

THE DISCIPLINARY BOARD OF THE
SUPREME COURT OF PENNSYLVANIA

[204 PA. CODE]

Amendments to the Pennsylvania Rules of Professional Conduct
and the Pennsylvania Rules of Disciplinary Enforcement
Relating to Safekeeping Property and
Funds of Clients and Third Persons - Mandatory Overdraft Notification

Notice of Proposed Rulemaking

Notice is hereby given that The Disciplinary Board of the Supreme Court of Pennsylvania is considering recommending to the Pennsylvania Supreme Court that it amend the Pennsylvania Rules of Professional Conduct, as set forth in Annex A, and the Pennsylvania Rules of Disciplinary Enforcement, as set forth in Annex B. The amendments to Rules 1.15 and 221 include definitions which are intended to make them consistent with the Regulations of the IOLTA Board. Rule 1.15 also provides that all Fiduciary Funds shall be invested in a Trust Account or in another investment which satisfies the requirements of the Prudent Investor Rule as set forth in the Pennsylvania Probate, Estates and Fiduciaries Code and this Rule.

Interested persons are invited to submit written comments regarding the proposed amendments to the Office of the Secretary, The Disciplinary Board of the Supreme Court of Pennsylvania, First Floor, Two Lemoyne Drive, Lemoyne, PA 17043, on or before July 3, 2006.

By: The Disciplinary Board of the
Supreme Court of Pennsylvania

Elaine M. Bixler
Secretary of the Board

Note: Material to be added is underlined.
Material to be deleted is bracketed.

Rule 1.15 Safekeeping Property

(a) The following definitions are applicable to Rule 1.15:

(1) Eligible Institution. An Eligible Institution is a bank, bank and trust company, trust company, credit union, savings bank, savings and loan association or foreign banking corporation authorized by federal or state law to do business in the Commonwealth of Pennsylvania, the deposits of which are insured by an agency of the federal government, or is an open end investment company registered with the Securities and Exchange Commission authorized by federal or state law to do business in the Commonwealth of Pennsylvania.

(2) Fiduciary. A fiduciary is a lawyer acting as a personal representative, guardian, conservator, receiver, trustee, or other position requiring the lawyer to safeguard the property of another.

(3) Fiduciary Funds. Fiduciary Funds are Rule 1.15 Funds which the lawyer holds as a fiduciary.

(4) IOLTA Account. An IOLTA Account is a Trust Account, as defined by the Pennsylvania Interest on Lawyers Trust Account Board, at an Eligible Institution from which funds may be withdrawn upon request as soon as permitted by law. Only Qualified Funds are to be held or deposited in an IOLTA Account. An IOLTA Account must be interest or dividend bearing unless an exemption is granted by the IOLTA Board.

(5) IOLTA Board. The IOLTA Board is the Pennsylvania Interest on Lawyers Trust Account Board.

(6) Non-IOLTA Account. A Non-IOLTA Account is a Trust Account which is an interest or dividend bearing account from which funds may be withdrawn upon request as soon as permitted by law at an Eligible Institution in which a lawyer deposits Rule 1.15 Funds. Only Nonqualified Funds are to be held or deposited in a Non-IOLTA Account. A Non-IOLTA Account shall be established only as: (i) a separate client Trust Account for the particular client or matter on which the net interest or dividend will be paid to the client or third person, or (ii) a pooled client Trust Account with sub-accounting by the Eligible Institution or by the lawyer, which will provide for computation of net interest or dividend earned by each client or third person's funds and the payment thereof to the client or third person.

(7) Nonqualified Funds. Nonqualified Funds are Rule 1.15 Funds, whether cash, check, money order or other negotiable instrument which are not Qualified Funds.

(8) Qualified Funds. Qualified Funds are Rule 1.15 funds which are nominal in amount or are reasonably expected to be held for such a short period of time that sufficient interest income will not be generated to justify the expense of administering a segregated account.

(9) Rule 1.15 Funds. Rule 1.15 Funds are funds which the lawyer receives in connection with a client-lawyer relationship, funds which the lawyer receives under circumstances described in Rule 5.7(a), (b), or (c), and funds which the lawyer receives in any other fiduciary capacity.

(10) Trust Account. A Trust Account is an account in an Eligible Institution, as that term is defined in Rule 221 of the Pennsylvania Rules of Disciplinary Enforcement, in which a lawyer holds Rule 1.15 Funds. A Trust Account must be maintained either as an IOLTA Account or as a Non-IOLTA Account.

[(a)] (b) A lawyer shall hold all Rule 1.15 Funds and all other property of clients or third persons that [is] are in a lawyer's possession in connection with a client-lawyer relationship or in a fiduciary capacity separate from the lawyer's own property. Such property shall be identified and appropriately safeguarded. Complete records of the receipt, maintenance and disposition of such property shall be preserved for a period of five years after termination of the client-lawyer relationship or after distribution or disposition of the property, whichever is later.

[(b)] (c) Upon receiving Rule 1.15 Funds or any other property of a client or third person in connection with a client-lawyer relationship or in a fiduciary capacity, a lawyer shall promptly notify the client or third person. Upon receiving Fiduciary Funds or any other property in a fiduciary capacity, a lawyer shall promptly comply with applicable requirements of the Pennsylvania Probate Estate and Fiduciaries Code, the Pennsylvania Supreme Court Orphans' Court Rules, and applicable Orphans' Court Rules of the county which has jurisdiction of the matter.

(d) Except as stated in this Rule or otherwise permitted by law or by agreement with the client or third person, a lawyer shall promptly deliver to the client or third person any property, including but not limited to Rule 1.15 Funds, that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding [such] the property, including Rule 1.15 Funds.

(e) A lawyer shall maintain the following books and records for each Trust Account:

(i) bank statements and check registers (which shall include the payee, date, amount and the client matter involved);

(ii) all transaction records provided to a lawyer by the Eligible Institution, such as canceled checks and records of electronic transactions;

(iii) records of deposits and a ledger separately listing each deposited item and the client or third person for whom the deposit is being made.

The records required by this Rule may be maintained in electronic or other form if they can be retrieved in printed hard copy. Electronic records must be regularly backed up by an appropriate storage device.

[(c)] (f) [When in connection with a client-lawyer relationship a lawyer is in possession of] When in possession of Rule 1.15 Funds or property in which two or more persons, one of whom may be the lawyer, claim an interest, the property shall be kept separate by the lawyer until the dispute is resolved. The lawyer shall promptly distribute all portions of the property, including Rule 1.15 Funds, as to which the interests are not in dispute.

[(d) In those parts of this Rule dealing with funds of clients or third persons which the lawyer receives in connection with a client-lawyer relationship, excluding funds which the lawyer receives while acting as fiduciary for an estate, trust, guardianship or conservatorship, the following definitions are applicable:

(1) Trust Account means an interest-bearing account in a financial institution, as defined in Rule of Disciplinary Enforcement 221, in which the lawyer deposits such funds.

(2) Qualified Funds means such funds when they are nominal in amount or are reasonably expected to be held for such a short period of time that sufficient interest income will not be generated to justify the expense of administering a segregated account.

(3) Nonqualified Funds means all other such funds.

(4) An Interest on Lawyer Trust Account (IOLTA Account) is an unsegregated interest bearing Trust Account with a financial institution for the deposit of Qualified Funds by a lawyer.

(5) The IOLTA Board means the Pennsylvania Interest on Lawyers Trust Account Board.]

[(e)] (g) The responsibility for identifying an account as a Trust Account shall be that of the lawyer in whose name the account is held. [A lawyer shall not deposit the lawyer's own funds in a Trust Account except for the sole purpose of paying bank services charges on that account, and only in an amount necessary for that purpose. A lawyer shall deposit into a Trust Account legal fees and expenses that have been paid in advance, to be withdrawn by the lawyer only as fees are earned or expenses incurred, unless the client gives informed consent, confirmed in writing, to the handling of fees and expenses in a different manner.] At all times while a lawyer holds [funds of a client or third person in connection with a client-lawyer relationship,] Rule 1.15 Funds the lawyer shall also maintain another account that is not used to hold such funds.

(h) A lawyer shall not deposit the lawyer's own funds in a Trust Account except for the sole purpose of paying bank services charges on that account, and only in an amount necessary for that purpose.

(i) A lawyer shall deposit into a Trust Account legal fees and expenses that have been paid in advance, to be withdrawn by the lawyer only as fees are earned or expenses incurred, unless the client gives informed consent, confirmed in writing, to the handling of fees and expenses in a different manner.

[(f)] (j) All Nonqualified Funds which are not Fiduciary Funds shall be placed in a Trust Account or in another investment vehicle specifically agreed upon by the lawyer and the client or third person which owns the funds.

(k) All Fiduciary Funds shall be invested in a Trust Account or in another investment which satisfies the requirements of the Prudent Investor Rule as set forth in the Pennsylvania Probate, Estates and Fiduciaries Code and this Rule.

[(g)] (l) All Qualified Funds shall be placed in an IOLTA Account. [The rate of interest payable on an IOLTA Account shall not be less than the highest rate or dividend generally available from the financial institution to its non-IOLTA Account customers when the IOLTA Account meets or exceeds the same minimum balance and other account eligibility qualifications applicable to those other accounts. In no event shall the rate of interest payable on an IOLTA Account be less than the rate paid by the financial institution on negotiable order of withdrawal accounts or super negotiable order of withdrawal accounts.] An account shall not be considered an IOLTA Account unless the financial institution at which the account is maintained shall:

(1) Remit at least quarterly any interest earned on the account to the IOLTA Board.

(2) Transmit to the IOLTA Board with each remittance and to the lawyer who maintains the IOLTA Account a statement showing at least the name of the account, service charges or fees deducted, if any, the amount of interest remitted from the account and the average daily balance, if available.

(m) The rate of interest or dividend payable on an IOLTA Account must be no less than the highest interest rate or dividend generally available from the Eligible Institution to its non-IOLTA customers when the IOLTA Account meets the same minimum balance or other eligibility qualifications. Interest or dividends and fees on the account shall be calculated in accordance with the Eligible Institution's standard practice, but Eligible Institutions may elect to pay a higher interest or dividend rate and may elect to waive any and all fees on IOLTA accounts.

[(h)] (n) **[A lawyer shall be exempt from the requirement that all Qualified Funds be placed in an IOLTA Account only upon exemption requested and granted by the IOLTA Board.]** A lawyer shall be exempt from the requirement that a Trust Account be income producing only upon exemption requested and granted by the IOLTA Board. If an exemption is granted, the lawyer must hold Rule 1.15 Funds,

including Qualified Funds, in a Trust Account. Exemptions shall be granted if: (1) the nature of the lawyer's practice does not require the routine maintenance of a Trust Account in Pennsylvania; (2) compliance with this paragraph would work an undue hardship on the lawyer or would be extremely impractical, based either on the geographical distance between the lawyer's principal office and the closest **[financial institution] Eligible Institution** or on other compelling and necessitous factors; or (3) the lawyer's historical annual Trust Account experience, based on information from the **[financial [institution] Eligible Institution]** in which the lawyer deposits funds, demonstrates the service charges on the account would significantly and routinely exceed any**[interest] income** generated.

[(i)] (o) A lawyer shall not be liable in damages or held to have breached any fiduciary duty or responsibility because monies are deposited in an IOLTA Account pursuant to the lawyer's judgment in good faith that the monies deposited were Qualified Funds.

[(j)] (p) There is hereby created the Pennsylvania Interest on Lawyers Trust Account Board (herein called the IOLTA Board), which shall administer the IOLTA program. The IOLTA Board shall consist of nine members who shall be appointed by the Supreme Court. Two of the appointments shall be made from a list provided to the Supreme Court by the Pennsylvania Bar Association in accordance with its own rules and regulations. With respect to these two appointments, the Pennsylvania Bar Association shall submit three names to the Supreme Court, from which the Court shall make its final selections. The term of each member shall be three years and no member shall be appointed for more than two consecutive three-year terms. The Supreme Court shall appoint a Chairperson. In order to administer the IOLTA program, the IOLTA Board shall promulgate rules and regulations consistent with this Rule for approval by the Supreme Court. Additionally, upon approval of the Supreme Court, the IOLTA Board shall distribute and/or expend IOLTA funds for the purposes set forth in this Rule. The IOLTA Board shall comply with the following:

(1) The IOLTA Board shall prepare an annual audited statement of its financial affairs.

(2) Disbursement and allocation of IOLTA Funds shall be subject to the prior approval of the Supreme Court. The IOLTA Board shall submit to the Supreme Court for its approval a copy of its audited statement of financial affairs, clearly setting forth in detail all funds previously approved for disbursement under the IOLTA program. Additionally, a copy of the IOLTA Board's proposed annual budget shall be provided to the Court, designating the uses to which IOLTA Funds are recommended.

[(k)] (q) Interest earned on IOLTA Accounts (IOLTA Funds) may be used only for the following purposes:

(1) delivery of civil legal assistance to the poor and disadvantaged in Pennsylvania by non-profit corporations described in section 501(c)(3) of the Internal Revenue Code of 1986, as amended;

(2) educational legal clinical programs and internships administered by law schools located in Pennsylvania;

(3) administration and development of the IOLTA program in Pennsylvania; and

(4) the administration of justice in Pennsylvania.

[(I)] (r) The IOLTA Board shall hold the beneficial interest in IOLTA Funds. Monies received in the IOLTA program are not state or federal funds and are not subject to Article VI of the act of April 9, 1929 (P.L. 177, No. 175) known as The Administrative Code of 1929, or the act of June 29, 1976 (P.L. 469, No. 117).

Comment:

[1] A lawyer should hold property of others with the care required of a professional fiduciary. The obligations of a lawyer under this Rule apply when the lawyer has come into possession of property of clients or third persons because the lawyer is acting or has acted as a lawyer in a client-lawyer relationship **[with some person.]** or because the lawyer is acting in a fiduciary capacity. Securities should be kept in a safe deposit box, except when some other form of safekeeping is warranted by special circumstances. All property which 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]** Rule 1.15 Funds, in one or more Trust Accounts. The responsibility for identifying an account as a Trust Account shall be that of the lawyer in whose name the account is held. Whenever a lawyer holds **[funds of a client or third person,]** Rule 1.15 Funds, the lawyer must maintain at least two accounts: one in which those funds are held and another in which the lawyer's own funds may be held. A lawyer should maintain on a current basis books and records in accordance with sound **[accounting]** bookkeeping practices consistently applied and comply with any recordkeeping rules established by law or court order.

[[2] The following books and records shall be maintained for each Trust Account:

(i) **bank statements and check registers (which shall include the payee, date, amount and the client matter involved);**

(ii) **all transaction records returned by the financial institution, including canceled checks in whatever form and records of electronic transactions;**

(iii) **records of deposits and a ledger separately listing each deposited item and the client or third person for whom the deposit is being made.**

[3] The records required by this Rule may be maintained in electronic or other form if they can be retrieved in printed hard copy. Electronic records must be regularly backed up by an appropriate storage device.]

[4] [2] While normally it is impermissible to commingle the lawyer's own funds with client funds, paragraph [(e)](h) provides that it is permissible when necessary to pay [bank] service charges on that account. Accurate records must be kept regarding that part of the funds which are the lawyer's.

[5] [3] Lawyers often receive funds from which the lawyer's fee will be paid. The lawyer is not required to remit to the client funds that the lawyer reasonably believes represent fees owed. However, a lawyer may not hold funds to coerce a client into accepting the lawyer's contention. The undisputed portion of the funds shall be promptly distributed. The disputed portion of the funds must be kept in a Trust Account and the lawyer should suggest means for prompt resolution of the dispute, such as arbitration. The undisputed portion of the funds shall be promptly distributed.

[6] [4] [Paragraph (c) also recognizes that t]Third parties may have lawful claims against specific funds or other property in a lawyer's custody such as a client's creditor who has a lien on funds recovered in a personal injury action. A lawyer may have a duty under applicable law to protect such third-party claims against wrongful interference by the client. In such cases, when the third party claim is not frivolous under applicable law, the lawyer must refuse to surrender the property to the client unless the claims are resolved. A lawyer should not unilaterally assume to arbitrate a dispute between the client and the third party. When there are substantial grounds for dispute as to the person entitled to the funds, the lawyer may file an action to have a court resolve the dispute.

[7] [5] Other applicable law may impose pertinent obligations upon a lawyer independent of **[any] and in addition to the** obligations arising from this Rule. For example, a lawyer who serves only as an escrow agent is governed by the law relating to fiduciaries even though the lawyer does not render legal service in the transaction **[and is not governed by this Rule.]** A lawyer who receives funds while serving as **[an executor or trustee] a fiduciary** remains subject to the formal accounting procedures and other **[supervision of the Orphans Court; when such funds are nominal in amount or reasonably expected to be held for such a short period of time that sufficient interest will not be generated to justify maintaining a segregated account; such funds]** requirements of the Pennsylvania Probate Estates and Fiduciaries Code and applicable Orphans' Court Rules. When the lawyer reasonably expects that the funds cannot earn income for the client or third person in excess of the cost incurred to secure such income while the funds are held, the lawyer may, in the discretion of the lawyer, [be deposited] deposit the funds into the IOLTA account of the lawyer. [even though such deposit is not required.] Without limitation, a lawyer may also have obligations with respect to funds held under the Social Security Act and the Real Estate Licensure Act.

[8] [6] A lawyer must participate in the Pennsylvania Lawyers Fund for Client Security. It is a means through the collective efforts of the bar to reimburse persons who have lost money or property as a result of dishonest conduct of a lawyer.

[9] [7] [Paragraphs (g) through (l) provide] Rule 1.15 provides, *inter alia*, for the Interest on Lawyer Trust Account (IOLTA) program, and the definitions in

[paragraph (d)] the Rule distinguish two types of funds of clients and third persons held by a lawyer: Qualified Funds, which must be placed in an IOLTA account, and Nonqualified Funds, which are to be placed in an interest or dividend bearing account unless the client or third person specifically agrees to another investment vehicle for the benefit of the client or third person. All Nonqualified Funds must be held or invested in accordance with all provisions of applicable law pertaining to those funds. For example, funds which the lawyer holds as a fiduciary must be deposited or invested in accordance with the relevant provisions of the Pennsylvania Probate, Estates, and Fiduciaries Code. There are further instructions in Rules 219 and 221 of the Pennsylvania Rules of Disciplinary Enforcement and in the Regulations of the Interest on Lawyers Trust Account Board, 204 Pa. Code, §81.01 et seq., which are referred to as the IOLTA Regulations.

Annex B

Rule 221. Funds of clients and third persons. Mandatory overdraft notification.

(a) For purposes of this rule[.]:

(1) Trust Account. A Trust Account **[of an attorney]** is an account in an Eligible Institution in which an attorney**[, in accordance with Rule 1.15 of the Pennsylvania Rules of Professional Conduct, deposits funds]** holds Rule 1.15 Funds **[received from a client or a third person in connection with a client-lawyer relationship, excluding funds which the attorney receives while acting as fiduciary for an estate, trust, guardianship or conservatorship.]** A Trust Account must be maintained either as an IOLTA Account or as a Non-IOLTA Account.

(2) Eligible Institution. An Eligible Institution is a bank, bank and trust company, trust company, credit union, savings bank, savings and loan association or foreign banking corporation authorized by federal or state law to do business in the Commonwealth of Pennsylvania, the deposits of which are insured by an agency of the federal government, or is an open end investment company registered with the Securities and Exchange Commission authorized by federal or state law to do business in the Commonwealth of Pennsylvania.

(3) Rule 1.15 Funds. Rule 1.15 Funds are funds which the lawyer receives in connection with a client-lawyer relationship, funds which the lawyer receives under circumstances described in Rule of Professional Conduct 5.7(a), (b), or (c), and funds which the lawyer receives in a fiduciary capacity. Rule 1.15 Funds include funds received as an escrow agent or as a settlement agent.

(b) An attorney shall maintain a Trust Account with respect to his/her practice in this Commonwealth only in **[a financial institution]** an Eligible Institution approved by the Supreme Court of Pennsylvania for the maintenance of such accounts. Subject to the provisions set forth herein, the Disciplinary Board shall establish regulations governing approval and termination of approval for **[financial institutions]** Eligible Institutions, shall make appropriate recommendations to the Supreme Court of Pennsylvania concerning approval and termination, and shall periodically publish a list of approved financial institutions.

[(f)] (c) The responsibility for identifying an account as a Trust Account shall be that of the attorney in whose name the account is held.

[(g)] (d) **[The]** An attorney shall maintain the following books and records [shall be maintained] for each Trust Account:

[(1)] bank statements and check registers (which shall include the

payee, date, amount and the client matter involved);

(2) all transaction records returned by the financial institution, including canceled checks in whatever form and records of electronic transactions;]

(1) periodic bank or financial statements and all transaction records provided to the attorney by the Eligible Institution, such as canceled checks and records of electronic transactions;

(2) check registers or separately maintained ledger (which shall include the payee, date and amount of each check, withdrawal and transfer and the matter involved); and

(3) records of deposits and a ledger separately listing each deposited item **[and]** the client or third person for whom the deposit is being made, and the source of each deposited item.

[(h)] (e) The records required by this Rule may be maintained in electronic or other form if they can be retrieved in printed hard copy. Electronic records must be regularly backed up by an appropriate storage device.

[(i)] (f) The records required by this rule may be subject to subpoena and must be produced in connection with an investigation or hearing pursuant to these rules. Failure to produce such records may result in the initiation of proceedings pursuant to Rule 208(f) (relating to emergency temporary suspension orders and related relief), which permits disciplinary counsel to commence a proceeding for the temporary suspension of a respondent-attorney who refuses to comply with a valid subpoena.

[(c)] (g) [A financial institution] An Eligible Institution shall be approved as a depository for Trust Accounts of attorneys if it shall be in compliance with applicable provisions of Rule 1.15 of the Pennsylvania Rules of Professional Conduct and the Regulations of the IOLTA Board and shall file with the Disciplinary Board an agreement (in a form provided by the Board) to make a prompt report to the Lawyers Fund for Client Security Board whenever any check or similar instrument is presented against a Trust Account when such account contains insufficient funds to pay the instrument, regardless of

(1) whether the instrument is honored, or

(2) whether funds are subsequently deposited that cover the overdraft or the dishonored instrument is made good.

(h) For purposes of this rule:

(1) **[(d) For purposes of this rule, a]** A Trust Account shall not be deemed to contain insufficient funds to pay a check or similar instrument solely because it contains insufficient collected funds to pay the

instrument, and no report shall be required in the case of an instrument presented against uncollected or partially uncollected funds. This provision shall not be deemed an endorsement of the practice of drawing checks against uncollected funds.

(2) [(j) For purposes of this rule, funds] Funds deposited in an account prior to the close of business on the calendar date of presentation of an instrument shall be considered to be in the account at the close of business on that date notwithstanding the **[financial institution's]** treatment of such funds by the Eligible Institution, for other purposes, as being received at the opening of the next banking day pursuant to 13 Pa.C.S. §4108(b) (relating to items or deposits received after cutoff hour).

(3) [(k) For purposes of this rule, a] A check or draft against a Trust Account shall be deemed to be presented at the close of business on the date of presentation.

[(l)] (i) No report need be made when the **[financial institution]** Eligible Institution determines that the instrument presented against insufficient funds had been issued in reliance on a deposited instrument that was ultimately dishonored. This provision shall not be deemed an endorsement of the practice of drawing checks against uncollected funds.

[(m)] (j) A failure on the part of **[a financial institution]** an Eligible Institution to make a report called for by this rule may be cause for termination of approval by the Supreme Court, but such failure shall not, absent gross negligence, give rise to a cause of action, by any person who is proximately caused harm thereby.

[(n)] (k) **[Financial institutions]** Eligible Institutions shall be immune from suit for the filing of any reports required by this rule or believed in good faith to be required by this rule.

[(o)] (l) **[A financial institution]** An Eligible Institution shall be free to impose a reasonable service charge upon the attorney in whose name the account is held for the filing of the report required by this rule.

[(p)] (m) A report filed pursuant to this rule shall not, in and of itself, be considered a disciplinary complaint.

[(q)] (n) A designated representative of the Lawyers Fund for Client Security Board shall conduct a preliminary inquiry and shall, where appropriate, refer the matter to the Office of Disciplinary Counsel for further investigation. Neither a report filed with the Lawyers Fund for Client Security Board pursuant to this rule nor a referral of such report to the Office of Disciplinary Counsel shall, in and of itself, be considered a disciplinary complaint.

[(r)] (o) Reports required to be made under this rule shall be made to the Lawyers Fund for Client Security Board within five business days of the presentation of the instrument.