



The State Bar *of California*

OPEN SESSION

AGENDA ITEM 5.2

AUGUST 2023

LEGAL SERVICES TRUST FUND COMMISSION

DATE: August 10, 2023

TO: Members, Legal Services Trust Fund Commission

FROM: Members, Legal Services Trust Fund Commission Rules Committee

SUBJECT: Codification of Grant Administration Practices: IOLTA Reserve Policy

EXECUTIVE SUMMARY

The Legal Services Trust Fund Commission Rules Committee (Rules Committee) is working to gather, codify, and revise, as necessary and appropriate, all of the decision points and considerations related to the grant administration process. The purpose of the codification process is to ensure transparency, ease administration, and provide clarity for grantee applicants, the Legal Services Trust Fund Commission (LSTFC), and staff.

On June 21, 2023, the Rules Committee met to discuss recommendations regarding the creation of an Interest on Lawyers' Trust Accounts (IOLTA) Reserve Policy. Topics discussed included:

- The role of the reserve to help provide grant stabilization and reduce major fluctuations in IOLTA distributions from year to year;
- The possibility of multiyear budgeting; and
- Increasing accuracy in revenue projections.

This memorandum presents the Rules Committee's final recommendations for approval after the LSTFC's consideration at its August 10, 2023, meeting.

BACKGROUND

Attachment A provides comprehensive background information on the codification process, governing authorities, and relevant updates to the issues identified above.

DISCUSSION

On June 21, 2023, the Rules Committee discussed the working group's recommendation regarding the establishment of a reserve policy for IOLTA funds. Given the considerations outlined in Attachment A, the working group recommended the creation of a restricted reserve of IOLTA funds to be accessed as part of planned grant distribution when revenues decrease, or in emergencies. In addition, the working group recommended determining grant distribution based on one year's projected revenue, rather than two; identifying conditions for adding to, or withdrawing from, the reserve; and supporting multiyear budgeting option in years of large distribution increases.

The Rules Committee agreed with the working group's proposed rule after some minor corrections and clarifications to the text during the meeting. (Attachment B.) However, the substance of the rule did not change.

RECOMMENDATIONS

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

RESOLVED, that the Legal Services Trust Fund Commission approves the Rules Committee's recommendation related to the creation of an IOLTA reserve and accompanying policy:

Adopt new State Bar Rule 3.683, as set forth in Attachment B, for the LSTFC to establish and manage a reserve of IOLTA funds while providing stronger guidance in determining grant distribution and prescribing circumstances for accessing the reserve.

If the Rules Committee's recommendation is adopted, the proposed rule will then be circulated for public comment, returned to the LSTFC for review of any significant feedback, and ultimately presented to the State Bar's Board of Trustees for approval.

ATTACHMENTS LIST

- A.** Memo and Attachments from June 21, 2023, Rules Committee Meeting
- B.** New Proposed State Bar Rule



The State Bar of California

OFFICE OF ACCESS & INCLUSION

Date: June 21, 2023

To: Members, Legal Services Trust Fund Commission Rule Committee

From: Members, Legal Services Trust Fund Commission IOLTA Reserve Policy Working Group

Subject: 4.1 Approve Recommendations Regarding IOLTA Reserve Policy

EXECUTIVE SUMMARY

This working group convened to discuss the development of a new Interest on Lawyers' Trust Accounts (IOLTA) grant reserve policy. The working group has identified as least three areas where the Legal Services Trust Fund Commission's (LSTFC) current approach, based on a 2006 memorandum, might be improved: (1) the existing approach does not provide specific guidance for determining the grant distribution amount in years where net revenue is decreasing, (2) it does not prevent large fluctuations in grant distribution as it was intended to, and (3) it conflates the concepts of cash-on-hand and reserve. This memo provides an overview of the working group's recommendations for a new State Bar Rule that will establish a fiscally responsible reserve policy that will address the above-identified concerns, to the extent possible. Of the above concerns, the working group was particularly interested in stabilizing grant amounts in future periods of declining revenue, given IOLTA's recent history of volatile interest rates.

DEFINITIONS

See Attachment A for a list of definitions for some of the fiscal terms and concepts used throughout the memorandum, as they relate to this topic.

GOVERNING AUTHORITIES

Each year, the LSTFC recommends for approval to the Board of Trustees (BOT) the amount of IOLTA funds to be made available for distribution in the following calendar year as grant

awards.¹ The statute goes on to say that it is also the LSTFC's charge to recommend "the amount to be maintained as a fiscally responsible reserve." (Bus. & Prof. Code § 6210.5(e)(2).) (Attachment B.)

The LSTFC follows the approach outlined in a 2006 memorandum (discussed in greater detail below) that provides specific guidance for determining IOLTA grant amounts when net revenue is increasing and general guidance when net revenue is decreasing. (Attachment C.) However, this policy is not codified and, thus, nonbinding.

BACKGROUND

EXISTING CASH-ON-HAND POLICY AND APPROACH TO IOLTA DISTRIBUTION AMOUNTS²

In the first eight years of the IOLTA grant (1984-1992), the Legal Services Trust Fund Program recommended to the BOT distribution of the total money projected to be "on hand" as of the end of the prior year, 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, 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 on hand about one full year's revenue.

In 1992, in response to low interest rates and declining revenue, the then-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 of the prior year's projected revenue. 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 (also called the reserve policy, see Attachment C). The goal was to build reserve funds that could be distributed during years of low remittance.

According to the approach outlined in the 2006 memorandum, when net 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 in years where net revenue has increased from the previous year:

1. The previous year's grant distribution is established as the planned grant distribution base amount;

¹ Business and Professions Code section 6210.5 went into effect on January 1, 2022. The new provision offers the LSTFC more autonomy in its decision-making. Going forward, the BOT must approve the LSTFC's recommended grant distribution unless it "conflicts with a statutory, fiduciary, or legal obligation of the State Bar."

² Partially excerpted from June 17, 2022, staff memo to LSTFC.

2. Increased revenue is used to increase grant distribution by 5 percent over the prior year's amount;
3. If additional funds remain, ten percent of the prior year's grant distribution is added to the reserve/cash on hand;³
4. Any additional projected funds remaining are split equally, increasing both grant distribution and reserve/cash on hand, up to a reserve cap of 75 percent of the prior year's revenue.

In contrast, the reserve policy does not provide a similar step-by-step formula for calculating the distribution amount when revenues are declining, setting only the target that reserves remain between 30 and 75 percent of the prior year's projected revenue. Moreover, the policy conflates cash on hand and reserves. What is referred to as a "reserve" is simply ensuring the State Bar has enough money to maintain cash flow during the year, should there be any unexpected and/or drastic drop in revenue.⁴

To adhere to the current guidance from the 2006 memorandum, State Bar staff must provide the LSTFC with IOLTA revenue projections not only for the remainder of the year—for which staff usually only has data from the first full quarter—but also for the *following* year. (To illustrate: For 2024 IOLTA distribution discussions, staff would not only need to project revenue for the remainder of 2023 after Q1, but also all of 2024.) It has proved challenging to provide accurate estimates, particularly in a quickly changing economic environment. Fortunately, in recent years, actual revenue has exceeded staff's initial estimates. However, had revenue fallen short of projections, corrective action may have been required (e.g., reducing the planned distribution amount).

OTHER FACTORS INFLUENCING IOLTA GRANT DISTRIBUTION DETERMINATIONS

Federal Funds Rate

The Federal Reserve sets the federal funds rate (FFR), which is the interest rate charged on lending between financial institutions to maintain their reserve balances. This amount is adjusted periodically and can have a significant influence on the economy (e.g., recent interest rate increases to attempt to control inflation). Fluctuating interest rates, in addition to the amount on deposit in client trust accounts, impact IOLTA funds.

³ The 2006 memo states that ten percent of the prior year's revenue should be added to the reserve; however, the example included in the memo illustrating the application of the formula used ten percent of the grant distribution.

⁴ Banks remit interest, at a minimum, at the end of each quarter, though monthly is preferred. Thus, the State Bar makes grant payments at the beginning of each quarter but must wait until the end of the quarter to determine if sufficient revenue has accumulated to cover the amounts distributed. Having cash on hand allows the State Bar to make timely and full grant payments when periodic revenue is insufficient.

In the past year alone, the FFR was increased several times from near zero to 4.75-5.00 percent. Though banks are not required to match the FFR when setting interest rates on their own accounts, the FFR nonetheless has a powerful influence on the interest rate adjustments that banks make on their consumer accounts. With higher interest accumulating on large client trust account balances, this drives the historically high IOLTA revenue we currently see, which in turn impacts IOLTA award amounts.

Leadership Bank Program

In 2019, the State Bar established the Leadership Bank program to help sustain revenue by incentivizing banks to offer a minimum interest rate on IOLTA accounts while also eliminating associated fees. In exchange, the State Bar recognizes these banks on its website for attorneys' consideration when opening a client trust account. Most of the IOLTA revenue in California—approximately 75 percent—comes from three banks (Wells Fargo, Chase, and Bank of America). Each of these banks currently participates in the Leadership Bank program, which requires a minimum interest rate of 68 percent of the current FFR, or 0.68 percent, whichever is higher.

The State Bar monitors participation and is proactive to ensure continued commitment from the program's participants. If any Leadership Bank with large amounts on deposit were to discontinue its partnership with the program and lower interest rates on client trust accounts, a significant drop in IOLTA revenue could result.

Though many banks lowered the interest earned on trust accounts during the pandemic, corresponding to the decreased FFR, IOLTA revenue has remained strong. This is mostly due to the high amount on deposit and the State Bar's work to ensure banks are remitting correct amounts. However, changes to any of the three factors discussed above (interest rates, amount on deposit, and Leadership Bank participation) can cause significant fluctuations in IOLTA revenue to a degree that is largely beyond the direct control of the LSTFC or the State Bar.

Fee Statements, Justice Gap Fund, and Other Contributions

IOLTA funds are supplemented from sources other than trust account interest revenue. For example, when licensed attorneys pay their dues to the State Bar each year, \$45 of that amount is directed to legal services.⁵ There is also a recommended voluntary donation of \$100 to support legal aid, known as the Justice Gap Fund. The State Bar accepts cy pres awards through the Justice Gap Fund as well. These funds are grouped with IOLTA. The combined amount varies from year to year but is usually at least several million dollars (\$5-10 million on average). All of these contributions ultimately count toward amounts available for distribution through IOLTA grants.

⁵ Attorneys may opt out of paying this amount under Business and Professions Code section 6140.03(b), but it is otherwise included as part of their fee statement.

State Bar Investment Policy

Currently, the State Bar places its existing IOLTA fund balance, minus the amount needed for grant disbursement, into short-term government bonds and notes. These are considered safe investment products that provide a modest return while guaranteeing no loss of principal. The interest generated by these accounts will go toward future grant distribution. A future codification topic will develop a more robust policy regarding investment of IOLTA funds that will be in alignment with the State Bar's investment policy and offer more specific guidance for the LSTFC's various grant funds.

ROLE OF EQUAL ACCESS FUND (EAF) IOLTA FORMULA GRANTS

Equal Access Fund grants are calculated and distributed on the same formula basis as IOLTA, but the funds originate from a different source (the state budget and court filing fees). EAF amounts are included in the Judicial Council of California's budget, and the Judicial Council contracts with the State Bar to have the funds administered through the LSTFC. While subject to change during the months-long budgeting process, the proposed amount of EAF funding for the following year is known as early as May when the governor's revised budget is released.

Since its inception in 1999, EAF IOLTA formula funding⁶ remained fairly consistent, experiencing an occasional substantial increase that was typically sustained in subsequent years. However, over the past three years EAF has fluctuated considerably, with the most notable change occurring in 2022, when EAF IOLTA formula funding nearly tripled.⁷ This was a purposeful one-time increase, partially in response to fears that reduced interest rates during the COVID pandemic would result in fewer available IOLTA funds for distribution. However, IOLTA revenues were higher than predicted, and the LSTFC authorized \$35.5 million of IOLTA funds to be distributed in 2022. The result was that 2022 yielded the highest combined IOLTA/EAF IOLTA formula grant distribution ever (approximately \$93.6 million). Because they are administered jointly, any major changes to funding amounts for either IOLTA or EAF IOLTA formula grants in a given year can impact the overall stability of State Bar grantees and their service capacity, as these grants are relied upon as core funding for most grantees.

DISCUSSION

WORKING GROUP PROPOSALS TO IMPROVE CURRENT APPROACH

Attachment D contains an illustration of what the 2024 IOLTA distribution could look like if following the recommendations outlined in this memorandum. (Please note that Attachment D

⁶ Other grants funded through the state budget, such as the Homelessness Prevention grants, are also sometimes denoted in budget documents as EAF grants. However, only the EAF IOLTA formula grants are relevant to, and discussed in, this memorandum.

⁷ Funding increased from \$21.1 million in 2021 to \$58.1 million in 2022. For 2023, funding dropped to \$31.6 million, while remaining above 2021 levels.

is based on current information as of the date of this memorandum and is subject to change as new and updated numbers become available).

- 1. The working group recommends discontinuing the practice of estimating IOLTA revenue over a period of nearly two years.** The current practice—which uses the 2006 memorandum for determining the distribution amount—not only looks at current year revenue, but it also predicts revenue for the following year. Given that the LSTFC receives a grant distribution recommendation for the coming year in June, staff has only the first quarter’s results to use in building a prediction model.

Staff has been relatively conservative in its estimates, and rates have generally increased, meaning that revenue has been higher than predicted, but this will not be the case indefinitely. Projecting that far out is speculative at best. If revenue were to decrease instead of increase, in the worst-case scenario it could result in a shortfall of funds needed for distribution, resulting in an inability to fulfill grant agreements.

Grant agreements with the State Bar always contain a caveat that, should funds be lacking, the State Bar is not obligated to pay the grant award. Nonetheless, the working group thinks it would be best to avoid such a situation, because failing to fulfill a grant agreement could have highly disruptive results for grantees relying on those funds.

Regardless of the impact, the fact that the estimates have not borne out further indicate that this is not the most reliable model to use. In addition to the use of projections over almost two years, in years of increasing net revenue, the 2006 memorandum establishes the current year’s IOLTA distribution amount as the base amount for distribution the following year. It then prescribes how much to add to the cash on hand and how much to add to the next year’s distribution without flexibility.

Instead, the working group recommends basing the next year’s IOLTA grant distribution on the ending net assets of the prior year, plus the estimate of the revenue for the current year minus expenses and any amount set aside for the reserve (or Total Ending Net Assets for Funding). Projections would be based on confirmed data from the first quarter and only require 9, rather than 21, months of estimates. This would be more manageable, and hopefully more accurate, without requiring the LSTFC to take a risk by relying on anticipated but unguaranteed revenue to maintain cash flow. It would also free the LSTFC to use more discretion in determining the distribution by adjusting the distribution and reserve amounts.

- 2. For purposes of grant stabilization, the working group recommends creating a separate account to function as a fiscally responsible reserve,** as permitted by Business and Professions Code section 6210.5(e)(2), which will require certain conditions to be

met before accessing funds to be paid out. Funds could be included as part of a planned grant distribution or accessed under emergency circumstances to cover existing grant payments. The model in Attachment D illustrates how the approach would work, but the proposed policy would leave the total contribution to the reserve in a given year mostly to the LSTFC's discretion.⁸

The hope would be to build a reserve that could then be accessed only under defined circumstances, either to help mitigate major fluctuations in IOLTA grant amounts year-to-year or to provide the necessary cash-on-hand in statewide emergencies. (This would be to supplement the distribution as a whole, not to supplement individual grantees experiencing an emergency.) However, in years with significant revenue increases, it would allow sufficient flexibility to direct more funds to the reserve without negatively impacting grant distribution.

This would be a move away from the formulaic approach required in years of increasing net revenue as outlined in the 2006 IOLTA grant distribution memorandum, and it would provide guidance that is lacking for years of decreasing net revenue. The reserve would not be built at the expense of grant disbursement. Indeed, the emphasis would remain on distributing as much funding as possible but setting aside a prudent amount for a reasonable reserve.⁹

3. Related, the working group **proposes \$25 million as the initial maximum reserve amount, with permission to increase over time to account for inflation.**¹⁰ As discussed above, the current year's projected revenue minus expenses and, if needed, a contribution to the reserve, would become the planned distribution amount for the following year. The proposed rule would also allow the LSTFC discretion to increase the maximum allowable reserve amount to plan for more measured increases to the distribution in years where the distribution would otherwise more than double and other interventions, such as multiyear budgeting, would be insufficient to ensure grant funds are spent effectively.

Given the very large increase in anticipated revenue this year, the recommendation in the model is to fully fund the reserve with a contribution of \$25 million. (Under different circumstances, the reserve could be built more gradually over a period of years.) However, in years where revenue experiences a significant drop (i.e., where current

⁸ This model directs \$25 million per year to the reserve due to a major anticipated revenue increase this year.

⁹ Any amount placed in reserve could generate additional grant funds by placing the reserve balance in interest-bearing accounts, which would go toward the revenue calculation for distribution. This can be explored more deeply as part of the investment policy topic to be addressed through codification later this year.

¹⁰ The \$25 million amount is the average of the prior ten years' distributions and administrative expenses. If the average IOLTA grant distribution increases significantly in a sustained way, the LSTFC might want to increase the target reserve in the future to meet potential grant needs.

year revenue is not covering most of the expenses, thus cutting into the cash on hand), it would be appropriate to plan to withdraw from the reserve to mitigate fluctuations in grant amounts the following year.

(See Attachment E for the proposed rule capturing these changes and the proposed policy.)

THE POTENTIAL ROLE OF MULTIYEAR BUDGETING

Historically, IOLTA grants have operated on one-year cycles. The requirement to distribute funds on a yearly basis under the IOLTA statute has been widely interpreted to mean that the funds must also be spent within a year. (See Attachment B, section 6216.) However, in 2022, when the Legislature authorized the large one-time increase to EAF funding, it also permitted spending the funding over two years instead of one. The LSTFC then piloted allowing grantees to submit two-year budgets for their 2022 EAF awards instead of one.¹¹

This approach stemmed from a desire to respond to grantees' long-term planning needs, which are compounded by large fluctuations in year-to-year funding. Grantees reported that significant fluctuations make it difficult to effectively budget on a long-term basis, which in turn impacts recruitment and retention because of uncertainty around whether current staffing levels and/or increased compensation can be maintained in the long-term. There was also a desire to allow grantees flexibility with this funding source when they needed to spend other grants and forgivable loans that had a shorter timeline for expenditure.

The second year of this two-year 2022 EAF multiyear budgeting opportunity began in January 2023. As expected, grantees received a 2023 allocation on top of any 2022 funds budgeted over a two-year basis, thus obligating grantees to spend the remainder of their 2022 grant along with the full 2023 grant. The working group believes it is necessary to continue to make multiyear budgeting an option, when and where appropriate, as a strategy to help reduce significant fluctuations in grant awards. Consequently, the proposed rule incorporates language to allow for this.

In practice, any multiyear budgeting proposal would first pass through the LSTFC's Eligibility & Budget Review Committee before receiving full LSTFC approval. This would provide an opportunity to elaborate on the requirements of the multiyear budgets, such as whether to permit carryover requests and, if so, the guidelines that would apply. The working group encourages the LSTFC to consider the multiyear budgeting option—in consultation with staff—in years where there are large increases in anticipated grant distribution, particularly when the reserve has reached its cap. It will have the added benefit of minimizing the amount held by the State Bar at any given time.

¹¹ EAF is administered on the same basis as IOLTA.

RESPONSE FROM THE LEGAL AID COMMUNITY AND RELEVANT CONSIDERATIONS

The preliminary memorandum was forwarded to Legal Aid Association of California (LAAC) on May 12 for circulation among the legal aid community. State Bar staff additionally held a webinar on May 24 to provide an overview of this topic and answer questions from the community. This provided various avenues for the community to respond to the proposal. LAAC will also attend this committee meeting to provide additional feedback and context from its discussions with the legal aid community.

Most of the feedback was supportive, or at least optimistic, about the proposed changes. LAAC and many grantees agree in principle that it makes sense to set aside some funding for when IOLTA revenue decreases. One grantee acknowledged that the decision to set aside some amount for reserve is prudent given the current funding environment generally. For example, it seems major funders like the Legal Services Corporation anticipate reducing awards by up to 30 percent. LAAC also noted that it has heard from foundations about possible funding decreases due to a volatile stock market, which could be another source of lost income for grantees.

Smaller organizations voiced support for more predictable funding amounts from a budgeting perspective. There seemed to be universal support for the flexibility offered by multiyear budgeting in response to large IOLTA increases so that hiring and spending can be done responsibly. However, LAAC reported that grantees also seek more budgeting guidance in response to these possible changes.

Most criticism and questions centered not on the concept of the reserve but rather the methodology for determining the grant distribution. There was some feedback that the State Bar would hold on to too much money and should be distributing the fund balance not only at the end of 2023 but the projected balance for 2024 as well, or at least some part of it.

WORKING GROUP RESPONSE

The working group appreciates the positive feedback as it highlights many of the primary concerns that this topic intended to address. Knowledge of the general funding environment was also important to this working group, which is why such considerations are included in the proposed rule, particularly in circumstances where the reserve may, or will, be accessed.

Regarding the feedback on the distribution method: During the webinar held in May, State Bar staff explained that the fund balance shown in the attachment for the following year (i.e., the fund balance for the end of 2024) is not a fixed amount of money held for the entire year. Rather, it is a projection of the total amount expected to be on-hand at the end of the following year, representing a distant point in time. To distribute the amount of money projected at the

end of 2024 in addition to the fund balance at the end of 2023 would be a return to the current method, which is disfavored due to its unreliability. It is also important to emphasize that all of these funds will be distributed. Simply the timing of that distribution will be different, and, unlike the current approach, it will not be speculative.

Moreover, the fund balance does not sit idle. The State Bar periodically places the balance, minus amounts needed for grant distribution, into interest-bearing government notes and bonds, which increases the total amount of funding available for distribution. Given the current interest rate, the interest generated is significant. The working group respectfully recommends against maintaining the current distribution method and instead reiterates its recommendation to only project revenue for the remainder of the current year.

RECOMMENDATIONS

Should the Rules Committee concur with the working group's proposal, passage of the following resolution is recommended:

RESOLVED, that the Rules Committee of the Legal Services Trust Fund Commission approves the following working group recommendation:

Adopt new State Bar Rule 3.683, as set forth in Attachment E, for the LSTFC to establish and manage a reserve of IOLTA funds while providing stronger guidance in determining grant distribution and prescribing circumstances for accessing the reserve.

Once the Rules Committee makes its final recommendations, these recommendations will be reviewed subsequently by both the LSTFC and, ultimately, the State Bar's Board of Trustees.

ATTACHMENTS

- A. Definitions
- B. Business and Professions Code sections 6210.5 and 6216 (relevant portions of IOLTA statute)
- C. 2006 Cash-on-Hand/Reserve Memorandum
- D. Fiscal worksheet illustrating proposal in context of 2024 IOLTA distribution
- E. Proposed State Bar Rule detailing IOLTA distribution and reserve policy

Attachment A – Definitions (in the Context of IOLTA Grants)

Revenue: Income from various sources (interest remitted by banks from client trust accounts, Justice Gap Fund, one-time donations, etc.) used to fund IOLTA grants and pay related administrative expenses

Cash-on-hand: Funds that are accessible and available to cover costs related to IOLTA grant administration on an as-needed basis (e.g., for grant-related expenses or to be rolled into a subsequent year grant distribution)

Reserve:

- **Historical definition:** The terms “reserve” and “cash-on-hand” (see above) have been used interchangeably regarding IOLTA grants since the implementation of the current distribution approach in 2006
- **New/proposed usage:** Funds that are set aside in a restricted account to be accessed and used only under certain conditions; not intended to be immediately available to cover general needs/expenses related to IOLTA grants but rather to help stabilize grant distribution from year-to-year or in emergency circumstances, for example

Fund balance: Amount of funds expected to be available at a specific future time after accounting for anticipated revenue, expenses, and any amount set aside for the separate reserve (essentially, a snapshot of the projected cash-on-hand figure at a point in time, such as the end of the calendar year)

Attachment B – Selected Provisions from the IOLTA Statute (Business and Professions Code sections 6210-6228)

6210.5.

(a) There shall be created, within the State Bar, a Legal Services Trust Fund Commission to administer IOLTA accounts, Equal Access Funds, or similar funds or grant moneys intended for the support of qualified legal services projects and qualified support centers, as those terms are defined in Section 6213.

(b) (1) The Legal Services Trust Fund Commission shall be comprised of 24 commissioners as follows:

(A) Six commissioners shall be appointed by the State Bar Board of Trustees.

(B) Two commissioners shall be appointed by the Senate Committee on Rules.

(C) Two commissioners shall be appointed by the Speaker of the Assembly.

(D) Ten commissioners shall be appointed by the Chair of the Judicial Council, of which three shall be nonvoting judicial advisors. The three nonvoting judicial advisors shall be comprised of two superior court judges and one appellate justice.

(E) Four commissioners shall be appointed by the Legal Services Trust Fund Commission, of which at least two shall be, or have been within five years of appointment, indigent persons as defined by Section 6213.

(2) No employee or independent contractor acting as a consultant to a potential recipient of Legal Services Trust Fund grants shall be appointed to the Legal Services Trust Fund Commission. All commissioners shall be designated employees under the Conflict of Interest Code of the State Bar.

(3) Except as provided in paragraph (4), each commissioner shall serve for a term of four years that begins upon appointment. Upon completion of an initial term, a commissioner may be reappointed for a second four-year term. An initial or second term may be extended by one or two years, for a maximum of 10 years, to allow a commissioner to serve as chair or vice chair. A commissioner currently serving as of January 1, 2022, may be reappointed to two additional full terms following the completion of their current term pursuant to paragraph (5).

(4) A commissioner appointed by the chair of the Judicial Council shall have no term limits.

(5) Each commissioner shall serve at the pleasure of the appointing entity. Each appointing entity may stagger their appointments so one-half of the commissioners are appointed in 2022 and the other one-half are appointed in 2023. A commissioner serving as of January 1, 2022, may continue to serve until replaced by the appointing entity or January 1, 2024, whichever occurs first.

(6) Commissioners who are not currently and have never been attorneys licensed in California or another jurisdiction and who submit a form designated by the commission to request a per diem shall be entitled to receive fifty dollars (\$50) per day for each day that they attend a commission meeting of at least one hour in length.

(c) The chair and the vice chair of the Legal Services Trust Fund Commission shall be selected by the Chair of the Judicial Council. The chair of the Legal Services Trust Fund Commission shall preside over

the commission's meetings. The Chair of the Judicial Council may select up to two chairs and two vice chairs to lead the commission.

(d) The Legal Services Trust Fund Commission shall be subject to the California Public Records Act (Division 10 (commencing with Section 7920.000) of Title 1 of the Government Code) and the Bagley-Keene Open Meeting Act (Article 9 (commencing with Section 11120) of Chapter 1 of Part 1 of Division 3 of Title 2 of the Government Code).

(e) (1) The Legal Services Trust Fund Commission shall recommend to the Board of Trustees of the State Bar rules to determine an applicant's eligibility for grants under this article and for rules related to grant administration, including rules to monitor and evaluate a recipient's compliance with Legal Services Trust Fund requirements and grant terms based on criteria established by the Legal Services Trust Fund Commission.

(2) The Legal Services Trust Fund Commission shall recommend to the Board of Trustees of the State Bar the amount proposed to be made available for grant distribution from IOLTA funds, along with the amount to be maintained as a fiscally responsible reserve.

(3) The Board of Trustees of the State Bar shall approve each recommendation made pursuant to paragraphs (1) and (2) unless the Board of Trustees of the State Bar makes a finding in writing that a recommendation conflicts with a statutory, fiduciary, or legal obligation of the State Bar.

(4) The decisions of the Legal Services Trust Fund Commission regarding individual grant awards shall take effect without approval by the Board of Trustees of the State Bar. However, the board may reverse or modify an individual grant award if it makes a finding in writing that the award violates Legal Services Trust Fund rules or a statutory, fiduciary, or legal obligation of the State Bar.

(f) Except as provided by subdivision (a) of Section 6033 and by Section 6140.03, the State Bar's actual administrative costs to administer the Legal Services Trust Fund Program, including IOLTA, Equal Access Funds, and similar funds and grant moneys shall be fully funded through these grant programs. The State Bar shall not provide administrative services to the Legal Services Trust Fund Commission in excess of the administrative costs allocated to the State Bar by the Legislature, or by the Legal Services Trust Fund Commission as part of any request by the Legal Services Trust Fund Commission's request for administrative support.

(g) At the conclusion of each fiscal year, the Legal Services Trust Fund Commission shall include a report of receipts of funds under this article, expenditures for administrative costs, and disbursements of the funds on a county-by-county basis, in the annual report of the State Bar's receipts and expenditures required pursuant to Section 6145. To ensure that awards made by the Legal Services Trust Fund Commission are consistent with statute, rules, and other governing authority, the State Bar shall develop a program to audit a representative sample of grant awards each year. The results of the most recent audit shall be included with the report of receipt of funds described in this subdivision.

(h) This section supersedes any conflicting State Bar rules regarding the Legal Services Trust Fund Commission or its responsibilities or oversight by the State Bar's board of trustees.

(Amended by Stats. 2022, Ch. 28, Sec. 10. (SB 1380) Effective January 1, 2023.)

6216. The State Bar shall distribute all moneys received under the program established by this article for the provision of civil legal services to indigent persons. The funds first shall be distributed 18 months from the effective date of this article, or upon such a date, as shall be determined by the State Bar, that adequate funds are available to initiate the program. Thereafter, the funds shall be distributed on an annual basis. All distributions of funds shall be made in the following order and in the following manner:

(a) To pay the actual administrative costs of the program, including any costs incurred after the adoption of this article and a reasonable reserve therefor.

(b) Eighty-five percent of the funds remaining after payment of administrative costs allocated pursuant to this article shall be distributed to qualified legal services projects. Distribution shall be by a pro rata county-by-county formula based upon the number of persons whose income is 125 percent or less of the current poverty threshold per county. For the purposes of this section, the source of data identifying the number of persons per county shall be the latest available figures from the United States Department of Commerce, Bureau of the Census. Projects from more than one county may pool their funds to operate a joint, multicounty legal services project serving each of their respective counties.

(1) (A) In any county which is served by more than one qualified legal services project, the State Bar shall distribute funds for the county to those projects which apply on a pro rata basis, based upon the amount of their total budget expended in the prior year for civil legal services without charge for indigent persons in that county as compared to the total expended in the prior year for civil legal services without charge for indigent persons by all qualified legal services projects applying therefor in the county.

(B) The State Bar shall reserve 10 percent of the funds allocated to the county for distribution to programs meeting the standards of subparagraph (A) of paragraph (3) and paragraphs (1) and (2) of subdivision (b) of Section 6214 and which perform the services described in subparagraph (A) of paragraph (3) of Section 6214 as their principal means of delivering civil legal services. The State Bar shall distribute the funds for that county to those programs which apply on a pro rata basis, based upon the amount of their total budget expended for free civil legal services for indigent persons in that county as compared to the total expended for free civil legal services for indigent persons by all programs meeting the standards of subparagraph (A) of paragraph (3) and paragraphs (1) and (2) of subdivision (b) of Section 6214 in that county. The State Bar shall distribute any funds for which no program has qualified pursuant hereto, in accordance with the provisions of subparagraph (A) of paragraph (1) of this subdivision.

(2) In any county in which there is no qualified legal services projects providing services, the State Bar shall reserve for the remainder of the fiscal year for distribution the pro rata share of funds as provided for by this article. Upon application of a qualified legal services project proposing to provide legal services to the indigent of the county, the State Bar shall distribute the funds to the project. Any funds not so distributed shall be added to the funds to be distributed the following year.

(c) Fifteen percent of the funds remaining after payment of administrative costs allocated for the purposes of this article shall be distributed equally by the State Bar to qualified support centers which apply for the funds. The funds provided to support centers shall be used only for the provision of civil legal services within California. Qualified support centers that receive funds to provide services to

qualified legal services projects from sources other than this article, shall submit and shall have approved by the State Bar a plan assuring that the services funded under this article are in addition to those already funded for qualified legal services projects by other sources.

(Amended by Stats. 2021, Ch. 723, Sec. 13. (SB 211) Effective January 1, 2022.)

AGENDA ITEM

MARCH 54-166

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

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	<u>AMOUNT</u>
A. <u>Revenue: 7/1/05 – 6/30/06</u>	
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. <u>Administrative Costs: 7/1/05 – 6/30/06</u>	
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. <u>Cash-on-Hand Calculation</u>	
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
<u>Grant Amount Calculation</u>	
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
Prior Year Distribution (2005-2006)	\$ 12,005,677
Percent Increase from Prior Year Distribution	6%

Attachment D - Modeling 2024 Distribution Based on Working Group Proposal

2023		2024 (reserve \$25M/ Distribute Prior Year Fund Bal not including Balance of Reserve)	
Fund Balance at Beginning of the Year	\$ 53,557,332	\$ 106,929,490	
Total Revenues	\$ 131,509,553	\$ 116,515,414	
Expenses			
IOLTA Grant Distribution	\$ 50,684,923	\$ 106,929,490	
Projected Admin Costs (not realized)	\$ 2,452,472	\$ 2,653,691	
Transfer to Restricted Reserve Fund	\$ 25,000,000	\$ -	
Total Expenses	\$ 78,137,395	\$ 109,583,181	
Fund Balance at End of the Year (not including restricted reserve balance)	\$ 106,929,490	\$ 113,861,723	
Restricted Reserve Balance	\$ 25,000,000	\$ 25,000,000	

State Bar Rule 3.683 Determination of IOLTA Distribution Amounts

- (A) The Legal Services Trust Fund Commission will annually recommend to the Board of Trustees the amount of IOLTA funds to be distributed and the amount to be held in reserve the next year.¹ The Commission will set the current year's projected IOLTA revenue total as the target distribution amount after deducting State Bar administrative costs and any amount set aside for the reserve. Instead of setting aside an amount for reserve, the Commission may increase the distribution with contributions from the reserve.
- (B) The reserve will be established as a restricted fund account that may be accessed to increase planned IOLTA grant distributions or to ensure sufficient funds for the State Bar to fulfill current-year IOLTA grant disbursements.
- (1) A minimum of 5 percent of current year revenue should be added to the reserve each year, subject to the maximum reserve balance set forth below, unless revenue is projected to fall, in which case the Commission may direct a smaller percentage of revenue, or none, to the reserve for the following year.
 - (a) The Commission may increase the amount of revenue directed to the reserve, unless it would exceed the maximum allowable balance.
 - (2) The maximum reserve balance will be set at \$25 million.
 - (a) The Commission may periodically choose to increase the maximum allowable reserve balance to account for inflation, as reflected by the overall percentage increase in the Bureau of Labor Statistics' Consumer Price Index in the prior twelve months.
 - (b) If the reserve has reached the maximum allowable balance, all revenue remaining after administrative costs will be distributed as grants. However, if the Commission determines that the grant distribution will be at least double the distribution of the prior year, and the size of the distribution cannot be effectively or efficiently used by grant recipients within the grant period, the Commission may increase the reserve by an amount not to exceed a total of \$40 million.
- (C) The Commission will determine whether to access funds held in reserve as part of the planned IOLTA grant distribution. Factors for consideration include, but are not limited to,
- (1) Catastrophic events or other emergency circumstances resulting in significantly decreased IOLTA revenue and/or legal aid funding generally;
 - (2) Catastrophic events or other emergency circumstances resulting in significantly increased need for legal aid services;
 - (3) IOLTA revenue decreases of more than 15 percent.
- (D) If IOLTA revenue yields insufficient funds for the State Bar to disburse quarterly IOLTA grant payments, the Commission will authorize use of the reserve to fulfill existing grant obligations.
- (E) IOLTA funds shall be distributed on an annual basis. However, the Commission may authorize yearly IOLTA grant distributions to be spent over a period of multiple years.

¹ Business and Professions Code § 6210.5(e).

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- (1) Catastrophic events or other emergency circumstances resulting in significantly decreased IOLTA revenue and/or legal aid funding generally;
 - (2) Catastrophic events or other emergency circumstances resulting in significantly increased need for legal aid services; or
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