

**TRUST ACCOUNT Q AND A:
Keeping the N.C. State Bar off Your Back**

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The State Bar Hand Book, issued annually to each lawyer, has 34 questions and answers regarding trust accounts, which are set out below. The **Comment** following some of these answers are mine, and certainly should not be considered in any way an official (or even unofficial) comment or statement of the The State Bar. We have also attached to this manuscript a copy of the State Bar's Trust Account Handbook, which can also be downloaded from the State Bar web site. Specific questions should be addressed to the State Bar.

Remember that the rules governing lawyers' trust accounts exist not only for the protection of the public, but also for the protection of lawyers.

For purposes of this manuscript, the comments are slanted toward the types of practice for which the Academy of Trial Lawyers' members are engaged.

Finally, note that there are references to Appendices throughout the manuscript. Those appendices are found at the end of the Q and A section of the Lawyers' Handbook and are not reproduced here.

Trust Accounts - What Are They and How Many Do You Need ?

1. What is a trust account ?

A trust account is a bank account maintained incident to a lawyer's law practice in which the lawyer holds funds received in a fiduciary capacity on behalf of or belonging to a client. Rule 1.15-1(1).

Comment: The trust account is where you keep other people's money which has been entrusted to you. Eventually, you may become entitled to some of it for payment of fees or expenses, but until such time as you become entitled, it is not your money, nor is it a "bank" from which you can make loans to yourself.

2. Who must have a trust account ?

Any lawyer who receives funds in a fiduciary capacity in the context of his or her law practice must have access to or maintain a trust account. The lawyer must have access to or establish a trust account before receiving such funds. Rule 1.15-2(a), (b) and (c).

3. Are there restrictions concerning the kinds of institutions where trust accounts may be maintained ?

Yes. Trust accounts may only be maintained at federally or North Carolina chartered

banks, savings and loan associations, or credit unions. Unless the client specifically provides written direction to the contrary, the bank at which a trust account is maintained must be in North Carolina. With the written consent of the client, a trust account dedicated to only one client's funds (see Rule 1.15-1 (c)) may be maintained at a bank outside of North Carolina or at a financial institution other than a bank inside or outside of North Carolina. Rule 1.15-2(c).

A law firm with offices in North Carolina and another state may send a North Carolina client's funds to a firm office in another state for centralized processing without client consent provided the funds are promptly deposited in a trust account with a bank that has branch offices in North Carolina. Rule 1.15-3 Comment [3].

4. How many trust accounts does a lawyer need ?

Generally speaking, a lawyer needs only one trust account to handle monies received in trust which are either nominal in amount or held for a short period of time. Within this common account, the funds of many clients may be commingled so long as adequate records are kept to identify the funds of each client. Rule 1.15-2.

Comment: There are circumstances in which a lawyer may, or even should, have more than one trust account. These circumstances are discussed in more detail, below, and would typically be found in situations in which funds are to be kept for extended periods, requiring special arrangements.

5. Does each lawyer in a firm need a separate trust account ?

No. Each lawyer in a firm may ethically use a common account so long as adequate records are maintained. However, multiple accounts are permissible. A lawyer may personally maintain several trust accounts if he or she desires. Rule 1.15-2.

Comment: There are many lawyers in North Carolina who practice in a kind of office and expense sharing arrangement in which the letterhead appears to describe a law firm. This presentation does not attempt to offer advice about such arrangements, but if the arrangement bears all the earmarks of a law firm, it may be treated as such. Probably, a single trust account would be acceptable, but circumstances may be such that separate trust accounts are advisable.

May a Trust Account Bear Interest ?

6. What sort of bank account must be maintained ?

Since a lawyer has an ethical obligation to pay or deliver client funds promptly as instructed by the client, trust accounts are generally demand accounts check writing privileges. Because trust funds are typically nominal in amount or held for only a short period of time, there is no general requirement that the trust account be interest-bearing. Rule 1.15-2(m).

7. Does a lawyer ever have an obligation to maintain an interest-bearing trust account ?

Yes. If, because of the size of the deposit or the length of time the deposited funds are to be held, a prudent person acting in a fiduciary capacity would be expected to invest the funds, a lawyer receiving money under such circumstances would have a corresponding obligation to deposit the funds in an interest-bearing account. Such an account is called a "dedicated trust account." Rule 1.15-1(c). The dedicated trust account in which such funds are deposited should be separate from the lawyer's general trust account. Any interest generated would be the property of the client. Rule 1.15-2(p).

Comment: As we will see, later, some clients may deposit funds to be drawn upon for payment of fees and expenses. These are not "retainers," but are fee or cost deposits which the lawyer may not draw out until the fees are earned or the expenses are incurred. If the matter for which the deposit is made is expected to be held for a lengthy period of time, they may be placed in a dedicated trust account, but, in my opinion, any interest earned must inure to the benefit of the client, not the lawyer. The reason for this is that the fees or expenses are not due the lawyer until earned or incurred, so no interest would be due.

8. What sort of account should a lawyer serving as a personal representative maintain?

A lawyer who is serving as a trustee, guardian, attorney in fact, or personal representative should usually maintain a separate, specially denominated account called a "fiduciary account." Rule 1.15-1(c). Generally speaking, a fiduciary account should be interest-bearing since the deposited funds are generally held in trust for significant periods of time. Rule 1.15-2(c), (p).

9. Is it ever appropriate for a lawyer to use an interest-bearing trust account as his or her general trust account ?

Yes. Lawyers wishing to participate in the State Bar's IOLTA program may maintain a general trust funds in interest-bearing checking accounts. The interest earned on such accounts is remitted by the depository bank directly to the IOLTA Board of Trustees, which subsequently distributes the funds in the form of grants to persons or entities for various public purposes in accordance with the rules of the IOLTA program. Rules 1.15-2(p) and 1.15-4.

How Do You Label A Trust Account ?

10. How should a trust account be identified ?

A trust account must be clearly labeled and designated as a "trust account," and all checks drawn on the account must be so identified. For instance, an appropriate title for the account might be "The Trust Account of John Smith" or "Smith, Jones & Williams Trust Account." An example of a properly labeled trust account check is found in Appendix E.

Each account in which funds are held by a lawyer pursuant to the lawyer's service as a trustee, guardian, personal representative, attorney in fact or escrow agent must be appropriately labeled as a fiduciary account unless such funds are held in a trust account. Rule 1.15-1(c), (e), (h), (l).

What Goes in the Trust Account ?

11. How does a lawyer know what funds should be deposited in the trust account ?

The general rule is that every receipt of money from a client or for a client which will be used or delivered on the client's behalf should be placed in the trust account or a fiduciary account if the funds are received by a lawyer while serving as a professional fiduciary. This includes funds received by the lawyer as an escrow agent. Rule 1.15-2(b) and (c), and Comment following Rule 1.15-3.

12. What about funds received by the lawyer as a fiduciary outside the context of his or her law practice ?

The trust account rules are not applicable in cases where the lawyer handles money for a business, religious, civic or charitable organization as an officer, employee, or other official of that organization. The lawyer's only professional obligation regarding such funds is to deal honestly. Rule 1.15-3.

Comment: Remember that we're talking about *lawyers'* trust accounts.

13. What about funds received by a lawyer acting as a court-appointed fiduciary or pursuant to appointment in some specific trust instrument ?

A lawyer serving in such a fiduciary role must segregate fiduciary property from his or her personal property, maintain the minimum financial records required for a fiduciary account, and instruct any financial institution in which fiduciary property is held to notify the North Carolina State Bar of any negotiable instruments drawn on the account which are presented for payment against insufficient funds. Rules 1.15-1(e) and (f); Rule 1.15-2(c), (e), (f), (k); Rule 1.15-3.

Comment: It is my opinion that in such situations it might be advisable to establish a dedicated trust account for that matter, particularly since the fiduciary obligation might entail having the funds in an interest bearing account.

14. Is it appropriate to deposit items other than cash or cash equivalents in the trust account ?

Generally speaking, any negotiable instrument may be deposited in a trust account whether or not it represents collected funds. Unless specifically permitted by law, the Rules of Professional Conduct or definitive interpretations thereof, no withdrawal should be made with respect to any deposited item until the funds represented by that item are collected. Rules 1.15-1(l) and 1.15-2(g).

What Does Not Go In The Trust Account ?

15. May a lawyer deposit his or her own funds in a trust account ?

No funds belonging to the lawyer may be deposited in the trust account except such funds as are necessary to open or maintain the account, pay service charges, and funds belonging in part to a client and in part presently or potentially to the lawyer, such as where a deposited item represents both the client's recovery and the lawyer's fee. In such a case, the portion of the funds belonging to the lawyer must be withdrawn from the trust account as soon as the lawyer becomes entitled to the funds unless the right of the lawyer to receive that portion is disputed by the client, in which event the disputed portion must remain in the trust account until the dispute is resolved. Rule 1.15-2(f).

Comment: Most lawyers maintain both their general and trust accounts at the same bank. It is best to arrange for payment of any service charges (which may frequently be deducted by the bank, directly) out of the lawyer's general account so there will be less chance of insufficient funds if a bank debit temporarily lowers the account balance below that which is required to meet all of the obligations for payment.

16. Should retainers be deposited in the trust account ?

Strictly speaking, no. A retainer in its trustee sense is money paid to the lawyer to reserve the exclusive use of the lawyer's services for a particular time or in regard to a particular matter. Since a retainer is deemed earned when paid, it immediately becomes the property of the lawyer and as such must not be deposited in the trust account. True retainers must be distinguished from fees paid in advance which are intended to be held by the lawyer as security deposits against work which is yet to be performed. Since a lawyer has an ethical obligation to refund the unearned portion of any fee paid in advance upon discharge or withdrawal, such funds are not considered property of the lawyer and must be held in the trust account until they are earned. Rule 1.15-2(a); Comment following Rule 1.15-3; and Rule 1.16(d).

What Records Are Required ?

17. What are the minimum record keeping requirements for trust and fiduciary accounts maintained at a bank ?

Any attorney maintaining a trust account or a fiduciary account at a bank must keep the following records:

- ✓ A records of receipts. This can be a journal, file of receipts, file of deposit slips or collection of checkbook stubs. The record of receipts must list the source, client, and date of the receipt of all deposited funds. Rule 1.15-3(a)(1). Examples of properly composed deposit slips are appended as Appendix Items A and B (in the Lawyer's Handbook, not reproduced, here).

- ✓ All canceled instruments drawn on the account or printed digital images thereof. Rule 1.15-3(a)(2).
- ✓ All instructions or authorizations to transfer, disburse, or withdraw funds from the account. Rule 1.15-2(a)(3).
- ✓ All bank statements or documents received from the bank regarding the account. Rule 1.15-3(a)(4).
- ✓ For a general trust account, a ledger containing a record for each person or entity from whom or for whom funds were received which shall accurately maintain the current balance of funds held for that person or entity. Rule 1.15-3(a)(5). See Appendix C and D.
- ✓ All records pertaining to the quarterly reconciliations of the general trust account with the statements provided by the bank. Rule 1.15-3(c).

Comment: When a deposit is made, the deposit slip should separately identify each item deposited, **by client**. If possible, copies of the checks or other instruments being deposited with your copy of the deposit slip.

18. What are the minimum record keeping requirements for a dedicated trust account or a fiduciary account maintained at a financial institution other than a bank ?

- ✓ A record of all depository receipts or deposit slips for the account listing the source and date of receipt. Rule 1.15-3(b)(1).
- ✓ A copy of all canceled instruments drawn on the account or printed digital images of such instruments. Rule 1.15-3(b)(2).
- ✓ All instructions or authorizations to transfer, disburse, or withdraw funds from the account. Rule 1.15-3(b)(3).
- ✓ All statements or documents received from the financial institution regarding the account. Rule 1.15-3(b)(4).
- ✓ All records required by law. Rule 1.15-3(b)(5).

19. How does this work in practice ?

It can be very simple. For a trust account maintained at a bank, all that is really required is a checkbook, a ledger card for each client, and a file for correspondence from the bank. When properly maintained, all the information required for deposits and disbursements can be recorded on the checkbook stub. The only other record that must be generated by

the lawyer is a ledger card for each client describing each transaction involving the client's funds and carrying a running balance. Rule 1.15-3(a).

Comment: Even if you don't use a case management system with accounting, there are several excellent computer programs for both trust and general accounting. In fact, these programs will allow you to manage many separate accounts and will provide all of the above requirements, and more, with ease.

20. How long must these records be kept ?

A lawyer must retain trust account and fiduciary account records for a period of six years following the completion of the transactions which generated the records. Rule 1.15-3(f).

21. Can trust account and fiduciary account records be kept on computer ?

Yes, if the records are retrievable in hard copy or in digital form for the six-year period. Rule 1.15-3(f).

22. How often must the records for a general trust account be reconciled ?

A lawyer must reconcile the general trust account...exclusive of funds belonging to the lawyer, which have been properly deposited in the account. Rule 1.15-3(c). All records pertaining to the quarterly reconciliations must be retained for a period of six years. Rule 1.15-3(c). Examples of trust account reconciliation formats are attached as Appendix Items F and G

Comment: While the State Bar requires only quarterly reconciliation, it is, in my opinion, the better practice to reconcile the accounts monthly. This is especially true if your trust account has a lot of activity.

What Disbursements Are Appropriate ?

23. May a lawyer unilaterally decide to use funds held in trust to pay his or her legal fees or the claims of other creditors ?

As the client's agent and fiduciary, the lawyer has an obligation to pay or deliver the funds in accordance with the client's most recent instructions. Unless the lawyer is authorized by the client to pay a particular charge or claim, the lawyer may not disburse trust funds for those purposes. Rule 1.15-2(m).

24. What if the lawyer has an interest in funds received in settlement of a claim or in satisfaction of a judgment ?

All receipts of trust funds must be deposited into the trust account intact. If an instrument represents funds belong in part to the client and in part to the lawyer, the portion

belonging to the lawyer must be withdrawn when the lawyer becomes entitled to the funds unless the right of the lawyer to receive the portion of the funds is disputed by the client. In that case the disputed portion must remain in the trust account until the dispute is resolved. Rule 1.15-2(f)(2) and (g).

25. What happens if a client directs a lawyer not to pay medical bills incident to the settlement of a tort claim ?

Generally, the lawyer must follow the client's most recent directions. Unless the health care provider in question has perfected a statutory lien against the funds in the hands of the lawyer, the lawyer must handle the settlement proceeds as directed by the client. RPC 75. *But see* 01 FEO 11.

Comment: As a general rule, the lawyer must always follow the client's instructions with respect to the disbursement of trust funds. This can create serious problems. I think the lawyer is entitled to satisfy any perfected statutory liens out of the funds received in payment of a personal injury claim, but can pay other claims against the money only upon the client's instruction. Often, the client may have requested the lawyer to write a health care provider to promise payment of an account out of the proceeds in exchange for the provider's forbearance in attempting collection. The client may have changed his/her mind and now instructs the lawyer not to pay the account. Unfortunately, in such a situation, the lawyer must do as the client says. Remember that claims by the client's health benefit plan for repayment, although characterized as a "lien," is not a statutory lien and the lawyer is obligated to follow the client's instructions with regard to payment. Medicaid and Medicare are statutory liens and must be repaid.

As an aside, I am advised that Medicare now only responds to requests for information regarding its claim of lien after notification that the case has been settled. It requires a copy of the release or settlement agreement, a copy of the fee agreement, and a copy of the proposed disbursement.

26. Is it ever proper for a lawyer to make disbursements from the trust account with respect to the funds represented by a deposited instrument which has not yet been collected ?

Prior to the adoption of RPC 191 in October 1995, a lawyer was permitted to issue trust account checks against funds which, although uncollected, were provisionally credited to the lawyer's trust account by the financial institution in which the trust account was maintained. RPC 191 still allows lawyers to disburse provisionally credited but uncollected funds from the trust account, but only in consequence of trust account deposits in the form of cash, wire funds, or certain types of negotiable instruments specified in the Good Funds Settlement Act, G.S. 45A. It is further provided that disbursements against such provisionally credited funds should be made only where the lawyer reasonably believed that the underlying deposited instrument is virtually certain to be honored when presented for collection, and the lawyer has sufficient assets or credit to fund any outstanding trust account checks issued in regard to a provisionally credited

item which may be dishonored.

Comment: As of this writing, I am advised that there has been an ethical inquiry to the State Bar about how long funds must be held in the trust account before disbursement. There is often great difficulty, if not impossibility, to obtain verification that funds have cleared. I believe the inquiry in question asks that a rule be adopted allowing disbursement after three days if the check was issued by an in-state bank, and seven days if the issuer is out-of-state. While the above rule allows disbursement if the lawyer “reasonably believes” the deposited check is “virtually” certain to be honored, it also requires the lawyer in such a case to have sufficient personal assets to cover the amount in the event of dishonor. I don’t think the requested rule makes it any safer for the lawyer to disburse because the lawyer remains “on the hook” if the instrument is, in fact, dishonored after the expiration of the three or seven days. For those of use who were around in the 80's when Iowa National went under, that remains a big risk. If you are unable to get a satisfactory response from the drawer bank, ask a representative of your bank to contact the drawer bank to see if it has paid the check.

All of this waiting can create problems. There will be pressure from the client to disburse the funds and it can be tempting to go ahead and do so, especially if there are sufficient funds in the trust account, anyway, to cover the disbursement. However, in such a scenario, the lawyer is actually paying this client with another client’s money. There may not be an insufficient funds notice sent to the State Bar but in the event of an audit, the lawyer making such a disbursement could well be in hot water.

27. What should a lawyer do if he or she properly disburses against a provisionally credited instrument which is ultimately dishonored ?

RPC 191 provides that the lawyer, upon learning that a deposited instrument has been dishonored, must act immediately to protect the property of the lawyer's other clients by personally paying the amount of the failed deposit or by securing or arranging for payment from sources available to the lawyer other than the trust funds or other clients. A lawyer should take care not to disburse against uncollected funds in situations where the lawyer's assets or credit would be insufficient to fund the trust account checks in the event that a provisionally credited item is dishonored.

28. May a lawyers disburse against provisionally credited items in cases other than real estate closings ?

RPC 191 specifically provides that it applies to transactions other than real estate conveyances.

Comment: This is the nightmare scenario suggested above. If you disburse a large settlement that has been provisionally credited, and a problem subsequently arises, you’d better have the ability to quickly cover the amount so as to protect other clients

What If a Trust Account Check Bounces ?

29. What should a lawyer do if his or her trust account check bounces ?

Theoretically, of course, this should never happen. As a practical matter, however, mistakes do happen and bank errors or administrative snafus within the lawyer's own office can result in an instrument's being returned for insufficient funds. If a trust account check is dishonored, the lawyer should immediately ascertain the nature of the problem and promptly correct it, even if this requires a deposit of the lawyer's own funds. Under no circumstances should the lawyer allow the trust funds of another client to be used impermissibly. Finally, the lawyer should immediately document the problem and any corrective action taken in a memorandum for his or her own files.

30. Must a report be made to the State Bar ?

Every lawyer must instruct his or her bank to notify the State Bar when any check drawn on a trust account or a fiduciary account is presented for payment against insufficient funds. That being the case, a lawyer who overdraws a trust account or a fiduciary account may soon expect to be contacted by a representative of the State Bar who will informally request an explanation of the problem. Once it is verified that an innocent mistake cause the shortage or apparent shortage in the account, the inquiry will be concluded and no further action will be taken. If, however, no adequate explanation is immediately forthcoming, a grievance file will be established and a formal investigation initiated. Rule 1.15-2(k). See Appendix K for a copy of the bank directive form.

Comment: If it is an innocent mistake, you should immediately contact the State Bar, even though the bank will do so. If the overdraft resulted from an error in your office, get it fixed immediately. This is one of those emergencies that requires you to drop everything until the problem is identified and fixed.

How Should Accounting Be Handled ?

31. How often should a lawyer provide an accounting to a client for the client's trust funds ?

An accounting must be provided to the client upon the completion of the disbursement of the client's funds and at such other times as may be reasonably requested by the client. If trust funds are retained for more than one year, the lawyer must provide annual accounts. All accountings must be in writing. Rule 1.15-3(d).

Comment: When the disbursement is completed, the better practice is to provide and accounting of all receipts and disbursements to the client. Take the time to sit down with the client and review it, answering all questions. Have the client sign and date a copy for your records, acknowledging approval of all of the disbursements, along with an acknowledgment that all questions were answered.

If funds are kept in trust for more than a year, it is probably better to transfer them to a dedicated trust account, to bear interest for the client.

32. How often should a lawyer provide an accounting for fiduciary funds received in connection with the lawyer's service as a professional fiduciary such as a personal representative or a trustee ?

Inventories and accountings of fiduciary funds received in connection with professional fiduciary services must be given to the clerk of court, or other appropriate judicial official, as required by law. If an annual or more frequent account is not required by law, a written accounting of all transactions concerning the fiduciary funds must be given to the beneficial owners, or their representatives, at least annually and upon the termination of the lawyer's services. Rule 1.15-2(e).

33. Do accountings for funds in a trust account have to be in a particular form ?

No. It is often possible to satisfy the accounting requirement by providing copies of documents generated during the representation, such as a settlement statement describing disbursements incident to the resolution of a tort claim or a HUD-1 statement describing the disbursements of the proceeds of sale in a real property transaction. In addition, the accounting requirement can generally be satisfied by providing the client with a copy of a properly maintained ledger card which describes all receipts and disbursements of the client's funds. An example of a client ledger card is found in Appendix D. Sample accounting forms are attached in Appendix Items I and J.

What Should Be Done With Unclaimed Trust Funds ?

34. Suppose a lawyer holds funds in a general trust account and does not know either the identity of the location of the owner of those funds. What should be done with the money ?

Under such circumstances, the lawyer must first make a diligent attempt to determine the identity and location of the owner of the funds in order that an appropriate disbursement might be made. If the lawyer is unsuccessful in ascertaining the identity and location of the owner of the funds, the lawyer should consider whether the funds must be escheated to the state of North Carolina. Pending escheat, such funds should be held and accounted for in the lawyer's trust account. Rule 1.15-2(q).

CONCLUSION

Taking care to handle your trust account properly can be the best insurance you have against malpractice or grievances. Remember:

- ✓ Balance and reconcile your trust account monthly, or at least quarterly;

- ✓ Consider using a computer-based trust accounting program - back up regularly;
- ✓ Communicate with the client regarding the status of funds held in trust;
- ✓ Do not commingle funds;
- ✓ Do not “borrow” money from the trust account. Even if you replace the money promptly, in doing so you have committed a serious infraction that will result in disciplinary action against you;
- ✓ Pay regular attention to your trust account - if you ignore it, you can get in trouble.