

IOLTA or Separate Client Trust Account?

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Reprinted from *Minnesota Lawyer* (December 25, 2000)

Nearly all lawyers understand that client and third-party funds must be deposited into a trust account. See Rule 1.15(a), Minnesota Rules of Professional Conduct (MRPC). For the vast majority of client and third-party funds, the appropriate type of trust account is an IOLTA--Interest on Lawyer Trust Account--in which funds belonging to multiple clients (or third parties) are pooled in a single account. Rule 1.15(e). The bank then pays the net interest earned on IOLTA accounts to the Lawyer Trust Account Board, who makes annual grants to agencies providing services to lower income individuals.

Fewer lawyers are familiar with the rules authorizing the establishment of a separate interest-bearing trust account for an individual client and when such an account should be used. Rule 1.15(f) requires a lawyer to deposit all client or third-party funds into an IOLTA account unless the funds are deposited into a separate interest-bearing account for the client or third person. Where separate trust accounts are established, the interest, net of any transaction costs, is paid to the client or third party.

The dilemma for lawyers is deciding which type of account to use for client or third-party trust funds. Rule 1.15(g) sets forth the criteria for determining whether to deposit client or third-party funds into an IOLTA account or a separate trust account. These factors are:

- the rate of interest which will be applied to the funds and the duration of time that the funds are anticipated to be held by the lawyer;
- the cost of establishing and administering the separate account, including the cost of the lawyer's services;
- the capability of the bank to calculate and pay interest on an individual account.

With the advent of technology, the third factor is no longer a realistic consideration. All financial institutions now have the ability to calculate and pay interest on individual accounts. Consequently, the first factor--rate of interest and duration of time funds held--and to a lesser degree, the second factor--cost of setting up a separate account--answer the question of which type of trust account should be used.

Because lawyers typically do not hold most client or third-party funds for significant periods, the IOLTA account is the appropriate account for the vast majority of client funds. The relatively modest rates of interest paid on individual accounts also plays a role in this result. In certain instances, however, the lawyer knows that the funds will be held for a significant period. In those cases, the lawyer may be obligated to establish a separate account for the client. This obligation arises where the amount of the funds is significant enough to generate interest that will substantially exceed the cost of establishing or administering a separate account.

Performing this rough calculation is not necessary for most trust account deposits. Retainers that the lawyer intends to draw upon, real estate closings, personal injury settlements and similar transactions typically do

not warrant consideration of a separate account because the funds are not anticipated to be held for any significant period of time. On the other hand, escrow transactions, funds held pursuant to court order, or some other contingency, may require the lawyer to consider a separate account.

Generally, the Director's Office has not applied a strict hindsight calculation analysis in determining whether to impose lawyer discipline for failing to use a separate account. Nevertheless, in a few cases, where the failure to establish a separate account resulted in significant prejudice to a client or third party, discipline has been imposed. The following example is indicative of the type of violation that has resulted in discipline.

The lawyer was representing a husband in his divorce. Pursuant to a temporary order, the parties' assets, which were substantial (in excess of \$400,000), were being sold, and the proceeds deposited into the lawyer's IOLTA account. Initially the funds were deposited into the IOLTA account because of the existence of a marital termination agreement that both parties anticipated signing within a week. The agreement provided for immediate disbursement of the proceeds to the parties. Hence, the lawyer's initial decision to deposit the marital asset proceeds into his IOLTA account was proper.

For various reasons, the marital termination agreement was not signed. The respective positions of the parties polarized and the dispute continued for nearly nine months. During this time, the funds remained in the lawyer's IOLTA account, with the interest paid to the Lawyer Trust Account Board.

When the parties eventually settled and the proceeds were disbursed, the wife inquired about the interest that she assumed had been earned on the funds. After doing the math, the husband similarly demanded that the lawyer account for the interest that should have accrued on the proceeds. In the end, the lawyer received private discipline for his ethical violation and was the subject of a civil suit by the parties seeking recovery of the lost interest.

A flaw in the lawyer's trust account procedures caused, or at least contributed, to this problem. Neither the lawyer nor his staff was performing a monthly trial balance (summary) of the client ledger balances when the statement was reconciled with the account register. A monthly trial balance of client ledger amounts is a required trust account procedure that is necessary to determine whether the trust account contains sufficient funds for all clients. See Opinion No. 9 of the Lawyers Professional Responsibility Board. It is also helpful in alerting lawyers to large client balances remaining in the trust account for inordinate periods, and likely would have reminded the lawyer in this case that further consideration of a separate client trust account was necessary.