

# Helping Attorneys Safeguard Client Funds

When serving as escrow custodians, it's important for attorneys to take positive action to protect client funds. While the law firm bears the primary responsibility for fraud protection, attorneys can enlist their bank's help to reduce the firm's risk.

## Interest-Only Lawyer Accounts Are Not Immune from Fraud

One serious fraud risk for law firms stems from the misconception that interest-only lawyer accounts (IOLAs) are automatically protected from fraud.

IOLAs (Interest-Only Lawyer Accounts) and IOLTAs (Interest-Only Lawyer Trust Accounts) are escrow accounts established by law firms to hold client funds until they are needed for a closing. Interest generated on these accounts is directed to the state IOLA/IOLTA fund for use in programs that promote the administration of justice and provide civil legal service to underserved populations.

Despite their special status, these accounts are still at risk for check fraud, wire fraud, or ACH fraud just like any other account. Escrowed amounts can be considerable, in the case of large real estate transactions, for example.



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## Treasury Management Tools to Combat Fraud

Law firms should take full advantage of treasury management tools offered by their bank. While treasury management used to be comprised of relatively simple processes, such as manually matching check numbers and check amounts, it has since evolved into a suite of digital tools that provide robust fraud protection above and beyond basic online banking.

**Positive Pay.** The firm provides the bank with a list of issued checks. Checks received by the bank are compared to this list every day, and only checks included on the list are paid. Clients are alerted to any checks not on the list, allowing them to identify unauthorized activity.

**Reverse Positive Pay.** The bank sends a list of all checks received before any are paid. The firm reviews all checks and alerts the bank to any that do not match their approved list, allowing suspected fraudulent payments to be returned.

**ACH Debit Block and Positive Pay.** As ACH debits come to the bank, they are not cleared automatically. Instead, they are made available to the client via online banking for review. If the decision is to pay, a filter can be created to allow future ACH transactions from the same vendor or supplier to be processed automatically.

**Other Tools.** Treasury management tools also include courier service to bring checks to the bank; online initiation of ACH and wire transfers; lockbox services, which are centralized physical or electronic payment destinations that shift payment processing to the bank; and account reconciliation tools that streamline the process.

## Sub-Accounts Protect IOLA Funds from Fraud

One of the best ways for attorneys to fully protect client funds deposited in an IOLA is to establish sub-accounts that support one master account. Client funds held in escrow remain in an IOLA sub-account until the transaction is ready to close, when funds are transferred to the law firm's IOLA master account for payment.

"If someone gains fraudulent access to the master account, and there are no sub-accounts, all of the funds in the IOLA—potentially millions of dollars—are at risk," says Jeffrey Mercado, CFP, MBA, Sr. Managing Director, and Head of Law Firm Banking at Sterling.

"The sub-account number is only used internally by the bank—it's not even seen at a closing—so there is very little opportunity for someone to discover and misuse that account number," says Mercado. "If someone tries to get money from the master IOLA account, it normally has a zero balance and the attempt would overdraft the account."

Segregating individual client funds in IOLA sub-accounts also provides greater transparency compared to pooling multiple clients' funds in one account. IOLA sub-accounts can be managed online with secure login, flexible ad-hoc reporting, granular user entitlements, transaction controls, and seamless integration across desktop and mobile devices. Payments can be generated in various forms, including wire and checks.

"Not all banks offer IOLA sub-accounts," says Mercado. "A lot of law firms still think it's easier to pool all of their escrowed client funds in one account, but doing that means forgoing the fraud protection that comes from isolating

those funds, or the ease of reconciliation that follows from having escrowed funds separated by client."

Sub-accounts can also be established for attorney trust accounts, which allow interest to accrue to the benefit of the client.

## Other Fraud Risks

Attorneys also need to be aware of fraud risks that are not unique to the legal profession. The specifics of fraud techniques are ever-changing, as criminals constantly look for vulnerabilities and banks aggressively seek to close security gaps and educate clients on fraud protection. In the last ten to 15 years, banking systems have become much better protected from cyber attacks, but various types of low-tech fraud are still common threats.

"Educating client law firms about possible vulnerabilities and how they can protect against fraud is a constant priority at Sterling," says Mercado. Here are some types of fraud that attorneys need to understand so they can take steps to protect firm and client funds.

**CHECK FRAUD.** Paper checks are highly vulnerable to fraud. Though more and more banking transfers are made electronically, checks are still in use and check fraud still exists. It's not uncommon for a fraudster to somehow see a check written by an attorney, take note of the bank name and the account number, and then create counterfeit checks.

"It should be standard practice to review accounts on a daily basis to ensure nothing looks out of the ordinary and the checks that have been presented are checks that were issued by the firm," says Mercado.

**WIRE AND ACH FRAUD.** Wire transfers and automated clearing house (ACH) transactions are safer than checks, but fraud is still possible. A wire or ACH transfer might be requested by a criminal impersonating a client who has the authority to make that request, or some form of social engineering might be used to trick an employee into making an illegitimate request.


“We see some law firms using a fax or unsecured email to request their wire transfers, both of which are extremely unsafe,” says Mercado. It’s far safer for firms to request wire transfers through a secure online banking portal, which provides an additional layer of security and limits the likelihood that fraudsters are able to impersonate clients, lessening the potential for fraud activity to occur.

Positive pay and other treasury management tools offered by banks provide robust protection against check, wire, and ACH fraud. (See the “Treasury Management Tools to Combat Fraud” on page 2 for details.)

### Other Ways to Reduce Fraud Risk

Some of the easiest ways to protect against fraud are really more about awareness and attitude than about implementing tools and techniques. Here are a few perspective shifts that can help law firms guard client funds.

- ➔ Don’t assume any bank check is valid. Bank-issued checks can be forged. You should allow several days for all checks to clear. Many clients don’t understand—and even bankers sometimes forget—that a check can clear the Federal Reserve Bank overnight and eventually bounce, have a stop payment order, or be counterfeit. “We recommend sending a wire, not a check, because it is more secure,” says Mercado.
- ➔ Limit access to accounts. The fewer people have account access, the better. If multiple employees handle accounts, that opens up one possible avenue for internal fraud.
- ➔ Set up alerts for large wires. Having more eyes on money movement is a simple way to increase the chances of detecting an unauthorized transfer. “In online banking, you can create notification triggers, where managing partners or all partners receive notice of outgoing wires that exceed some arbitrary amount,” says Mercado.



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