

MANAGING CLIENT TRUST ACCOUNTS

RULES, REGULATIONS, AND TIPS

This booklet has been prepared by the Vermont Professional Responsibility Program as a guide for both new and experienced lawyers who have questions about trust accounts. Our purpose is to provide you with the basic rules, highlight areas that will require your best judgment because there are no absolute rules in those areas, and dispense some practical experience provided by years of answering lawyers' questions. Whenever you are dealing with trust accounts, please do not hesitate to call the Professional Responsibility Program if you have any questions: (802) 859-3000 or (802) 828-3204.

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INTRODUCTION.....	1
GETTING STARTED.....	1
Do I need a trust account?.....	1
What are some examples of client funds?	2
Advance fee/cost deposits	2
Settlements.....	2
Overpayments of bills	2
Escrow Funds.....	2
Funds Held in Other Fiduciary Capacities	2
What does not go into a trust account?	3
Fully earned fees (i.e., payments of bills).....	3
Reimbursements for cost advances.....	3
Lawyer’s personal or business transactions	3
Which trust account do I use?	3
IOLTA (Interest on Lawyers’ Trust Accounts)	3
Individual Interest-Bearing Client Trust Account.....	4
How do I open an IOLTA account?	4
What about bank fees?	5
How do I open an individual interest-bearing trust account?	5
DAY-TO-DAY OPERATION & PROPER RECORDKEEPING	6
What do I deposit to the trust account?	6
How do I keep proper deposit records?.....	6
How do I disburse funds from a client trust account?	7
What other records must I keep?	8
MONTHLY ACTIVITIES	9
Bank Reconciliation	9
Reconcile your Individual Client Transaction Summaries	9
Review Reconciled Client Balances.....	9
REPORTING TO CLIENTS	10
CLIENT SECURITIES AND PROPERTIES	11
TRUST ACCOUNT AUDITS.....	11
FREQUENTLY ASKED QUESTIONS.....	12

INTRODUCTION

The trust accounting rules currently in effect for Vermont lawyers are found at V.R.P.C. 1.15, 1.15A, and 1.15B. The Rules impose a strict fiduciary standard that all funds received by a lawyer which belong wholly or in part to a client or third person must be maintained in an interest-bearing trust account while in the lawyer's possession. The trust account must be segregated from any lawyer funds. It must also be maintained in a financial institution authorized by law to do business in Vermont and which has filed the agreement required by V.R.P.C. 1.15B(d). Finally, the trust account must generate interest for the benefit of either the client or the Vermont Bar Foundation (VBF). The client trust account that generates interest for the benefit of the VBF is frequently referred to as an IOLTA (Interest on Lawyers' Trust Accounts) account. If you have questions about the Vermont Bar Foundation, please contact the Executive Director of the VBF, Deborah Bailey, P.O. Box 1170, Montpelier, Vermont 05601, telephone (802) 223-1400, email dbailey@vtbarfndn.org

The trust accounting rules have been implemented in an attempt to protect both clients and lawyers. The client must feel confident when entrusting money to his or her lawyer that the funds will be maintained in a safe place, fully accounted for, and promptly remitted. The lawyer who conscientiously follows the rules is maintaining insurance against false claims of financial improprieties with client funds. This should create a "win-win" situation for both you and your clients.

GETTING STARTED

Do I need a trust account?

The purpose of a trust account is to protect the funds of clients and third parties. The Rules require a lawyer to deposit and hold in a trust account any funds belonging to a client or third person. The purpose of this requirement is to protect client funds from the lawyer's own creditors or personal financial problems. Therefore, any lawyer who expects to be handling client funds should open a trust account. A law firm may open one account for all lawyers in the firm. If you are not in private practice or your practice is of a nature that you do not expect to receive client funds, you do not need to open a trust account.

What are some examples of client funds (which are therefore required to be placed in a trust account)?

Advance fee/cost deposits

Advance fee/cost deposits are funds given to you by clients to pay for future fees and costs. These are costs you have not yet paid or fees you have not yet earned. Advance fee/cost deposits are considered client funds and must be deposited into the trust account because the client has the expectation that the funds will be safeguarded until needed. If you handle advance fee/cost deposits, you need a trust account.

Settlements

Settlements are considered client funds and must be handled in accordance with V.R.P.C. 1.15 and 1.15A. In addition, V.R.P.C. 1.5(c) requires that at the conclusion of a contingent fee matter, the lawyer must provide the client with a written statement stating the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination. [Remember that all contingent fee arrangements must be in writing. See V.R.P.C. 1.5(c)].

Overpayments of Bills

Overpayments are considered to be partially earned (the part covering the outstanding balance) and partially unearned (the overpayment portion). Overpayments must initially be deposited into the trust account. The earned portion must be withdrawn once the funds have been collected. (See the section on disbursing funds for more information about collected funds.) The unearned portion may be refunded to the client or, if the client so chooses, held in the trust account to apply to future services. Under no circumstances is it permissible to deposit client overpayments to the general business account. If you would rather not deposit the overpayment into the trust account, you can send the payment back to the client and ask that the check be reissued for the proper amount.

Escrow Funds

Escrow and other funds incident to closing real estate or personal property transactions must be deposited and held in a trust account.

Funds Held in Other Fiduciary Capacities

If you are holding funds in connection with a representation in which you're acting as a trustee, agent, escrow agent, guardian, administrator, or executor, those funds must be deposited and held in a trust account. Be aware of the comment to Rule 1.15, which indicates that there are situations in which the applicable law of fiduciaries imposes duties upon lawyers beyond those imposed by the Rules of Professional Conduct.

What does not go into a trust account?

Knowing what must *not* go into the trust account is just as important as knowing what must go into the trust account. Depositing earned fees or personal funds into a trust account can change the nature of the account and subject it to a lawyer's creditors. The following are some types of funds that must not be deposited into the trust account.

Fully earned fees (i.e., payments of bills)

This is money you receive from your client that is already earned. If your client is paying the exact amount shown on your invoice, that payment does not go into the trust account.

Reimbursements for cost advances

"Cost advance" is generally the term used to describe funds that the lawyer has advanced out of his/her own pocket. These costs should be paid out of the general business account, not the trust account. V.R.P.C. 1.8(e) authorizes lawyers to advance court costs and expenses of litigation. When you bill the clients for these costs and they make a full or partial payment, you should deposit the funds into your general business account.

Sometimes the reimbursements for costs advanced will be paid from a settlement when it is received. Because part of the settlement belongs to the client, the settlement must be deposited into the trust account. The lawyer's portion to cover costs and fees is then withdrawn after the settlement check clears the bank.

Lawyer's personal or business transactions

Deposits related to a lawyer's personal or business transactions must not be placed in the trust account. The trust account is designed to hold client funds, not funds relating to employees, stockholders, outside counsel, friends, businesses of the lawyer, and personal real estate transactions. Make sure trust account deposits are for your clients and connected with a representation before depositing the funds into the trust account.

Which trust account do I use?

You've determined that you handle client money and therefore need to open a trust account. Which type of trust account do you use?

IOLTA (Interest on Lawyers' Trust Accounts)

Interest on IOLTA accounts is paid to the Vermont Bar Foundation (VBF). These types of accounts should be used if you're going to be handling client money for a short period of time or the funds are nominal in amount.

Individual Interest-Bearing Client Trust Account

If the deposit of client funds is reasonably expected to earn a substantial amount of interest for the client, the attorney should open a separate trust account for those funds. The separate account should be set up with the client's taxpayer ID number. The lawyer, not the client, should be the signatory on the account. If the client declines the establishment of an interest bearing account for his/her benefit, then the funds should be deposited into the attorney's general IOLTA account.

How do I open an IOLTA account?

1. Decide which financial institution you want to use for the account.

V.R.P.C. 1.15A(d) defines "financial institution" to include banks, savings and loan associations, credit unions, savings banks and any other businesses or persons that accept and hold funds held in trust by lawyers.

In addition, V.R.P.C. 1.15B(a)(1) and (d) require the account to be in a financial institution that has filed an agreement with the Professional Responsibility Board "to report to the Board in the event any properly payable instrument is presented against such a trust account containing insufficient funds, irrespective of whether or not the instrument is honored." The Board publishes a list of such financial institutions annually. You can find the list on the Vermont Judiciary website at <http://www.vermontjudiciary.org/LC/MasterPages/PRB-Attytrusts.aspx>. You may also call the Office of Disciplinary Counsel at (802) 859-3000 to inquire whether a specific institution is on the list.

2. Give the bank instructions that you want to open an IOLTA account.

Each financial institution has its own requirements for opening an account. Rule 1.15A(a) requires such accounts to be clearly identified as "trust" accounts. You should make sure that the pooled interest-bearing trust account bears the VBF's tax identification number **03-0285318**. In addition, you should remind the financial institution that the interest must be remitted to the VBF and that the account is one for which the institution must notify Disciplinary Counsel whenever an instrument drawn on the account is presented against insufficient funds.

3. Order checks and deposit slips.

The checks and deposit slips for your IOLTA account should be clearly labeled "Client Trust Account" or "IOLTA Account." In addition, it is a good idea to have the checks a different color from the checks used for your general business account. Both of these details may prevent the incorrect use of the trust account in the future.

The cost of printing checks and deposit slips is your responsibility. You can make an initial deposit to the trust account in an amount sufficient to cover this cost. Your other option is to have this cost charged to your general business account. Under no circumstances should it be deducted from client funds in the trust account.

What about bank fees?

Many attorneys mistakenly believe that a bank cannot charge fees on an IOLTA account. Some of the fees incurred on an IOLTA account are deducted from the interest earned on the account and the difference is remitted to the VBF. V.R.P.C. 1.15B(a) states that “The interest or dividends accruing on this account, net of any transaction costs, . . . shall be paid over to the Vermont Bar Foundation”

To the extent that the bank imposes fees in excess of those covered by earned interest, those fees must be paid by the lawyer, not the clients. Under Rule 1.15(b), a lawyer may deposit his or her own funds into a trust account for the sole purpose of paying service charges or fees on that account, but only in an amount necessary for that purpose.

How do I open an individual interest-bearing trust account?

1. Decide which financial institution you want to use for the account.

The requirements for individual interest-bearing accounts are the same as for IOLTAs. The bank must be on the list of approved banks as described above.

2. Give the bank instructions that you want to open an individual interest-bearing trust account.

You will need your client’s tax identification number. This is either a Social Security number or an EIN (Employer Identification Number). You should not use the tax identification number of you or your law firm. Using your own ID number will not safeguard your client’s funds.

The account should be labeled with the name of your client in care of you or your law firm. The bank statements should come to you although the bank may send a duplicate statement to your client if you wish. The attorney should be the signatory on the account.

In most banks, these accounts are very similar to savings accounts. As such, you are often limited to the number of checks and deposits you can make in a month before being charged a fee.

You may not need to order checks or deposit slips if the activity on the account is minimal. Many lawyers have their individual interest-bearing trust accounts and IOLTA accounts at the same bank. They electronically transfer client funds from the individual interest-bearing account to their IOLTA account and write checks from there, as needed. When you transfer the money into your IOLTA, it should be disbursed in a timely manner.

DAY-TO-DAY OPERATION & PROPER RECORDKEEPING

One of the most frequent questions presented to the Professional Responsibility Program relates to when a lawyer can write a check against funds deposited into a trust account. The question cannot be answered without first discussing the types of funds that must be deposited into a trust account.

What do I deposit to the trust account?

Any deposit containing client funds must be deposited directly into the trust account. No funds belonging to the lawyer may be deposited into the trust account with three exceptions: (1) receipts belonging in part to a client and in part to the lawyer; (2) funds to restore appropriate balances; and (3) funds to pay service charges or fees on the account, as provided in V.R.P.C. 1.15(b).

This simple concept, that client funds must be deposited to the client trust account and lawyer funds must never be deposited to the client trust account, gets complicated when put into practice. Your firm will receive funds from many different sources and for many different purposes. To decide if these funds must be deposited to a trust account, you need to determine if the client still has an ownership interest in any portion of the funds when you receive them.

For example:

- a. If you have sent the client a billing statement for legal services performed and the client gives you a check in the amount of the billing statement, these are clearly earned fees and must be deposited to your general business account.
- b. If your client gives you a cost advance to be disbursed on his/her behalf as costs related to litigation are incurred, these funds must be deposited to a client trust account.
- c. If your client sends a check that contains both earned fees and a cost advance, the check must be deposited into your trust account. Once the funds have been collected, you transfer the earned fees to your general business account.

How do I keep proper deposit records?

Part of keeping proper records is identifying the client clearly, by name or file number, on the deposit slip. Each line of the deposit slip should show the client identity of the deposit items. (*See example*). Keep a copy of the deposit slip for your records. In addition, it is a good idea to make copies of the deposited items to back up your deposit slip. Should you forget to record the deposit in your records, the copy will be there for reference.

Sample check from client

John Doe 1325 4 th Avenue Anywhere, Vermont 00000 802-555-5555	8687 Date <u>November 18, 2008</u>
Pay to the <u>My Law Firm</u> \$ 5,000.00	
Five thousand and no/100 Dollars	
Any Bank USA Anywhere, VT	
for <u>Attorney fees</u>	<u>John Doe</u>

Sample deposit slip to trust account
 You can see how the check from your client has been recorded.

DATE	11/18/0X											
	Currency	Checks	Doe Check # 8687	Tucker								Total
			\$5,000	\$3,500								\$8,500
<i>Total Deposit</i>											\$8,500.00	
My Law Firm Trust Account – Any Bank USA												

How do I disburse funds from a client trust account?

Funds may be disbursed only based on the understanding between you and your client. Although this may be a verbal agreement, it is preferable (mandatory in contingent fee cases) to have a written agreement acknowledging receipt of the funds and designating their purpose.

You should disburse trust account funds promptly after the entitlement to the funds is established. However, such disbursements should be made only after the deposit that created the funds has resulted in “collected funds” or has given rise to a situation in which the Rules of Professional Conduct allow you to write against funds that you reasonably believe will be collected.

When a deposited item has cleared the banking system, it becomes collected funds. Do not confuse collected funds with available funds. Often banks make funds available for withdrawal before those funds have been collected due to the

requirements set forth in Federal Reserve Regulation CC. The only items that are recognized as collected when deposited are cash and wire transfers. All other deposit items, including cashier's checks, money orders, and certified checks, will have varying times for collection; check with your bank to determine the length of time you need to wait before making a disbursement. Rule 1.15(f) addresses collected funds in Vermont, and Rule 1.15(g) sets forth certain types of non-collected funds which an attorney may treat as collected, subject to the terms and limits set forth in that rule. Rule 1.15(h) makes it clear that if an attorney relies on non-collected funds and those funds are not collected, it is the attorney's responsibility to act immediately to protect the funds of his clients and affected third persons.

Have written evidence supporting issuance of each check

You may never remove funds from a trust account without being able to document undisputed entitlement to those funds. If the client funds in the trust account are understood to be an advance fee deposit, such fees must be promptly removed from the trust account as soon as the fee is earned. Should a client dispute the billing, the disputed portion of the fee should remain in the trust account until the dispute is resolved. Similarly, if a client disputes a proposed settlement distribution, you should promptly disburse the undisputed funds and retain the disputed funds in the trust account until the dispute is resolved.

Disbursements from the client trust account on behalf of a client may never exceed the amount that the client has on deposit in the trust account. If they do, you are using one client's funds on behalf of another client.

Note: All checks drawn on the trust account should be written to a named payee. You should not make a check payable to "cash." In addition, you should not make cash withdrawals from the trust account. All withdrawals should be made by check or by bank transfer.

Identify checks by client

Identify the client on the face of each check. If the check covers more than one client, show the breakdown by client and amount. Attach a breakdown to your copy of the check.

What other records must I keep?

Rule 1.15 provides that complete records of trust account funds and other client property must be kept for a period of six years after termination of the representation. Rule 1.15A provides that, at a minimum, the records must include the following four features:

(1) a system showing all receipts and disbursements from the account or accounts with appropriate entries identifying the source of the receipts and the nature of the disbursements;

(2) a record for each client or person for whom property is held, which shall show all receipts and disbursements and carry a running account balance;

(3) records documenting timely notice to each client or person of all receipts and disbursements from the account or accounts; and

(4) a single source for identification of all accounts maintained as required in this rule.

MONTHLY ACTIVITIES

A. Bank Reconciliation

Once a month you will receive your bank statement. The account balance on the bank statement must be reconciled to the account balance shown in your check register. There is usually a form for performing the reconciliation on the back of the bank statement, or you can devise your own format. Differences between the bank statement balance and the checkbook balance should be investigated immediately and corrected either in your records or by the bank.

B. Reconcile your Individual Client Transaction Summaries

As soon as you have completed the bank reconciliation, you should make sure the individual client balances total to the reconciled check register balance. The easiest way to do this is to make a list of the clients and the balance that shows for each. When the list is complete, total the balances and compare it to the balance in your register. If every item has been posted correctly and all the math is correct, these two numbers will agree. If they do not agree, it means:

(1) you have left a client off the list; or

(2) activity during the month was not posted to the client summaries correctly;
or

(3) you added or subtracted incorrectly.

Find the error and correct it immediately.

C. Review Reconciled Client Balances

Keep both the bank reconciliation and the client balance listing with your client trust records. If more than one lawyer uses the trust account, each lawyer with client funds in the account should review the balances for his or her clients. This review should be used to determine if the balance on deposit should be applied to billings for services, refunded to the client, or transferred to an individual interest-bearing account.

Note: If you have an employee or other person maintain the trust account records, you should review his/her monthly reconciliations. This ensures that they are being prepared and that the client records are accurate. It also emphasizes the importance of maintaining these records accurately and on a timely basis. The fact that a bookkeeper or secretary in your office was maintaining the records will not excuse you from responsibility if they are not handled properly.

REPORTING TO CLIENTS

You are required to report to your client whenever money is received or disbursed on your client's behalf. Specifically, V.R.P.C. 1.15(d) states that upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person. In addition, V.R.P.C. 1.15A(a)(3) provides that the trust account system must include records documenting "timely notice" to clients of all receipts and disbursements from the trust account. The reporting of this activity is not optional; it is required.

The reporting of trust account activity can be done in many different ways. The most common method is to show the activity on your client's monthly billing statement. The information listed on the statement should include:

- The amount of your client's money held in the trust account at the beginning of the month
- New deposits (including the source of the deposit) or other additions
- All disbursements (including the name of the payee)
- The new balance of your client's money in the trust account at the end of the month

If the amount owed on the bill is going to be paid from the trust account unless the client objects, a statement noting this should appear on the bill.

If you are disbursing settlement proceeds to a client, a settlement statement must be prepared. (See V.R.P.C. 1.5(c)). The statement must show the amount of the settlement, attorney fees and costs, third party disbursements, and client distribution. If any funds remain in the trust account after the distribution, the balance remaining and the purpose for its retention should be noted on the statement.

You may have an occasion when you're holding client money for a long period of time with no transactions occurring. These types of situations rarely generate billing statements or regular reporting to clients. Under V.R.P.C. 1.15(d), you are required to send a prompt accounting at the request of the client; however, it is good practice to at least send an annual accounting to your client that shows how much money is being held. This reminds your client that you are holding funds and allows you to stay in contact. If there is no specific reason to hold these funds in the trust account, they should be refunded to the client.

CLIENT SECURITIES AND PROPERTIES

Although most of the provisions of V.R.P.C. 1.15, 1.15A, and 1.15B address the handling of client funds, the rules also impose fiduciary duties on the lawyer who is holding client property other than funds. V.R.P.C. 1.15(a) provides that a lawyer shall hold client property separate from the lawyer's own property; client property other than funds must be identified as such and appropriately safeguarded. Complete records pertaining to such property must be maintained for a period of six years following termination of the representation.

TRUST ACCOUNT AUDITS

The Vermont Rules of Professional Conduct provide for trust account audits:

Rule 1.15A. Trust Accounting System

(b) A lawyer or law firm shall submit to a confidential compliance review of financial records, including trust and fiduciary accounts, by the Professional Responsibility Program's Disciplinary Counsel. The information derived from such compliance reviews shall not be disclosed by anyone in such a way as to violate the evidentiary, statutory, or constitutional privileges of a lawyer, law firm, client, or other person, or any obligation of confidentiality imposed by these rules, except in accordance with Administrative Order No. 9. A copy of any final report shall be provided to the lawyer or law firm.

(c) The Supreme Court may at any time order an audit of financial records, including trust and fiduciary accounts, of a lawyer or law firm and take such other action as it deems necessary to protect the public.

In accordance with Rule 1.15A, the Professional Responsibility Program conducts periodic audits of attorneys' trust accounting systems. Disciplinary Counsel selects a group of attorneys and/or firms whose trust accounting systems will be reviewed for compliance with the Vermont Rules of Professional Conduct. The list of attorneys is forwarded to an accountant whose firm has been retained by the Professional Responsibility Program. The firm contacts each attorney to schedule a "compliance exam." Upon completing an exam, a CPA in the firm prepares a "compliance report" that is forwarded to Disciplinary Counsel. Disciplinary Counsel reviews the report and, depending on the circumstances, works with the attorney to make any necessary changes, recommends that the attorney face formal disciplinary charges, or informs the attorney that the attorney's system complies with the Rules of Professional Conduct.

Submission to a compliance audit is mandatory under Rule 1.15A. Administrative Order No.9, Rule 7, also provides that failure to furnish information to Disciplinary Counsel, without having a reasonable basis for refusal, is grounds for professional discipline.

FREQUENTLY ASKED QUESTIONS

What do I do with unclaimed trust account funds?

Unclaimed funds result from either a balance left in the trust account for a client you can no longer locate or from outstanding checks which you are unable to reissue. Any unclaimed trust funds must be dealt with pursuant to the Vermont Unclaimed Property Act, 27 V.S. A. §§ 1241-1270. See also VBA Advisory Ethics Opinion 1998-09.

What do I do when I issue a check that never gets cashed?

As part of your monthly bank reconciliation, you should have a list of checks that have not cleared your account. A good practice is to send letters to the payees of any checks older than six months. The letter should indicate that you issued a check that remains outstanding. Ask the payee to cash the check or to contact you for a replacement if necessary, making sure to cancel the original check. If a letter is returned unclaimed, you would handle the funds in accordance with the provisions noted above.

What do I do with an unidentified balance in the trust account?

A lawyer should be able to identify the owner of each dollar in his or her trust account. Occasionally, however, a lawyer ends up with a balance in the trust account that is not identified as belonging to a particular client. You must make a reasonable effort to identify these funds.

What should I do if I cannot obtain my client's taxpayer identification number in order to set up a separate trust account for the client's benefit?

Your client's funds should remain in the IOLTA trust account until you have the correct taxpayer identification number for a separate interest-bearing account. You should document your efforts to obtain the identification number by keeping a record of telephone calls, copies of letters, etc. You should not, however, use your own or your firm's taxpayer identification number on the separate client account pending the receipt of the client's identification number.

What should I do if I receive an overdraft notice on my client trust account from my bank?

You should immediately contact your bank and take whatever steps are necessary to correct the deficiency in your client trust account. If necessary, you should deposit your own funds to make up any shortfall until the cause of the overdraft is determined.

What should I do when a client wants to pay by credit card?

You can accept credit card payments from clients. Such payments may be either advance fee/cost deposits or earned fees. If you decide to accept credit card payments for both, you must set up your accounts such that the two types of payments are not improperly commingled. This will generally require two separate merchant accounts.

The Vermont Bar Association now offers its members a credit card processing service for attorneys which correctly handles the deposits of earned and unearned fees. The program is called the Law Firm Merchant Account and is administered through Affinisphere Merchant Solutions. For more information on this program, please see www.affinisphere.com/vtbar.

How long must I retain my trust account records?

V.R.P.C. 1.15(a) requires that trust account records must be retained for a period of six years following the ***termination*** of the representation.