Rules and Regulations

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DEPARTMENT OF AGRICULTURE

Food and Nutrition Service

7 CFR Parts 210 and 220

National School Lunch and Breakfast Programs; Revision of School Food Service Accountability Requirements

AGENCY: Food and Nutrition Service, USDA.

ACTION: Interim rule.

SUMMARY: The Food and Nutrition Service (FNS) is amending the regulations for the National School Lunch Program (NSLP) and School Breakfast Program (SBP) on an interim basis to restructure the financial accountability requirements for these programs. Under this rule, the determination of nonprofit status, as a condition for program participation, is made by determining the financial status of the school food service as a whole rather than the financial status of each Federal program and nongrant activity separately. This Interim rule sets forth definitions for nonprofit school food service and for revenue to such food service and requires School Food Authorities (SFAs) to maintain appropriate revenue and expenditure records in order to substantiate the nonprofit status of their school food service. State agencies (SAs) are responsible for establishing the accounting systems for SFAs to use. This rule eliminates the requirement that cost be considered in assigning and paying NSLP and non-severe need SBP reimbursements to SFAs. The term "operating balance" is eliminated and instead, SAs are responsible for monitoring nonprofit school food service net cash resources. SAs are also responsible for establishing systems for determining and monitoring SBP costs for the purpose of establishing eligibility for and determining payment of severe need SBP reimbursement rates.

This rule simplifies Federal program requirements, reduces federally required reporting and recordkeeping burdens for SFAs, removes the program specific restrictions on Federal reimbursement, and provides added flexibility to SFAs in financing school food service operations. The rule also provides SAs with additional flexibility in administering the National School Lunch and School Breakfast Programs.

DATES: Effective October 1, 1982. To be assured of consideration, comments must be postmarked on or before December 31, 1982.

ADDRESSES: Comments may be mailed to Stanley C. Garnett, Branch Chief, Policy and Program Development Branch, School Programs Division, FNS, USDA, Alexandria, Virginia 22302. Comments may also be delivered or reviewed during regular business hours (8:30 a.m. to 5:00 p.m., Monday through Friday) at 3101 Park Center Drive, Alexandria, Virginia.

FOR FURTHER INFORMATION CONTACT: Stanley C. Garnett, Branch Chief, Policy and Program Development Branch, School Programs Division, FNS, USDA, Alexandria, Virginia 22302, (703) 756–3620.

SUPPLEMENTARY INFORMATION:

Classification

This action has been reviewed under Executive Order 12291 and has been classified as not major because it does not meet any of the three criteria identified under the Executive Order. It does not have an annual effect on the economy of $100 million or more, nor does it result in major increases in costs or prices for consumers; individual industries; Federal, State or local government agencies; or geographic regions. Furthermore, it does not have significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of U.S. based enterprises to compete with foreign-based enterprises in domestic or export markets.

This rule has also been reviewed with regard to the requirements of Pub. L. 96–354, the Regulatory Flexibility Act. Samuel J. Cornelius, Administrator of the Food and Nutrition Service, has certified that this proposed rule will not have a significant adverse economic impact on a substantial number of small entities although it could affect virtually all SFAs participating in the School Nutrition Programs.

The Department is issuing this as an interim rule rather than a final to provide States and local school food authorities the opportunity to comment based on actual operational experience. In accordance with the Paperwork Reduction Act of 1980 (44 U.S.C. 3507), the reporting and/or recordkeeping requirements that are included in § 210.14(a–1) and § 210.14(g)(3) of this interim rule will be submitted for approval to the Office of Management and Budget (OMB). They are not effective until OMB approval has been obtained.

Background

On April 9, 1982, the Department published a proposed rule in the **Federal Register** (47 FR 15342) to restructure the financial accountability requirements for the NSLP and SBP. The proposal was designed to implement Section 819 of Pub. L. 97–35 which removed most references to cost accountability from the provisions of the National School Lunch and Child Nutrition Acts dealing with the use of Federal reimbursements in these programs. Under Section 819, Federal NSLP and non-severe need SBP funds are no longer restricted by law to the financing of certain specified costs, i.e., food used in the NSLP in the case of Section 4 NSLP funds, the service of free and reduced price lunches in the case of Section 11 NSLP funds, and the service of breakfasts in the case of non-severe need SBP funds. Also eliminated by Section 819 of Pub. L. 97–35 was the provision in Section 12 of the National School Lunch Act which limited total reimbursement received by any SFA under the NSLP and SBP to the net cost of operating these programs. The revised legislation now requires only that NSLP and non-severe need SBP funds be used to assist SFAs in providing program benefits within an overall nonprofit school food service environment.

With the elimination of program specific Federal cost restrictions, SAs could allow SFAs to use Federal NSLP/Commodity and non-severe need SBP reimbursements to support their overall nonprofit school food service. Under this concept, Federal reimbursements could be used to support non-program food service, such as a la carte service, in

addition to NSLP and SBP food service. This would be a rare occurrence, however, since SFAs have traditionally utilized profits from a la carte sales to subsidize their NSLP and SBP operations.

In addition to providing SFAs with some added flexibility in financing their nonprofit school food service operations this concept would decrease the amount of recordkeeping and reporting at the SFA level since separate costs for the NSLP, SBP and other school food service would not be required. However, SFAs would still be required to maintain revenue and expenditure records sufficient to establish the nonprofit status of their food service operations.

This revision in Federal program accountability requirements does not alter existing Federal financial management standards. The requirement that SAs establish and maintain financial management systems conforming to the standards enumerated in Departmental regulations (7 CFR Part 3015, Subpart H) remains in effect. In so doing, State agencies would have the option of continuing their established cost-based accounting systems if they wish or of establishing new or revised financial management systems to monitor and support revised Federal program accountability requirements. This is in keeping with the Department's long established policy of allowing SAs to impose additional requirements for participation in the NSLP and SBP which may be more stringent than the Department's regulations but are not inconsistent with them. It should be noted, however, that reductions in accounting and recordkeeping at the local level will be dependent upon the extent to which SAs alter their existing cost-based accounting systems.

In response to the April 9 proposal, the Department received 29 comments. Only two commentors clearly disapproved of the proposed rule. Of the remaining comments, 18 indicated general approval of the Department's overall approach while 11 of these offered specific recommendations for change. The remaining nine comments did not indicate approval or disapproval but did offer specific recommendations that were in line with the overall philosophy of the proposal. In view of this, the Department also considers these comments as generally supportive of the proposal. The Department would like to thank all of the commentors who responded to the proposal. Especially appreciated were the detailed suggestions made by many of the commentors which were very helpful in formulating this interim rule.

The remainder of this preamble will discuss the specific changes in program financial requirements that are being made under this interim rule. For ease of reference the changes are presented under the same headings and in the same order as in the preamble of the proposed rule.

1. *Assignment of NSLP reimbursement rates*—Under the proposal, SAs would continue to be required to assign NSLP reimbursement rates to participating SFAs at the beginning of each school year but would no longer be required to assign varying rates of reimbursement based on the anticipated cost of producing a lunch and certain specific anticipated revenues available to meet that cost. Those State agencies that wished to vary Federal reimbursements to SFAs, within the maximum rates established by the Secretary, would have had the option to do so based on the anticipated cost of producing lunches and the relative need of participating SFAs as reflected by the anticipated availability of State and local revenues.

One commentor stated that the reference to cost in discussing the option of assigning varying rates implies that only States with cost based accounting procedures would be able to exercise this option. While cost based accounting would provide a good basis for varying rates of reimbursement, the Department does not intend that this be the only basis. The Department believes that SAs should have the flexibility to assign varying rates based on the financial condition of SFAs as determined by the SA through its established accounting and reporting system. Accordingly, § 210.11(b) has been revised in this interim rule to provide SAs with this flexibility.

2. *Payment of NSLP and non-severe need SBP reimbursements*—Under the proposal, SAs would no longer be required by Federal regulation to consider cost in the payment of NSLP and non-severe need SBP reimbursements to SFAs. However, SAs could retain their existing cost-based systems and continue to limit program reimbursements to allowable program costs.

Commentors addressing this provision expressed support for this approach. Some felt that the elimination of cost considerations in the actual payment of NSLP reimbursements would provide SFAs with added flexibility in financing their nonprofit school food service operations and would decrease accounting, recordkeeping and reporting burdens at both the SFA and SA levels. Others, however, while supporting the financial flexibility afforded by this provision also expressed support for cost based accounting as an effective management tool. In response, the Department wishes to make it clear that this provision does not preclude SAs from maintaining or modifying existing cost-based accounting procedures. Furthermore, a SA could limit NSLP and non-severe need SBP reimbursement to the respective or combined costs of those programs. The Department believes that this degree of flexibility is desirable in meeting individual State needs and is retaining the proposed change in this interim rule.

3. *Nonprofit school food service*—Under the proposal, a SFA would have been required to maintain a nonprofit school food service as a condition for participating in the NSLP and/or SBP. Nonprofit school food service was defined as all food service operations conducted by the SFA principally for the benefit of school children. These operations would include the National School Lunch, School Breakfast and Special Milk Programs and could also include a la carte or other food service operations if all revenues generated by or attributable to these operations are used solely for the benefit of the nonprofit school food service.

SFAs would be required to maintain records of their nonprofit school food service revenues and expenditures in accordance with the accounting system established by the SA. However, if the SFA participates in the SMP it would be required to account separately for milk purchased and served under that Program. Also, if the SFA receives severe need SBP reimbursement rates for any of its schools, it would be required to conform to the accounting system established by the SA for documenting SBP costs.

Four comments were received on the nonprofit school food service revenue/expenditure recordkeeping requirements. Two commentors indicated that the Department should specify the accounting, recordkeeping and reporting procedures for SFAs to use while two others were concerned that overall recordkeeping burdens would not be reduced substantially by the proposal. In response to these comments, the Department believes that SA flexibility in this area is essential to accommodate State and local management and accounting requirements while ensuring compliance with Federal program requirements. As indicated earlier in this preamble, the accounting and reporting systems adopted by the SA will determine the extent to which paperwork burdens will

be reduced at the local level. The Department believes, however, that substantial reductions can be made. For these reasons, the provisions of the proposed rule in this area have not been changed in this interim rule.

The proposed treatment of nonstudent meals served within the nonprofit school food service remains the same in this interim preamble but in response to two commentors, is reworded for clarity as follows: It is the Department's policy that nonstudent meals (except for food service workers and supervisory adults) served within the nonprofit school food service not be supported by that food service except by revenues from or specifically contributed for such nonstudent meals. To comply with this policy in the absence of specific per meal cost information, SFAs shall insure that the price charged for nonstudent meals is not less than the full price for a paying child plus the Federal reimbursement for a paid meal and the per meal value of USDA donated commodities. Downward adjustments in nonstudent meal prices may be made to reflect revenues specifically contributed to the nonprofit school food service for the support of such meals. For example, a school district may subsidize teacher's meals as a fringe benefit.

Under the proposed rule, SFAs would have also been required to account separately for all competitive food services which are not operated as part of the SFA's nonprofit school food service. Profits from any such competitive food service operations could be used only for the benefit of the nonprofit school food service, the SFA or individual school, or student organizations approved by the SFA or school. Fifteen comments were received on these provisions. Most of these commentors (10) expressed concern that the rule as written could require SFAs to account for all food sales occurring within the SFA regardless of sponsor or location; for example, food and beverage sales at school athletic events sponsored by student organizations. While schools do have the authority to authorize and control such food service, commentors did not feel that it was properly subject to the accountability requirements of the NSLP and SBP. The Department agrees and has clarified this interim rule to require that SFAs account only for food service operations conducted by the SFA.

4. *Allowable expenditures*—Under the proposed rule, expenditures of nonprofit school food service revenues would be limited to allowable school food service direct and indirect costs in accordance with OMB Circular A–87 and Departmental regulations (7 CFR Part 3015) on allowable costs.

The Department also proposed to allow nonprofit school food service revenues to be used for capital expenditures associated with altering or otherwise improving nonprofit school food service facilities. The purchase of land or buildings was not allowed. Generally, commentors supported this provision but some expressed concern that revenues which should be used to improve meal quality or lower student prices might be used for capital expenditures instead. The Department is sensitive to such concerns but recognizes the increasing need for financial flexibility at the local level as well as the need for adequate facilities in order to provide quality food service. Therefore, this interim rule will allow nonprofit school food service revenues to be used for altering or improving school food service facilities. However, since the department believes that the nonprofit school food service is not intended to provide school real estate facilites, the interim rule will prohibit the expenditure of nonprofit school food service revenues for the purchase of land or the purchase or construction of buildings.

5. *Revenue*—The definition of nonprofit school food service revenue in this rule remains essentially the same as proposed. In response to comments received, the definition has been slightly reworded to accommodate either cash or accrual accounting systems.

6. *Net cash resources*—The proposed rule eliminated the term "operating balance" and instead, would have required State agencies to monitor the net cash resources available to each SFA's school food service. Net cash resources were defined as including but not being limited to, cash on hand, cash receivable, accrued earnings on investments, cash on deposit and the value of stocks, bonds or other negotiable securities less cash payable. The value of food inventories were not included in net cash resources. SFAs would have been required to limit their net cash resources to an amount that did not exceed three months normal operating cost of their nonprofit school food service. State agencies would have been given the flexibility of monitoring net cash resources during audits and supervisory assistance reviews. If the State agency determined that an SFA's net cash resources exceeded three months normal operating cost for the SFA's nonprofit school food service, corrective action would have been required. The proposal specified the types of corrective action that could be undertaken. As part of its ongoing management evaluation process, FNS would review each State agency's system for monitoring and controlling the net cash resources of SFAs.

These provisions generated more comments (19) than any other part of the proposed rule. Major concerns were:

a. The definition of net cash resources is based on accrual accounting. Some States and SFAs utilize cash based accounting systems.

b. The determination of three months normal operating cost would require a cost based accounting system.

c. The three month operating cost limit is not sufficient for many SFAs since it would not allow for advance volume purchasing or for food service equipment replacement.

d. The proposed regulations do not specify how the monitoring of net cash resources is to be accomplished or the frequency of that monitoring.

In response to these valid concerns the Department has made the following changes in this interim rule:

a. The definition of net cash resources has been changed to accommodate cash as well as accrual accounting systems.

b. The regulatory guideline limit for net cash resources has been changed from "three months normal operating cost" to "three months average expenditures".

c. SAs have been given the authority to approve higher or lower net cash resource limits on an individual SFA basis according to the needs of each SFA. SAs will be required to develop and maintain criteria for approving such higher or lower limits. These criteria would be subject to review by FNS.

d. In order to afford SAs maximum flexibility in monitoring the net cash resources of SFAs, the Department is not specifying the method or frequency of review. However, as guidance to SAs this interim rule suggests that the monitoring of net cash resources be accomplished through audits and/or supervisory assistance reviews, and should be conducted at a minimum within the frequency required for such reviews and audits.

7. *Severe need reimbursement rates for the SBP*—Under the proposed rule, State agencies would be allowed to set up their own systems or to continue existing systems for determining and monitoring breakfast costs where such costs were needed to determine eligibility for and payment of severe need breakfast reimbursement rates. Per meal breakfast costs would be used in the determination of severe need eligibility as well as in the payment of severe need breakfast reimbursement.

Depending upon the accounting system used by the SFA, per meal costs could be determined on an overall SFA basis or on a school basis. For any school year, severe need reimbursement payments to any SFA would be limited to the lesser of: (1) The cost of providing free and reduced price breakfasts to eligible children in schools determined to be in severe need (per meal cost multiplied by the number of free and reduced price breakfasts served) less the reduced price payments received by such schools; or (2) the number of free and the number of reduced price breakfasts served to eligible children in schools determined to be in severe need multiplied by the applicable severe need reimbursement rates.

Two commentors pointed out that Pub. L. 97–35 makes schools with State mandated breakfast programs automatically eligible for severe need reimbursement rates until July 1, 1983 for States with annual legislatures and July 1, 1984 for States with biennial legislatures. Therefore, these schools should be exempted from the reimbursement cost comparison in the SBP regulations until their automatic severe need eligibility expires. The Department agrees and has made the appropriate changes in this interim rule. However, the Department recommends that SAs in the affected States establish accounting procedures for determining eligibility for and the actual payment of severe need SBP reimbursements which can be implemented upon expiration of the exemption.

All other proposed provisions concerning severe need reimbursement remain unchanged in this interim rule.

List of Subjects

7 CFR Part 210

Food assistance programs, National school lunch program, Grant programs—Social programs, Nutrition, Children, Reporting and recordkeeping requirements, Surplus agricultural commodities.

7 CFR Part 220

Food assistance programs, School Breakfast Program, Grant programs—Social programs, Nutrition, Children, Reporting and recordkeeping requirements.

Accordingly, Parts 210 and 220 are amended on an interim basis as follows:

PART 210—NATIONAL SCHOOL LUNCH PROGRAM

1. In § 210.2, paragraph (d) is removed and reserved, a new paragraph (i–2) is added, paragraph (j) is revised to define "nonprofit school food service," and paragraphs (k) and (n–3) are revised to read as follows:

§ 210.2 Definitions.

* * * * *

(i–2) "Net cash resources" means all monies, as determined in accordance with the State agency's established accounting system, that are available to or have accrued to a School Food Authority's nonprofit school food service at any given time, less cash payable. Such monies may include but are not limited to, cash on hand, cash receivable, earnings on investments, cash on deposit and the value of stocks, bonds or other negotiable securities.

(j) "Nonprofit school food service" means all food service operations conducted by the School Food Authority principally for the benefit of school children, all of the revenue from which is used solely for the operation or improvement of such food service.

(k) "Nonprofit" when applied to schools or institutions eligible for the Program means exempt from income tax under the Internal Revenue Code of 1954, as amended; or in the Commonwealth of Puerto Rico, certified as nonprofit by the Governor.

* * * * *

(n–3) "Revenue" when applied to nonprofit school food service means all monies received by or accruing to the nonprofit school food service in accordance with the State agency's established accounting system including, but not limited to, children's payments, earnings on investments, other local revenues, State revenues, and Federal cash reimbursements.

* * * * *

2. In § 210.7, paragraph (b) is revised to read as follows:

§ 210.7 Use of funds.

* * * * *

(b) Revenues received by the nonprofit school food service in any School Food Authority shall be used only for the operation or improvement of such food service: *Provided, however,* That such revenues shall not be used to purchase land or buildings or to construct buildings.

* * * * *

3. In § 210.8, the words "lunch program" in paragraphs (e)(10) and (e)(11) are changed to read "nonprofit school food service"; in paragraph (e)(14) the words "lunch program" are changed to read "school food service"; and paragraphs (e)(1) and (e)(2) are revised as follows:

§ 210.8 Requirements for participation.

* * * * *

(e) * * *

(1) Maintain a nonprofit school food service and observe the limitations on the use of nonprofit school food service revenues set forth in § 210.7(b) and the limitations on any competitive school food service as set forth in § 210.15b of this part;

(2) Limit its net cash resources to an amount that does not exceed three months average expenditures for its nonprofit school food service; or such other amount as may be approved by the State agency, or FNSRO where applicable.

* * * * *

§ 210.8a [Amended]

4. In § 210.8a, paragraph (f) is amended by changing the words "feeding operation" to "nonprofit school food service".

5. In § 210.11, the last sentence of paragraph (c) is removed, paragraph (d) is removed, and paragraphs (e) and (f) are redesignated (d) and (e), respectively. The second and third sentences of paragraph (a), the second sentence of paragraph (b), and redesignated paragraph (d) are revised to read as follows:

§ 210.11 Reimbursement payments.

* * * * *

(a) * * * General cash-for-food assistance payments shall be made to assist schools in obtaining food for the program. Special cash assistance payments shall be made to assist schools in providing free and reduced price lunches to children eligible for such lunches. * * *

(b) * * * At the beginning of the school year, State agencies, or FNSROs where applicable shall, within these maximum rates of reimbursement, initially assign rates of reimbursement for School Food Authorities or for schools through School Food Authorities. Such rates of reimbursement may be assigned at levels based on financial condition. * * *

* * * * *

(d) The total general cash-for-food assistance reimbursement and special cash assistance reimbursement paid to any School Food Authority for lunches served to children during the school year shall not exceed the sum of the products obtained by multiplying the total number of free, reduced price and paid lunches respectively, served to eligible children during the school year by the applicable maximum per lunch reimbursement for each type of lunch prescribed for the school year.

* * * * *

§ 210.13 [Amended]

6. In § 210.13, paragraph (a) is amended by removing the words "and other information concerning the operation of its nonprofit lunch program as set forth in paragraph (c) of this section," and paragraph (b) is amended by changing the reference to § 210.14(g)(2) in the first sentence to § 210.14(g)(1).

7. In § 210.14, paragraphs (a–1) and (g)(3) are revised to read as follows:

§ 210.14 Special responsibilities of State agencies.

* * * * *

(a–1) Each State agency, or FNS where applicable, shall establish a system of accounting under which School Food Authorities shall account for all revenues and expenditures of their nonprofit school food service. The system established shall also permit determination of school food service net cash resources, and shall include criteria for approval of net cash resources in excess of or less than three months average expenditures. In addition, School Food Authorities shall be required to account separately for other food services which are operated by the School Food Authority.

* * * * *

(g) * * *

(3) Within 90 days after the end of each school year each State agency shall submit information on the State revenue matching requirements prescribed in § 210.6 of this Part. This information shall be submitted on a form provided by FNS.

* * * * *

8. Section 210.15 is revised to read as follows:

§ 210.15 Review of net cash resources.

During audits, supervisory assistance reviews or by other means, State agencies, or FNSROs where applicable, shall be responsible for monitoring the net cash resources of the nonprofit school food service of each School Food Authority participating in the Program. In the event that such resources exceed three months average expenditures for the School Food Authority's nonprofit school food service or such other amount as may be approved by the State agency or FNSRO where applicable, the State agency or FNSRO where applicable, may require the School Food Authority to reduce children's prices, improve food quality or take other actions designed to improve the nonprofit school food service. In the absence of any such action, adjustments in the rates of reimbursement under the Program shall be made.

* * * * *

9. In § 210.15b, the first sentence of paragraph (a) is amended by changing the words "a school's nonprofit food service under the program" to "lunches served under the Program", and the second sentence of paragraph (a) is revised as follows:

§ 210.15b Competitive food services.

(a) * * * The sale of competitive foods approved by the Secretary may be allowed at the discretion of the State agency and School Food Authority provided that, any profit from the sale of such foods accrue to the benefit of the nonprofit food service or to the school or to student organizations approved by the school.

* * * * *

PART 220—SCHOOL BREAKFAST PROGRAM

1. In Section 220.2, paragraph (p) is revised and new paragraphs (o–1), (o–2), and (t–1) are added to read as follows:

§ 220.2 Definitions.

* * * * *

(o–1) "Net cash resources" means all monies as determined in accordance with the State agency's established accounting system, that are available to or have accrued to a School Food Authority's nonprofit school food service at any given time, less cash payable. Such monies may include but are not limited to, cash on hand, cash receivable, earnings or investments, cash on deposit and the value of stocks, bonds or other negotiable securities.

(o–2) "Nonprofit school food service" means all food service operations conducted by the School Food Authority principally for the benefit of school children, all of the revenue from which is used solely for the operation or improvement of such food service.

(p) "Nonprofit" when applied to schools or institutions eligible for the Program means exempt from income tax under the Internal Revenue Code of 1954, as amended; or in the Commonwealth of Puerto Rico, certified as nonprofit by the Governor.

* * * * *

(t–1) "Revenue" when applied to nonprofit school food service means all monies received by or accruing to the nonprofit school food service in accordance with the State agency's established accounting system including, but not limited to, children's payments, earnings on investments, other local revenues, State revenues, and Federal cash reimbursements.

* * * * *

2. In § 220.7, paragraph (d)(2) is amended by changing the words "feeding operation" to "nonprofit school food service"; (e)(9), (e)(10) and (e)(13) are amended by changing the words "breakfast program" to "nonprofit school food service"; and (e)(1) is revised to read as follows:

§ 220.7 Requirements for participation.

* * * * *

(e) * * *

(1)(i) Maintain a nonprofit school food service, (ii) use all revenues received by such food service only for the operation or improvement of that food service, except that such revenues shall not be used to purchase land or buildings, or to construct buildings (iii) limit its net cash resources to an amount that does not exceed three months average expenditure for its nonprofit school food service or such other amount as may be approved by the State agency, and (iv) observe the limitations on any competitive food service as set forth in § 220.12 of this part;

* * * * *

3. In § 220.9, paragraph (b) is amended by removing the word "maximum" from the first sentence; paragraphs (c) and (d) are revised, and paragraph (e) is amended by adding a sentence to the end of the paragraph as follows:

§ 220.9 Reimbursement payments.

* * * * *

(c) The total reimbursement for breakfasts served to eligible children in, (1) schools not in severe need, and (2) severe need schools in State's with State Breakfast mandates as provided for in § 220.9(e)(3) (i) and (ii) in any School Food Authority during the school year shall not exceed the sum of the products obtained by multiplying the total numbers of such free, reduced price and paid breakfasts, respectively, by the applicable rate of reimbursement for each type of breakfast as prescribed for the school year.

(d) For any school year, severe need reimbursement payments to any School Food Authority except as provided for in (c) above shall be the lesser of: (1) The cost of providing free and reduced price breakfast to eligible children in schools determined to be in severe need, less the reduced price payments received by such schools; or (2) the number of free and the number of reduced price breakfasts, respectively, that are served to eligible children in schools determined to be in severe need,

multiplied by the applicable severe need reimbursement rates for such breakfasts.

(e) * * * The State agency, or FNSRO where applicable, shall be responsible for establishing systems for determining breakfast costs where such costs are necessary to the determination of whether or not a school is in severe need.

4. In § 220.11, paragraph (c) is revised to read as follows:

§ 220.11 Reimbursement procedures.

* * * * *

(c) Where a school participates in both the National School Lunch Program and the School Breakfast Program, the State agency or FNSRO, where applicable, may authorize the submission of one claim for reimbursement to cover both programs.

* * * * *

5. In § 220.12, the first sentence of paragraph (a) is amended by changing the words "a school's nonprofit food service under the Program" to "breakfasts served under the Program", and the second sentence of paragraph (a) is revised as follows:

§ 220.12 Competitive food services.

(a) * * * The sale of competitive foods approved by the Secretary may be allowed at the discretion of the State agency and School Food Authority provided that the sale of such foods is part of the School Food Authority's nonprofit food service, or if not part of the nonprofit food service, that any profit from the sale of such foods accrue to the benefit of the nonprofit food service or to student organizations approved by the School.

* * * * *

6. In § 220.13, paragraph (i) is revised, paragraph (j) is redesignated paragraph (k) and a new paragraph (j) is added as follows:

§ 220.13 [Amended]

* * * * *

(i) Each State agency, or FNS where applicable, shall establish a system of accounting under which School Food Authorities shall account for all revenues and expenditures of their nonprofit school food service. The system established shall also permit determination of school food service net cash resources, and shall include criteria for approval of net cash resources in excess of three months average expenditures. In addition, School Food Authorities shall be required to account separately for other food services which are operated by the School Food Authority.

(j) During audits, supervisory assistance reviews, or by other means, State agencies, or FNSROs where applicable, shall be responsible for monitoring the net cash resources of the nonprofit school food service of each School Food Authority participating in the Program. In the event that such resources exceed three months average expenditures for the School Food Authority's nonprofit school food service, or such amount as may be approved by the State agency or FNSRO where applicable, the State agency or FNSRO where applicable, may require the School Food Authority to reduce children's prices, improve food quality or take other actions designed to improve the nonprofit school food service. In the absence of any such action, adjustments in the rates of reimbursement under the Program shall be made.

* * * * *

(Catalog of Federal Domestic Assistance Nos. 10.553 and 10.555)

(Sec. 819, Pub. L. 97-35, 95 Stat. 533, 42 U.S.C. 1759a, 1773 and 1757)

Dated: July 14, 1982.

Samuel J. Cornelius,

Administrator, Food and Nutrition Service.

[FR Doc. 82-19479 Filed 7-19-82; 8:45 am]

BILLING CODE 3410-30-M

DEPARTMENT OF THE TREASURY

Comptroller of the Currency

12 CFR Part 2

[Docket No. 82-14]

Disposition of Credit Life Insurance Income

AGENCY: Comptroller of the Currency, Treasury.

ACTION: Final rule.

SUMMARY: The Comptroller of the Currency (OCC) is amending an existing regulation, 12 CFR Part 2, to reflect recommendations of the Federal Financial Institutions Examination Council ("Council"). The amendments clarify the permissibility of bonuses and incentives to bank employees for credit life insurance sales; describe the circumstances under which credit life insurance income may be allocated to bank holding company affiliates other than the bank; and delete unnecessary provisions.

EFFECTIVE DATE: August 19, 1982, except that the reasonable compensation proviso in 12 CFR 2.4(b) is effective May 1, 1983.

FOR FURTHER INFORMATION CONTACT: Ford Barrett, Assistant Chief Counsel, Comptroller of the Currency, Washington, D.C. 20219. Telephone (202) 447-1896.

SUPPLEMENTARY INFORMATION:

Special Studies

The Secretary of the Treasury has certified that the amendments do not require a regulatory flexibility analysis on the ground that the amendments will have no significant economic impact. The amendments will change several minor details of a long standing OCC regulation and bring it into conformity with a policy statement recommended by the Council. In addition, the amendments permit OCC to delete several provisions in the existing regulation that are thought to be unnecessary.

The amendments do not constitute a major rule under section 3 of Executive Order 12291, and therefore no regulatory impact analysis is necessary. The Council concluded that its recommended policy statement, from which the amendments are drawn, will have a beneficial impact on financial institutions. The effect on bank holding companies and individuals was assessed as immaterial and minor, respectively. Since OCC's regulation has been in effect for more than three years, the impact of the amendments should not differ from the Council's assessment. Moreover, the staff of the Federal Reserve Board has advised that no problems or industry opposition has been encountered in the 12 months since that agency adopted the Council's policy statement. Finally, the deletion of provisions relating to board of director approvals and the retention of minority shareholders' share of credit life insurance income in trust, should have a favorable impact.

Background

On January 26, 1982, OCC proposed amending Part 2 to make it consistent with a policy statement adopted by the Council following solicitation of public comment. In the Notice of Proposed Rulemaking (47 FR 3555; January 26, 1982), OCC noted that Part 2 and the Council's policy statement were identical in overall purpose and effect, but that differences existed in certain details. Moreover, OCC's experience with Part 2 since its promulgation in 1978 indicated that certain provisions were no longer necessary.

Eleven comments were received on the proposed amendments. In view of the substantial number of comments received by OCC in 1976 when the regulation was first proposed and by the

Council in 1980 when its policy statement was published for comment, the low response can probably be interpreted as general approval of the proposed changes. It may also reflect the Federal Reserve Board's adoption of the Council's policy statement nearly a year age. See 46 FR 24690 (May 1, 1981). In any event, four of the comments, including the comment of the American Bankers Association, endorsed OCC's proposed changes with no significant reservations.

The remaining comments focused on a proposed clarification allowing national bank officials to receive bonuses for the sale of credit life insurance and on the compensation to be paid to the bank when credit life insurance income is credited to non-bank affiliates of the holding company. Both topics are discussed below.

Bonuses

The Council's policy statement on disposition of credit life insurance income prohibits bank officers and other designated persons from retaining for their own personal benefit commissions from the sale of credit life insurance to loan customers. OCC's regulation incorporates the same prohibition. However, Part 2 does not contain another provision recommended by the Council clarifying that bank employees can participate in a bonus or incentive plan under which payments based on credit life insurance sales are made in cash or in kind out of the bank's funds not more frequently than quarterly and in an amount not exceeding in any one year 5 percent of the recipient's annual salary. Accordingly, OCC proposed a similar clarification be added to its regulation.

One comment suggested raising the 5 percent limit to 20 percent, while another advocated eliminating the quarterly limitation. In view of the small number of comments offering these suggestions, we believe it is better to retain the Council's recommended limitations, at least for the time being. The Council's recommended limitations were designed to give financial institutions the flexibility of paying bonuses while at the same time "reducing the potential for abusive sales practices." The latter is a reference to the concern that some credit life purchase may be less than voluntary on the part of the borrower, which raises the possibility of a violation of federal antitrust laws and the antitying provisions of the Bank Holding Company Act Amendments of 1970, 12 U.S.C. 1971 *et seq.*[1] In addition, there is the danger that a loan officer might make a loan not otherwise considered prudent for the sake of reaping a sizeable or frequent bonus.[2]

One comment inquired whether the term "salary" as used in the bonus provision is meant to refer to the employee's total compensation for the year, i.e., salary plus bonuses and incentives not related to credit life insurance sales, or whether it is meant to refer solely to an employee's base salary. OCC believes this decision should be left to bank management.

Reasonable compensation

The Council's policy statement recommended that income derived from the sale of credit life insurance be credited to the income accounts of the bank (or its operating subsidiary) and not to the bank's individual employees, officers, directors, principal shareholders, their interests, or other affiliates. However, the Council stated that the income could be credited to an affiliate operating under the Bank Holding Company Act or to a trust for the benefit of all shareholders, provided the bank is paid "reasonable compensation" for the use of its personnel, premises and good will in the sale of the insurance. The Council stated: "As a general rule, 'reasonable compensation' means an amount equivalent to at least 20 percent of the affiliate's net income attributable to the financial institution's credit life insurance sales."

OCC's existing regulation, 12 CFR 2.4(b), also allows credit life income to be credited to an affiliate, but contains no provision for reasonable compensation to the bank. Part 2 does require, however, that the minority shareholders' proportionate share be placed in trust and paid to them periodically. The Council did not recommend this approach, believing that a reasonable compensation provision would be less burdensome while still protective of the interests of minority shareholders. Accordingly, OCC proposed deleting the minority shareholder requirement and substituting a flexible reasonable compensation provision. OCC also requested comment on several alternative approaches.

The six comments addressing this question were divided in their views, except it was agreed that the regulation should not require the income to go solely to the bank. Two comments argued that any reasonable compensation provision would cause a net increase in taxes paid by the holding company, since some income now sheltered in reinsurance company affiliates would have to be paid to the bank as compensation for use of its personnel, premises and good will.

OCC has previously stated that income tax factors are not a significant regulatory consideration in deciding how credit life insurance income should be allocated within a holding company system.[3] To the extent they should be considered, the tax effect appears minimal since a holding company's bank subsidiary is capable of reducing its tax liability through tax exempt investments. Thus, for the many holding companies with bank subsidiaries whose tax liability is small or non-existent as a result of their tax exempt portfolios, the reasonable compensation measure would not cause a significant change in tax liability. Moreover, the benefits of the reasonable compensation provision are increased bank earnings resulting in a strengthened capital position, plus more credible accounting policies recognizing the expenses incurred by one subsidiary in marketing an affiliate's product.

In light of the comments, OCC believes the least burdensome approach for the industry as a whole is to adopt the original proposal of eliminating the cumbersome minority shareholder provision and substituting a flexible reasonable compensation requirement. The elimination of the minority shareholder provision should be beneficial to the many holding companies owning less than 100 percent of the stock of a national bank subsidiary.[4] Moreover, the reasonable

[1] Antitrust concerns were an important consideration in OCC's adoption of 12 CFR 2. See 42 FR 48518, 48524 (Sept. 23, 1977). There were also cited in two court decisions relating to credit life insurance practices of national banks. *IBAA* v. *Heimann*, 613 F. 2d 1164, 1168 (D.C. Cir. 1979); *First National Bank of LaMarque* v. *Smith*, 436 F. Supp. 824, 830 (S.D. Tex. 1977), *aff'd*, 610 F. 2d 1258 (5th Cir. 1980).

[2] For this reason some bankers regard incentives for other than overall performance as dangerous. According to O. Leslie Nell, formerly executive vice president of The Indiana National Bank, "* * * as loan officers, all of us in this room would probably agree that it is not a very good idea to give a loan officer an incentive for volume. You do that and you know he will not be with you for very long, and you won't be around for very long to judge his performance." *The Journal of Commercial Bank Lending* (July 1974), cited in OCC Interpretive Letter No. 86, CCH Fed. Banking L. Rep ¶85,161. Too large or too frequent a bonus could generate what one court called "an inherent conflict of interest: the loan officer's judgment may be influenced by his direct financial reward from making the loan." *First National Bank of La Marque* v. *Smith*, *supra*, 610 F. 2d at 1265.

[3] 42 FR 48522 (Sept. 23, 1977).

[4] A significant number of bank holding companies own 80 percent of the stock of their subsidiary banks.

compensation requirement is flexible; it is stated in the form of a guideline which may be varied if holding company management can supply justification satisfactory to OCC.

The actual administration of the reasonable compensation provision is also flexible. Where the entire credit life premium is credited to the bank's reinsurance company affiliate, holding company management has the option of compensating the bank with an amount equivalent to 20 percent of the reinsurance company's net income attributable to the bank's credit life sales.[5] Alternatively, the bank would be paid 20 percent of the net income of a pro forma insurance agency affiliate receiving the ongoing rate of commission.

Where a bank holding company operates an insurance agency furnishing credit life insurance to both the bank's customers and to customers of the holding company's non-bank subsidiaries (e.g., a finance company), reasonable compensation to the bank would be 20 percent of the net income from credit life sales made by the bank.

In keeping with the flexible nature of the reasonable compensation provision, OCC is less interested in the mathematical precision of the calculations than it is in whether the bank's crucial role in marketing the credit life insurance receives adequate recognition.

The effective date of the reasonable compensation provision is May 1, 1983, the same date established by the Federal Reserve Board for state member banks. National banks that elect to wait until May 1, 1983, to implement the provision must continue to adhere to the minority shareholder requirement in the existing 12 CFR 2.4(b) until that date.

Other proposals

OCC's other proposed amendments will be adopted as proposed, including the deletion of the existing 12 CFR 2.4(c) and 2.5(a).

List of Subjects in 12 CFR Part 2

Credit life insurance income, National banks

Accordingly, 12 CFR 2 is amended to read in pertinent part as follows:

PART 2—DISPOSITION OF CREDIT LIFE INSURANCE INCOME

1. The authority citation for 12 CFR Part 2 is revised to read:

Authority: 12 U.S.C. 1 et seq., 24 (Seventh), 60, 73, 92, 93a, and 12 U.S.C. 1818(n).

[5] Net income should be based upon the Generally Accepted Accounting Principles method before income from investment of reserves.

2. Section 2.1 is revised to read:

§ 2.1 Authority.

This part is issued by the Comptroller of the Currency under the general authority of the national banking laws, 12 U.S.C. 1 et seq., and under the specific authority of 12 U.S.C. 24 (Seventh), 60, 73, 92, 93a and 1818(n).

3. Section 2.3(e) is revised to read as follows:

§ 2.3 Definitions.

* * * * *

(e) The term "credit life insurance" means credit life, health and accident insurance, sometimes referred to as credit life and disability insurance, and mortgage life and disability insurance.

4. Section 2.4 is revised to read as follows:

§ 2.4 Distribution of credit life insurance income.

(a) No bank employee, officer, director or principal shareholder may retain commissions or other income from the sale of credit life insurance in connection with any loan made by the bank. Except as provided in paragraph (b) of this section, retention of credit life insurance income by such persons or by corporations, partnerships, associations or other entities in which such persons have an interest of more than 5 percent is an unsafe and unsound banking practice. Notwithstanding this prohibition, bank employees and officers may participate in a bonus or incentive plan under which payments based on credit life insurance sales are made in cash or in kind out of the bank's funds not more frequently than quarterly and in an amount not exceeding in any one year 5 percent of the recipient's annual salary. Alternatively, bonuses paid to any one individual during the year for credit life sales may not exceed 5 percent of the average salary of all loan officers participating in the plan and may not be paid more frequently than quarterly.

(b) As an accounting and operations matter, income derived from credit life insurance sales to loan customers shall be credited to the income accounts of the bank and not to the bank's individual employees, officers, directors, principal shareholders, their interests or other affiliates. However, such income may be credited to an affiliate operating under the Bank Holding Company Act or to a trust for the benefit of all shareholders; *Provided* That the bank receives reasonable compensation in recognition of the role played by its personnel, premises and good will in credit life insurance sales. It is suggested that "reasonable compensation" means an amount equivalent to at least 20 percent of the affiliate's net income attributable to the bank's credit life insurance sales.

(c) Nothing in this section shall be construed to prohibit a bank employee, officer, director, or principal shareholder who holds an insurance agent's license from agreeing to compensate the bank for the use of its premises, employees, and good will; Provided, That all income received by said employee, officer, director, or principal shareholder from this activity is turned over to the bank as compensation.

5. Section 2.5 is revised to read as follows:

§ 2.5 Responsibilities of directors.

Directors shall observe the rules in § 2.4 and shall be mindful of their duty under both the common law and 12 U.S.C. 73 to promote and advance the interests of the bank over their own personal interests.

Dated: May 26, 1982.

C. T. Conover,

Comptroller of the Currency.

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FEDERAL TRADE COMMISSION

16 CFR Part 4

Clearance Procedures

AGENCY: Federal Trade Commission.

ACTION: Rule related notice.

SUMMARY: This notice discusses the relationship between the Commission's rule governing participation in Commission proceedings by former employees (16 CFR 4.1(b)(8)) and a newly amended disciplinary rule of the D.C. Court of Appeals. No change in the Commission rule is contemplated.

FOR FURTHER INFORMATION CONTACT: Jack Schwartz (202) 523-3521, Deputy Assistant General Counsel, Federal Trade Commission, 6th Street & Pennsylvania Avenue NW., Washington, D.C. 20580.

SUPPLEMENTARY INFORMATION: When the Commission published its revised rule governing participation in Commission proceedings by former Commission members and employees (46 FR 26293, May 12, 1981) ("FTC Rule" or "Commission Rule"), it announced that it would "reexamine its rule, as need be, after final action by the D.C. Court of Appeals" on proposed amendments to Canon 9 of the Code of Professional Responsibility. The D.C.