WHAT LAWYERS NEED TO KNOW ABOUT BANK FAILURES AND TRUST ACCOUNTS

November 1, 2008 **Ruth Smith** **Regular News**

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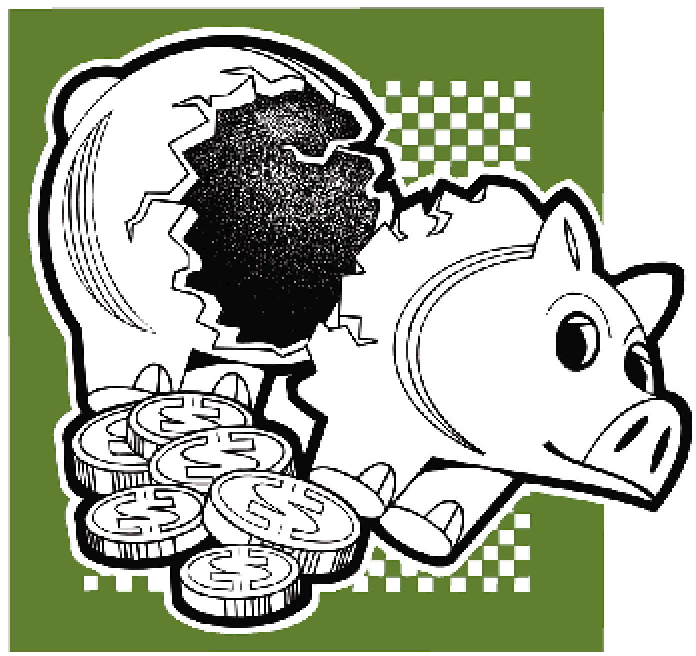

Recent bank failures are causing lawyers to give greater consideration to the safety of their client trust funds and whether any steps need to be taken to avoid or lessen any threats to those funds.

Rule 5-1.1(a), Rules of Professional Conduct, mandates that a lawyer hold in trust all funds and property of clients that come into the lawyer's possession. Such funds are to be held in a bank or savings and loan association in an account that is a "clearly labeled and designated" trust account. IOTA accounts, which are to be established for nominal or short-term client funds (where the costs to earn income for the client would exceed the income), are to be established in a bank or savings and loan that is insured by the FDIC. Rule 5-1.1(g)(1)(D). In view of the duty to safeguard client property, non-IOTA accounts should be held in an FDIC-insured financial institution as well, unless the client directs otherwise.

The Federal Deposit Insurance Corporation (FDIC) is an independent agency of the United States government that protects against the loss of insured deposits if an FDIC-insured bank or savings association fails. FDIC deposit insurance is backed by the full faith and credit of the United States government. On October 14, 2008, the maximum coverage limit for FDIC deposit insurance temporarily increased from $100,000 to $250,000 per depositor (client or third-party owner of the trust funds) through December 31, 2009.

According to the FDIC, trust accounts are "fiduciary accounts" or "deposit accounts owned by one party but held in a fiduciary capacity by another party." All fiduciary accounts are required by 12 C.F.R §330.5(b), to meet certain disclosure requirements. These are first that the fiduciary nature of the account must be disclosed in the bank's deposit account records (*e.g.* , "ABC Law Firm Trust Account"). Pursuant to Rule 5-1.1(a), the trust account is required to be a "clearly labeled and designated" trust account. Thus, the first requirement should be met upon compliance with the rule, as the designation discloses the existence of a fiduciary relationship.

And, second, the name and ownership interest of each owner must be ascertainable from the deposit account records of the insured bank or from records maintained by the lawyer (or someone hired by the lawyer to perform the recordkeeping task). Rule 5-1.2 requires certain minimum trust accounting records, which include ledgers that set forth receipts, disbursements, transfers, and balances for each client. Compliance with the rule should satisfy the second disclosure requirement.

According to the FDIC, provided that the disclosure requirements are fully satisfied, then funds deposited by a fiduciary on behalf of one or more persons or entities (the owners) are insured as the deposits of the owners. That is, for a trust account, the FDIC will provide insurance coverage of up to $250,000 for each client. The trust funds will be aggregated and insured to the statutory limit with any other funds which the client may hold individually at the same insured depository institution.

A discussion of fiduciary accounts is available on the FDIC Web site at: **www.fdic.gov/deposit/deposits/insured/faq3.html**.

Florida Ethics Opinion 72-37 states that there is no ethical requirement that a lawyer divide trust funds in order to ensure complete FDIC coverage. However, the opinion states that a lawyer is expected to act prudently with respect to the trust account and consider the deposits' size in relation to the size and reputation of the financial institutions concerned. Obtaining information on a financial institution's solvency would be useful in such an evaluation.

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Lawyers can call their bank officer and ask for a copy of their rating with one of the two chief bank rating services used by financial institutions. Unfortunately, the FDIC does not release its ratings on the safety and soundness of banks to the public. But, the FDIC's Web site contains a list of several private companies that provide ratings of financial institutions. The ratings generally are a numerical or letter grade that reflects the safety or soundness of the institution. The list can be obtained at:.

When there is concern about the stability of a bank in which a trust account is maintained, and when the account contains more than $250,000 for one client, or the amount of client-held funds in the bank when combined with the trust funds held for that client exceed $250,000, it may be prudent to consider consulting with the client to determine if these funds should be divided over two or more institutions to receive the benefit of full FDIC coverage.

Additionally, it is probably good practice, regardless of the current stability of a particular institution, to advise clients of the bank in which the clients' funds will be placed in trust. This will enable the clients to determine if the clients may hold other funds at that same institution which, when combined with the funds held in the trust account on their behalf, will exceed FDIC coverage limitations.

As noted previously, in order for each client to receive the advantage of full FDIC coverage, trust account recordkeeping must be properly maintained as required pursuant to Rule 5-1.2. The identity of each client and amount of funds held on behalf of each client must be ascertainable from the lawyer's records. In the event of a bank failure, those records will be utilized by the FDIC to pay insurance to the lawyer, who will then be responsible for remitting the insurance payments to the clients. Thus, lawyers must be vigilant in ensuring good trust account records are maintained.

There are no disciplinary cases in which a lawyer has been held liable to a client for failure to protect client funds against uninsured losses in the event of a bank failure. There is one malpractice case that considered this issue. *Bazinet v. Kluge*, 14 A.D.3d 324, 788 N.Y.S.2d 77 (2003), involved a situation in which an attorney made two deposits of over $1 million each into an IOTA account at a bank that failed after the deposits. The appellate court held: "There is no requirement imposed by law that an attorney-escrow agent place escrow funds in an account fully insured by the FDIC, and there are no allegations that [the attorney] knew that [the bank] was in danger of closing. The proximate cause of [the depositor's] injury, if any, was [the bank's] unforeseen demise." Id. at 325, 788 N.Y.S.2d at 78. ▲

It is unclear if Florida courts would take the same position. However, lawyers do have an ethical obligation to act prudently with client funds. Lawyers should be certain to keep compliant trust accounting records and consider the financial health of any financial institution in which client funds are maintained. If there are any concerns about the institution, the lawyer should consult with any client who is not receiving the advantage of full FDIC coverage and determine what actions can be taken to prevent any potential loss of these funds.

For more information, call the Bar's Ethics Department at 1-850-561-5780.

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