



**UNITED STATES DEPARTMENT OF EDUCATION**  
OFFICE OF INSPECTOR GENERAL

Audit Services  
Sacramento Region

October 18, 2010

**Control Number**  
**ED-OIG/A09J0009**

David Bata  
Vice President and Manager  
Zions First National Bank  
1001 17<sup>th</sup> Street, Suite 1050  
Denver, Colorado 80202

Dear Mr. Bata:

This **Final Audit Report**, entitled *Zions First National Bank's Management of Collection Account Funds and Oversight Activities under the ECASLA Loan Participation Purchase Program*, presents the results of our audit. The purpose of the audit was to determine whether Zions First National Bank (Zions), operating as a custodian under the Ensuring Continued Access to Student Loans Act of 2008 (ECASLA) Loan Participation Purchase (LPP) Program (1) had adequate controls to ensure that its management of collection account funds complied with the terms and conditions of the Master Participation Agreement (MPA) and applicable U.S. Department of Education (Department) guidance; and (2) provided reasonable oversight of loan servicers and/or sponsors to ensure compliance with the terms and conditions of the MPA and applicable Department guidance. Our review focused on Zions' activities under the LPP Program for academic year 2008-2009 loans (the 2008-2009 LPP Program).<sup>1</sup> However, we did review 20 academic year 2009-2010 loans to determine whether Zions held title to loans while they were subject to the LPP Program.<sup>2</sup> Our review covered the period August 28, 2008, through October 31, 2009, which corresponds to the timeframe that Zions operated as a custodian under the 2008-2009 LPP Program and for one month under the 2009-2010 LPP Program.

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<sup>1</sup> For purposes of the LPP Program, an academic year 2008-2009 loan is one that (1) has a loan period that includes, or begins on or after, July 1, 2008, (2) has a first disbursement made on or after May 1, 2008, but no later than July 1, 2009, and (3) was fully disbursed no later than September 30, 2009.

<sup>2</sup> We were not able to evaluate 2008-2009 LPP Program loans for this purpose because all of the loans had either been redeemed by the sponsors or sold to the Department at the time of our review. Once the loans were redeemed or sold, Zions was no longer responsible for maintaining loan documentation.

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## BACKGROUND

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ECASLA (Pub. Law 110-227) was enacted on May 7, 2008, in part, to address concerns that there may be inadequate loan capital to meet the demand for academic year 2008-2009 loans.<sup>3</sup> ECASLA added Section 459A to the Higher Education Act of 1965, as amended (the HEA), authorizing the Department to purchase or to enter into forward commitments to purchase certain Federal Family Education Loan (FFEL) Program loans. The purpose of the LPP Program, in part, was to ensure that lenders had a reliable source of funds to originate new FFEL Program loans.<sup>4</sup>

The 2008-2009 LPP Program was conducted under the terms of the MPA, dated July 25, 2008. The MPA created a relationship between sponsors, eligible lender trustees (when applicable), custodians, and the Department. By executing an adoption agreement, each of these entities agreed to the terms and conditions of the MPA. Brief descriptions of the entities operating under the LPP Program and their roles are discussed below.

- Sponsor – An eligible FFEL Program lender or holder of eligible FFEL Program loans. The sponsor may be a secondary market or beneficial holder under an eligible lender trustee agreement.<sup>5</sup> The sponsor sells participation interests in loans to the Department through a custodian.
- Custodian – An eligible FFEL Program lender that is a national or State chartered bank. A custodian cannot be affiliated with sponsors or eligible lender trustees that it has entered into adoption agreements with. The custodian is granted the legal title to the loans for which a participation interest is sold to the Department.
- Department – The Department purchases participation interests in FFEL Program loans from sponsors through custodians.
- Servicer – The sponsor, in its capacity as servicer, or another servicer of FFEL Program loans, services the LPP Program loans under an eligible servicing agreement with a custodian.

When a sponsor wanted the Department to purchase a participation interest in its loans, it would transfer title of the loans to a custodian. The custodian would then sell a participation interest in

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<sup>3</sup> Public Law 110-350 was enacted on October 7, 2008, in part, to extend the Department's loan purchase authority to academic year 2009-2010 loans. The Department offered a separate LPP Program for academic year 2009-2010 loans.

<sup>4</sup> The Health Care and Education Reconciliation Act of 2010 (Pub. Law 111-152), enacted on March 30, 2010, ended the origination of new FFEL Program loans after June 30, 2010. Beginning July 1, 2010, all Stafford, PLUS, and consolidation loans will originate through the William D. Ford Federal Direct Loan Program.

<sup>5</sup> A beneficial holder does not meet the HEA criteria to participate in FFEL Programs. However, a beneficial holder may participate in FFEL Programs through an agreement with an eligible lender to serve as its trustee. In order for a beneficial holder, that is not an eligible lender under § 435(d) of the HEA, to participate in the LPP Program, its eligible lender trustee must also execute the adoption agreement.

the loans to the Department and distribute the proceeds of the transaction to the sponsor. Under the 2008-2009 LPP Program, sponsors were required to redeem the Department’s participation interests by either (1) remitting a redemption payment for each participation interest to the Department by September 30, 2009, or (2) selling the underlying loans to the Department by October 15, 2009.

Zions was one of six Department-approved custodians under the 2008-2009 LPP Program, providing trust and custody services for loans in which the Department purchased a participation interest.<sup>6</sup> Formed in 1957, Zions is a nationally chartered bank providing a variety of financial services, including trust and custody services. Zions operated as custodian for the following sponsors under the 2008-2009 LPP Program: Utah Higher Education Assistance Authority (UHEAA), Missouri Higher Education Loan Authority (MOHELA), Panhandle-Plains Student Finance Corporation (PPSFC), and New Mexico Educational Assistance Foundation (NMEAF).<sup>7</sup> In total, the Department purchased about \$33.3 billion of participation interests in FFEL Program loans under the 2008-2009 LPP Program. Zions was the custodian for about \$1.1 billion, or 3.5 percent, of the total participation interests purchased by the Department. Loans for which Zions operated as custodian under the 2008-2009 LPP Program were serviced by four entities: UHEAA, MOHELA, Panhandle-Plains Management and Servicing Corporation (PPMSC), and the Council for South Texas Economic Progress, Inc. (CoSTEP). Table 1 provides information on participation interests the Department purchased during the 2008-2009 LPP Program for which Zions operated as the custodian.

<b>Table 1. Participation Interests for which Zions Operated as Custodian</b>			
<b>Custodian Lender Identification</b>	<b>Sponsor</b>	<b>Servicer(s)</b>	<b>Cumulative Participation Interests Purchased</b>
834437	UHEAA	UHEAA	\$423,235,777
834442	MOHELA	MOHELA	682,471,418
834430	PPSFC	PPMSC and CoSTEP	50,577,047
<b>TOTAL</b>			<b>\$1,156,284,242</b>

<sup>6</sup> Only five approved custodians actually provided trust and custody services under the 2008-2009 LPP Program.

<sup>7</sup> NMEAF opted not to sell a participation interest in its loans to the Department under the 2008-2009 LPP Program. Thus, Zions did not provide any trust and custody services for NMEAF during the period covered by our audit.

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## AUDIT RESULTS

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Zions generally had adequate controls to ensure that its management of collection account funds complied with the terms and conditions of the MPA and applicable Department guidance. Zions established a collection account for each sponsor for the purpose of holding all collections with respect to loans subject to the LPP Program for the benefit of the Department, as holder of the participation interests. Zions distributed the funds on deposit in the collection account in accordance with Sections 11(b) and 11(d) of the MPA. However, as discussed in Finding No. 1, we found that (1) Zions' policies and procedures did not include a requirement to obtain the Security Release Certificate (security release) executed by sponsors and secured parties before submitting the Participation Purchase Request (PPR) to the Department, (2) Zions transferred PPR proceeds to secured parties prior to obtaining the required security releases executed by sponsors and secured parties, and (3) Zions did not routinely submit the executed security release(s) to the Department within the required submission period. We also found that Zions improperly invested collection account funds in money market funds that invested in securities that were not Permitted Investments under the MPA and Department guidance.

We also found that Zions' oversight of servicers' activities needed improvement. Zions' oversight and monitoring primarily consisted of a review of the servicers' FFEL Program compliance audit reports, the ECASLA sponsor Agreed Upon Procedures (AUP) attestation engagement reports, and periodic site visits to the servicers.<sup>8</sup> However, the main purpose of the compliance audits is to evaluate the servicers' administration of the FFEL Program, not their administration of the LPP Program; and the AUP attestation engagements do not prevent issues of noncompliance from occurring, rather they detect noncompliance after the fact. In addition, Zions visited only one of the four servicers for which it had oversight responsibilities under the 2008-2009 LPP Program. As discussed in Finding No. 2, we found that Zions did not (1) have a required eligible servicing agreement with one servicer, (2) ensure that servicers transferred collections to the applicable collection account within 2 business days after receipt, (3) consistently submit Monthly Aggregate Settlement Date Reports (MASDR) within 7 business days after the end of the month, and (4) review the weekly Loan Schedule and Custodial Certification (Weekly Loan Schedule) and monthly Loan Schedule and Custodial Certification (Monthly Loan Schedule) to ensure servicers submitted accurate information to the Department.

A draft of this report was provided to Zions for review and comment. In its comments to the draft report, Zions did not explicitly state whether it concurred with our findings and recommendations, but it did describe the corrective actions already taken to address each finding. We have summarized Zions' comments at the end of each finding and included their complete comments as Attachment 2 to this report. We have also provided our response after the summary of Zions' comments for each finding. Zions did not provide any comments to our recommendations. We have not changed the findings or recommendations based on Zions' comments.

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<sup>8</sup> The ECASLA sponsor AUP attestation engagement reports are required under Section 8 of the MPA for the 2008-2009 LPP Program.

## **FINDING NO. 1 – Zions Did Not Comply with Requirements Covering Security Release Certificate Submissions and Permitted Investments**

For loans subject to a preexisting security interest, Zions' policies and procedures did not include a requirement to obtain the security release executed by sponsors and secured parties prior to submitting a PPR to the Department. Zions transferred PPR proceeds to secured parties with security interests in the underlying loans before it obtained the required security releases. The *Revised Funding Request Submission Instructions* attached to the Department's Electronic Announcement (EA) No. 53 requires that sponsors and secured parties execute their parts of security releases prior to submission of the PPR. Zions also did not routinely submit executed security releases to the Department within the required 7 business days of receiving the PPR proceeds. In addition, Zions improperly invested collection account funds in money market funds that did not meet the definition of Permitted Investments, as defined in the MPA and Department guidance.

### **Zions Did Not Obtain Required Security Releases Prior to the Submission of PPRs to the Department and Did Not Always Submit Executed Security Releases Timely**

During our review of Zions' policies and procedures for submitting PPRs to the Department on behalf of sponsors, we found that Zions conformed to Department requirements, except for the timing of when Zions obtained the required security release(s) executed by sponsors and secured parties.

The Department's *Revised Funding Request Submission Instructions*, dated September 25, 2008, require that any secured party with a security interest in loans that are to be included in a PPR must agree to release its security interest upon the Department's purchase of a participation interest.<sup>9</sup> Because the Department's participation interest would represent a 100 percent beneficial ownership in the principal portion of such loans, the custodian needed to obtain the security release(s) prior to submitting the PPR to the Department and disbursing the PPR proceeds.

The *Revised Funding Request Submission Instructions* attached to EA No. 53 state—

The Security Release Certificate, with sections I and II executed by the financial institution [secured party] with a preexisting financial interest [security interest] in the Loans, and the Sponsor, respectively, must be submitted to the Custodian by the Sponsor, just prior to when each Participation Purchase Request is submitted to the Department . . . . The Custodian will hold the partially executed Security Release Certificate in escrow for benefit of the financial institution, pending payment from the Department. The Security Release Certificate, which

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<sup>9</sup> The instructions were included as an attachment to EA No. 16, *Revised Document Submission Process for Request for Funding*, issued on August 8, 2008, and updated on September 25, 2008. EA No. 53, *Loan Purchase Participation Program – Revised Definition of “File Creation Date” and Changed Payment Mechanism Announcement*, issued on March 13, 2009, superseded EA No. 16. The timing requirements related to the security release did not change under EA No. 53.

is Exhibit G in the Master Participation Agreement, must be signed by a designated officer of the relevant financial institution, releasing their security interest in that Eligible Loan.

Upon the receipt of funds from the Department, the Custodian will forward payment to the financial institution. When the Custodian receives acknowledgement from the financial institution that the monies have been received, then the Custodian will execute section III of the Security Release Certificate and forward to the Department. The Department must receive the completed Security Release Certificate prior to funding a new Participation Purchase Request for that Sponsor's Loans or seven business days from the Custodian's receipt of payment, whichever is earlier. The Department will not fund a new Participation Purchase Request until all Security Release Certificates pertaining to prior purchases have been properly executed and received by the Department.

Contrary to EA No. 53, Zions' policies and procedures did not require it to obtain the security release executed by the sponsor and secured party until after it (1) submitted the PPR to the Department, and (2) transferred proceeds from the PPR to the secured party. Item 10 of Zions' policies and procedures for PPRs states:

Upon confirmation of receipt of funds from the warehouse or other interim financing lender the Security Release Certificate is required to be submitted to the DOE [Department] prior to the next Participation Purchase Request. The Sponsor will obtain all necessary signatures and send to the Custodian. Custodian will execute and deliver the Security Release Certificate to the DOE via email.

We discussed Zions' policies and procedures for PPRs with a Vice President from the Corporate Trust Division (Vice President) who confirmed the above timing for obtaining the security release(s), which we confirmed in our review. We reviewed the documentation for 10 of the 42 PPRs requiring security releases that Zions submitted on behalf of its sponsors. Of the 10 PPRs reviewed, we found that 9 were submitted prior to obtaining the necessary security releases executed by sponsors and secured parties.<sup>10</sup> As an example, the documentation for one PPR that we reviewed from MOHELA disclosed the following sequence of events:

May 20, 2009: Zions submitted the PPR to the Department.

May 21, 2009: Zions received the PPR proceeds from the Department and transferred the proceeds to the secured party with the security interest in the loans (Wells Fargo Bank).

May 22, 2009: Zions received the security release executed by MOHELA and Wells Fargo Bank, executed it, and submitted it to the Department.

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<sup>10</sup> The PPR submission date and receipt date of the security release for the one remaining PPR we reviewed were the same. We confirmed that the security releases for the 10 PPRs we reviewed were (1) executed by the sponsors, secured parties, and Zions, and (2) submitted to the Department.

Thus, Zions submitted the PPR to the Department and transferred the PPR proceeds to Wells Fargo Bank prior to obtaining the security release executed by MOHELA and Wells Fargo Bank. As a result, the Department purchased a participation interest in loans that were not certified as being free and clear of preexisting security interests. Under this scenario, it is possible that the secured party receiving the PPR proceeds might not release its security interest in the loans. The Zions Vice President stated that it is unlikely that a secured party would not release its security interest once it receives the PPR proceeds because the secured party typically provides funding for the loans only a few days before a participation interest in the loans is sold to the Department. Thus, the secured party is generally paid back within a few days.

We also found that for 2 of the 10 PPRs reviewed, Zions did not submit the executed security releases to the Department within 7 business days of receiving the funds, as required by EA No. 53. As shown in Table 2, the security releases for these PPRs were submitted to the Department 19 and 22 business days after Zions received the PPR proceeds.

<b>PPR Date (Sponsor)</b>	<b>Date Zions Received PPR Proceeds</b>	<b>Date Zions Submitted Security Release</b>	<b>Variance in Business Days</b>	<b>Funding Date of Subsequent PPR</b>
Jan. 26, 2009 (PPSFC)	Jan. 30, 2009	Feb. 25, 2009	19	Feb. 27, 2009 <sup>(a)</sup>
Feb. 24, 2009 (PPSFC)	Feb. 27, 2009	Mar. 30, 2009	22	Apr. 1, 2009 <sup>(a)</sup>
<sup>(a)</sup> The Department did not fund the subsequent PPR until after it received the executed security release(s) for the previous PPR.				

The Vice President stated that the MPA only required the security release(s) to be submitted to the Department prior to a new PPR. However, the *Revised Funding Request Submission Instructions* attached to EA No. 53 state, “The Department must receive the completed Security Release Certificate prior to funding a new Participation Purchase Request . . . or seven business days from the Custodian’s receipt of payment, whichever is earlier.”

**Zions Did Not Invest Collection Account Funds in Permitted Investments**

Zions invested collection account funds in money market funds that did not meet the definition of Permitted Investments, as defined by the MPA and applicable Department guidance. Section 11(a) of the MPA states, “Amounts on deposit in the Collection Account may be invested only in Permitted Investments.” Section 3 of the MPA defines Permitted Investments as “overnight or short-term U.S. Treasury securities that will, in all cases, mature on or prior to the day immediately preceding the date such funds are required to be disbursed.” The Department issued updated guidance on the 2008-2009 LPP Program, in the form of frequently asked questions (FAQ), on August 26, 2008. Item No. 11 of the *LPP Program FAQ* addresses the definition of Permitted Investments, as follows:

Q11 The Master Participation Agreement defines “Permitted Investments” as “overnight or short-term U.S. Treasury securities that will, in all cases, mature on or prior to the day immediately preceding the date such funds are required to be

disbursed.” Does this allow the Custodian to make investments in repurchase agreements or money market funds?

A11 The Department interprets “Permitted Investments” to include (a) U.S. Treasury securities with a maturity of up to 60 days; (b) repurchase agreements that are fully collateralized by U.S. Treasury securities with a term of not more than 30 days and entered into with the broker-dealer subsidiary of any depository institution organized under the laws of the United States or any State thereof that has outstanding unsecured commercial paper or other short-term unsecured debt obligations that are rated A-1 or better by S&P and P-1 by Moody's (or a comparable rating); and (c) units of money market funds that are exclusively comprised of U.S. Treasury securities with a weighted average term of not more than 60 days that are rated not lower than AAA by S&P and AAA by Moody's (or a comparable rating). Custodians shall not invest in any other investment vehicles.

Because Zions invested collection account funds exclusively in two money market funds, part (c) of item A11 above applies. For each money market fund, we reviewed the most recent Semi-annual or Annual Report that listed the individual investments for each money market fund and determined that the money market funds were not Permitted Investments as defined in the MPA and applicable Department guidance. Specifically, we found that repurchase agreements comprised over 55 percent of each fund's value at the end of the reporting periods.<sup>11</sup> Thus, the money market funds did not exclusively comprise U.S. Treasury securities as required by Section 3 of the MPA and item A11, part (c) of the Department's FAQ. Investing collection account funds in money market funds that are not Permitted Investments may put collection account funds at risk of loss because these money market funds' holdings may not be fully invested in U.S. Treasury securities.

At the exit conference, a Zions Manager stated that he believed that Zions complied with the intent of the MPA and Department guidance because the money market funds that invest only in U.S. Treasury securities tend to be less liquid than the money market funds that invest in repurchase agreements, and as a result may not provide timely access to funds when loan redemptions occur. The Manager also believed that the repurchase agreements that the money market funds invested in were collateralized entirely by U.S. Treasury securities. However, we found that the holdings for one of the two money market funds included repurchase agreements that were backed by Government National Mortgage Association securities, which are not U.S. Treasury securities. Regardless of the type of securities backing the repurchase agreements, item A11, part (c) of the Department's FAQ cited above requires that money market funds exclusively comprise U.S. Treasury securities.

Under the terms of the MPA, custodians may be held liable for losses arising from its actions or the actions of its delegees. Specifically, Section 14(b) of the MPA states, “Except to the extent of losses, claims, damages and liabilities that arise out of the Custodian's willful misfeasance, bad faith or negligence in the performance of its duties under this Agreement, the amount of the

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<sup>11</sup> A repurchase agreement is an agreement in which the seller of a security commits to buy the security back from the purchaser at a specified price at a designated future date. The sale of the security and agreement to repurchase the security occur simultaneously.



Custodian’s liabilities to the Department and its officials, employees and agents under this Section 14(b) shall be limited to the amount of the aggregate fees paid to it for its services hereunder.”

## RECOMMENDATION

- 1.1 We recommend that the Chief Operating Officer for Federal Student Aid hold Zions responsible, to the extent permitted under Section 14(b) of the MPA, for any liabilities arising from the noncompliance described in Finding No. 1.

### Zions Comments and OIG Responses

Zions did not explicitly state whether it concurred with our finding and recommendation, but provided comments to each part of our finding. Zions described the corrective actions already taken to address each part of our finding, which appear to adequately address the issues identified in our finding. We have not made any changes to our finding and recommendation based on Zions’ comments.

#### Zions Did Not Obtain Required Security Releases Prior to the Submission of PPRs to the Department and Did Not Always Submit Executed Security Releases Timely

- *Zions Comment.* Zions stated that it was in compliance with the original procedures established pursuant to Section 9(b)(vii) of the MPA, which required that fully executed security releases be provided to the Department releasing any liens on loans purchased by the Department. As part of its corrective action plan, Zions stated that it instituted the updated procedures outlined in the Department’s EA No. 53.
- *OIG Response.* The *Revised Funding Request Submission Instructions*, attached to EA No. 53, was issued after the MPA was finalized and before Zions performed any custodial duties for its sponsors. Thus, Zions should have been aware of and instituted the procedures outlined in the *Revised Funding Request Submission Instructions*, which provided instructions for the security release submission requirement established in Section 9(b)(vii) of the MPA.

#### Zions Did Not Invest Collection Account Funds in Permitted Investments

- *Zions Comment.* Zions stated that it invested collection account funds in money market funds, each component of which was included in the Department’s definition and interpretation of Permitted Investments as provided in Item No. 11 of the Department’s *LPP Program FAQ*. As part of its corrective action plan, Zions stated that all collection account funds were to be invested in a money market fund that comprised only U.S. Treasury securities.

- *OIG Response.* The two money market funds that Zions used to invest collection account funds during the 2008-2009 LPP Program did not meet the definition of Permitted Investments because they did not exclusively comprise U.S. Treasury securities. Zions' corrective action would correct this deficiency, because all collection account funds would be invested in a money market fund that comprised only U.S. Treasury securities.

## **FINDING NO. 2 – Zions' Oversight of Servicer Activities Needed Improvement**

As a custodian, Zions was responsible for monitoring servicer activities to ensure that its servicers adhered to the requirements of the MPA and applicable Federal laws, regulations, and Department guidance. We determined that Zions' oversight of servicer activities needed improvement. Specifically, we found that Zions did not (1) have a required eligible servicing agreement (ESA) with one servicer, (2) ensure that servicers transferred collections to the appropriate collection account within 2 business days after receipt, (3) consistently submit the Monthly Aggregate Settlement Date Reports (MASDR) within 7 business days after the end of the month, or (4) review the Weekly Loan Schedules and Monthly Loan Schedules to ensure the accuracy of the information.

Zions did perform limited monitoring by reviewing the servicers' FFEL Program compliance audit reports<sup>12</sup> and the ECASLA sponsor AUP attestation engagement reports and by conducting periodic site visits to the servicers.<sup>13</sup> However, we found that these monitoring activities were not adequate because the primary purpose of the compliance audits was to evaluate the servicers' administration of the FFEL Program, not their administration of the LPP Program; and the attestation engagements do not prevent issues of noncompliance from occurring, rather they detect noncompliance after the fact. Furthermore, Zions visited only one of four servicers for which it had oversight responsibilities under the 2008-2009 LPP Program. The site visit occurred prior to the servicer's participation in the 2008-2009 LPP Program and thus did not involve a review of the servicer's activities under the LPP Program. However, the site visit did cover several areas, including PPRs, servicer deposits, MASDR reporting and submission, and investments, in preparation for the LPP Program.

Section 12(a) of the MPA requires each loan subject to the LPP Program to be serviced by a servicer (which may be the sponsor) at the direction of the custodian under the terms of an ESA and in accordance with Department regulations. The work performed by a servicer usually includes account management, loan payment collections, and other customary services. In addition, Section 12(d) of the MPA states—

The Custodian shall take all reasonable steps, actions and proceedings necessary to ensure that each Servicer will manage, service, administer, make collections

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<sup>12</sup> Section 428(b)(1)(U) of the HEA and 34 C.F.R. Section 682.305(c) require all lenders participating in the FFEL Program to have an annual compliance audit performed by a non-Federal auditor. A participating lender is any lender that originates or holds FFEL Program loans. Lenders that participate in the FFEL Program may engage servicer organizations (servicers) to perform certain functions relating to the administration of that program. Section 487(c)(1)(C) of the HEA and 34 C.F.R. § 682.416(e) require servicers to have an annual compliance audit performed on the servicer's administration of the FFEL Program.

<sup>13</sup> According to a Zions Manager, Zions typically makes site visits to its servicers once every 2 years.

and calculate any amounts owed to the Department with respect to the Eligible Loans . . . in compliance with all applicable Federal and State laws, including all applicable rules, regulations and other requirements of the Higher Education Act and the applicable Guarantee Agreement. The Custodian shall ensure that each Servicer shall be responsible for segregating, marking each Eligible Loan as owned by the Custodian and remitting to the Custodian all payments received on the Eligible Loans for the benefit of the Department as the holder of the Class A Participation Certificate, including but not limited to, physical or electronic marking of relevant computer records.

Attachment 1 to this report provides a summary of the duties and obligations that the MPA requires custodians to perform. Section 18 of the MPA allows a custodian to delegate to another eligible lender (including a sponsor) or related servicer some of its duties and obligations under the MPA. When a custodian delegates one or more of its duties and obligations, Section 18 of the MPA requires the following:

If the Custodian delegates any of its obligations to a delegee as permitted in this Section 18: (i) the Custodian shall exercise due care in its appointment of such delegee, (ii) if the Custodian performs any of its non-delegated obligations hereunder in reliance on such delegee's performance of delegated obligations, such reliance shall be reasonable under the circumstances, (iii) the Custodian shall take those steps that are reasonable under the circumstances to ascertain whether such delegee is properly performing the delegated obligations, and (iv) if such delegee has failed to perform any of its delegated obligations, the Custodian shall either assume the delegated obligations or promptly appoint a successor delegee to perform such obligations.

We determined that Zions delegated the following activities to its servicers or sponsors: (1) preparing and submitting the Weekly and Monthly Loan Schedules and exception reports, if applicable; (2) holding loan documents in trust; (3) calculating the redemption payment for Class A participation interests to be paid by the sponsor to the Department; and (4) preparing the partnership's tax filings.

### **Zions Did Not Have a Required Agreement with One Servicer**

Our review of ESAs between Zions and its servicers found that it had not entered into an ESA with one of its four servicers for the 2008-2009 LPP Program. The Department purchased a participation interest in loans totaling about \$50.5 million from PPSFC that were serviced by two different entities: PPMSC and CoSTEP. PPMSC serviced \$38.8 million (76.8 percent) of the loans, while CoSTEP serviced the remaining \$11.7 million (23.2 percent).

Although the servicing agreement between Zions and PPMSC met the requirements for an ESA under the MPA, we found that Zions had not entered into an ESA with CoSTEP as required by Section 12(a) of the MPA. Zions did provide a servicing agreement between PPSFC and CoSTEP that authorized CoSTEP to service PPSFC's loans. Section 8(a) of this agreement states that it is intended to be an ESA as defined in the MPA. A Zions Vice President believed that the agreement between PPSFC and CoSTEP represented a sub-servicing agreement and because PPSFC had an ESA with Zions, a separate ESA between Zions and CoSTEP was not necessary. However, this agreement did not constitute an ESA because Zions, as the custodian,

was not a party to the agreement. Zions, as legal owner of the loans while they were subject to the LPP Program, was required to have an ESA with CoSTEP directly.

Section 13(a) of the MPA requires the custodian to take all reasonable steps, actions, and proceedings necessary to enforce all terms, covenants, and conditions of the ESA. Zions was not a party to the servicing agreement between PPSFC and CoSTEP. Therefore, Zions did not have the authority to monitor and oversee the servicer's activities or enforce the terms, covenants, and conditions of the servicing agreement between PPSFC and CoSTEP. Without an ESA with CoSTEP, Zions could not legally perform all of its responsibilities as custodian under the LPP Program.

### **Zions Did Not Ensure that Servicers Transferred Collections to the Collection Accounts within the Required Timeframe**

Based on our review of servicer accounting records and collection account statements, we determined that Zions did not adequately monitor its servicers to ensure that the funds they collected under the LPP Program were deposited in a timely manner into the collection account. Section 12(c)(v) of the MPA requires servicers to deposit all collections into the collection account no later than 2 business days after receipt. As the custodian, Zions was responsible for ensuring that servicers complied with the deposit requirements specified in the MPA.

Section 13(d) of the MPA requires the custodian to “notify the Department in writing promptly upon becoming aware of any default or failure to perform any obligations on the part of the Servicer under the Servicing Agreement.” Section 13(e) of the MPA adds that “[t]he Custodian shall not waive any default by the Servicer under the Servicing Agreement without the written consent of the Department.” Untimely deposit of collections into the collection account may be deemed a *Servicer Event of Default* under Section 3 of the MPA. *Servicer Event of Default* is defined, in part, as:

- (i) any failure by the Servicer to remit to the Custodian any Collections within two (2) Business Days following receipt, or any failure by the Servicer to pay any other amounts required to be paid by the Servicer hereunder or under any related Eligible Servicing Agreement, which failure continues unremedied for a period of one (1) Business Day following the Servicer becoming aware of such failure . . .

In EA No. 34, *Interpretative Guidance Regarding Loan Purchase Programs*, dated October 31, 2008, the Department provides guidance on the 2 business day requirement in its response to Question No. 4:

Q4 Section 11 of the MPA requires that all collections – including refunds and cancellations – be deposited in the collections account of the custodian within two business days of receipt by the sponsor or servicer. Failure by the sponsor to remit to the custodian payments received on loans is an event of default under Section 3 of the MPA. Is there a grace period within which the collection may be remitted to the custodian after two business days that would not result in a default?

A4 Although the Department expects that most payments will be remitted to the custodian within the two-day period, it expects that even with the exercise of due diligence by the sponsor, it may take longer than two days to properly identify whether a payment pertains to a participated loan. The Department may terminate the participation or increase the spread if a sponsor event of default occurs. However, in determining an appropriate response to untimely remittances, the Department will consider the frequency with which these instances occur, the explanation provided for the occurrence, and any prior notification concerning such remittances.

**Results of OIG Review of Servicer Accounting Records**

Our review of servicer accounting records for all deposits identified in the collection account statements for MOHELA, UHEAA, and PPSFC found that the servicers did not consistently meet the deposit requirements contained in Section 12(c)(v) of the MPA. We compared the dates of when funds were received by servicers to the dates of when funds were deposited in the appropriate collection account to determine whether servicers complied with the 2 business day deposit requirement. For purposes of our review, we classified deposits as fully compliant, partially compliant, or not compliant because each deposit was made up of several smaller deposits with various receipt dates.<sup>14</sup>

As shown in Table 3, in most instances servicers did not deposit collections within 2 business days after receipt as required under the MPA. Collectively, PPMSC and CoSTEP did not comply with the timing requirement nearly 50 percent of the time.

<b>Table 3. Servicer Compliance with Collection Account Deposit Requirements</b>			
<b>MOHELA (\$8.5 million in deposits)</b>			
Number of Deposits	Fully Compliant	Partially Compliant	Not Compliant
200	5	192	3
	2.5%	96%	1.5%
<b>UHEAA (\$5.7 million in deposits)</b>			
Number of Deposits	Fully Compliant	Partially Compliant	Not Compliant
142	4	125	13
	2.8%	88%	9.2%
<b>PPMSC / CoSTEP (\$1.2 million in deposits)</b>			
Number of Deposits	Fully Compliant	Partially Compliant	Not Compliant
106	13	43	50
	12.3%	40.6%	47.2%
<b>TOTAL (\$15.4 million in deposits)</b>			
Number of Deposits	Fully Compliant	Partially Compliant	Not Compliant
<b>448</b>	<b>22</b>	<b>360</b>	<b>66</b>
	<b>4.9%</b>	<b>80.4%</b>	<b>14.7%</b>

We tested all 448 deposits identified in the sponsors’ collection account statements and found that only 22 deposits (4.9 percent) were fully compliant, that is, all receipts were deposited within 2 business days after receipt. When a servicer does not deposit collections timely, the

<sup>14</sup> We classified a deposit as fully compliant if all receipts included in a deposit were deposited within 2 business days, partially compliant if some receipts were deposited within 2 business days, and not compliant if all receipts included in a deposit were deposited more than 2 business days after receipt.

collection account does not generate the amount of investment income that it otherwise could have realized. The investment income not realized results in a smaller monthly payment to the Department, which in turn, leads to a higher aggregate outstanding participation balance and greater yield for the Department. Because the Department earns the yield regardless of when collections are deposited to the collection account, there is no adverse effect on the Department as a result of untimely deposits. However, untimely deposits adversely affect the sponsor because the investment income not realized on the collection account balances and the increase in yield payments to the Department reduce the amount that the sponsor receives at the end of the LPP Program on a dollar-for-dollar basis.

Although untimely deposits adversely affect the sponsor, the financial impacts are minimal. During the 2008-2009 LPP Program, the average rates of return (annualized) on investments in the collection accounts for MOHELA, UHEAA, and PPSFC were 0.08 percent, 0.002 percent, and 0.06 percent, respectively. The combined investment income earned in the collection accounts for MOHELA, UHEAA, and PPSFC during this period was \$10,248, an insignificant amount considering the \$1.1 billion in participation interests purchased by the Department from these three sponsors.

***Results of OIG Review of Collection Account Statements***

Our review of sponsors’ collection account statements showed that Zions did not always have the information it needed to assess servicer compliance with the 2 business day deposit requirement. A Zions Vice President told us that when a servicer deposits receipts into the collection account, the servicer provides detailed information including the principal and interest breakdown and the date funds were received. Zions uploads the information into its financial system, which serves as the information source for the collection account statements. As shown in Table 4, servicers failed to provide the date funds were received on collection account statements about 18 percent of the time.

<b>Table 4. Frequency that Servicers Omitted Receipt Dates on Collection Account Statements</b>			
<b>Sponsor</b>	<b>Number of Deposits</b>	<b>Number of Times Servicer Receipt Date Was Omitted</b>	<b>Percent Omitted %</b>
MOHELA	200	52	26.0
UHEAA	142	3	2.1
PPSFC	106	26	24.5
<b>TOTAL</b>	<b>448</b>	<b>81</b>	<b>18.1</b>

Based on the number of omissions identified, we concluded that Zions did not adequately review the deposit information to ensure that servicers routinely provided the date on which funds were received. When a servicer fails to input this date, Zions is unable to verify whether or not the collections were deposited into the collection account within the required timeframe.

Although the Department expects that some collections will not be deposited within 2 business days after receipt, we concluded that the frequency of untimely deposits represents a systemic problem since only 22 of the 448 deposits tested were fully compliant. In addition, Zions failed to identify 81 deposits (18 percent) that did not include a receipt date that Zions needed in order

to determine the timeliness of servicers' deposits into the collection accounts. At the exit conference, a Zions Vice President stated that the process for receiving deposits evolved during the 2008-2009 LPP Program. According to the Vice President, Zions initially required servicers to provide only the interest and principal breakdown for each deposit. However, beginning in February 2009, Zions required the servicers to also provide the dates they received the funds because it realized that without these dates it was unable to monitor the timeliness of servicers' deposits into the collection accounts.

### **Zions Did Not Consistently Submit the MASDR within the Required Timeframe**

Zions did not ensure that the MASDRs were consistently submitted to the Department by the reporting deadlines specified in EA No. 17, *Monthly Aggregate Settlement Date Report Submission Procedures*, dated August 8, 2008 (updated September 25, 2008). According to a Zions Vice President, timely preparation and submission of the MASDR requires a collaborative effort between Zions and its servicers. Zions was responsible for obtaining monthly information from the servicers in a timely manner to ensure that the MASDRs were submitted to the Department by the reporting deadlines. We determined that the monthly reports were not submitted timely on many occasions for two of three sponsors because Zions did not ensure that servicers provided the monthly loan information in time for Zions to verify, compile, and submit the MASDRs by the reporting deadlines. The *Monthly Aggregate Settlement Date Report Data Fields – Definitions and Submission Procedures*, attached to EA No. 17, require custodians to submit the MASDRs "to the Department seven business days after the end of the month." When MASDRs are not submitted by the reporting deadline, the Department may not receive the monthly payments it is entitled to in a timely manner.

The Vice President described the MASDR preparation and submission process as follows:

- Servicers provide Zions with all of the information, except for the yield information that is calculated by Zions, that is reported in the MASDRs;
- Zions verifies the accuracy of the information provided by comparing it to information in the collection account statements;
- Zions inputs the information into the MASDRs after completing the verification process;
- Zions calculates and inputs the monthly yield information into the MASDRs; and
- Zions submits the MASDRs to the Department.

We evaluated the timeliness of Zions’ submission of MASDRs to the Department for each sponsor by comparing dates on Pay.gov confirmation numbers<sup>15</sup> from the MASDRs and email transmittals provided by a Department official to the MASDR reporting deadlines. As shown in Table 5, we found that Zions submitted 6 of 31 MASDRs (19 percent) after the reporting deadline of 7 business days after the end of the month. We determined that 3 of the 6 MASDRs that were submitted late resulted in delayed payments to the Department.

<b>Table 5. Timeliness of MASDR Submissions</b>				
<b>Sponsor</b>	<b>Number of MASDRs</b>	<b>Number of MASDRs Late</b>	<b>Percent Late %</b>	<b>No. of Days Late</b>
MOHELA	11	3	27.3	2 <sup>(a)</sup> , 7, & 11
UHEAA	7	0	0	--
PPSFC	13	3	23.1	2 <sup>(a)</sup> , 2 <sup>(a)</sup> , & 4
<b>TOTAL</b>	<b>31</b>	<b>6</b>	<b>19.4</b>	
<sup>(a)</sup> Although the MASDR was submitted late, the Department still received the monthly payment it was entitled to receive on time.				

**Zions Did Not Review Weekly and Monthly Loan Schedules to Ensure Accurate Information Was Reported**

We found that one servicer included incorrect information in Field 22 (Sponsor ID) of the Weekly and Monthly Loan Schedules<sup>16</sup> that were submitted to the Department. Zions delegated the preparation and submission of the Weekly and Monthly Loan Schedules to its servicers.<sup>17</sup> When a custodian delegates one or more of its responsibilities, Section 18 of the MPA requires the custodian to “take those steps that are reasonable under the circumstances to ascertain whether such delegee is properly performing the delegated obligations. . . .” For example, reasonable steps could include reviewing reports prepared by a delegee to obtain reasonable assurance that the information presented in the report is correct. Zions had not developed and did not perform any procedures to ensure that Weekly and Monthly Loan Schedule information its servicers provided to the Department was accurate.

We reviewed data Field 22 in the Weekly and Monthly Loan Schedules for each sponsor to verify that the correct lender identification (LID) was used. The March 13, 2009, *Loan Schedule and Custodial Certification Data File Fields—Definitions and Submission Procedures* attached

<sup>15</sup> The Pay.gov confirmation number is the confirmation number provided to the custodian on the Pay.Gov Web site immediately upon remitting payment. The payment date is incorporated into the Pay.gov confirmation number. For example, the Pay.gov confirmation number for the July 10, 2009, MASDR payment for MOHELA was FRP120090710652.

<sup>16</sup> The Loan Schedule and Custodial Certification is used for two reporting purposes: (1) to report the loans that will be subject to the LPP Program as part of a PPR (Weekly Loan Schedule); and (2) to report the total pool of loans that are subject to the LPP Program as of month end (Monthly Loan Schedule).

<sup>17</sup> Section 18 of the MPA prohibits custodians from delegating the preparation and submission of the Weekly and Monthly Loan Schedules. However, based on discussions with Department officials, the Department allows custodians to delegate this responsibility. In addition, guidance issued by the Department in the *Revised Funding Request Submission Instructions* attached to EA No. 53 states that the sponsor, or its delegee, is responsible for submitting the Weekly and Monthly Loan Schedules.



to EA No. 53 define Field 22 as "... the current holder/Sponsor who has placed or will place this loan in the Participation. . . . This is not the Custodian LID/RID." We verified that the correct LID was used in the Weekly and Monthly Loan Schedules for UHEAA and PPSFC. However, for MOHELA, we identified four different LIDs in Field 22 of the Weekly Loan Schedules and three different LIDs in Field 22 of the Monthly Loan Schedules as illustrated below.

**Weekly Loan Schedules**

828863 – MOHELA LID  
834442 – Zions Custodian LID  
806773 – Boone County National Bank LID  
814548 – U.S. Bank, NA LID

**Monthly Loan Schedules**

828863 – MOHELA LID  
834442 – Zions Custodian LID  
806773 – Boone County National Bank LID

The only LID that should have been reported in Field 22 in the Weekly and Monthly Loan Schedules was 828863, the LID for MOHELA. Because Zions had not reviewed the information that servicers provided in the Weekly and Monthly Loan Schedules, the Department had no assurance that the data in these schedules were reliable. At the exit conference, a Zions Vice President stated that it would be difficult for Zions to prevent errors because the servicers provide the Weekly and Monthly Loan Schedule information directly to the Department. Zions should have taken reasonable steps, such as reviewing reports prepared by its servicers, to ascertain whether its servicers were providing accurate and reliable information to the Department for any reporting activities it delegated, as required by Section 18 of the MPA.

As noted in Finding No. 1, under Section 14(b) of the MPA, custodians may be held liable for losses arising from its actions or the actions of its delegees.

**RECOMMENDATION**

- 2.1 We recommend that the Chief Operating Officer for Federal Student Aid hold Zions responsible, to the extent permitted under Section 14(b) of the MPA, for any liabilities arising from the noncompliance described in Finding No. 2.

**Zions Comments and OIG Responses**

Zions did not explicitly state whether it concurred with our finding and recommendation, but provided comments to each part of our finding. Zions described the corrective actions already taken to address three parts of our finding. We have not made any changes to our finding and recommendation based on Zions' comments.

### Zions Did Not Have a Required Agreement with One Servicer

- *Zions Comment.* Zions stated that PPSFC failed to inform Zions that it had established a sub-servicing arrangement with CoSTEP. Zions stated that once it became aware of the sub-servicing agreement with CoSTEP, it informed PPSFC that, pursuant to the terms of the MPA, the custodian is required to be a party to all servicing agreements. Zions added that PPSFC did not participate in the 2009-2010 LPP Program.
- *OIG Response.* Zions did not dispute our finding that it did not have a servicing agreement with CoSTEP during the 2008-2009 LPP Program. We verified that PPSFC did not participate in the 2009-2010 LPP Program.

### Zions Did Not Ensure that Servicers Transferred Collections to the Collection Accounts within the Required Timeframe

- *Zions Comment.* Zions stated that the Department recognized that servicers could not be 100 percent compliant with the 2 business day deposit requirement when the Department addressed the requirement in EA No. 34, *Interpretive Guidance Regarding Loan Purchase Programs*. In its corrective action plan, Zions stated that in the event a deposit was submitted untimely, it would notify the servicer and sponsor and request an explanation for the untimely deposit. Zions added that it worked closely with the Department to clear any servicer deposit issues.
- *OIG Response.* The Department recognized that some deposits may not meet the 2 business day deposit requirement in EA No. 34. The Department also stated in EA No. 34 that in determining an appropriate response to untimely remittances, it would consider the frequency of the untimely remittances, the explanation provided for the untimely remittances, and any prior notification concerning such remittances. Because only 22 of the 448 deposits we tested were fully compliant, we concluded that the frequency of untimely deposits represented a systemic problem. Zions' corrective action plan, which included notifying the servicer and sponsor when a deposit was late and requesting an explanation for the untimely deposit, appears to address the areas where Zions' oversight of servicer deposits needed improvement.

### Zions Did Not Consistently Submit the MASDR within the Required Timeframe

- *Zions Comment.* Zions stated that sponsors and servicers provided information needed to complete the MASDRs. Zions also stated that delays in the submission of the MASDRs could occur when there were balancing and/or reconciliation issues between information in the MASDRs and the Monthly Loan Schedules and/or collection accounts. Lastly, Zions stated that it has worked diligently with sponsors, servicers, and the Department to ensure the timely delivery of the MASDRs.
- *OIG Response.* Although we understand that balancing and/or reconciliation issues may arise, Zions should have obtained the information needed to prepare the MASDRs from servicers and sponsors early enough to ensure that the necessary reconciliations or

adjustments were made before the reporting deadlines. As stated in our report, when MASDRs were not submitted by the reporting deadline, the Department may not have received the monthly payments it was entitled to in a timely manner.

Zions Did Not Review Weekly and Monthly Loan Schedules to Ensure Accurate Information Was Reported

- *Zions Comment.* Zions stated that it exercised due care when it delegated the duty of creating and submitting the Weekly and Monthly Loan Schedules to its servicers and sponsors. Zions stated that it ensured that the Loan Schedules were submitted to the Department.
- *OIG Response.* When a custodian delegates one or more of its duties or obligations, Section 18 of the MPA requires the custodian to “take those steps that are reasonable under the circumstances to ascertain whether such delegee is properly performing the delegated obligations. . . .” By only ensuring that the Weekly and Monthly Loan Schedules were submitted to the Department, Zions did not ensure that servicers and sponsors were properly performing the delegated obligation of preparing the Loan Schedules.

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## OBJECTIVES, SCOPE, AND METHODOLOGY

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The purpose of the audit was to determine whether Zions, operating as a custodian in the ECASLA LPP Program (1) had adequate controls to ensure that its management of collection account funds complied with the terms and conditions of the MPA and applicable Department guidance; and (2) provided reasonable oversight of loan servicers and/or sponsors to ensure compliance with the terms and conditions of the MPA and applicable Department guidance. Our review was limited to the following areas:

- Zions’ management of collection account funds;
- Zions’ oversight and monitoring of servicer activities; and
- Zions’ oversight and monitoring of delegated duties.

Our review covered Zions’ controls and oversight activities for the period August 28, 2008 (the date the first adoption agreement was executed), through October 31, 2009 (the report date for the Monthly Loan Schedules used to identify the academic year 2009-2010 loans).

Prior to our initial site visit to Zions, we met with various Department officials from the Office of General Counsel and Federal Student Aid to obtain background information about the LPP Program and the custodian’s role in the program. To obtain background information on Zions and its operations, we reviewed—

- Information Zions submitted to the Department in its application to become an approved custodian under the LPP Program.
- The Zions Internal Audit Report, dated September 23, 2009, covering its Corporate Trust Operations.
- The FFEL Program Compliance Audit Report for Zions for the year ended December 31, 2008.
- Audited financial statements for Zions Bancorporation for the years ended December 31, 2008, and December 31, 2007.

To obtain background information on the sponsors/servicers and their operations, we reviewed—

- ECASLA sponsor AUP attestation engagement reports for MOHELA (for month ended November 30, 2008), UHEAA (for month ended March 31, 2009), and PPSFC (for month ended September 30, 2008).
- FFEL Program compliance audit reports for MOHELA (for year ended December 31, 2008), UHEAA (for fiscal year ended June 30, 2008), and PPMSC (for year ended December 31, 2008).
- Audited financial statements for MOHELA (for fiscal years ended June 30, 2009, and June 30, 2008), UHEAA (for fiscal years ended June 30, 2008, and June 30, 2007), NMEAF (for fiscal years ended June 30, 2009, and June 30, 2008), PPSFC (for fiscal years ended August 31, 2008 and August 31, 2007), and PPMSC (for year ended December 31, 2008), and the unaudited financial statements for UHEAA (for the 9 months ended March 31, 2009).
- Information on the following entities' Web sites: MOHELA, UHEAA, PPSFC, PPMSC, NMEAF, and CoSTEP.

To evaluate Zions' controls for managing collection account funds, we—

- Reviewed and gained an understanding of relevant laws, regulations, guidance, and agreements, which included: (1) ECASLA; (2) the "Notice of terms and conditions of purchase of loans under the Ensuring Continued Access to Student Loans Act of 2008," published in the Federal Register on July 1, 2008 (73 FR 37422); (3) the Department's Electronic Announcements; (4) the Department's *LPP Program FAQ*; (5) the MPA and applicable adoption agreements; and (6) eligible servicing agreements.
- Reviewed Zions' policies and procedures for managing collection account funds related to PPRs, loan redemptions, loan sales, servicer deposits, and investments.
- Interviewed officials in Zions' Corporate Trust Division, including the Manager, Vice President, and Trust Administrator.
- Reviewed the collection account statements, MASDRs, and Weekly and Monthly Loan Schedules for each sponsor, and assessed the consistency of the information in the three sources.

- Gained an understanding of how funds flowed through the collection account and evaluated Zions' compliance with applicable Department guidance and agreements by reviewing the documentation for one month's activity for each sponsor, UHEAA's collection account activity for March 2009 and September 2009, and sample transactions for a PPR, loan redemption, loan sale, and servicer deposit.
- Reviewed the yield calculations performed by Zions and the Department to determine whether the calculations were consistent and whether the Department received the yield it was entitled to receive.
- Reviewed the Semi-annual or Annual Reports for the money market funds to determine whether collection account funds were invested in Permitted Investments.

To evaluate whether Zions provided reasonable oversight and monitoring of servicer activities and delegated duties, we—

- Gained an understanding of the terms and conditions of the MPA and Department guidance applicable to the custodian's oversight of servicer activities and delegated duties.
- Reviewed Zions' written policies and procedures for monitoring servicers and sponsors and interviewed Zions officials.
- Reviewed Zions' new business acceptance/due diligence checklists, the agendas and questionnaires for site visits made to servicers, and the ESAs that Zions entered into with its servicers.
- For each sponsor, reviewed the servicer accounting records for all deposits (100 percent review) to evaluate the servicers' compliance with the timely deposit requirement.
- For each sponsor, reviewed the "Description" field of the collection account statements for all deposits to determine whether servicers routinely provided the receipt dates.
- Compared the MASDR submission dates from the Pay.gov confirmation numbers and email transmittals from a Department official to the MASDR reporting deadlines in order to determine whether Zions submitted the MASDRs on time.
- Reviewed Field 22 (Sponsor ID) in the Weekly and Monthly Loan Schedules for each sponsor to determine whether incorrect LIDs were included.

To determine whether Zions (1) followed its policies and procedures for submitting PPRs to the Department, and (2) submitted the executed security release(s) to the Department within 7 business days after receiving the PPR proceeds, we reviewed 10 PPRs and the related security releases from a universe of 42 PPRs requiring a security release. We reviewed 4 of MOHELA's 23 PPRs, 3 of UHEAA's 9 PPRs, and 3 of PPSFC's 10 PPRs. We received the documentation for one of MOHELA's PPRs as part of our initial request for information at the entrance meeting. We later requested that Zions provide 9 additional PPRs and the related security releases, 3 for each sponsor. Given that the purpose of our review was to confirm that Zions followed its policies and procedures for submitting PPRs and obtaining/executing security releases (and thus did not comply with the requirement specified in EA No. 53 to obtain security releases prior to submitting PPRs), we allowed Zions to select the PPRs and related security

releases for us to review. We did not extend our review beyond the 10 PPRs and related security releases because we were able to confirm from our review that Zions did follow its policies and procedures for submitting PPRs to the Department.

To determine whether Zions held title to loans while they were subject to the LPP Program, we obtained the October 2009 Monthly Loan Schedules for MOHELA and UHEAA. The Monthly Loan Schedules for MOHELA and UHEAA contained 22,272 and 37,436 loans, respectively. We randomly selected 20 loans (10 MOHELA loans and 10 UHEAA loans) and reviewed loan documentation such as promissory notes, loan detail reports from the servicers' loan servicing systems, repayment and disbursement schedules, and disclosure statements. We determined that Zions properly held title to all 20 loans, and we decided not to extend our review to a larger sample. As previously stated in the report, we reviewed the loan documentation for academic year 2009-2010 loans because at the time of our review, all of the academic year 2008-2009 loans had either been redeemed by the sponsors or sold to the Department.

To achieve our audit objectives, we relied, in part, on computer-processed data contained in Zions' financial system and the loan servicing systems of the sponsors/servicers. We verified the completeness of the data by comparing information in the MASDRs we obtained from Zions to information in the MASDRs that we obtained from the Department. We determined that the MASDRs that Zions provided to us were the same MASDRs that it provided to the Department. We also verified the consistency and reliability of selected data elements relevant to our review by comparing information in the MASDRs to information in the collection account statements and Weekly and Monthly Loan Schedules. We concluded that Zions' financial system and the loan servicing systems of the sponsors/servicers were sufficiently reliable for the purposes of our audit.

We performed our audit work at Zions' Corporate Trust offices located in Denver, Colorado, between October 13, 2009, and December 4, 2009. We held an exit briefing with Zions officials on April 14, 2010. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## **ADMINISTRATIVE MATTERS**

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Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determinations of corrective action to be taken will be made by the appropriate Department of Education officials.

This report incorporates the comments you provided in response to the draft report. If you have any additional comments or information that you believe may have a bearing on the resolution of

this audit, you should send them directly to the following Department of Education official, who will consider them before taking final Departmental action on this audit:

William J. Taggart  
Chief Operating Officer, Federal Student Aid  
U.S. Department of Education  
Union Center Plaza, Room 112E1  
830 First Street, N.E.  
Washington, DC 20202

It is the policy of the U. S. Department of Education to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within 30 days would be appreciated.

In accordance with the Freedom of Information Act (5 U.S.C. § 552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

Sincerely,

/s/

Raymond Hendren  
Regional Inspector General for Audit

#### Attachments

#### Electronic cc:

Richard Sullivan III, Senior Vice President and Director, Zions  
Casey Gunning, Vice President, Zions  
William J. Taggart, Chief Operating Officer, FSA  
Eduardo Ochoa, Assistant Secretary for Postsecondary Education

## Acronyms and Abbreviations Used in this Report

AUP	Agreed Upon Procedures
CoSTEP	Council for South Texas Economic Progress, Inc.
Department	U.S. Department of Education
EA	Electronic Announcement
ECASLA	Ensuring Continued Access to Student Loans Act of 2008
ESA	Eligible Servicing Agreement
FAQ	Frequently Asked Questions
FFEL Program	Federal Family Education Loan Program
HEA	Higher Education Act of 1965, as amended
LID	Lender Identification
LPP Program	Loan Participation Purchase Program
MASDR	Monthly Aggregate Settlement Date Report
MOHELA	Missouri Higher Education Loan Authority
Monthly Loan Schedule	Loan Schedule and Custodial Certification used to report the total pool of loans that are subject to the LPP Program as of month end
MPA	Master Participation Agreement, dated July 25, 2008
NMEAF	New Mexico Educational Assistance Foundation
PPMSC	Panhandle-Plains Management and Servicing Corporation
PPR	Participation Purchase Request
PPSFC	Panhandle-Plains Student Finance Corporation
Security Release	Security Release Certificate
UHEAA	Utah Higher Education Assistance Authority
Vice President	Vice President, Zions Corporate Trust Division
Weekly Loan Schedule	Loan Schedule and Custodial Certification used to report the loans that will be subject to the LPP Program as part of a PPR
Zions	Zions First National Bank



**Attachment 1: Custodian Duties and Obligations under the MPA**

<b>MPA Section</b>	<b>Duties/Obligations of Custodian</b>
<b>§4</b>	<b>Delivery of Loans to Custodian; Purchase and Sale of Participation Interests</b>
§4(b)	The custodian shall hold all rights, title, and interests in the loans until the redemption date. The custodian (or its designee) shall hold loan documents in trust. The custodian shall not release loan documents, except: (i) to the sponsor upon receipt of the redemption payment, (ii) to the Department upon exercise of put, (iii) for servicing purposes, and (iv) when permitted by the Department in writing.
§4(c)	On the purchase date, (i) the custodian receives purchase price from the Department and remits it to the sponsor, and (ii) the custodian provides the Department with a Class A Participation Interest and Loan Schedule and Custodial Certificate.
§4(e)	The custodian holds the promissory notes in its name. If eligible loans are evidenced together with ineligible loans by a Master Promissory Note, book entry is used by the custodian.
<b>§5</b>	<b>Participation Certificates; Loan Schedule and Custodian Certificates</b>
§5(a) thru (e)	On or prior to the purchase date, the custodian issues a Class A certificate to Department and Class B certificate to the sponsor. Loan Schedules and Custodial Certificates are included with Class A or B certificates.
<b>§7</b>	<b>Subsequent Disbursements</b>
§7	The custodian shall make scheduled disbursements (with the sponsor providing the necessary funds) on loans and shall issue participation interests in such disbursements.
<b>§8</b>	<b>Reporting; Due Diligence</b>
§8(b)(1)	The custodian provides to the Department a MASDR showing loan activity, aggregation of Participant’s Yield, and principal paid to the Department on its Class A participation interest.
§8(b)(2)	An audit conducted by an independent public accountant of the custodian’s activities is due prior to the later of (1) 90 days after the termination date or (2) the date on which the Department publishes audit guidance.
<b>§10</b>	<b>Representations and Warranties</b>
§10(c)	The custodian is required to make various representations and warranties.
<b>§11</b>	<b>Collections; Distributions</b>
§11(a)	The sponsor establishes a collection account at the custodian for all payments and proceeds and invests only in Permitted Investments.
§11(b)	Upon the first business day of each month, the custodian distributes funds in the collection account in the following order: (i) to the Department to pay its yield, (ii) to the Department to reduce Class A principal, and (iii) to the sponsor, any remaining amounts.
§11(d)	At the termination date, the custodian distributes funds in the collection account in the following order: (i) to the Department to pay its yield, (ii) to the Department to reduce Class A principal, and (iii) to the sponsor, any remaining amounts.
<b>§12</b>	<b>Servicing</b>
§12(a)	The custodian enters into an “eligible servicing agreement” with a servicer.
§12(c)	In addition to customary terms and conditions, the eligible servicing agreement shall include (but is not limited to): <ul style="list-style-type: none"> <li>• An acknowledgement that the Department is a third party beneficiary under the agreement and is entitled to instruct the servicer and exercise remedies in the event of a servicer default.</li> <li>• A provision that the servicer will deposit all collections into the collection account within 2 business days after receipt.</li> <li>• A provision that the agreement is terminable by the Department with 30 days notice and the loans deconverted and transferred without any costs, penalties, or fees paid by the Department.</li> <li>• A provision that the servicer shall provide documents and information to the custodian to enable the custodian to oversee the servicer.</li> </ul>
§12(d)	The custodian shall ensure that the servicer shall be responsible for segregating, marking each loan

MPA Section	Duties/Obligations of Custodian
	as owned by the custodian, and remitting all loan payments to the custodian.
<b>§13</b>	<b>Enforcement of the Servicing Agreements</b>
§13(a)	The custodian shall enforce the servicing agreements and cause the servicer to specify whether deposits to the collection account are principal or interest.
§13(d)	The custodian shall notify the Department if the servicer is in default.
§13(e)	The custodian shall not waive default by the servicer without the Department's consent.
<b>§15</b>	<b>Redemption; Put Option; Termination</b>
§15(a)	The custodian calculates the redemption payment for Class A participation interests to be paid by the sponsor to the Department.
§15(b)	Upon receipt of redemption payment, the custodian shall (i) remit the payment to the Department, (ii) transfer title in loans to the sponsor and release all interests, (iii) deliver all loan documents to the sponsor, and (iv) cancel Class A and B participation interests.
§15(c)	If the sponsor requests to put loans to the Department, the custodian shall (i) transfer title in loans to the Department and release all interests, (ii) deliver all loan documents to the Department, and (iii) cancel Class A and B participation interests. In addition, at the Department's discretion, the custodian will (i) receive payment from the Department for net amount due the sponsor, (ii) deposit funds into the collection account, and (iii) distribute funds in the collection account per §11.
§15(e)	At the termination date, all loans not redeemed by the sponsor become property of the Department. The custodian remits to the sponsor any excess redemption payments (if any) over liabilities due to the Department.
§15(f)	The custodian shall not release any loans from a Class A interest if, after the release, the principal balance of the loans would be less than the principal balance of Class A participation interests and yield due to the Department.
<b>§17</b>	<b>Custodian Events of Default; Removal of Custodian</b>
§17	The custodian may be removed upon an event of default and a successor custodian named.
<b>§18</b>	<b>Delegation of Duties by Custodian</b>
§18	The custodian may delegate certain obligations to another eligible lender (including the sponsor) or a servicer. However, the custodian may not delegate: (i) holding legal title in its own name in the purchased loans; (ii) issuing and authenticating participation certificates; (iii) issuing the participation interests; (iv) creating and delivering the loan schedules and custodial certificates and reports required under §8; and (v) hold and disburse all collections and redemption payments. If the custodian delegates its obligations, it shall take steps to ascertain that the delegee is performing the obligations.
<b>§23</b>	<b>Tax Matters</b>
§23(a)	The agreement is a partnership.
§23(b)	The partnership's fiscal year end is December 31. The custodian shall prepare Schedule K-1 (Form 1065) for the Department and the sponsor.
§23(c)	The custodian shall establish and maintain a separate capital account for each partner. The partnership's income, gains, losses and expenses shall be allocated among the capital accounts.
§23(d)	If the partnership pays any taxes directly, subsequent distributions to the partners shall be adjusted so that the burden of taxes is borne by the partner(s) to which such tax obligation is attributable.

**Attachment 2: Zions' Comments to the Draft Report**

**ZIONS BANK®**

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August 20, 2010

VIA EMAIL

United States Department of Education  
Office of Inspector General  
Raymond Hendren  
Regional Inspector General for Audit  
501 I Street, Suite 9-200  
Sacramento, CA 95814  
[ray.hendren@ed.gov](mailto:ray.hendren@ed.gov)

RE: Draft Audit Report – Zions First National Bank's Management of Collection Account Funds and Oversight Activities under the ECASLA Loan Participation Purchase Program  
Control Number: ED-OIG/A09J0009

Dear Mr. Hendren:

Please find attached response to the findings and recommendations regarding the above referenced Draft Audit Guide.

If you have any questions please do not hesitate to call me at (720) 947-7448.

Best regards,

/s/

Casey Gunning  
Vice President

**United States Department of Education  
Office of Inspector General**

**Response to Draft Audit Report**

***Finding No. 1 – Zions Did Not Comply with Requirements Covering Security Release Certificate Submissions and Permitted Investments***

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**Zions Did not Obtain Required Security Releases Prior to the Submission of PPRs to the Department and Did Not Always Submit Executed Security Releases Timely**

Response:

Zions Bank has is in compliance with the original procedures established pursuant to Section 9(b)(vii) “Security Release Certification” of the Master Participation Agreement which requires that the Sponsor deliver to the Department a fully executed Security Release Certification with respect to purchased loans which provides the Department with the necessary lien release on the purchased loans.

Corrective Action Plan:

Zions Bank instituted the updated procedures as outlined in Electronic Announcement 53.

**Zions Did Not Invest Collection Account Funds in Permitted Investments**

Response:

Zions Bank, pursuant to the written investment direction of each Sponsor, invested collection account funds in money market funds that were rated AAA by S&P and Moody’s, invested in U.S. Treasury securities with a weighted average term of 60 days and repurchase agreements that are fully collateralized by U.S. Government securities. Each component of the selected investment is included in the Departments definition and interpretation of Permitted Investments as provided in Item No. 11 of the LPP Program FAQ.

Corrective Action Plan:

All collection account funds are invested in a 100% U.S. Treasury securities money market fund.

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***Finding No. 2 – Zions’s Oversight of Servicer Activities Needs Improvement***

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**Zions Did Not Have a Required Agreement with One Servicer**

Response:

Panhandle-Plains Student Finance Corporation (PPSFC) failed to notify Zions Bank it had established a sub-servicing arrangement with the Council for South Texas Economic Progress (COSTEP).

Corrective Action Plan:

Upon becoming aware of the sub-servicing arrangement with COSTEP, Zions Bank notified PPSFC that pursuant to the terms of the Master Participation Agreement, the Custodian is required to be a party to all servicing agreements.

PPSFC closed out the 2008-2009 Loan Participation Program and did not participate in the 2009-2010 Loan Participation Program.

**Zions Did Not Ensure that Servicers Transferred Collections to the Collection Accounts within the Required Timeframe**

Response:

During the establishment of the ECASLA program the Sponsors, Servicers and Custodians worked diligently with the Department in drafting sessions and other industry focus groups to establish reasonable guidelines for the processing of borrower payments received by the Servicer and submission of borrower payments to the Custodian. During this process the Servicers and Sponsors highlighted the challenges that the two day requirement would create in regards to customary industry practice.

After the Master Participation Agreement was established, the Department provided additional guidance regarding the two day requirement within Electronic Announcement 34, Interpretive Guidance Regarding Loan Purchase Programs (dated October 31, 2008). As part of the guidance the Department recognized that the Servicer could not be 100% compliant with the two day requirement.

Corrective Action Plan:

Zions Bank requires that all deposits made by the servicer include the date of deposit to monitor the two day requirement is met. In the event a deposit is submitted to Zions Bank beyond the two day requirement, Zions Bank notifies the Sponsor and Servicer and requests an explanation for the occurrence. Zions Bank also works closely with the Department to clear any servicer deposit issues (also see response to completion of MASDR below).

### **Zions Did Not Consistently Submit the MASDR within the Required Timeframe**

Response:

The Sponsor and Servicer provide information to the Custodian in order to complete the MASDR. In the event there is a balancing and/or a reconciliation issue between the MASDR to the Monthly Loan Schedule (MLS) and/or to the collections to the account this can delay the submission of the MASDR.

If the submission of the MASDR is anticipated to be delayed the Sponsor and Zions Bank immediately notifies the Department of any potential delays and works with the Department to remediate any such occurrence.

Corrective Action Plan:

Zions Bank, the Sponsors and Servicers have worked diligently with the Department over the course of the program to ensure the timely delivery of the MASDR.

### **Zions Did Not Review Weekly and Monthly Loan Schedules to Ensure Accurate Information Was Reported**

Response:

The Loan Schedule is created by the Sponsor and Servicer and submitted directly to the Department by the Sponsor/Servicer via the Gateway. This duty has been delegated to the Sponsor/Servicer by Zions Bank as Custodian in all instances.

Pursuant to Section 18 of the MPA, Zions Bank has exercised due care in its appointment to a delegee by delegating those duties to an experienced Servicer and Department approved Sponsor. Zions Bank as Custodian ensured that the Loan Schedules were submitted to the Department pursuant to the terms of the MPA.