek Board approval to petition the Court to adopt the Rule. (Attachment 5 is the Rule that the Legal Services Trust Fund Commission requests be released for public comment.)

NEED FOR PROPOSED RULE

B&P Code §6213(k) defines “eligible institution” as a “bank or any other type of financial institution authorized by the Supreme Court.” Based on our experience implementing the comparability requirements and current economic conditions, we conclude that a Court rule clarifying the meaning of “eligible institutions” is necessary. The B&P Code section is both too narrow and too broad – too narrow in that it does not explicitly authorize any financial institution except banks, and too broad in that it does not include the key safety requirement that the financial institutions carry federal deposit insurance. From a public relations standpoint, the safety requirement is particularly significant given the current economic climate and the precarious position of some financial institutions.

The rescinded 1981 Court order had provided:

“... 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; rescinded by Supreme Court Order S158605 Order Regarding the State Bar IOLTA Program, filed January 3, 2008)

With respect to eligible institutions, the proposed rule provides:

- (2) An “eligible institution” under Business and Professions Code section 6213(k) is a bank, savings and loan, or other financial institution regulated by a federal or state agency that
 - (a) can pay interest or dividends, and
 - (b) carries deposit insurance from an agency of the federal government,

The new Rule is drafted in recognition that while not all investment vehicles authorized by the legislature will be federally insured, all IOLTA accounts must still be held at a financial institution that carries federal insurance for its deposit accounts. Moreover, the new Rule refers to “interest or dividends” in keeping with the fact that cash management overnight “sweep” products earn dividends instead of interest. Other than those modifications, the new proposed Rule tracks the wording of the rescinded order with respect to the definition of an “eligible institution” as a “bank, savings and loan, or other financial institution regulated by a federal or state agency.” It is the intent of the LSTFC that the same financial institutions that had qualified to hold IOLTA accounts prior to implementation of the amended statute, continue to be eligible. Thus, banks, savings & loans, savings banks, and credit unions (the latter three are often referred to collectively as “thrifts”) all can hold IOLTA accounts.

LENGTH OF PUBLIC COMMENT AND REASON

In November 2007, the Board released for public comment a proposed rule – similar to the proposed Rule which is the subject of this agenda item. The proposed rule released in 2007 was widely disseminated for public comment, particularly within the financial institutions and legal services communities. In addition, two public hearings were held regarding the proposed rule— one in San Francisco on December 4th, and one in Los Angeles on December 13th. While the California Bankers Association commented on the State Bar implementing rules, it did not comment upon the proposed rule of court. Nor did any other entity comment on the proposed rule of court.

This proposed rule preserves the “status quo” with respect to eligible institutions, and therefore the LSTFC does not anticipate opposition to the rule, and it proposes a 45-day comment period that will begin on November 21 and end on January 6, 2009. This will enable the LSTFC to bring the issue back to the Board of Governors at its January meeting, for authority to petition the Supreme Court to adopt the rule as proposed.

PERSONNEL/BUDGET IMPLICATIONS

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

BOARD BOOK/ADMINISTRATIVE MANUAL IMPACT

None

RULE AMENDMENTS

There is no immediate rule amendment. However, a new Rule of Court is possible if upon return from public comment the Board petitions the Supreme Court for a new Rule and the Petition is granted.

PROPOSED BOARD COMMITTEE RESOLUTION

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

RESOLVED, that the Board Committee on Stakeholder Relations release the proposed rule for 45-day public comment to commence on November 21, 2008 and end on January 6, 2009, and that the matter be brought back to the Committee in January for recommendation to the Board of Governors that it authorize a Petition to the Supreme Court to adopt the rule; and it is

FURTHER RESOLVED, that this authorization for release for public comment is not, and shall not be construed as, a statement or recommendation of approval of the proposed rule.

ATTACHMENTS

- Attachment 1: Business & Professions Code §§6210-6228
- Attachment 2: 1981 Supreme Court Order
- Attachment 3: Proposed rule released for public comment in November 2007
- Attachment 4: 2008 Supreme Court Order rescinding its 1981 Order
- Attachment 5: Proposed Supreme Court Rule 9., which is requested to be released for public comment