

**OVERVIEW OF
THE CLIENT
SECURITY FUND
AND THE NEED
FOR ADDITIONAL
FUNDING**

2015

“The Client Security Fund was established to help alleviate the harm caused by dishonest attorneys by reimbursing victims up to \$100,000 for losses due to attorney theft or an act equivalent to theft. Financed with attorney dues, the Fund is a cost-effective way of assisting victims for whom reimbursement would generally not be available from any other source. The Fund needs an increase in the dues assessment to be able to resolve applications in a timely manner and accomplish its public protection goal.



SUMMARY

When an attorney steals from a client, the consequences can be devastating — to the individual client as well as to the legal profession as a whole. The Client Security Fund (CSF) was established to help alleviate the harm caused by reimbursing victims up to \$100,000 (depending on when the loss occurred) for losses due to attorney theft or an act equivalent to theft. Financed with attorney dues, the Fund is a cost-effective way of assisting victims for whom reimbursement would generally not be available from any other source. The Fund also provides a unique opportunity to promote public confidence in the administration of justice and the integrity of the legal profession. The California Fund continues to receive and process more applications per year than any other such Fund in the United States.

The Client Security Fund, established under Business & Professions Code 6140.5, is designed to alleviate losses resulting from the dishonest conduct of California attorneys and is entirely separate from disciplinary proceedings. All 50 states and the District of Columbia have client protection funds. The Client Security Fund Commission, appointed by the State Bar Board of Trustees, administers the Fund and makes the decisions on the applications for reimbursement according to the Client Security Fund rules.

The Client Security Fund Commission is a 7 member volunteer Commission appointed by the Board of Trustees to administer the Fund and its rules. The Commission is comprised of 4 lawyers and 3 non-lawyer public members. The Commission meets 6 times per year. The Fund has its own substantive and procedural rules that involve different legal elements and has a different legal standard of proof than discipline proceedings. The majority of CSF applications do not involve cases in which restitution has been ordered by the State Bar Court, or in which a detailed discipline investigation has been completed. The Fund cannot process an application to resolution until there

is final discipline against the Respondent attorney issued by the California Supreme Court.

The actions of the Fund and the Commission constitute legal proceedings in which Applicants and Respondents have due process rights, that result in legal adjudications (Commission Tentative and Final Decisions, Notices of Intention to Pay). The California Supreme Court held that Fund decisions must have findings of fact and conclusions of law and the decisions are reviewable in superior court mandamus proceedings. Fund decisions/defaults have collateral estoppel effect, form the basis of collections actions and are used in reinstatement proceedings.

Until 1987, CSF's annual assessment varied from \$10 to \$5 to \$0. In 1988, legislation changed the maximum assessment level from \$25.00 to \$40.00. Except for the years 2002 through 2005, when it was reduced to \$35.00, the assessment has remained at \$40.00 to date for active attorneys and \$10.00 for inactive attorneys. These assessments and the accumulated surplus allowed the Fund to pay 100% of all qualifying losses to date.

In 2009, however, the average yearly applications to the Client Security Fund tripled and remained well above the historic average through 2013. For example, in 2008 the Fund received 825 new applications while in 2009 the Fund received 3,028 new applications. The increase was due to the loan modification fraud schemes perpetrated by some California attorneys. Unfortunately, due to this increase, the yearly revenue to the Fund has been less than the likely payouts on yearly applications since 2009. The Fund has been surviving on an accumulated surplus that was exhausted in 2014. Although the number of applications received in 2014 decreased to 1500, which is still above historic levels, it is always possible that new fraudulent schemes could result in another period of dramatic increase, for example in the immigration law area.

In 2013 the Fund paid out \$11 million on 1,999 applications. In 2014 the Fund paid out \$9 million on 1,200 applications. At its current funding level, the Fund will have only approximately \$6 million for reimbursements in 2015 and each ensuing year.

Historically CSF has resolved applications within 12-18 months of final discipline. With less money for reimbursements wait times for the victims will increase. Based on historical averages, the Fund will likely pay approximately \$17.6 million on the current open inventory of approximately 5800 applications. Given that the Fund will have only \$6 million per year for reimbursements, it will take approximately 3 years to reimburse on the current inventory without taking into account any of the new applications that will continue to be filed.

The Fund needs an increase in the assessment to be able to resolve applications in a timely manner and accomplish its public protection goal.

CSF HISTORY

- 1969** In Blackmon v. Hale (1969) 79 Cal Rptr. 569, the Second District Court of Appeal criticized the California State Bar for failing to establish a Client Security Fund.
- 1972** Bar-sponsored legislation is passed and a Client Security Fund is created effective March 4, 1972. Section 6140.5 of the Business and Professions Code establishes the fund to reimburse individuals for pecuniary losses caused by dishonest lawyers arising from or connected with the practice of law.
- The maximum allowable payment to an Applicant was \$25,000.00. The legislation allowed the Board to increase annual membership fees by an additional amount per active member “not to exceed \$25.00.”
- Initially, the Board of Governors delegated administration of the program to the Disciplinary Board and set the assessment at \$10.00. (Until 1987, the amount assessed varied from \$10 to \$5 to \$0.)
- 1983** In 1983, the fund was assessed administrative expenses through the interfund process. Until 1983, administrative expenses were paid for from the general fund.
- 1985** The Supreme Court issues its opinion in Saleeby v. State Bar (1985) 39 C3d 547. In Saleeby the Court articulated certain minimum due process requirements affecting decisions regarding payments from the fund, including the need for findings of fact and conclusions of law and held that rejections of applications are reviewable in the superior courts through administrative mandamus.
- 1986** In response to Saleeby, the Client Security Fund Commission is created and new rules, adopted by the Board of Governors in 1985, go into effect (patterned after the ABA Model Rules for Client Protection). Under the Rules of Procedure,

Client Security Fund Matters, an appointed Commission is delegated all decisions regarding payment of applications, either by its decisions or through policies it sets that guide staff's work. Under these rules, both Applicants and Respondent attorneys have the right to object to Commission tentative decisions. Applicants and Respondent attorneys are also advised of their right to judicial review of a final decision.

- 1987** The Board increased the assessment in support of the fund to the maximum allowable of \$25.00.
- 1988** The Legislature amended 6140.5 to require the State Bar to maintain a Client Security Fund and require the State Bar to add the amount of payouts, plus interest and processing costs, to membership fee billings if the lawyer is publicly reprimanded or suspended. For any lawyer who resigns with disciplinary charges pending, or for a lawyer who is suspended or disbarred, restitution of any reimbursed amount, along with applicable interest and costs, must be paid as a condition of reinstatement. The legislation also changed the maximum assessment level from \$25.00 to \$40.00.
- 1989** The Board increased the assessment in support of the fund from \$25.00 to \$40.00.
- 1991** In Johnson v. State Bar (L.A. Co. Super.Ct. No. BS 002283), the court expanded the right to judicial review of a Commission decision to pay an application by granting a writ of mandate to a Respondent attorney. The court concluded that the attorney had a sufficient beneficial interest to challenge the Commission's decision to pay an award in an administrative mandamus proceeding because of significant financial and "reputational" interests.
- 1992** Partly in response to Johnson, the Commission undertook a major revision of the rules expanding and clarifying the rights of Applicants and Respondents in the

review process. The Board of Governors adopted the revised Rules of Procedure, Client Security Fund Matters on August 24, 1991, effective January 1, 1992.

- 1998** In June 1998, the bar essentially shut down due to the veto of the fee bill. Although, the fund continued to receive funding under 6140.5(c) and continued its activities, the number of new applications filed with the fund dropped significantly during 1998 and 1999 (approximately 40 percent fewer for both years). When the discipline system was restored in March 1999, the monthly filing rate began to gradually increase. By the year 2000, the number of new applications filed returned to historical levels. Although the fund did not lose its number of authorized staff during the bar crisis, five of its experienced staff members were laid off and replaced by members from the State Bar Court under the union “bumping” rules.
- 1999** In March 1999, the State Bar reopened and State Bar staff in the Client Security Fund returned to their prior positions with the State Bar Court.
- 2000** Due to the shutdown of the discipline system which caused a two-year decrease in the number of applications filed and paid, the fund experienced an unusually high increase in its fund balance.
- 2001** As a result of the high fund balance, the assessment in support of the fund was reduced from \$40.00 to \$35.00 for the years 2002 and 2003.
- 2002-3** Assessment is set at \$35.
- 2004-5** Assessment remains at \$35.
- 2006** Effective January 1, 2006, Section 6140.5(a) was amended to expand the purpose of the Client Security Fund to include relieving or mitigating pecuniary losses caused by the dishonest conduct of foreign legal consultants registered

with the State Bar and attorneys registered with the State Bar under the Multi-Jurisdictional Practice Program.

- 2006** Effective January 1, 2006, Section 6140.55 was amended to authorize assessments of up to \$40 per year for active members of the State Bar and up to \$10 per year for inactive members. Assessment is set at \$40 for active members and \$10 for inactive members.
- 2007-8** Assessment remains at \$40 for active members of the State Bar and \$10 for inactive members.
- 2008** Board of Governors increases maximum allowable payment from \$50,000.00 to \$100,000.00 for losses occurring on or after January 1, 2009. The \$100,000.00 maximum payment applies to all applicants regardless of marital status. The cap was increased to help alleviate the devastating harm caused by large-scale losses to victims, and to keep the Fund more in line with other funds around the country.
- 2009** The average yearly applications to the Client Security Fund tripled due to loan modification schemes.
- 2010** New Client Security Fund rules go into effect January 1, 2010 to be used to review applications filed on or after January 1, 2010. Rules were re-written to simplify language into “plain English” and re-numbered to fit into numbering system of all State Bar rules.
- 2010-12** New applications to the Fund remain at triple the historic average.
- 2013 – present** New applications to the Fund remain above the historic average.

IMPORTANCE OF THE FUND TO THE PUBLIC PROTECTION MISSION

The Fund provides the legal profession with a unique opportunity to promote public confidence in the administration of justice and the integrity of the legal profession. It is also a cost-effective way of providing reimbursement to victims that is generally not available from any other source.

The Client Security Fund, established by Bar-sponsored legislation in 1972, represents one of the State Bar's major efforts to achieve its public protection goals. In addition to disciplinary procedures, as part of the Bar's public service, the Fund helps to alleviate injury to legal consumers who sustain money or property loss as the result of dishonest conduct by a member of the Bar. The Fund is designed to reimburse victims who have lost money or property due to theft, or an act equivalent to theft, committed by a lawyer acting in a professional capacity.

The Client Security Fund works closely and cooperatively with the State Bar's lawyer discipline system and the State Bar Court to achieve the Fund's objectives - to come to the aid of those clients who have suffered a loss caused by a small number of errant lawyers.

Applicants to the Fund are people who had the resources, or worked hard to save up their funds to hire an attorney and then had their hard-earned money taken by a dishonest attorney. Or the applicants are people whose case settled, or who won a judgment, and then had the lawyer misappropriate those funds for his or her own use. In these situations, the applicants used their own resources to hire legal counsel and were then betrayed by the attorney. These applicants often find themselves in the position of having to look for free legal services to finish the job that the dishonest lawyer did not do or to pursue the lawyer for compensation for the theft. The Client Security Fund reimburses these fees and misappropriated funds back to the victims. The sooner the Fund can reimburse on the qualified applications the more likely it is

that these victims will not have to add their needs to the already over-burdened legal services agencies.

The Fund receives numerous calls daily from applicants expressing to the staff the dire circumstances that they find themselves in and literally begging the Fund to expedite their applications. The Fund explains to the applicants that there are limited funds for reimbursement and that the Fund generally handles applications in the order received based on when discipline is final. For those applicants who recently filed applications with the Fund, the staff has to explain that it could likely take up to 36 months before their matter is resolved. Unfortunately, the longer it takes to reimburse on an application, due to lack of funding, the more likely it is that the Fund could lose track of an applicant. Applicants often move without informing the Fund of a new address, or they lose their homes and do not continue their contact with the Fund. While Fund staff attempts to find current addresses for the applicants, staff is often unsuccessful, and sometimes even learns that an applicant is deceased.

The ability of the Fund to accomplish its public protection mission could be compromised if the Fund does not have adequate funding to reimburse qualified applicants in a timely manner.

UNDERFUNDING AND THE LOAN MODIFICATION CRISIS

In 2009, the average yearly applications to the Client Security Fund tripled and remained at that level through 2012. In 2008 the Fund received 825 new applications. In 2009 the Fund received 3,028. In 2010, 3,875 were received.

Unfortunately, the yearly revenue to the Fund has been less than the likely payouts on yearly applications since 2009. As a result, the Fund had been surviving on an accumulated surplus that was exhausted in 2014. The Fund will now only be able to reimburse approximately \$6 million, which is the amount received each year from the dues assessment after the administrative costs of the Fund are paid.

The large volume of applications filed with the Fund beginning in approximately 2009 due to the loan modification schemes resulted in a large inventory of CSF applications that had been filed but could not yet be resolved. CSF has to wait for final discipline from the Supreme Court before it can resolve an application. In 2011 and 2012, while continuing to receive large numbers of new applications, and monitoring the status of those already filed, the Fund had a number of respondents with a large volume of applications filed against them receive final discipline within a short period of time.

As disbarments and other discipline on the respondent attorneys becomes final, CSF has been working to process as many applications as possible while still taking into consideration the Fund's balance.

Approximately 5800 open applications are pending in CSF. The Fund has approximately \$6 million available for reimbursements in 2015 and about half of the pending applications are related to loan modifications. There are approximately 1500 applications filed against 5 "mass joinder – loan modification" respondents that will likely be ready for processing at the end of 2015. The total amount requested against just the 5 mass joinder respondents is \$7.4 million.

There are 1100 applications that were filed against one loan modification respondent that remain pending awaiting discipline. The applications were filed in 2009 and 2010. The total amount requested is \$3.7 million.

There are also over 700 applications pending that were filed against a recently disbarred loan modification respondent. The Commission has begun reviewing and paying these applications. The total amount requested against this Respondent is over \$2.8 million.

These examples demonstrate the large amounts requested by applicants against just a few of the loan modification respondents against whom applications have been filed. Approximately half of the total amount requested on pending CSF applications is still related to loan modification fraud. Unfortunately, CSF's ability to process the applications as timely as possible, has been limited by the funding challenges that CSF is currently facing. The longer it takes to reimburse the applicants, the more time that staff spends on the phone explaining the limits of the Fund to disappointed, sometimes desperate applicants.

ADMINISTRATION OF THE CLIENT SECURITY FUND

The California Client Security Fund has a dedicated staff of professionals who administer the Client Security Fund in conjunction with the volunteer Client Security Fund Commission. CSF staff members are employees of the State Bar of California. The CSF staff consists of 1 Attorney Director, 2 Attorneys, 2 paralegals, and 6 administrative staff members. The 7 member dedicated volunteer Client Security Fund Commission reviews thousands of pages of documents at each of its 6 meetings a year in performing its important duty of determining which applicants qualify for reimbursement under the CSF rules.

Among other duties, CSF legal and administrative staff opens the new files, corresponds with the applicants and respondents, monitors the applications pending discipline, investigates and conducts the legal analysis of the files, writes the legal decisions, serves the decisions, organizes and presents the objections to decisions to the Commission, orders the reimbursement checks, closes and stores the files, monitors the amounts owed by respondents to CSF, and provides the information necessary to pursue collection to the Office of General Counsel and Membership Billing.

The volunteer Commission reviews and approves the written legal decisions, gives guidance to the legal staff on individual case handling as well as overall policy decisions, makes the ultimate decision on which applications qualify for reimbursement, and monitors and makes recommendations regarding the financial health of the Fund, among other duties. The 4 attorney and 3 non-attorney members of the Commission dedicate hundreds of hours each year to the work of the Fund, performing often tedious review of detailed legal and bank documents to ensure that proper decisions are made. The Commission takes its public protection duty seriously and administers the Fund ethically and efficiently.

The California Client Security Fund handles far more reimbursement requests every year, than any other client protection fund. The Fund has received and opened 13,835 new applications in the last five years and processed to resolution (either pay or deny) 11,158 in that same time period. California also has more due process requirements than any other client protection

fund. In Saleeby v. State Bar, 39 Cal.3d 547 (1985) the California Supreme Court held that applicants to the Fund have to be given an opportunity to be heard, to respond to the Bar's determinations and to have a right of review. This due process protection was eventually extended to respondent attorneys as well. Written decisions on each application are served on both the applicant and the respondent attorney. Written decisions must include findings of fact and conclusions of law upon which review can be made. A formal oral hearing is not required, but is within the discretion of the Commission. Any relevant evidence is admissible and the Commission uses a preponderance of the evidence standard. If either party disagrees with the final decision of the Commission, the decision is reviewable by administrative mandamus in superior court.

The administrative costs for CSF are approximately \$2 million each year. This amount covers the salaries and benefits of the 11 CSF employees, and the support costs that CSF pays as part of the larger organization that is the State Bar. In 2013 and 2014 the administrative costs were slightly higher as CSF employed temporary help and authorized overtime to help reduce the large inventory of loan modification applications.

Comparing the California CSF administrative costs to the administrative costs of other client protection funds in the country shows that the average administrative cost per case is significantly lower than the other states, even though California has a much larger volume of applications and much stricter due process requirements than any other state.

**The State Bar of California
Client Security Fund
Administrative Costs Comparison with Other Funds
For the Year 2013**

Jurisdiction	Administrative Costs	No. of Case Dispositions	Average Administrative Cost Per Case Disposition	No. Cases Paid	Average Administrative Cost per Case Paid
California	\$ 2,304,197.00	3687	\$ 624.95	1999	\$ 1,152.67
New York	\$ 923,827.00	555	\$ 1,664.55	218	\$ 4,237.74
Ohio	\$ 350,272.00	213	\$ 1,644.47	168	\$ 2,084.95
New Jersey	\$ 1,662,255.00	203	\$ 8,188.45	106	\$ 15,681.65
Pennsylvania	\$ 521,753.00	148	\$ 3,525.39	100	\$ 5,217.53
Florida	\$ 219,030.00	120	\$ 1,825.25	49	\$ 4,470.00
Connecticut	\$ 580,279.00	71	\$ 8,172.94	15	\$ 38,685.27

Large jurisdictions with identifiable administrative costs.

Number of Case Dispositions means cases resolved either by payment, rejection, or termination/withdrawal.

* California costs for 2013 include the addition of 4 temporary attorneys, 4 temporary investigators, and staff overtime.

NECESSARY LEVELS OF FUNDING

Below are charts and narratives that discuss the CSF funding issue and lay out options for various possible future levels of funding. The Fund currently receives \$40.00¹ from active State Bar members and \$10.00 from inactive members.

EFFECT OF THE LOAN MODIFICATION CRISIS

Total Amount CSF paid out or will pay out due to the Loan Modification crisis

The effect of the loan modification crisis on the Fund cannot be understated and further examination is required to prepare for possible future such crises. Prior to the loan modification crisis in the years 2005-2010, the average annual payout from the Fund was \$4.3 million. Using this average and adjusting for inflation, the Fund could have expected to payout \$22.8 million total for the years 2011-2015. The actual payout for these years, including the budgeted payout for 2015, will be \$40.8 million or an increase of \$18 million. The estimated payout on current applications filed as of January 1, 2015 is \$17.6 million and approximately half (\$8.8 million) of these applications are related to the loan modification crisis. The combined total, including the \$18 million that has already been paid out on loan modification cases, is \$26.8 million that can be attributed to the loan modification crisis. The Fund was able to absorb some of this impact due to the \$14 million reserve it had at the end of 2010. Currently, there is no such reserve to pay off existing applications and no reasonable expectation of creating a reserve to deal with the next potential crisis at present funding levels.

Future projections of estimated payments per year/time to process applications

¹ Some state client protection funds are financed by budget appropriations on an as needed basis. Most, however, are financed by annual attorney assessments ranging from a low of \$2 per attorney in Indiana to a high of \$75 per attorney in Connecticut. At least five funds assess attorneys at rates higher than the \$40 California assessment: CT - \$75; HI - \$50; IA - \$50; NJ - \$50; and DE - \$45.

As of April 2015, there has been a decrease in the number of applications filed and a slight decrease in the amount requested on these applications. The amount requested in 2014 was \$20.8 million with an estimated payout of 37.68%. This resulted in estimated reimbursements of \$7.8 million. This may be an anomaly or the result of a trend and further analysis will be required to monitor this going forward. Current projections anticipate a 7% reduction in the amounts requested on applications received by the Fund in 2015. The estimated payout percentage amount is projected to remain the same (approximately 38%). This will result in an additional \$19.4 million being requested on new applications, of which 38% or about \$7.3 million will be added to the estimated reimbursement amount. This \$7.3 million will be used as a baseline going forward in these discussions. Furthermore, while the Commission would like to handle applications as promptly as possible once discipline is final, current funding does not allow this. Based on the amounts requested and the amounts currently available for reimbursement, it will take approximately 36 months to reimburse the newly filed applications. The Commission would like to reduce this processing time to within 18 months of final discipline.

FUNDING OPTIONS REQUIRING ADDITIONAL DUES ASSESSMENT

One-time assessment to eliminate outstanding estimated reimbursements

Using the current trend in the filing rate of new applications and the estimated payout amounts, the Fund will add an estimated reimbursable amount of approximately \$7.3 million a year. The earliest a special assessment could be obtained from the Legislature would be for the 2016 fee statement. The table below shows that it would require a one-time special assessment of an additional \$110 for active and \$20 for inactive members to generate enough revenue to cover all of the estimated applications at the end of 2016. This would be in addition to the current annual fee of \$40 for active and \$10 for inactive members. The fee would revert back to \$40.00 after one year.

One Time Special Assessment to Address Loan Modification Crisis

What would it take to have the funds to pay off the balance + the new projected requested amounts added in 2016?

Estimated payout as of beginning of 2016	\$18,901,700
Estimated applications in 2016	\$7,300,000
Administrative expense	<u>\$2,000,000</u>
Total amount needed:	\$28,201,700

Member Status	Member Fee	Members Paid	Revenue
Active	\$150.00	170,954	\$25,643,100
Active-Scaling, 75% of Fee			
Collected	\$112.50	13,385	\$1,505,813
Active-Waiver, 50% of Fee Collected	\$75.00	<u>235</u>	\$17,625
Total Active		<u>184,574</u>	\$27,166,538
Inactive	\$30.00	39,711	\$1,191,330
Inactive-Waiver, 50% of Fee Collected	\$15.00	<u>68</u>	\$1,020
Total Inactive		<u>38,586</u>	\$1,192,350
Total Active & Inactive		<u>217,622</u>	Total Revenue \$28,358,888

Amount of One-time assessment needed to eliminate enough of the outstanding reimbursements so that the remaining reimbursements could be processed within 18 months of final discipline

The goal is to have enough funds to resolve CSF applications within 18 months of final discipline. Since the estimated annual reimbursement amount is \$7.3 million, adding another half year to this would make the estimated 18 month reimbursement amount \$10.9 million. To accomplish this, an additional one-time assessment would be needed as illustrated in the table below. The fee would revert back to \$40.00 after one year.

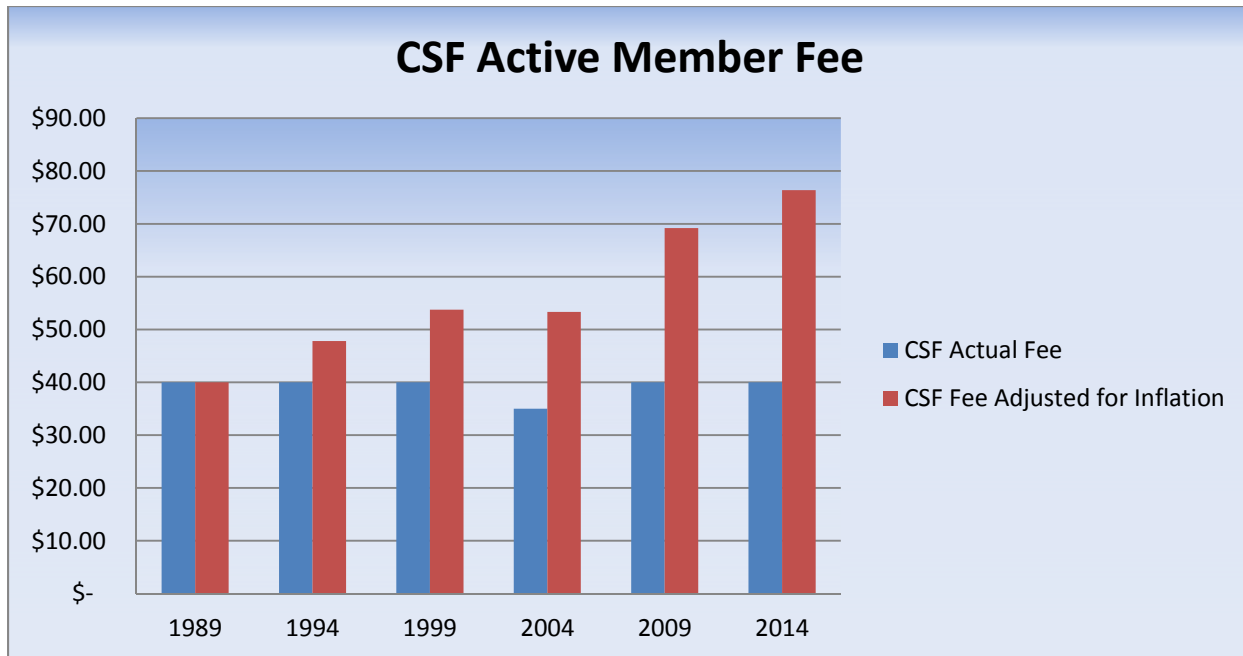
One-Time Special Assessment to Address Loan Mod Crisis			
What if we cut the balance to where it could be paid off in 18 months?			
Estimated payout as of beginning of			
2016	\$18,901,700		
Estimated applications in 2016	\$7,300,000		
Administrative expense	\$2,000,000		
Total additional needed:	<u>\$28,201,700</u>		
Subtract 1.5 years of estimated payouts	<u>\$10,950,000</u>		
Total additional needed to get within 18 months	<u><u>\$17,251,700</u></u>		
Member Status	Member Fee	Members Paid	
Active	\$91.00	170,954	\$15,556,778
Active-Scaling, 75% of Fee			
Collected	\$68.25	13,385	\$913,495
Active-Waiver, 50% of Fee			
Collected	\$45.50	235	\$10,695

One-Time Special Assessment to Address Loan Mod Crisis			
Total Active		184,573	\$16,480,968
Inactive	\$20.00	39,711	\$794,227
Inactive-Waiver, 50% of Fee			
Collected	\$10.00	68	\$680
Total Inactive		<u>39,779</u>	\$794,907
		Total	
Total Active & Inactive		217,622	Revenue \$17,275,875

This table indicates that it would require an additional one-time assessment of \$51 for active and \$10 for inactive members to generate enough revenue to reimburse all of the estimated pending applications at the end of 2016 within 18 months of discipline. This is in addition to the current annual fee of \$40 for active and \$10 for inactive members.

CSF fee adjusted for inflation

The CSF fee was set at \$40 for active members in 1989. In 2006, an additional fee of \$10 was added for inactive members. If these fees had kept up with inflation, they would be \$76.37 for active members and \$11.74 for inactive members for the year 2015. If these were the amounts that had been assessed in 2015, the revenue generated for the fund would have been \$13.9 million. To adjust the CSF assessment for inflation, the Fund would need an increase of \$36.37 (from \$40.00 to \$76.37) for active members and an increase of \$1.74 (from \$10.00 to \$11.74) for inactive members.



Amount of time required to reimburse current pending applications

At the end of 2014, the Fund's estimated reimbursable amount was \$17.6 million dollars. The current funding levels allow for only \$6 million in payments per year. At the same time, approximately \$7.3 million in estimated payments will be added each year, which results in an overall increase of \$1.3 million per year using current projections. It will take until 2017 or 3 years for the Fund to obtain enough revenue to reimburse the current inventory of \$17.6 million in reimbursements. The Fund will continue to add more to the amounts requested than applications paid, so that the outstanding balance is projected to be \$21.5 million in 2017 or an increase of \$3.9 million. These additional requested reimbursable amounts will result in a longer wait time for reimbursement. It will take four years or until 2021 to pay off the projected outstanding balance as of 2017. The projected outstanding balance of estimated reimbursable amounts in 2021 is \$26.7 million or a 51% increase from the end of 2014.

Amount of assessment necessary to keep up with new applications every year and 3 year assessment to address the loan modification crisis

In order to keep up with the projected amount of new applications each year, a \$10 fee increase is necessary. In addition, another \$15 is needed to reduce the current outstanding estimated payments balance to an amount that can be processed and paid within 18 months. To accomplish these important objectives, the total fee would be set at \$65 for the first 3 years and \$50 thereafter for active members.

Fee Required To Keep Pace With New Estimated Applications			
Estimated payout per year	\$7,300,000		
Administrative expense	<u>\$2,000,000</u>		
Total required	\$9,300,000		
Member Status	Member Fee	Members Paid	Revenue
Proposed Active	\$50	170,954	\$8,547,680
Active-Scaling, 75% of Fee Collected	\$38	13,385	\$501,920
Active-Waiver, 50% of Fee Collected	\$25	<u>235</u>	\$5,876
Total Active		<u>184,573</u>	\$9,055,477
Inactive	\$10	39,711	\$397,113
Inactive-Waiver, 50% of Fee Collected	\$5	<u>68</u>	\$340
Total Inactive		<u>39,779</u>	\$397,454
Total Active & Inactive		<u><u>217,622</u></u>	\$9,452,930
Only a \$10.00 increase			

Fee Required To Keep Pace With New Estimated Applications			
Additional Fee Above \$50.00 Needed To Pay Outstanding Qualifying Amounts Within 18 months (3 year Sunset)			
Estimated payout as of beginning of 2016	\$18,901,700		
Subtract 18 months of estimated payouts	<u>\$10,950,000</u>		
Total additional needed to get within 18 months	\$7,951,700		
Number of years to achieve 18 month payoff	3		
Additional Amount per year needed	\$2,650,567		
Member Status	Member Fee	Members Paid	Total
Proposed Active	\$15.00	170,954	\$2,564,304
Active-Scaling, 75% of Fee			
Collected	\$11.25	13,385	\$150,576
Active-Waiver, 50% of Fee			
Collected	\$7.50	235	\$1,763
			Total Revenue
Totals: \$65.00 for 3 yrs/ \$50.00 thereafter		217,622	\$2,716,643

Assessment increase needed to create a reserve

The loan modification crisis eliminated the reserve that CSF had accumulated over its history. Ideally the Fund would like to maintain a reserve of approximately one year's worth of reimbursements, in order to prepare for possible future contingencies. However, given the current state of the Fund's finances and the amount of an increase in the fee assessment needed to break even and cover the existing outstanding requested amounts, discussion of creating a reserve will be set aside for future consideration.

EXAMINATION OF INTERNAL SOLUTIONS FOR FUNDING

OPTIONS THAT ARE WITHIN THE COMMISSION'S DISCRETION

Reduce the cap and/or pay a pro rata amount

The Client Security Fund Commission is proud that since the inception of the Fund the Fund has reimbursed 100% of qualifying losses. The Commission also tried to compensate for the large losses that a small number of victims experience by raising the maximum reimbursable amount from \$50,000.00 to \$100,000.00 in 2009. The Fund works to promote public confidence in the administration of justice and the integrity of the legal profession by reimbursing the victims of attorney theft. Applicants to the Fund must file discipline complaints and wait for the complaint to be resolved before the CSF application that has been filed can be reviewed and resolved. This often results in years of waiting for reimbursement. The Fund, so far, has been able to reimburse the full amount that qualifies under the rules up to \$100,000.00 to these victims.

If the financial circumstances of the Fund necessitate, the Commission has the power under its rules to use its discretion to decrease the maximum reimbursable amount, and/or to pay a pro rata share of the amounts that qualify for reimbursement. While this is an option that could result in some savings to the Fund, the Commission would like to consider these options only as a last resort in extremely dire circumstances. The Commission currently has concluded that it would rather applicants receive the full amount that qualifies for reimbursement, even if it takes longer to reimburse the applicants, than to reduce the waiting time but only pay half or some other percentage of the qualifying loss.

If the Commission were to reduce the maximum reimbursable amount back to the previous maximum of \$50,000.00, the Fund could save approximately \$800,000.00 per year over the next 3 years². However, the savings is achieved to the detriment of those who have suffered

² Based on analysis of applications pending with the Fund requesting more than \$50,000.00. This is an estimate only as some of the applications do not yet have discipline and the Commission has not reviewed these applications for eligibility.

the largest losses. Reducing the cap essentially harms the victims who have already lost the most at the hands of dishonest attorneys. Reducing the maximum reimbursable amount goes against the trend in other states that are increasing or already have higher caps than California. The New York maximum reimbursable amount is \$400,000.00. Reducing the cap is also contrary to the Fund's goal of alleviating as much of a victim's loss as possible in an attempt to make them whole. Reimbursing just a small portion of a large monetary loss, does not help restore a victim's faith in the legal profession.

If the Commission were to reduce the amount of payments to only a set percentage of the qualifying amount, the Fund could save that percentage of funds to pay other victims. However, once again, this does not help the Fund achieve its public protection goal. Victims wait years for reimbursement and, and then will be disappointed further by not receiving the full qualifying amount that was misappropriated or unearned.

CSF projections show that if the Commission were to pay only 50% of qualifying losses, the wait time for reimbursement would be reduced, at the most from approximately 3 years after discipline to 18 months. However, if applicants object to the reimbursement, as is allowed under the rules, then it could create more work for the Fund and result in longer wait times. Furthermore, it is difficult to determine how to implement such payments in a fair manner. The Fund's policy is to reimburse applications in the order received in the office; however this is dependent on when the discipline is final. If the Commission were to begin paying only 50% of qualifying amounts, there would be applicants who filed applications with the Fund in previous years, who would only receive 50% of their loss, when applicants who filed after or in the same year would have already received 100% of their loss because the discipline has already been imposed.

Only pay California residents

The Fund has always reimbursed for the harm caused by a licensed California attorney, even if the attorney is illegally practicing in another state. Some states only pay residents of their own state, and some states require a nexus between the lawyer's representation of the client and

the state. Over the past 5 years, approximately 36% of the applications paid were paid to non-California residents.

The Fund could save significant amounts if it paid only California residents, but in the current legal climate where multi-jurisdictional practice is becoming more common it seems that such a change would be harmful to the public and contrary to trends encouraging more open boundaries for legal practice. This is also contrary to the goal of the Fund which is to improve the reputation of the California lawyer.

Change rules to eliminate payments of loan/investment cases

The applications involving loans and investments often involve large losses and can be difficult to investigate. The Fund requires that the loss arise out of and in the scope of the attorney/client relationship and but for that relationship the loss could not have occurred. These cases often involve conduct that is not necessarily customary to the practice of law.

Over the past 4 years the Fund has paid out \$446,000.00 on these types of applications. While this is not a huge savings, this is an option that the Commission could consider.

OPTIONS THAT ARE OUTSIDE THE COMMISSION'S DISCRETION

Obtain funds for CSF from the general fund or other budgets within the bar

The State Bar could allocate funds from other sources to the Client Security Fund, if such sources exist. The State Bar's General Fund is one possible source. This is the primary operating fund of the State Bar. The 2014 audited financial statements show the General Fund to have a \$2.6 million balance. However, this is consumed by the 2015-17 budget that projects more than a \$500,000 General Fund deficit in 2016, and more than a \$4 million deficit in 2017, absent a licensing fee increase.

The Admissions Fund, Annual Meeting Fund, and Benefit Reserve Fund, are all dedicated to specific purposes that consume the fund balance shown in the 2014 audited financial

statements. Loans could be made from these funds to CSF, but that would only postpone the CSF funding issue, as the loans would have to be paid back. The CSF funding issue is not a short term problem to be fixed with a short term solution. Funding for CSF needs to be without future repayment liabilities.

The Annual Meeting Fund could be redirected to CSF, and the annual Meeting scaled back, but this is only \$100,000, not enough to make the difference sought.

The 2014 audited financial statement shows the Building Fund to have a \$7.5 million balance. However, this includes \$2.7 million in non-spendable capital assets, leaving a \$4.8 million balance. This balance is consumed by building maintenance and development projects at 845 Figueroa and 180 Howard: \$1.4 million for Los Angeles infrastructure projects; \$4.39 million for San Francisco infrastructure projects; \$3.53 million for San Francisco tenant floor build outs. Finance is already looking at other fund balances (e.g., Administration of Justice Fund) to fund these building maintenance and development projects that exceed the Building Fund balance.

The Administration of Justice (AOJ) Fund is another potential funding source. This fund is comprised of 3 sub funds: the Bar Relations/Elimination of Bias Fund; the Legislative Activities Fund; and the Legal Education & Development Fund. The Bar Relations/Elimination of Bias Fund and Legislative Activities Fund both fund specific activities to which their fund balances are committed. The Legal Education & Development Fund (LE&D) is mostly royalty revenues from the State Bar's affinity programs. This is a potential focus for available money.

This fund helped fund the purchase of the Los Angeles 845 Figueroa Street building. A \$3.4 million loan was made from this fund to the LA facilities Fund for this purchase. That loan was paid back to the AOJ Fund at the end of 2014. Thus, there is a fund balance in the LE&D Fund of some \$4.5 million. This is currently targeted for the necessary maintenance and development of the 180 Howard Street building and in follow up maintenance and development at the 845 Figueroa Street building, noted above. There are also Information Technology projects that require more funds than are currently available. Current projections

are that the balance of the LE&D/AOJ Fund is exhausted by the commitment of its funds to these necessary building and IT projects.

The Information Technology Assessment Fund and Technology Improvement Fund have a combined balance of about \$5.7 million. This is consumed by IT projects over the next few years of about \$9.8 million.

The Equal Access Fund; Justice Gap Fund; Legal Services Trust Fund; Lawyers Assistance Program Fund; Legal Specialization Fund; Public Protection Reserve; and Sections Fund, all are dedicated to specific purposes such that their fund balances are not really available for contribution to CSF. The Public Protection Reserve has a balance of \$6.4 million. But this is encumbered with a pledge to secure the Bank of American loan by which we acquired the Los Angeles facility. So even if this was a potential target, this fund is already “spoken for.”

There is nearly \$400,000 in annual lease revenue from the Smart & Final lease that is being donated to the Legal Services Trust Fund for 2014. There is an expectation that this annual contribution to legal services will continue. But these funds could be redirected to CSF for one or more years. There is also the lease revenue of some \$2 million from the Howard Street building. This is committed to building maintenance and development projects noted above, particularly the development of further leasable tenant space in the building. If current revenues and fund balances are used, as anticipated, to create more leasable space at 180 Howard Street, lease income could increase significantly in later years, which then could be contributed to CSF. But there is no revenue currently available for a contribution to CSF.

There is also the \$40 contribution/deduction to legal services provided in Business & Professions Code Section 6140.03. Members paying their fees are given the option of deducting \$40 from their annual licensing fee, or contributing it to legal services. This could be legislatively changed to provide that some portion of this go to CSF rather than to legal services or back to members. The current \$40 CSF contribution by members is mandatory under Business & Professions Code Section 6140.55. Some portion of the \$40 addressed in Section 6140.03 could be moved to the CSF contribution in Section 6140.55.

Prohibit fee waivers on CSF amounts

Some members of the Bar do not pay the full CSF assessment amount due to fee waivers that are granted or that they qualify for. It is possible that some additional revenue could be generated to CSF by denying waivers of the CSF portion of the assessment. However, because the CSF assessment is set by statute as part of the membership fee (Bus. & Prof. Code sec. 6140.55 says the board “may increase the annual membership fees” with the CSF assessment), excluding the assessment from the scaling provision in Section 6141.1(b) would require an amendment to that provision. For those waivers, however, under Section 6141.1(a), the board could choose to prohibit waiver of the CSF portion of the assessment by rule (“The payment by any member of the annual membership fee, any portion thereof, ... may be waived by the board as it may provide by rule.”)

Examine Collection Efforts

Pursuant to CSF rules, collection of amounts owed to CSF are handled by the Office of General Counsel. B&P Code Section 6140.5 requires that attorneys repay CSF any amounts paid out against them, plus interest and costs. For those applications on which the State Bar Court ordered restitution, the Fund has an automatic judgment. If restitution was not ordered, the Office of General Counsel has to go to court to pursue the judgment. Furthermore, the statute provides that the amounts that CSF reimburses be added to the dues of the respondent attorney. CSF and the Office of General Counsel work closely with membership billing to exchange information for collection purposes.

Historically, CSF has collected 10% or less of the amounts paid out each year. California’s experience in this regard is not much different from that of the other client protection funds in the U.S.

The Office of General Counsel employs a collection agency to pursue amounts owed to CSF. Unfortunately, the vast majority of the amounts owed to CSF, even when pursued by the collection agencies, are not collectable.

CSF is most successful in collecting from those attorneys who have to pay CSF in order to come back to active status after discipline, and in collecting from disbarred or resigned attorneys who want to be reinstated. Disbarred and resigned attorneys cannot apply for reinstatement until CSF is reimbursed all amounts that it paid out against them.

Below is a chart showing the amounts CSF was successful in collecting from 2011 through the beginning of 2015.

CSF Collections 2011 thru May 31, 2015						
CSF Collection Type	2011	2012	2013	2014	5/2015	Total
Collection Agency	\$11,270	\$79,825	\$6,204	\$10,011	\$1,650	\$108,960
Paid to CSF By Respondents	\$354,144	\$328,848	\$178,437	\$274,102	\$220,329	\$1,355,860
Total	\$365,414	\$408,673	\$184,641	\$284,113	\$221,979	\$1,464,820
Percentage from Collection Agency	3%	20%	3%	4%	1%	7%

Another collection option that could increase funds to CSF is the tax intercept program. In 2013, the legislature approved the State Bar's participation in the tax intercept program. However, even though some of the amounts collected through this program might be amounts owed to CSF, the determination was made that all amounts collected through tax intercept would be given to legal services. It would require legislative approval to change the law so that CSF money collected would be returned to CSF and not go to legal services.

While it is important to continue to pursue collections, the Fund's history, and the experience of other client protection funds around the country, indicate that large percentages of the debts owed are not collectable.

EXAMINATION OF EXTERNAL SOLUTIONS FOR FUNDING OTHER THAN AN INCREASE IN THE DUES ASSESSMENT

Voluntary contributions

CSF could explore the possibility of obtaining voluntary contributions to supplement its funding. The voluntary contribution program could take the form of an “opt-in” or “opt-out” option on the dues bill, similar to the option available for contributions to legal services. This would require legislative approval.

Alternatively, CSF could seek voluntary contributions from law firms and individual attorneys through a campaign not tied to the dues statement.

While it is worth pursuing various avenues for supplementing CSF funding, such voluntary contributions are inherently unpredictable and are not a viable long-term solution to the funding issues facing CSF.

WHO RECEIVES CSF REIMBURSEMENT?

CSF reviews all applications that are received by the CSF office to determine if the applicant qualifies for reimbursement. The applications are investigated, proper proof is gathered, and the applications are given legal review and evaluation and prepared for formal decision and service. While some applications are closed administratively by letter if they clearly fall outside the scope of the Fund’s rules, applicants who disagree with the administrative closing can request Commission review and receive a formal written decision. Applicants do not have to be citizens to apply to the Fund.

CSF does not have a “means test” and therefore does not monitor data on the incomes of those who apply for CSF reimbursement. However, most requests for reimbursement fall in the \$5,000.00 and under range (year to date for 2015 - 70% of applications have requested \$5000

and under). The purpose of the Client Security Fund is to reimburse those who have been victimized by dishonest attorneys. The focus is on rectifying the harm to the consumer. CSF staff works with applicants to obtain the proof necessary to support their CSF applications. Many of the applicants are unsophisticated and require the assistance of CSF staff to explain what proof is needed and how it can be obtained. Often the victims do not speak English, therefore CSF employs staff who speak Spanish, Chinese and Korean to help with making applicants feel comfortable in coming to the Fund for reimbursement.

Fund rules exclude some applicants from reimbursement including among others, relatives of the respondent attorney, law and business partners of the respondent attorney, creditors, lienholders and government agencies. The Commission also has the discretion to deny applications for various reasons including if reimbursement does not fulfill the purposes of the Fund.

From 2010 through 2014, CSF paid reimbursement on 6,413 applications. Of the 6,400 applications paid, 4,000 were paid to residents of California and 2,300 were paid to residents of other states.

The Client Security Fund conducted a review of the zip codes of all of the applicants who received reimbursement from the Fund for the past five years (2010- 2014). The Fund then used public records to determine the median income for the area covered by those zip codes. The chart below illustrates that the majority of the people who received reimbursement from CSF in the past 5 years who were California residents were from areas where the income was right at or below the California median. From a review of the data, it also appears that these applicants were from the areas hardest hit by foreclosures in California.

PAID CSF APPLICATIONS FILED BY CALIFORNIA RESIDENTS 2010-2014

By median income range*

Median Household Income Range	# Applications Paid to CA Residents	% To Total
0-\$20,000	15	.40
\$20,000-\$30,000	318	7.8
\$30,000-\$40,000	864	21.2
\$40,000-\$50,000	1048	25.7
\$50,000-\$60,000	689	16.9
\$60,000-\$70,000	591	14.5
\$70,000-\$80,000	263	6.4
\$80,000-\$90,000	136	3.3
\$90,000-\$100,000	71	1.7
OVER \$100,000	88	2.1
TOTAL	4083	100%

*The Median Household Income for the State of California in 2010 was \$46,766.00. The median income numbers are from the 2010 census data as reported by zip code

RECOMMENDATIONS

Based on the above analysis and discussion, it is clear that if the Client Security Fund is going to be able to reimburse Fund applicants in a timely manner, then more funds are needed. The Fund can continue with its current funding and still help large numbers of applicants, however, wait times will increase. While all options can be considered, the best option appears to be to request a permanent \$10.00 increase for active members and a three year additional \$15.00 increase for active members. The total assessment for CSF would then be \$65.00 for active

members for three years, reverting to \$50.00 for active members after that time period. The \$10.00 amount for inactive members would remain the same. This would allow the Fund to reimburse the outstanding amounts that are likely to qualify on the applications already filed with the Fund within approximately 18 months of discipline and to have the funds necessary to reimburse the applications that will continue to be filed with the Fund each year.