

Ethically Speaking



By Charles Slanina, Esquire

The Banking Mess: The FDIC and Attorney Liability for Escrow Funds Deposited in Banks that Fail, Part II

Last month, “Ethically Speaking” discussed the safety of attorney trust deposits in light of the dismal housing market and rash of bank failures. Since then, the economy has suffered additional setbacks. The federal government has had to bail out Fannie Mae and Freddie Mac. Lehman Brothers has declared bankruptcy. The government has instituted a bail out of AIG. The stock market has been tumultuous with commentators comparing the situation to the Great Depression. Investors seeking safe harbors have turned to three-month Treasury bills even though they provide interest below 1%.

All of this raised the question as to whether or not client and third party funds held in attorney trust accounts are adequately protected by the Federal Deposit Insurance Commission (“FDIC”). Specifically, is the attorney or law firm the depositor, or is the client or third party for whom the money was held in trust the depositor? Held in the balance of this question is whether the \$100,000 “per depositor” coverage provided by FDIC applied to each client or whether the attorney or firm has a maximum of \$100,000 as the depositor.

The information available at the time of the last article, as well as, the opinions of the Association of Professional Responsibility Lawyers and some state Lawyers’ Fund for Client Protection agencies, expressed the concern that the FDIC would view the attorney or law firm as the depositor, limiting escrow account coverage to \$100,000 regardless of the amounts on deposit or the number of clients with funds held in trust.

The FDIC has posted a statement that offers some reassurances at www.fdic.gov/deposit/deposits/financial/fiduciary.html:

“Funds deposited by a fiduciary on behalf of one or more principals are insured as the funds of the principal (the actual owner) to the same extent as if the funds were deposited by the principal, provided all of the following requirements are met:

- the fiduciary nature of the account must be disclosed in the account title;
- the identities and the interests of the principals for whom the fiduciary is acting must be ascertainable from either the deposit account records of the bank or records maintained in good faith and in the regular course of business by the depositor or by some person or entity undertaking to maintain such records for the depositor.”


In the case of attorney trust accounts, the Rule 1.15 mandates that the Delaware Professional Conduct Rules appear to meet those FDIC requirements.

The Massachusetts IOLTA reached a similar conclusion stating in July 2008 that for the purpose of FDIC insurance, IOLTA accounts are fiduciary accounts. As such, EACH CLIENT is insured as if the funds were deposited directly by the principal (the client), provided certain requirements are met. Massachusetts goes on to note that while it is reassuring that FDIC has confirmed that the insurance applies to each client, it notes that there are still a large number of IOLTA accounts that contain individual client funds in excess of \$100,000 which would

be at partial risk. It recommends as the easiest way to increase FDIC insurance, to spread the escrowed IOLTA funds across multiple banks while cautioning that bank selection is key. It recommends that attorneys exercise due diligence to determine the safety and soundness of the bank by use of Veribanc, a bank rating company (www.veribanc.com).

While it appears that attorneys and clients can draw whatever comfort that FDIC protection provides, attorneys can no longer adopt a “deposit it and forget it” attitude with regard to their Rule 1.15 duty to safeguard client property. Attorneys should take the extra step of ascertaining the financial health of the institutions in which they place such deposits. They may also want to heed the suggestion of the Massachusetts IOLTA to spread client funds among multiple banks (after exercising due diligence to make sure the other banks are solvent as well) to stack the FDIC coverage. This may only be practical where client funds are held for an extended period of time and not for “in and out” transactions such as real estate settlements.

“Ethically Speaking” thanks Michael McGinniss of the Office of Disciplinary Counsel for his contributions to this month’s column.

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