there may have to be a one-half of one percent increase in the tax for Social Security on employers and employees, and some type of gradual increase in retirement age, worked out with the senior groups. If we were to raise the retirement age by one month a year for twelve years, over that period the retirement age would be raised by one year, and save billions of dollars for the retirement fund.

Also, Medicare will face serious shortfalls in only a few years. Here I favor changes now. For example, why shouldn't everyone with an income of over $100,000 a year pay for his or her own physician's fees? Hospital coverage and other features could remain the same. That one change would save billions of dollars.

Do Senators like Kent Conrad and Byron Dorgan of North Dakota have no valid point of concern?

They do. Since 1969 the federal government has included Social Security surpluses in our budgets so that the deficits would not look so bad. I have joined Sen. Fritz Hollings of South Carolina in trying to stop that practice, but administrations of both parties like to make their budgets look better.

During the evening negotiations on the Balanced Budget Amendment on the night the vote was first scheduled, Sen. Conrad was able to get an agreement to gradually move away from this practice, but he finally rejected the offer. One of my colleagues in the Senate told me, ''Sen. Conrad was on the verge of a great victory for the Social Security cause and for sensible budgeting, but he blew it.'' I believe that judgment is premature. It is still possible that something can be worked out.

For the sake of Social Security recipients, and for the sake of the future of our country, I hope something will be.●

THE UNITED STATES-NORTH KOREA AGREED FRAMEWORK

● Mr. THOMAS. Mr. President, as the chairman of the Senate Subcommittee on East Asian and Pacific Affairs I come to the floor of the Senate this afternoon to briefly respond to certain statements made yesterday by representatives of the Government of the Democratic People's Republic of Korea regarding the agreed framework between our two countries governing the Democratic People's Republic of Korea's nuclear program.

North Korea has, for the second time in a month, again threatened to scuttle the agreement by making ludicrous take-it-or-leave-it demands. This time, it refuses to accept delivery from the Republic of Korea of two light-water reactors called for under the framework. The Democratic People's Republic of Korea's Foreign Ministry issued a statement in Switzerland stating that if the United States does not agree to another country furnishing the reactors, ''because of the United States' attitude in insisting on supplying the South Korea type, we will be forced to take an appropriate position.'' The statement continued, ''Even if that brings about the breakdown of the framework agreement * * * we will have nothing to lose but fear.''

Mr. President, I—and, I am sure, my colleagues—grow weary of the continual 11th hour posturing and brinkmanship which seems to be the mainstay of the North's negotiating strategy. In a speech in the Senate on February 13, 1995, I made clear my position:

> I will not support the provision by the United States of one scintilla more than is called for in the Agreed Framework without substantial concessions from the DPRK; nor will I accept any diminution of the central role that has been set out for the ROK. South Korea is making a huge contribution to implementing the agreement, and it is their national interest that is most at stake. To accede to any demands by the DPRK in this regard is to assist it in its ongoing attempts to undermine US–ROK relationship.

This apparently bears repeating to drive it home to the North. If the Democratic People's Republic of Korea thinks that we will capitulate on the reactor issue, it is seriously mistaken. To put it into words that the Government in Pyongyang cannot mistake, its wish for reactors manufactured elsewhere is like a hungry man looking at ''keurim eui teok i da,'' rice cakes in a picture. The North Koreans need to know, clearly and unequivocally, that on this point the Congress and administration are in complete and unwavering agreement; there is no acceptable alternative. We will stand by our position, stand by our principles, and most importantly stand by our important ally South Korea. If Pyongyang chooses to abandon the agreement, then so be it, we will quickly find ourselves back at the U.N. Security Council where the Democratic People's Republic of Korea will find itself the subject of tough economic sanctions.

Mr. President, next week at my behest the members of the Foreign Relations Committee will meet with Ambassador Galucci. I look forward to that meeting both as an opportunity to hear first hand about these latest developments, and as a chance to reiterate my position for the administration.●

STUDENT LOAN CONFLICTS OF INTEREST

● Mr. SIMON. Mr. President, my colleagues from Massachusetts, Senator KENNEDY, yesterday recited a long list of items where the new Congress has declared war on working Americans.

One item that he mentioned is the attack on student financial aid: 75 percent of all college student aid comes from the Federal Government, much of that in the form of loans. The only significant Federal student aid subsidy that reaches middle-class families is the Federal payment of interest while students are in school. Now, it seems that this benefit is in danger in the House of Representatives.

Mr. President, I have argued that as far as student aid is concerned, we should not be balancing the budget on the backs of students while banks and middlemen continue to receive excessive subsidies in the Student Loan Program.

Two weeks ago, a letter I wrote to the Washington Post made the point that the Guaranteed Student Loan Program is not the private sector system that its proponents would have us believe it is, and that it is riddled with dangerous conflicts of interest.

In a response that appeared in yesterday's Washington Post, Roy Nicholson, the chairman of USA Group, charges me with vilifying and ''attempt[ing] to silence'' him, while ignoring ''the substance of the debate'' on student loans.

Ironically, Nicholson does not respond to the substance of the inspector general's concern, raised in my letter, that ''billions of dollars of the Nation's [student loan] portfolio are at risk because many guaranty agencies * * * have a clear conflict of interest.''

Mr. President, I ask that the two letters and the inspector general report be printed in the RECORD at the conclusion of my remarks.

Guaranty agencies like USA Group are supposed to act as bank regulators on behalf of the U.S. Government. Since banks have little financial incentive to put serious effort into collecting payments on Government-backed student loans, it is the guarantors' responsibility to ensure that—before taxpayers reimburse banks for a default—the bank actually did try to collect.

But what if, as in the case of USA Group, the guarantor works not just for the Government, but for the banks, too? Clearly, this is a case of the shepherd moonlighting for the wolf. The inspector general provides a number of examples of how these arrangements put taxpayer dollars at great risk.

Last year, a specific incident involving USA Group made this conflict painfully clear. In an effort to address the default problem, Congress 2 years ago directed the Education Department to oversee the loan collectors. But last June, when the Department tried to implement the new rules—something that guarantors, as protectors of the taxpayers, should support—USA Group sued to stop the rules, arguing that it was not fair to them as contractors for the banks.

The student loan industry has decided that the only way to keep their entitlements in the face of President Clinton's money-saving reforms to the Student Loan Program is to portray the reforms as big Government, in contrast to the current private sector system.

Don't be fooled. It is not a private sector system when the Government takes virtually all the risk of default through entities it backs with the full faith and credit of the United States.

Mr. President, taking a closer look at what is really going on in the Guaranteed Student Loan Program is not ''the politics of vilification'' or an ''attempt to silence.'' It is what the substance of the debate should be. It should come as no surprise to my colleagues that people do try to take advantage of Federal programs. I do not consider it out-of-bounds to describe the structures and perverse incentives that lead to abuse.

President Clinton has proposed that the costly and risky Guarantee Program be phased out and replaced by the Direct Student Loan Program, which is working remarkably well at the first 104 colleges involved this year. He is also proposing that guaranty agencies return $1.1 billion in excess Federal reserves over the next 5 years.

These money-saving proposals should be seriously considered by Congress. Yet committee chairmen in both Houses are talking only about ways to put brakes on the Direct Loan Program.

Mr. President, we cannot afford to ignore the enormous abuses in the Guarantee Program. I urge my colleagues to take a closer look at both the Guaranteed and Direct Student Loan Programs, and to focus our efforts on providing assistance to students and taxpayers.

The material follows:

[From the Washington Post, March 2, 1995]

CONFLICT OF INTEREST IN THE STUDENT LOAN PROGRAM

In opposing President Clinton's money-saving reforms of the student loan program [''Clinton, GOP Split Over Student Loans,'' front page, Feb. 14], USA Group argues that it supports the ''competition'' in the current ''private-public partnership.''

Ironically, the only things ''private sector'' about USA Group are its salaries.

As a guarantor responsible for helping to oversee banks' roles in the student loan program, USAG has no private investors or contributors. Every penny of the $141,087,845 that USAG had in the bank in 1993 came from federal entitlements set by lobbying Congress, not through private-sector competition.

Furthermore, USAG has taken those taxpayer funds and used them to start other businesses, including becoming lenders—putting USAG in the position of regulating its own banking activity. The Education Department's inspector general has called this a ''clear conflict of interest,'' putting ''billions of dollars of the nation's [student loan] portfolio as risk.''

USAG paid its chairman $527,833 plus benefits in 1992, even though it is a ''charitable'' organization and its employees are essentially public servants.

Taxpayers and students can do without ''partners'' like these.

PAUL SIMON

[From the Washington Post, March 9, 1995]

THE DEBATE ABOUT STUDENT LOANS

Sen. Paul Simon's March 2 letter—which responds to The Post's Feb. 14 front-page story about the issue of direct government loans for college students—ignores the substance of the debate and instead levels an attack on USA Group Inc., the nation's leading guarantor-administrator of student loans.

Sen. Simon's letter continues an unfortunate pattern in which the proponents of government lending try to discredit those who disagree with them, and he recklessly disregards the facts about USA Group.

USA Group is proud of its public service to millions of American students, but that work doesn't make us public employees. The company was established as a nonprofit corporation in 1960, five years before enactment of the Higher Education Act, which created the guaranteed student loan program. From its inception, a major portion of revenues has derived from non-guarantor activities serving higher education.

USA Group affiliates annually open their books for numerous independent audits, including those undertaken by federal agencies. Contrary to Sen. Simon's unsubstantiated assertion, USA Group has never taken taxpayer funds to start other businesses, and these audits clearly demonstrate our compliance with the highest fiduciary standards.

USA Group's voice of experience, which Sen. Simon attempts to silence, is warning the nation's thoughtful policymakers—and there are many on both sides of the aisle—about the pitfalls they risk by accelerating government lending before we know whether the government can effectively operate a $25 billion to $30 billion a year consumer loan program.

The politics of vilification has no place in the debate. Let's hope that reason and fact prevail in determining whether government lending is in the best long-term interests of students, schools and taxpayers.

ROY A. NICHOLSON,
Chairman and Chief Executive Officer, USA Group.

U.S. DEPARTMENT OF EDUCATION,
San Francisco, CA, March 15, 1993.

Re Management Improvement Report No. 93–02.

To: Maureen McLaughlin, Acting Assistant Secretary for Postsecondary Education.

From: Regional Inspector General for Audit, region IX.

Subject: ED Should Prohibit Conflicts of Interest Between Guaranty Agencies and Affiliated Organizations.

The purpose of this Management Improvement Report is to advise you of an opportunity to improve the administration of the Federal Family Education Loan Program (FFELP) by prohibiting conflicts of interest between guaranty agencies and affiliated organizations that the guaranty agencies are required to monitor.

Affiliations with a FFELP loan servicer, secondary market, or other FFELP service provider compromise a guaranty agency's impartiality in administering the loan insurance program, and ensuring that lenders exercise due diligence in collecting insured loans. Currently, billions of dollars of the nation's FFELP portfolio are at risk because many guaranty agencies are affiliated with FFELP loan servicers, secondary markets, and other FFELP service providers, and thus have a clear conflict of interest.

BILLIONS OF DOLLARS OF THE FFELP PORTFOLIO ARE AT RISK

We obtained data from 12 guaranty agencies that represent about $59 billion in total loan guarantees (approximately $42 billion in loans in repayment, and $17 billion in loans in deferment). In fiscal year 1991, the 12 guarantors we contacted accounted for approximately 68 percent of the new FFELP loan volume. Nine of the 12 guaranty agencies, with approximately $40 billion in loan guarantees, are affiliated with organizations that they are required to monitor. Of the $40 billion in loan guarantees, we have identified approximately $11 billion that are at risk due to the potential conflicts of interest. The schedule in Attachment A of this report illustrates the potential dollars at risk. The matrix in Attachment B of this report illustrates the various affiliations that may result in a conflict of interest. The notes to Attachment B explain the criteria we used to determine whether an affiliation exists. Where specific guaranty agencies are named in the body of this report, their designations correspond to those listed in the attachments to this report.

THE AFFILIATIONS CAUSE A NUMBER OF PROBLEMS

The affiliations take many forms. For example, Guaranty Agency B was so closely affiliated with a profit-making FFELP service provider that its CPA firm issued consolidated financial statements. Often, the guaranty agency acts as a parent corporation, with nonprofit and profit subsidiaries providing it with various services. In fact, Guaranty Agency G and a FFELP loan servicer functioned as divisions within a larger corporation. In other cases, the firms are legally separate, but are controlled by common management. In almost every affiliation, the firms share board members, corporate officers, management and employees. The firms also share assets, such as buildings, office space, computer equipment, and furniture.

The affiliations between guaranty agencies, FFELP loan servicers, secondary markets, and other FFELP service provides create many conflicts of interest. We interviewed ED and General Accounting Office (GAO) officials and reviewed ED OIG audit reports and guaranty agency program reviews performed by both Regional and Headquarters staff of the Office of Student Financial Assistance (OSFA). Each official we interviewed expressed concern that the conflicts could seriously impair the effectiveness of the FFELP. Similar concerns were expressed in the audit reports and program reviews. The concerns relate primarily to the guaranty agencies' loss of independence, the integrity of FFELP electronic data, the preferential treatment of affiliates, and the weakened financial condition of guaranty agencies. These concerns are discussed in the following paragraphs.

AFFILIATIONS CAUSE A LOSS OF INDEPENDENCE

Guaranty agencies play a critical oversight role in the FFELP. When a guaranty agency is affiliated with an organization that it is required to monitor, it may lack the independence necessary to objectively administer the program. Conflicting internal priorities may place undue pressure on the guaranty agency to make decisions that are not in the best interest of the taxpayer.

In one state, for example, the secondary market was instrumental in founding Guaranty Agency I. Later, the guarantor and the secondary market joined forces to create a new management company. As a result of this reorganization, the guaranty agency and the secondary market came under common management. Additionally, the secondary market has provided the guaranty agency with $3.5 million in loans and is committed to provide an additional $10 million line of credit.

In such cases, the guaranty agency may be unable to deal impartially with a corporation that is actively involved in its management and is a major source of its funding. If the guaranty agency disallows claims submitted by the secondary market, it hurts the finances of one of the guaranty agency's major funding sources.

The area of lender due diligence further demonstrates how important it is for the guaranty agency to remain independent of an organization it is required to monitor. Basically, lender due diligence regulations stipulate that the guaranty agency must ensure that the lender has taken all the required steps to collect the loan before it pays a default claim. In this case the lender can be the original lender, a secondary market, or a loan service acting on behalf of a lender. Therefore, the guaranty agency must review the collection activity of the lender or its agent to determine compliance with Federal due diligence requirements.

There is an obvious conflict of interest when a guaranty agency reviews the due diligence practices of its affiliated secondary market or loan servicer. In such cases, the guaranty agency's findings affect its own financial position. The close relationships between the FFELP service providers pose a significant risk that due diligence irregularities. could occur and go unreported.

A Guaranty Agency Failed To Remain Independent. In one state, a guaranty agency that was not one of the twelve included in our review, contractually delegated all of its duties and functions to its affiliated secondary market. In February 1989, OSFA conducted a review of the guaranty agency and requested the refund of over $1 million because the agency failed to follow due diligence requirements. The guaranty agency appealed OSFA's findings and requested that the Secretary waive the right to repayment because the financial cost would ruin its affiliated secondary market. ED denied the appeal and stated that the guarantor's regulatory violations were a matter between the guaranty agency and ED, regardless of the relationship between the guarantor and the secondary market.

The guaranty agency's appeal was clearly designed to protect the financial condition of its affiliated secondary market. It also demonstrates how the financial health of an affiliate may influence the decision-making of the guaranty agency.

The conflict was even more apparent in June 1990, when the same guaranty agency completed a lender review of its affiliated secondary market and reported numerous areas of noncompliance, including due diligence violations. However, the guaranty agency neither required the appropriate repayments resulting from the violations nor took action to ensure future corrective action. The guaranty agency's actions were even more egregious because it had contracted with the secondary market to review the secondary market's own claims and determine whether the guaranty agency should pay them.

About eight months later, in February 1991, OSFA conducted a review of the same secondary market. OFSA found that the guaranty agency's prior review had not been appropriately resolved, and compelled the secondary market to formally address the findings. Only after OSFA's intervention did the guaranty agency assess a liability of over $1.1 million against its affiliate. In our opinion, the guaranty agency's reluctance to enforce the Federal regulations clearly demonstrates that the interests of the taxpayers and those of its affiliate where in direct conflict.

AFFILIATIONS COMPROMISE THE INTEGRITY OF THE FFELP ELECTRONIC DATA

The administration of the FFELP requires a great amount of electronic data to pass between the lenders, the FFELP service providers, the guaranty agencies, and ED. This electronic data provides the basis for computing virtually all of the costs associated with the FFELP. It also provides ED with its primary means of monitoring the effectiveness of the program as a whole. Therefore, the integrity of the electronic data is essential to achieving the program's overall goals.

An important mission of the guaranty agency is to conduct lender and servicer reviews to ensure that there are adequate internal controls over computer generated data, and that the data is accurately transferred between entities. The guaranty agencies also review the accuracy and reasonableness of the fees and expenses computed by the automated systems.

ED and GAO have reported numerous problems with the accuracy and the completeness of the FFELP database. We believe that the conflicts of interest have contributed to the lack of integrity of the database because the guaranty agencies often have disincentives to identify and resolve systemic problems with the automated systems.

First, identifying the causes of the problems can be costly and often involves reviewing a system that the agency itself designed for its affiliate. Second, implementing the changes needed to improve the integrity of the data may place a financial burden on its affiliate. Consequently, the guaranty agency may conduct only cursory reviews of its affiliates in order to satisfy the Federal requirements, and ignore the underlying causes of the problems. In such cases, the guaranty agency may continue to accept and forward data of questionable accuracy in order to avoid the costly expenditures needed to ensure accurate and complete electronic data.

For example, ED OIG auditors conducted an assist audit of Guaranty Agency B for GAO. ED OIG auditors concluded that the guaranty agency's computer system was less accurate than the agency claimed it to be. When the auditors requested the guaranty agency to provide the dollar amount of loans in repayment, it initially computed the amount to be $2.4 billion. Later, it revised the amount to $2.2 billion, and finally to $2.3 billion. The auditors concluded that the guaranty agency's revisions will impact future trigger figures. At the time, approximately 40 percent of the loans in question were serviced by the guaranty agency's affiliated loan servicer.

AFFILIATIONS MAY RESULT IN PREFERENTIAL TREATMENT

FFELP service providers contract with guaranty agencies and lenders to provide a myriad of services such as loan origination, loan servicing, collections, litigation, and other administrative functions. Often the service providers are for-profit corporations that are subsidiaries or affiliates of the guaranty agencies. The potential for abuse exists in such arrangements.

Guaranty Agencies May Give Their Affiliates Unfair Advantages. The guaranty agency is in the position to spin-off specialized companies and then provide the new company with a level of sales that increases its odds for success. For instance, a guaranty agency could exert undue pressure on its affiliated secondary market to use the services of its new for-profit loan servicer.

Approximately 42 percent of Guaranty Agency C's $7.9 billion portfolio is handled by its servicing arm. Similarly, about 32 percent of Guaranty Agency A's $9.1 billion portfolio is serviced by one of its affiliates. About 45 percent of Guaranty Agency G's $4.1 billion portfolio is serviced by its affiliated loan servicer.

In another example, the Treasurer of Guaranty Agency B informed ED OIG auditors that it was successful in starting a new for-profit subsidiary without the infusion of capital. The guaranty agency was able to provide its new subsidiary with immediate cash flows from rent resulting from a building management agreement and from loan origination fees. According to the treasurer, the guaranty agency also permanently transferred some of its employees to the subsidiary.

Later, the same guaranty agency's CPA firm asserted in its working papers that the volume of transactions between the agency and its newly formed subsidiary was ''excessive.'' The working papers also noted that the IRS may view the condition as undue favoritism towards a for-profit subsidiary. Such a relationship makes it more difficult for unaffiliated FFELP service providers to enter the market and compete.

Officers and Employees May Use Their Positions For Personal Gain. The guaranty agency's officers and senior management have direct control over how the guaranty agency delegates certain functions to outside companies. They also must determine the reasonableness of the fees charged by outside contractors for their services. In the same way a guaranty agency may exert pressure on an affiliate to use the services of another affiliate, officers may use their positions to exert pressure on the guaranty agency to use the services of certain companies that benefit the officers' financial positions.

For example, Guaranty Agency I joined forces with a secondary market to establish a management company. The guaranty agency and secondary market transferred all of their employees to the management company, and entered into a management services agreement with the new company. The Chairman of the Board for the management company that oversees the guaranty agency is also the President of the secondary market. This same officer is also 100% owner of a for-profit company that provided services to the guaranty agency and the secondary market. The President's personal corporation was paid over $150,000 by the guaranty agency and over $750,000 by the secondary market during the fiscal year ended September 30, 1991.

Although the President's corporation claims that it provides its services to the guaranty agency and secondary market at cost, it receives free rent in the building owned by the guaranty agency's management company and is allowed to bill unproductive time to the management company. With these benefits, the President's company has been able to successfully market its services in three other states.

Guaranty Agencies May Misuse Federal Funds. As long as guaranty agencies are allowed to start and operate FFELP service companies, there is a risk that Federal funds may be used for purposes for which they were not intended. For example, a guaranty agency that was not one of the twelve included in our review improperly used $3.1 million of its reserve fund to start and operate an affiliated, for-profit loan servicing operation. An ED OIG audit report concluded that the guaranty agency had misused the reserve fund and recommended that it refund the $3.1 million to the reserve fund.

Guaranty Agencies May Absorb the Costs of For-Profit Affiliates. Guaranty agencies can also support affiliates by paying some of their expenses. As previously noted, guaranty agencies and their affiliates often share buildings, office space, computer equipment, furniture, and even employees. This allows the affiliates to incur owner expenses and to increase profits.

For example, from 1989 to 1991, Guaranty Agency B paid approximately $768,000 in software development cost incurred by an affiliate that provided a specific service for the guaranty agency. Its agreement with that affiliate states the guaranty agency will continue to absorb the cost for the computer hardware, software, maintenance and enhancements incurred by its affiliate while performing this service. The affiliate is a for-profit corporation which earned approximately $1.4 million by providing this and other services to the guaranty agency.

AFFILIATIONS MAY WEAKEN GUARANTY AGENCIES FINANCIALLY

As guaranty agencies subcontract more activities to affiliates, they could become shell corporations with fewer financial assets.

Such an occurrence has many negative implications for guaranty agency reserves. Furthermore, ED may find it more difficult to recover misspent funds from the guaranty agencies if their revenue flows have been diverted to affiliates. Fees and income designated for the guaranty agencies assist them in continuing to carry out their mission and increasing their reserves. When these income streams are diverted to affiliates through subcontracting, the guaranty agencies' reserves may be reduced and the agencies' overall financial condition may be weakened.

For example, Guaranty Agency B delegated escrow account services to an affiliate. Federal regulations (34 CFR 682.408) allow the guaranty agency to act as an escrow agent for receiving FFELP proceeds and transmitting them to the borrower. In return, the guaranty agency may invest the proceeds of the loans and retain the interest that it earns on the float. This interest assists the guaranty agency to build up its reserves. The guaranty agency delegated the escrow function to a for-profit affiliate and allowed the affiliate to retain the interest on the float. The guaranty agency paid over $400,000 of the costs incurred by its affiliate for operating the escrow system, but allowed its affiliate to retain over $1 million in interest earned on the float.

CONFLICT OF INTEREST RULES ARE COMMON

Every organization needs to be confident that its employees are acting in the organization's best interest. To achieve this, many entities restrict their employees' activities in order to prevent those employees from having a conflict of interest.

In the Federal government, for example, Executive Order 11222 requires agencies to issue regulations governing standards of conduct for their employees. ED has issued its regulations under 34 CFR Part 73. Section 73.11(a)(1) states that an employee may not:

''Have a direct or indirect financial interest that conflicts, or appears to conflict, substantially with the employee's official duties and responsibilities * * *.''

Further, Section 73.20 prohibits an employee from accepting gifts or favors from any person who conducts business or financial operations that are regulated by the Department or whose business or financial interests may be substantially affected by the employee's official duties.

State and local governments have similar prohibitions. For example, under California law:

''No public official at any level of state or local government shall make, participate in making or in any way attempt to use his official position to influence a governmental decision in which he knows or has reason to know he has a financial interest.''

Professional organizations such as the American Bar Association, and the American Institute of Certified Public Accountants (AICPA) have adopted rules prohibiting their members from becoming entangled in business relationships that result in, or give the appearance of, a conflict of interest. Such rules are needed because much of their work involves issues of public trust.

An example of these conflict of interest rules is found in the AICPA's Code of Professional Conduct. That code requires accountants to maintain personal and professional business relationships that do not compromise their integrity and objectivity (Rule of Conduct 102). The AICPA has concluded that any member that holds a material financial interest in the client that is being reviewed has violated the principle of independence (Rule of Conduct 101).

The Securities and Exchange Commission (SEC), which relies on the accountant's independence when reviewing certain financial statements, has adopted related regulations that state:

''* * * an accountant will be considered not independent with respect to any person or any of its parents, its subsidiaries, or other affiliates (1) in which, during the period of his professional engagement to examine the financial statements, * * * his firm, or a member of his firm had, or was committed to acquire, any direct financial interest or any material indirect financial interest * * *.'' (17 CFR 210.2–01(b))

The AICPA and the SEC have concluded that both the accountant and the accounting firm lose the independence necessary to render an objective opinion when the accountant has a material financial interest, or actively participates in the management of the client being reviewed.

Organizations that prohibit conflicts of interest do not assume that their employees or members are dishonest. Rather, they recognize that persons who are responsible for interests of more than one party are often placed in untenable situations. First, they have no clear guideline as to which of the conflicting interests should have priority. Second, even the appearance of a conflict of interest reduces public confidence in their actions. In the case of governmental employees or representatives, public confidence is essential.

ED relies on guaranty agencies to review the compliance practices of other organizations that do business with ED. The results of the guaranty agency reviews may significantly impact taxpayer funds. If ED prohibits its employees from having financial interests that create conflicts of interest, or even the appearance of a conflict of interest, it should place similar prohibitions on agencies that have responsibility for ensuring appropriate actions in regard to billions of dollars of Federally insured student loans.

1992 AMENDMENTS ALLOW ED TO REQUIRE REPORTING OF INDIVIDUAL CONFLICTS OF INTEREST

ED is aware of the problems caused by the conflicts of interest between guaranty agencies and their affiliates. In fact, ED's recommendations for the Higher Education Amendments of 1992 (HEA) included language that would prohibit the officers and employees of guaranty agencies from having a financial interest in organizations that the agency is required to monitor. However, ED's recommendations did not prevail. Instead, the final version of the HEA only included a new reporting requirement. The provision requires certain paid officials of guaranty agencies, eligible lenders, and loan servicing agencies to report to the Secretary, if the Secretary should so require, any financial interest held in other institutions that participate in the FFELP.

The new provision indicates Congress's interest in identifying conflicts of interest, but it needs to be strengthened.

First, the new reporting requirement significantly increases the oversight responsibilities of the Department by requiring it to monitor the financial holdings of hundreds of officers and employees. ED officials informed us that the Office of Postsecondary Education is not in a position to handle the increased workload that the new provision requires without increasing staffing levels. Consequently, the new reporting requirement may not be implemented in the near future.

Second, the new provision stops short of prohibiting financial holdings that cause conflicts of interest.

Third, the new reporting requirement deals with only the financial holdings of individual officers and employees. The provision does not address the conflicts that arise when guaranty agencies have a financial interest in the institutions that they are required to monitor.

We believe that conflicts of interest could adversely impact the administration of the FFELP, regardless of whether the conflicts occur with individual officers and employees, or with affiliated agencies. In our opinion, prohibiting all affiliations, as described in the Recommendations section of this report, provides the best method of eliminating the potential conflicts of interest in the FFELP. It would also reduce the oversight burden of the new reporting requirement.

SUMMARY

The nation's guaranty agencies provide a critical oversight function on behalf of the Federal government. They must administer the FFELP objectively and efficiently. By affiliating with FFELP loan servicers, secondary markets, and other FFELP service providers, guaranty agencies often place themselves in the position of choosing between the interests of the taxpayers or their affiliates. The resulting conflicts of interest place billions of dollars of the FFELP portfolio at risk of mismanagement, waste, and abuse.

For many years professional organizations, Federal, state, and local governments have utilized conflict of interest rules to guard the public trust. ED prohibits its employees from having financial interests that create conflicts of interest, or even the appearance of a conflict of interest. We believe that ED should place similar prohibitions on guaranty agencies that are responsible for ensuring appropriate actions in regard to billions of dollars of Federally insured student loans.

RECOMMENDATIONS

We recommend that the Department amend its regulations, or, if necessary, seek legislative change to:

1. Prohibit guaranty agencies or their officers and employees from having any affiliation with an entity that is a participant or a service provider in the FFELP. Participants in the FFELP include the guaranty agencies, lenders, secondary markets, and eligible postsecondary institutions. FFELP service providers include entities that provide services that support the originating, servicing, and collecting of Federally insured loans.

2. Develop timetables for the guaranty agencies and their officers and employees to divest themselves of their current holdings or to legally separate the guaranty agency from its affiliates.

OTHER MATTERS

This memorandum was prepared in accordance with those GAO standards which the Inspector General has determined to be applicable to Management Improvement Reports. The work conducted on this issue does not constitute an audit.

We would appreciate your views and comments concerning our recommendations within 30 days of the date of this report. If you have any questions, or would like to discuss the report, please call me.

SEFTON BOYARS.

ATTACHMENT B

CRITERIA FOR AN AFFILIATION

We contacted twelve guaranty agencies and requested that they provide us with information about their relationships with loan servicers, secondary markets, and other FFELP service providers. Additionally, we contacted officials from ED and GAO, and reviewed numerous reports prepared by ED and independent CPA firms. Of the 12 agencies that we selected for review, 9 were affiliated with FFELP firms that they are required to monitor, and thus, have a potential conflict of interest. For the purposes of this review, we defined an affiliation as:

An organizational setting where, regardless of each firm's legal structure, a loan servicer, secondary market, other FFELP service provider, or any combination thereof, reported to the same senior management staff or board of directors (or its equivalent) as the guaranty agency.

An organizational setting where, regardless of each firm's legal structure, a loan servicer, secondary market, other FFELP service provider, or any combination thereof, shared at least one of its senior management staff or board of directors (or its equivalent) with the guaranty agency.

An instance where the guaranty agency, its parent, or management company held an ownership interest in, or was a member of (in the case of a nonprofit corporation), a loan servicer, secondary market, or any other organization that provided services to the FFELP.

An instance where an official of the guaranty agency, its parent, or management company held an ownership interest in any organization that provided services to the FFELP.

We recognize that some organizations that have a potential conflict of interest manage to prevent the conflict from harming the FFELP. However, our discussions with program officials revealed that those organizations that successfully manage the potential conflicts generally do so because of the efforts of key managers and employees. Consequently, replacing these key individuals with less conscientious managers and employees may significantly increase the risk of abuse.

SPECIFIC AFFILIATIONS THAT WE OBSERVED

The following paragraphs briefly discuss the organizational environment that exists at each guaranty agency we reviewed. Since the organizational structures are often very complicated, we have limited our discussion to a general overview. The guaranty agencies discussed in the following paragraphs correspond to those listed in the schedule found in Attachment A and the matrix shown above.

GUARANTY AGENCY A

This guaranty agency has a parent corporation that operates the guaranty agency, a loan servicer, and a secondary market as separate corporations under its umbrella. Each of the four corporations has a separate board of directors. However, at least one individual serves on all four boards, and several individuals serve on three of the four boards. Additionally, at least two individuals serve as officers in all four corporations, and several individuals serve as officers in three of the four corporations.

Until November, 1992, the secondary market activity was a departmental function of the guaranty agency. In November 1992, the secondary market was incorporated as one of the above mentioned companies. The guaranty agency plans to transfer some of its employees to its newly formed secondary market.

Approximately 84 percent of the secondary market's portfolio, and 79 percent of the loan servicer's portfolio are guaranteed by their affiliated guarantor.

GUARANTY AGENCY B

This guaranty agency underwent sweeping organizational changes in 1992. At the time of our review the changes were not completely finalized. Generally, the end result will be a management company which operates 1) a guaranty agency, 2) a nonprofit FFELP service provider that provides supporting services such as account management, litigation services, and loan disbursement services to the guarantor, and 3) a for-profit FFELP service provider that provides some of the same supporting services to the guarantor as its nonprofit counterpart. The new management company owns all of the stock of the for-profit FFELP service provider, and the two corporations share at least one board member.

The above corporations work very closely with three other organizations that were previously founded by the guaranty agency. These three firms are 1) a loan servicer, 2) a secondary market, and 3) an educational resource firm. Although the secondary market and the educational resource firm were legally separated from the guaranty agency, they continue to share common board members with the new management company mentioned above. The management company holds 25 percent of the stock of the loan servicer, and the two corporations share board members.

Approximately 55 percent of the secondary market's portfolio, and 69 percent of the loan servicer's portfolio are guaranteed by their affiliated guarantor.

GUARANTY AGENCY C

This guarantor, along with a loan servicer and secondary market, is operated as a division of a larger agency. There is no separate legal structure for the guarantor, loan servicer, or secondary market. All three divisions report to the same senior management and board of directors. Approximately 71 percent of the secondary market's portfolio, and 60 percent of the loan servicer's portfolio are guaranteed by their affiliated guarantor.

GUARANTY AGENCY D

This guaranty agency is operated by a state commission that is appointed by the Governor. The State Commission, along with its Executive Director, is responsible for operating the guaranty agency and the secondary market. The State Commission has only one board of commissioners to oversee the guaranty agency and the secondary market.

Approximately 99 percent of the secondary market's portfolio is guaranteed by its affiliated guarantor.

GUARANTY AGENCY E

This guaranty agency is a component of a state authority that manages all the Federal and state student loan programs. A separate state authority operates the secondary market. However, the management and board of the two authorities are the same.

Approximately 100 percent of the secondary market's portfolio is guaranteed by its affiliated guarantor.

GUARANTY AGENCY F

This guaranty agency is housed together with a loan servicer at the same state agency. There is only one board of commissioners for the guaranty agency and the loan servicer, and both are served by the same senior management staff.

Approximately 100 percent of the loan servicer's portfolio is guaranteed by its affiliated guarantor.

GUARANTY AGENCY G

This guaranty agency is a division of a larger corporation. The corporation has a guaranty agency division and a FFELP servicing division. The guarantor and servicer are managed by separate corporate vice presidents. The president of the corporation also holds the offices of Chairman of the Board of Directors, Chief Executive Officer, and Treasurer.

Approximately 100 percent of the loan servicer's portfolio is guaranteed by its affiliated guarantor.

GUARANTY AGENCY H

This guaranty agency provides FFELP servicing to participating lenders and secondary markets. The loan servicer is part of a division of the guaranty agency that reported to the Senior Vice President of Operations. The guaranty agency claims that it began phasing-out its loan servicing activities in the spring of 1989. However, it still retains a significant servicing portfolio.

Approximately 95 percent of the loan servicer's portfolio is guaranteed by its affiliated guarantor.

GUARANTY AGENCY I

This guaranty agency has a parent company that is the sole member (or shareholder) of both the guaranty agency and the secondary market. In this case, all three organizations are separate nonprofit corporations. The parent company is the employer with respect to virtually all of the staff of the guaranty agency and the secondary market, and provides the staff to its subsidiaries under a management contract.

The three companies have separate boards. However, the two presidents of the guaranty agency and the secondary market also serve on the board of the parent company. In fact, the Chairman of the Board of the parent company is also the president of the secondary market. This same person is the 100% owner of a for-profit company that was paid approximately $900,000 in 1991 to provide services to the guaranty agency and the secondary market.

Approximately 52 percent of the secondary market's portfolio is guaranteed by its affiliated guarantor.

GUARANTY AGENCIES J, K, & L

Our inquiries did not lead us to conclude that the above guarantors were affiliated with a loan servicer, secondary market, or other FFELP service provider.●

AUTHORIZING THE TAKING OF A PHOTOGRAPH IN THE CHAMBER OF THE U.S. SENATE

Mr. GREGG. Mr. President, I ask unanimous consent that the Senate proceed to Senate Resolution 87, submitted earlier today by Senator DOLE, and that the resolution be agreed to and the motion to reconsider be laid upon the table.

The PRESIDING OFFICER. Without objection, it is so ordered.

So the resolution (S. Res. 87) was agreed to, as follows:

Resolved, That paragraph 1 of Rule IV of the Rules for the Regulation of the Senate Wing of the United States Capitol (prohibiting the taking of pictures in the Senate Chamber) be temporarily suspended for the sole and specific purpose of permitting the National Geographic Society to photograph the United States Senate in actual session on a date and time to be announced by the Majority Leader, after consultation with the Minority Leader.

SEC. 2. The Sergeant at Arms of the Senate is authorized and directed to make the necessary arrangements therefor, which arrangements shall provide for a minimum of disruption to Senate proceedings.

MEASURE READ FOR THE FIRST TIME—H.R. 988

Mr. GREGG. Mr. President, I inquire of the Chair if H.R. 988 has arrived from the House of Representatives.