SUPREME COURT ADMINISTRATIVE DETERMINATION RE: AMENDMENTS TO IOLTA RULES

In adopting amendments to Rule 1:21-6(a) (Recordkeeping) and Rule 1:28A (Income on Lawyer Trust Accounts (IOLTA)), the Supreme Court has reaffirmed the central premise of the IOLTA Program since its inception: no portion of the income realized by IOLTA could have been received by any client because the principal amounts on deposit were too small or held for too short a period of time for that income to exceed administrative costs and other charges and realize income for any client. If the income did not go to IOLTA, it would have been retained and realized by the financial institutions in which the non-interest-bearing trust account deposits had been made.

For many years, the New Jersey Supreme Court has regulated attorneys' activities in accepting client deposits in trust, and has established a number of requirements for attorneys who handle trust deposits and financial institutions that maintain attorney trust accounts. The Court's Rule requirements are designed to protect the public interest. They include how accounts are to be maintained, how records are to be kept, how the funds are to be made available, how notices of shortfalls are to be issued, and other matters. In addition, the Court's rules provide that attorney trust deposits be placed only in approved financial institutions that agree to comply with all applicable requirements.

The Supreme Court's regulation of attorney trust account deposits has created a significant economic benefit for approved financial institutions. For trust deposits held at interest for the benefit of the client, financial institutions realize economic return in the same way as for any other interest-yielding deposits. For trust funds not held at interest for the client, the financial institutions also retain all income yielded from the deposits, unless the funds qualify for deposit in IOLTA accounts. IOLTA deposits are pooled to yield interest income for IOLTA after the financial institutions have realized the same just and reasonable income earned on non-IOLTA interest-bearing deposits.

IOLTA revenue is used exclusively for the three important public purposes identified in Rule 1:28A. In creating the IOLTA program, the Court has apportioned the economic benefit resulting from its regulation of attorney trust deposits. Without the Court's regulation, financial institutions might not realize any economic benefit at all from these trust deposits. The Court's apportionment of the economic benefit ensures that the financial institution will receive a just and reasonable return comparable to that received from other interest-bearing accounts. The balance of the financial institution's return is remitted to IOLTA, in the form of periodic interest payments. Under this approach, a reasonable portion of the economic benefit resulting from the Court's regulation of trust deposits is directed toward important public purposes.

In 1998 the United State Supreme Court held that under the state law of Texas, the common law doctrine that interest follows principal prevailed, and that interest income under that state's IOLTA program was the property of the client. In New Jersey, the Legislature has created a number of statutory exceptions to the common law interest-follows-principal rule. Similarly, the IOLTA Court Rule creates such an exception in the limited context of IOLTA account deposits that would realize no net income for the client. As set forth above, the income generated by pooled IOLTA accounts and remitted to IOLTA constitutes a portion of the overall income from such accounts that, but for the remittance to IOLTA, would remain entirely the property of the financial institutions.

The rule amendments the Court adopts today reaffirm and clarify the underlying premise of the IOLTA program.

The other principal aspect of the Rule concerns a requirement in the IOLTA Board's Guidelines for Financial Institutions that participate in the IOLTA program. The Guideline requirement stipulates that the interest rate for IOLTA "must be comparable to the highest available rate offered to similar customers when the IOLTA account meets the same minimum balance requirements." It also provides that "[t]he net yield must provide a reasonable return, according to the standard established by the IOLTA Fund from time to time." The comparability requirement has been a part of the IOLTA Guidelines since 1992; the Court approved the reasonable return requirement in May of 2002.

The IOLTA Board proposed the addition of the comparability and reasonableness requirements to conform the Court Rule to the previously approved IOLTA guidelines. After consideration of comments to the proposed Rule, the Court has concluded that such conformance is unnecessary and that the subject matter is best left to the operational guidelines of the IOLTA Fund, as approved by the Court.

The Court authorized inclusion of the comparability and reasonableness standards in the Guidelines because the IOLTA Fund is the banking customer in respect of the interest income generated by pooled IOLTA accounts. The IOLTA Fund is dedicated to important public purposes. The IOLTA Board has a fiduciary responsibility to maximize revenue for the Fund and to distribute and account for the revenue pursuant to Court Rule. The IOLTA Board sought guidance from the Court on how to exercise its revenue maximization responsibilities. The Board has indicated that comparability under the Guidelines will be determined by examining whether a given financial institution offers to IOLTA the same accounts and rates that it offers to other depositors of the same size and type. The Board has indicated that reasonableness under the guidelines will be determined by periodically calculating the average interest rates paid by all approved financial institutions for similar accounts. The Court has authorized both approaches previously, and continues to do so under the revised Rule and IOLTA guidelines.

Finally, the Court has asked the IOLTA Board to monitor the net IOLTA account yield from approved financial institutions using the foregoing methodology and to identify and make public those financial institutions performing at or above the average market rate and those that are below. The information is to be made available to all attorneys maintaining trust accounts. The Court requests that attorneys give serious consideration to this information in deciding where to retain their accounts.

The Court understands and appreciates the many efforts by financial institutions to cooperate with and contribute to the success of the IOLTA program in New Jersey. It is concerned, however, by the low rate of return on IOLTA accounts generated by some financial institutions. The Court views the IOLTA Fund as a banking customer and consumer in respect of the interest yield on pooled IOLTA accounts. As such, the Court believes that the comparable and reasonable standards it has authorized the IOLTA Board to use are tools that enable attorneys to determine the most prudent placement of IOLTA deposits.

February 6, 2003