STATE BAR ASSOCIATION OF NORTH DAKOTA
ETHICS COMMITTEE
OPINION NUMBER 2011-04

ASSUMED FACTS

A lawyer, who does collection work for a client, deposits collection payments in a separate trust account opened specifically for that client. Under the lawyer's current practice, after the funds clear in about three to five days, the lawyer pays those funds to the client. The client wants to set up a **bank sweep** process whereby funds are automatically drawn out of the trust account each day and paid to the client. No other clients' funds are deposited in this account. The lawyer states that although it is unlikely the account will ever be overdrawn because "funds are constantly being deposited in this account," the lawyer implies that there is a possibility the account could be overdrawn. The letter from the lawyer requesting the opinion does not identify whether any portion of the amount deposited in the client trust account belongs to the lawyer and would be swept into the lawyer's general business operating account.

A **bank sweep** is an automated overnight banking process in which funds are removed from an account regularly and put electronically into another account, either internally or externally. Some sweep account processes remove only a portion of the funds, leaving a small balance remaining in the account to cover banking costs and potential overdrafts. A sweep, as described by the requesting lawyer, could remove funds that have not cleared; and, it will remove funds without the lawyer consenting to each individual withdrawal every time a payment is credited to the account.

QUESTION

Can a lawyer, who is involved in a debt collection law practice, have an individual client trust account that uses a daily bank sweep process to take in collection payments and disburse those funds automatically to a client every day?

BRIEF ANSWER

Yes, but safeguards are required. In particular, the bank sweep process that is set up must comply with North Dakota Rule of Professional Conduct, Rule 1.15.

DISCUSSION

N.D.R. Prof. Conduct

This ethics question implicates Rule 1.15, N.D.R. Prof. Conduct. Research indicates that the sweep process is used by some debt collection attorneys. There are, however, no specific ethics rules or guidelines in North Dakota allowing this banking procedure. Some IOLTA programs in other states use a bank sweep process to capture interest earned in combined client trust accounts. See, e.g., Ark. Rules Prof. Conduct, Rule 1.15(c)(1)(iv)(5); www.msbf.org/iolta/IOLTAfininfo.htm (Michigan); N.C. Rule Governing Admin. of Plan for

Interest on Lawyer's Trust Accounts (IOLTA), Subchapter D, Section 1316(e)(vi); and S.C. Rules Prof Conduct, Rule 1.15(d)(4)(iv). Therefore, it would seem that bank sweeps are not per se unethical. North Dakota does not use a bank sweep process to capture the interest in IOLTA accounts.

In at least one state, Wisconsin, there is a specific provision in its professional code of ethical conduct addressing special debt collection attorney trust accounts. See Wisc. S.R.C. Rule 1.15(e)(4)(g) and 1.15(e)(5)(c)(adopted July 1, 2007). These ethics rules allow collection attorneys to petition the office of lawyer regulation for an exception to the requirements of Rule 1.15, if adequate assurances can be made related to account security, record keeping, and reporting requirements. Under this exception, the lawyer can distribute the funds deposited in the account without waiting for the funds to clear, as long as the funds have been deposited prior to disbursement. The rule does not specifically address the sweep process. Since North Dakota does not have this exception in its Rules of Professional Conduct, the posed question must be analyzed under our current Rule 1.15.

N.D. R. Prof. Conduct, Rule 1.15(a) states that whenever a lawyer receives property (money) of a client or third person, that property shall be deposited in one or more identifiable interest bearing trust accounts in accordance with Rule 1.15(f). Under Rule 1.15(f), the trust account must be located at an "eligible institution", which basically means the financial institution must be federally regulated and authorized by the federal government or state law to do business in North Dakota. Rule 1.15(k) provides that an eligible financial institution must be approved by the North Dakota Disciplinary Board. The financial institution must file an agreement with the Disciplinary Board to report to the Disciplinary Board when any instrument is presented against the lawyer trust account containing insufficient funds. Further, interest bearing funds need to be deposited in an account from which the lawyer or law firm can withdraw funds without delay so prompt payment can be made to the client.

Rule 1.15(f) identifies three different types of trust accounts: (1) a pooled trust account for depositing funds of multiple clients without sub accounting, and the interest going to the North Dakota Bar Foundation (commonly referred to as an IOLTA account); (2) a pooled interest account having multiple client funds with sub accounting and interest going to each individual client as earned on the individual funds deposited; and (3) a trust account for a single client with interest going to the client. Rule 1.15(f) requires that funds, which are nominal in amount or which will be held for a short period of time, be deposited in a "pooled" interest bearing trust account. Rule 1.15(f)(1). The interest on these accounts is captured for the Bar Foundation by the IOLTA process. When a client's funds are large enough, or the funds will be held in an account long enough to earn a fair amount of interest, the lawyer needs to create an individual client trust account or use a pooled trust account with sub accounting. The individual client trust account can also be used when the client requests it, or other circumstances make it the best way to deal with client funds.

Rule 1.15(f)(3) indentifies three factors that the lawyer should consider in determining which of the three trust accounts the lawyer should use for a client's funds. They are: (1) the amount of interest expected to be earned during the period the funds remain deposited; (2) the cost of establishing and administering the account; and (3) the capability of the financial institution to pay interest on an individual account or pooled account with sub accounting. Comment [1] to Rule 1.15 indicates that a lawyer should use "sound judgment" in making this determination. However, if a client directs that funds be deposited in a separate account for the client, the lawyer should obey that directive and deposit the funds in a separate interest bearing client trust account, as long as the lawyer can do so and still comply with the requirements of Rule 1.15.

Once the lawyer receives client funds, or funds to which the client and lawyer have a claim, the funds must be deposited promptly in one of the three types of client trust accounts. The lawyer must then promptly notify the client about receipt of the funds, and promptly deliver the client's share of the funds to the client. Rule 1.15(d). The lawyer must also provide a full accounting to the client upon the client's request. Id.

DISCUSSION OF THE QUESTION POSED

There does not appear to be anything in the North Dakota Rules of Professional Conduct, in North Dakota Ethics Opinions, or in North Dakota Supreme Court disciplinary decisions, which specifically prohibit the daily bank sweep practice proposed by the requesting lawyer. Bank sweeps are an accepted banking practice with a high degree of security and accountability. FDIC has specific rules related to the practice and whether the funds are federally insured. The requesting lawyer's client has specifically asked the lawyer to open a separate trust account to receive the client's funds. Assuming this account is established at a financial institution approved by the Disciplinary Board, the financial institution signs an agreement with the Disciplinary Board, and the account pays interest, there is nothing ethically improper about establishing a separate client trust account for the collection client. Any interest earned in the account would belong to the client. Rule 1.15(d) requires that upon receipt of client funds, the lawyer should promptly notify the client and deliver the client's share of those funds to the client. A bank sweep process accomplishes this Rule 1.15(d) directive as promptly as banking procedures allow. The lawyer must also make a full accounting of the fund deposits and transfers. Current banking practices provide a full accounting for funds received and withdrawn. And, with electronic banking, the client can be promptly informed that a deposit of funds into the account has occurred and the bank has transferred those funds to the client and lawyer. (This statement assumes the client has consented to the bank's electronic notification to be an acceptable notification by the attorney of receipt and disbursement of client funds.) The lawyer can keep these records on file for the requisite period of time required by Rule 1.15.

There is, however, a major issue that could occur with a bank sweep. Under the requesting lawyer's current banking practice for this collection client, the lawyer waits three to five days for the funds to clear the bank before the transfer of the funds to the client occurs. This obviates the possibility of an overdraft, which the financial institution would have to report to the Disciplinary Board. But, by the requesting lawyer's own admission, there is a possibility that an overdraft could occur with a daily bank sweep. If the attorney is also entitled to some of the funds in the account, or the daily sweep pulls all or most of the funds from the account, an overdraft could occur, which would be unethical trust fund conduct. If this were not the case, Wisconsin would not have seen it necessary to make special provisions in its Rule 1.15 allowing collection attorneys to withdraw funds from a special debt collection trust account before the funds clear. North Dakota does not have such a rule. Unless Rule 1.15 is amended to allow the practice of withdrawing funds from the account before the funds have cleared, this would be an ethical violation. However, if the bank, client and lawyer can agree to modify the bank sweep in such a manner that only those funds of a certain age are swept out of the account, there would not be a possibility of an overdraft. There may be another way to accomplish this with client consent, such as leaving enough client money in the account to cover any possible overdraft. The lawyer, however, could not put his or her own funds into the account to avoid the overdraft. Under Rule 1.15(b), a lawyer can deposit some of the lawyer's own funds into a client trust account "only for the purpose of paying bank service charges, fees associated with credit card payments, or wire transfers related to the account, but only in amount necessary for that purpose." It would, therefore, appear to be unethical for a lawyer to deposit enough funds in the account to cover the overdraft amount and charges. Thus, to be an ethical practice, the client would have to agree to a bank sweep process that removes only funds that have cleared the bank or agree to keep enough of the client's money in the debt collection client's individual trust account equal to an amount that would not cause an overdraft when the account is swept daily.

CONCLUSION

A lawyer representing a client in a debt collection law practice can establish a separate interest bearing trust account for a debt collection client. The lawyer can honor the client's request for a daily sweep of the trust account, as long as the sweep occurs only after the deposited funds have cleared or another process is set up with the client's consent to remove the possibility of an overdraft on the account. The process must also comply with the other requirements of Rule 1.15.

This opinion was drafted by Alvin O. Boucher and approved by the Ethics Committee on January 11, 2012

Dann E. Greenwood, Chair