



The State Bar of California

OPEN SESSION AGENDA ITEM 703 JULY 2020

DATE: July 16, 2020

TO: Members, Board of Trustees

FROM: Banafsheh Akhlaghi, Chair, Legal Services Trust Fund Commission
Eric Isken, Vice-Chair, Legal Services Trust Fund Commission
Doan Nguyen, Acting Program Manager, Office of Access & Inclusion

SUBJECT: Approval of Proposed Interest on Lawyers' Trust Accounts (IOLTA) Grant Distribution for 2021 and Review of Planned Distribution for 2020

EXECUTIVE SUMMARY

The Board of Trustees annually sets the grant amount available for distribution from Interest on Lawyers' Trust Accounts (IOLTA) to qualified nonprofit legal aid organizations in California. Interest revenue generated by these accounts is the main source of funding for these grants, referred to as "IOLTA grants." Over the years, these funds have been supplemented by Justice Gap Fund donations and optional contributions from State Bar licensees as part of their annual licensing fee payments.

At this time last year, the Federal Reserve had set the Federal Funds Rate (FFR) at 2.5 percent. Based on bank remittances at that time, staff projected \$39 million in IOLTA revenue in 2020. On March 16, 2020, the FFR dropped to near zero and is likely to stay there for some time. As a consequence, the Legal Services Trust Fund Commission and staff anticipate the IOLTA revenue will drop to approximately \$20.02 million for the calendar year 2020, and \$8.2 million in 2021. Due to the substantial reduction in anticipated revenue, in addition to asking the Board to approve the IOLTA grant distribution in the amount of \$23,546,275 for the 2021 calendar year, this agenda item requests that the Board confirm the IOLTA grant distribution amount for 2020 at \$55,294,144.¹

¹ The amount the Board initially approved for distribution in 2020 was \$55.5 million. However, due to changes in eligibility for some organizations in the ensuing months, the Commission made adjustments to the distribution, leading to \$55.3 million.

This a critical time for legal service organizations who are facing rising demands for legal services. Based on current projections, notwithstanding the decline in interest rates, the IOLTA program has sufficient resources to continue funding at previously approved levels and leave sufficient reserves to support funding over the next few years.

BACKGROUND

IOLTA STATUTE

In 1981, the Legislature authorized the IOLTA program under Business and Professions Code sections 6210-6228 (IOLTA statute). The purpose of the statute was to increase access to justice and improve the administration of justice through expansion of legal services. In pursuit of those goals, the Legislature prioritized improving the quality of existing free legal services in civil matters to indigent persons and initiating new programs to provide such services.

The IOLTA statute requires lawyers to place nominal client funds, or funds that are on deposit for short periods of time, into interest- or dividend-bearing accounts in which the interest or dividend is paid to the State Bar.² Such accounts can only be kept at approved financial institutions certified by the State Bar to ensure compliance with the IOLTA statute.

The interest earned from pooled IOLTA accounts is remitted to the State Bar. The State Bar subtracts its administrative costs and then distributes the approved fund amount (based on the IOLTA statutory formula) to organizations that provide free civil legal aid in California to indigent persons, or legal training, legal technical assistance, and advocacy support to the organizations that directly serve indigent persons.³ The Office of Access & Inclusion administers the Legal Services Trust Fund Program for the State Bar under the oversight of the commission and Board of Trustees.

DISTRIBUTION OF IOLTA FUNDS

Each year, the Board sets the amount of IOLTA grants to be made available for distribution.⁴ For many legal aid organizations, IOLTA funding provides their core support, meaning that organizations have the flexibility to use the funds where they need it most; many other funders impose specific restrictions on funds (e.g., salaries only, but no benefits or no overhead costs; specific projects; etc.). Unlike foundation funding that may not be as consistent, IOLTA grants generally offer stability to grantees by supporting all aspects of their operational need to provide free civil legal services to the indigent. Moreover, once a grantee's eligibility is

² If there is a large sum of money involved, or it will be held for a long time, an attorney can hold the client's funds in an individual account, designated as a Client Trust Account, and the interest earned will go to the client.

³ Per the IOLTA statute, an "indigent person" is an individual: (1) whose income is not higher than 125 percent of the federal poverty threshold; or (2) eligible for Supplemental Security Income or free services under the Older Americans Act (seniors 60+) or Developmentally Disabled Assistance Act (Business and Professions Code section 6213(d)).

⁴ Typically, the Board makes its decision during the year prior to the grants being distributed. Thus, the decision as to the IOLTA grant amount for 2021 is scheduled to be made this year.

established, they are guaranteed funding for that year based upon a statutorily mandated formula.

In the first eight grant years (1984–1992), the Legal Services Trust Fund Program recommended distribution of the total money projected to be “on hand” as of the end of the prior year, subtracting administrative costs during the same period. In other words, the program collected money for a year and then gave it out in the following year, such that 100 percent of the money for grants was “on hand” for distribution throughout the year. Financial institutions continued to remit interest earned, so the program always had about one full year’s revenue on hand.

In 1992, in response to low interest rates and declining revenue, the Board, then known as the Board of Governors, adopted a cash-on-hand policy to hold only 75 percent of a year’s cash on hand. Over the years, subsequent interest rate declines led to further reductions, bringing the target range to 30-to-75 percent.

IOLTA revenue remained flat between 2001 and 2004—approximately \$10 million—but showed a steady increase beginning with the 2005 grant year. In 2006, the commission proposed—and the Board of Governors approved—a revision to the cash-on-hand policy described above (also known as the reserve policy, see Attachment A). The goal was to build reserve funds that could be distributed during lean years. Then, as now, the Board and the commission recognized that the ability to rely on stable IOLTA funding is critical to the health and survival of legal aid organizations that receive IOLTA funding.

In applying the cash-on-hand policy over the past few years, a portion of increased receipts was held in reserve as a hedge against future declines in revenue. Under the policy, when revenue is higher than in the previous year, grants are increased incrementally while also increasing the reserve/cash on hand. The cash-on-hand policy applies the following methodology:

1. The previous year’s grant distribution is established as the planned grant distribution base amount;
2. The planned grant distribution base is increased by 5 percent over the prior year’s amount;
3. 10 percent of the prior year’s grant distribution is added to the reserve/cash on hand; and
4. Any remainder in the total projected funds available for the year is split equally, increasing both grant distribution and reserve/cash on hand.

This planning to build a reserve proved essential during the Great Recession of 2008 and is now as important as ever as we enter a new economic recession. IOLTA revenue reached what was then a record high of \$22.3 million in 2008. Then, due to the recession and unprecedented low interest rates, IOLTA revenue dropped to \$7 million and stayed at or below that amount for nearly a decade. Funds put aside because of the reserve policy (and additional revenue from sources such as the Justice Gap Fund and the Legal Services Assistance Fund) supplemented low IOLTA revenue.

Recertification Efforts and Leadership Bank Program to Increase Revenue

In 2008, the State Bar adopted revisions to the State Bar Rules to reflect the comparability law enacted in 2007, mandating that IOLTA-eligible institutions pay comparable interest rates or dividends on their IOLTA accounts by choosing one of three options:

1. Establish IOLTA accounts as comparable-rate products;
2. Pay the comparable-product rate on IOLTA deposits accounts, less chargeable fees, if any; or
3. Pay the Established Compliance Rate (known as ECR) determined by the Legal Services Trust Fund Commission⁵ (See State Bar Rule 2.130).

For the past couple years, the Office of Access & Inclusion has engaged in an intensive bank recertification and negotiation effort. The Office of Access & Inclusion receives interest from approximately 170 financial institutions offering IOLTA accounts. The recertification process confirms compliance of these banks with the IOLTA statute, particularly ensuring that IOLTA accounts holding those assets are receiving comparable interest rates to similarly situated accounts.

The State Bar established a Leadership Bank program in late 2019 to increase revenue for the IOLTA programs. A Leadership Bank pays at least the ECR rate on all IOLTA accounts and waives fees or charges on these accounts. These financial institutions are highlighted on the State Bar website as preferred IOLTA-eligible institutions and lead partners supporting access to justice through the IOLTA program. The implementation of the new Leadership Program increased the number of banks paying above the federal fund rate and advanced the State Bar's goal to increase access to justice.⁶

The recent increase in IOLTA revenue was the result of rising interest rates combined with the new Leadership Bank Program and 2018–2019 recertification efforts to ensure compliance and negotiate higher interest rates, which resulted in higher distributions. In 2019, the State Bar distributed \$27.5 million in IOLTA grants, nearly double the amount distributed in the prior year. For 2020, the amount currently approved for distribution doubled again, to approximately

⁵ The Commission set the ECR at 68 percent of the FFR, or 0.68 percent (whichever is higher) in 2008. At the highest FFR in 2019, the ECR was 1.70 percent. It has since returned to 0.68. Note that financial institutions are not obligated to adopt the ECR if they offer a similar interest rate on IOLTA accounts as they do on their other financial products. Consequently, many financial institutions may be offering lower interest rates than the ECR given the current economic climate.

⁶ State Bar staff will continue to encourage IOLTA-eligible institutions to demonstrate their commitment to IOLTA-funded organizations by choosing to be a Leadership Bank. However, current events cast doubt on the ability of the IOLTA program to encourage participation in the Leadership Bank Program and to leverage the benefits of comparability in the short term, given that interest rates have returned to the very low levels seen in the 2008 recession.

\$55 million, and the reserve as of December 31, 2019 was \$49.8 million. The chart below illustrates the IOLTA grant distributions over the past six years.⁷

Year	IOLTA Grant Distribution (in millions)	Percent Change over Previous Year
2020	\$55.3 (authorized)	101%
2019	\$27.5	98%
2018	\$13.8	26%
2017	\$11	(1%)
2016	\$11.1	10%
2015	\$10.1	5%

CHANGES TO THE FEDERAL FUNDS RATE AND ONGOING FUNDING CHALLENGES

Through most of 2019, the FFR was 2.5 percent, the highest it had been in more than 10 years. By the end of 2019, the FFR decreased to 1.75 percent, but actual IOLTA revenues still exceeded 2019 estimates by \$5 million. Unfortunately, in March 2020, the FFR fell precipitously to zero to 0.25 percent in an attempt to offset the dramatic impact of COVID-19 on the economy.⁸

The current FFR is likely to remain low for quite some time.⁹ The consequence of these changes will be significantly lower IOLTA revenue than originally anticipated for 2020, changing our projection of \$39 million to approximately \$20.02 million based on April 2020 bank remittances, the first full month after the FFR dropped. Though we anticipated some decrease in the interest rate by the end of 2019, and even possible recession, the recent drop in interest rates to 0.25 percent was completely unexpected when the Board approved a 2020 IOLTA distribution of \$55.5 million.

Unfortunately, it is too soon to have a reliable prediction of when the FFR will increase. Assuming, as is likely, that the FFR stays steady through 2021, IOLTA revenue is projected at \$8.2 million annually, a fraction of the high watermark experienced in 2019. This will require using a greater proportion of the reserve to supplement the IOLTA distributions in the next few years, consistent with the reserve policy discussed earlier.

⁷ Note that IOLTA revenue mentioned in the previous section and the grant distribution do not always match. This is due to maintaining a reserve and supplementing grants with additional funds through licensing fees and other sources.

⁸ The FFR represents a target range of interest rates, in this case zero to 0.25 percent. The standard is to use the higher end of the range as the target when working with financial institutions.

⁹ In the case of the recession starting in 2008, interest rates did not increase for seven years—until December 2015—and the increase was gradual.

DISCUSSION

RECOMMENDED 2020 IOLTA DISTRIBUTION

Based on the following information and considerations, the commission and staff recommend no change to the 2020 IOLTA distribution of \$55.3 million, leaving projected net assets of \$19.7 million at the end of the 2020 calendar year.

Projected 2020 IOLTA Revenue

The FFR was reduced to zero to 0.25 percent on March 16, 2020. After review of April bank remittances, which was the first full month since the FFR changed, staff projected 2020 IOLTA revenue at approximately \$20.02 million for the calendar year. While this is nearly \$19 million less than the projection for 2020 this time last year pre-COVID-19, there are sufficient available assets for the State Bar to make timely and complete grant payments through the end of 2020, while still maintaining a reasonable reserve. Changes to the 2020 distribution are discretionary, and under normal circumstances, midyear modifications are not contemplated by either the Board or the Commission. In fact, the Board has never decreased the IOLTA distribution midyear. Modifying the distribution would only become necessary in the instance that the Board and the commission felt it necessary to keep more cash on hand in 2021 for increased distributions, or increased reserve amounts in that year or future years. Based on a series of factors enumerated below, the commission and staff do not currently believe such an action is necessary.

It is important to keep in mind that the FFR is expected to remain low for the foreseeable future. This will likely induce some banks to further reduce their interest rates in the coming year. As a result, we anticipate lower interest revenue of \$8.2 million starting in 2021 and beyond.

Grantees' Response to Potential 2020 Funding Changes

Given the dramatic decline in interest rates and the ensuing economic crisis, the commission thought it prudent to consider alternative funding scenarios for 2020 IOLTA funds, including the following options: No change; 13 percent reduction; 25 percent reduction; and 33 percent reduction.¹⁰ Any reduction in 2020 would go to the following year distribution or reserve, allowing for a more gradual decline over the next few years.

The Office of Access & Inclusion held a webinar on April 30 to provide IOLTA grant recipients an overview of these possible IOLTA distribution scenarios. Approximately 150 people attended the webinar. A survey was distributed to grantees to secure their feedback on their preferences regarding the 2020 and 2021 IOLTA distributions, as well as any impact they anticipate on their operational capacity from COVID-19.

¹⁰ The Commission later considered a reduction of 10 percent, after the survey described above was distributed to grantees.

Of 99 grantees, 93 responded to the survey. For 2020, more than two-thirds of respondents reported they anticipate no change to their expenses or a slight decrease. 16 percent expect an increase of 10-to-30 percent in their expenses this year. Similar responses were reflected in the 2021 projected expenses. Two-thirds of the respondents expect a decrease in funding from other sources in 2020, and 82 percent expect a decrease in outside funding in 2021, mostly between 10-to-30 percent. If this holds true, organizations with increasing expenses but decreasing sources of funding (approximately one fifth of grantees) would be most acutely affected.

Grantees also ranked their preference amongst the four distribution scenarios discussed above using forced-choice ranking. A ranking of one (most preferred) was weighted more heavily than a ranking of four (least preferred). Chart 1 reflects the weight given to each ranking preference and the number of responses for each scenario across ranking preference.

Chart 1

Weight	40%	30%	20%	10%	Weighted Score	Total Responses
	Ranked #1	Ranked #2	Ranked #3	Ranked #4		
No change	29	12	10	42	2.3	93
13% reduction	17	37	37	2	2.74	93
25% reduction	19	33	39	2	2.74	93
33% reduction	28	11	7	47	2.22	93

The two most extreme options—keeping the current distribution or reducing it by 33 percent—were both the most preferred and least preferred options. Many grantees preferred more modest reductions as their second or third choices, which is why, with the weighted rankings, a 13 percent or 25 percent reduction emerged as the most preferred—or supported—choices overall. (See Chart 1 above).

Several comments mentioned the increased demand for services given the ongoing crisis and the fact that reducing funding may now impact their ability to provide services. Similarly, some have assumed financial obligations that they expected to meet based on the previously-approved funding distribution and would risk default or layoffs with major decreases in funding. Moreover, any reduction in 2020 funding would occur late in the year, leaving the possibility of an uneven impact on organizations that were spending proportionately each quarter versus those that saved more funds for the second half of the year.¹¹ A major reduction, such as 33 percent, might even destabilize some agencies so much that they would cease to operate, depriving them of the intended benefit of preserving additional funds for future years.

¹¹ Funding is made quarterly. At this point in 2020, organizations have or will shortly receive first-through-third quarter funding. Thus, any cuts would entirely impact the fourth quarter. Though grantees submit quarterly reports, they are not required to spend equal amounts of the grant each quarter. They can budget as they see fit within the calendar year as long as the award is spent down during the grant year or any approved carryover period.

On the other hand, several organizations preferred a moderate reduction now to ensure stable funding in the next couple of years. Just as there are ongoing conversations and meetings around what will happen with IOLTA, grantees expressed deep uncertainty about their other funding sources; multiple survey responses underscored the fact that they were only able to estimate what the future may hold in terms of expenses and funding. There is the possibility of additional emergency funding, but it is too soon to say what amount, if any, will be available this year. If more funding streams become available, it could partially offset the reductions to 2020 IOLTA funds, at least for some organizations, but it would unlikely reach all grantees.¹²

While maintaining the current 2020 distribution of \$55.3 million will result in a 57 percent decrease in 2021 grants to \$23.6 million, staff and the commission strongly believes that the no change recommendation, coupled with allowing considerably greater flexibility for carrying over funds from 2020 to 2021 (already approved by the commission), will enable programs to address their individual needs more effectively. At times, grantees face challenges in spending down the full grant amount.

The survey results demonstrate the varying challenges organizations are facing during the current health crisis, with some needing increased funding to match immediate increased demand and others anticipating demand for services to rise in 2021 or beyond. Flexible carryovers will provide programs that need to save funding for 2021 with the ability to do so, while also allowing programs with increased need in 2020 to spend down their full grant award. While we recognize that allowing programs large carryovers, as opposed to returning unused funds to be redistributed through the IOLTA formula in a subsequent year, could potentially divest programs that have yet to apply for IOLTA funding, this concern appears to be outweighed by the concrete needs of the current grantees and the low-income communities they serve.

RECOMMENDED 2021 IOLTA DISTRIBUTION

After careful review of the revenue projections and consideration of the needs of low-income Californians and legal aid programs, the Commission recommends a distribution of \$23,546,275 for the 2021 calendar year, a 57 percent decrease over the 2020 grant distribution, leaving a projected reserve of \$8,170,928 at the end of 2021.

The reserve policy discussed above describes a target reserve amount that is 30-75 percent of the prior year's projected revenue. In applying the cash-on-hand policy over the past few years, a portion of increased receipts was held in reserve as a hedge against future declines in revenue. Under the policy, when revenue is higher than in the previous year, grants are increased incrementally while also increasing the reserve/cash on hand. However, that formula is not applicable in the current situation where revenue is decreasing.

¹² For example, a bill that would provide an additional \$31 million for renters' legal assistance is being considered in the California Legislature.

Aside from maintaining a target reserve of 30-75 percent of the prior year's projected revenue, there is no clear guidance for how the Board and the commission should determine the distribution and reserve amounts when revenue decreases. In fact, the reserve policy acknowledges this difficulty when faced with an uncertain market but does not offer a solution.

It is clear that the larger the reserve as a percentage of the prior year's revenue, the less funds that will be available for distribution. Establishing a larger reserve could allow for more stable funding in subsequent years if revenue continues to decrease, but it deprives grantees of funds that are available now, during a time when they have reported increased demand for services. In contrast, a smaller reserve reflects a decision to distribute more funds currently. It maximizes the available funding but may leave grantees in a more difficult position in succeeding years, as funding will continue to decrease in tandem with decreasing revenue. Of course, grantees that are more concerned with future funding than maximizing current funding could limit their spending of current year grants and request carryovers for the difference.

The lowest reserve target amount according to the policy is 30 percent of the prior year's revenue (because the Board is considering the 2021 distribution, this means 30 percent of 2020 revenue). This is necessary to ensure the State Bar can meet its first quarter grant payment obligations while waiting for incoming revenue to replenish available assets. The function of the reserve is well-illustrated by this year's swift drop in interest rates. Even with no changes to the grant distribution in 2020, the State Bar would be able to make all grant payments, despite declining revenue, because money will come from the reserve to make up the difference.¹³ Any reduction would be discretionary rather than mandatory.

The recommended distribution of \$23.5 million represents the maximum possible distribution in 2021, based on no change to the 2020 distribution and a 30 percent reserve in 2021. If the Board wishes to establish a larger reserve amount, the distribution will decrease by the same amount that the reserve increases.¹⁴

Between the projected amount to be available in 2021 and the Commission's flexible approach to carryover of IOLTA funds from 2020, it appears that sufficient funding will be available for most organizations to operate at a funding level slightly lower than their 2019 levels if no changes are made to the 2020 distribution. Prior to 2020, the 2019 distribution of \$27.5 million reflected an historic high in IOLTA funding. The spike in funding in 2020 was significant, as the planned distribution more than doubled that of 2019. Organizations were informed at the outset of 2020 that this year's increases in funding were unlikely to continue in future funding cycles. Thus, 2020 represents something of an anomaly, and returning to 2019 funding levels would still provide strong support for the work of the grantee organizations.

¹³ The 2020 reserve was planned to be \$29.5 million, but net assets are likely to be closer to \$19.7 million by the end of the year under the current distribution plan.

¹⁴ If the Board were to set the reserve at 75 percent of projected 2020 revenue, then the grant distribution in 2021 would be \$11.3 million and the reserve would be \$20.4 million.

POTENTIAL FUNDING CHANGES

If changes to the Equal Access Funds (EAF) or other funding sources occur, impacting IOLTA-funded grantees, the Commission respectfully asks the Board to delegate authority to it in order to determine whether increases or decreases to the 2020 and/or 2021 IOLTA distributions are appropriate. Governor Gavin Newsom approved the 2020 Budget Act on June 29 and the State's Budget does not include a five percent reduction to EAF that was originally anticipated. Furthermore, an additional \$31 million was recently approved for homelessness prevention as part of the redistribution of the \$331 National Mortgage Settlement. 75 percent of these funds will be distributed, by formula, to programs that provide eviction defense or other tenant defense assistance in landlord-tenant disputes. The remaining 25 percent will be distributed through a competitive grant process. Additionally, some legislators are considering other proposals to provide more funding to legal services in these critical times. Since we will not learn the outcomes of these additional funding changes for quite some time, providing the commission authority to make any necessary modifications to the 2020 and/or 2021 IOLTA distributions will enable the State Bar to respond efficiently and swiftly.

FISCAL/PERSONNEL IMPACT

The recommended distribution is net of the \$2.1 million projected costs to administer the program. Administration of the IOLTA program is fully funded through IOLTA revenue. This recommendation does not affect the general fund budget. No additional staff or other expenses will be incurred as a result of the adoption of recommendation.

AMENDMENTS TO RULES OF THE STATE BAR

None

AMENDMENTS TO BOARD OF TRUSTEES POLICY MANUAL

None

STRATEGIC PLAN GOALS & OBJECTIVES

Goal: 4. Support access to legal services for low- and moderate-income Californians and promote policies and programs to eliminate bias and promote an inclusive environment in the legal system and for the public it serves, and strive to achieve a statewide attorney population that reflects the rich demographics of the state's population.

Objective: a. Support increased funding and enhanced outcome measures for Legal Services.

RECOMMENDATIONS

Should the Board of Trustees concur in the proposed action, passage of the following resolutions are recommended:

RESOLVED, that the Board of Trustees maintains the 2020 IOLTA distribution at \$55,294,144,¹⁵ leaving net assets in the amount of \$19,684,821 (projected); and it is

FURTHER RESOLVED, that the Board of Trustees approves the 2021 IOLTA distribution in the amount of \$23,546,275, with a projected reserve of \$8,170,928 at the end of 2021; and it is

FURTHER RESOLVED, if changes to the Equal Access Fund or other funding sources occur, impacting IOLTA-funded grantees, the Board of Trustees will delegate authority to the Legal Services Trust Fund Commission to determine whether increases or decreases to the 2020 and/or 2021 IOLTA distributions are appropriate.

ATTACHMENT(S) LIST

- A. State Bar 2006 Cash On Hand Policy/Reserve Policy
- B. Proposed IOLTA 2020 and 2021 Grant Distribution Funding Detail

¹⁵ The amount the Board of Trustees initially approved for distribution in 2020 was \$55.5 million. However, due to changes in eligibility for some organizations in the ensuing months, the commission made adjustments to the distribution, leading to \$55.3 million.

AGENDA ITEM

MARCH 54-166

Legal Services Trust Fund Program:
Set Amount for Distribution for
2006-2007 IOLTA Grants

BCSR

03/17/06

Open / Action
Item III.B.

DATE: February 28, 2006

TO: Members of the Board of Committee on Stakeholder Relations
Members of the Board of Governors

FROM: Judy Garlow, Director, Legal Services Trust Fund Program

SUBJECT: Legal Services Trust Fund Program:
Set Amount for Distribution for 2006-2007 IOLTA Grants

Executive Summary

Each year, the Board of Governors sets an amount for distribution in Legal Services Trust Fund Program grants from interest on lawyer trust accounts ("IOLTA"). Since 1992, the method for setting the amount has been to allocate for the grants the amount of prior year revenue less administrative costs, adjusted by an amount by which cash on hand as of June 30 is projected to be more or less than a specific percent of the prior year's net revenue. Most recently, this cash-on-hand target has been 30 percent. After consultation with the Legal Aid Association of California, the Legal Services Trust Fund Commission is recommending adjusting this target for this year upward to approximately 50 percent, so as to take advantage of increased IOLTA revenue to put us in a position to cushion the effects of lower interests rates as needed in the future. Using this system will result in 2006-2007 grants of \$12.7 million, up about 6 percent from the \$12 million distributed in the 2005-2006 grant year.

BACKGROUND

The Board of Governors each year sets an amount for distribution in IOLTA grants to be administered by the Legal Services Trust Fund Program. That amount is distributed for the grant year beginning July 1. The amount is set in March or April, depending on the board meeting schedule, so that the Trust Fund Commission can notify each recipient program of a grant amount, give them 30 days to prepare proposed budgets, review the budgets and still get grant agreements signed and the checks mailed in July.

For each of the first eight grant periods (fiscal years 1984-1985 through 1991-1992), the amount approved for distribution was the total money projected to be on hand June 30. This amounted to the total revenue of the program in the year preceding the grant period, less administrative costs during the same period. In other words, the program collected money for a year and then gave it out in the following year.

At the beginning of the grant year, 100 percent of the money for grants was on hand. Grants were disbursed in quarterly payments. At the same time, money came in that would become the next year's grants, so the program always had on hand about one full year's revenue.

In 1992, the Board of Governors changed that system on the recommendation of the Legal Aid Association of California and the Trust Fund Commission. We moved away from a system where grants were made up only of money already in hand, and to a system of paying part of the grant out of income as it came in. The motivation for this change was the view that the program did not need to keep such a large amount of cash on hand, especially in times of low interest rates and correspondingly lower revenue.

The basic distribution method remained, as before, to allocate for grants the amount of prior year revenue less administrative costs. To determine the amount for distribution, this net prior year revenue amount was adjusted by the amount by which cash on hand as of June 30 was projected to be more or less than a set percentage of the prior year's revenue amount. When the original change was made in 1992, interest rates had begun to drop and the target was set at 75 percent, in order to increase grants by 6 percent over the previous year even though revenue was down about 7 percent. Subsequently, interest rates fell dramatically. The cash-on-hand target was reduced to 60 percent and then to 30 percent, where it has remained for the last 12 grant years.

In years when revenue is increasing, the money coming in exceeds the grant amount going out, and cash on hand builds up above 30 percent. That "extra" amount is added onto the grants for the next year, resulting in a larger increase. In years when revenue is decreasing, the money coming in is less than the grant amount going out, and cash on hand drops below 30 percent. We make up for that by holding back money to increase the cash on hand for the next year, resulting in a greater decrease in grants.

This system has had the desired effect of putting the money in the hands of grant recipients quickly, and has minimized the amount of the program's cash on hand. Because of the swings in interest rates in the last several years, however, it has also meant there were somewhat unpredictable swings in the amount of grants from year to year. As just one example, the total grant amount went up 22 percent in 2001 and then back down 38 percent the following year. Although the grants on average represent a small share of each recipient's total income, in many cases, the ups and downs have been significant. In a time of increasing revenue, the Trust Fund Commission decided to explore whether there might be a better approach.

PROPOSED CHANGE

The Commission has now discussed its proposed change with the Legal Aid Association of California, which consulted with all of the recipients of Trust Fund Program grants. LAAC came back to the Commission in support of the proposal, with a few relatively small suggestions that the Commission has incorporated into this recommendation.

The proposal is to increase cash on hand above 30 percent with the goal of decreasing the fluctuation in grants caused by sizable increases and decreases in interest rates. In years of increasing revenue, grants would be held to a smaller increase than is currently provided for, so as to increase cash on hand. Then in years of decreasing revenue, the cash on hand will be spent down again, to keep grants larger than they would otherwise have been.

The recommendation of the Commission and the legal services community involves a three-step calculation for years in which income is increasing:

- The amount for distribution will be allowed to increase by 5 percent before increasing cash on hand above the current 30 percent. For 2006-2007, this means an increase from \$12 million to \$12.7 million in total grants.
- The funds that would represent the next 10 percent increase--in this case, \$1.2 million--will go to increasing the cash on hand.
- In years when revenue increases more than that, the additional amount will be divided equally between increased grants and increased cash on hand, up to a cap of 75 percent of the previous year's available funds. For this year, there is \$229,520 to be shared equally between grants and increased cash on hand.

Two elements of this change will required ongoing discussion between the Legal Services Trust Fund Commission and the Legal Aid Association, to arrive at further recommendations as needed by this time next year. The first of these two elements is the system for distributing the funds held back when we come upon years of declining income. It is much more difficult to come up with an automatic formula for that. It is likely that a policy will be developed after consultation with the Legal Aid Association.

A second issue for ongoing discussion is the cap on the amount held back to increase cash on hand. LAAC suggested limiting the cash on hand to a specific target, in the range of 50 to 75 percent. The Trust Fund Commission has agreed to a 75 percent cap, and also agreed to discuss whether it should be smaller (or larger) than that. The amount for this year will be 53 percent. Between now and the next time the board goes through this process, a year from now, we can explore the most effective cap. This is a decision that must in any case be made annually, based on the particular income in that year.

CURRENT AND PROJECT REVENUE AND CASH ON HAND

Using this revised system for determining the grant amount will result in setting the grant amount for 2006-2007 at \$12.7 million. This grant amount is larger than the 2005-2006 distribution, due primarily to increased income from substantial increases in the balance on deposit in attorney-client trust accounts and also to small increases in the interest rates on checking accounts.

We currently expect net IOLTA revenue (income less expenses) for the period July 1, 2005 through June 30, 2006 to be \$14 million. At this income level, the program expects to have on hand as of June 30, 2006 about \$7.5 million, which is 53 percent of last year's net revenue. To calculate the grant amount for the coming year, we have added to last year's grant amount a 5 percent increase, plus half of the amount by which net revenue is greater than 15 percent of last year's grants.

RECOMMENDATION

The attached schedule shows the calculation, based on actual experience to date and projections through the rest of the grant year.

Because money will continue to be disbursed as it is received, the Trust Fund Commission will continue to monitor revenue closely and will return with recommendations if there are significant variances from the projections. The agreements signed with grant recipients will continue to include language to make clear that payment of these grants is contingent upon the Legal Services Trust Fund Program having sufficient money on hand from IOLTA revenue to make the scheduled payments. In addition, the Trust Fund Commission will meet with LAAC over the coming months to evaluate the effectiveness of the procedures used this year and what changes should be made for the future.

BOARD BOOK/ADMINISTRATIVE MANUAL IMPACT: None.

PROPOSED RESOLUTION

The Board Committee on Stakeholder Relations will have a recommendation at the time of your meeting. If you agree with this proposal, the following resolution would be appropriate:

RESOLVED, upon recommendation of the Board Committee on Stakeholder Relations, that the Board hereby approves that the distribution of IOLTA grants from the Legal Services Trust Fund Program for the grant period July 1, 2006 through June 30, 2007 shall be made in the order and manner provided by Business and Professions Code Section 6216, and the funds to be distributed shall be \$12,720,721 calculated as follows

- (1) The amount projected to be received by the Legal Services Trust Fund Program and the interest earned thereon from July 1, 2005 through June 30, 2006, totaling \$15,256,329, shall be allocated for the grant period July 1, 2006 through June 30, 2007.
- (2) The administrative costs to be deducted prior to distribution shall be the costs projected for the period July 1, 2005 through June 30, 2006, totaling \$1,220,280.
- (3) To be subtracted from the total amount prior to distribution shall be \$1,200,568, 10 percent of prior year net revenue reserved for cash on hand.
- (4) Also to be subtracted from the total amount prior to distribution shall be \$114,760, one-half of the amount over 15 percent of prior year net revenue reserved for cash on hand, and it is

FURTHER RESOLVED that grant payments are to be made from funds received pursuant to Business and Professions Code Section 6212 and the income earned from investment of such funds, and that payment of grants is contingent upon the State Bar having sufficient money on hand from such sources to make the scheduled payments; and it is

FURTHER RESOLVED that the Legal Services Trust Fund Commission is directed to monitor program revenue during the grant year and to recommend action to change the total grant amount for the year if needed in the event of significant variances from projections.

STATE BAR OF CALIFORNIA
Legal Services Trust Fund Distribution
Available Funds for Grant Period 2006-2007

DATE: FEBRUARY 21, 2006

AMOUNT**A. Revenue: 7/1/05 – 6/30/06**

2005:	3rd Quarter	\$	3,726,984
	4th Quarter		3,679,345
2006:	1st Quarter (Projected)		3,900,000
	2nd Quarter (Projected)		<u>3,950,000</u>
Total Revenue		\$	15,256,329

B. Administrative Costs: 7/1/05 – 6/30/06

7/1/05 – 12/31/05	\$	734,972
1/1/06 – 6/30/06 (Budgeted)		815,308
Less Projected Equal Access Fund Reimbursements		<u>(330,000)</u>
Total Administrative Costs	\$	1,220,280

C. Cash-on-Hand Calculation

Cash on Hand 6/30/05	\$	5,547,400
Add: Net Revenue 7/1/05 – 6/30/06		14,036,049
Less: 2005-2006 Grants (Net of amounts from past years redistributed)		<u>(12,005,677)</u>
Projected Cash on Hand – 6/30/06 (53 percent of prior year net revenue)	\$	7,577,772

Grant Amount Calculation

2005-2006 Net Revenue	\$	14,036,049
Less 10 percent reserved for cash on hand		(1,200,568)
Less one-half of amount over 15 percent reserved for cash on hand	\$	<u>(114,760)</u>

Total Grant Amount for 2006-2007	\$	12,720,721
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Prior Year Distribution (2005-2006)	\$	12,005,677
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Percent Increase from Prior Year Distribution	6%
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Selection Guidelines for State Bar Appointments to the ABA House of Delegates

The State Bar will strive to appoint members from its applicant pool meeting the following guidelines:

- One (1) delegate who qualifies as the young lawyer representative;
- Up to two (2) delegates to include the most immediate past member of the ABA Board of Governors and any immediate past officer of the ABA from the California ABA Delegation;
- Two (2) members who have not had substantial volunteer experience but who possess the leadership and other skills to be successful delegation members; and
- Six (6) delegates who have substantial bar experience, especially with the ABA, and are typical of other State Bar appointments.

Unless otherwise authorized by the Board of Governors, Each each member of the State Bar's ABA delegation would be eligible for reappointment to no more than three (3) consecutive two-year appointments or a maximum of six (6) consecutive years of service with the delegation. Delegates who have completed such service may apply in the future after a period of not less than two years from the date of the expiration of the delegate's last term of service with the State Bar.

All members will be encouraged to become broadly participant in ABA activities in order to fully represent the interests of California attorneys.

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RESOLVED, upon recommendation of the Board Committee on Stakeholder Relations, that the Board hereby approves that the distribution of IOLTA grants from the Legal Services Trust Fund Program for the grant period July 1, 2006 through June 30, 2007 shall be made in the order and manner provided by Business and Professions Code Section 6216, and the funds to be distributed shall be \$12,720,721 calculated as follows:

- (1) The amount projected to be received by the Legal Services Trust Fund Program and the interest earned thereon from July 1, 2005 through June 30, 2006 totaling \$ 15,256,329, shall be allocated for the grant period July 1, 2006 through June 30, 2007.
- (2) The administrative costs to be deducted prior to distribution shall be the costs projected for the period July 1, 2005 through June 30, 2006, totaling \$1,220,280.
- (3) To be subtracted from the total amount prior to distribution shall be \$1,200,560 10 percent of prior year net revenue reserved for cash on hand.
- (4) Also to be subtracted from the total amount prior to distribution shall be \$114,760, one-half of the amount over 15 percent of prior year net revenue reserved for cash on hand, and it is

FURTHER RESOLVED that grant payments are to be made from funds received pursuant to Business and Professions Code Section 6212 and the income earned from investment of such funds, and that payment of grants is contingent upon the State Bar having sufficient money on hand from such sources to make the scheduled payments; and it is

FURTHER RESOLVED that the Legal Services Trust Fund Commission is directed to monitor program revenue during the grant year and to recommend action to change the total grant amount for the year if needed in the event of significant variances from projections.

RESOLVED, upon recommendation of the Committee on Group Insurance Programs, that the Board Committee on Operations, acting on behalf of the Board between regularly scheduled meetings, hereby approves the formal acknowledgment of Raphael Cotkin's 25 years of service to the State Bar of California; and it is

FURTHER RESOLVED, that that Board Committee on Operations, acting on behalf of the Board between regularly scheduled meetings, hereby authorizes the Committee on Group Insurance Programs to formally present this Board Resolution to Raphael Cotkin at it's Planning Session dinner on Monday, March 13, 2006.

[The above is a report of emergency fax-poll action taken by the Board Committee on Operations on behalf of the Board, March 3 – 6, 2006, between regularly scheduled Board meetings.]

RESOLVED, upon the recommendation of the Los Angeles County Bar Association, that the Board Committee on Operations, acting on behalf of the Board between meetings, approves the resolution adopted by the Los Angeles County Bar Association; and it is

FURTHER RESOLVED, that the Board Committee on Operations, acting on behalf of the Board between meetings, authorizes participation in this resolution in the Tribute Book by March 15, 2006, to be presented to the Chief Justice at the dinner in his honor on April 4, 2006.

[The above is a report of emergency fax-poll action taken by the Board Committee on Operations on behalf of the Board, March 3 – 6, 2006, between regularly scheduled Board meetings.]

Upon motion made, seconded and adopted, it was

RESOLVED, upon recommendation of the Board Committee on Operations, that the Board hereby rejects the Foundation's proposed change to the at-will termination clause, accepts the Foundation's change to the revenue, and modifies Article 2.3 of the MOU along the lines discussed, and delegate to the Executive Director the authority to communicate a final proposal to the Foundation; and it is

Proposed IOLTA 2020 and 2021 Grant Distribution Funding Detail

A. Revenue - January through December Prior Year		2020	2021
Actual IOLTA Revenue	\$	46,454,116	\$ 11,458,963
Projected IOLTA Revenue		-	8,561,986
Justice Gap Funds including cy pres		1,537,668	800,000
Fee Statement Contributions		6,255,553	6,165,478
Interest & Tax Intercept Funds		838,881	250,000
Total Revenue:	\$	55,086,218	\$ 27,236,427
B. Expenses - January through December Prior Year			
IOLTA Grant Distributions		27,463,024	55,294,144
Administration, Net of EAF & Bank Settlement		1,863,242	2,100,000
Total Expenses:	\$	29,326,266	\$ 57,394,144
C. Prior Year Revenue less Expenses	\$	25,759,952	\$ (30,157,717)
D. Net Assets from Prior Year			
Available Net Assets at Jan 1 Prior Year		24,082,586	49,842,538
Prior Year Revenue less Expenses		25,759,952	(30,157,717)
Prior Year Ending Net Assets:	\$	49,842,538	\$ 19,684,821
E. Current Year Projected Revenue & Expenses			
IOLTA Revenue		20,020,949	8,200,000
Justice Gap Revenue		800,000	800,000
Fee Statement Contributions		6,165,478	4,932,382
Interest Income & Tax Intercept Funds		250,000	200,000
Administration, Net of EAF & Bank Settlement		(2,100,000)	(2,100,000)
Projected Current Year Net Income:	\$	25,136,427	\$ 12,032,382
Prior Year Ending Net Assets:	\$	49,842,538	\$ 19,684,821
Funds Available:		\$ 74,978,965	\$ 31,717,203
F. Grants			
Prior Year Grant distribution (baseline)	\$	27,463,024	\$ 55,294,144
Total Grants:	\$	55,294,144	\$ 23,546,275
Percentage Change vs Prior Year Grant Allocation:		102%	-57%
G. Reserve/Cash on Hand/Net Assets			
Projected Reserve/Ending Net Assets:	\$	19,684,821	\$ 8,170,928
Reserve as Percentage of Prior Year Total Revenue:		36%	30%

Note: The 2020 column figures in the Prior Year sections are actual 2019 amounts. In the 2021 column, the prior year figures are projected 2020 amounts.