LEGAL SERVICES CORPORATION

45 CFR Part 1629

Bonding of Recipients

AGENCY: Legal Services Corporation.

ACTION: Final rule.

SUMMARY: This rule requires any non-governmental recipient of Corporation funds to obtain a bond or bonds to indemnify such recipients against loss resulting from the fraud or lack of integrity, honesty or fidelity of directors, officers, employees or agents of such recipients. It provides protection for recipients and the Corporation against such acts and ensures that scarce resources will not be misappropriated.

EFFECTIVE DATE: August 16, 1984.

FOR FURTHER INFORMATION CONTACT: Richard N. Bagenstos, Assistant General Counsel, (202) 272-4010.

SUPPLEMENTARY INFORMATION: On June 6, 1984, the Legal Services Corporation published in the Federal Register (49 FR 23395) a proposed rule concerning a requirement that all recipients carry fidelity bonds to cover those affiliated with the programs who handle LSC funds. The proposed rule would have set the level of the bond required at twenty-five (25) percent of the program's annualized LSC funding level. Interested parties were given thirty days, until July 6, 1984, to submit comments on the proposed rule. Twenty-two comments were received by the end of the comment period and were given thorough consideration. Other comments received after the comment period closed also were reviewed, and no new issues were raised in those comments.

This rule implements a policy articulated by the Corporation's Board at its meeting in Savannah, Georgia on March 30, 1984, that all persons who handle Corporation funds granted to recipients be bonded against loss due to fraud or dishonesty. Instances of dishonesty such as misappropriation of funds for personal use, embezzlement of funds, personal use of program credit cards, falsification of travel and housing documents, defalcation of petty cash funds, misuse of client trust funds and embezzlement of interest payments involving programs in various parts of the country have been documented by the Corporation. Sanctions in these cases have ranged from reprimands through discharge to successful criminal prosecution. While in some cases restitution was made, in others, where the programs were not bonded, they absorbed the losses. If a mandatory bonding requirement had been in place at the time of such incidents, the programs would not have been forced to bear the entire loss. The Corporation's research reveals that most programs currently carry coverage against fraud and dishonesty at some level. The purpose of this regulation is to make mandatory a requirement for adequate protection for the limited funds available to serve eligible clients.

This rule is authorized by the mandate in the Legal Services Corporation Act, as amended, to provide economical and effective legal assistance to eligible clients, and to ensure the compliance of recipients and their employees with the provisions of the Act, regulations, rules and guidelines promulgated by the Corporation.

Section 1629.1 of the rule requires that a program carry bond coverage of a value equal to at least ten (10) percent of the progam's previous year annualized LSC funding level, or a minimum of $50,000. The proposed rule would have required a bond equal to twenty-five (25) percent of a program's annual LSC funding level. On the basis of comments received as well as on its own extensive study of the matter, the Corporation has determined that a level of 10% of annualized funding would provide adequate protection for all but the smallest programs. The $50,000 minimum level was set on the basis of comments and in response to the recognition that a loss to a small program is proportionately greater in effect than a similar one to a large program. Language was added to make it clear that the requirement extended to new grantees or contractors as well as those already receiving LSC funds.

A number of comments suggested that the level be set by each local program. After consideration, the Corporation determined to retain a mandatory level of bonding, to ensure adequacy of coverage. While proper coverage varies with circumstances, a preponderence of the comments appeared to agree that a 10% level is adequate protection and not excessive or burdensome in cost.

Section 1629.2 of the rule requires that at least those directors, officers, employees and agents who handle funds or property of the program as defined in Section 1629.3 shall be covered by the required bond or bonds to protect the program against loss due to acts of fraud and dishonesty on the part of such persons.

Section 1629.3 provides guidance concerning what constitutes the handling of funds or property. Generally, handling means a relationship to the funds or property which gives rise to a risk of loss. Such risk of loss can occur through physical contact with cash, etc. However, persons who from time to time perform counting, packaging, tabulating, messenger or similar duties of an essentially clerical character involving physical contact with funds or other property would not be "handling" when they perform these duties under conditions and circumstances where risk of loss is negligible because of factors such as close supervision and control or the nature of the property.

Risk of loss may also arise through the power to exercise contact or control, or the power to transfer property. If a person meets such criteria, this rule requires that he or she be covered by the bond, whether individual or blanket. Persons who actually disburse funds or property or sign checks or similar instruments should be considered as being in this category. Whether other persons who may influence, authorize or direct disbursements or the signing or endorsing of checks or similar instruments would be considered to be "handling" funds or other property should be determined by reference to the risk of loss arising from the particular duties or responsibilities of such persons.

A person with supervisory authority over those described above may be considered "handling" under the terms of the proposed rule. However, to the extent that only general responsibility for the conduct of the business affairs of the program is involved, including such functions as approval of contracts, authorization of disbursements, auditing of accounts and similar responsibilities, such persons would be considered to be "handling" only when the facts of the particular case raise the possibility that funds or other property of the program are likely to be lost in the event of fraud or dishonesty. The mere fact of general supervision would not necessarily, in and of itself, mean that such persons are "handling."

In Section 1629.4, the rule defines "fraud" and "dishonesty" as used in this Part. That section makes it clear that the major criterion is risk of loss of the program, and that the required bond must provide for recovery for loss even though the act giving rise to the loss by the program does not result in personal gain for the person committing the act.

Section 1629.5 describes permissible forms of bonds, making it clear that blanket or schedule bonds are appropriate as well as individual bonds which aggregate at least the required level of ten (10) percent of the program's annualized funding.

Section 1629.6, providing that programs which choose to bond individuals rather than to carry a blanket bond for the program shall fix the amount required annully pursuant to a formula provided in that section, has been deleted in response to comments. This deletion does, not, however, prevent the use of individual bonds to fulfill the requirement of the regulation so long as such bonds aggregate to the minimum required coverage.

Section 1629.7, providing that the programs must report bond coverage in their applications for refunding, beginning with FY 1985, has been renumbered 1629.6.

List of Subjects in 45 CFR Part 1629

Legal services, Bonding.

For the reasons set out in the preamble a new 45 CFR Part 1629 is added as follows:

PART 1629—BONDING OF RECIPIENTS

Sec.

Authority: Secs. 1006(b)(1)(A) and 1007(a)(3), Pub. L. 93-355, as amended, Pub. L. 95-222 (42 U.S.C. 2996e(1)(A) and 2996f(3)).

§ 1629.1 General.

(a) If any program which receives Corporation funds is not a government, or an agency or instrumentality thereof, such program shall carry fidelity bond coverage at a minimum level of at least ten (10) percent of the program's annualized LSC funding level for the previous fiscal year, or of the initial grant or contract, if the program is a new grantee or contractor. No coverage