



The State Bar of California

OPEN SESSION AGENDA ITEM 701 NOVEMBER 2021

DATE: November 18, 2021

TO: Members, Board of Trustees

FROM: José Cisneros, Board of Trustees
Leah T. Wilson, Executive Director

SUBJECT: Discussion Regarding the Final Report and Recommendations from the Committee on Special Discipline Case Audit for the Development of a California Trust Account Program; Request for Extension on Deadline for Public Comment Issuance

EXECUTIVE SUMMARY

At its meeting in July 2021, the Board of Trustees established a special committee of the Board, the Committee on Special Discipline Case Audit, to further analyze the audit report on closed discipline cases against Thomas Girardi and to develop a proposed corrective action plan to be approved by the Regulation and Discipline Committee (RAD) or the Board of Trustees.

The recommendations in the committee's report (attached), comprise that corrective action plan and are aimed at strengthening the regulatory framework for client trust account (CTA) management through proactive oversight and intervention.

The Board of Trustees is asked to receive the committee's report and to direct further work designed to advance those recommendations to an implementation stage; in addition, the Board is asked to extend the deadline for a public consideration of the recommendations and any related rule proposals to June 30, 2022.

BACKGROUND

At its meeting in July 2021, the Board of Trustees established a special committee of the Board, the Committee on Special Discipline Case Audit, to further analyze the audit report on closed discipline cases against Thomas Girardi and to develop a proposed corrective action plan to be approved by the RAD or the Board of Trustees. Pursuant to the committee's authorizing charter, a final report on increasing the State Bar's ability to effectively and proactively regulate attorney CTAs based on this corrective action plan and a corresponding public comment period is to be issued no later than December 31, 2021.

The attached report of the Committee on Special Discipline Case Audit reflects the work done in response to this directive.

DISCUSSION

The committee met six times to address the expansive charge outlined in its charter, which included a directive to study:

- Random audits of attorney CTAs held by California licensed attorneys;
- Audits of CTAs on a regular basis by certified public accountants (CPAs);
- Annual self-funded audits and reporting of CTAs;
- The use of third-party escrow accounts for some or all attorneys;
- New and amended statutes, State Bar rules, rules of professional conduct, and other rules governing attorney conduct, as well as standards governing discipline for CTA violations;
- Bonding requirements; and
- The use of technology and other tools in these efforts.

In addition, the committee considered other issues identified during the course of its work including:

- Increasing attorney education on responsibilities for client trust accounting;
- Identifying patterns of complaints requiring increased scrutiny by State Bar;
- Training of Office of Chief Trial Counsel managers and staff and Special Deputy Trial Counsel;
- Addressing complaints about attorney conduct regarding prompt disbursement of client funds, threats to withdraw representation, and failure to communicate with clients;
- Increasing attorney education on responsibilities for client trust accounting; and
- Making malpractice insurance mandatory.

The attached report contains 12 recommendations, several of which relate to the establishment of a new Client Trust Account Protection Program (CTAPP). Key committee recommendations are summarized below.

ESTABLISH A CLIENT TRUST ACCOUNT PROTECTION PROGRAM

Recommendation: Annual Registration of CTAs

The State Bar should require, as part of annual license renewal, that every licensed attorney report whether they are or are not responsible for one or more CTAs. If responsible, the

attorney should be required to list the CTAs for which they are responsible by account number and financial institution.

Recommendation: Annual Certification of Compliance

The State Bar should require, as part of the annual license renewal process, that every attorney licensed by the State Bar who is responsible for CTAs certify in writing that they are knowledgeable about and compliant with the provisions of the Rules of Professional Conduct rule 1.15, “Safekeeping Funds and Property of Clients and Other Persons.”

Recommendation: Annual Self-Assessment by All Attorneys Responsible for CTAs

The State Bar should require all attorneys responsible for CTAs to complete an annual self-assessment.

Recommendation: Compliance Reviews of Selected Attorneys by CPAs

Compliance reviews of selected attorneys should be conducted annually by an independent third-party CPA at the expense of the law firm or attorney, based on policies and procedures developed by the State Bar in collaboration with the CPA community.

Recommendation: Risk Review and Follow-Up

On the basis of compliance review results and complaint and charges data, the State Bar should follow up all compliance reviews with a response proportional and appropriate for those findings. This range of actions, listed in order of increasing scrutiny, might include:

1. File closed.
2. Written statement of deficiencies to be corrected within a specified deadline.
3. Selection for random or risk-based audit.
4. Referral for investigation and possibly disciplinary action.

Recommendation: Enhanced State Bar Licensee Education

The State Bar should invest in increased support for attorneys responsible for CTA management.

Recommendation: Public Education and Client Outreach

The State Bar should develop an outreach program through its various communication platforms to educate the public and clients with respect to a CTA opened on their behalf and of the responsibility of attorneys to communicate timely, report on changes in funds, and account in a timely manner for client trust funds. In addition, attorneys opening a CTA should be required to distribute State Bar-produced information on CTAs to clients at the time they establish a CTA for that client.

Recommendation: Phased Implementation of the CTAPP

Recognizing that significant resource investment will be needed to implement CTAPP, as outlined below, that additional time is needed to fully design the program, and that rule and statutory changes will be needed to effectuate certain program elements, it is recommended

that the State Bar implement CTAPP in phases. Preliminary implementation phases for the recommended actions are:

Phase I (first-half 2022)

- i. Annual Registration
- ii. Annual Certification of Compliance

Phase II (second-half 2022)

- i. Enhanced State Bar Education and Professional Development
- ii. Annual Self-Assessment by All Attorneys
- iii. Public Education and Client Outreach

Phase III (2023)

- i. Annual Compliance Review by CPAs of Selected Attorneys
- ii. Annual Risk Review and Follow-Up Actions (including audits)

OTHER RECOMMENDATIONS

Recommendation: Revise or Clarify Rule 1.15(d)

The Board of Trustees should direct the Committee on Professional Responsibility and Conduct (COPRAC) to draft a revision or clarification of rule 1.15(d) to remove the burden of soliciting reimbursement from the client and to clarify the meaning of “promptly” by replacing that term with a rebuttable presumption timeframe for disbursement, likely 30–60 days.

Recommendation: Clarify Rule 1.4

The Board of Trustees should direct State Bar staff to clarify rule 1.4 to ensure that developments regarding the receipt and disbursement of funds on behalf of clients are specifically included in the language of that rule, including reference to rule 1.15(d)(1).

Recommendation: Conduct Additional Exploratory Research on Malpractice and Other Forms of Insurance, as well as Bonds, as a Means of CTA Protection

The State Bar should do additional research on the use of malpractice and other forms of insurance, as well as the use of bonds as a method for protecting CTAs from intentional, tortious actions (fraud, theft, misappropriation, etc.). Issues to be addressed include the appropriateness, expense, coverage, and process of recovering client funds through these various types of insurance and bonds.

NEXT STEPS

While the committee covered an immense amount of ground in a relatively short period of time, there are a number of additional activities that need to be undertaken prior to recommendation of implementation, including:

1. Using the framework developed by the committee to finalize the design of the CTAPP.
2. Finalize estimated one-time and ongoing CTAPP costs and identify potential funding sources.
3. Create a rule and statutory path and timeline for CTAPP implementation.
4. Develop proposals by COPRAC to amend rule 1.15 and 1.4.
5. Perform additional study of insurance and bonding as a means of client protection.

With these additional activities in mind, the Committee on Special Discipline Case Audit seeks the Board of Trustees' approval to extend the deadline for public comment on all recommendations to June 30, 2022.

FISCAL/PERSONNEL IMPACT

The CTAPP is estimated to have a one-time cost of at least \$500,000 and ongoing costs of approximately \$3.35 million annually. It is estimated that this funding level would support 15 FTEs and 500 compliance reviews and audits annually. In addition, the estimated funding level assumes an investment in automation of the CTAPP at all levels, including with respect to the transmission of CTA information between licensees and the State Bar.

The State Bar's General Fund cannot currently support estimated CTAPP implementation costs. Additional licensing fees would need to be levied to generate CTAPP operating revenue. As a point of reference, \$3.35 million across all licensees equates to a per capita assessment of less than \$20.

AMENDMENTS TO RULES

None

AMENDMENTS TO BOARD OF TRUSTEES POLICY MANUAL

None

STRATEGIC PLAN GOALS & OBJECTIVES

Goal: 2. Ensure a timely, fair, and appropriately resourced admissions, discipline, and regulatory system for the more than 250,000 lawyers licensed in California.

RECOMMENDATIONS

Should the Board of Trustees concur in the proposed action, passage of the following resolution is recommended:

RESOLVED, that the Board of Trustees, upon recommendation of the Committee on Special Discipline Case Audit, directs staff to finalize CTAPP design and effectuating rule proposals for consideration at the Board of Trustees' January or March 2022 meeting; and it is

FURTHER RESOLVED, that the Board of Trustees, upon recommendation of the Committee on Special Discipline Case Audit, refers proposed changes to rule 1.15 to COPRAC for finalization; and it is

FURTHER RESOLVED, that the Board of Trustees, upon recommendation of the Committee on Special Discipline Case Audit, refers proposed changes to rule 1.4 to COPRAC for finalization; and it is

FURTHER RESOLVED, that the Board of Trustees, upon recommendation of the Committee on Special Discipline Case Audit, directs staff to study the potential role of bonds and insurance in CTA protection; and it is

FURTHER RESOLVED, that the Board of Trustees, upon recommendation of the Committee on Special Discipline Case Audit, approves to an extension of the deadline for public comment period on all recommendations stemming from the committee's work to June 30, 2022.

ATTACHMENT LIST

A. Final Report and Recommendations



The State Bar *of California*

Committee on Special Discipline Case Audit Report to Board of Trustees

November 19, 2021

INTRODUCTION

At its meeting in July 2021, the Board of Trustees established a special committee of the Board, the Committee on Special Discipline Case Audit, to further analyze the audit report on closed discipline cases against Thomas Girardi and to develop a proposed corrective action plan to be approved by the Regulation and Discipline Committee or the Board of Trustees. Pursuant to the committee's authorizing charter, a final report on increasing the State Bar's ability to regulate attorney client trust accounts based on this corrective action plan and a corresponding public comment period, is to be issued no later than December 31, 2021.

The committee was specifically directed to work with staff to conduct a study and develop recommendations for increasing the State Bar's ability to effectively and proactively regulate client trust accounts and attorney client trust account management. Consistent with the urgency and importance of its assignment, the committee has met approximately every two weeks since its formation.

This report and its recommendations are the product of that study. The recommendations aim to strengthen the State Bar's oversight and regulation of client trust accounts by incorporating program elements whose effectiveness have been demonstrated in other jurisdictions and domains. The elements of the proposed Client Trust Account Protection Program (CTAPP) are an interrelated set of steps that build accountability and oversight. The recommended program begins with requiring registration of trust accounts, annual certifications of compliance as well as self-assessment and compliance review. Self-assessment and compliance review will allow the State Bar to conduct risk assessment and management through a graduated set of corrective actions including audits and formal discipline. Each element in combination results in a comprehensive program of education, deterrence, detection, and enforcement. These proposed changes are designed both to improve trust accounting practices in general and help avoid and detect negligence in that respect and also, particularly through risk assessment and audit, better detect those attorneys who engage in intentional misconduct regarding entrusted funds.

The current regulatory framework in California for the oversight of client trust accounts is defined in the Rules of Professional Conduct, specifically in [rule 1.15](#), Safekeeping Funds and Property of Clients and Other Persons (referred to throughout as rule 1.15).¹ The provisions of this rule define how client funds are to be managed and the record-keeping required for these accounts. The required practices for implementation of the provisions of that rule are spelled out in detail in the State Bar's [Handbook on Client Trust Accounting for California Attorneys](#).

Up to now the State Bar has not had a comprehensive and proactive program for education about, and enforcement of, the provisions of rule 1.15. While the Handbook is an effective tool when it is used, more is needed to ensure that attorneys are fully educated in how to manage

¹ See the full text at calbar.ca.gov/Portals/0/documents/rules/Rules-of-Professional-Conduct.pdf, p. 26ff, accessed October 26, 2021.

their trust accounts and are deterred from engaging in misconduct regarding entrusted property. Rather than leading in this area of regulation, California has allowed itself to fall behind. The program proposed by the committee is designed to correct this failure.

The current system of client trust account regulation relies significantly on complaints brought by clients against their attorneys. As prescribed by Business and Professions Code [section 6091](#), the State Bar can audit a client trust account only when a client files a complaint alleging mishandling of trust funds. However, because clients can easily be deliberately kept uninformed about their rights with respect to funds to which they are entitled as well as the timing of that entitlement, a complaint-driven approach to addressing violations of the rules is wholly inadequate.

The recommendations in this report are aimed at strengthening the regulatory framework for client trust account management through proactive oversight and intervention, rather than relying primarily on a passive complaint-driven approach.

In addition, the committee examined several related issues and brings forward recommendations regarding them, including amendments to the Rules of Professional Conduct (timely disbursement of client funds, failure to communicate, and threats to withdraw representation); training of Office of Chief Trial Counsel (OCTC) staff and special deputy trial counsel (SDTC) on investigation and prosecution of client trust account complaints; and additional means of protecting entrusted client funds, including third-party managed accounts, forms of insurance, and the use of bonds.

THE CHARGE OF THE COMMITTEE

The committee charter and roster are specified in the resolution of the Board of Trustees that passed at the July meeting. The charge of the committee, which can be found [here](#), was to study the use of various methods of client trust account oversight and client protection, including

- Random audits of attorney client trust accounts held by California licensed attorneys;
- Audits of client trust accounts on a regular basis by certified public accountants (CPAs);
- Annual self-funded audits and reporting of client trust accounts;
- The use of third-party escrow accounts for some or all attorneys;
- New and amended statutes, State Bar rules, rules of professional conduct, and other rules governing attorney conduct, as well as standards governing discipline for client trust account violations;
- Bonding requirements; and
- The use of technology and other tools in this effort.

At its first meeting, the committee added the following lines of inquiry to its original charge:

- Increasing attorney education on responsibilities for client trust accounting;
- Identifying patterns of complaints requiring increased scrutiny by State Bar;
- Training of OCTC managers and staff and SDTC;
- Possible rule or statutory amendments regarding prompt disbursement of client funds, threats to withdraw representation, and failure to communicate with clients;
- Increasing attorney education on responsibilities for client trust accounting; and
- Making malpractice insurance mandatory.

COMMITTEE MEETINGS

The table below summarizes the topics discussed at each of the meetings of the committee, all of which took place in 2021. Pursuant to Government Code section 11126(a)(1) and 11126(c)(2), the committee met in closed session to specifically discuss the audit of closed OCTC files. Complete agendas and meeting notices can be found [here](#).

Meeting Date	Topics
September 2 Conference Call	Audit of Closed Office of Chief Trial Counsel Files (closed session)
September 9 Conference Call	Audit of Closed Office of Chief Trial Counsel Files (closed session) Study and Recommendations to Regulate Attorney Client Trust Accounts
September 27 Conference Call	Study and Recommendations to Regulate Attorney Client Trust Accounts Audit of Closed Office of Chief Trial Counsel Files (closed session)
October 12 Conference Call	Program Management Design: Client Trust Accounts Audit of Closed Office of Chief Trial Counsel Files (closed session)
October 28 Conference Call	Attorney Conduct Issues and Client Trust Account Rules Training of Office of Chief Trial Counsel Managers, Staff, and Special Deputy Trial Counsel Program Management Design: Client Trust Accounts Audit of Closed Office of Chief Trial Counsel Files (closed session)
November 5 Conference Call	Review and Discussion of Final Report to Board of Trustees

COMMITTEE FINDINGS

THE NECESSITY OF CLIENT TRUST ACCOUNT MANAGEMENT

The need to protect client trust accounts was brought to prominence by the American Bar Association's (ABA) Commission on Evaluation of Disciplinary Enforcement, popularly known as the McKay Commission, in its final report in 1991.² In that report, the McKay Commission noted that in 1989 alone, client security funds in 28 jurisdictions received claims for approximately \$72 million in stolen client funds.³ To address the oversight of client trust accounts, the McKay Commission proposed to supplement existing ABA model policy on trust account overdraft notification requirements with recommendation 16, Random Audits of Trust Accounts. The commission noted that audits function to both deter and detect fraud and theft of client funds.

At present, nine states have implemented a random audit program as part of their comprehensive client trust account management programs.⁴ These programs combine functions that *educate* attorneys regarding the requirements of client trust account management, *inform* the public about their rights with respect to client trust accounts, *deter* potential harm to clients, and *detect* and *discipline* instances of theft or fraud.

In general, these programs discover and correct a significant share of client trust account management deficiencies. Most of these deficiencies are considered minor and are corrected immediately or within a short timeframe. Interviews with program managers and review of published statistics for client trust account programs in other states indicate that about 1–3 percent of attorneys who are audited are subsequently subject to formal disciplinary action.

The need to protect client trust accounts is widely recognized beyond U.S. borders. The committee specifically examined how client trust account safety is managed in Canada, which, in several of its provinces, has implemented various combinations of universal, periodic, random, and risk-based examination of client trust accounts. These programs are more comprehensive than their American counterparts, and law firms as well as individual lawyers are subject to higher levels of regulation with respect to client trust accounts. The evidence suggests that the Canadian provinces' more rigorous programs have paid off. Thus, the level of serious or major deficiencies in those jurisdictions is, perhaps not surprisingly, much higher than in the U.S.: 10 percent (British Columbia), 14 percent (Ontario), and 5 percent (Alberta).

AN ESSENTIAL RESPONSIBILITY OF STATE GOVERNMENT

Protecting public funds is a function that is also recognized as a responsibility by other departments of California state government, including the Department of Financial Protection

² See the full report at americanbar.org/groups/professional_responsibility/resources/report_archive/mckay_report/, accessed October 26, 2021.

³ Ibid., see text of Recommendation 16.

⁴ The nine states are: Connecticut, Delaware, Iowa, Kansas, New Hampshire, New Jersey, North Carolina, Vermont, and Washington.

and Innovation, which audits non-real estate escrow accounts, and the California Department of Consumer Affairs, Cemetery and Funeral Bureau, which audits consumer funds held in trust by businesses for maintenance and final rites. The committee reviewed the practice of these departments to better understand how they meet the challenge of protecting client funds. Finally, practices of the Treasurer's office of the City and County of San Francisco were also reported to the committee as an additional example of a comprehensive audit and compliance review program.

On the basis of the study of other state bars and their equivalents in Canadian provinces, as well as with an understanding of parallel activity being conducted by various state and local government agencies within California, the committee selected a set of program elements it believes will provide Californians with substantially improved oversight of client trust accounts.

ANOTHER OPTION CONSIDERED: THIRD-PARTY MANAGED ACCOUNTS

Alternative methods of client fund protection through a requirement that all client funds be held in third-party managed accounts (TPMA), akin to escrow accounts, were also reviewed. If this model were to be introduced in California, attorneys would no longer be directly responsible for or permitted manage client funds or settlement funds. Although TPMAs are most widely used in the United Kingdom and France, there is a U.S. model currently being tested, as described below.

In early 2021, the Utah Supreme Court authorized a pilot program through which lawyers can partner with a third party (Xira Connect, Inc.) to provide client trust fund accounting services through a software platform. This use is permitted through the mechanism of a regulatory "sandbox," through which the traditional implementation of the provisions of Utah's rule 1.15 is waived for sandbox participants. .⁵

In France, client funds are held by a local Caisse des Règlements Pécuniaires des Avocats (CARPA) or Fund for Lawyers' Pecuniary Settlements, the use of which was established in 1957 and made mandatory in 1986.⁶ The CARPA is an institution owned and controlled by each local bar in France.

Barristers (courtroom advocates and specialist legal advisors) in the United Kingdom (England and Wales) may directly receive client funds for their services, but funds such as those for alternative dispute resolution, disbursement, and settlements are held by BARCO, a third party institution owned and operated by the Bar Council.⁷

⁵ For the Supreme Court of Utah's order and description of the program, see <https://utahinnovationoffice.org/wp-content/uploads/2021/04/Auth-Packet-Xira.pdf>, accessed October 14, 2021.

⁶ See the discussion of CARPA at <https://www.lawgazette.co.uk/analysis/compensation-fund-can-we-learn-from-france/51762.article>, accessed October 14, 2021.

⁷ See [https://uk.practicallaw.thomsonreuters.com/7-633-7078?transitionType=Default&contextData=\(sc.Default\)&firstPage=true#co_anchor_a240770](https://uk.practicallaw.thomsonreuters.com/7-633-7078?transitionType=Default&contextData=(sc.Default)&firstPage=true#co_anchor_a240770), accessed October 14, 2021.

The committee is not recommending a change to a TPMA system for California at this time, as such a change would be a massive undertaking.

COMMITTEE RECOMMENDATIONS

During its meetings, the committee gave careful consideration to recommendations related to each of the elements of client trust account management programs that it studied. These recommendations, which together comprise a new State Bar CTAPP, are presented below.

Table 1. Recommendations by Purpose

Recommendation	Education	Deterrence	Detection
Annual Registration	X	X	
Annual Certification	X	X	
Self-Assessment	X	X	
Compliance Review		X	X
Risk Review and Follow- Up Action (incl. Audit)	X	X	X
Enhanced State Bar Education and Professional Development	X		
Support for Clients	X		X
Utilization of Technology		X	X

Recommendation 1: Annual Registration of Client Trust Accounts

The State Bar should require, as part of annual license renewal, that every licensed attorney report whether or not they are responsible for one or more client trust accounts. If responsible, the attorney should be required to list the client trust accounts for which they are responsible by account number and financial institution.

Rationale: The State Bar needs to collect this information to have a complete picture of the number of licensed attorneys who manage client trust accounts and the number of accounts. At the same time, the registration process would allow attorneys who are not responsible for client accounts to indicate this status. This registration information will allow the State Bar to distinguish the universe of attorneys who are responsible for one or more client trust accounts, from which a random sample of attorneys can be drawn for audit purposes (see below). This information should not be considered public.

Recommendation 2: Annual Certification of Compliance

The State Bar should require, as part of the annual license renewal process, that every attorney licensed by the State Bar who is responsible for client trust accounts certify in writing that they are knowledgeable about and compliant with the provisions of the Rules of Professional Conduct rule 1.15, “Safekeeping Funds and Property of Clients and Other Persons.”

Rationale: Every licensed attorney should be aware of rule 1.15 and know whether and how it applies to their practice of law. This certification would only be required from attorneys who indicate in the annual registration process outlined in recommendation 1 that they are responsible for one or more client trust accounts. Certification means that the attorney or their firm received funds or property from clients or third parties related to the representation of a client, maintained a client trust account, and followed all client trust account and safekeeping property rules. Requiring certification raises awareness of the requirements outlined in the rule and serves as notice that the State Bar is actively engaged in protecting client trust funds by monitoring compliance with this rule.

Recommendation 3: Annual Self-Assessment by All Attorneys Responsible for Client Trust Accounts

A self-assessment reports a small set of key indicators of client trust account management practices by attorneys. This self-assessment is envisioned as an online form through which attorneys would report key items for each client trust account, for example:

- Total number of bank deposits during the calendar year
- Total number of bank withdrawals during the calendar year
- End of year bank balance
- Total amount of all uncashed checks at end of year
- Total amount of all deposits at end of year
- Monthly three-way reconciliations completed
- Number and amount of any cash withdrawals or checks made payable to “cash”
- Number and amount of any transfers to or from other accounts

Rationale: Obtaining basic descriptive information provides the State Bar with information that allows it to focus on accounts that appear to be at risk for mismanagement. At the same time, the self-assessment report provides a tool for attorneys to evaluate their management of client trust accounts and take corrective action. Data solicited will be easily reported and will be based on items in other jurisdictions that have demonstrated value in exposing risk. In finalizing the self-assessment contemplated as part of the CTAPP, the State Bar will build upon the related effort underway by the Office of Professional Competence, which updated the Board of Trustees on planned self-assessments at a meeting in the summer of 2021.

Recommendation 4: Compliance Reviews of Selected Attorneys by Certified Public Accountants

Compliance reviews of selected attorneys should be conducted annually by an independent, third-party CPA at the expense of the law firm or attorney, based on policies and procedures developed by the State Bar in collaboration with the CPA community.

Rationale: Compliance reviews are a method of examining records in a client trust account to ascertain whether key processes are being conducted and documented as required. A compliance review may be reported out as a series of yes-or-no questions, short narrative explanations, or checklists. For example, a compliance review might examine whether client

trust accounts and their checks and deposit slips are labeled correctly; whether separate client ledgers have been established for each client trust account; or whether monthly three-way reconciliations have been conducted and documented correctly. Compliance reviews can also illuminate the effectiveness of rules and requirements, and lead to changes in rules or improved training designed to raise the level of compliance for all.

Collaborative development of compliance review processes and procedures with the CPA community will be essential to ensuring that the reviews conducted by CPAs adhere to the standards and requirements of client trust accounting, which differ from the generally accepted accounting principles used by CPAs when compiling financial statements.

Selection of Attorneys for Compliance Review

Selection of attorneys for compliance review should be based on both risk assessments (attorneys for whom current data suggest are at higher risk for client trust account deficiencies) combined with random selection from the universe of attorneys responsible for client trust accounts.

Risk assessment allows the State Bar to focus resources and protection where the risk to clients is greatest. As data is collected from self-assessment reports, compliance reviews, complaint histories, and audit results, the definition of risk will become more multidimensional, comprehensive, and predictive.

The following tables summarize likely risk factors based on current data. The practice areas shown are those in which the proportion of bank overdraft notices regarding client trust accounts (table 2) and complaints about funds⁸ (table 3) exceeds the proportion of all attorneys working in these practice types and areas. Attorneys who practice in civil litigation, personal injury, and family law generate a disproportionate share of bank overdraft notices and complaints about funds.

Table 2. Risk Factors: Bank Overdraft Notices by Type of Practice and Area of Practice

Type of Practice	Regulation and Discipline Committee	Percentage of Attorneys Practicing
Solo	72%	21% ⁹
Area of Practice		
Civil	26%	19%

⁸ Complaints about funds include issues such as failing to promptly notify client re receipt of client funds or property, failing to maintain in client trust account funds received or held for client, failing to promptly account in writing to client or other refunds or property, and other similar client trust account matters.

⁹ The State Bar of California, "Licensee Demographics," active attorneys as of February 7, 2019.

(<http://members.calbar.ca.gov/search/demographics.aspx>) Additional data provided by the Office of Research & Institutional Accountability on October 27, 2021.

Personal Injury	23%	18%
Employment/Labor	12%	8%
Family Law	11%	5%

Table 3. Risk Factors: Complaints Related to Funds by Area of Practice

Area of Practice	Percentage of Complaints About Funds	Percentage of Attorneys Practicing
Civil	26%	19%
Personal Injury	28%	18%
Family Law	10%	5%

The receipt of a bank overdraft notice indicates that an account is in negative balance. In almost every instance, this is the result of a bookkeeping error and not indicative of attorney malfeasance. In fact, only 13 percent of these notices require formal investigation; most are resolved with a simple query letter. Ultimately, less than 1 percent of these notices result in formal disciplinary action. But drawing attention to and correcting these minor deficiencies helps prevent the subsequent development of more serious deficiencies. Continued risk assessment will allow the State Bar to refine its ability to predict and mitigate risks to client funds.

In finalizing risk-based criteria for compliance review implementation, the State Bar must be mindful of available data on racial disparities in the discipline system, particularly in relation to disproportionate numbers of reportable actions, on bank matters (bank overdraft notices) associated with Black male attorneys.¹⁰ In addition, attorneys with smaller, and fewer client trust accounts (who are often solo practitioners), are less able to cover shortfalls in any particular account than attorneys with large numbers of and high-dollar value accounts. Although not allowed by rule 1.15, there is evidence that this type of shortfall coverage is practiced by at least some attorneys, constituting a rule violation that would not necessarily generate bank overdraft notices.

¹⁰ See discussion in “Report on Disparities in the Discipline System,” November 14, 2019, a research memorandum that noted “Although the number of complaints across different allegation categories was largely similar across racial/ethnic groups, one notable exception is the number of Reportable Action, Banks (RAB). RABs reflect the circumstance where banking institutions notify the State Bar when there is NSF activity on a client trust account. Among attorneys with 10 or more complaints against them, Black, male attorneys had an average of 6.8 RABs whereas White, male attorneys had an average of 3.7. The State Bar will explore this differential rate of RAB matters, as well as overall disparities in complaint filings by race, gender, and solo practice status, as part of the next phase of discipline disparity work.” (p. 6).
<https://board.calbar.ca.gov/docs/agendaitem/Public/agendaitem1000025090.pdf>, accessed October 14, 2021.

Thus, risk criteria that emphasize bank overdraft notices may inadvertently result in increased oversight of Black male attorneys and solo practitioners. If this oversight leads primarily to supportive intervention, it should be viewed positively; if it exacerbates existing discipline disparities, the bases for risk-criteria selection will need to be reevaluated.

Recommendation 5: Risk Review and Follow-Up

On the basis of compliance review results and complaint and charges data, the State Bar should follow up all compliance reviews with a response proportional and appropriate for those findings. This range of actions, listed in order of increasing scrutiny, might include:

1. **File closed.** If no deficiencies or only minor deficiencies are noted and corrected during compliance review or audit.
2. **Written statement of deficiencies to be corrected within a specified deadline.** Corrective action required may include a formal audit. Followed by subsequent submission of documentation by the attorney that errors have been corrected; upon receipt and review of acceptable findings/response, file is closed.
3. **Selection for random or risk-based audit.** A select number of attorneys with responsibility for client trust accounts should be audited every year.
4. **Referral for investigation and possibly disciplinary action.** For cases that uncover more serious misconduct.

Rationale: Only the State Bar has the authority to enforce the provisions of rule 1.15. Based on the experiences of other jurisdictions, it is anticipated that the overwhelming majority of findings will result in error correction that does not rise to the level of formal discipline. To that end, the State Bar should have at its disposal a graduated set of nondisciplinary interventions and sanctions. When findings suggest additional formal action is warranted, the State Bar should utilize the existing disciplinary system to investigate and prosecute individual cases.

Recommendation 6: Enhanced State Bar Education

The State Bar should invest in increased support for attorneys responsible for client trust account management, providing support through a variety of channels, for example:

1. A mandatory continuing legal education (CLE) course specific to client trust account management for attorneys who indicate that they have responsibility for client trust accounts;¹¹
2. Use of multiple channels (e.g., video, podcast, newsletter, website, print, and social media) to disseminate knowledge and highlight challenges and provide solutions for effective and compliant client trust account management;
3. Remedial programs to mentor, educate, and oversee attorneys; and

¹¹ The *Plan for Preventative Education for Attorneys* presented by the Office of Professional Competence to the Board of Trustees at the July 2021 meeting includes a proposed nonmandatory CLE course on Client Trust Accounts (p. 5). The course is to be designed consistent with the self-assessment checklist being developed by the same office on this topic. See Item 703 here, <https://board.calbar.ca.gov/Agenda.aspx?id=16294&tid=0&show=100030118&s=true#10037720>

4. Presentations to local bar associations, law schools, and accountants regarding client trust account management.

Rationale: Attorneys, especially solo practitioners and those in smaller law offices, need support to ensure they are managing client trust accounts correctly. Other jurisdictions report that most error is inadvertent error, not based on fraudulent intent. Increasing the availability and formats of content related to the State Bar's [*Handbook on Client Trust Accounting for California Attorneys*](#) would help make more attorneys more successful in managing these accounts.

Recommendation 7: Public Education and Client Outreach

Public Education: The State Bar should develop informational resources utilizing a variety of channels to inform the public of their rights with respect to a client trust account opened on behalf a client and of the responsibilities of the client's attorney—for example, to communicate timely, report on changes in funds, and account in a timely manner for client trust funds.

Client Outreach: The State Bar should develop an outreach program through its various communication platforms to educate clients with respect to a client trust account opened on their behalf and of the responsibility of attorneys to communicate timely, report on changes in funds, and account in a timely manner for client trust funds. In addition, attorneys opening a client trust account should be required to distribute State Bar-produced information on client trust accounts to clients at the time they establish a client trust account for that client.

Rationale: Clients cannot assert their rights unless they know what those rights are. Educating the public broadly and clients specifically is a way to enhance public protection and enlist clients in the exercise of their rights with respect to client trust accounts. Typical frequently asked questions might include: What is a client trust account? Why does a lawyer need one? How do I know my money is safe? What should I do if I have concerns about how my money is being handled?

Recommendation 8: Phased Implementation of Client Trust Account Protection Program

Recognizing that significant resource investment will be needed to implement CTAPP, as outlined below, that additional time is needed to fully design the program, and that rule and statutory changes will be needed to effectuate certain program elements, it is recommended that the State Bar implement CTAPP in phases. Suggested implementation phases for the recommended actions are:

Phase I (first-half 2022)

- i. Annual Registration
- ii. Annual Certification of Compliance

Phase II (second-half 2022)

- i. Enhanced State Bar Education and Professional Development
- ii. Annual Self-Assessment by all Attorneys

iii. Public Education and Client Outreach

Phase III (2023)

- i. Annual Compliance Review by CPAs of Selected Attorneys
- ii. Annual Risk Review and Follow-Up Actions (including audits)

RULE AND STATUTORY CHANGES NEEDED TO IMPLEMENT

Many of the recommendations presented above are expected to require either the amendment of current rules or statutes or the creation of new rules.¹²

Table 4. Recommendations and Potential Rule and Statute Changes Required

Recommendation	Rule of Court	Rules of Professional Conduct	Statute
Annual registration Annual certification of compliance Compliance review	New Rule of Court 9.8.5	Amend rule 1.15 <i>Safekeeping Funds and Property of Clients and Other Persons</i> Amend rule 5.1 <i>Responsibilities of Managerial and Supervisory Lawyers</i>	N/A
Mandatory self-assessment	New Rule of Court 9.8.5	N/A	Amend Business and Professions Code § 6091 if needed in addition to a Rule of Court
Audit	N/A	N/A	Amend Business and Professions Code § 6091
Mandatory CLE	New Rule of Court 9.8.5	N/A	Amend Business and Professions Code § 6091 if needed in addition to a Rule of Court
Public education	N/A	N/A	N/A
Client notification	Include in new Rule of Court 9.8.5 if an administrative remedy is imposed	Add a new rule if a disciplinary duty is imposed	

¹² The approach and suggested changes described here are based on the guidance of Randall Difuntorum of the State Bar's Office of Professional Competence, memo of October 25, 2021.

A new Rule of Court could be used to establish the CTAPP. Amendments to the Rules of Professional Conduct (i.e., [rule 1.15](#) and [rule 5.1](#)) would reference and point to compliance with the new Rule of Court.

Amendments to Business and Professions Code [section 6091](#) would add language indicating that the State Bar may also require an audit of a lawyer's client trust accounts pursuant to the new Rule of Court described above.

Not reflected in the table above, amendments to State Bar rules can be used to specify the details of the CTAPP including, for example, specific reporting requirements and deadlines.

REQUIRED FINANCIAL RESOURCES

STAFF RESOURCES

The following table summarizes the staff resources in select jurisdictions and agencies engaged in active client trust account oversight along with the number of audits conducted annually in those jurisdictions and by whom. Staffing typically includes a program manager, CPAs (senior and junior), data analysts, and support staff. Even when the audit function is outsourced (either by the State Bar itself or by individual law firms), program staff are still required to review the results of all the required reporting and determine the risk and appropriate follow up actions, up to and including forwarding to disciplinary staff for investigation and possible discipline.¹³

The State Bar of California is much larger than any of these jurisdictions and currently licenses approximately 190,000 active attorneys, almost five times more than New Jersey, the next largest jurisdiction with a proactive audit program.

Table 5. Annual Audits and Audit Staff in Select Jurisdictions and Departments

Jurisdiction and Agency	Audit Type	Number Licensees	Number of Annual Audits	Number of Audit Staff (FTE)	Use of Contract CPAs
Connecticut	Compliance	21,036	365	2	No
Delaware	Compliance	3,058	60	2	CPA firm does all audits
New Jersey	Compliance	40,137	400	11	No
Law Society, Alberta, Canada	Compliance/Financial	10,548	150	10	Yes (hired by law firm)

¹³ Outsourcing the audit function is not viewed as optimal by most jurisdictions and state government departments studied. Of the nine states with active client trust account protection programs that include auditing, only Delaware outsources this function.

CA Dept. of Financial Protection & Innovation	Escrow Account	1,034	10–15 Prelim.	15	Only for most extensive audits
	Compliance/Financial	(locations)	125–175 Regular 10–20 Special		

For purposes of the present fiscal analysis, a staff of 15 has been estimated as follows. At approximately \$200,000 per fulltime employee (fully loaded), this amounts to an annual cost of \$3 million. New funding sources would need to be obtained to fund this cost.

INFORMATION TECHNOLOGY

In order to achieve an effective client trust account safety program and make the most efficient use of staff, a significant investment in information technology will be required. Effective use of online tools should also be aimed at minimizing the burden on the attorneys who are responsible for client trust accounts. This investment is needed to support the development and ongoing maintenance of all aspects of the proposed program, including registration, certification, self-assessment, compliance reviews, and auditing.

The CTAPP should be developed to maximize automation. Tools that will support direct inter-institutional transfer of bank account information and automated self-assessment and compliance review processes, for example, should be explored and prioritized. Online data collection and the organization of compliance review and audit data into a database will be essential for the ongoing purpose of analyzing the data and linking it to complaint data. This will allow the State Bar to detect patterns and identify risk factors at both the individual and aggregate, statewide levels.

The State Bar should explore both insourcing and outsourcing the technology functionality needed to automate CTAPP data collection and analysis. The Law Society of Alberta, Canada, for example, contracts with PricewaterhouseCoopers (PwC) to receive and analyze all account information from attorneys. Analytics in dashboard format are reported out to the Law Society for action. The annual cost of that contract is approximately US\$200,000.

Given the scope of the California undertaking, an estimate of \$500,000 in one-time and \$350,000 in ongoing, technology investment is estimated for initial program development fiscal modeling purposes.

Together, CTAPP staffing and technology costs are estimated to total \$3.35 million annually, with an additional one-time investment of \$500,000. This funding level is estimated to support a combination of up to 500 compliance reviews and audits annually.

Recommendation 9: Develop Detailed Proposals for Program Implementation

State Bar staff should develop detailed proposals for implementation of the CTAPP as outlined in this report. These proposals should include more developed estimates of fiscal impact and should identify potential program funding sources. Staffing models should include consideration of in-house, outsourced, and hybrid models of program staffing. Information

technology infrastructure proposals should include in-house, outsourced, and hybrid models of development and maintenance of required web services, databases, and user support services.

MODIFICATIONS TO EXISTING RULES OF PROFESSIONAL CONDUCT

The committee reviewed the following existing rules of professional conduct in the course of its work and generated recommendations as outlined below.

Prompt Disbursement of Client Funds

Rule 1.15 (d) requires attorneys to notify, account for, maintain records regarding, and disburse funds, securities, or property held for a client or other person. The committee believes that clients would be better served if the rule were revised to accomplish two purposes: (1) to relieve the client of the burden of requesting a disbursement of funds to which they are entitled in order to compel an attorney to proceed with disbursement; and (2) to replace the term “promptly” with a deadline measured by a time certain, such as 30 to 60 days.

The committee discussed approaches to correcting these defects including establishing a clear timeframe for disbursement of funds (a rebuttable presumption of a 30–60-day disbursement timeframe from receipt of funds or resolution of any demands on those funds, for example), and a requirement that attorneys notify clients when settlement funds are received.

This change would put the burden on the attorney to demonstrate why funds were not distributed by the deadline in the rule. There are many valid reasons, including pending disputes over some or all of the funds, the need to resolve liens placed against entrusted funds and waiting for deposited checks to clear before disbursing funds to the client. As things now stand, however, the burden is on the State Bar to prove that the attorney has violated the rules by holding on to funds for too long. Because the attorney is in possession of the relevant information, it makes sense to place the burden of proof on the attorney.

Recommendation 10: Revise or Clarify Rule 1.15(d)

The Board of Trustees should direct the Committee on Professional Responsibility and Conduct to draft a revision or clarification of rule 1.15(d) to remove the burden of soliciting reimbursement from the client and to replace the term “promptly” with a deadline measured by a time certain, likely 30-60 days. The revised rule should provide that missing the deadline creates a rebuttable presumption that the rule has been violated.

Attorney Threats to Withdraw Representation in Response to Complaint

The committee reviewed the current framework Rules of Professional Conduct, [rule 5.6\(b\)](#) and Business and Professions Code, [section 6090.5](#)) for regulating attorney threats to withdraw in response to a client’s complaint to the State Bar. After consideration, the committee determined that since Business and Professions Code section 6090.5 was revised operative January 1, 2021, and now establishes a broadly stated cause for discipline if an attorney

threatens withdrawal, the new statute should be monitored to evaluate whether it is serving its intended purposes.

The committee does not recommend any additional rule or statutory changes to address this issue at this time.

Failure to Communicate

The committee reviewed the current framework for regulating attorney conduct with respect to failure to communicate about the receipt and disbursement of funds received on behalf of clients. The committee believes that it would be beneficial to clarify the meaning of “significant developments” in Rules of Professional Conduct [rule 1.4](#) to ensure that developments related to client funds are explicitly included, linking the requirements of CRPC 1.15(d)(1) to those of 1.4(a)(3).

Recommendation 11: Clarify Rule 1.4

The State Bar should direct State Bar staff to clarify rule 1.4 to ensure that developments regarding the receipt and disbursement of funds on behalf of clients are specifically included in the language of that rule, including reference to rule 1.15(d)(1).

ENHANCED TRAINING OF OFFICE OF CHIEF TRIAL COUNSEL MANAGERS, STAFF, AND SPECIAL DEPUTY TRIAL COUNSEL

The committee reviewed the current practices of the OCTC with respect to client trust account training. In the past year, OCTC has created and launched a series of four sessions totaling six hours of instruction on Fundamentals of Effective Client Trust Account Investigations and Prosecutions for all investigators and attorneys. The committee reviewed the content and plan for these training sessions. OCTC believes that these sessions represent a significant improvement over previous training in this area and will serve to improve OCTC’s work in client trust account matters. In addition, the committee reviewed the current training of SDTC with respect to client trust account matters. This training is less robust and is not mandatory. The committee supports staff’s stated plan of mandating client trust account-related training for SDTC effective with the upcoming contract renewal period.

The committee does not recommend any additional measures with regard to OCTC or SDTC training in this area.

BONDING AND INSURANCE AS MEANS OF CLIENT TRUST ACCOUNT PROTECTION

Given that Thomas Girardi did not carry malpractice insurance and failed to report claims against his practice, the committee considered the question of whether mandatory malpractice insurance could provide an additional means of client trust account protection. Currently, legal

malpractice insurance is not required for attorneys practicing in California.¹⁴ Under the current regulatory framework, the State Bar relies on attorneys to report when three or more lawsuits are filed against them for malpractice or other wrongful conduct committed in a professional capacity within a 12-month period.¹⁵ Similar claims against attorneys with malpractice insurance are reported to the State Bar by the insurance carrier.¹⁶ Uninsured attorneys are required to report to the State Bar any settlement, judgment, or arbitration award against them that are based on negligence and other specified factors.¹⁷

Beyond the reporting issues that would presumably be addressed by mandatory coverage, the larger question of whether or not malpractice insurance itself provides meaningful client trust account protection remains. The committee was not able to fully assess this question during its deliberations, nor was it able to study different forms of insurance that may provide protections beyond those afforded by malpractice insurance. However, the committee believes that the role of insurance in client trust account protection deserves further consideration and study.

Similarly, the committee briefly considered the use of fidelity bonds or surety bonds to protect client trust accounts. Fidelity bonds are a type of business insurance held by firms that protects them against losses caused by their employees. The bond protects against intentional acts of fraud, embezzlement, theft, misappropriation, dishonesty, and other acts through which funds, including client funds, might be lost. These policies are held by firms, not by individuals.

Surety bonds are meant to ensure that a business or a professional will do their work in accordance with relevant licensing laws and other regulations. Unlike an insurance policy (an agreement between two parties), a surety bond is an agreement between three parties. A surety agreement involves the principal (the business or professional who purchases the surety bond), the surety (the company backing the bond), and the obligee (the client). There are many types of surety bonds, with a wide variety of terms and coverages.

Recommendation 12: Conduct Additional Exploratory Research on the Use of Malpractice and Other Forms of Insurance, as Well as Bonds, as a Means of Client Trust Account Protection

State Bar staff should do additional research on the use of malpractice and other forms of insurance, as well as the use of bonds as a method for protecting client trust accounts from intentional, tortious actions (fraud, theft, misappropriation, etc.). Issues to be addressed include the appropriateness, expense, coverage, and process of recovering client funds through these various types of insurance and bonds.

¹⁴ Malpractice insurance was studied in depth by the State Bar's Malpractice Insurance Working Group in 2018 and 2019. Details and report are available on the [State Bar website](#).

¹⁵ See [Business and Professions Code § 6068\(o\)\(1\)](#).

¹⁶ See [Business and Professions Code § 6068.8\(b\)](#).

¹⁷ See [Business and Professions Code § 6068.8\(c\)](#).