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June 24, 2016

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Re: Federal Deposit Insurance Corporation Notice of Proposed Rulemaking—Recordkeeping for Timely Deposit Insurance Determination; RIN 3064-AE33; 81 Fed. Reg. 10026 (February 26, 2016)

Dear Mr. Feldman:

On behalf of the American Bar Association (ABA), which has nearly 400,000 members, I write to express our concerns regarding the above-referenced notice of proposed rulemaking (Proposed Rule) issued by the Federal Deposit Insurance Corporation (FDIC) to the extent that it would require lawyers or law firms that establish and maintain client trust accounts at covered financial institutions to disclose the identity of their clients with funds in those accounts and the amount of the funds owned by each client.¹

The ABA appreciates the FDIC's efforts to improve financial institution recordkeeping to ensure that depositors have prompt access to insured funds in the event of a failure. However, the ABA is concerned that the new disclosure requirements in the Proposed Rule would impose unreasonable and excessive burdens on many law firms with client trust accounts and undermine both the confidential lawyer-client relationship and traditional state court regulation of lawyers. These proposed disclosure requirements are also unnecessary in light of lawyers' existing ethical duties to maintain complete and accurate records regarding client trust accounts. In addition, the requirements would be inconsistent with express language in the new Customer Due Diligence Rule recently issued by the Treasury Department Financial Crimes Enforcement Network (FinCEN) that protects the confidentiality of attorney escrow and law firm client trust account information. The ABA therefore urges the FDIC to include language in the final rule exempting law firm client trust accounts from the rule's new expanded recordkeeping and disclosure requirements.

The FDIC's Proposed Changes to Financial Institution Recordkeeping

In its Proposed Rule, the FDIC has proposed requiring large insured depository institutions with two million or more deposit accounts—so-called “covered institutions”—to “maintain complete and

¹ Throughout these comments, references to “law firm” include individual lawyers representing clients as solo practitioners as well as legal practices with more than one lawyer. Similarly, references to “law firm client trust accounts” or “law firm trust accounts” include accounts established by solo practitioners or by law firms with more than one lawyer.

accurate data on each depositor's ownership interest by right and capacity for all of the institution's deposit accounts, and to develop the capability to calculate the insured and uninsured amounts for each deposit owner" in order to ensure that the FDIC can provide the depositors with prompt access to their insured funds in the event of a bank failure.² Although covered institutions are already required to maintain certain depositor information, the Proposed Rule would expand these existing recordkeeping duties to include all account holders,³ including law firms and other agents or custodians holding pass-through deposit accounts containing client funds.⁴

Under Section 360.9 of the FDIC's current regulations, covered institutions must be able to provide the FDIC with standard deposit account information that can be used in the event of the institution's failure. However, many of these records are incomplete or ambiguous; for example, multiple accounts are often listed under one name but at different addresses or under different names but at the same address.⁵ In addition, current FDIC regulations provide that when financial intermediaries—such as banks, brokers, agents, and custodians—establish pass-through accounts on behalf of others, information identifying the beneficial owners of those deposit accounts can be maintained off-site in the deposit broker's or other agent's records. Therefore, in the event of a bank failure, the financial intermediaries are expected to submit the required depositor information to the FDIC in a standard format within a certain time period, which then allows the FDIC to review the depositor information provided by the agent and make a deposit insurance determination.⁶

As explained in the Proposed Rule, "the FDIC does not believe that relying on the status quo is a viable approach with respect to the possible failure of a covered institution," as the current system can be labor intensive and requires depositors' access to these funds to be temporarily restricted as the FDIC places temporary holds on the entire balance while the agency waits to receive the necessary information from the broker or agent concerning their client or customer's account.⁷ Therefore, the FDIC has proposed requiring the covered institutions to maintain up-to-date information on both the principal and underlying depositors at the covered institutions to help expedite the FDIC's deposit insurance determinations for pass-through deposit accounts.

The ABA's Concerns Regarding the Proposed Rule

The ABA opposes the new recordkeeping provisions in the Proposed Rule to the extent that they would require lawyers and law firms to report sensitive and confidential information regarding their clients whenever they establish and maintain deposit accounts on behalf of those clients, for several important reasons.

² See Proposed Rule, 81 Fed. Reg. at 10026.

³ §370.3 of the Proposed Rule's text broadly states that "a covered institution must obtain from each account holder and maintain in its records the information necessary to comply with this section unless otherwise permitted in accordance with §370.4." See Proposed Rule, 81 Fed. Reg. at 10051.

⁴ *Id.* at 10027 and 10029.

⁵ *Id.* at 10027.

⁶ *Id.* at 10029.

⁷ *Id.*

1. Because Lawyers and Law Firms Are Required to Maintain Trust Accounts for Many of Their Clients, Requiring Them to Disclose Their Clients' Account Information and Provide Continuous Updates Would Be Costly, Burdensome, and Impractical

Lawyers and law firms often handle money that belongs to clients, such as settlement checks, fees advanced for services not yet performed, or money to pay various court fees. If the funds are large or will be held long enough so that they can earn net interest for the benefit of the client, lawyers deposit the funds into one or more separate trust accounts they establish at banks or other financial institutions and the net interest earned is provided to the client. Often, however, the amount of money that a lawyer handles for a single client is small or held for only a short period of time and hence cannot earn interest for the client in excess of the costs incurred to collect that interest. In those instances, a lawyer places these deposits into a combined, or pooled, trust account—in most states, an “Interest on Lawyers’ Trust Account” (IOLTA).⁸

Explaining the need for these client trust accounts, the U.S. Supreme Court has noted that “attorneys are frequently required to hold clients’ funds for various lengths of time . . . (and it) has long been recognized that they have a professional and fiduciary obligation to avoid commingling their clients’ money with their own, but it is not unethical to pool several clients’ funds in a single trust account.” *Brown v. Legal Foundation of Washington*, 538 U.S. 216, 220-221 (2003) (discussing *Phillips v. Washington Legal Foundation*, 524 U.S. 156, 160-161 (1998)). Consistent with those general principles, ABA Model Rule of Professional Conduct 1.15, dealing with “Safekeeping of Property,” requires lawyers to hold property of clients or third persons that is in the lawyer’s possession in connection with the legal representation separate from the lawyer’s own property.⁹ Every state court system has adopted—and vigorously enforces—binding rules similar to ABA Model Rule 1.15.¹⁰

Under Model Rule 1.15, lawyers are required to deposit into a client trust account any legal fees and expenses that have been paid in advance, and the lawyer is permitted to withdraw funds from the trust account “only as fees are earned or expenses incurred.”¹¹ While the client’s funds are held in the trust account, the lawyer is obligated to maintain on a current basis books and records in accordance with generally accepted accounting practices and comply with any recordkeeping rules established by law or court order, such as the Model Rules for Client Trust Account Records.¹² The lawyer must also maintain complete records on such funds for a period of five years after termination of the representation.¹³ In addition to safeguarding legal fees and expenses advanced by clients, many

⁸ In all but six U.S. jurisdictions, this pooled trust account is required by the state’s supreme court or legislature to be an IOLTA, with the interest earned on the account being paid to a non-profit entity to be used to fund various charitable purposes. In the six states that do not require IOLTAs, if the lawyer chooses not to establish such an account, the lawyer must place the funds in a pooled, non-interest bearing account if the funds are small enough or held for a short period of time so that they cannot earn net interest for the client. Additional information about IOLTAs in general is available at http://www.americanbar.org/groups/interest_lawyers_trust_accounts.html.

⁹ See ABA Model Rule of Professional Conduct 1.15(a). ABA Model Rule 1.15 and the related comments are available at http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_15_safekeeping_property.html.

¹⁰ See chart comparing ABA Model Rule 1.15 in the various individual states, available at http://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/mrpc_1_15.authcheckdam.pdf.

¹¹ See ABA Model Rule 1.15(c).

¹² See ABA Model Rule 1.15(a). The ABA Model Rules for Client Trust Account Records, adopted in August 2010, are available at http://www.americanbar.org/content/dam/aba/migrated/cpr/clientpro/adopted_8_10_10.pdf.

¹³ See ABA Model Rule 1.15(a).

lawyers and law firms also establish separate client trust accounts for other purposes, such as when the lawyer or law firm is “administering estate monies or acting in similar fiduciary capacities” for the client.¹⁴

Although lawyers and their law firms are currently required to maintain complete records of their client trust funds, the ABA is concerned that the Proposed Rule’s new disclosure requirements compelling law firms to disclose their individual clients’ account information to the covered institution holding the account—and then to provide updates to the institution on a continual basis—would be costly, burdensome, and impractical. Because lawyers and law firms are obligated to hold client funds in separate client trust accounts, and law firm trust accounts often hold the funds of dozens or even hundreds of different clients—many of which change on a daily basis—it would be unreasonable to require the law firms to report these changes to the covered institution on a continuous, daily, or even a periodic basis. In our view, the considerable time, effort, and expense that would be required for law firms to collect, organize, and report this highly detailed—and constantly changing—information for the large percentage of their clients for whom they must establish and maintain trust accounts is excessive and clearly disproportionate to any marginal benefits the information might be expected to provide to the FDIC. This is especially true, given the extraordinarily rare occurrence of very large bank failures.

2. Requiring Lawyers and Law Firms with Client Trust Accounts to Disclose Their Clients’ Identities and Account Information Would Violate Client Confidentiality

The ABA is concerned that by requiring lawyers and law firms to disclose confidential information to financial institutions or the government regarding the identity of every client that owns funds in the law firm’s client trust account and the amount of those client funds, the new disclosure provisions in the Proposed Rule are inconsistent with ABA Model Rule of Professional Conduct 1.6 dealing with “Confidentiality of Information” and with the many binding state rules of professional conduct that closely track the ABA Model Rule.¹⁵ ABA Model Rule 1.6 states that “a lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent” or unless one or more of the narrow exceptions listed in the Rule is present.¹⁶

The range of client information that lawyers are not permitted to disclose under ABA Model Rule 1.6 is broader than that covered by the attorney-client privilege. Although Rule 1.6 prohibits lawyers from disclosing information protected by the attorney-client privilege and the work product doctrine, Rule 1.6 also forbids lawyers from voluntarily disclosing other non-privileged information that the client wishes to keep confidential.¹⁷ This category of non-privileged, confidential client information

¹⁴ See ABA Model Rule 1.15, Comment [1].

¹⁵ See ABA Model Rule of Professional Conduct 1.6, and the related comments, *available at* http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_6_confidentiality_of_information.html. See also Charts Comparing Individual Professional Conduct Rules as Adopted or Proposed by States to ABA Model Rules, *available at* http://www.americanbar.org/groups/professional_responsibility/policy.html.

¹⁶ Although ABA Model Rule 1.6(6) allows a lawyer to disclose confidential client information “to comply with other law or a court order,” nothing in the Proposed Rule, the Federal Deposit Insurance Act, or the other statutes cited by the FDIC expressly or implicitly requires lawyers to reveal client confidences to financial institutions or the government.

¹⁷ See, e.g., Alabama Ethics Op. 89-111 (1989) (lawyer may not disclose name of client to funding agency); Texas Ethics Op. 479 (1991) (law firm that obtained bank loan secured by firm’s accounts receivable may not tell bank who firm’s

includes the identity of the client as well as other information related to the legal representation, including, for example, the amount of advance legal fees and expenses provided to the law firm as well as any other confidential information that the client may choose to reveal to the lawyer but does not wish to be revealed to third parties.

Disclosing this type of confidential client information would be clearly inconsistent with lawyers' existing ethical duties outlined in Rule 1.6 and the binding state rules of professional conduct that mirror the ABA Model Rule. In addition, the risk that the client's identity—and other confidential beneficial ownership information about the client—could be divulged by the lawyer or law firm could discourage a client from retaining a lawyer or law firm and entrusting them with funds, thereby substantially interfering with a client's fundamental right to counsel.

3. The Proposed Rule's New Disclosure Requirements for Law Firms with Client Trust Accounts and Corresponding Recordkeeping Requirements for Covered Institutions is Unnecessary to Achieve the FDIC's Objectives

The ABA believes that requiring lawyers and law firms to disclose—and covered institutions to maintain—up-to-date information on the identity of law firm clients with funds in client trust accounts and the amount of those client funds is simply not needed to achieve the FDIC's stated policy objective of ensuring that depositors have prompt access to insured funds in the event of a failure. In its Proposed Rule, the FDIC expressed concerns that its current regulations—which allow financial intermediaries that establish pass-through accounts on behalf of clients or others to maintain information about the beneficial owners of those accounts off-site in the intermediaries' records—may not be adequate to allow the FDIC to quickly determine the owners' insurance coverage and make those funds available following a bank failure. But because lawyers and law firms already have clear ethical and fiduciary duties to segregate these client funds and maintain complete records that could be quickly provided to the FDIC in the unlikely event of a very large institution's failure, the FDIC's rationale for requiring the covered institution to maintain constantly updated duplicate or overlapping records of these client funds does not apply to such client trust accounts.

As explained more fully above, lawyers and law firms are already subject to extensive state court rules that impose stringent duties to keep client funds separate from those of the law firm; to maintain detailed, current account records in accordance with generally accepted accounting practices; and to keep these records for a period of five years after termination of the representation.¹⁸ Because lawyers and law firms have clear ethical and fiduciary duties to maintain accurate client trust account records under existing state law, this client account information held by the law firms is likely to be complete and up-to-date and can be provided to the FDIC in an expedited fashion if the covered institution holding the account fails. Therefore, it would be reasonable and appropriate for the FDIC to exempt law firm client trust accounts from the increased disclosure requirements of the final rule.

clients are and how much each owes); South Carolina Ethics Op. 90-14 (1990) (lawyer may not volunteer identity of client to third party); and Virginia Ethics Op. 1300 (1989) (in absence of client consent, nonprofit legal services corporation may not comply with federal agency's request for names and addresses of parties adverse to certain former clients, since that may involve disclosure of clients' identities, which may constitute a client secret).

¹⁸ See discussion of ABA Model Rule 1.15 dealing with "Safekeeping of Property" on pages 3-4 and footnote 10, *supra*, regarding the related binding rules adopted by individual state supreme courts.

4. The Limited Exceptions in the Proposed Rule are Inadequate

In the Proposed Rule, the FDIC proposed language that would allow a covered institution to apply for an exception from the new disclosure requirements of §370.3 of the Proposed Rule's text if it can satisfy one of the following three conditions:

First, a covered institution would be able to apply for exception if it does not have the information needed to calculate deposit insurance coverage for an account or for all accounts of a specific type, that it has requested such information from the account holder, and the account holder has not been responsive to the covered institution's request.

Second, a covered institution would be able to apply for exception if it can provide a reasoned legal opinion that the information needed from an account holder to calculate deposit insurance coverage is protected from disclosure by law.

Third, a covered institution would be able to apply for exception if it can provide an explanation of how the information needed to calculate deposit insurance coverage changes so frequently that updating the information on a continual basis would be neither cost effective nor technologically practicable.¹⁹

Although each of these limited exceptions could potentially provide indirect relief to certain law firms maintaining client trust accounts at a covered institution in certain circumstances if the covered institution chose to invoke the exception, the ABA believes that the exceptions are inadequate and do not provide sufficient relief for several reasons.

First, the three exceptions are flawed and inadequate because they are directed to—and must be requested by—the covered institution, rather than the law firms whose confidential client information is being sought. Therefore, if an institution does not understand or agree with its law firm customers' position that it is inappropriate or overly burdensome to require the law firm to provide the institution with detailed and constantly updated information regarding the law firm clients' funds in the trust account, the institution is not likely to seek the exception and the law firm account holder does not appear to have standing to seek the exception directly from the FDIC.

In addition, the first exception above requires the covered institution to show that it has requested the information from the account holder and that the account holder has not been responsive before the institution can even apply for the exception. However, it is unnecessary and inappropriate to require banks to request this information from law firms with client trust accounts where it is already known that the law firms are not required by law to respond to the inquiry and there are ethical restrictions—such as the law firms' duty to protect client confidentiality under ABA Model Rule 1.6—that should prevent response.

Furthermore, even if the institution decides to request one or more of the three exceptions outlined above in an effort to relieve a law firm customer of the obligation to provide detailed client account information, the Proposed Rule states that the FDIC would have "sole discretion" to approve or

¹⁹ See Proposed Rule at 10041.

disapprove of the application, and even if it were approved, that approval “could be conditional or time-limited, depending on the facts and circumstances set forth in the application.”²⁰

As explained above, the ABA believes that requiring the disclosure of confidential client information—including the identities of clients and the amount of their funds entrusted to the lawyer and the lawyer’s law firm—is inconsistent with the lawyer’s ethical duty to protect client confidentiality. Requiring law firms to provide continuous updates to the financial institution is also inherently burdensome, costly, and unnecessary given the lawyers’ and law firms’ existing duties to maintain complete and accurate records of their clients’ funds. Therefore, the three narrow, conditional, and potentially time-limited exceptions in the Proposed Rule do not effectively address these inherent concerns.

5. A Broader and More Categorical Exception for Law Firm Client Trust Accounts is Needed to be Consistent with Language in the New FinCEN Customer Due Diligence Rule Stating that Law Firms Need Not Disclose the Identities or Beneficial Ownership Information of Clients for Whom Attorney Escrow or Client Trust Accounts are Established

Finally, the ABA is concerned that unless the FDIC’s Proposed Rule is modified to clarify that covered institutions need not obtain—and law firm customers need not disclose—confidential information regarding the identity of clients with funds in the law firms’ client trust accounts and the amount of each client’s funds, it will conflict with express language regarding the confidentiality of law firm client trust account information that was included in the new Customer Due Diligence regulation recently issued by FinCEN.²¹ The new FinCEN Rule, titled “Customer Due Diligence Requirements for Financial Institutions” (CDD Rule), was issued on May 11, 2016.

The FinCEN CDD Rule—designed to combat money laundering, terrorist financing and other illicit financial activity by clarifying and strengthening customer due diligence requirements for banks and other financial institutions—requires these institutions to obtain information regarding the beneficial owners of entities opening new accounts. The final language of the rule clarifies that when law firms open escrow and client trust accounts on behalf of their clients, those accounts will be deemed to be “intermediated accounts,” and the law firms will only have to disclose (and the institutions need only obtain) the law firms’ beneficial ownership information, not information regarding the identity or beneficial ownership of the clients for whom the accounts were established.²²

In the final rule, FinCEN agreed with concerns raised by the ABA and other commenters regarding the special issues and challenges posed by attorney escrow and client trust accounts, including the lawyers’ professional obligation to maintain client confidentiality under state law and codes of professional conduct, as well as the significant operational challenges facing law firms in collecting,

²⁰ *Id.* at 10042.

²¹ See Department of the Treasury Financial Crimes Enforcement Network Final Rule—Customer Due Diligence Requirements for Financial Institutions; RIN 1506-AB25; Docket Number FINCEN—2014-0001; 81 Fed. Reg. 29398 (May 11, 2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-05-11/pdf/2016-10567.pdf>.

²² See FinCEN Final Rule, 81 Fed. Reg. at 29416.

reporting, and continuously updating the beneficial ownership information for these accounts.²³ As FinCEN explained in its final CDD Rule:

One commenter representing the legal profession requested that escrow accounts established by lawyers to keep their clients' funds in trust be given the same treatment [as other intermediated accounts], due to lawyers' professional obligations to maintain client confidentiality under State law and codes of professional conduct. This commenter proposed that in the case of such accounts, only the lawyers and law firms establishing these accounts would be deemed legal entity customers from which beneficial ownership information would be collected.

FinCEN understands that many attorneys maintain client trust or escrow accounts containing funds from multiple clients and other third parties in a single account. Funds flow in and out of these accounts during the normal course of business, and while these movements may not be as frequent as those found in, for example, pooled accounts in the securities and futures industries, they nevertheless create significant operational challenges to collecting this information with reference to the relevant clients and third parties. As in the case of nonexcluded pooled investment vehicles, FinCEN believes that it would be unreasonable to impose such collection obligations for information that would likely be accurate only for a limited period of time.

FinCEN also understands that State bar associations impose extensive recordkeeping requirements upon attorneys with respect to such accounts, generally including, among other things, records tracking each deposit and withdrawal, including the source of funds, recipient of funds, and purpose of payment; copies of statements to clients or other persons showing disbursements to them or on their behalf; and bank statements and deposit receipts (footnote omitted).²⁴

For these reasons, FinCEN determined that for the purposes of the final CDD Rule, attorney escrow and client trust accounts will be treated like other intermediated accounts, and financial institutions should treat the intermediary law firm as its customer, not the law firm's clients. As a result, FinCEN concluded that financial institutions need only collect beneficial ownership information regarding the law firm establishing the escrow or client trust account, not information concerning the identity or beneficial ownership of the law firm's clients for whose benefit the accounts are established or maintained.²⁵

In light of FinCEN's recent well-reasoned decision not to require financial institutions to collect information from law firm customers regarding the identities of their clients for whom they establish escrow or client trust accounts or information regarding the beneficial ownership of the funds held in those accounts, it would be inconsistent and improper for the FDIC to require covered institutions to collect this same type of information that FinCEN has expressly exempted, as well as additional confidential information concerning the amount of each client's deposits. Now that FinCEN has recognized the importance of such factors as lawyers' professional obligations to maintain client confidentiality under state law; the "significant operational challenges" faced by law firms in

²³ *See id.*

²⁴ *Id.*

²⁵ *Id.*

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collecting and then continuously updating and reporting client beneficial ownership information; and the extensive recordkeeping requirements that states already impose on lawyers, the FDIC should acknowledge these same special factors and adopt a similar exemption for law firm client trust accounts in its final rule.

Conclusion

For all these reasons, the ABA urges the FDIC to include language in its final rule exempting law firm client trust accounts from the expanded recordkeeping and disclosure requirements of the new rule and clarifying that while law firms must continue to maintain complete and detailed records regarding the beneficial owners of these accounts, that information need not be disclosed to the financial institution or the FDIC unless and until the institution fails.

Thank you for considering the views of the ABA on these important issues. If you have any questions regarding the ABA's position on the Proposed Rule, please contact ABA Governmental Affairs Director Thomas Susman at (202) 662-1765 or ABA Associate Governmental Affairs Director Larson Frisby at (202) 662-1098.

Sincerely,

A handwritten signature in black ink, appearing to read "Paulette Brown", with a long, sweeping horizontal line extending to the right.

Paulette Brown
President, American Bar Association