

# Missouri's New Trust Account Overdraft Notification Rule

By Nancy L. Ripperger

Some would say that “nothing in the known universe travels faster than a bad check.” Missouri attorneys who overdraw their trust accounts are about to find out that news of the bad check does travel very quickly to the Chief Disciplinary Counsel (“CDC”). On October 8, 2009, Missouri became the 40th state to adopt a trust account overdraft notification rule.<sup>1</sup> The rule went into effect on January 1.

## HOW DOES THE NEW RULE WORK?

The rule is very simple. It provides that every lawyer practicing or admitted in Missouri is deemed to have consented to overdraft reporting by any financial institution holding a client trust account, including both IOLTA<sup>2</sup> and non-IOLTA trust accounts.<sup>3</sup> Rule 4-1.15(g).

The Missouri Advisory Committee, as directed by Rule 4-1.15(g), has promulgated a regulation implementing the new rule. The regulation requires financial institutions<sup>4</sup> to agree to several conditions in order to be eligible to hold client trust funds. First, the financial institution must report to the CDC *anytime* a check or debit is presented against the lawyer's trust account if the account contains insufficient funds to pay the item. This includes making a report to the CDC even when the financial institution returns the item unpaid. Second, the financial institution must make its report to the CDC within five days of

the overdraft. Finally, the financial institution must maintain a copy of all records regarding dishonored items for five years.<sup>5</sup>

If the financial institution fails to follow the requirements set forth above, the Advisory Committee or CDC can seek to revoke the financial institution's right to hold client trust account funds. The financial institution can also cancel its agreement with the Advisory Committee. If the financial institution's right to hold the funds is revoked or the financial institution cancels its agreement, lawyers are required to remove all trust account funds from the financial institution within 30 days.<sup>6</sup>

## WHAT IS THE PURPOSE OF THE RULE?

The overdraft notification rule has several purposes. Its primary purpose is to be an early warning system for attorney trust account violations so as to allow the CDC to intervene when the problem first occurs.<sup>7</sup> Of particular concern to the CDC is obtaining information about possible attorney misappropriations in a timely manner.<sup>8</sup>

In the past, the CDC generally only learned of the attorney's misappropriations after a client had made a complaint and CDC staff subsequently audited the attorney's trust account. These audits would often reveal that the attorney had engaged in inappropriate trust account practices for long periods of time and clients other than the complainant had been harmed.

The rule is also designed to have a

deterrent effect on attorneys who might contemplate misappropriating client funds or engaging in sloppy trust accounting practices and procedures<sup>9</sup> — the thought being that an attorney who knows his trust account activities are being monitored will be more careful and trustworthy regarding trust account activities.

Finally, it is contemplated that education will be a beneficial result of overdraft notification.<sup>10</sup> The rule provides the CDC with a way of identifying attorneys who need training in setting up and implementing proper trust account practices and procedures.

## HOW OFTEN DO TRUST ACCOUNT OVERDRAFTS OCCUR?

In the first 15 days of January 2010, the CDC has already received 15 overdraft notices.<sup>11</sup> Based upon initial numbers and the experience of other states, the CDC anticipates receiving in excess of 300 overdraft notification notices in 2010. By providing training and education to attorneys, the CDC is hopeful that the number of overdraft notices will decrease over time.<sup>12</sup>

## HOW WILL THE CDC HANDLE NOTICE OF AN OVERDRAFT?

Upon receipt of an overdraft notice, CDC staff will send an inquiry letter to the attorney asking the attorney to provide a written explanation of the overdraft and to provide supporting documentation. The attorney will also

be asked to provide three months of statements for the trust account.<sup>13</sup>

After the attorney provides his or her initial response and bank statements, CDC staff may ask for more detailed information or records, including cancelled checks, deposit slips, subsidiary ledgers, fee agreements, etc.

If the overdraft occurred because of a bank error, the attorney will be asked to provide a letter from the bank documenting the bank's error. Upon receipt of documentation from the bank of its error, the CDC will close its investigation.

If the overdraft occurred because of lack of adequate practices and procedures upon the part of the attorney, CDC will work with the attorney to correct the problems. This may include directing the attorney to attend trust accounting CLEs or reviewing law office management materials available from The Missouri Bar. If the CDC determines that the attorney needs substantial assistance in setting up appropriate trust account practices and procedures, he may refer the lawyer to a law office management consultant and/or request that the attorney enter into a diversion<sup>14</sup> agreement whereby the CDC can monitor the attorney's progress in implementing proper practices and procedures.

The CDC anticipates most overdraft matters will be closed without the CDC pursuing formal disciplinary action against the attorney.<sup>15</sup>

Of course, if it is discovered that the attorney misappropriated client funds, engaged in other serious trust account violations, or there is an established pattern and practice of the attorney overdrawing his trust account, the CDC will institute formal disciplinary proceedings against the attorney. This includes situations whereby the attorney

contends that he was only "borrowing" client funds or where "negligent misappropriations" have occurred because of poor recordkeeping.<sup>16</sup>

## HOW CAN YOU ENSURE THAT YOU REMAIN IN COMPLIANCE WITH THE NEW RULE?

Complying with the new rule may require some action upon your part. First, you should check and see if your financial institution is on the list of institutions approved by the Advisory Committee to hold attorney trust account funds. The list can be found on the Legal Ethics Counsel's website at <http://www.mo-legal-ethics.org>. If your financial institution is not on the list of approved financial institutions, you should move your trust account to an approved institution.<sup>17</sup>

Second, you should make sure that all trust accounts are denominated as "Attorney Trust Accounts" at your financial institution.<sup>18</sup>

Third, you should ensure that you take appropriate steps to comply with generally accepted accounting procedures for client trust funds. If you are not familiar with what records you should maintain, Rule 4-1.15(d) now provides guidance. Rule 4-1.15 requires attorneys to maintain records which show clearly and expressly the date, amount, source, and explanation for all receipts, withdrawals, deliveries and disbursement of funds or other property of clients or third parties. These records would include, but not be limited to: checkbooks, cancelled checks, check stubs, vouchers, ledgers, journals, closing statements, accountings or other statements of disbursement.

Also be aware of common causes of overdrafts and what you need to do

to prevent them. Other states report that the most frequent cause is a "late deposit." This occurs when the deposit on which checks are written is not posted to the account until after the deposited funds become available for withdrawal. You should also check with your financial institution to ascertain when the deposited funds are expected to clear and can be drawn upon without risk.<sup>19</sup> Another common cause of an overdraft is failing to maintain sufficient funds in the account to cover service charges or check-printing charges.<sup>20</sup> Balancing your trust account records on a monthly basis will help in discovering mathematical errors. You also may want to consider using one of the many commercially available computer programs to maintain trust account records, as these programs minimize the chance of mathematical errors.

If you feel that you need additional training regarding proper trust accounting, the CDC, along with Legal Ethics Counsel, the IOLTA office and The Missouri Bar, has developed a trust accounting CLE designed to provide you with practical hands-on information about the basics of trust accounting. The dates of the CLE are listed on The Missouri Bar's website.

If you follow the steps set forth above it is unlikely you will overdraw your trust account. However, if for some reason an overdraft occurs, you should promptly respond to any request for information from the CDC and cooperate with the CDC while it conducts its investigation.

If you have any additional questions regarding the new rule and appropriate trust accounting procedures, contact Sara Rittman, Legal Ethics Counsel, at 573-638-2263.

## ENDNOTES

1 The following jurisdictions have a trust account overdraft notification rule: Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Georgia, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Minnesota, Missouri, Montana, Nebraska, Nevada, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Utah, Vermont, Virginia, Washington and Wisconsin. Information obtained from the ABA Standing Committee on Client Protection.

2 IOLTA stands for Interest on Lawyer Trust Account Program. An IOLTA account is a pooled trust account held at an eligible institution that is comprised of client and third party funds that cannot otherwise earn income for the client or third party in excess of the costs incurred to secure such income. This interest income on these accounts is collected by the Missouri Lawyer Trust Account Foundation and distributed in the form of grants to provide legal services to the poor and other law-related services. Rule 4-1.15(a)(7). More information on the IOLTA program can be found at <http://www.moiolta.org/>.

3 In 2008 the Supreme Court revoked the opt-out provisions of IOLTA. As a result, the use of non-IOLTA accounts is limited to situations whereby the attorney has established a separate trust account for the deposit of funds of a particular client or third party and the net earnings from the account are paid to the client or third party. Rule 4-1.15(a)(9).

4 A financial institution includes banks and savings and loans authorized to do business in Missouri whose deposits are insured by the federal government. Rule 4-1.15(a)(5). In Missouri, credit unions are not allowed to hold

client trust funds.

5 Regulation for Rule 4-1.15.

6 The financial institution is required to give notice to the attorney. Regulation for Rule 4-1.15.

7 Lynda C. Shely, *The ABA Model Rules For Trust Account Notification And Model Rule For Payee Notification: Client Protection For The Next Millennium*, 11 PROF. LAW 23 (Spring 2000).

8 The rule will not detect or prevent all trust account misappropriations. Some misappropriations result without overdrafts to the trust account and some misappropriations occur outside the trust account. William J. Wernz, *Trust Account Overdraft Notice Rule*, BENCH & BAR OF MINNESOTA (October 1990).

9 Shely, *supra* note 7.

10 *Id.*

11 Not all of the banks have signed an agreement with the Advisory Committee yet. In addition, the banks have five days to report the overdrafts. When you couple this with the two to three days it takes for mail delivery, the CDC has really only received notice of overdrafts occurring between January 1 and January 7, 2010.

12 Both Montana and Minnesota have had a trust account overdraft notice rule in place for more than 15 years. In recent years the number of overdrafts in these states has decreased significantly. James E. Aiken, *Trust Account Overdraft Notification Rule*, The Montana Lawyer, August 2007; Betty Shaw, *Overdraft Notification*, 63 No. 4 Bench & Bar of Minnesota (April 2006).

13 The failure to respond to the request is a violation of Rule 4-8.1(c) and will result in the CDC seeking discipline against the attorney's license.

14 For information about the CDC's diversion program, see Rule 5.105.

15 The report of an overdraft to the CDC does not automatically result in a disciplinary action. Regulation for Rule 4-1.15.

16 Misappropriation of client funds occurs anytime an attorney makes unauthorized use of client funds, including when the attorney unintentionally uses client funds because of poor recordkeeping. Shaw, *supra* note 11.

17 Rule 4-1.15(g) provides that a client trust account must be in an institution approved by the Advisory Committee.

18 Rule 4-1.15(a)(3), (c).

19 U.S. banking laws require that banks give customers access to their funds within one to five working days. (The timing depends on whether the check-issuing bank is foreign or domestic, local or out-of-state.). However, even though the check is available for withdrawal, the transaction can be reversed at a later date if the check was a forgery. This may be several weeks after the check was available for withdrawal. This is a special concern with cashier checks, as there are many scams involving fake cashier's checks. If you receive a cashier's check, you may want to call the issuing bank and confirm that the check is authentic.

20 Rule 4-1.15(e) provides that a lawyer may deposit his own funds in a client trust account for the sole purpose of paying bank service charges on the account, but only in an amount necessary for that purpose.



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