CHAPTER ONE

HOW TO OPEN AND MANAGE ESCROW ACCOUNTS

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[1.0] I. INTRODUCTION

This book is now in its fifth edition. This new chapter was written with the intent of answering very practical questions which we have received over the years. It is not intended to be a scholarly chapter but a practical, step-by-step set of instructions on how to open and manage your escrow accounts. The following chapters and appendices expand on the law and usage of the account.

[1.1] II. OPENING AN IOLA ACCOUNT

If you assume control of funds for a client or any other person, you must open an attorney escrow account. First you choose a bank. The bank must comply with the dishonored check (overdraft) rule.[1] You must also select a bank which participates in the IOLA program.[2] Although not required, you should select a bank which provides FDIC coverage. The bank should be a New York State bank. It is possible to open an account in an out-of-state bank but only if that bank complies with the dishonored/overdraft check reporting requirements and you have the written consent of the client(s).[3]

Your account must have a designation "attorney trust account", "attorney escrow account" or "attorney special account" printed on the check. Additionally, the account may have printed on it the acronym "IOLA". The same information must appear on deposit slips. It is helpful to purchase checks in a different color from your general and other accounts. This will reduce the risk of writing checks from the wrong account.

Since April 2021, lawyers are prohibited from carrying overdraft protection on attorney escrow accounts.[4] Linkage of accounts is discouraged also. Your escrow account should not be linked to any other account. Some due diligence is required as often times banks may automatically link accounts without your knowing about it. You need to make sure that your escrow account is not linked to any other account which does not contain client funds.

The only persons allowed to be signatories on the trust account are lawyers licensed to practice law in the State of New York. [There is a New York NYSBA Ethics Opinion, Opinion 693 (8/22/97), which indicates that a paralegal may be given permission to use a signature stamp to execute escrow checks. The Opinion calls for direct supervision of the attorney over the non-lawyer who is using the stamp. It is the very strong opinion of the editors of this book that you should never do that.]

The tax ID number for an IOLA account is IOLA's tax ID number. The interest on this account is delivered periodically by the bank to IOLA. Initially you must register the account with IOLA.[5] Monthly statements go to the attorney and of course you must balance the account regularly. The lawyer is responsible for all check printing costs, wire fees, stop payments and overdraft fees. You are not responsible for any monthly maintenance fees, if any, as they are deducted from interest by the bank before sending the interest to IOLA.

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1 *See* 22 N.Y.C.R.R. § 1300.1.

2 *See* 22 N.Y.C.R.R. § 1300.1. Full due diligence requires the attorney to check both the NYS Lawyers Fund for Client Protection (http://nylawfund.org/) and the IOLA fund (www.iola.org/) to be sure the bank is on both lists.

3 *See* 22 N.Y.C.R.R. § 1200 (Rule 1.15(b)).

4 *See* 22 N.Y.C.R.R. § 1300.1.

5 IOLA Attorney Enrollment Form, https://www.iola.org/lawyers/iola-attorney-enrollment-form.

[1.2] III. RECORDKEEPING

As soon as you receive funds, a record of the receipt must be inserted in three places: the client file, the checkbook ledger, and a client ledger. The checkbook or computer printed check should have stubs for each check. A ledger is a requirement. You may use a paper system such as a notebook or a computer program to maintain the checkbook and client ledgers. There must be a separate "page" for each client so that you can track the deposits, disbursement and balance for each client. The total balance for all clients must equal the balance in the escrow account less any minor funds added by the attorney to cover any costs of the account. To ensure this, all accounts should be reconciled monthly, Although staff may be assigned to perform this task, the attorney must supervise the task to ensure no defalcation has occurred.

The records need to specifically identify the date, source and description of each item deposited as well as the date, payee and purpose of each withdrawal or disbursement. Rule 1.15(d) provides a more detailed description of required bookkeeping records.

Checks made payable to the attorney and client or the client alone must be endorsed by the client or the agent under the client's power of attorney.

Do not lump transactions together. If there are multiple deposits to be made, every deposit for a client should be individually transacted on a separate deposit slip. Similarly, checks should be written separately for each client transaction. It is possible to do an electronic transfer of fees to the attorney but only if the transactions can be readily tracked to the individual clients.

Do not postdate checks and give them to anyone to hold. The funds must be collected before the attorney may write checks against the funds. It is helpful to distinguish between available and collected. The term "available" refers only to your bank account's provisional balance. You may only write checks against funds that have completed the federal collection process.

[1.3] IV. RECEIPT OF FUNDS

This section provides examples of the types of funds that an attorney typically receives and how to handle them. It is not an exhaustive list.

1. The attorney receives the sum of $2.5 million to be held in escrow pursuant to a development contract with the money paid to the client upon completion of the project which will take, in all probability, four to five years;

   This sum should not be placed in an IOLA account. It should be placed in a separate interest-bearing account. The account must be in the attorney's name. The client cannot be a named owner or in any way be allowed access to the funds. The escrow agreement[6] should set forth who is entitled to the interest earned on the account. That individual or company's taxpayer identification number is used for the account. The attorney may add a subscript to the account indicating the client's identity for convenience only. Such subscript does not indicate ownership of the account or give the client any authority over the account.[7]

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6 See the Appendix for model escrow agreements. It is important to always have an agreement before accepting funds.

7 For large deposits the FDIC coverage should be reviewed with the client. Such coverage is currently $250,000 per depositor. If the client uses the same bank as the attorney escrow account, the total coverage for all of the client's potential loss will include both the personal accounts and what is in the escrow. See chapter 3 section 3.4 for a full discussion on FDIC and NCUA insurance. There is no requirement for the attorney to have full FDIC or NCUA insurance coverage for each client's funds held in an escrow account.

2. The attorney receives $425,000 as a result of a settlement of an action of which one-third goes to the attorney. As soon as the settlement check is received, it should be deposited to your attorney escrow account. Whether to place the funds in an IOLA account or a separate account is a matter of judgment. There are no hard and fast rules.[8] If you make a mistake by putting funds in your IOLA account such that the interest generated is substantial and the client seeks the interest, you may apply to the IOLA fund for a refund upon submission of proper proof.

   No funds should be disbursed unless and until the deposit has been collected by your bank.[9] Inquire and understand your bank's collection policies and timetables. Remember that available funds are not the same as collected funds. The term "available funds" refers only to your bank account's provisional balance, not funds that have completed the federal collection process. Once the settlement funds have been collected, the funds should be promptly disbursed. The client is entitled to the money as soon as possible. You are asking for trouble if you do not get the money to the client quickly. Your attorney fee should be taken out of the escrow account by a check written to you as soon as possible after collection. If left in the account it constitutes illegal comingling.

   It should be noted that you must honor all legitimate liens against the proceeds such as doctor bills, expert witness fees and the like related to the action. However, you may not honor other liens against the client absent a court order or the request of the client.

   Occasionally a client may request that the lawyer retain some of the funds for legal fees for a future matter. The attorney may do so.[10] However, the attorney should not hold funds not pertaining to a legal matter. You should not act as your client's banker. If you undertake that role, you are asking for trouble.

3. The attorney receives $25,000.00 as deposit on a real estate closing the attorney representing the seller. Typically, this would be placed in an IOLA account until closing. It is unlikely that a deposit of this size would generate sufficient interest to justify opening a separate account.

   At the closing, it is appropriate to write checks from the escrow account to the various payees involved in the closing such as the county clerk, title company and real estate broker. Again, absent a court order or permission from your client, you cannot pay general creditors of your client.

   Remember that all funds deposited in the escrow account must be collected, not just cleared or available before the attorney can write checks against those funds (see example 2 above).

[1.4] V. STAKEHOLDER OBLIGATIONS

Under most circumstances, once you take funds into your escrow account, you have become a stakeholder. You have responsibilities to both parties. These responsibilities are contained in the escrow agreement. Typically, you cannot release these funds until you have the consent of your client and the other attorney or other party, absent very specific provisions in the escrow agreement. One solution is to bring an impleader action in which the court decides what occurs with the funds.

General Business Law Article 36-c, § 778, 778-a, requires that: "An escrow agent who undertakes to hold the buyer's down payment in the purchase and sale of a home shall have a fiduciary obligation to segregate and safe guard the buyer's down payment in a special bank account. . ." However, the law also

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8 See the discussion of *Bazinet v. Kluge*, 196 Misc. 2d 231, 764 N.Y.S.2d 320 (Sup. Ct. 2003) and its progeny in Chapter 2.

9 See NYSBA Ethics Opinion 737 (2/2/02).

10 See NYSBA Ethics Opinion 983 (10/8/13).

provides in § 778-a (4): "If the escrow agent is an attorney admitted to practice in this state, a bank account authorized by section four-hundred ninety-seven of the Judiciary Law shall be a lawful depository for down payments held by the attorney in escrow." That is an IOLA account.

[1.5] VI. SUCCESSION PLANNING

Upon the death of a sole practitioner of a sole owner of an IOLA account, no withdrawals can be made until an application has been made to Supreme Court in the judicial district where the attorney maintained the law office for a successor signatory to the account. The successor must be a lawyer in good standing and admitted to practice in New York.

The application can be made by the legal representative of the deceased lawyer's estate, a lawyer affiliated with the deceased lawyer, a person with a beneficial interest in the account, an officer of a bar association or counsel for a disciplinary committee.

NYSBA has an excellent set of resources for succession planning which may be helpful to the lawyer.[11] It is good practice for a sole practitioner to have a colleague who will take on this obligation in the event of the lawyer's death or disability.

11 NYSBA Law Practice Management Committee, NYSBA Planning Ahead Guide: How to Establish an Advance Exit Plan to Protect Your Clients' Interests in the Event of Your Disability, Retirement or Death, https://nysba.org/pubs.