

TRUST ACCOUNT MANAGEMENT: HANDLING CLIENT AND THIRD PARTY FUNDS
By the Staff of the Indiana Supreme Court Disciplinary Commission
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I. Introduction

How Lawyers End Up with Client and Third Party Funds

A lawyer may end up with client and third party funds in his or her possession in a variety of ways. Probably the most common way is for a lawyer to receive a settlement or judgment check made payable to the lawyer, his or her client, and a subrogation lien holder in a personal injury action. Lawyers also end up with client and third party funds in other ways. In a divorce, a lawyer may be asked by the court to sell the real estate and hold the funds from the sale of the real estate until the court makes its final decision on the property settlement. A lawyer may also ask a client to give him an advance on the lawyer's fee and bill against this advance on an hourly basis. Another common way for lawyers to end up with client funds is for the lawyer to ask a client to give him or her an advance to pay the expenses of litigating a case.

~~These examples are not a comprehensive list of how a lawyer ends up with client and/or third party funds. There are numerous other ways that a lawyer may end up with client and/or third party funds in his or her possession. Because of their duties as fiduciaries, lawyers must treat these funds with special care. This special care begins with lawyers properly designating funds as belonging to the lawyer, the client, and to a third party. Lawyers' fiduciary duties also require lawyers to properly maintain client funds and third party funds separate from the lawyer's funds in a trust account. Lawyers' fiduciary duties are spelled out in several rules.~~

II. Rules and Statutes Pertaining to Trust Account Management

- Prof. Cond. R. 1.15¹: Safekeeping Property (ATTACHMENT A)
- Prof. Cond. R. 1.16(d): Duty to refund unearned fees at the termination of representation
- Prof. Cond. R. 5.1: Responsibilities of a Partner or Supervisory Lawyer
- Prof. Cond. R. 5.2: Responsibilities of a Subordinate Lawyer
- Prof. Cond. R. 5.3: Responsibilities Regarding Nonlawyer Assistants
- Prof. Cond. R. 8.4(b): Misconduct; criminal acts
- Prof. Cond. R. 8.4(c): Misconduct; dishonesty, fraud, deceit or misrepresentation
- I.C. 35-43-4-2: Theft
- I.C. 35-43-4-3: Conversion
- Admis. Disc. R. 23, §29(a): Trust Account Recordkeeping Requirements (ATTACHMENT B)
- Admis. Disc. R. 23, §29(b) through (g): Trust Account Overdraft Notification (ATTACHMENT C)
- Admis. Disc. R. 23, §30: Audits of Trust Accounts (ATTACHMENT D)
- Rules Governing Attorney Trust Account Overdraft Reporting (ATTACHMENT E)

III. A Lawyer's Fiduciary Duties in Handling Client and Third Party Funds

A. What is a trust account?

¹ All references to the Indiana Rules of Professional Conduct are to the rules as amended effective July 1, 2005.

Most trust account management obligations grow out of Prof. Cond. R. 1.15. Interestingly, Rule 1.15(a) does not mention trust accounts by name, it merely states that, "Funds shall be kept in a separate account" The Comment [1], however, provides: "All property that is the property of clients or third persons, including prospective clients, must be kept separate from the lawyer's business and personal property, and, if monies, in one or more trust accounts." See also, Admis. Disc. R. 23, §29(a)(1): "Attorneys shall deposit all funds held in trust in accounts clearly identified as 'trust' or 'escrow' accounts"

B. Key Fiduciary Principles

In general, lawyers act in a fiduciary relationship to their clients. Many of the general principles that apply to a fiduciary's duties in handling the principal's property apply with equal (if not greater) force to lawyers. "A lawyer should hold property of others with the care required of a professional fiduciary." Comment [1] to Prof. Cond. R. 1.15.

With respect to handling property of others, here are some key fiduciary principles. Each of these principles is embedded in Rule 1.15.

1. Duty to segregate: "A lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from the lawyer's own property." Prof. Cond. R. 1.15(a).
2. Duty to safeguard: "Funds shall be kept in a separate account maintained in the state where the lawyer's office is situated, or elsewhere with the consent of the client or third person. Other property shall be identified as such and appropriately safeguarded." Prof. Cond. R. 1.15(a).
3. Duty to promptly notify of receipt of funds: "Upon receiving funds or other property in which the client or third person has an interest, a lawyer shall promptly notify the client or third person." Prof. Cond. R. 1.15(d).
4. Duty to promptly deliver funds: "Except as stated in this rule or otherwise permitted by law or by agreement with the client, a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive" Prof. Cond. R. 1.15(d).
5. Duty to account: "[U]pon request by the client or third person, [a lawyer] shall promptly render a full accounting regarding such property." Prof. Cond. R. 1.15(d).

C. Prohibition against Commingling

The inverse side of the obligation to segregate client or third party funds is the prohibition against commingling. The concept of commingling is simple. Commingling is the simultaneous presence of funds belonging to a lawyer and a client or third party in the same account. When commingling occurs, there is a loss of identity of funds as between the lawyer and clients or third persons.

Commingling occurs anytime a lawyer's own funds are held in an account that also contains client or third party funds. Commingling can occur in two different ways. First, the lawyer

deposits his own funds into a trust account containing funds belonging to clients or third parties. Second, the lawyer deposits client or third party funds in an account that is not a trust account and that contains the lawyer's own funds.

1. Proper Identification of Trust Account

Part of the obligation to safeguard trust funds is the duty to assure that those funds are properly identified as such. It is insufficient for a lawyer to segregate trust funds in an account that is not properly designated as a trust account. The account must be formally designated a "Trust Account" or "Escrow Account." All documents associated with a trust account should indicate its trust nature by being properly labeled, including checks, deposit tickets, monthly bank statements. More importantly, the account must be identified as a trust account to the financial institution and the financial institution's records must reflect that it is a trust account. See Admis. Disc. R. 23, §29(a)(1). Thus, the lawyer's agreement with the bank² should clearly provide that it is a trust account.³ This avoids any danger that the financial institution will freeze or attach the funds if proceedings supplementary to execution are filed by one of the lawyer's personal creditors or the bank exercises a set off against the funds upon a default on a personal obligation owed to the bank by the lawyer. It also assures that the funds in the account will not be considered a part of the lawyer's bankruptcy, probate or marital estate should the lawyer file for bankruptcy, die or divorce. It will also protect the funds from seizure by the IRS in the event of a levy against the lawyer.

2. Risks of Lawyer Commingling Money in Client Trust Account

²For simplicity, financial institutions will be occasionally referred to as "banks." It is understood that lawyers may use a variety of financial institutions as depositories for their trust accounts, including banks, savings and loan associations, savings banks, credit unions and the like. See Admis. Disc. R. 23, section 29(g)(1).

³When opening a trust account, the bank is required to obtain a federal tax identification number or social security number from the lawyer or law firm for purposes of reporting interest (if any) to the Internal Revenue Service. How the lawyer handles this situation depends upon the circumstances. If the trust account is a non-IOLTA trust account that does not earn any interest, the lawyer may use his or her federal tax identification number or his or her own social security number. Because no interest will be earned or reported, there are no tax ramifications. If the trust account is an IOLTA account, the interest (less bank charges) will be paid over to the Indiana Bar Foundation pursuant to Prof. Cond. R. 1.15(f)(5)(A). For a discussion of the IOLTA program, see section III(E), infra. In this event, the lawyer will supply the Bar Foundation's federal tax identification number to the bank, and the bank will report the interest earned on the account to the IRS under the Bar Foundation's tax identification number. If a lawyer holds client funds that are not nominal in amount and not to be held for a short period of time, the lawyer may, in consultation with the client, determine to hold the funds in a separate interest-bearing account, with the interest, net of bank charges, accumulating for the benefit of the client. In this event, the lawyer **should not** use his or her tax identification or social security number on the account. If he or she does, the interest will be reported to the IRS as income of the lawyer or law firm. Instead, the lawyer should use the client's tax identification or social security number or apply for a separate federal tax identification number in the name of the client to assure that the interest is reported in the name of the client. The same rule applies to situations in which the lawyer controls an account as a fiduciary for a trust or an estate.

There are numerous risks that are imposed upon clients when a lawyer holds his own funds in a bank account that is denominated a trust account.

- (a) There is the risk that the lawyer's personal creditors will be able to gain access to client funds in the trust account in order to satisfy the lawyer's personal obligations.⁴
- (b) Negligent invasion of client funds. There is the problem that the lawyer is obligated to keep track of his or her own funds in the trust account, as well as funds of clients or third persons. Sloppiness in accounting or confusion in the identity of funds could lead to the reckless or negligent invasion of client funds when the lawyer innocently intends to access funds in the trust account erroneously thought to belong to the lawyer.
- (c) A lawyer's tendency to look to the trust account as a source of funds that belong, in part, to the lawyer, may habituate the lawyer to draw funds from the account for personal use even when it does not contain funds belonging to the lawyer. A lawyer's use of client funds for his personal benefit is a criminal act. See, section VI, infra.
- (d) Maintenance of a trust account is a public declaration that the funds in the account do not belong to the lawyer in his or her personal capacity. By placing or retaining his or her own funds in the trust account, the lawyer acts inconsistently with the established purpose of the account and, in effect, engages in misrepresentation to the world about the true purpose and function of the account.
- (e) The lawyer who deposits or retains his or her own funds in a trust account invites the accusation that he is using the account to shield his personal assets from his own creditors. It may not be that every lawyer who commingles personal funds in a trust account intends to defraud creditors, but such an improper use is not without precedent.
- (f) Especially by retaining earned fees in a trust account, a lawyer may be tempted to improperly use the trust account to shield income from recognition in the tax year received. Thus, the trust account is misused as a vehicle for defrauding the taxing authorities.
- (g) Importance of promptly disbursing funds earned by the lawyer. When funds are paid into trust and the lawyer is entitled to a portion of those funds as a fee after there has been a division of interests as between the client and the lawyer, the lawyer should promptly withdraw his earned fees. If the lawyer delays withdrawing fees after they are earned, the retention of the earned fees in the trust account constitutes improper commingling.

⁴The very nature of a fiduciary account is that it does not contain funds belonging to the fiduciary in any non-fiduciary capacity. It is certainly possible that a persistent personal creditor of a lawyer could discover the fact that the lawyer maintains personal funds in his trust account and argue persuasively that the account's fiduciary character should be disregarded because of the lawyer's failure to honor the obligation to segregate funds held in a fiduciary capacity from personal funds. In any event, there is the even greater risk, under these circumstances, that client funds will be frozen and unavailable to clients until there has been a full accounting and separation of the funds belonging to the lawyer from funds belonging to clients.

3. Risks of Lawyer Commingling Client Funds in Lawyer's Personal or Business Account

- (a) Client funds become available to the lawyer's personal creditors in the event of an attachment of those funds pursuant to proceedings supplementary to execution or otherwise under the Depository Financial Institutions Adverse Claims Act. IC 28-9-1-1, et seq. Even if the identity of the funds is later clarified, the client funds may be frozen for up to ninety (90) days by virtue of the automatic hold provision of IC 28-9-4-2.
- (b) Upon bankruptcy, dissolution of marriage or death of the lawyer, client funds may become a part of the lawyer's bankruptcy, marital or probate estate. Once again, there may eventually be a separation of interests in the funds, but in the meantime, client funds will be unavailable to their true owners.
- (c) Client funds are available to cover checks written for the personal benefit of the lawyer, resulting in conversion of client funds. See, section VI, infra.

D. Pooled trust accounts versus separate trust accounts.

Generally, funds held for clients that are small in amount or not being held for a substantial period of time will be combined into a pooled trust account. The administrative burden and costs of opening and maintaining a separate interest-bearing account for each client or sub-accounting for interest earned on a pooled account is generally not justified by the small amount of interest that could be earned on the funds. Notwithstanding the fact that the account is pooled, there must be sub-accounting methods in place (discussed below) that accurately account for each individual client's funds. When the lawyer is handling large amounts of client funds, especially for significant periods of time, the lawyer should consult with the client concerning whether or not that client's funds should be segregated into a separate trust account that earns interest. Any interest earned on trust funds belongs to the client, not to the lawyer. Prof. Cond. R. 1.15(f)(1); In re Pub. Law No. 154-1990, 561 N.E.2d 791 (Ind. 1990).

E. IOLTA Accounts.

Effective February 1, 1998, the Indiana Supreme Court promulgated rules creating an Interest on Lawyers Trust Account (IOLTA) program in Indiana. Prof. Cond. R. 1.15(f) through (i). Whereas previously lawyers generally pooled their trust funds in non-interest bearing accounts, under the IOLTA program lawyers are allowed to have their pooled trust accounts draw interest. The interest on trust funds in an IOLTA account does not belong to the lawyer, nor does it belong to the clients. Instead, by opening an IOLTA account, the bank is directed to pay the interest on the account over to the Indiana Bar Foundation to be used to fund law-related programs that are in the public interest. The IOLTA program has been designed in such a way as to make participation by lawyers very simple. Attached as ATTACHMENT F are materials produced by the Indiana Bar Foundation about the IOLTA program. More information is available on the IOLTA program by contacting the Indiana Bar Foundation or visiting its website at: www.inbf.org.

In late 2004, the Supreme Court announced a change to the Interest on Lawyers Trust Account (IOLTA) program to require that all lawyers who maintain pooled trust accounts participate in the IOLTA program. Press release, "Legal Aid to the Poor Gets Boost from Supreme Court: Court to Adopt Universal IOLTA Plan" (Nov. 23, 2004), available on-line at <http://www.in.gov/judiciary/press/2004/1123b.html> (last visited Oct. 4, 2005). On February 5,

2005, the Court ordered amendments to Prof. Cond. R. 1.15 implementing mandatory IOLTA participation, effective July 1, 2005. See, Attachment A.

F. Lawyers in Other Fiduciary Roles

When the lawyer holds funds in some capacity other than as an attorney acting in a representative capacity, e.g., as trustee of a trust or as personal representative of an estate, the lawyer should maintain a separate trust or escrow account for each such fiduciary role and should not intermingle those funds with client trust funds or with other similar fiduciary accounts.

G. Signatory Authority over Trust Accounts

Only lawyers admitted in Indiana should have signatory authority over a trust account. Admis. Disc. R. 23, sec. 29(a)(6), contemplates that a lawyer may designate an agent as a trust account signatory. It should only be in limited and highly controlled situations that a lawyer delegates signature authority over a trust account to a non-lawyer. In the event there is such a delegation, the lawyer must institute and maintain thorough internal controls to insure against the mishandling of funds. The lawyer must receive the monthly bank statement directly from the bank without it passing through the hands of the non-lawyer who is responsible for the day-to-day management of the trust account and carefully review the bank statement. Also, someone who has no signatory authority over the account must be responsible for periodic account reconciliations. See Rule 7(B)(2), Trust Account Overdraft Reporting Rules. Surety bonding for all employees who have control over the trust account should be obtained. Comprehensive staff training for all staff having functions relating to the management of a trust or other fiduciary account is essential.

H. Where Should Lawyers Maintain Client Trust Accounts?

The trust account must be at a financial institution located within the state of Indiana unless there is specific consent from all account beneficiaries to hold funds in an out-of-state bank. Prof. Cond. R. 1.15(a).

A lawyer must maintain his or her trust account only in a financial institution approved by the Disciplinary Commission. Approval is contingent upon the institution agreeing to provide notice to the Disciplinary Commission of all overdrafts on lawyer trust accounts. Admis. Disc. R. 23, § 29(b) through (g). A current list of approved financial institutions is available on the Disciplinary Commission's website at: <http://www.in.gov/judiciary/discipline/docs/trust-account-depositories.pdf>.

IV. Whose funds are these?

A good rule of thumb is to ask the question: "At this point in time, who owns these funds?" If the answer to that question is that the client or a third party owns the funds, the funds belong in trust. If the answer is the lawyer owns the funds, the funds do not belong in trust.

A. What funds must go into the trust account?

1. Advanced Expenses: Funds paid by the client to the lawyer to defray anticipated costs that will arise during the course of representation, e.g., filing fees, deposition costs, expert witness fees, belong in trust until disbursed to pay for those costs. Prof. Cond. R. 1.15(c).

2. Advanced Fees: Fee retainers that are in the nature of deposits to secure payment of fees to be earned by the lawyer in the future on an hourly basis must be deposited into the trust account, not the operating account. *Matter of Kendall*, 804 N.E.2d 1152, 1158 (Ind. 2004). See also, Prof. Cond. R. 1.15(c). These funds should be held in trust until fees are earned through hourly work or by whatever method is agreed upon with the client and the client is billed. Sufficient funds to satisfy the bill may be issued from the trust account to the lawyer or law firm by way of a properly documented trust check once the client has received a proper billing and the bill is shown to have been satisfied by a transfer from trust. In the event the client disputes the charges, the disputed fees should be immediately returned to trust until the dispute is resolved.

By contrast, a flat fee, as is common in many criminal representations, need not be deposited into the trust account. *Kendall* at 1157. Flat fees are, generally, deemed to be earned when paid, and so flat fees should be deposited into the operating account. However, this does not relieve the lawyer of an obligation to promptly refund unearned fees and expenses upon being discharged by the client before the completion of the legal matter. See Prof. Cond. R. 1.16(d); *Matter of Stanton*, 504 N.E.2d 1 (Ind. 1987). Upon being discharged before representation is complete, the lawyer's entitlement to fees is not pursuant to the fee contract, but is to be determined on a *quantum meruit* basis. *Galanis v. Lyons & Truitt*, 715 N.E.2d 858 (Ind. 1999); *Estate of Forrester v. Dawalt*, 562 N.E.2d 1315 (Ind.App. 1990). Nonrefundable retainers, while not prohibited under proper circumstances, or other types of minimum fee arrangements that create financial disincentives for a client to discharge counsel are of questionable validity. *In re Thonert*, 682 N.E.2d 522 (Ind. 1997). For a more in-depth discussion of nonrefundable retainers, see Lester Brickman & Lawrence A. Cunningham, *Nonrefundable Retainers Revisited*, 72 N.C. L. Rev. 1 (1993).

3. Funds Belonging to Lawyer and Client: All funds in which the client, the lawyer, or third parties each claim an interest must be initially deposited into trust until such time as there is a division of interests in the funds. A good example is a personal injury settlement in the form of a check or insurance company draft made payable to the joint order of the client and the lawyer. These funds should be deposited to and held in trust until such time as a written disbursement statement is presented to and approved by the client showing all proposed disbursements and the net proceeds payable to the client. See Prof. Cond. R. 1.5(c).
4. Receipt of Aggregated Non-Trust and Trust Funds: Funds paid to the lawyer by a client in a single check or credit card transaction some of which belong in trust and some of which do not belong in trust should be initially deposited in trust and a trust account check written to promptly disburse the non-trust monies. Initial deposit of such a check or credit card transaction into an operating account should be avoided as it places those funds at risk, even if for a brief period of time.
5. Disputed Funds: All funds in which more than one person (including the lawyer) claim an interest should be held in trust until such time as there is a division of interests between or among the claimants. When a lawyer holds funds against which there is a valid security interest by a third party (e.g., subrogation lien, properly executed medical letter of protection), the lawyer should not issue the funds to the client, even though the client demands it, unless the competing, third party claim against the funds has been resolved. See, e.g., *In the Matters of Allen and Young*, 802 N.E.2d 922 (Ind. 2004). The lawyer may need to obtain assistance to mediate the dispute between the client and the third party or file an interpleader action to determine the respective rights and interests of the client and the

third party. On the other hand, if there is not a properly perfected security interest against the settlement, the lawyer should not disburse settlement funds to the client's creditors absent the express consent of the client.

6. Handling of Cash Belonging in Trust: Cash properly belonging in trust must not be held in a safe deposit box, a safe or any other supposedly "secure" place. A lawyer may not hold client funds in the form of cash without depositing them into trust. There is no audit trail or documented accountability for cash. Payments of cash to a lawyer for deposit into trust should be documented through the issuance of a receipt to the payor, with a copy retained by the lawyer, and promptly deposited.

B. What funds may go into the trust account?

Money to Defray Bank Service Charges: The lawyer may be able to arrange with a financial institution to not charge administration fees on a trust account. Even under this circumstance, it may be necessary for the lawyer to maintain \$1.00 of personal funds in the account in order to keep it from being closed out during times when the account would otherwise have a zero balance. For non-IOLTA accounts, if there are monthly bank charges against a trust account holding pooled client funds, the lawyer should not allow them to be debited against the client funds that happen to be in the trust account on the day when the charges are debited. The bank may be willing to debit the trust account bank charges from another account containing the lawyer's personal or business funds. If such arrangements are not available, this is one exception to the general rule that the lawyer's own funds should never be held in trust. Prof. Cond. R. 1.15(c) recognizes this by allowing a lawyer to "deposit his or her own funds reasonably sufficient to maintain a nominal balance in a client trust account." In order to honor the proscription against maintaining a balance of lawyer funds that is not nominal, we recommend not holding in the trust account at any given time more than the estimated amount of funds necessary to defray bank charges for a three-month period. The balance of lawyer funds should be replenished approximately once every three months.

If a trust account is an IOLTA account, bank charges will usually be set off against interest. In the event the bank charges exceed the amount of interest earned on the account, those excess charges are not to be debited from the trust account principal, but are to be billed to the Indiana Bar Foundation.

There should be a subsidiary ledger reflecting the fact that the trust account contains funds belonging to the lawyer and that the purpose is to cover bank fees and charges or to maintain a nominal balance in order to keep the account open. Bank charges that are assessed against the account should be deducted from the balance on the lawyer's subsidiary ledger. Those funds should be replenished when they run too low to cover anticipated bank charges.

C. What funds must not go into the trust account?

1. Funds Belonging Exclusively to the Lawyer: Funds owned by the lawyer in which clients or third parties own no interest must not go into the lawyer's client trust account. The lawyer should never maintain a "cushion" of the lawyer's own funds in order to avoid overdrafts. Absent bank error, for which the lawyer has no responsibility, a properly managed trust account should never result in an overdraft.

2. Withdrawing Earned Fees from Trust Account: When there has been a division of interests in funds as among the lawyer, the client and any third parties, the lawyer's earned fees should be promptly withdrawn from trust. Maintaining earned fees in trust constitutes improper commingling. Generally, the best time to disburse earned fees is contemporaneously with disbursing net proceeds to the client.
3. Employee Payroll Taxes: Withheld employee payroll taxes must not be put into an attorney trust account. These are not funds being held in the lawyer's capacity as an attorney, but rather are being held pursuant to an employer-employee relationship. For business reasons, a lawyer/employer may wish to hold withheld taxes in a separate account, but it should not be the client trust account.

V. Handling Disbursements from Trust

- A. Trust account disbursements should only be done by way of a fully documented transaction, i.e., a check made payable to a named payee or a bank wire transfer.
- B. A trust check should never be made payable to cash or bearer.
- C. Withdrawals from a trust account should never be made by way of a cash withdrawal from an automated teller machine.
- D. Cash should never be received back at the time of making a trust account deposit. Rather, the entire check should be deposited into trust, and checks should be written for authorized disbursements.
- E. Earned attorney fees should be paid out of trust in the form of a trust check written payable to the order of the lawyer or law firm and documented as being for earned fees. A trust check should never be issued directly to one of the lawyer's or law firm's personal creditors, even if it constitutes the disbursement of funds from trust that the lawyer has earned as fees. Rather, the entire amount of earned fees should be disbursed by check out of the trust account, deposited into the operating account, and checks written from the operating account to the lawyer's creditors.
- F. Similarly, costs incurred by the lawyer on behalf of the client should be paid directly out of the trust account with a trust check payable to the order of the vendor of the goods or services. If the lawyer advances costs on behalf of the client, the check should be written out of the operating account because the advance is being made with the lawyer's funds.

VI. Conversion and Theft of Client and Third Party Funds

- A. A lawyer's unauthorized use of client and/or third party funds will lead to serious disciplinary problems. A lawyer who is holding client or third party funds in his or her trust account must not invade those funds for any unauthorized purpose. A lawyer's unauthorized use of client or third party funds is a crime.
- B. Ind. Professional Conduct Rule 8.4 (b) prohibits a lawyer from committing a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness to practice law. I.C. 35-43-4-3 defines the crime of conversion as: "A person who knowingly or intentionally exerts unauthorized control over property of another commits criminal conversion" I.C. 35-43-

4-2 defines the crime of theft as: "A person who knowingly or intentionally exerts unauthorized control over property of another person, with the intent to deprive the other person of any part of its value or use, commits theft" A lawyer who commits the crime of theft or conversion commits an act of dishonesty in violation of Ind. Professional Conduct Rule 8.4(c). See, e.g., *Matter of Towell*, 699 N.E.2d 1138, 1141 (Ind. 1998); *Matter of Wilson*, 715 N.E.2d 838, 841 (Ind. 1999).

- C. Remember that a lawyer in possession of money belonging to a client or third party should never use those funds for his or her own benefit, for the benefit of another client, or for the benefit of anyone else. If a lawyer uses money belonging to a client or a third party for his own benefit, the benefit of another client, or anyone else, that lawyer commits the crime of conversion or theft. When a lawyer has possession of money belonging to a client or third party, he or she should never treat the money as his or her own. This money belongs in trust or should be paid to the appropriate party. Any other use of these funds, without authorization of the party who owns the funds, is a criminal act.

VII. Fundamental Concepts in Trust Account Management

- A. Although client funds are often maintained in a pooled trust account, they must be treated as though each client's funds are held in a separate account.
1. The funds of one client can **never** be used to cover disbursements out of trust on behalf of another client.
 2. The tool for maintaining the separate identity of each individual client's funds is a subsidiary ledger for each client who has funds in the trust account. Each client's subsidiary ledger must reflect all receipts and disbursements from the trust account on behalf of that client. It will indicate at all times the balance of funds held in the trust account on behalf of that client. Receipts to trust should not be recorded on the client ledger until they have been actually deposited. Disbursements from trust should not be made unless the client ledger has been checked to confirm that funds are available to support the disbursement. Some software accounting programs will not allow a disbursement from a client sub-account, even though there are sufficient funds to cover the disbursement in the trust account, unless there are sufficient funds on deposit attributable to that client sub-account. This is an excellent safeguard to avoid "robbing Peter to pay Paul."
- B. Funds should never be paid out of trust on behalf of a client until the funds on which a trust check is written have been collected through banking channels. In other words, at the time funds are disbursed there should be minimal risk of a charge back to the trust account in the event a deposited instrument is not honored by the payor bank. Most banks will make deposited funds available for withdrawal on the first business day following the business day⁵ on which the funds are deposited. This, of course, does not mean that a credited deposit will not be charged back to the account in the event the depository bank receives notice from the payor bank that the instrument has not been honored. Should a disbursement be made from the trust account in reliance on the deposit of funds that may

⁵Typically, business transacted after a defined point in time in the afternoon (typically 2:30 p.m.) will be considered a next business-day transaction by the bank.

yet be dishonored, the lawyer runs the risk that, upon a dishonored deposit being charged back to the trust account, other clients' funds will have been used to cover the disbursement. If there are not enough funds belonging to other clients in the trust account to cover the charge back, the account will go into overdraft status.⁶ The best way to minimize the risks of a deposited item being dishonored and charged back to the trust account is to wait a prudent period of time before disbursing funds in reliance upon the deposited funds being good. An appropriate waiting period would be to follow the waiting periods defined by the Federal Reserve Board in Regulation CC for availability of funds. These waiting periods are set out below, but questions should be resolved by the lawyer consulting his or her banker or Regulation CC, 12 C.F.R. Part 229.

1. Funds available on the same business day as the business day of deposit:
 - (a) Electronic direct deposits.
2. Funds available on the first business day after the business day of deposit:
 - (a) U.S. Treasury checks payable to depositor.
 - (b) Wire transfers.
 - (c) Checks drawn on the depository bank.
 - (d) Cash deposited in person with a bank employee.

⁶It is not always possible to be 100% certain that deposited funds have been collected. One reason for this is that the banking system works in such a way that a depository bank is not notified when a deposited item has been honored by the payor bank. Rather, the depository bank will only receive notice from the payor bank if the instrument has been dishonored. Thus, the lawyer cannot contact his or her own bank and confirm that a deposited item has been collected. The only thing the depository bank will be able to report is that there has not been a notice of dishonor up to that point in time. The lawyer can always contact the payor bank and ask to confirm whether the item has been paid. For a more detailed discussion of the collection of bank deposits, see Robert D. Cooter & Edward L. Rubin, *Orders and Incentives As Regulatory Methods: The Expedited Funds Availability Act of 1987*, 35 UCLA L. Rev. 1115 (1988). See also, 12 CFR Part 229 (2004) (known generally as "Regulation CC--Availability of Funds and Collection of Checks"). At the extreme, if a deposited instrument has been forged, it could be several weeks before the victim of the forgery discovers it, the depository bank receives notice and charges the deposit back to the trust account. In the end, there is always some unavoidable, but miniscule degree of risk associated with the disbursement of funds upon the deposit of a check into a trust account. Use of conservative and prudent trust account management practices by the lawyer will minimize such risks. In the event a dishonor occurs that could not have been reasonably anticipated, resulting in the charge back of a deposit to a trust account, the lawyer will be faced with a confusing situation that will need to be promptly rectified in order to assure that other clients' funds have not been put at risk; however, culpability through the lawyer discipline system should not be one of the problems facing the lawyer at that point. Failure to use prudent trust account management practices, however, may be treated differently.

- (e) State and local government checks payable to the depositor and deposited in person with a bank employee.
 - (f) Cashier's, certified, and teller's checks payable to the depositor and deposited in person with a bank employee.
 - (g) Federal Reserve Bank checks, Federal Loan Bank checks, and U.S. postal money orders payable to the depositor and deposited in person with a bank employee.
3. Funds available on the second business day after the business day of deposit:
- (a) All instruments listed in paragraph 2(d) through (g) above that were deposited by some method other than delivery in person to an employee of the depository bank, e.g., deposit through an ATM or overnight deposit drop.
 - (b) All other local checks. A local check is a check written on a paying bank that is located in the same Federal Reserve check-processing region as the bank branch where the check is deposited. Your banker will be able to assist you in identifying local checks.
4. Funds available on the fifth business day after the business day of deposit:
- (a) All other non-local checks. A non-local check is a check written on a paying bank that is located in a different check-processing region from the bank branch where the check is deposited.
5. Exceptions. The foregoing are general guidelines, and certain exceptions are applicable. The lawyer should check with his or her banker if there is any doubt about what availability period applies. Exceptional circumstances include:
- (a) When your bank believes a deposited check will not be paid.
 - (b) When the lawyer deposits checks totaling more than \$5,000 on any one day.
 - (c) When the lawyer re-deposits a check that has previously been returned unpaid.
 - (d) When the lawyer has overdrawn his or her account repeatedly in the previous six months.
 - (e) The bank has an emergency, such as failure of communications or computer equipment.
- C. The lawyer should never issue a post-dated trust check on the assumption that it will be presented on a future date after deposited funds have been collected. The reason for this is that the deposited instrument might be dishonored and the deposit not credited to the trust account or charged back against the trust account balance. Thus, unless the lawyer can get the post-dated trust check returned or is able to stop payment on it, it may be debited against other clients' funds in the trust account or may be dishonored due to insufficient funds in the trust account.

- D. New Jersey has recognized a very narrow exception to the prohibition against disbursing deposited funds from trust until they are collected in cases where the deposited instrument is in the form of a certified, bank or cashier's check and the funds are received in connection with a real estate or commercial property closing. See New Jersey Advisory Opinion 454, 105 N.J.L.J. 441 (May 15, 1980), as amended at 114 N.J.L.J. 110 (August 2, 1984). A reprint of these ethics advisory opinions is attached as ATTACHMENT G. New Jersey Advisory Opinion 454 was cited favorably by the New Jersey Supreme Court in *In re Moras*, 131 N.J. 164 (1993). Indiana has no direct authority on point.
- E. Always maintain an audit trail.
1. An audit trail consists of source documents that reflect all transactions into and out of a trust account. Source documents include:
 - (a) Copy of the deposit ticket, deposit receipt or bank credit memorandum;
 - (b) Bank statement showing the credit of deposited funds;
 - (c) Checkbook stub or checkbook register;
 - (d) Check or bank debit memorandum;
 - (e) Bank statement showing the debit of disbursed funds.
 2. Deposit tickets should be annotated to identify each deposited item (whether cash or instrument), the client's name (or file number) and the source of the funds. No unidentified cash deposits should be made into trust.
 3. Checks should be annotated to identify the client's name (or file number) and the purpose of the check. No check should ever be written on a trust account without the memorandum line being filled out to clearly identify the purpose of the check.
 4. The deposit ticket and the check should be annotated well enough to direct the lawyer to the client matter file corresponding to the receipt or disbursement. In turn, the client matter file or other accounting files should contain adequate documentation to fully explain all deposits or disbursements.
- F. Records pertaining to the handling of client trust funds must be maintained for a period of five years following termination of representation. Prof. Cond. R. 1.15(a); Admis. Disc. R. 23, sec. 29(a)(2) (effective January 1, 1997).

VIII. Mechanics of Trust Account Maintenance

The following is an outline of the steps lawyers should take maintain their client trust account. This outline is not a comprehensive discussion on the law of client trust accounts; it is intended as a guide for how a lawyer should handle trust account transactions.

- A. Handling Deposits: When a lawyer receives funds in which a client or third party have an interest, the lawyer should immediately contact the client or third party to obtain the necessary endorsements. Then, the lawyer should deposit the client or third party funds into

his trust account. The lawyer should make an entry in the checkbook registry, the trust receipt book, and the client's subsidiary ledger. The lawyer should keep the following documents to record this transaction: deposit ticket (keep a copy), checkbook register, entry in trust receipts book, and entry in client's subsidiary ledger.

1. Receipt of funds.
 2. Promptly notify client and obtain necessary endorsements.
 3. Deposit into trust account.
 - (a) Deposit slip prepared.
 - (b) Funds deposited.
 - (c) Checkbook register entry is made.
 - (d) Duplicate deposit slip is maintained.
 4. Entry is made into trust receipts book (see example at ATTACHMENT H).
 5. Entry is made into client's subsidiary ledger (see example at ATTACHMENT I).
- B. Handling Disbursements: After the funds have been collected by the bank (See, section VII (B) supra), the lawyer should promptly disburse the funds to the client and/or third party with the consent of the client. If the client refuses to consent to disburse funds owed to a third party, the lawyer should hold these funds in trust until the dispute between the client and the third party has been resolved. The lawyer should have the client consent to disburse the funds in writing. In case of a disbursement of funds from a contingent fee matter, the lawyer is required to provide the client with a written settlement statement showing the remittance to the client (See, Prof. Cond. R. 1.5(c)). After obtaining the consent of the client, the lawyer should prepare, sign, and issue the appropriate check(s). The lawyer should make an entry in the checkbook registry, trust disbursements book, and the client's subsidiary ledger. The lawyer should keep the following documents to record this transaction: check(s) (keep a copy), checkbook register, entry in trust disbursements book, and entry in client's subsidiary ledger.
1. Documentation supporting disbursement is received or created.
 2. Disbursement is made promptly after receipt of funds, once deposited funds are collected and the client has consented to the same.
 - (a) Check is prepared and signed by lawyer.
 - (b) Check is issued.
 - (c) Checkbook register entry is made.
 3. Entry is made into trust disbursements book (see example at ATTACHMENT J).
 4. Entry is made into client's subsidiary ledger (see example at ATTACHMENT I).

C. Monthly Reconciliation and Trial Balances: Lawyers should do a monthly reconciliation of their trust account records. This monthly reconciliation is a three-way check to verify the accuracy of trust account records (See ATTACHMENTS K and L for examples).

1. Step 1: The balance of all trust receipts and disbursements is reconciled to the total of all individual client ledger balances.
2. Step 2: The total of all individual client ledger balances is reconciled to the checkbook register balance.
3. Step 3: The checkbook register balance (as adjusted for outstanding checks and deposits in transit) is reconciled to the balance on the monthly trust account bank statement.

IX. Other Issues in Trust Account Management

A. Interest on Trust Accounts.

1. Unless it is an IOLTA account, a pooled trust account should not be interest bearing. If a non-IOLTA trust account does earn interest, the interest belongs *pro rata* to the clients or third parties whose funds earned the interest, and not to the lawyer. *In re Pub. Law No. 154-1990*, 561 N.E.2d 791 (Ind. 1990). Thus, if the account is interest bearing, the lawyer will have the affirmative obligation to sub-account for the interest so that each person who had funds in trust during any part of the month in which interest is paid is credited with a *pro rata* share of the interest. The administrative costs of sub-accounting for the interest will typically outweigh the benefit to the account beneficiaries. Thus, rather than incur these administrative costs, pooled trust accounts are typically held in non-interest bearing accounts.
2. It may be cost beneficial for trust funds to be held at interest in a separate trust account for clients whose funds are being held in trust for a long period of time or where a substantial amount of client money is being held, even for a shorter period of time. These situations should be handled on a case-by-case basis in consultation with each individual client.
3. In no event should the lawyer treat any interest earned on trust funds as the lawyer's own funds. To do so would constitute conversion of those funds.
4. On October 22, 1997, the Indiana Supreme Court issued rules to implement an Interest on Lawyer's Trust Accounts ("IOLTA") program effective February 1, 1998. These rules are at found Indiana Rule of Professional Conduct 1.15(f) through (i). For a discussion of IOLTA, see materials in ATTACHMENT E. Generally speaking, by participating in the IOLTA program, a lawyer is allowed to earn interest on his or her pooled trust account so long as the interest proceeds, generally after setting off bank administrative charges against interest, are paid in to the IOLTA program, which is administered by the Indiana State Bar Foundation. The Indiana IOLTA program applies universally to all lawyers who operate trust accounts in their law practices, thereby making participation mandatory.

B. Trust Account Overdraft Reporting

1. Effective July 1, 1997, all Indiana lawyer trust accounts were required to be maintained in financial institutions that have been approved by the Disciplinary Commission for that purpose. Admis. Disc. R. 23, §29(a)(1). A bank will be approved as a depository for lawyer trust accounts upon entering into an agreement with the Disciplinary Commission to report to the Commission all overdrafts on any trust account. An overdraft occurs whenever any properly payable instrument is presented against a trust account containing insufficient funds, irrespective of whether or not the instrument is honored. Admis. Disc. R. 23, §29(b). Thus, if the lawyer maintains a line-of-credit or some other back-up source of funds to cover overdrafts (a practice that should not be followed), there will still be an overdraft that will be reported to the Disciplinary Commission if the line of credit needs to be accessed to cover a shortfall. There will also be an overdraft report even though the bank exercises the business judgment to honor a check and allow the account to have a negative balance.
2. It is not the bank's obligation to guess whether or not an account is subject to overdraft reporting. Rather, it is the lawyer's obligation to provide notice to the bank of any accounts that are properly subject to overdraft reporting. Each lawyer associated in practice who shares a trust account has a joint and several responsibility to see to it that the bank receives the proper notice. See, *Matter of Anonymous*, 734 N.E.2d 583 (Ind. 2000). An account is subject to overdraft reporting if it includes funds held in any fiduciary capacity in connection with a representation, whether as trustee, agent, guardian, executor or otherwise. Admis. Disc. R. 23, §29(a)(1). Thus, if a lawyer is acting purely in a fiduciary capacity that is not related to a legal representation, the fiduciary account is not subject to overdraft reporting. However, if the lawyer is acting in a legal representation capacity and also serves in another fiduciary capacity, the account is subject to overdraft reporting.
3. Upon receipt of a notice of overdraft, the Disciplinary Commission will send notice to the lawyer that a written and documented explanation of the overdraft is required within a period of ten (10) business days. After review of the explanation and such other materials as may be requested by the Commission, the inquiry will either be closed with a notice to the lawyer providing the reason for closure, or the inquiry will be referred to the members of the Disciplinary Commission to consider whether or not the circumstances of the overdraft should result in a formal investigation into possible lawyer misconduct. Attached as ATTACHMENT M is a report of the results of bank overdraft reports for the period from July 1, 1997 through June 30, 2006.

C. Unclaimed Trust Funds

1. Every effort should be made to promptly forward trust funds to their rightful owner. If a lawyer does not have a good reason to keep funds in trust, those funds should be promptly disbursed to their rightful owners so that the lawyer is relieved of the obligation to safeguard and account for the funds. It may happen occasionally that the lawyer loses track of a client and cannot pay funds from the trust account to the client. In these instances, the lawyer should proceed pursuant to the terms of IC 32-34-1-1, *et seq.*, the Unclaimed Property Act.