

# AGENDA ITEM

## MAR 163

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

DATE: February 8, 2008

TO: Members, Board Committee on Stakeholder Relations  
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 – Proposed Approval following Public  
Comment

### **EXECUTIVE SUMMARY**

In 2007, the California Legislature amended the IOLTA statutes to allow attorneys to invest trust funds in a wider range of financial instruments and require banks to offer the same interest rates on IOLTA accounts that they offer on other comparable accounts. Business & Professions Code sections 6210-6213, amended October 10, 2007, require that attorneys hold IOLTA accounts at financial institutions, which are defined by the statute as a bank or other institution authorized by the Supreme Court, that offers rates comparable to rates paid to other depositors, and expands the range of secure investment vehicles in which IOLTA accounts may be held. At the time the IOLTA statutes were amended, a 1981 interim Supreme Court order was in place which defined eligible financial institutions to include entities besides banks and also required deposits to be FDIC insured. In November 2007, the Board petitioned the Supreme Court to rescind this order because the insurance requirement was incompatible with the new types of investment vehicles approved by the statute. The Board also asked the Court to adopt a new interim order which would continue the broader definition of financial institutions that had been in place since the IOLTA statutes were originally passed.

The Supreme Court approved the petition with respect to rescission of the 1981 order thereby removing the inconsistent FDIC requirements, but declined to adopt a new interim order, instead requesting that the State Bar provide information on the need for any additional order or rule of court authorizing financial institutions other than banks to hold IOLTA accounts. Without an order from the Court, banks are the only type of financial institution authorized by the IOLTA statutes to hold trust fund accounts. However, other types of financial institutions, such as savings and loans and credit unions, have historically

and currently hold attorney trust funds. Based on staff's experience implementing the comparability statute, we recommend that the State Bar pursue either a rule of court or a statutory amendment to identify types of financial institutions, other than banks, that may hold IOLTA accounts and to reinstate the requirement that financial institutions holding IOLTA accounts carry federal insurance.

This agenda item was presented to the Board at its January 2009 meeting after a 45-day public comment period on the proposed Rule of Court. At that time, we requested that the Committee on Board Operations authorize staff to also pursue legislation to more broadly 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 recommended that any legislative amendment address the attorney reporting requirement as well. The Committee on Board Operations requested further information, and this item is being returned to the Board for reconsideration.

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 §§6210-6228 [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, originally drafted in 1981, 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. AB 1723 was signed into law on October 10, 2007 and went into effect on January 1, 2008. (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 a new 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 and therefore the order's language requiring deposits to be insured could not apply to the new types of investments. In addition, 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 to define "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 new 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 new 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 in complying with the statute. In the year since the amended statute went into effect, the LSTFP has qualified almost 300 institutions that hold IOLTA accounts, most of which also 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 a critical need to clarify and expand the types of financial institutions that are eligible to hold IOLTA accounts. In November 2008, the Board Committee on Stakeholders' Relations approved sending the proposed Rule of Court 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.)

Several legal aid organizations, including the Legal Aid Association of California, which is a membership organization for legal aid programs, voiced their strong support for the Rule and there was no opposition. The proposed Rule was presented to the Committee on Board Operations at its January 2009 meeting. At that time we requested the Committee on Board Operations authorize staff to alternatively pursue a court rule and legislation 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 recommended that any legislative amendment address the attorney reporting requirement as well. The Board Operations Committee requested further information, and this item is being returned to the Board for reconsideration. The Commission strongly urges that the Board adopt the resolution as drafted to ensure that the State Bar is in compliance with the comparability legislation.

### **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 (which does not encompass all of the financial institutions that previously held and currently hold IOLTA

accounts), 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” so that it encompasses those institutions that have always been eligible to hold IOLTA accounts (banks, savings banks, savings and loan associations, and credit unions) and to include the requirement that an eligible institution carry deposit insurance.

As stated in the attached memorandum from James M. Rockett<sup>1</sup> to the Legal Services Trust Fund Commission, the proposed rule and legislative language that requires that the eligible institution carry deposit insurance from an agency of the federal government, limits the entities that can hold IOLTA to those that are either insured by FDIC (for banks, savings banks, savings and loan associations) or NCUSIF (for credit unions)— both of which are backed by the full faith and credit of the United States. Other types of federal insurance, such as the SIPIC insurance that covers securities broker-dealers, are not “deposit insurance.” (Attachment 6 is Mr. Rockett’s Memorandum dated February 9, 2009 to the LSTFC.) Because we have maintained the same high standards for qualifying financial institutions that we maintained prior to implementation of comparability, currently all financial institutions that hold IOLTA accounts carry FDIC or NCUSIF insurance that are backed by the full faith and credit of the United States.

The Board is requested to authorize staff to pursue appropriate clarification either by legislative amendment or Supreme Court action: If the legislature approves a statutory 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 of Court 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”

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*1 James M. Rockett, Esq. is the co-chair of the Financial Institutions, Corporate and Regulatory Group of the law firm of Bingham McCutchen LLP. Mr. Rockett is a prominent banking lawyer who has spent more than 30 years exclusively representing banking and financial services clients, ranging from large national financial institutions to community banks and thrifts. Among other areas of expertise, his focus includes bank regulation, regulatory compliance and operations.*

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 & loan associations and savings banks (also called “thrifts”), and credit unions – all can hold IOLTA accounts – and all must carry deposit insurance that is backed by the full faith and credit of the United States.

## **B. Legislative Amendment**

In the normal course, new legislative bills must be introduced before mid-January: In order to comply with legislative deadlines, including the requirement that bills must be introduced no later than February 27, 2009, the proposed legislation has been drafted and will be submitted for possible introduction by the Assembly Judiciary Committee. These steps were necessary to facilitate any Board resolution on this issue. Should the board decide not to proceed with the proposed legislation, we may request that it be revised or withdrawn.

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 7 is the proposed amended B&P Code §§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 4<sup>th</sup>, and one in Los Angeles on December 13<sup>th</sup>. 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.

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. The proposed Rule preserves the “status quo” with respect to eligible institutions, and as anticipated, the LSTFC did not receive any opposition to the Rule. Several legal aid organizations submitted public comment regarding the importance of the rule to preserve the IOLTA program. (Attachment 8 is a Summary of Public Comment, with the original letters attached.)

## **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 that the Board Committee on Stakeholder Relations and the Board of Governors authorize staff to pursue a legislative amendment both defining “financial institutions” and requiring attorneys to report on whether or not they hold IOLTA accounts and also to pursue necessary relief in the Supreme Court.

## **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 recommends that the Board of Governors authorize staff to seek an amendment to the IOLTA statute at Business and Professions Code §§6212 and 6213, in the form attached to this agenda item; and it is

FURTHER RESOLVED, that the Board Committee on Stakeholder Relations 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 Stakeholder Relations, the following resolution is suggested:

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

FURTHER RESOLVED, that upon recommendation of the Board Committee on Stakeholder Relations, 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: James Rockett, Bingham McCutchen LLP, February 9, 2009 Memorandum to the Legal Services Trust Fund Commission
- Attachment 7: Proposed amended Business & Professions Code Section 6212 and 6213 (Redlined)
- Attachment 8: Summary of Public Comment