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Part II

Department of Education

34 CFR Part 682

Federal Family Education Loan (FFEL) Program; Proposed Rule

DEPARTMENT OF EDUCATION

34 CFR Part 682

RIN 1840–AC33

Federal Family Education Loan (FFEL) Program

AGENCY: Department of Education.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Secretary proposes to amend the Federal Family Education Loan (FFEL) Program regulations. These proposed regulations are needed to implement changes to the Higher Education Act of 1965, as amended (HEA) giving the Secretary additional powers to assure the safety of Federal reserve funds and assets maintained by guaranty agencies insuring educational loans under the FFEL Program pursuant to agreements with the Secretary. The proposed regulations would establish appropriate conflicts of interest restrictions for guaranty agency staff and affiliated individuals and would prohibit agencies from using Federal reserve funds for certain purposes.

DATES: Comments must be received on or before November 4, 1996.

ADDRESSES: All comments concerning these proposed regulations should be addressed to Ms. Pamela A. Moran, Chief, Loans Branch, Policy Development Division, Student Financial Assistance Programs, U.S. Department of Education, 600 Independence Avenue, SW., Room 3053, Regional Office Building 3, Washington, DC 20202–5449. Comments may also be sent through the internet to ''ga__reserves@ed.gov''.

To ensure that public comments have maximum effect in developing the final regulations, the Department urges the commenters to clearly identify the specific section or sections of the regulations that each comment addresses and to provide comments in the same order as those sections appear in the regulations. The Department has found it very helpful if commenters who wish to modify a proposed provision submit their version of how they believe the specific regulatory provision should read.

Comments that concern information collection requirements must be sent to the Office of Management and Budget at the address listed in the Paperwork Reduction Act section of this preamble. A copy of those comments may also be sent to the Department representative named in this section.

FOR FURTHER INFORMATION CONTACT: Mr. George Harris, Senior Policy Specialist, U.S. Department of Education, 600 Independence Avenue, SW., Room 3045, Regional Office Building 3, Washington, DC 20202–5449. Telephone: (202) 708–8242. Individuals who use a telecommunications device for the deaf (TDD) may call the Federal Information Relay Service (FIRS) at 1–800–877–8339 between 8 a.m. and 8 p.m., Eastern time, Monday through Friday.

SUPPLEMENTARY INFORMATION:

Background

The FFEL Program regulations (34 CFR Part 682) govern the Federal Stafford Loan Program, the Federal Supplemental Loans for Students Program (no longer active), the Federal PLUS Program, and the Federal Consolidation Loan Program (formerly collectively known as the Guaranteed Student Loan Programs). A guaranty agency is a State or private nonprofit entity that performs certain administrative roles in the FFEL Program. The Department's regulations require the guaranty agency to deposit all funds received in connection with its FFEL guaranty activities into a reserve fund to be used solely for its activities as a guaranty agency under the FFEL Program. The regulations also specify that the reserve fund may only be used to pay certain costs associated with those programmatic activities. See 34 CFR 682.410(a). Under section 422(g) of the HEA, the reserve funds and assets of the guaranty agencies are the property of the United States.

In light of its role in the program and its responsibility for holding and protecting Federal funds, the guaranty agency's role is best characterized as that of a trustee holding money for the benefit of another. See *Education Assistance Corp.* v. *Cavazos,* 902 F.2d 617, 627 (8th Cir. 1990), *cert. denied* 111 S.Ct. 246 (1990); *Ohio Student Loan Com'n* v. *Cavazos,* 900 F.2d 894 (6th Cir. 1990), *cert. denied* 111 S.Ct. 245 (1990); *Student Loan Fund of Idaho* v. *Riley,* Case No. CV 94–0413–S–LMB (D.Ida, Memo. Decision, Sept. 14, 1995) at 17–19. Under these circumstances, a guaranty agency is responsible for acting as a fiduciary responsible for protecting the interests of the Department and the taxpayers in the reserve funds.

Over the years, some guaranty agencies, both State and private nonprofit, have become involved in activities outside of their FFEL guaranty activities. Since the FFEL Program reserve fund may be used only for FFEL guaranty activities, any other activities should have been funded exclusively from sources unrelated to the FFEL guaranty activities. These sources may include specifically designated State appropriations or private capital raised independently of the agency's FFEL guaranty activities. If a guaranty agency has consistently funded and maintained these non-FFEL guaranty funds separate from its reserve funds, the separate funds are not covered by the restrictions in the Department's regulations. These proposed regulations cover only expenditures made from the reserve fund.

The Secretary understands that some guaranty agencies involved in separately funded non-FFEL guaranty activities use personnel and resources to perform both the activities of the FFEL guaranty agency and other activities. It is vital for the guaranty agency to establish and comply with a plan for allocating costs appropriately between the FFEL guaranty activities and other activities to ensure that Federal funds are not subsidizing non-FFEL guaranty activity. Thus, under § 682.418(c) in these proposed regulations, each guaranty agency that shares costs with any other program, agency, or organization must develop a cost allocation plan consistent with the requirements described in OMB Circular A–87 and maintain the plan and related supporting documentation for audit. A guaranty agency would be required to submit its cost allocation plans for the Secretary's approval if it is specifically requested to do so by the Secretary.

The Secretary is also aware that some guaranty agencies have contracted with other entities associated with the guaranty agency (through a shared holding company-like corporate structure or interlocking governing boards or officers) for services and goods. These arrangements raise the possibility of self-dealing and create concerns that the guaranty agency or its contracting officials may have a conflict of interest in establishing and monitoring the contracting arrangement. These proposed regulations address these issues.

In developing these proposed regulations, the Secretary has attempted to modify various governmentwide rules to fit the unique role and structure of guaranty agencies. As noted earlier, guaranty agencies receive and hold Federal funds to pay certain FFEL Program costs and expenses. They are trustees for the Federal Government and are expected to comply with fiduciary standards. Although guaranty agencies are not Federal contractors, the Secretary did consider whether, to protect the Federal fiscal interest, the Secretary should require agencies to conform to the strict rules applicable to government contractors in the areas of

permissible costs, required cost allocation, and conflicts of interest. However, the Secretary believes that it is not yet necessary to require a strict application of those rules to the guaranty agencies. Instead, the Secretary is proposing in this NPRM a more limited approach that is tailored to address the specific issue of reserve funds and to clarify ambiguities that have led to some of the concerns identified previously.

Prior to the publication of these proposed regulations, representatives of the Department met in Washington, DC on July 22–23, 1996 with representatives of guaranty agencies, the National Council of Higher Education Loan Programs, Inc., and other interested parties from various sectors of the FFEL and student aid community for the purpose of learning their views on the direction that the proposed regulations should take. Although any regulations the Secretary proposes pursuant to section 422(g)(1)(C) of the HEA to prevent the ''misapplication, misuse, or improper expenditure of reserve funds and assets'' are not required to be developed under a formal negotiated rulemaking process, the Department generally has found consultative dialogue with the FFEL industry to be helpful. In this respect, the parties at the consultation meeting provided useful information concerning some of the major points that the Department would need to take into consideration while drafting proposed regulations designed to assure the safety of reserve funds and assets maintained by guaranty agencies in the FFEL Program.

Proposed Regulatory Changes

The Secretary proposes to amend the following sections of the regulations:

Section 682.401 Basic Program Agreement

These regulations codify, in § 682.401(b)(28), the Department's existing policy concerning the conversion of a guaranty agency's loan records system if an agency plans to place its new guarantees or convert the records relating to its existing guaranty portfolio to an information or computer system that is owned by or otherwise under the control of an entity that is different than the party that owns or controls the agency's existing information or computer system.

Section 682.410 Fiscal, Administrative, and Enforcement Requirements

Section 682.410(a)(2)—The Secretary proposes to clarify in § 682.410(a)(2)(i) that a guaranty agency may use the reserve fund to pay an insurance claim only if the claim would meet the Federal reinsurance requirements specified in § 682.406 at the time the agency pays the claim.

If a guaranty agency fails to comply with Federal reinsurance requirements to the extent that the agency's failure caused a lender's properly serviced and submitted claim to be considered an ineligible claim for purposes of allowing the agency to receive a Federal reinsurance payment from the Secretary, the FFEL reserve fund may not be used by the agency to pay the claim. However, the Secretary expects that the agency would comply with any contractual agreement it had with the lender that would support the lender's demand that the agency use or obtain non-FFEL funding to honor the terms of the agency's insurance agreement with the lender.

Section 682.410(a)(11)—The proposed regulations add a definition of the term ''reasonable cost'' that would apply to guaranty agency reserve fund expenditures.

Section 682.410(b)(11)—The Secretary proposes to amend the FFEL Program regulations to require guaranty agencies to prohibit conflicts of interest by guaranty agency staff and affiliated individuals.

On November 29, 1993, the Director of the Office of Management and Budget published OMB Circular A–110 (''Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and other Non-Profit Organizations''). This circular contains standards for obtaining consistency and uniformity among Federal agencies in the administration of grants to, and agreements with, institutions of higher education, hospitals, and other nonprofit organizations. OMB Circular A–110 is issued under the authority of 31 U.S.C. 503 (the Chief Financial Officers Act), 31 U.S.C. 1111, 41 U.S.C. 405 (the Office of Federal Procurement Policy Act), Reorganization Plan No. 2 of 1970, and E.O. 11541 (''Prescribing the Duties of the Office of Management and Budget and the Domestic Policy Council in the Executive Office of the President'').

After reviewing OMB Circular A–110, the Secretary has determined that, to maintain program integrity, the Secretary must issue regulations restricting actual or potential conflicts of interest among guaranty agencies and their personnel. In light of past reviews finding significant problems resulting from affiliations between guaranty agencies and other FFEL Program participants, such as secondary markets and lender servicers, the Secretary initially considered a strict prohibition on any connection between guaranty agencies and those other organizations. A ''bright line prohibition'' would be easier for the Secretary to monitor and would provide the most assurance of program integrity. However, given the common and longstanding affiliations in the FFEL Program and wishing to minimize the potentially disruptive effect on the continuation of loans to students and parents that could result from a total divestiture of all guaranty agency affiliations, the Secretary is proposing a more conservative approach to determine if that approach would achieve the goal of preventing conflicts of interest involving guaranty agencies and their personnel. Therefore, these proposed regulations would require the adoption by guaranty agencies of appropriate procedures and policies to require—(a) increased auditing of the agency's claims review process; (b) independent reporting lines for agency staff involved in the claim review function; and (c) sufficient internal controls to ensure that staff involved in originating and servicing loans are not involved in the claims review process. In addition, under the proposed ''prohibited uses of the reserve fund'' section in § 682.418(a), further protection of the Federal fiscal interest would be provided by the Secretary's proposal to prohibit an agency from making any payment for goods, property, or services provided by an affiliated organization that exceeds the affiliated organization's actual and reasonable cost of providing those goods, property, or services, unless the guaranty agency demonstrates to the Secretary, and receives the Secretary's concurrence, that such a payment is in the Federal fiscal interest. However, in light of the previous discussion of the ''bright line prohibition,'' the Secretary requests comment on that approach.

When the Department's Inspector General reviewed the management structures and affiliations at 12 selected guaranty agencies that held $59 billion in loan guarantees for the period ending September 30, 1992, the Inspector General concluded that those guaranty agencies had potential conflicts of interest involving a significant portion of their loan portfolios. At the beginning of fiscal year 1996, the original principal amount of outstanding loans insured by guaranty agencies exceeded $123 billion. Based on the Inspector General's previous analysis, this suggests that a substantial portion of the loan portfolios held by all agencies may continue to be

at risk because of guaranty agency organizational structures and affiliations that have caused real or potential conflicts of interest. Therefore, given the magnitude of the Federal interest that guaranty agencies administer under their agreements with the Secretary, the Secretary has decided to couple the protections proposed in these regulations with a provision stating that the Secretary may impose more stringent requirements, including requiring the agency's total divestiture of any interest in an affiliated organization, if the agency fails to comply with these requirements or there is evidence of a compromised claims review process. The Secretary expects that the more limited restrictions will eliminate the need for stricter measures. However, public comment is solicited as to whether a strict prohibition against an agency having any affiliation with another organization would be more appropriate at this time.

These proposed regulations are intended to avoid the potential misuse of a guaranty agency's reserve fund if the guaranty agency contracts for goods, property, or services with an organization with which it is affiliated or with which it has overlapping personnel or financial interests. As the Secretary has previously stated, ''it is already well understood that * * * [existing regulations were not] meant to permit excessive or unreasonable expenditures.'' 59 FR 41184–85 (August 10, 1994). This current understanding would be made explicit in proposed § 682.418(a)(1). In addition, under existing law, the guaranty agency and its personnel must act consistently with their fiduciary obligations in all procurement activities. Nevertheless, the Secretary is concerned that a guaranty agency may have an incentive to use its reserve fund to pay unreasonable prices and fees for supplies, equipment, property, and services provided by an affiliated organization or one with overlapping personnel or financial interests, and the Secretary is now proposing the requirement of specific conflict of interest codes to deal with this potential for abuse.

If there are overlapping personnel or financial interests or both between the guaranty agency and another party to a procurement, it is possible that decisions concerning the appropriate use of the guaranty agency's reserve fund could be improperly influenced by prospects of personal gain resulting from the guaranty agency's payment of unreasonable prices and fees. In this instance, the interests of borrowers and taxpayers would be relegated to a secondary consideration. The proposed conflict of interest codes address this potential influence by prohibiting guaranty agency personnel from participating in the procurement process if they have a real or potential conflict of interest.

Currently, in the case of an affiliation between a guaranty agency and the party supplying goods, property, or services to the agency, the existing fiduciary obligations of guaranty agencies and their personnel preclude them from delegating to affiliated organizations functions previously performed by the guaranty agency itself, unless the affiliated organization provides those goods, property, or services to the guaranty agency at its actual cost. Although no occasion has yet come to the Secretary's attention in which the delegated function had never been performed by the guaranty agency itself, similar fiduciary principles would also be applicable to this latter situation. The proposed regulations would codify the effect of these existing fiduciary requirements by prohibiting a guaranty agency from making any payments to affiliated organizations for goods, property, or services if those payments exceed the affiliated organization's actual and reasonable cost of providing them. Since there may be exceptional circumstances in which a compelling reason justifies payments that may appear to exceed the reasonable costs for supplies, equipment, property, and services provided to a guaranty agency by an affiliate, a guaranty agency may demonstrate to the Secretary, on a case-by-case basis, that such a payment would be in the Federal fiscal interest. If the Secretary agrees with the guaranty agency's proposed payment, the Secretary would notify the guaranty agency that it may use its reserve fund to pay for the goods, property, or services in question.

The proposed regulations generally follow the governmentwide codes of conduct provisions established in OMB Circular A–110. The Secretary has determined that a guaranty agency administered under the authority of a State as a political subdivision or agency of the State is subject to oversight pursuant to State codes of conduct rules affecting personnel and contracting procedures. In the Secretary's view, the various State codes of conduct laws provide protection of the Federal fiscal interest that would meet some of the requirements of the conflict of interest provisions proposed in these regulations and provide special protection of the Federal fiscal interest unavailable in other agencies. Therefore, for purposes of these proposed regulations, a State guaranty agency whose employees are covered under codes of conduct established by State law would be exempted from the general prohibition proposed in § 682.410(b)(11)(i)(A) against agency employees, officers, trustees, or agents being engaged in the selection, award, and administration of contracts or agreements. However, a State guaranty agency would not be exempted from either the specific provisions proposed in § 682.410(b)(11)(i)(B) relating to claims processing or the prohibition proposed in § 682.410(b)(11)(i)(C) relating to the solicitation or acceptance of gratuities, favors, or anything of monetary value from contractors or parties to agreements. This exemption for States is designed to tailor the regulations to only those situations in which Federal action is necessary.

Section 682.418 Prohibited Uses of Reserve Fund Assets

The Secretary proposes to add a new § 682.418 to specify certain uses of a guaranty agency's reserve fund that are prohibited.

The Secretary, Congress, and other parties have been concerned about the improper uses of the Federal reserve funds by guaranty agencies. In the course of conducting program reviews of guaranty agencies, the Department has found that some guaranty agencies have used the reserve fund, which is intended to be used for the benefit of students and taxpayers, to pay excessive compensation to their officers and employees or have spent excessive amounts of the reserve fund on buildings or equipment and other assets. The Department's reviewers have also found that some guaranty agencies frequently use the reserve fund for costs of entertaining school personnel and other individuals for purposes unrelated to the fulfillment of the agency's responsibilities under the HEA. The use of Federal funds to pay for a guaranty agency's hospitality suite or entertainment at functions such as school association meetings clearly is not the type of expense for which the reserve fund is intended, nor should the assets of the reserve fund be used by the agency to pay its legal expenses in contesting the Secretary's efforts to enforce regulatory or statutory requirements against the agency. The concerns that Congress had about these abuses were instrumental in its decision to legislate in this area. The Omnibus Budget Reconciliation Act of 1993 (Pub. L. 103–66) was enacted on August 10, 1993, and added section 422(g)(1)(C) of the HEA, which authorized the Secretary to direct guaranty agencies to

cease and desist from any misapplication, misuse, or improper expenditure of reserve funds and assets.

To implement this requirement, the Secretary has determined that it is appropriate to issue regulations governing cost principles and cost allocation for guaranty agencies and identifying prohibited costs that a guaranty agency may not charge to the reserve fund under the FFEL Program. As explained in the following paragraphs, under existing regulations the Secretary has expected guaranty agencies to follow, as appropriate, OMB Circular A–87 (''Cost Principles for State and Local Governments'') and OMB Circular A–122 (''Cost Principles for Nonprofit Organizations''). However, the Secretary has determined that the OMB circulars do not fully address the issues raised by the activities of guaranty agencies. Accordingly, the Secretary has decided to issue these proposed regulations based in large measure on the OMB circulars.

Currently, under § 682.410(b)(1)(i), a guaranty agency that is a State agency must have an audit conducted in accordance with 31 U.S.C. chapter 75 (the ''Single Audit Act''). Under the Single Audit Act, the Director of the Office of Management and Budget has issued OMB Circular A–128 (''Audits of State and Local Governments''), which requires the auditor to determine that amounts claimed are determined in accordance with OMB Circular A–87. Thus, while there is no explicit provision in the Department's regulations requiring a State guaranty agency to follow the cost principles of OMB Circular A–87, a failure to do so could result in an audit finding that the agency violated the Department's regulations by failing to comply with these principles.

With regard to nonprofit guaranty agencies, § 682.410(b)(1)(ii) currently requires that an audit be conducted in accordance with OMB Circular A–133 (''Audits of Institutions of Higher Education and other Non-Profit Institutions''). OMB Circular A–133 requires the auditor to determine that amounts claimed were determined in accordance with OMB Circular A–122. Some guaranty agencies have misinterpreted the language in OMB Circular A–133 that states ''* * * the auditor shall determine whether * * * amounts claimed or used for matching were determined in accordance with * * * Circular A–122.'' These guaranty agencies interpreted this to mean that the only funds covered by the circular are matching funds. The Secretary believes that such an interpretation is incorrect. The definition of Federal financial assistance in Circular A–133 does not limit that assistance to matching funds.

The proposed regulations generally follow existing governmentwide cost principles established in OMB Circulars A–87 and A–122. The Secretary has determined, however, that to ensure the efficient and effective operation of the FFEL Program, some cost items prohibited under those OMB circulars should be allowable under the FFEL Program, and some limits specific to the guaranty agencies should be imposed. OMB Circular A–122 also includes definitions of items of cost that the Secretary believes should apply to guaranty agency operations in these proposed regulations.

Executive Order 12866

1. Potential Costs and Benefits

These proposed regulations have been reviewed in accordance with Executive Order 12866. Under the terms of the order, the Secretary has assessed the potential costs and benefits of this proposed regulatory action.

The potential costs associated with the proposed regulations are those resulting from statutory requirements and those determined by the Secretary to be necessary for administering the title IV, HEA programs effectively and efficiently. Burdens specifically associated with information collection requirements, if any, are identified and explained elsewhere in this preamble under the heading of Paperwork Reduction Act of 1995.

In assessing the potential costs and benefits—both quantitative and qualitative—of these proposed regulations, the Secretary has determined that the benefits of the proposed regulations justify the costs.

The Secretary has also determined that this regulatory action does not unduly interfere with State, local, and tribal governments in the exercise of their governmental functions.

To assist the Department in complying with the specific requirements of Executive Order 12866, the Secretary invites comment on whether there may be further opportunities to reduce any potential costs or increase potential benefits resulting from these proposed regulations without impeding the effective and efficient administration of the title IV, HEA programs.

Summary of Potential Costs and Benefits

The potential costs and benefits of these proposed regulations are discussed elsewhere in this preamble under the headings Proposed Regulatory Changes and Paperwork Reduction Act of 1995.

2. Clarity of the Regulations

Executive Order 12866 requires each agency to write regulations that are easy to understand.

The Secretary invites comments on how to make these proposed regulations easier to understand, including answers to questions such as the following: (1) Are the requirements in the proposed regulations clearly stated? (2) Do the proposed regulations contain technical terms or other wording that interferes with their clarity? (3) Does the format of the proposed regulations (grouping and order of sections, use of headings, paragraphing, etc.) aid or reduce their clarity? Would the proposed regulations be easier to understand if they were divided into more (but shorter) sections? (A section is preceded by the symbol ''§'' and a numbered heading; for example, § 682.410 Fiscal, administrative, and enforcement requirements.) (4) Is the description of the proposed regulations in the ''Supplementary Information'' section of this preamble helpful in understanding the proposed regulations? How could this description be more helpful in making the proposed regulations easier to understand? (5) What else could the Department do to make the proposed regulations easier to understand?

A copy of any comments that concern how the Department could make these proposed regulations easier to understand should be sent to Stanley M. Cohen, Regulations Quality Officer, U.S. Department of Education, 600 Independence Avenue, S.W. (Room 5100, FB–10B), Washington, DC 20202–2241.

Regulatory Flexibility Act Certification

The Secretary certifies that these proposed regulations would not have a significant economic impact on a substantial number of small entities.

Guaranty agencies are financial organizations. According to the U.S. Small Business Administration Size Standards, financial organizations with less than $100 million in assets are classified as small entities. All guaranty agencies have at least $100 million in assets. Therefore, there are no small entities affected by these proposed regulations.

Paperwork Reduction Act of 1995

Section 682.418 contains information collection requirements. As required by the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)), the Department of Education has submitted a copy of this

section to the Office of Management and Budget (OMB) for its review.

Collection of Information: Federal Family Education Loan Program. Documentation and notification requirements.

Guaranty agencies receive payments from the Secretary and others for exclusive use in the FFEL Program, and the accumulated surplus of those payments over permissible expenditures is Federal property to be returned to the Secretary upon the guaranty agency's termination or under certain other circumstances. The Secretary needs and uses the information to determine whether the guaranty agencies comply with the requirements for safeguarding this property and the limitations on its use.

Section 682.418(c) of these regulations requires a guaranty agency that shares costs with any other program, agency, or organization to develop a cost allocation plan consistent with the requirements described in OMB Circular A–87 and to maintain the plan and related supporting documentation for audit. A guaranty agency is not required to submit its cost allocation plans for the Secretary's approval unless it is specifically requested to do so by the Secretary. There is no requirement to annually report this information to the Secretary. However, the annual recordkeeping burden required by the development of an agency's cost allocation plan and the maintenance of required supporting documentation for audit is estimated to be one hour for each of the agencies that would be subject to this requirement. There are 36 existing guaranty agencies. Approximately 25 of those agencies share costs with other programs, agencies, or organizations. The Secretary estimates that it will take each of the 25 agencies approximately 1 hour to develop its cost allocation plan, resulting in a collective annual recordkeeping burden of 25 hours for all of those agencies. The maintenance of documentation supporting an agency's shared costs is already required under existing regulations in § 682.410(a); thus, these proposed regulations add no new burden in that area.

Organizations and individuals desiring to submit comments on the information collection requirements should direct them to the Office of Information and Regulatory Affairs, OMB, room 10235, New Executive Office Building, Washington, DC 20503; Attention: Desk Officer for U.S. Department of Education.

The Department considers comments by the public on this proposed collection of information in—

- Evaluating whether the proposed collection of information is necessary for the proper performance of the functions of the Department, including whether the information will have practical use;
- Evaluating the accuracy of the Department's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;
- Enhancing the quality, usefulness, and clarity of the information to be collected; and
- Minimizing the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology; *e.g.,* permitting electronic submission of responses.

OMB is required to make a decision concerning the collection of information contained in these proposed regulations between 30 and 60 days after publication of this documentation in the Federal Register. Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. This does not affect the deadline for the public to comment to the Department on the proposed regulations.

Invitation to Comment

Interested persons are invited to submit comments and recommendations regarding these proposed regulations.

All comments submitted in response to these proposed regulations will be available for public inspection, during and after the comment period, in room 3042, Regional Office Building 3, 7th and D Streets, SW., Washington, DC, between the hours of 8:30 a.m. and 4:00 p.m., Monday through Friday of each week except Federal holidays.

Assessment of Educational Impact

The Secretary particularly requests comments on whether the proposed regulations in this document would require transmission of information that is being gathered by or is available from any other agency or authority of the United States.

List of Subjects in 34 CFR Part 682

Administrative practice and procedure, Colleges and universities, Education, Loan Programs, Reporting and recordkeeping requirements, Student aid, Vocational education.

Dated: September 12, 1996.

Richard W. Riley,

Secretary of Education.

(Catalog of Federal Domestic Assistance Number 84.032 Federal Family Education Loan Program)

The Secretary proposes to amend title 34 of the Code of Federal Regulations by revising Part 682 as follows:

PART 682—FEDERAL FAMILY EDUCATION LOAN (FFEL) PROGRAM

1. The authority citation for Part 682 continues to read as follows:

Authority: 20 U.S.C. 1071 to 1087–2, unless otherwise noted.

2. Section 682.401 is amended by adding a new paragraph (b)(28) to read as follows:

§ 682.401 Basic program agreement.

* * * * *

(b) * * *

(28) *Change in agency's records system.* The agency shall provide written notification to the Secretary 30 days prior to placing its new guarantees or converting the records relating to its existing guaranty portfolio to an information or computer system that is owned by or otherwise under the control of an entity that is different than the party that owns or controls the agency's existing information or computer system. If the agency is soliciting bids from third parties with respect to a proposed conversion, the agency shall provide written notice to the Secretary as soon as the solicitation begins. The notifications described in this paragraph must include a concise description of the agency's conversion project and the actual or estimated cost of the project.

* * * * *

3. Section 682.410 is amended by revising the introductory text in paragraph (a)(2), revising paragraphs (a)(2) (i), (ii), and (x), and adding new paragraphs (a)(11)(iii) and (b)(11) to read as follows:

§ 682.410 Fiscal, administrative, and enforcement requirements.

(a) * * *

(2) *Uses of reserve fund assets.* A guaranty agency may not use the assets of the reserve fund established under paragraph (a)(1) of this section to pay costs prohibited under § 682.418, but shall use the assets of the reserve fund to pay only—

(i) Insurance claims that meet the requirements of § 682.406 at the time the claims are paid;

(ii) Costs that are reasonable, as defined under § 682.410(a)(11)(iii), and that are ordinary and necessary for the

agency to fulfill its responsibilities under the Act, including costs of collecting loans, providing preclaims assistance, monitoring enrollment and repayment status, and carrying out any other guaranty activities. Those costs must be—

(A) Allocable to the FFEL Program;

(B) Not prohibited under applicable Federal, State, or local laws or regulations;

(C) In compliance with any limitations or exclusions contained in the regulations in this part, Federal laws, terms and conditions of the agency's agreements with the Secretary, or other governing regulations as to types or amounts of cost items;

(D) Not higher than the agency would incur under established policies, regulations, and procedures that apply to any non-Federal activities of the guaranty agency;

(E) Not included as a cost or used to meet cost sharing or matching requirements of any other federally supported activity, except as specifically provided by Federal law;

(F) The net of all applicable credits; and

(G) Documented in accordance with applicable legal and accounting standards;

* * * * *

(x) Any other costs or payments ordinary and necessary to perform functions directly related to the agency's responsibilities under the Act and for their proper and efficient administration;

* * * * *

(11) * * *

(iii) *Reasonable cost* means a cost that, in its nature and amount, does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. The burden of proof is upon the guaranty agency, as a fiduciary under its agreements with the Secretary, to establish that costs are reasonable. In determining reasonableness of a given cost, consideration must be given to—

(A) Whether the cost is of a type generally recognized as ordinary and necessary for the proper and efficient performance and administration of the guaranty agency's responsibilities under the Act;

(B) The restraints or requirements imposed by factors such as sound business practices, arms-length bargaining, Federal, State, and other laws and regulations, and the terms and conditions of the guaranty agency's agreements with the Secretary; and

(C) Market prices of comparable goods or services.

* * * * *

(b) * * *

(11) *Conflicts of interest.* (i) A guaranty agency shall maintain and enforce written standards of conduct governing the performance of its employees, officers, trustees, and agents engaged in the selection, award, and administration of contracts or agreements. The standards of conduct must, at a minimum, require disclosure of financial or other interests and must mandate disinterested decisionmaking. The standards must provide for appropriate disciplinary actions to be applied for violations of the standards by employees, officers, trustees, or agents of the guaranty agency, and must include provisions to—

(A) Prohibit any employee, officer, trustee, or agent participating in the selection, award, or decisionmaking as to the administration of a contract or agreement supported by the reserve fund described in paragraph (a) of this section if that participation would create a conflict of interest. Such a conflict would arise if the employee, officer, trustee, or agent, or any member of his or her immediate family, his or her partner, or an organization that employs or is about to employ any of those parties has a financial or ownership interest in the organization selected for an award or would benefit from the decision made in the administration of the contract or agreement. The prohibitions described in this paragraph do not apply to employees of a State agency covered by codes of conduct established under State law;

(B) Ensure sufficient separation of responsibility and authority between its lender claims processing as a guaranty agency and its lending or loan servicing activities or both within the guaranty agency or between that agency and one or more affiliates, including independence in direct reporting requirements and such management and systems controls as may be necessary to demonstrate, in the independent audit required under § 682.410(b)(1), that claims filed by another arm of the guaranty agency or by an affiliate of that agency receive no more favorable treatment than that accorded the claims filed by a lender or servicer that is not an affiliate or part of the guaranty agency; and

(C) Prohibit the employees, officers, trustees, and agents of the guaranty agency from soliciting or accepting gratuities, favors, or anything of monetary value from contractors or parties to agreements, except that nominal and unsolicited gratuities, favors, or items may be accepted.

(ii) *Guaranty agency restructuring.* If the Secretary determines that action is necessary to protect the Federal fiscal interest because of an agency's failure to meet the requirements of § 682.410(b)(11)(i), the Secretary may require the agency to comply with any additional measures that the Secretary believes are appropriate, including the total divestiture of the agency's non-FFEL functions and the agency's interests in any affiliated organization.

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4. A new § 682.418 is added to subpart D to read as follows:

§ 682.418 Prohibited uses of reserve fund assets.

(a) *General.* (1) A guaranty agency may not use the assets of the reserve fund established under § 682.410(a)(1) to pay costs prohibited under paragraph (b) of this section and may not use the assets of the reserve fund to pay for goods, property, or services provided by an affiliated organization that would exceed the affiliated organization's actual and reasonable cost of providing those goods, property, or services, unless the agency demonstrates to the Secretary, and receives the Secretary's concurrence, that such a payment would be in the Federal fiscal interest.

(2) All guaranty agency contracts with respect to its reserve fund or assets must include a provision stating that the contract is terminable by the Secretary upon 30 days notice to the contracting parties if the Secretary determines that the contract includes an impermissible transfer of the reserve fund or assets or is otherwise inconsistent with the terms and purposes of section 422 of the HEA.

(b) *Prohibited uses of reserve fund assets.* A guaranty agency may use the assets of the reserve fund established under § 682.410(a)(1) only as prescribed in § 682.410(a)(2). Uses of the reserve fund that are not allowable under § 682.410(a)(2) include, but are not limited to—

(1) *Advertising,* either directly or through a third party, except for those advertising costs solely related to recruitment of personnel, procurement of goods or services, or disposal of surplus materials;

(2) *Compensation for personnel services,* including wages, salaries, pension plan costs, post-retirement health benefits, employee life insurance, unemployment benefit plans, severance pay, costs of leave, and other benefits, to the extent that total compensation to an employee, officer, trustee, or agent of the guaranty agency is not reasonable

for the services rendered. Compensation is considered reasonable to the extent that it is comparable to that paid in the labor market in which the guaranty agency competes for the kind of employees involved. Costs that are otherwise unallowable may not be considered allowable solely on the basis that they constitute personnel compensation. In no case may the reserve fund be used to pay any compensation, whether calculated on an hourly basis or otherwise, that would be proportionately greater than 118.05 percent of the total salary paid (as calculated on an hourly basis) under section 5312 of title 5, United States Code (relating to Level I of the Executive Schedule).

(3) *Contributions and donations,* including cash, property, and services, by the guaranty agency to others, regardless of the recipient or purpose, unless pursuant to written authorization from the Secretary;

(4) *Entertainment,* including amusement, diversion, hospitality suites, and social activities, and any costs associated with those activities, such as tickets to shows or sports events, meals, alcoholic beverages, lodging, rentals, transportation, and gratuities;

(5) *Fines, penalties, damages, and other settlements* resulting from violations or alleged violations of the guaranty agency's failure to comply with Federal, State, or local laws and regulations that are unrelated to the FFEL Program. This prohibition does not apply if the violation or alleged violation occurred as a result of compliance with specific requirements of the FFEL Program or in accordance with written instructions from the Secretary;

(6) *Legal expenses* for prosecution of claims against the Federal government, unless the guaranty agency substantially prevails on those claims. In that event, the Secretary approves the reimbursement of reasonable legal expenses incurred by the guaranty agency;

(7) *Lobbying activities,* as defined in section 501(h) of the Internal Revenue Code, including dues to membership organizations to the extent that those dues are used for lobbying;

(8) *Major expenditures,* including those for land, buildings, equipment, or information systems, whether singly or as a related group of expenditures, that exceed 5 percent of the guaranty agency's reserve fund balance at the time the expenditures are made, unless the agency has provided written notice of the intended expenditure to the Secretary 30 days before the agency makes or commits itself to the expenditure. For those expenditures involving the purchase of an asset, the term ''major expenditure'' applies to costs such as the cost of purchasing the asset and making improvements to it, the cost to put it in place, the net invoice price of the asset, ancillary charges, such as taxes, duty, protective in transit insurance, freight, and installation costs, and the costs of any modifications, attachments, accessories, or auxiliary apparatus necessary to make the asset usable for the purpose for which it was acquired, whether the expenditures are classified as capital or operating expenses;

(9) *Public relations,* and all associated costs, paid directly or through a third party, to the extent that those costs are used to promote or maintain a favorable image of the guaranty agency. The term ''public relations'' does not include any activity that is ordinary and necessary for the fulfillment of the agency's FFEL guaranty responsibilities under the Act, such as training of program participants and secondary school personnel and customer service functions that disseminate FFEL-related information and materials to schools, loan holders, prospective loan applicants, and their parents. In providing that training at workshops, conferences, or other ordinary and necessary forums customarily used by the agency to fulfill its responsibilities under the Act, the agency may provide light meals and refreshments of a reasonable nature and amount to the participants;

(10) *Relocation of employees* in excess of an employee's actual or reasonably estimated expenses or for purposes that do not benefit the administration of the guaranty agency's FFEL program. Except as approved by the Secretary, reimbursement must be in accordance with an established written policy; and

(11) *Travel expenses* that are not in accordance with a written policy approved by the Secretary or a State policy. If the guaranty agency does not have such a policy, it may not use the assets of the reserve fund to pay for travel expenses that exceed those allowed for lodging and subsistence under subchapter I of chapter 57 of title 5, United States Code, or in excess of commercial airfare costs for standard coach airfare, unless those accommodations would require circuitous routing, travel during unreasonable hours, excessively prolonged travel, would result in increased cost that would offset transportation savings, or would offer accommodations not reasonably adequate for the medical needs of the traveler.

(c) *Cost allocation.* Each guaranty agency that shares costs with any other program, agency, or organization shall develop a cost allocation plan consistent with the requirements described in OMB Circular A–87 and maintain the plan and related supporting documentation for audit. A guaranty agency is required to submit its cost allocation plans for the Secretary's approval if it is specifically requested to do so by the Secretary.

(Authority: 20 U.S.C. 1078)

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