Understanding the New Client Trust Account Requirements

By Mary Andreoni and David Holtermann

Lawyers licensed to practice in Illinois need to be familiar with the amendments to Rule of Professional Conduct 1.15 that took effect September 1, 2011. These amendments, announced by the Illinois Supreme Court in July, make three key changes regarding how lawyers handle client funds and client trust accounts:

• Changes to Rule 1.15(a) and (f) clarify that there are only two options for the deposit of client funds—an IOLTA client trust account or a client trust account established to hold the funds of the client with the client receiving the interest. No client funds may be held in an account that does not earn interest.

• Additions to Rule 1.15(a) include new trust account recordkeeping requirements for lawyers.

• Rule 1.15(h) creates a trust account overdraft notification system, under which banks that hold client trust accounts must agree to notify the ARDC in the event the account is overdrawn.

A quick look at the purpose of Rule 1.15—titled “Safekeeping of Property”—puts these amendments in context. The rule specifies the responsibilities and obligations of lawyers who hold the property of clients in trust. Underlying these is the general principle that a lawyer holding the funds or property of a client or third person has a fiduciary duty to safeguard them and to segregate them from the lawyer’s personal and business assets.

Based on this principle, Rule 1.15 and its predecessors long have required lawyers to hold client funds in trust accounts for safekeeping. That principle continues through the recent amendments to the rule. The key changes reinforce it by clarifying the two allowable types of client trust accounts lawyers may use for the deposit of client funds. The expanded recordkeeping requirements provide an additional safeguard for client funds. As an “early warning” system for mismanagement of an account that could lead to a loss of funds, the overdraft notification requirement provides a further safeguard.

The remainder of this article highlights these key changes and provides guidance about what they mean and what practitioners may need to do in response.

Key Change #1: Only Two Types of Client Trust Accounts

The amendments to paragraphs (a) and (f) of Rule 1.15 clarify that there are only two options for depositing client funds: either an IOLTA account or a non-IOLTA client trust account.

An IOLTA account is a pooled interest-bearing client trust account, held at an eligible financial institution, for the deposit of nominal or short-term funds of clients or third persons. Interest on IOLTA accounts is payable to the Lawyers’ Trust Fund of Illinois (LTF), which makes grants to support...
legal aid programs throughout Illinois.

A non-IOLTA client trust account is a separate, interest-bearing account established for the benefit of a particular client or client matter where the net income earned on the funds is paid to the client. Client funds may not be held in an account that does not earn interest.

Paragraph (g) lists the factors a lawyer should consider in determining whether client funds are nominal or short term. Generally speaking, nominal or short-term client funds are those that cannot generate net interest for the client (i.e., in excess of the costs of establishing, maintaining and administering a separate account for the benefit of the client) and should be deposited in an IOLTA account. Funds that are not nominal or short-term should be placed in a separate, interest-bearing trust account with interest paid to the client.

Under paragraph (g), lawyers are required to exercise reasonable judgment in making the determination about whether client funds are nominal or short term. That exercise of reasonable judgment—and the connected decision on whether to place client funds into one of the two allowed types of accounts—may not be the basis of any disciplinary charge.

Most lawyers who handle client funds already use a pooled IOLTA account and the amended rules require no additional action, unless the lawyer wants to verify that the trust account is properly set up and that interest is, in fact, remitted to LTF. (Bank errors in the coding of IOLTA accounts are not uncommon.) If a lawyer or firm needs to establish an IOLTA account, simple step-by-step instructions and forms are available from LTF on its web site at www.ltf.org. You can also contact LTF staff for more assistance.

Key Change #2: Recordkeeping Requirement

The addition of subparagraphs (1) through (8) to Rule 1.15(a) provides lawyers with detailed guidelines for keeping records of client trust account funds and transactions. Before the amended rule, lawyers were required to keep “complete records” of trust accounts and to “promptly render a full accounting” of trust funds or property upon request. But the rule did not provide lawyers with practical guidance for complying with their obligations or in establishing

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accounting systems. The amended rule fills this gap. It continues to require lawyers to maintain records for seven years, but additionally spells out the elements of the records to be made, collected, and maintained by lawyers. The rule also requires account reconciliation at least once a quarter. These required procedures encourage careful accounting that helps safeguard client funds. In addition, they benefit lawyers by requiring records that can be used to refute concerns that funds were handled improperly.

In response to these changes, lawyers should carefully read Rule 1.15(a)(1-8) and review their trust account recordkeeping and reconciliation procedures. The ARDC has several resources that illustrate the requirements. These include basic accounting journals and forms that can be used as guides, as well as a form reconciliation report. These are available on the ARDC web site at www.iardc.org. Most comprehensively, the ARDC’s Client Trust Account Handbook provides a detailed look at recordkeeping and reconciliation procedures in addition to a broad overview of the requirements of Rule 1.15. It is also available online at https://www.iardc.org/toc_mail.html.

Key Change # 3: Automatic Overdraft Notification

The final key change is the addition of an automatic overdraft notification provision under Rule 1.15(h). Banks that wish to be “eligible financial institutions” to hold client trust funds must agree to report to the ARDC anytime a properly payable instrument is presented against a client trust account containing insufficient funds, whether or not the instrument is honored. The rule requires lawyers to maintain trust accounts only in banks that have agreed to make such reports to the ARDC.

This overdraft notification provision, which is also the rule in 42 other jurisdictions, provides another safeguard for client funds. It will not lead to any ARDC inquiry unless the lawyer’s trust account has insufficient funds to honor a check or other debit.
A bounced check on a client trust account is an early warning of lawyer conduct that could injure clients. Early notice can help contain problems before many clients are affected and losses incurred. Experience in other states shows that most regulatory action taken under overdraft notification rules involves educational intervention. Prosecutions are not routine.

Because an agreement to provide overdraft notification to the ARDC is a prerequisite for holding client funds (whether in an IOLTA or non-IOLTA client trust account), lawyers need to verify that their bank has submitted such an agreement. Both the ARDC and LTF maintain a list of banks that have submitted agreements and are therefore eligible for the deposit of client funds. The list is cross-posted at www.iardc.org and www.ltf.org. After verifying the eligibility of their bank, lawyers should make sure the bank is aware of any trust accounts subject to the overdraft notification provision.

**Conclusion**

There is no reason to be daunted by the amendments to Rule 1.15. After reviewing the amendments and consulting resources such as this article and the materials available from the ARDC and LTF, complying with the new provisions should be neither complicated nor difficult.

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