

Protecting Client Trust Accounts from Bank Failures

Accounts Are Insured...but there are limits

The recent stress in financial markets and the banking industry has raised many questions about the security of funds held by lawyers on behalf of their clients. While the Federal Deposit Insurance Corporation (FDIC) continues to insure bank accounts from bank insolvencies, there are limits to the insurance coverage in some situations and exceeding those limits could expose client funds to certain risks.

Effective November 21, 2008 through December 31, 2009, the FDIC provides unlimited deposit insurance coverage for IOLTA accounts. All funds in an IOLTA account, regardless of size, will now be insured in full by the FDIC and backed by the full faith and credit of the United States Government as part of the Temporary Liquidity Guarantee Program (TLGP). The FDIC has also recently increased deposit insurance coverage to \$250,000 per depositor, up from \$100,000. The increased deposit insurance coverage, however, is temporary and currently set to expire on December 31, 2009. Although the FDIC is also temporarily providing unlimited insurance coverage for certain *non-interest* bearing deposit accounts (including IOLTA accounts), this does not apply to client funds held in individual trust accounts, since such accounts must be interest bearing under RPC 1.15A(i). It is recommended that you contact your financial institution to verify that they are participating in the Temporary Liquidity Guarantee Program.

The Washington Rules of Professional Conduct (RPC) require a lawyer to hold client or third party funds in a trust account at an FDIC or National Credit Union Administration (NCUA) insured institution. Usually, such funds are held in a pooled interest-bearing trust account known as an IOLTA account, with interest paid to the Legal Foundation of Washington (LFW).

If the client or third-person funds will produce a positive net return, the funds must be placed in a separate interest-bearing individual trust account (or pooled interest-bearing trust account) with interest paid to the particular client, unless the client or third person requests that the funds be deposited in an IOLTA account.

While the RPCs require all client or third-person funds be held in an FDIC insured account, the rule does not specifically require all funds in the account be within the FDIC insurance limits. The rules do require, however, that when selecting a bank or other institution for trust account purposes, a lawyer must do so “in the exercise of ordinary prudence.” Lawyers should also note credit unions have unique issues regarding insurability. In some cases, NCUA rules may require that the individual clients for whom the lawyer is holding funds in trust belong to the credit union in order to qualify for the insurance coverage. Lawyers should consider discussing insurance coverage matters with a credit union representative.

IOLTA Accounts

The FDIC treats the deposits in an IOLTA account as the accounts of the individual clients, provided certain requirements are met (see below). Generally, funds in an IOLTA account are insured as funds of the actual owner (the client) to the same extent as if deposited by the actual

owner, rather than the fiduciary (lawyer). However, as stated above, the TLGP now provides unlimited insurance coverage for IOLTA accounts. It appears that the intent of the TLGP is to provide unlimited coverage for IOLTA accounts *in addition to* the maximum insurance coverage provided for other deposits with the same financial institution (\$250,000 for individual accounts and unlimited coverage for certain non-interest bearing deposit accounts).

The requirements which must be met in order for the FDIC to treat deposits in lawyer trust accounts as funds of individual clients are as follows:

- The fiduciary nature of the account must be disclosed in the account title (e.g., Perry Mason Client Trust Account);
- The account must contain the tax identification number of the Legal Foundation of Washington for IOLTA accounts (91-1263533); and
- The identities and interests of the clients can be ascertained from records maintained in the regular course of business by the depositor (e.g., Perry Mason Law Firm). Properly accounting for client trust funds is crucial in ascertaining fund amounts belonging to each client in the event an FDIC insurance claim is filed. At the minimum, proper accounting means identifying the client on whose behalf each deposit or withdrawal is made, keeping running balances in all account registers, and regularly reconciling the balance belonging to each client. For complete ethical requirements on maintenance of trust account records, see RPC 1.15B.

If these FDIC standards applicable to fiduciary accounts are *not* met, all such deposits will be treated as though they belong to the fiduciary (lawyer) and will be insured only up to a total of \$250,000 when combined with any other balances in accounts belonging to the fiduciary in the same bank.

Separate Interest-bearing Individual Trust Accounts

Separate interest-bearing trust accounts are limited to \$250,000 in FDIC insurance coverage. As described above, these accounts must satisfy the requirements for being treated as a fiduciary account, i.e.,: the fiduciary nature of the account is disclosed in the title, the client's tax identification number is used on the account, and adequate records are maintained. Because funds are insured as belonging to the client, these funds may be at risk if the client has other deposit accounts at the same financial institution. For example, if a client has \$160,000 in a separate interest-bearing individual trust account in a bank and \$160,000 in a personal account in the same bank, the client's insurance coverage is capped at \$250,000, leaving \$70,000 uninsured. Because of the \$250,000 per depositor insurance coverage limit, lawyers should, among other things, consider:

- Informing clients about the location of the individual client trust account, and FDIC insurance coverage (e.g., "The FDIC is currently limiting certain deposit insurance coverage of your funds at [name of bank] to \$250,000. The \$15,000 I am holding in an

individual trust for you counts towards that insurance coverage at [name of bank]. If you have additional funds in the same institution approaching or exceeding the insurable limit, you may wish to make other arrangements so that all of your deposits there will remain insured. Alternatively, you may wish me to deposit the \$15,000 into my IOLTA account, where it will be insured.”)

- Exercising ordinary prudence by taking reasonable steps to investigate a bank’s financial solvency if a lawyer has deposited client funds exceeding the FDIC deposit insurance coverage limits.
- Dividing the funds into interest bearing trust accounts at different financial institutions to maximize the client’s deposit insurance coverage should a lawyer hold more than \$250,000 in trust for any one client.

The landscape surrounding our nation’s financial institutions continues to change as various regulatory agencies address the situation. Please check this site for the latest updates.

For more information about this important matter, please click on the various links below or contact WSBA Professional Responsibility Counsel David Powell at (206) 727-8219.

Useful links regarding the Washington Rules of Professional Conduct and managing client trust accounts:

RPC 1.15A:

http://www.courts.wa.gov/court_rules/?fa=court_rules.display&group=ga&set=RPC&ruleid=garpc1.15a

RPC 1.15B:

http://www.courts.wa.gov/court_rules/?fa=court_rules.display&group=ga&set=RPC&ruleid=garpc1.15b

WSBA Informal Ethics Opinion 1957 (whether lawyer is required to open multiple accounts to ensure full FDIC coverage):

<http://pro.wsba.org/IO/print.aspx?ID=1197>

WSBA Informal Ethics Opinion 1426 (having more than one trust account):

<http://pro.wsba.org/IO/print.aspx?ID=506>

September – October 2008 changes in FDIC insurance coverage:

<http://www.fdic.gov/deposit/deposits/changes.html>

FDIC page with information about the TLGP:

<http://www.fdic.gov/regulations/resources/TLGP/index.html>

Statement of H. Thomas Wells Jr., President, American Bar Association Re: FDIC Inclusion of IOLTA in Unlimited Deposit Insurance Under Temporary Liquidity Guarantee Program:

<http://www.abanet.org/abanet/media/statement/statement.cfm?releaseid=497>

WSBA Managing Client Trust Accounts brochure:

<http://www.wsba.org/media/publications/pamphlets/managing.htm>

FDIC list of private bank rating services:

<http://www.fdic.gov/bank/individual/bank/>

FDIC information on the eight ownership categories recognized by FDIC regulations and the requirements that must be met to have coverage beyond the basic \$250,000 insurance amount:

<http://www.fdic.gov/deposit/deposits/insured/ownership.html>

FDIC insurance coverage estimating tool:

<http://www.fdic.gov/EDIE/index.html>