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A Good Rule, Poorly Written: How the Financial Crisis Highlighted the Inadequacy of IOLTA Rate Rules

Cover Page Footnote

J.D. Candidate, May 2016, The Catholic University of America, Columbus School of Law; B.A., 2003, University of North Carolina at Greensboro. The author would like to thank Professor Heidi Schooner for her insight and expertise in refining the focus of this paper. He would also like to thank his wife, Praneetha, for her limitless patience and love, and the entire Arthur family for their constant encouragement and support. Finally, the author owes a debt of gratitude to the members of the Catholic University Law Review, whose efforts contributed immeasurably to the quality of this Comment.

A GOOD RULE, POORLY WRITTEN: HOW THE FINANCIAL CRISIS HIGHLIGHTED THE INADEQUACY OF IOLTA RATE RULES

Andrew Arthur⁺

“If we are to keep our democracy, there must be one commandment: Thou shalt not ration justice.”¹ This ethos underlies a variety of programs designed to provide needy Americans with access to the judicial system, including the IOLTA program.² IOLTA, an acronym for “Interest on Lawyers’ Trust Accounts,” is a partnership between banks and the legal community where banks pay interest on attorneys’ short-term deposit balances held in trust for the attorneys’ clients.³ Although the interest earned on any particular account may be insignificant, its impact is magnified when it is aggregated with interest from IOLTA accounts statewide to fund legal services programs.⁴ The impact is also directly influenced by the prevailing interest rates banks pay on IOLTA balances,⁵ with minimum rates governed by rules in almost every state.⁶ Since

⁺ J.D. Candidate, May 2016, The Catholic University of America, Columbus School of Law; B.A., 2003, University of North Carolina at Greensboro. The author would like to thank Professor Heidi Schooner for her insight and expertise in refining the focus of this paper. He would also like to thank his wife, Praneetha, for her limitless patience and love, and the entire Arthur family for their constant encouragement and support. Finally, the author owes a debt of gratitude to the members of the *Catholic University Law Review*, whose efforts contributed immeasurably to the quality of this Comment.

1. *Thou Shall Not Ration Justice*, THE LEGAL AID SOC’Y, <http://www.legal-aid.org/en/las/thoushaltnotationjustice.aspx> (last visited Oct. 19, 2014) (quoting Honorable Learned Hand, Chief Judge of the United States Court of Appeals for the Second Circuit, 75th Anniversary Address at the Legal Aid Society of New York (Feb. 16, 1951)).

2. *See, e.g., id.* *see also Kentucky IOLTA Fund*, KY. BAR ASS’N, <http://www.kybar.org/63> (last visited Oct. 12, 2014) (illustrating the use of Judge Learned Hand’s quote on an IOLTA website).

3. *See* Dru Stevenson, *Rethinking IOLTA*, 76 MO. L. REV. 455, 456–57 (2011) (discussing the basic operation of IOLTA programs).

4. *Id.* at 457; *see also What is IOLTA?*, IOLTA.ORG, <http://www.iolta.org/what-is-iolta> (last visited Sept. 18, 2014) (“Without taxing the public, and at no cost to lawyers or their clients, interest from lawyer trust accounts is pooled to provide civil legal aid to the poor and support improvements to the justice system.”).

5. *See* Terry Carter, *No Longer Flush IOLTA Programs Find New Funding to Support Legal Services*, A.B.A. J., Mar. 2013, at 61 (“When the Federal Reserve announced in December 2008 that it was lowering the interest rate to virtually zero, it had the effect of nearly zeroing out a mainstay in funding civil legal services for the poor: interest on lawyers’ trust accounts, aka IOLTA.”).

6. *See* ALA. RULES OF PROF’L CONDUCT R. 1.15(k) (2012); CAL. BUS. & PROF. CODE § 6212(b) (West 2014); FLA. ST. BAR R. 5-1.1(g)(5)(B) (West 2014); MD. CT. R. 16-610(b)(1)(D)(i); N.Y. COMP. CODES R. & REGS. tit. 21, § 7000.9(c)(1)–(3) (2015); S.C. APP. CT. R. 412(c)(2)(A)–(B); TEX. ACCESS TO JUSTICE FOUND. R. 7(a)(1)–(2) (West 2009); WIS. SUP. CT. R. 20:1.15(cm)(4); WYO. RULES OF PROF’L CONDUCT R. 1.15A(b)(3) (2012).

its adoption, IOLTA has become a significant part of states' legal aid program funding.⁷

IOLTA came to the United States by way of programs that were first developed in Canada and Australia over forty years ago.⁸ In 1981, the Florida Bar Association Foundation started the first IOLTA program in the United States and IOLTA programs now exist in every state.⁹ During its implementation, however, it faced numerous legal challenges under the Fifth Amendment's Taking and Just Compensation clauses.¹⁰ Opponents argued that the program constituted a state taking of interest that rightfully belonged to clients whose funds were held in trust.¹¹ The Supreme Court settled this issue in *Brown v. Legal Foundation of Washington*, holding that IOLTA programs did not violate the Fifth Amendment.¹²

With constitutional issues resolved for the time being, the principal legal authority for IOLTA programs now resides in various state statutes,¹³ court rules,¹⁴ rules of professional conduct,¹⁵ and bar association rules.¹⁶ Collectively, these rules govern the responsibilities of participating attorneys, the reporting and record-keeping requirements, and the terms of eligibility for banks to participate as IOLTA depository institutions.¹⁷ These eligibility terms include the requirements that address the rate of interest to be credited to IOLTA accounts.¹⁸ These "comparability" requirements require IOLTA deposits to earn no less than comparable non-IOLTA deposits or set the required rate at a certain

7. See Stevenson, *supra* note 3 at 458–59 (stating that IOLTA programs "generat[e] \$150-250 million every year for legal aid agencies across the nation") (footnote omitted).

8. *IOLTA History*, IOLTA.ORG, <http://www.iolta.org/what-is-iolta/iolta-history> (last visited Sept. 18, 2014).

9. *Id.*

10. See Stevenson, *supra* note 3, at 466 (2010) (discussing appellate court challenges to IOLTA).

11. See, e.g., Phillips v. Wash. Legal Found., 524 U.S. 156, 162–63 (1998).

12. *Brown v. Legal Found. of Washington*, 538 U.S. 216, 240 (2003) (agreeing with the U.S. Court of Appeals for the Ninth Circuit's holding that "[t]here was . . . no constitutional violation when" the petitioners did not receive the interest from the money placed in IOLTA accounts "[b]ecause of the way the IOLTA program operates, the compensation due [the petitioners] for any taking of their property would be nil." (quoting *Washington Legal Found. v. Legal Found. of Washington*, 271 F.3d 835, 861 (9th Cir. 2001), *aff'd sub nom. Brown v. Legal Found. of Washington*, 538 U.S. 216 (2003))).

13. See, e.g., OHIO REV. CODE ANN. § 4705.10 (West 2014); N.Y. COMP. CODES R. & REGS. tit. 21, § 7000.9 (2015).

14. See, e.g., HAW. SUP. CT. R. 11.

15. See, e.g., ALA. RULES OF PROF'L CONDUCT R. 1.15 (2012).

16. See, e.g., N.M. BAR R. 24-109(B)(3) (LexisNexis 2014).

17. See, e.g., ALA. RULES OF PROF'L CONDUCT R. 1.15(k).

18. See *infra* Part I.B.

percentage of the Federal Funds Target Rate (FFTR).¹⁹ The FFTR is set periodically by the Federal Open Market Committee of the Federal Reserve.²⁰

Since the beginning of the Financial Crisis in 2007,²¹ these rate-setting rules have permitted a decline in interest revenue from IOLTA programs.²² IOLTA interest rate rules are affected directly or indirectly by the monetary policy of the Federal Reserve and low central bank interest rates have kept IOLTA rates at historic lows for a six-year period.²³ As a result, legal aid programs that rely on IOLTA funding continue to face the challenge of seeking other forms of revenue or reducing the scope of their services to underprivileged citizens in need of legal services.²⁴

This Comment critically examines how the extraordinary economic conditions of the Financial Crisis revealed serious inadequacies in the rules that govern IOLTA interest rates and bank participation, which demonstrates an unintended negative effect of the Federal Reserve's monetary policy response. First, this Comment describes IOLTA's purpose and adoption and examines the current methods used to set minimum rates. Second, it addresses how unforeseeable economic conditions and ensuing monetary policy since 2007 have adversely and significantly affected IOLTA program revenues and, in turn, the administration of legal aid services. Third, this Comment analyzes how the current rules undermine the purpose of IOLTA and permit inconsistent participation by banks at the detriment of the IOLTA program and perhaps some of the banks themselves. Finally, given the ethical imperative for supporting legal aid programs, this Comment proposes several reforms which would give teeth to IOLTA rules and ensure the viability and stability of IOLTA revenues to fund legal aid in future years.

19. See *infra* Part I.B.

20. See *Open Market Operations*, BD. GOVERNORS FED. RES. SYS., <http://www.federalreserve.gov/monetarypolicy/openmarket.htm> (last visited Sept. 10, 2014).

21. See FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 27 (2011), available at http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf ("The financial crisis of 2007 and 2008 was not a single event but a series of crises that rippled through the financial system and, ultimately, the economy.").

22. Stevenson, *supra* note 3, at 459 (2010) ("Despite its prevalence and popularity, IOLTA faces a severe depletion of resources after the 2008 housing and banking crisis."). According to Professor Stevenson, IOLTA funding is imperiled by "continuously low interest rates, which lead to lower amounts of funds collected from IOLTA accounts." *Id.* at 458 n.11.

23. See *infra* Part I.B.

24. Carter, *supra* note 5 ("Some states have tacked on additional court fees, professional fees and others that are steered to IOLTA programs. Many programs engage in outreach to the bar for contributions or other ways of steering funds to them.").

I. EXAMINING IOLTA RULES AND THEIR IMPACTS DURING THE FINANCIAL CRISIS

A. A Common Purpose, but a Diverse Locus of State Authority

The central purpose of IOLTA is “to increase access to justice for individuals and families living in poverty and to improve our justice system.”²⁵ This idea has been consistently and clearly expressed since it “began in Florida in 1971 as a result of an investigation into means to provide funds for the improvement of the administration of justice.”²⁶ In Pennsylvania, for example, today IOLTA funds provide for the “delivery of civil legal assistance to the poor and disadvantaged in Pennsylvania by non-profit corporations.”²⁷ Montana’s IOLTA program sustains missions “[p]roviding legal services, through both paid staff program(s) and pro bono program(s), to Montana’s low income citizens who would otherwise be unable to obtain legal assistance; . . . promoting a knowledge and awareness of the law; and . . . improving the administration of justice.”²⁸ Aside from costs of administering the fund, Arizona must use IOLTA revenues to “assist in the delivery of legal services to the poor and law-related education programs designed to teach young people, educators and other adults about the law, the legal process and the legal system . . . [and] fund studies or programs designed to improve the administration of justice.”²⁹ In similar language across the country, state IOLTA rules express the program’s mandate to deliver legal aid services to those who cannot afford it.³⁰

Although IOLTA’s purpose is consistent nationwide, individual states have chosen varying seats of authority to regulate IOLTA programs.³¹ IOLTA regulations were primarily incorporated within the respective state rules of professional conduct regarding the safekeeping of property.³² Other states govern IOLTA using court rules that mirror standards expressed in the states’ respective rules of professional conduct.³³ A small number of states have

25. *What is IOLTA?*, *supra* note 4.

26. Petition of N.H. Bar Ass’n, 453 A.2d 1258, 1259 (N.H. 1982).

27. PA. RULES OF PROF’L CONDUCT R. 1.15(s)(1) (2014).

28. MONT. RULES OF PROF’L CONDUCT R. 1.18(a)(1)–(3) (West 2014).

29. ARIZ. SUP. CT. R. 43(f)(6)(A)–(B).

30. *See, e.g.*, D.C. BAR R. XIV, § 1 (West 2014) (stating that the “fundamental function” of the IOLTA program is “the support of legal services organizations and administration of justice programs.”).

31. *See infra* notes 32–35 and accompanying text.

32. *See, e.g.*, ALA. RULES OF PROF’L CONDUCT R. 1.15(k) (2012); CAL. BUS. & PROF. CODE § 6212(b) (West 2014); MICH. RULES OF PROF’L CONDUCT R. 1.15(a)(2) (West 2014); OKLA. ST. RULES OF PROF’L CONDUCT R. 1.15(h)(2) (West 2015); PA. RULES OF PROF’L CONDUCT 1.15(o)(3) (West 2014); WYO. RULES OF PROF’L CONDUCT R. 1.15A (2012).

33. *See, e.g.*, ARIZ. SUP. CT. R. 43(f); HAW. SUP. CT. R. 11(c)(1)(D)(i); MD. CT. R. 16-610(b)(1)(D); N.H. SUP. CT. R. 50(1)(B); VA. SUP. CT. R. pt. 6, § 4, para. 20.

codified IOLTA regulations by statute.³⁴ Still others regulate IOLTA through state bar rules.³⁵ Regardless of the type of legal authority chosen by each state, almost every regulation contains language establishing a basis to determine minimum IOLTA interest rates and banking institution eligibility for participation.

B. IOLTA Minimum Rate Provisions

1. Rate Comparability Provisions

Included in most states' IOLTA regulations is a method to calculate the minimum interest rate that participating banks must pay on IOLTA accounts.³⁶ A minority of states' rules make no provision for *any* minimum rate of interest to be paid.³⁷ However, the majority of state IOLTA rules contain comparability provisions that ensure IOLTA accounts are eligible to earn interest that is comparable to non-IOLTA accounts of a similar type.³⁸ Comparability provisions were not initially common to IOLTA regulations; the Ohio IOLTA program was the first to implement rate comparability rules, and a majority of

34. See, e.g., N.Y. COMP. CODES R. & REGS. tit. 21, § 7000.9 (2015); OHIO REV. CODE ANN. § 4705.10 (West 2014).

35. See, e.g., FLA. ST. BAR R. 5-1.1(g)–(k) (West 2014); IDAHO BAR. COMM. R. 1306 (West 2014); ME. BAR R. 6(a)(2)–(5) (West 2014); MO. BAR R. 4-1.145 (West 2014); N.C. BAR R. ch. 1, subch. D., § .1317 (West 2014); UTAH BAR. R. 14-1001 (West 2014).

36. See, e.g., UTAH BAR. R. 14-1001(f).

37. See ARIZ. SUP. CT. R. 43(f)(3); IOWA CT. R. 45.4(3); N.D. RULES OF PROF'L CONDUCT R. 1.15(f) (West 2014); OR. RULES PROF'L CONDUCT R. 1.15-2(c) (West 2014); VA. SUP. CT. R. pt. 6, § 4(B).

38. See, e.g., ALA. RULES OF PROF'L CONDUCT 1.15(k); ARK. RULES OF PROF'L CONDUCT R. 1.15(c)(2)(i) (West 2014); CAL. BUS. & PROF. CODE § 6212(b); CONN. RULES OF PROF'L CONDUCT 1.15(h)(3)(A) (West 2014); DEL. RULES OF PROF'L CONDUCT 1.15(h) (West 2014); D.C. BAR R. XI, § 20(f) (West 2014); FLA. ST. BAR R. 5-1.1(g)(5)(A); GA. RULES OF PROF'L CONDUCT 1.15(II)(c)(2)(iv) (West 2014); HAW. SUP. CT. R. 11(c)(1)(D)(i); IDAHO BAR COMM'N R. 1306(b) (West 2014); ILL. RULES OF PROF'L CONDUCT R. 1.15(f) (West 2014); IND. RULES OF PROF'L CONDUCT R. 1.15(f)(5) (West 2014); KAN. RULES OF PROF'L CONDUCT R. 1.15(g)(2) (West 2014); KY. SUP. CT. R. 3.830(4); LA. RULES OF PROF'L CONDUCT R. 1.15(g)(2) (West 2014); ME. BAR R. 6(a)(4)(C)(2); MD. CT. R. 16-610(b)(1)(D); MASS. SUP. JUD. CT. R. 3:07(g)(i) (LexisNexis 2015); MICH. RULES OF PROF'L CONDUCT R. 1.15(a)(2) (West 2014); MINN. RULES OF PROF'L CONDUCT R. 1.15(o) (West 2014); MO. BAR R. 4-1.145(a)(5) (West 2014); MONT. RULES OF PROF'L CONDUCT R. 1.15(c)(1)(D) (West 2014); NEB. CT. R. 1.15; NEV. SUP. CT. R. § 3-903(B)(4); N.H. SUP. CT. R. 50(1)(B); N.J. CT. R. 1:28A-2(e)(1); N.M. BAR R. 24-109(B)(3) (LexisNexis 2015); N.Y. COMP. CODES R. & REGS. TIT. 21, § 7000.9; N.C. BAR ch. 1, subch. D., § .1317; OHIO REV. CODE ANN. § 4705.10(A)(2) (West 2014); OKLA. RULES OF PROF'L CONDUCT R. 1.15(h)(2); PA. RULES OF PROF'L CONDUCT R. 1.15(o)(3); R.I. RULES OF PROF'L CONDUCT 1.15(f)(5); S.C. SUP. CT. R. 412(c)(2)(A); S.D. RULES OF PROF'L CONDUCT R. 1.15(d)(3)(iv) (2014); TENN. SUP. CT. R. 43, § 2 (West 2014); TEX. ACCESS TO JUSTICE FOUND. R. 7(a) (West 2014); UTAH BAR R. 14-1001(f)(1); VT. RULES OF PROF'L CONDUCT R. 1.15B(a) (West 2014); WASH. RULES FOR ENF'T OF LAW. CONDUCT R. 15.7(e)(1) (West 2014); WIS. SUP. CT. R. 20:1.15(cm)(4)(b) (West 2014); WYO. RULES OF PROF'L CONDUCT R. 1.15A(b)(1) (LexisNexis 2015).

states followed thereafter.³⁹ The language of California's rule is representative of comparability provisions nationwide and mandates that "the rate of interest or dividends payable on any IOLTA account shall not be less than the interest rate or dividends generally paid by the eligible institution to nonattorney customers on accounts of the same type meeting the same minimum balance and other eligibility requirements as the IOLTA account."⁴⁰

While rate comparability provisions ensure that IOLTA accounts earn at least as much as their counterpart non-IOLTA accounts, they do not afford IOLTA accounts the limited special protections guaranteed by other minimum rate-setting rules.⁴¹ IOLTA accounts are subject to the same prevailing rate conditions that affect deposit accounts generally.⁴² A variety of factors influence deposit rates and, therefore, banks' rate-setting decisions.⁴³ Depository banks earn the majority of their income from net interest income, which is the difference between the interest borrowers pay to the bank and the interest the banks pay to depositors.⁴⁴ The difference between the average interest rate the bank charges borrowers and the average interest rate the bank pays depositors constitutes the bank's net interest margin.⁴⁵ Banks strive to set interest rates that will produce a healthy interest margin, but must adjust these rates in response to the abundance or scarcity of deposits to fund loans as well as the availability and

39. Linda K. Rexer, *The History of IOLTA*, A.B.A. DIALOGUE MAG., http://apps.americanbar.org/legalservices/dialogue/su10/su10_iolta1.html (last updated Sept. 9, 2010) (giving a brief overview of the evolution of IOLTA regulations).

40. CAL. BUS. & PROF. CODE § 6212(b); *see also* CONN. RULES OF PROF'L CONDUCT R. 1.15(h)(3)(A) ("The eligible institution shall pay no less on its IOLTA accounts than the highest interest rate or dividend generally available from the institution to its non-IOLTA customers when the IOLTA account meets or exceeds the same minimum balance or other eligibility qualifications on its non-IOLTA accounts.").

41. *See supra* notes 38–40 and accompanying text (illustrating that IOLTA rules may require IOLTA funds to earn rates comparable to non-IOLTA accounts without setting a specific minimum interest rate).

42. *See* Rexer, *supra* note 39 (stating that Ohio's rule requires lawyers to "hold IOLTA accounts only in financial institutions that pay those accounts the same rates as accounts of non-IOLTA customers").

43. *See* Laura Bruce, *How Interest Rates Are Determined*, BANKRATE.COM (Aug. 25, 2009), <http://www.bankrate.com/finance/cd/how-interest-rates-are-determined.aspx> ("Interest rates are affected by a number of factors. The Federal Reserve . . . raises and lowers short-term interest rates in an effort to maintain . . . stability.").

44. Robert DeYoung & Tara Rice, *How Do Banks Make Money? The Fallacies of Fee Income*, ECON. PERSP., Nov. 2004, at 34, 34–35, available at http://www.chicagofed.org/digital_assets/publications/economic_perspectives/2004/ep_4qtr2004_part3_DeYoung_Rice.pdf ("To be sure, the interest margin banks earn by intermediating between depositors and borrowers continues to be the primary source of profits for most banking companies.").

45. *See id.* at 34. This principle is illustrated in a classic banker's joke: "According to the '3-6-3 rule,' bankers paid a 3 percent rate of interest on deposits, charged a 6 percent rate of interest on loans, and then headed to the golf course at 3 o'clock." *Id.*

demand for credit in the borrowing community.⁴⁶ One of the many factors that determine a bank's interest rates is the behavior of the Federal Reserve in setting central interest rates.⁴⁷

Since the onset of the Financial Crisis, a principal objective of the Federal Reserve has been to encourage economic activity by individuals and businesses.⁴⁸ A primary tool of this monetary policy has been to significantly lower the rates at which most banks lend money.⁴⁹ The Federal Reserve's Federal Open Market Committee (FOMC), which determines monetary policy in the United States, manages the Funds Target Rate (FFTR).⁵⁰ According to the FOMC, "monetary policy" comprises "the actions undertaken by a central bank, such as the Federal Reserve, to influence the availability and cost of money and credit to help promote national economic goals."⁵¹ The FOMC, in particular, is responsible for setting monetary policy through "open market operations,"⁵² which are "the purchase and sale of securities in the open market by a central bank,"⁵³ and the FFTR is one of its principal tools.⁵⁴

Although the FFTR has been set low to optimize economic growth and stability, the extended low rates have had a direct impact on depositors'

46. See Bruce, *supra* note 43; see also Hesna Genay & Darrin R. Halcomb, *Rising Interest Rates, Bank Loans, and Deposits*, CHI. FED. LETTER (The Fed. Reserve Bank of Chi., Chi., Ill.), Nov. 2008, at 1, 1–2, available at https://www.chicagofed.org/digital_assets/publications/chicago_fed_letter/2004/cflnovember2004_208.pdf ("Historically, rising interest rates have been associated with slower growth of bank loans and deposits. . . . [And] higher interest rates can lead to slower loan growth through their effects on deposits.").

47. Bruce, *supra* note 43.

48. *What Is The Fed: Monetary Policy*, FED. RES. BD. S.F., <http://www.frbsf.org/education/teacher-resources/what-is-the-fed/monetary-policy> (last visited Nov. 7, 2014).

49. *Selected Interest Rate: Historical Data*, BD. GOVERNORS FED. RES. SYS., <http://www.federalreserve.gov/releases/h15/data.htm> (last visited Sept. 14, 2014) (showing a decline in Bank Prime Loan Rates between 2008 and 2013). "The prime rate is a 'reference or base rate' that banks use to set the price or interest rate on many of their commercial loans and some of their consumer loan products." *What Is the Prime Rate, and Who Borrows at that Interest Rate?*, FED. RES. BANK S.F. (June 2005), <http://www.frbsf.org/education/publications/doctor-econ/2005/june/prime-interest-rate>.

50. *Open Market Operations*, *supra* note 20; see also Mark F. Bernstein, *The Federal Open Market Committee and the Sharing of Governmental Power with Private Citizens*, 75 VA. L. REV. 111, 111 (1989) ("[T]he FOMC has complete control over the purchase and sale of government securities by the Federal Reserve Banks, one of the chief instruments of monetary policy . . .").

51. *About the FOMC*, BD. GOVERNORS FED. RES. SYS., <http://www.federalreserve.gov/monetarypolicy/fomc.htm> (last visited Sept. 10, 2014). "The Federal Reserve Act of 1913 gave the Federal Reserve responsibility for setting monetary policy." *Id.*

52. *Id.*

53. *Credit and Liquidity Programs and the Balance Sheet*, BD. GOVERNORS FED. RES. SYS., http://www.federalreserve.gov/monetarypolicy/bst_openmarketops.htm (last visited Feb. 26, 2015).

54. *About the FOMC*, *supra* note 51.

interest.⁵⁵ Consequently, certain depositors who rely on interest income for subsistence or retirement are adversely affected.⁵⁶ The *Wall Street Journal* has observed that the Federal Reserve's extended strategy of maintaining a low FFTR has produced disparate effects that may preserve the economic vitality of certain sectors of the economy at the expense of certain individuals: "A long spell of low interest rates has created a windfall worth billions to banks, mortgage borrowers and others it was designed to benefit. But for many people who were counting on their nest eggs, those same low rates can spell trouble."⁵⁷

Rate comparability rules mean that IOLTA accounts, like retirees, now face the quandaries posed by sustained periods of low interest rates.⁵⁸ The current rate environment is unprecedented—from IOLTA's inception in 1981 until 2008, the average prime rate, or rate at which banks typically lend to their most creditworthy customers, ranged from 4.12% to 18.87%.⁵⁹ By contrast, the average prime rate has not surpassed 3.25% since 2009.⁶⁰ In order for banks to ensure a viable net interest margin during that time, they have in turn paid interest rates that approach zero.⁶¹ IOLTA accounts under rate comparability rules, which guarantee the rates offered to all depositors generally, have not been exempt from these lower deposit interest rates.

2. Federal Funds Target Rate Provisions

As an alternative to pure rate comparability provisions, many states permit participating banks to index their IOLTA rates directly to the FFTR.⁶² Instead

55. See *supra* notes 48–49 and accompanying text; see also Mark Whitehouse, *Fed's Low Interest Rates Crack Retirees' Nest Eggs*, WALL ST. J. (Apr. 4, 2011, 12:01 AM), <http://online.wsj.com/articles/SB10001424052748703410604576216830941163492> (describing how the Federal Reserve's lowering of interest rates harms savers by reducing "income on investments" and failing to "compensat[e] for inflation").

56. Whitehouse, *supra* note 55.

57. *Id.*

58. *Id.*

59. *Selected Interest Rate: Historical Data*, *supra* note 49 (showing historical data for Bank Prime Loan Rates).

60. *Id.*

61. *Maryland Consumer & Business Online Rates*, BANK AM., <https://www.bankofamerica.com/deposits/bank-account-interest-rates.go> (last visited Oct. 18, 2014) (explaining that Bank of America, for example, paid, as of October 18, 2014, three-hundredths of one percent on Interest Checking account balances in excess of \$100,000 in Maryland).

62. See, e.g., ALA. RULES OF PROF'L CONDUCT 1.15(k) (2012); ARK. RULES OF PROF'L CONDUCT R. 1.15(c)(2)(i) (West 2014); CONN. RULES OF PROF'L CONDUCT 1.15(h)(3)(A) (West 2014); DEL. RULES OF PROF'L CONDUCT 1.15(h) (West 2014); D.C. BAR R. XI, § 20(f) (West 2014); IDAHO BAR COMM'N R. 1306(b) (West 2014); ILL. RULES OF PROF'L CONDUCT R. 1.15(f) (West 2014); ME. BAR R. 6(a)(4)(C)(2) (West 2014); MINN. RULES OF PROF'L CONDUCT R. 1.15(o) (West 2014); MO. BAR R. 4-1.145(a)(5) (West 2014); N.M. BAR R. 24-109(B)(3) (LexisNexis 2015); N.Y. COMP. CODES R. & REGS. tit. 21, § 7000.9 (2015); N.C. BAR ch. 1, subch. D., § .1317(b)(3) (West 2014); S.C. SUP. CT. R. 412(c)(2)(A); UTAH BAR R. 14-1001(f)(1) (West 2014); WASH. RULES FOR ENF'T OF LAW. CONDUCT R. 15.7(e)(1) (West 2014).

of focusing on the rates paid on other accounts, these states authorize banks to use the FFTR as a basis for determining the minimum IOLTA interest rates to be paid by eligible participating banks.⁶³ A common formulation of this type of rule gives banks the choice between paying a rate comparable to the rate offered to non-IOLTA customers, or, instead, paying a rate based on the FFTR.⁶⁴ Rate rules that provide this option typically express the rate requirement as a percentage of the FFTR; the percentage of the FFTR to be paid currently varies by state from fifty-five percent to eighty percent of the FFTR.⁶⁵

Some states pair FFTR-based interest rates with an absolute rate floor.⁶⁶ In Illinois, for example, “[a]s an alternative to the [rate comparability provision] the financial institution may pay a ‘safe harbor’ yield equal to 70% of the Federal Funds Target Rate or 1.0%, whichever is higher.”⁶⁷ A safe harbor rate seeks to ensure that actual interest rates paid on IOLTA accounts remain above a certain

63. See *supra* note 62.

64. See, e.g., IDAHO R. BAR. COMM. R. 1306. It states:

An eligible financial institution may satisfy the comparability requirements of subsection (b) by electing one of the following options: (1) establish the IOLTA account as the comparable rate product; (2) pay the comparable rate on the IOLTA account in lieu of actually establishing the comparable rate or dividend product; or (3) pay a rate equal to the greater of 70%, or such other rate as may be recommended by the Foundation, of the Federal Fund Target Rate as of the first business day of the IOLTA account earnings period, which rate is deemed to be net of allowable reasonable service charges or fees, on an IOLTA account.

Id.

65. Compare N.M. BAR R. 24-109(B)(3)(a)(iii) (“[E]ligible institutions [must] . . . pay an amount on funds that would otherwise qualify for the investment options noted in Subparagraph (c) of Subparagraph (3) of this paragraph equal to fifty-five percent (55%) of the federal funds targeted rate as of the first business day of the month or other IOLTA remitting period . . .”), with MINN. RULES OF PROF’L CONDUCT R. 1.15(o)(3) (“An approved eligible financial institution must pay no less on IOLTA accounts than (i) the highest earnings rate generally available from the institution to its non-IOLTA customers on each IOLTA account . . . or, (ii) 80% of the Federal Funds Target Rate on all its IOLTA accounts.”).

66. See CONN. RULES OF PROF’L CONDUCT R. 1.15(h)(3)(A); DEL. RULES OF PROF’L CONDUCT R. 1.15(h)(1)(C); ILL. RULES OF PROF’L CONDUCT R. 1.15(f)(4); N.Y. COMP. CODES R. & REGS. tit. 21, § 7000.9(b)(1)–(2); N.C. BAR R. ch. 1, subch. D. § 1317(b)(3); S.C. APP. CT. R. 412; TEX. ACCESS TO JUSTICE FOUND. R. 7(a)(3); WASH. RULES FOR ENF’T LAW. CONDUCT R. 15.7(e)(1)(iii). In particular, the New Jersey Supreme Court amended its IOLTA rules to pair a rate floor with its FFTR percentage rule, citing to economic circumstances that projected the FFTR to remain at 0.00%. Supplemental Administrative Determination, Regarding IOLTA and the Best Customer Standard, N.J. SUP. CT., Feb. 18, 2009.

67. ILL. RULES OF PROF’L CONDUCT R. 1.15(f)(4).

minimum.⁶⁸ Other states offer slight variations or limitations on this type of rate rule.⁶⁹

Because it is a monetary policy tool set by the Federal Reserve, the FFTR, which controls IOLTA interest under these rules, is inherently subject to change over time.⁷⁰ Since the end of 2008, however, the rate has remained historically anomalous—and low.⁷¹ As economic crisis loomed in late 2007, the FOMC began a series of dramatic cuts to the FFTR, and set a “near-zero target rate” for the FFT toward the end of 2008.⁷² This rate target was the lowest ever set,⁷³ and has remained static since 2008.⁷⁴

The Federal Reserve has employed other strategies to bolster the economy, including a “quantitative easing” strategy of purchasing United States Treasury securities to keep borrowing costs low.⁷⁵ In October 2014, six years after introducing the strategy, the Federal Reserve announced that the progress of the country’s economic recovery was sufficient to discontinue quantitative easing,⁷⁶ but it does not appear to have changed its FFTR strategy.⁷⁷ Although the FOMC has recently commented on positive economic trends that signal a future change in this policy, it stated “that it plans to keep short-term interest rates low for a ‘considerable’ time.”⁷⁸

Because rates are expected to remain low for a considerable time, IOLTA deposit rates based on the FFTR are likely to remain low as well. In turn, legal

68. See *Approved IOLTA Depositories*, MASS. IOLTA, <http://www.maiolta.org/financial/depositories.shtml> (last visited Sept. 16, 2014) (stating that banks “choosing the Safe Harbor rate are helping to meet the legal needs of Massachusetts residents by insuring their rate maintains a minimum level at all times and increases with other market rates”).

69. See, e.g., NEV. SUP. CT. R. 217(2) (West 2014). Nevada’s formulation is a slight variation that allows banks to pay a minimum rate “[e]qual to the Federal Fund Target Rate, or, the Federal Discount Rate plus .50 percent.” *Id.* Kentucky allows banks the option to pay IOLTA interest at the rate of seventy percent of the FFTR, but only if the FFTR is between one and four percent. KY. SUP. CT. R. 3.830(5) (West 2014).

70. See *Open Market Operations*, *supra* note 20 (showing the fluctuation in historical FFTRs).

71. *Id.* (indicating that FFTRs since “late 2008” represent historic lows for an extended period of time).

72. *Id.* The rationale for this rate setting policy is further discussed in Part I.B.2

73. Neil Irwin, *Fed Cuts Key Rate to Record Low*, WASH. POST (Dec. 17, 2008), <http://www.washingtonpost.com/wp-dyn/content/article/2008/12/16/AR2008121601754.html>.

74. *Open Market Operations*, *supra* note 20.

75. Binyamin Appelbaum, *Federal Reserve Caps Its Bond Purchases; Focus Turns to Interest Rates*, N.Y. TIMES (Oct. 29, 2014), <http://www.nytimes.com/2014/10/30/business/federal-reserve-janet-yellen-qe-announcement.html>; see also Brett W. Fawley & Luciana Juvenal, *Quantitative Easing: Lessons We’ve Learned*, REGIONAL ECONOMIST, July 2012, at 8, available at https://www.stlouisfed.org/legacy_assets/publications/pub_assets/pdf/re/2012/c/QE.pdf.

76. Appelbaum, *supra* note 75.

77. Alain Sherter, *Moneywatch: Fed Vows to Keep Interest Rates Low for “Considerable” Time*, CBS MONEYWATCH (Sept. 17, 2014, 3:14 PM), <http://www.cbsnews.com/news/fed-vows-to-keep-interest-rates-low-for-considerable-time>.

78. *Id.*

aid programs that rely on IOLTA interest income face diminished funding.⁷⁹ Yet with few exceptions, state IOLTA organizations have not changed IOLTA rules in response to static, low interest rates.⁸⁰

C. Factors Affecting Eligible Bank Participation

Banks are an indispensable part of the IOLTA program: they create attorneys' IOLTA accounts, accept and account for deposits made to the accounts, calculate and credit interest earned, and pay that interest to the appropriate legal aid organization.⁸¹ Bank participation, however, is not mandatory.⁸² Instead, the terms governing eligibility to offer IOLTA accounts are contained in the rules promulgated by the relevant rulemaking authority in each state.⁸³ IOLTA rules typically refer to such banks as "participating,"⁸⁴ "eligible," or "approved" institutions.⁸⁵ The basis for this institutional eligibility differs by state. For example, in North Dakota and Rhode Island, any bank that does business in the respective state is eligible to participate in IOLTA.⁸⁶ Some states, such as Oregon and Vermont, have IOLTA rules that condition a bank's eligibility on the execution of an explicit agreement that the bank reports certain types of transaction activity on an IOLTA account.⁸⁷ But the most common provision,

79. Robert J. Derocher, *The IOLTA Crash: Fallout for Foundations*, A.B.A. BAR LEADER, Sept.–Oct. 2012, available at http://www.americanbar.org/publications/bar_leader/2012_13/september_october/iolta_crash_fallout_foundations.html (last visited September 14, 2014).

80. The New Jersey Supreme Court revised its IOLTA rate comparability rule in 2009, noting that "[i]n light of the 'floating' Federal Funds Target Rate being grounded at 0.00%, there is a need for immediate action to assist banks seeking guidance about how to meet the Best Customer [rate comparability] Standard." Supplemental Administrative Determination, Regarding IOLTA and the Best Customer Standard, N.J. SUP. CT. (Feb. 18, 2009). The Kentucky rule, which only permits banks to use the FFTR as a rate-setting guide when the FFTR is between one and four percent, would not allow a bank to rely on that provision today. See KY. SUP. CT. R. 3.830(5).

81. See Derocher, *supra* note 79 (explaining how few states have found success in changing how IOLTA programs are funded).

82. See *Info for Banks*, IOLTA.ORG, <http://www.iolta.org/info-for-banks> (last visited Sept. 18, 2014).

83. See *supra* Part I.A.

84. See KY. SUP. CT. R. 3.830(3)–(5).

85. See DEL. RULES OF PROF'L CONDUCT R. 1.15(d)(12)(A) (West 2014).

86. See N.D. RULES OF PROF'L CONDUCT R. 1.15(f)(4) (West 2014) ("An eligible financial institution is a bank, savings bank, trust company, savings and loan association, savings association, credit union, or federally regulated investment company authorized by federal or state law to do business in North Dakota and insured by [the proper relevant body]."); R.I. RULES OF PROF'L CONDUCT 1.15(f)(4) (West 2014) ("IOLTA accounts may be established with any financial institution authorized by federal or state law to do business in Rhode Island.").

87. See VT. RULES OF PROF'L CONDUCT R. 1.15B(d) (West 2014) (stating that eligible banks must "notify Disciplinary Counsel whenever (1) any properly payable instrument is presented against such a trust account containing insufficient funds, irrespective of whether or not the instrument is honored; and (2) whenever any transaction, no matter the type, causes such an account to be overdrawn").

by far, requires banks to comply with established rate comparability rules in order to maintain their status as eligible institutions.⁸⁸

Although banks are not obligated by rule to participate as IOLTA depository institutions, there are incentives for bank participation:

[F]inancial institutions receive a benefit under the IOLTA system (since they can utilize the funds at a higher rate of return than the interest paid to the nonprofit organization) As there is strong competition between financial institutions, it is likely that institutions not offering IOLTA type accounts will totally lose use of the funds because lawyers will move accounts to institutions providing such services.⁸⁹

In addition, participation in IOLTA programs earns banks Community Reinvestment Act (CRA) credit, which is an important factor in determining a bank's eligibility to expand in certain markets or participate in a merger or acquisition.⁹⁰

Nothing in the IOLTA rules prohibits any institution from paying a rate higher than that guaranteed by a state's minimum IOLTA rate provisions. Highlighting the competition of deposits described above, many state IOLTA programs and bar associations provide special recognition to institutions that offer interest rates for IOLTA accounts that are higher than the minimum rate prescribed by the rules.⁹¹ This recognition encourages attorneys to reward these "honor roll" banks by choosing to house their IOLTA accounts and other business with the banks.⁹²

Oregon and Texas, for example, are two states with IOLTA programs that have taken an active and organized approach to encourage banks to pay higher than minimum interest rates on IOLTA accounts.⁹³ The Oregon Law

88. See *supra* Part I.B.1.

89. Betsy Borden Johnson, "With Liberty and Justice for All": IOLTA in Texas—The Texas Equal Access to Justice System, 37 BAYLOR L. REV. 725, 727 (1985).

90. See Thom Weidlich, *IOLTAs Can Be Good Way to Build Deposits*, AM. BANKER (June 7, 2004, 5:48 PM), http://www.americanbanker.com/special-reports/169_16/-223736-1.html; see also *About Us: Community Reinvestment Act*, FED. RES. BANK ST. LOUIS, http://www.stlouisfed.org/community_development/cra.cfm#main (last visited Sept. 15, 2014) ("An institution's record of meeting the credit needs . . . is taken into consideration . . . when [it] seeks to expand through merger acquisition or branching.").

91. See, e.g., *Info for Banks*, *supra* note 82 ("Many IOLTA programs publicly recognize financial institutions that treat IOLTA favorably. Some states have an 'Honor Roll' for financial institutions, and other states provide different forms of recognition. Several states also present awards at bar association functions . . .").

92. See, e.g., *Information for Lawyers*, OR. L. FOUND., <http://www.oregonlawfoundation.org/lawyers.html> (last visited Sept. 14, 2014) ("You can help the Oregon Law Foundation by establishing your IOLTA account at (or moving your IOLTA account to) a bank that is committed to maximizing the rate of return on IOLTA accounts. The Oregon Law Foundation's 'Leadership Banks' have shown such a commitment.").

93. Ken Smith et al., *Partnership Bank Programs: Maximizing IOLTA Revenue in Difficult Times*, A.B.A. DIALOGUE MAG., <http://www.americanbar.org/content/dam/aba/publishing/>

Foundation's "Leadership Bank" program provides special recognition and benefits to banks that voluntarily paid higher rates on IOLTA accounts.⁹⁴ As of 2012, it boasted bank participation that included "one out of every three Oregon banks" and "five of [the] 10 biggest banks."⁹⁵ The effect of this participation was that "69[%] of all IOLTA deposits are in . . . [b]anks, paying [an] average net yield of 0.71[%] compared with . . . 0.10[%] estimated yield that these banks pay their non IOLTA customers holding comparable accounts."⁹⁶

The Texas Access to Justice Foundation (TAJF) implemented its "Prime Partners" program in 2007 to attract and reward banks paying higher IOLTA rates.⁹⁷ As in Oregon, participating banks in Texas paid at least one percent interest on IOLTA accounts, and earned special recognition and benefits.⁹⁸ In 2012, TAJF said that additional IOLTA revenue attributable to the higher rates paid by its "Prime Partner" banks was \$1.5 million, which "is sufficient to fund 30 additional legal aid lawyers at the national average salary of \$50,000 per year."⁹⁹

Many large national banks do not elect to compete for IOLTA deposits by offering higher rates than those required by rule, but still manage to retain a large share of the overall IOLTA market.¹⁰⁰ Despite its previous recognition of

dialogue/ls_dial_su12_iolta1.authcheckdam.pdf (last visited April 9, 2015) ("The Leadership Bank program has achieved its goal of maximizing IOLTA revenue while also maintaining the excellent working partnership of the banking and legal communities. It builds on the positive banking relationships that Oregon IOLTA has developed through its sustained efforts over many years.").

94. *Id.* These benefits are summarized on the website of the Oregon Law Foundation: Participation in IOLTA can be seen as a community service by banks and can result in favorable coverage by the media. Since Oregon lawyers are committed to access to justice issues and funding, some financial institutions in Oregon use their IOLTA accounts as a way to attract new customers. In addition, the Oregon Law Foundation will promote among attorneys the patronage of financial institutions in which IOLTA accounts will generate funds for legal services to the poor, including assisting attorneys in locating Leadership Banks in their area.

Info for Banks, OR. L. FOUND., <http://www.oregonlawfoundation.org/banks.html> (last visited Nov. 14, 2014).

95. Smith et al., *supra* note 93.

96. *Id.*

97. *Id.*

98. *Id.* In its pitch to obtain involvement of Texas banks,

TAJF crafted a bold proposition: Pay more than required under comparability and your bank will be highly publicized in the legal community as a "Prime Partner," willing to comply and to go above and beyond for the benefit of low income people who need access to our civil justice system.

Id.

99. *Id.*

100. See, e.g., Beverly Michaelis, *Speak up for IOLTA – Tell U.S. Bank What You Think*, OR. L. PRAC. MGMT. (Aug. 1, 2011), <http://oregonlawpracticemanagement.com/2011/08/01/speak-up-for-iolta-tell-us-bank-what-you-think/> ("U.S. Bank holds more IOLTA accounts in Oregon than any other banking institution.").

successful efforts to build large bank participation,¹⁰¹ the Oregon Legal Foundation noted that “U.S. Bank . . . [is] decreasing its IOLTA interest rate from 0.7% to a tiered average of 0.13%. This decrease . . . will result in a [twenty percent] loss in annual IOLTA revenue or \$160,000 for 2014.”¹⁰² Big bank participation in the Texas “Prime Partners” program also diminished at the onset of the Financial Crisis.¹⁰³ Other banks may avoid or reconsider participation in IOLTA based on rate considerations. In 2010, JP Morgan Chase ended its participation in the New Jersey IOLTA program because it did not wish to comply with rate comparability provisions.¹⁰⁴

D. Diminishing IOLTA Revenues After 2007 and State Responses

Because IOLTA program revenues ordinarily tend to fluctuate in concert with the central interest rates set by the Federal Reserve,¹⁰⁵ the IOLTA program is a procyclical phenomenon that tends to mirror the overall strength of the American economy.¹⁰⁶ As a result of the Federal Reserve’s ongoing efforts to keep borrowing rates low, and banks’ ensuing action to lower interest rates to preserve net interest margins, IOLTA interest revenues rapidly declined after 2007 and remain at historic lows.¹⁰⁷ This phenomenon has been widely recognized by the legal community, which has felt its practical effect over the last six years: when interest rates are depressed for extended periods of time, reduced IOLTA revenues affect the delivery of legal aid services that rely on IOLTA revenues.¹⁰⁸ The effect is further compounded by the inherent risk of volatility caused by related economic factors, such as the relative strength of the housing market.¹⁰⁹

101. See Smith et al., *supra* note 93 (“Oregon’s program demonstrates that these relationships can even be forged with large banks like Wells Fargo and US Bank that hold the bulk of IOLTA deposits.”).

102. *President’s Report in 2013 Annual Report*, OR. L. FOUND., <http://www.oregonlawfoundation.org/docs/OLFAR.pdf> (last visited Sept. 14, 2014).

103. See Smith et al., *supra* note 93 (“After the Fed Rate dropped to near zero, three of the five biggest banks dropped out of the program.”).

104. Brian T. Murray, *N.J. Attorneys, Law Firms Pull Client Trust Accounts Held by Chase*, N.J. STAR LEDGER (August 2, 2010, 8:54 PM), http://www.nj.com/business/index.ssf/2010/08/attorneys_pulling_client_trust.html.

105. See Chris Tweeten, *Legal Services Needs Your Help*, MONT. LAW., April 2009, at 4, available at <http://c.y.mcdn.com/sites/www.montanabar.org/resource/collection/EAA30F23-4767-49DA-BBE7-152CF93C8535/April2009MTLawyer.pdf> (noting how IOLTA funds are reduced as the Federal Reserve’s “benchmark interest rate” falls).

106. Carter, *supra* note 5.

107. *Id.* *Interest Rates*, IOLTA.ORG, <http://www.iolta.org/what-is-iolta/items-interest-rates> (last visited Sept. 18, 2014).

108. *Id.*; see also Kathleen A. McKee, *The Impact of the Current Economy on Access to Justice*, 62 ME. L. REV. 613, 629 n.38 (2010) (explaining how interest rate reductions led to a drop in the projected funding for legal services to the underprivileged in Virginia).

109. See Stevenson, *supra* note 3, at 465–66. Stevenson explains that:

The extent of IOLTA revenue reduction is remarkable. “In Texas, IOLTA revenue has dropped from \$20 million in 2007 to an estimated \$4.4 million in 2012—an 80 percent decline.”¹¹⁰ The District of Columbia Bar Foundation reported that between 2008 and 2014, its IOLTA revenue fell from approximately \$2.4 million to \$539,898, despite a net increase of over 700 accounts.¹¹¹ Florida, a state hit hard by the Financial Crisis, saw “IOLTA revenue tumble 88[%] over the last five years, from \$44 million to \$5.5 million.”¹¹²

States have been affected by IOLTA rate declines in varying degrees, but “layoffs, salary cuts, and office closures for organizations providing civil legal services to the poor continue to unfold across the country,” as legal aid providers face mounting demand and shriveling IOLTA funds.¹¹³ According to the American Bar Association (ABA) statistics, in just the first four years of the recession, “IOLTA grants to legal service providers nationwide from 2008 to 2011[] plung[ed] from \$231 million to \$106 million.”¹¹⁴

The procyclical nature of IOLTA rates and program funding tends to suggest that rates and revenue can be expected to be at their lowest when the overall health of the economy is at its poorest.¹¹⁵ Additionally, there is evidence that demand for legal services remains the same or even increases when the economy is relatively weak, and legal aid funding from IOLTA is depressed; for example, “South Jersey Legal Services, which covers seven counties, will lay off five attorneys and close two offices beginning in January.”¹¹⁶ As a result, “[i]t

[M]ost IOLTA deposits are from real estate transactions, so a downturn in the real estate market means fewer IOLTA deposits to generate interest. Depressed property values shrink the size of the IOLTA deposits that do come in, further depleting the funds. Many IOLTA programs try to mitigate these problems by having the entity that receives and distributes the funds engage in regular charitable fundraising and apply for grants from other private foundations or government entities.

Id. (footnotes omitted).

110. Derocher, *supra* note 79. According to Derocher, state IOLTA resources have been decimated: “Less than five years after receiving \$1.9 million in IOLTA revenue, the Boston Bar Foundation . . . [received] \$600,000 in IOLTA funds in 2011—a nearly 70 percent decline. The Montana Justice Foundation, which received \$1 million via IOLTA in 2007, expects just \$160,000 in such revenue in 2012-13.” *Id.*

111. Catherine Ho, *D.C. IOLTA Program Struggles Amid Low Interest Rates*, WASH. POST (Sept. 7, 2014), http://www.washingtonpost.com/business/capitalbusiness/dc-iolta-program-struggles-amid-low-interest-rates/2014/09/05/d769c672-33b7-11e4-8f02-03c644b2d7d0_story.html.

112. Derocher, *supra* note 79.

113. *Id.*

114. *Id.*

115. *Id.*

116. Matt Katz, *Financial Crisis Harms Legal Aid for N.J. Poor, States Facing Deep Fund Shortage*, PHILA. INQUIRER (Sept. 27, 2008), http://articles.philly.com/2008-09-27/news/25247143_1_legal-aid-interest-rates-housing-market.

expects to provide legal help to 9,000 people next year, down from 12,000 this year.”¹¹⁷

Some legal aid programs that typically rely on IOLTA have been able to find other sources of income to offset the impact of rate reductions. The Maryland Legal Services Corporation, for example, was able to partially offset a fifteen percent reduction in IOLTA revenue in 2013 by successfully petitioning the legislature for court filing fees and increased allocation from other state funds.¹¹⁸ In 2009, Texas’ TAJF successfully petitioned the state legislature for \$20 million in funding that year.¹¹⁹ In Alabama, where IOLTA revenues to the Alabama Law Foundation declined by sixty-two percent between 2008 and 2014, attorneys were encouraged to make a fifty-dollar, tax-deductible contribution in conjunction with the payment of annual assessments to the Client Security Fund.¹²⁰

The Department of Justice’s recent settlement with Bank of America, in the wake of an investigation into mortgage-backed securities, requires Bank of America to pay \$30 million into IOLTA programs across the country, representing a significant windfall for these programs.¹²¹ In some states, “cy pres” awards, or “residual funds from class actions[,] [are] now given wholly or partially to legal services.”¹²² For instance, in 2010, “Texas’ IOLTA . . . received \$2.6 million [from] cy pres funds,” and “\$1.38 million in cy pres cash flowed into the Montana Justice Foundation.”¹²³

Despite these attempts to obtain alternative sources of funding, IOLTA programs continue to struggle under depressed interest rates.¹²⁴ Until IOLTA account revenues increase, state legal aid programs will need to continue

117. *Id.*

118. *See, e.g.*, MD. LEGAL SERVS. CORP., ANNUAL REPORT 3 (2013), available at http://mlsc.org/wp-content/uploads/2010/09/MLSC_AR2013.pdf (noting that despite these additional income sources, Maryland’s operating grants were cut by five percent). Maryland’s IOLTA income for 2013 was \$2.1 million, compared to \$6.4 million in IOLTA revenues in 2007. *Id.*; *see also* MD. LEGAL SERVS. CORP., FISCAL YEAR 2007 ANNUAL REPORT 1 (2007), available at <http://www.mlsc.org/2007AnnualReport.pdf> (describing 2007 IOLTA revenues).

119. Carter, *supra* note 5.

120. *Alabama Law Foundation Added to Client Security Fund Statement*, ALA. L. FOUND., <http://www.alabamalawfoundation.org/2014/03/25/alabama-law-foundation-contribution-added-to-client-security-fund-statement/> (last visited Nov. 7, 2014). Reductions in funding to the Alabama Law Foundation “forced [it] to cut grants to the Volunteer Lawyers Programs, Legal Services Alabama and other grantees by 20%.” *Id.* Additionally, Alabama’s “five Volunteer Lawyers Programs had already received cuts of 40% in Legal Services Corporation funding.” *Id.*

121. Catherine Ho, *Legal Aid Groups to Get \$30 Million from Bank Settlement*, WASH. POST (Aug. 27, 2014), http://www.washingtonpost.com/business/capitalbusiness/legal-aid-groups-to-get-30-million-from-bank-settlement/2014/08/27/8b0cbc96-2d61-11e4-994d-202962a9150c_story.html.

122. Carter, *supra* note 5.

123. *Id.*

124. Derocher, *supra* note 79.

identifying alternative funding sources to supplement their revenues or face reductions to their programs.¹²⁵

II. THE EXTRAORDINARY ECONOMIC CIRCUMSTANCES OF THE FINANCIAL CRISIS REVEALED THE INADEQUACY OF CURRENT IOLTA RULES

A. *They Never Saw It Coming*

When states first began to adopt IOLTA rules, they did so in an economic environment that was markedly different than the present.¹²⁶ In the twenty-five years preceding Florida's implementation of the first IOLTA program in 1981, the average prime lending rate was over seven percent.¹²⁷ After 1981, the prime rate remained at least six percent in every year until 2002.¹²⁸

In 1997, when Indiana finally adopted IOLTA, the last state in the country to do so, the average net interest margin at United States banks was above four percent.¹²⁹ The average interest paid on a one-month certificate of deposit between 1981 and 1999 was over seven percent.¹³⁰ Net interest margins remained above 3.75% until 2003.¹³¹ In these conditions, it would be reasonable to expect that IOLTA deposits would earn more than a nominal rate of return. It was in this stable and ordinary economic climate that IOLTA rules were adopted, with rate-setting language that reflected the market at the time of adoption.¹³²

With the most severe economic catastrophe of the twentieth century, the Great Depression, forty years in the past, it is likely that the states did not foresee another sustained period of economic recession or imagine how a recession might have such a profound effect on IOLTA programs. But the current recession shows how IOLTA's rate rules, which worked so well in ordinary times, have done little to ensure consistent delivery of IOLTA revenues to legal aid programs.¹³³

125. Katz, *supra* note 116; *see also* Derocher, *supra* note 79.

126. *See* Carter, *supra* note 5; Derocher, *supra* note 79.

127. *Selected Interest Rate: Historical Data*, *supra* note 49.

128. *Id.* Rates remained between four percent and five percent until 2005, when average prime rates rose again to over six percent.

129. *Net Interest Margin for All U.S. Banks*, FED. RES. BANK ST. LOUIS, <http://research.stlouisfed.org/fred2/series/USNIM> (last visited Sept. 30, 2014); *Information for Participating Financial Institutions*, IND. BAR FOUND., <http://www.inbf.org/IOLTA/InformationforFinancialInstitutions/tabid/101/Default.aspx> (last visited April 9, 2015).

130. *Selected Interest Rate: Historical Data*, *supra* note 49.

131. *Net Interest Margin for All U.S. Banks*, *supra* note 129.

132. *See supra* Part I.B.1; *see also supra* notes 129–31 and accompanying text.

133. *See supra* Part I.D.

B. Current IOLTA Rules Permit Federal Monetary Policy to Undermine the Just Ideals of IOLTA

There is no question that the purpose of IOLTA programs, to provide funding for legal aid services, is clear.¹³⁴ But the rate rules, read in light of the current interest rate environment, beg the question: was IOLTA income intended to be a stable and sustainable source of support for needy citizens seeking access to justice in all economic conditions, or was it simply a charitable allocation to be made when the Federal Reserve sets interest rates high enough? While focusing on the nation's big-picture economic woes, the Federal Reserve's monetary policy has unintentionally decimated IOLTA revenue—at a time when demand for legal aid is likely at its highest.¹³⁵

The broad acceptance of IOLTA's mission, to provide legal assistance to the neediest Americans, supports the idea that IOLTA interest rates should not be tied to a monetary policy capable of radically lowering deposit rates.¹³⁶ The vigor with which IOLTA was implemented and defended against constitutional challenges, tends to suggest that the legal community, as well as the sanctioning states, not only believe strongly in the underlying program purpose, but also have an interest in the IOLTA rate mechanisms themselves.¹³⁷ Rate setting provisions based on FFTR, which result in an IOLTA rate floor, may also imply the states' intent to specifically protect IOLTA accounts.¹³⁸

Banks may reasonably counter that there is an inherent logic in keeping IOLTA rates in lockstep with the Federal Reserve's monetary policy, rather than using some independent rate setting methodology. After all, the FFTR does not simply reflect market interest rate conditions, but actually influences them.¹³⁹ Furthermore, unless a bank decides to lend at higher interest rates than the

134. See *supra* Part I.A.

135. See *supra* Part I.D. Tragically, as Derocher notes, “the funding downturn came at a time of reduced federal aid to legal aid programs, coupled with increased public demand for such services from people facing unemployment, home foreclosure, and related economic crises.” Derocher, *supra* note 79.

136. See *supra* Part I.A. It took only sixteen years to implement it in all fifty states after Florida implemented the first IOLTA program in 1971. Petition of N.H. Bar Ass'n, 453 A.2d 1258, 1259 (N.H. 1982).

137. See Stevenson, *supra* note 3, at 466 (2010) (discussing appellate court challenges to IOLTA in *Phillips v. Wash. Legal Found.*, 524 U.S. 156, 163 (1998); *Washington Legal Found. v. Legal Found. of Washington*, 271 F.3d 835, 841 (9th Cir. 2001), *aff'd sub nom.* *Brown v. Legal Found. of Washington*, 538 U.S. 216 (2003); *Wash. Legal Found. v. Tex. Equal Access to Justice Found.*, 94 F.3d 996, 999 (5th Cir. 1996); *Wash. Legal Found. v. Mass. Bar Found.*, 993 F.2d 962, 968–69 (1st Cir. 1993); *Cone v. State Bar of Fla.*, 819 F.2d 1002, 1003 (11th Cir. 1987)). For instance, the Ninth Circuit, in *Washington Legal Foundation v. Legal Foundation of Washington*, noted that the “change from the tradition that no interest was obtained from lawyers' trust accounts,” occurred because “in the 1970's, interest rates reached unprecedented high levels.” *Wash. Legal Found.*, 271 F.3d at 868–69.

138. See *supra* notes 66–68 and accompanying text.

139. *Federal Open Market Committee*, BD. GOVERNORS FED. RES. SYS., <http://www.federalreserve.gov/monetarypolicy/fomc.htm> (last visited Nov. 10, 2014).

prevailing competitive market rates, it likely cannot afford to pay higher interest rates without compressing its net interest margin—its largest source of income—or finding another way to offset the higher interest paid to IOLTA.¹⁴⁰ A declining net interest margin could adversely impact banks with less diversified sources of revenue, particularly smaller banks.¹⁴¹

Bank performance data, however, does not suggest that interest margin compression has made it impossible for banks to afford paying higher IOLTA rates.¹⁴² Because the FFTR is both a descriptive and prescriptive monetary policy tool that addresses macroeconomic factors that extend beyond the financial services sector of the economy,¹⁴³ bank performance (unlike IOLTA rates) does not move in lockstep with the FFTR.¹⁴⁴ In fact, many banks, despite a completely static federal monetary policy, have shown positive financial performance trends since 2008.¹⁴⁵ Even if one takes the conservative position that IOLTA interest rates should be predicated on the banks' capacities to afford them, this financial performance data tends to support a conclusion that bank profitability, rather than Federal Reserve rates, is a more accurate measure of what rates banks can afford to pay.¹⁴⁶

140. See DeYoung & Rice, *supra* note 44, at 35 (explaining how most banks' interest margins are their primary source of profits).

141. See *A Quick Comparison Of Interest Margins For The Largest U.S. Banks*, FORBES (Sept. 11, 2014, 1:48 PM), <http://www.forbes.com/sites/greatspeculations/2014/09/11/a-quick-comparison-of-interest-margins-for-the-largest-u-s-banks/> (explaining that banks without diverse revenue streams have suffered greater losses from contracting interest rates than their more diversified competitors).

142. See JAN SCHILDACH & CLAUDIUS WENZEL, *BANK PERFORMANCE IN THE U.S. AND EUROPE: AN OCEAN APART 7* (2013), available at https://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD000000000320825.pdf. The bank performance data shows that:

US banks' revenues—though lacking meaningful growth—have constantly been above pre-crisis levels in recent years. Despite suffering from a decline in the interest margin of late, net interest income is still substantially higher than before the onset of the crisis, thanks to lower funding costs and, more recently, increased portfolios of debt securities and an uptick in lending volumes

Id.

143. See *Minutes of the Federal Open Market Committee*, BD. GOVERNORS FED. RES., <http://www.federalreserve.gov/monetarypolicy/fomcminutes20140917.htm> (last updated Oct. 8, 2014). The Committee's broad assessment includes all aspects of the economy, such as labor, capital markets, and housing. *Id.*

144. Compare SCHILDACH & WENZEL, *supra* note 142, at 3 (showing that U.S. bank performance has improved markedly since 2008), with *Open Market Operations*, *supra* note 20 (showing that the FFTR has been essentially flat and near zero since the end of 2008).

145. See SCHILDACH & WENZEL, *supra* note 142, at 3.

146. See *id.* at 1, 7 (noting that U.S. banks are experiencing "stable revenues that are significantly above pre-crisis levels"); Smith et al., *supra* note 93 (acknowledging that Texas' "Prime Partners banks" paid more than the "safe harbor" rate on IOLTA accounts (internal quotation marks omitted)).

C. Current IOLTA Rules Do Not Provide Consistent, Logical Incentives for Participating Banks

Every bank that participates in IOLTA derives at least two benefits: first, the deposits themselves provide banks funding to make loans and generate interest income; and, second, opening an IOLTA account provides opportunities for contact between the attorneys and the banks, which affords the banks the opportunity to earn profitable non-IOLTA business from the attorneys.¹⁴⁷ However, assuming all other factors are equal, banks offering higher-than-minimum rates experience higher costs in deriving these benefits because those banks would theoretically expect a lower net interest margin unless they charged higher interest rates on loans—potentially making it a less attractive place to do business.¹⁴⁸

The rules governing bank participation in IOLTA programs have created a curious state of affairs. “Honor roll[s]” published by state bar associations and legal aid corporations recognize banks that elect to voluntarily pay higher rates on IOLTA accounts.¹⁴⁹ However, the names of the largest national banks do not consistently appear on these lists.¹⁵⁰ The listed banks are most often local or regional banks rather than large national banks.¹⁵¹ Although large banks participate in IOLTA, they often pay only the minimum rates necessary to participate under state IOLTA rules.¹⁵² However, despite this tendency to pay lower IOLTA rates, big banks may still control a predominant share of the

147. Johnson, *supra* note 89, at 727 (stating that banks “can utilize [IOLTA] funds at a higher rate of return than the interest paid to the nonprofit [legal aid] organization,” and competition between banks makes it “likely that institutions not offering IOLTA type accounts will totally lose use of the [the nonprofits] funds because lawyers will move accounts to institutions providing such services”).

148. See DeYoung & Rice, *supra* note 44, at 34, 38, 40–42 (explaining how despite the increasing rate of noninterest income in bank profits, banks still heavily rely on interest-based accounts).

149. See, e.g., *IOLTA Honor Roll*, MD. LEGAL SERVS. CORP., <http://mlsc.org/iolta-honor-roll/> (last visited Nov. 3, 2014) (listing the banks on Maryland’s “IOLTA Honor Roll”).

150. See, e.g., *id.*; *NC IOLTA Eligible Bank List*, N.C. IOLTA, http://www.nciolta.com/iolta_banklist.asp (last visited Oct. 1, 2014) (recognizing ten banks in North Carolina paying a higher IOLTA rate: Albemarle Bank & Trust, Bank of North Carolina, Bank of Oak Ridge, Coastal Bank & Trust, LifeStore Bank, Macon Bank, Old Town Bank, Providence Bank, Roxboro Savings Bank, and Towne Bank).

151. See, e.g., *supra* note 150.

152. See, e.g., *IOLTA Honor Roll*, *supra* note 149 (showing that HSBC Bank USA is the only national bank that “agreed to pay a net yield of the greater of [one percent] or [sixty-five percent] or more of the federal funds target rate on IOLTA deposits”). While some large national banks elect to pay a higher IOLTA rate, they may not choose to do so consistently across all markets; Wells Fargo Bank pays at least one percent on IOLTA accounts in Oregon, but not in Maryland. Compare *Where You Bank Matters*, OR. L. FOUND., <http://www.oregonlawfoundation.org/docs/LeadershipBanks.pdf> (last visited Nov. 3, 2014), with *IOLTA Honor Roll*, *supra* note 149 (declining to list Wells Fargo on Maryland’s “IOLTA Honor Roll”).

IOLTA deposits in some states.¹⁵³ This could reduce the potential revenue impact of IOLTA funds statewide.¹⁵⁴

Counterintuitively, the current rules permit large banks to derive the principal advantages of IOLTA participation—deposit funding and opportunities to obtain and retain attorneys’ business—while often paying the lowest IOLTA rates required by rule.¹⁵⁵ Smaller banks, which often pay a higher IOLTA rate than the minimum required by state rules,¹⁵⁶ bear a higher interest expense burden without enjoying a tangible competitive advantage.¹⁵⁷

III. IOLTA REGULATIONS NEED, AND DESERVE, TEETH

Since 2008, the monetary policy of the Federal Reserve has exposed an obvious flaw in the rules that govern IOLTA programs. The FFTR, a useful tool in governing macroeconomic monetary policy and access to credit, is not a sensible basis to determine the funding of IOLTA programs. By making IOLTA interest rates dependent on rates set by the Federal Reserve, states have guaranteed that income from IOLTA programs will, at best, be unpredictable. At worst, IOLTA revenues will be depressed during sustained periods of economic difficulty—periods when the need for legal aid funding tends to increase. Either scenario presents a challenge to the funding and administration of state legal aid programs. States have employed stopgap approaches to alternative funding instead of considering rule changes that would substantially bolster, or at least stabilize, IOLTA interest revenues.¹⁵⁸ But many of these stopgap measures, such as legislative grants or additional court filing fees, shift the burden of legal aid funding from banks to the public.

The simplest proposed rule change is to tighten the terms of banks participation in IOLTA programs without prescribing any actual changes to rate setting provisions of the controlling rules. Because banks are free to determine whether they participate in IOLTA, and whether to offer a higher rate than mandated by the state rules, state IOLTA programs should develop bank participation standards that reward banks that choose to voluntarily pay a higher rate of interest than the rate paid to comparable non-IOLTA accounts.¹⁵⁹ The rulemaking authority in each state should revise participation standards to require that banks pay an “honor roll” rate in order to offer IOLTA account services.

153. See Smith et al., *supra* note 93; see also Michaelis, *supra* note 100 (noting that U.S. Bank holds the greatest number of Oregon’s IOLTA accounts).

154. See *supra* note 153 and accompanying text.

155. See *supra* Part I.C.

156. See *supra* notes 150–52 and accompanying text.

157. See *supra* note 146 and accompanying text.

158. See Katz, *supra* note 116 (discussing alterations Pennsylvania made to IOLTA rules to address the low interest rate effects).

159. See Smith et al., *supra* note 93 (explaining how Oregon banks can obtain benefits paying higher returns on IOLTA accounts).

By limiting provision of IOLTA services exclusively to banks that voluntarily pay higher IOLTA interest rates, two beneficial outcomes may occur. First, the resulting participant banks will attain a larger deposit base not only through IOLTA accounts, but also through the commercial deposits of attorneys who use them.¹⁶⁰ If larger national banks determine that IOLTA deposits are a necessary part of their business, then they would have to pay a higher rate, and bear an equivalent burden to obtain them. Second, limiting participation to banks that pay an established rate will ensure that legal aid revenues, which are supported by IOLTA interest income, are not only higher than current levels, but also more predictable in the future.¹⁶¹

Other proposals may address the minimum rate-setting rule directly. One idea that would ensure the most consistent delivery of IOLTA revenues would be the establishment of a fixed statutory rate similar to the fixed, flat rate established by the optional Texas Prime Partners program.¹⁶² Legal aid services will benefit from a far more predictable source of revenue each year, which will permit long-term planning and staffing.¹⁶³ Banks also stand to benefit from a modest fixed IOLTA rate. If, for example, a state set the IOLTA rate at one percent by rule, banks would feel interest margin pressure for the near future; but years from now, when prime lending rates rise again, a fixed IOLTA rate will actually improve the net interest margin.¹⁶⁴ Such a proposal stands in contrast to current comparability provisions, and states need to address this issue.

IV. CONCLUSION

The current IOLTA program is a noble idea, but its rules were not drafted to ensure a consistent source of revenue through difficult economic conditions. Instead, the Federal Reserve's monetary policy, which is intended to repair economic difficulties, adversely affects the interest income earned by IOLTA programs. For as long as interest rates remain depressed, or if low rates persist again in the future, legal aid programs that substantially rely on IOLTA will continue to suffer.

160. *See id.*

161. *See id.* (explaining how Oregon's "Leadership Banks program" provided greater IOLTA funding predictability).

162. *See, e.g., id.* (discussing how Texas' Prime Partners program sets "a flat 1.0[%]" rate for its participants).

163. *See id.* (discussing the impact of the increased revenue from the Texas Prime Partners program).

164. Because net interest margin is the difference between what a bank makes on loan interest and what it pays on deposits, if a bank pays out more on IOLTA deposits under current interest rates, its net interest margin would be squeezed. *See* Greg Edwards, *Banks Face Continuing Net Interest Margins Pressure*, ST. LOUIS BIZ TALK (Dec. 18, 2012), <http://www.bizjournals.com/stlouis/blog/2012/12/banks-face-continuing-net-interest.html> (explaining how net interest margins work). However, once the interest rates rise again, if the IOLTA accounts rates are set at a low rate, the banks' interest margin on the accounts will increase. *See id.*

States have the authority to determine the rules of their respective IOLTA plans and the terms of the banks' participation. By updating the rules to plan for economic volatility, or at least governing participation standards to reward model bank behavior, states can continue to fulfill the vital mission of providing legal aid services, particularly in sour economic climates, when they are most needed.

