

AGENDA ITEM

JANUARY 112

Interest on Lawyers Trust
Accounts (IOLTA) Proposed
Rule of Court and/or
Legislative Amendment to
IOLTA Statute – Return
following Public Comment on
Proposed Rule of Court

DATE: December 18, 2008

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

FROM: Anthony Williams, Legislative Advocate, Wada Williams Law Group LLP
Stephanie L. Choy, Legal Services Trust Fund Program

SUBJECT: Interest on Lawyers Trust Accounts (IOLTA) Proposed Rule of Court and/or
Legislative Amendment to IOLTA statute – Return following Public
Comment on Proposed Rule of Court

EXECUTIVE SUMMARY

AB 1723 (the “comparability bill”) was signed into law on October 10, 2007. The resultant legislation, codified in Business & Professions Code §§6210-6213, requires that attorneys hold IOLTA accounts at financial institutions that offer rates comparable to rates paid to other depositors, 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 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 the Legal Services Trust Fund Program’s experience implementing the legislation, we recommend pursuing either a rule of court or an amendment to the statute to identify types of financial institutions, other than banks, that may hold IOLTA accounts.

This agenda item is returning to the Board after a 45-day public comment period on a

proposed Rule of Court to address this issue. We recommend and request authority to simultaneously seek a legislative amendment to define “financial institutions” within the IOLTA statute. Moreover, because legislative staff has expressed ongoing concerns regarding the need to require attorneys to report whether or not they are obligated to hold an IOLTA account, we recommend the legislative amendment address the attorney reporting requirement as well.

Questions regarding this agenda item should be directed to Anthony Williams, Attorney/Legislative Advocate, Wada Williams Law Group, LLP (916) 448-4000 or 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 specified 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 §§6210-6213.)

In November 2007, in order to accomplish the legislative intent of the new law, the Board authorized 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. Since the original legislation allowed IOLTA accounts to be held in a “bank or such other financial institutions as are authorized by the Supreme Court,” the Supreme Court’s 1981 order defined additional types of financial institutions which could hold IOLTA accounts. (Attachment 2 is the 1981 Order.) The rescission of the interim order 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 Bar sought a new interim order from the Court that defined “eligible institutions” as including institutions other than “banks” and other wording to support the IOLTA program.

At the November 2007 meeting of the Board Committee on Stakeholder Relations, the Legal Services Trust Fund Commission (“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.

On January 3, 2008, the Supreme Court rescinded its 1981 order, but rather than implement the requested 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 3 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 either a legislative amendment or the attached Rule of Court (“Rule”), which clarifies and expands the types of financial institutions that are eligible to hold IOLTA accounts. In November, the Board Committee on Stakeholders’ Relations approved sending the proposed Rule out for public comment. (Attachment 4 is the Rule that the Legal Services Trust Fund Commission released for public comment; Attachment 5 is the Notice of Public Comment.)

NEED FOR A DEFINITION BY SUPREME COURT RULE OR LEGISLATIVE AMENDMENT

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, we conclude that there is a need for an expanded definition of “eligible institutions.” This expanded definition can be accomplished either by pursuing a legislative amendment or seeking adoption of a rule of court clarifying the meaning of “eligible institutions.” As currently drafted, 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.

Therefore, it is necessary to either seek an amendment to the existing statute or adoption of the proposed Rule to broaden the definition of “eligible institution” and to

include the requirement that an eligible institution carry deposit insurance. The Board is requested to authorize staff to pursue an appropriate solution. If the legislature approves an amendment that will take effect January 2010, then a Petition to the Supreme Court for an interim rule effective until January 2010 would be recommended, and if the legislature does not approve an amendment, then adoption of the proposed Rule to be read in conjunction with the existing statute is necessary.

A. Court Rule

With respect to eligible institutions, the proposed Rule sent out for public comment, 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 1981 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 referred to collectively as “thrifts”) all can hold IOLTA accounts.

B. Legislative Amendment

In the normal course, new legislative bills must be introduced before mid-January: enacted bills have an anticipated effective date of January 1, 2010. Therefore, we recommend that a legislative amendment be proposed now, rather than waiting for Supreme Court action on a petition on this matter. Assuming the legislature passes a bill to define “financial institutions” eligible to hold IOLTA accounts, then the petition to the Supreme Court need only address the interim time period until the effective date of the bill. Should the legislation not pass, then we would seek the proposed Rule that would be read together with the existing legislation.

The proposed amendment to the legislation would be phrased as follows:

As used in this article:

(k) “Eligible institution” means:

(1) a bank, savings and loan, or other financial institution regulated by a federal or state agency, that

(i) pays interest or dividends on the IOLTA account, and

(ii) carries deposit insurance from an agency of the federal government,
or

(2) any other type of financial institution authorized by the Supreme Court.

Additionally, the legislative staff to the Assembly Judiciary Committee has been concerned that attorneys currently have no statutory obligation to report whether or not they are obligated to hold IOLTA funds. It would be expedient to address this situation now, and the amendment we propose would add statutory language requiring that member attorneys report to the State Bar all IOLTA account information, as set forth in the attached proposed statutory wording. This requirement would enable Legal Services Trust Fund Program staff to better monitor IOLTA accounts. (Attachment 6 is the proposed amended Business & Professions Code Section 6212 and 6213.)

OVERVIEW OF PUBLIC COMMENT RECEIVED

As previously indicated, in November 2007, the Board released for public comment a proposed rule of court – 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. 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. Because this proposed Rule preserves the “status quo” with respect to eligible institutions, the LSTFC does not anticipate opposition to the Rule.

The proposed rule released for public comment on November 21, 2008 was posted on the State Bar website and sent to the California Bankers Association. As of the date of preparation of this agenda item, no comment has been received. The deadline for written comment is January 6, and you will be updated at your meeting if public comment is received before then.

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

There is no immediate rule amendment. However, a new Rule of Court is possible if the Supreme Court grants the petition for a new Rule.

RECOMMENDATION

The Legal Services Trust Fund Commission and staff recommend the Board Committee on Operations and the Board of Governors authorize staff to pursue a legislative amendment both defining “financial institutions” and requiring attorneys report on whether or not they hold IOLTA accounts and also pursue necessary relief in the Supreme Court.

RESOLUTION

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

RESOLVED, that the Board Committee on Operations recommends that the Board of Governors authorize staff to seek an amendment to the IOLTA statute at Business and Professions Code sections 6212 and 6213, in the form attached to this agenda item; and it is

FURTHER RESOLVED, that the Board Committee on Operations recommends that the Board of Governors authorize staff to also pursue necessary relief in the Supreme Court either by seeking an interim order or submitting the Proposed Rule of Court to the Supreme Court to implement the IOLTA statute, in the form attached to this agenda item.

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

RESOLVED, that upon recommendation of the Board Committee on Operations the Board of Governors authorize staff to seek an amendment to the IOLTA statute at Business and Professions Code sections 6212 and 6213, in the form attached to this agenda item; and it is

FURTHER RESOLVED, that upon recommendation of the Board Committee on Operations, the Board of Governors authorizes staff to also pursue necessary

relief in the Supreme Court either by seeking an interim order or submitting the proposed Rule of Court to the Supreme Court to implement the IOLTA statute, in the form attached to this agenda item.

NOTE ON ATTACHMENTS:

- Attachment 1: Business & Professions Code §§6210-6228
- Attachment 2: 1981 Supreme Court Order
- Attachment 3: 2008 Supreme Court Order rescinding its 1981 Order
- Attachment 4: Proposed Supreme Court Rule 9._, which is requested to be adopted
- Attachment 5: Notice of Public Comment
- Attachment 6: Proposed amended Business & Professions Code Section 6212 and 6213 (Redlined)