Guidance for Attorneys: IOLTA Account or Separate Account?

Arizona Supreme Court Rule 43 requires attorneys to place client funds in a trust account, with placement of nominal sums or funds held for a short period of time in an IOLTA account. The rule states that an attorney shall take into consideration the following factors when determining whether to deposit clients’ funds into an IOLTA account or to open a separate trust account:

A. “The amount of interest or dividends which the funds would reasonably be expected to earn during the period they are to be deposited or invested;
B. The cost of establishing and administering the account, including the cost of the lawyer’s services; and
C. The capability of financial institutions or investment companies reasonably available for deposit or investment of client funds to calculate and pay interest or dividends to individual clients.”

The rule goes on to state, “No disciplinary matter shall be pursued by the state bar against any lawyer or law firm solely by reason of the making of a good faith determination of the appropriate account in which to deposit or invest client funds.”

The Mechanics of IOLTA

The Arizona Foundation for Legal Services & Education offers the following guidance for making a good faith determination of whether the amount of interest an account will generate will justify the cost of opening and maintaining the account for the client. If the attorney can earn net interest for the client, the attorney must do so.

In deciding what benchmark amount of interest a separate client trust account must earn to generate net interest, the attorney should consider all costs associated with such an account.

These costs will be either directly or indirectly passed on to the client, so the client’s separate account must earn enough to justify its existence. Several cost factors to consider in this determination include:

Internal costs:
1. the expenses of the attorney’s or law firm’s staff time in establishing a separate account;
2. the preparation and filing of tax forms (e.g. IRS 1099 forms);
3. the bookkeeping and accounting expenses for tracking the account;
4. the monthly reconciliation of the account for the client;
5. closing the account and remitting the funds to the client

External costs:
1. the minimum balance requirement at the bank at which the account is placed;
2. the expense of ordering pre-numbered checks;
3. the service charges, if any, assessed against the account by the bank;
4. other additional fees that the bank may have for investment policies
After an approximation of these costs has been made, this amount becomes the benchmark amount of interest. If a particular client’s funds do not earn that benchmark figure, than the money should not be placed in a separate account for the client. If the funds cannot generate the benchmark figure, then the account will cost more in expenses than it will generate in interest income, so the funds should be placed in the IOLTA account. Such client funds are ones that are “nominal” or held for a “short period of time.” If the client’s funds can earn the benchmark figure or more, then the funds must be invested separately for the client. Several examples of applications of this benchmark figure follow:

1. A small firm or solo practitioner with relatively low overhead expenses may determine that an $80 figure is a reasonable approximation of the internal and external costs associated with setting up and maintaining a separate interest bearing account for the client.

   Suppose a $15,000 check that is to be held for six months is received on behalf of a client. If this money were placed in an account bearing 1.5 percent interest, it would earn $110.96

   Formula: $15,000 x 1.5% (average rate paid on NOW accounts at this time) divided by 365 x 180 days (time of deposit) = $110.96

   This would justify a separate client account. But, if this same check were to be held for only two weeks, a separate account should not be set up because it would earn only $8.63.

2. A medium-sized firm may determine that a $120 figure is a reasonable approximation of the internal and external costs associated with setting up and maintaining a separate interest bearing account for the client.

   Suppose an $80,000 check that is to be held for two months is received on behalf of a client. A separate account should be set up because more than $197.26 in interest would be earned. But, if this same check were to be held for one week, the funds should be deposited in the IOLTA account since only $23.01 interest would be earned.

3. A large firm may determine that a $160 figure is a reasonable approximation of the internal and external costs associated with setting up and maintaining a separate interest bearing account for the client.

   Suppose a $150,000 check that is to be held for six weeks is received on behalf of a client. A separate account should be set up because $258.90 would be earned. However, if this same amount were to be held for one week, it should be placed in the IOLTA account since only $43.15 in interest would be earned.

   An attorney or firm must periodically adjust their benchmark amount of interest figure to accurately reflect changing costs in the determinative factors and the interest rate. As the examples illustrate, it is not just the amount of the client’s funds that is decisive. A combination of the size of the funds, the duration that the funds will be held, and the current interest rate must be used to determine which client trust funds are to be deposited in the IOLTA account and which client trust funds are to be deposited in an account for the individual client.
The following table provides another answer to the practical question of what is “nominal in amount” or expected to be held for a “short period of time.” For illustration, the table assumes that $100 is a reasonable estimate of the minimum amount of interest that a segregated trust account for an individual client must generate to be practical in light of the costs involved in earning or accounting for any such income.

<table>
<thead>
<tr>
<th>Principal Deposit</th>
<th>Number of days required to generate $100 of interest at 1.5% compounded daily</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1,000</td>
<td>2500 days</td>
</tr>
<tr>
<td>$3,000</td>
<td>811 days</td>
</tr>
<tr>
<td>$5,000</td>
<td>487 days</td>
</tr>
<tr>
<td>$10,000</td>
<td>243 days</td>
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<tr>
<td>$20,000</td>
<td>122 days</td>
</tr>
<tr>
<td>$40,000</td>
<td>61 days</td>
</tr>
<tr>
<td>$75,000</td>
<td>32 days</td>
</tr>
<tr>
<td>$100,000</td>
<td>24 days</td>
</tr>
</tbody>
</table>

These examples are given as guidance. Attorneys and firms should ensure that they perform their own calculations using the relevant numbers. The bank interest rate and the benchmark amount of interest for each individual attorney or firm must be used for actual calculations.

For IOLTA questions, please contact Kay Lapid, IOLTA Administrator at the Arizona Foundation for Legal Services & Education at 602-340-7260, or Kay.Lapid@azflse.org.

Additional Resources:

LOMAP

The State Bar of Arizona’s Law Office Assistance Program (LOMAP) provides confidential and individual management consulting services to the State Bar of Arizona members, including assistance with setting up trust accounts. Please contact Tracy Ward, Practice Management Advisor, at 602-340-7219 or tracy.ward@staff.azbar.org or Susan Traylor, Practice Management Advisor, at 602-340-7355, or susan.traylor@staff.azbar.org.

Ethics Hotline: For ethics questions, please call the Bar’s ethics hotline at 602-340-7284.