Dear Ms. Hanson:

This Final Audit Report, entitled Wells Fargo Bank, National Association’s (Wells Fargo) Management of Collection Account Funds and Oversight Activities under the Ensuring Continued Access to Student Loans Act (ECASLA) Loan Participation Purchase (LPP) Program, presents the results of our audit. The purpose of the audit was to determine whether Wells Fargo, as Custodian, (1) had adequate controls to ensure its management of the Collection Account 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 Sponsors and Servicers to ensure compliance with the terms and conditions of the MPA and applicable Departmental guidance. Our review covered the LPP Program for academic year 2008-2009 loans (the 2008-2009 LPP Program).

BACKGROUND

ECASLA (Pub. Law 110-227) was enacted on May 7, 2008, in part, to address concerns that there may have been inadequate loan capital to meet the demand for academic year 2008-2009 loans. ECASLA added Section 459A to the Higher Education Act of 1965 (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.

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 (ELT) (when applicable), Custodians, and the Department. By executing an adoption agreement, each of these

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1 For purposes of the LPP Program, academic year 2008-2009 means that the loan was for a loan period that included, or began on or after, July 1, 2008, and the first disbursement was made on or after May 1, 2008, but not later than July 1, 2009, and the loan was fully disbursed no later than September 30, 2009.
2 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.
entities agreed to the terms and conditions of the MPA. Brief descriptions of the entities that operated 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 could be a secondary market or beneficial holder under an ELT agreement. The Sponsor sold participation interests in loans to the Department through a Custodian.

- **Custodian** – An eligible FFEL Program lender that was a national or State chartered bank. A Custodian could not be affiliated with Sponsors or ELTs with which it had entered into adoption agreements. The Custodian was granted the legal title to the loans for which a participation interest was sold to the Department.

- **Department** – The Department purchased 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, serviced the LPP Program loans under an Eligible Servicing Agreement (ESA) with a Custodian.

In order to sell a participation interest to the Department, a Sponsor would first transfer title of the loans to a Custodian. The Custodian would then sell the participation interest in the loans to the Department and distribute the proceeds of the transaction back to the Sponsor. Under the 2008-2009 LPP Program, Sponsors were required to redeem the Department's participation interests in one of two ways. First, by remitting a redemption payment by September 30, 2009, for each participation interest to the Department; or second, by selling the underlying loans by October 15, 2009, to the Department under the ECASLA Loan Purchase Commitment Program (LPC). Under the LPC Program, the Department purchased fully disbursed, eligible FFEL Program loans.

Wells Fargo was one of five Department-approved Custodians under the 2008-2009 LPP Program that provided trust and custody services for loans in which the Department purchased a participation interest. Headquartered in San Francisco, California, Wells Fargo is a financial services company that provides banking, insurance, investment, mortgage, and consumer finance services. Wells Fargo’s Corporate Trust Services Division, located in Jacksonville, Florida, was responsible for managing the sale and purchase of participation interests between eight Sponsors and the Department under the 2008-2009 LPP Program. Wells Fargo had five Relationship Managers who were responsible for administering the participation interests associated with the eight Sponsors. Two Relationship Managers were located in Jacksonville, Florida; two in Minneapolis, Minnesota; and one in Des Moines, Iowa. In addition to being an approved Custodian for the 2008-2009 LPP Program, Wells Fargo was an approved Custodian for the 2009-2010 LPP Program.

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4 A beneficial holder did not meet the HEA criteria to participate in the FFEL Program. However, a beneficial holder may have participated in the FFEL Program through an agreement with an eligible lender to serve as its trustee. In order for a beneficial holder, that was not an eligible lender under § 435(d) of the HEA, to participate in the LPP Program, its ELT must have also executed the adoption agreement.

5 Under the LPC Program, the Department purchased certain FFEL Program loans made for the 2008-2009 academic year. Under the provisions of the Master Loan Sales Agreement, the Department purchased a loan at a price that was equal to the outstanding principal balance of the loan, plus the total accrued but unpaid interest owed on the loan by the borrower, plus a reimbursement of the one percent lender fee, plus $75 per loan.
In total, the Department purchased about $33.3 billion of participation interests in FFEL Program loans under the 2008-2009 LPP Program. Wells Fargo was the Custodian for about $21 billion, or 63 percent, of the total participation interests purchased by the Department under the 2008-2009 LPP Program. Loans for which Wells Fargo operated as Custodian under the 2008-2009 LPP Program were serviced by seven entities: ACS, Great Lakes Educational Services (Great Lakes), Nelnet, Pennsylvania Higher Education Assistance Agency (PHEAA), Education Services Foundation, South Carolina Student Loan Corporation (SCSLC), and Sallie Mae. Table 1 provides information on participation interests the Department purchased during the 2008-2009 LPP Program for which Wells Fargo operated as the Custodian.

Table 1 – Participation Interests for which Wells Fargo Served as Custodian

<table>
<thead>
<tr>
<th>Sponsor</th>
<th>Servicer(s)</th>
<th>Cumulative Participation Interest Purchased</th>
</tr>
</thead>
<tbody>
<tr>
<td>Graduate Leverage</td>
<td>ACS, Great Lakes, Nelnet</td>
<td>$30,797,626</td>
</tr>
<tr>
<td>Iowa Student Loan Liquidity Corporation (ISLLC)</td>
<td>PHEAA</td>
<td>$144,846,241</td>
</tr>
<tr>
<td>Mississippi Higher Education Assistance Corporation (MHEAC)</td>
<td>Education Services Foundation, ACS, PHEAA</td>
<td>$244,195,136</td>
</tr>
<tr>
<td>National Education Financing II</td>
<td>ACS, Great Lakes</td>
<td>$13,859,358</td>
</tr>
<tr>
<td>NorthStar Education Finance</td>
<td>Great Lakes</td>
<td>$217,233,641</td>
</tr>
<tr>
<td>SCSLC</td>
<td>SCSLC</td>
<td>$245,117,834</td>
</tr>
<tr>
<td>Sallie Mae Education Credit Finance Corporation (SLM ECFC)</td>
<td>Sallie Mae, Great Lakes, Nelnet</td>
<td>$20,212,971,803</td>
</tr>
<tr>
<td>Student Lending Works</td>
<td>ACS</td>
<td>$26,431,075</td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td>$21,135,452,714</td>
</tr>
</tbody>
</table>

Appendix B to this report provides a summary of the Custodian’s duties and obligations under the MPA. Among the duties required under the MPA, Wells Fargo created and maintained a Collection Account on behalf of each Sponsor, verified the calculations of the participant’s yield owed to the Department, executed and submitted the Participation Purchase Requests (PPR), executed each Bill of Sale, created and maintained the participation interests and certificates, and submitted the Monthly Aggregate Settlement Date Report (MASDR) to the Department. Wells Fargo’s five Relationship Managers handled deposits into the Collection Account, invested the

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6 Wells Fargo delegated the calculations of the participant’s yield to the Sponsors. The Relationship Managers stated that they recalculated the participant’s yield to determine if the Sponsor’s yield calculations were correct and added the amount of the Collection Account’s investment income to the Monthly Aggregate Settlement Date Report (MASDR).
Collection Account’s balances, and made the monthly payments from the Collection Account to the Department and the Sponsor in accordance with the MPA. The MPA also allowed the Custodian to delegate functions to a third party. As such, Wells Fargo delegated permitted duties and responsibilities to the Sponsors and Servicers including (1) calculating the participant’s yield due to the Department; (2) creating the MASDR; (3) holding loan documents; and (4) preparing and submitting both the Weekly Loan Schedule and Custodial Certification (Weekly Loan Schedule) and Monthly Loan Schedule and Custodial Certification (Monthly Loan Schedule). Because Wells Fargo delegated these duties to the Servicers and/or Sponsors, it was responsible for ensuring that its delegates were properly performing the delegated obligations in accordance with the terms and requirements of the MPA and applicable Departmental guidance.

AUDIT RESULTS

Except for the deficiencies in monitoring and oversight detailed in this report, Wells Fargo had controls to reasonably ensure that its management of Collection Account funds complied with the terms and conditions of the MPA and applicable Departmental guidance. We found that Wells Fargo (1) established a Collection Account for each Sponsor to hold all collections related to the loans subject to the 2008-2009 LPP Program for the Department as holder of participation interests; (2) invested Collection Account funds in Permitted Investments; and (3) distributed the funds on deposit in the Collection Accounts in compliance with Sections 11(b) and 11(d) of the MPA. However, we found that Wells Fargo did not sufficiently monitor and provide oversight of its Sponsors and Servicers as required by Section 18 of the MPA. Specifically, Wells Fargo did not have sufficient policies and procedures to ensure consistent monitoring and oversight of its Sponsors and Servicers. As a result, Wells Fargo had not consistently managed and documented its monitoring efforts and had not demonstrated sufficient oversight related to the performance of its Sponsors and Servicers. Without consistent management, including sufficient monitoring and oversight, Wells Fargo cannot assure that it adequately performed its duties as Custodian in accordance with the terms and conditions of the MPA and other Departmental guidance.

In its comments to the draft report, Wells Fargo did not concur with our finding and recommendation. Although Wells Fargo provided additional documentation with its comments, the documentation included no new information and, as such, did not warrant any change to the report finding or recommendation. Wells Fargo also provided us with independent audit reports of the Servicers; however, those reports were not specific to the requirements of the 2008-2009 LPP Program. Wells Fargo’s comments are summarized at the end of the finding along with our response. The full text of its comments to the draft report is included as Appendix C to the report.

Wells Fargo stated that the additional documentation provided included proprietary information that would cause economic harm if released and requested that it not be included as part of the public release of this report. Since the additional documentation is voluminous, we have not included it as part of this report. For any request for this additional documentation, we will make a determination of the documentation’s qualification to be considered as confidential commercial information, pursuant to Exemption (b)(4) of the Freedom of Information Act, 5 U.S.C. § 552(b)(4), and act appropriately.
FINDING – Wells Fargo Did Not Sufficiently Monitor and Provide Oversight of its Sponsors and Servicers

Wells Fargo delegated certain duties under the MPA to its Sponsors and Servicers. We found that Wells Fargo did not sufficiently monitor and provide oversight of its Sponsors and Servicers to determine that they properly performed the delegated obligations as required by the MPA. Specifically, Wells Fargo did not (1) have sufficient policies and procedures to ensure consistent monitoring and oversight of the 2008-2009 LPP Program; (2) maintain sufficient documentation of its monitoring and oversight; (3) ensure that a Servicer accurately identified loans subject to a pre-existing security interest on the Weekly Loan Schedule; and (4) verify that Servicers remitted borrower payments within 2 business days of receipt.

Wells Fargo Did Not Have Sufficient Policies and Procedures to Ensure Consistent Monitoring and Oversight of the 2008-2009 LPP Program

Wells Fargo did not have sufficient written policies and procedures for monitoring its eight Sponsors and seven Servicers. With five Relationship Managers located in three separate locations, it was critical to have policies and procedures to ensure consistency in monitoring and oversight. In addition, monitoring and oversight were necessary to ensure that its Sponsors and Servicers properly performed the delegated obligations. Specifically, Section 18 of the MPA stated –

The Custodian may delegate to another Eligible Lender (including the Sponsor) or to the related Servicer certain of its obligations. . . . 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. . . (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.

Wells Fargo delegated many of the Custodian’s functions to its Sponsors and Servicers; as such, it relied heavily on the information provided by its Sponsors and Servicers. According to the Wells Fargo Vice President, Student Loan Product Manager (Student Loan Product Manager), the Servicers and Sponsors agreed to accept responsibility for the information provided as well as hold the Custodian harmless in the Adoption, Custodian, and Servicer Agreements. Although Wells Fargo delegated certain responsibilities, Section 14(b) of the MPA stated that –

The Custodian shall be liable in accordance herewith only to the extent of the obligations specifically undertaken by the Custodian under this Agreement, and with respect to those obligations delegated by it pursuant to the terms hereof, only to the extent the Custodian shall not have complied with Section 18. . . . 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 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.
Wells Fargo officials stated that it had adequate controls in place to provide oversight to ensure compliance with the MPA. According to Wells Fargo officials, its Tickler System\(^7\) matched the requirements contained in the MPA. Wells Fargo provided the Account Control Tickler Standards, dated May 2010\(^8\) along with a listing of all ticklers associated with the 2008-2009 LPP Program. We reviewed the documents provided and concluded that the Tickler System is a general use system that allows Relationship Managers to establish one-time or recurring reminders that appear on a specific date. Examples of the ticklers contained in the Tickler System for the 2008-2009 LPP Program included a reminder (1) for one of the Relationship Managers to prepare and mail the Schedule K-1 (Form 1065) and any other information needed to the Department and the Sponsor for income tax preparation; (2) to deliver the Monthly Rolling Forecast Report and MASDR via email to the Department by the 7th business day of the month; (3) to enter the investment income amount and the pay.gov confirmation number on the MASDR; and (4) to verify the participant’s yield on the MASDR. After reviewing the ticklers related to the 2008-2009 LPP Program, we found that the established ticklers did not address many of the Custodian’s responsibilities contained in the MPA such as (1) ensuring that legal title of the loans was held in the Custodian’s name; (2) calculating redemption payments; (3) issuing and authenticating participation certificates; and (4) creating and delivering the Weekly and Monthly Loan Schedules. In addition, the ticklers related to the 2008-2009 LPP Program did not include adequate steps or reminders to ensure that the obligations delegated to the Sponsors and Servicers were performed as required.

Wells Fargo had not consistently managed and documented its monitoring efforts and had not provided sufficient oversight of Servicer activities and delegated duties. Without sufficient policies and procedures to ensure consistent monitoring and oversight of its Servicers and delegatees, Wells Fargo cannot demonstrate that it consistently performed its duties as Custodian in accordance with the terms and conditions of the MPA and other Departmental guidance.

**Wells Fargo Did Not Maintain Sufficient Documentation of Monitoring and Oversight**

According to Wells Fargo’s Student Loan Product Manager and Relationship Managers, Wells Fargo’s monitoring and oversight activities over delegated functions included verifying the participant’s yield rates\(^9\) and the rates reflected in the MASDR, recalculating the participant’s yield, and verifying the average daily principal balance and number of days in the period. However, none of the five Relationship Managers were able to provide evidence of their monitoring and oversight efforts over the delegated functions. Such evidence would include monitoring reports or average daily balance calculations to support their verification of the participant’s yield calculations for the 2008-2009 LPP Program. Without documentation of monitoring activities, Wells Fargo could not demonstrate that it took reasonable steps to ascertain that the Sponsors and Servicers properly performed the delegated responsibilities.

If a Custodian delegated one or more of its responsibilities, Section 18 of the MPA required the Custodian to take reasonable steps to determine whether the delegate was properly performing the delegated obligations. Examples of reasonable steps would include developing formal policies and procedures, maintaining sufficient documentation of monitoring, and documenting the

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\(^7\) The Tickler System is an electronic system that Relationship Managers use to establish reminders for future trust account activities.

\(^8\) Account Controls Tickler Standards are Wells Fargo’s written procedures for its Tickler System.

\(^9\) The participant’s yield rates consisted of the commercial paper rate plus 0.5 percent (or 3 percent, if an event of default occurred).
verification of yield calculations and timeliness of borrower payment deposits into the Collection Account.

The Student Loan Product Manager stated that the Relationship Managers calculated the participant’s yield. In support of the Student Loan Product Manager’s statement, Wells Fargo provided a listing of all its ticklers related to the 2008-2009 LPP Program. However, the tickler listing included reminders instructing the Relationship Managers to verify the yield calculations, not to calculate them. In performing our audit, we reviewed and compared Sponsors’ participant’s yield calculations and payments made from the Collection Accounts to the Department’s yield calculations. Although we found calculation variances for 17 of 46 months reviewed for four Sponsors, all of the differences occurred at the beginning of the 2008-2009 LPP Program and most were minimal.10 For 3 of the 17 months for which variances existed, we noted variances of between 16.3 and 23.5 percent. However, these variances reflected larger participant’s yields calculated by the Sponsor in comparison to the Department’s calculation. Department officials stated that the Department changed its yield calculation methodology and shared it with the Custodians, including Wells Fargo. Department officials also stated that if discrepancies occurred, the Department’s yield calculation took precedence and was used to determine the payment amount.

Wells Fargo Did Not Ensure That a Servicer Accurately Identified Loans Subject to a Pre-existing Security Interest on the Weekly Loan Schedule

Wells Fargo did not effectively monitor and provide oversight of one of its Servicers, MHEAC, to ensure that loans were accurately identified on the Weekly Loan Schedule as being subject to a preexisting security interest as required by the Loan Schedule and Custodial Certification Data File Fields – Definitions and Submission Procedures, updated September 2, 2009, attached to Electronic Announcement (EA) No. 62, Loan Purchase Participation Program - Revised Loan Schedule and Eligibility Edits Announcement, dated May 14, 2009, (updated September 2, 2009). The MPA’s Section 3 “Definitions” specified that an “Eligible Loan” was one where “the Sponsor, together with the Eligible Lender Trustee (if applicable) had good and marketable title to, and was the sole owner of, the Loan, free and clear of all security interests . . . (other than an interest or lien that will be released simultaneously with the purchase of the related Class A Participation Interest pursuant to a Security Release Certification) . . .”

We found that the Servicer for one Sponsor did not identify 22,536 loans totaling $1.9 million that were subject to a pre-existing security interest in the Weekly Loan Schedule’s “Lienholder” field,11 even though Wells Fargo submitted a Security Release Certification to the Department for the loans. In comparing the Security Release Certifications Forms provided by Wells Fargo and a Financial Management System (FMS) report provided by the Department, we found that one Servicer did not accurately identify the loans subject to the preexisting security interest. Although the Servicer submitted the Weekly Loan Schedule for the July 14, 2009, PPR, Wells

10 Calculation variances of 14 of 46 months reviewed were less than 10 percent and there were no variances for the remaining 29 of 46 months.
11 The “Lienholder” (Field 42) was a required data field on the loan schedule. The field indicated if the loan was subject to a preexisting security interest that was to be released upon the Department’s purchase of a participation interest in the loan.
Fargo did not effectively monitor and provide oversight of its Servicer to ensure that the loans were accurately identified to the Department as subject to a pre-existing security interest as required by the instructions accompanying EA No. 62.

Wells Fargo’s Student Loan Product Manager explained that the Sponsor decided to use its own funds, instead of the proceeds from the July 14, 2009, sale of the participation interest in the loans to the Department, to obtain the release of the security interest in the loans that served as collateral for a Bond Indenture; thus these loans were not subject to a pre-existing security interest at the time of the sale and were not identified as such in the Weekly Loan Schedule. However, the Student Loan Product Manager stated that this decision may not have been communicated by the Sponsor to the Relationship Manager. In addition, the Student Loan Product Manager acknowledged that Wells Fargo did not inform the Department of the Sponsor’s change in plans. Wells Fargo provided supporting correspondence from the Servicer, dated July 21, 2010, which stated that on July 14, 2009, the Sponsor used funds from its General Fund (rather than the proceeds of the sale of a participation interest to the Department) to obtain the release of the security interest in the loans that served as collateral for a Bond Indenture. As a result, the Bond Indenture’s trustee released its security interest in the loans. Therefore, at the time the participation interest was sold to the Department on July 14, 2009, the loans were no longer subject to a pre-existing security interest.

The timing of events indicates that the security interests were released on the same date as the PPR. However, since Wells Fargo submitted a Security Release Certifications Form, it should have ensured that the Servicer identified the loans subject to a pre-existing security interest on the Weekly Loan Schedule; or Wells Fargo should have informed the Department of the correct status of the security interests by notifying the Department that the Security Release Certification was no longer applicable.

Wells Fargo Did Not Verify That Servicers Remitted Borrower Payments Within 2 Business Days of Receipt

Wells Fargo did not monitor to ensure that Servicers deposited borrower payment collections for two Sponsors, MHEAC and SCSLC, within the timeframe required by the MPA. Wells Fargo officials agreed that its staff did not monitor the Servicers’ deposits into the Collection Accounts. As Custodian, Wells Fargo was responsible for ensuring that Servicers complied with the deposit requirements in the MPA.

Section 12(a) of the MPA required each loan subject to the LPP Program to be serviced by a Servicer (which may have been a Sponsor) at the direction of the Custodian under the terms of an ESA. Section 12(c)(v) of the MPA required Servicers to “deposit all collections into the Collection Account not later than two (2) Business Days after receipt[.].” The work performed by a Servicer usually included account management, collecting loan payments, and other customary services. In addition, Section 12(d) of the MPA stated—

The Custodian shall take all reasonable steps, actions and proceedings necessary to ensure that each Servicer will manage, service, administer, make collections and calculate any amounts owed to the Department with respect to the Eligible Loans . . . 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...

Section 13(d) of the MPA required 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 added 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 have been deemed a Servicer Event of Default under Section 3 of the MPA. Servicer Event of Default was 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 provided 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.

We reviewed 6 months of borrower payment collections along with the respective Collection Account statements for two of the eight Sponsors. The six monthly Collection Account statements showed collections totaling $5.4 million. However, Wells Fargo officials agreed that staff did not monitor Servicer deposits into the Collection Accounts. Wells Fargo did not appear to have verified that the Servicers deposited borrower payments in the Collection Accounts within the 2-day timeframe for any of its eight Sponsors.

12 Under Section 11(a) of the MPA, collections include all payments and other proceeds of any kind received on or with respect to the loans subject to a participation interest. As such, collections included payments received from borrowers.
Wells Fargo officials explained that Collection Account deposits were received daily from the Servicers. The Servicers notified Wells Fargo’s Relationship Managers, via email, that collections consisting of borrower payments would be transmitted electronically for deposit into the Collection Account. In reviewing the email transmittals from each Servicer, we found that the deposits of borrower payments were segregated by principal and interest amounts; however, the Servicer did not identify the number of borrower payments being transmitted or the dates the individual loan payments were received by the Servicer. As a result, Wells Fargo did not have sufficient information on the deposits it received from the Servicers to determine if the Servicers made timely deposits to the Collection Accounts.

Wells Fargo’s Student Loan Product Manager acknowledged that she did not verify or sample the Servicers’ payment information and did not require Servicers to submit borrower payment history. In the exit conference, Wells Fargo officials stated that it was not reasonable to expect staff to review the details associated with borrower payments since the Servicers made daily deposits. The Student Loan Product Manager stated that adequate steps were taken to ensure deposits were made within the required timeframe in that the Servicers notified Wells Fargo of the amounts transmitted and that follow-up procedures were in place with the Servicers and Sponsors if the amounts were not received by Wells Fargo. The Student Loan Product Manager also stated that under the ESAs, Servicers were required to remit payments to the Custodian, and under the Custodian Agreements, Sponsors were required to monitor the servicing activities. In addition, according to the Student Loan Product Manager, the Sponsors and Servicers had controls in place to process borrower payments, which were independently reviewed by external auditors.

Wells Fargo provided external audit reports of the Servicers. However, the audit reports were not for the period of the 2008-2009 LPP Program and were not specific to the requirements of the LPP Program. As a result, we were unable to determine if external auditors reviewed, and found no issues with, the Servicers’ processes for remitting borrower payments in accordance with the requirements contained in Section 12(c)(v) of the MPA. Since the Custodian Agreement required the Sponsor to monitor servicing activities, Wells Fargo, as Custodian, was required to provide sufficient oversight to ensure the Sponsors were properly performing the delegated functions and Servicers were performing the required functions in accordance with the terms and conditions of the MPA and other Departmental guidance. In addition, without sufficient monitoring, Wells Fargo may not have been in a position to promptly notify the Department of any default or failure to perform on the part of a Servicer, as required under Section 13(d) of the MPA.

**Recommendation**

1.1 We recommend that the Chief Operating Officer for Federal Student Aid (FSA) hold Wells Fargo responsible, to the extent permitted under Section 14(b) of the MPA, for any liabilities associated with the finding.

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13 An example of borrower payment history is loan-level information detailing the date and amounts of collections received by the Servicer.
Wells Fargo’s Comments

In its comments to the draft report, Wells Fargo did not concur with the finding and recommendation. According to Wells Fargo, its policies and procedures were reasonable under the circumstances, documentation of oversight was not required, and its oversight of Servicers was sufficient.

Wells Fargo stated that its policies and procedures were commercially reasonable, consistent with the LPP Program agreements, and ensured consistent monitoring and oversight. Specifically, Wells Fargo stated that –

- Under Section 18 of the MPA, Well Fargo’s oversight of the delegated functions needed to be reasonable under the circumstances. According to Wells Fargo, it had performed in a manner consistent with its oversight of commercial student loan trusts.14

- We misunderstood the nature of the procedures that were in place and how Wells Fargo ensured oversight. Wells Fargo had policies and procedures in place related to the acceptance and administration of custodial accounts, and these policies and procedures were in compliance with other oversight agencies, such as the U.S. Department of the Treasury, the Federal Reserve Bank, and the Office of the Comptroller of Currency.

- Its Tickler System served as an effective tool in maintaining compliance, and Wells Fargo exercised oversight and control on an as-needed basis for those duties under the MPA that did not have specific deadlines.

- It used standard forms (for example, Security Release Certification) drafted by the Department.

- It was not necessary to develop new policies and procedures beyond the dictates of the MPA and the Department’s guidance.

Wells Fargo stated that it was not required to maintain documentation of its oversight. Specifically, Wells Fargo stated that –

- Its Tickler System served as written evidence of its monitoring activity.

- It maintained, on a short-term basis, documentation relating to yield calculations and other compliance issues, but once the Department accepted a report and remitted funds, there was no need to retain the documentation.

Wells Fargo maintained that it aptly oversaw the activities of its Servicers. Specifically, Wells Fargo stated that –

- The issues pertaining to the mistakenly identified security interests and the timely deposit of collections did not support our conclusions presented in the finding.

- The policies and procedures Wells Fargo used to oversee servicer compliance in the LPP Programs were largely the same as those used in commercial student loan securitizations. The Department had not set up any procedure to rescind a submitted Security Release

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14 A student loan trust generally refers to asset-backed securities collateralized by student loans.
Certificate; as such, there was little Wells Fargo could have done to rescind the Security Release Certificate it submitted.

- Regarding the timeliness of Servicer deposits, Wells Fargo cited the use of lockboxes and noted that only the Department and Sponsor had access to the lockboxes. Wells Fargo monitored Servicer deposits by reviewing deposit reports submitted by Servicers. At no time was there an adverse effect on the Department’s position.

**OIG Response**

Wells Fargo provided no additional information that would require a change to the report finding or recommendation. As Custodian, Wells Fargo delegated the majority of its custodial responsibilities to its Servicers and Sponsors. Wells Fargo relied on its Servicers and Sponsors to perform its delegated obligations.

In response to Wells Fargo’s assertion that its policies and procedures were commercially reasonable, consistent with the LPP Program agreements, and ensured consistent monitoring and oversight –

- Section 18 of the MPA required the Custodian to “take those steps that are reasonable under the circumstances to ascertain whether such delegee is properly performing the delegated obligations . . .”

- In addition to being a new program in 2008-2009, the LPP Program operated under unique circumstances, including that the participation interests were assets purchased with Federal funds and the Department had financial interest in the participation interests. We agree that commercial student loan trust procedures could be utilized, however, we found that Wells Fargo’s procedures were not sufficient, without further modification, to meet its obligations under the MPA. Acceptance of such policies and procedures by other oversight agencies would not indicate that the policies and procedures were sufficient and acceptable to meet its obligations under the unique terms of the LPP Program.

- As we noted in the finding, although Wells Fargo officials stated that the Tickler System matched the requirements contained in the MPA, we found that the established ticklers did not address many of the Custodian’s responsibilities contained in the MPA and did not include adequate steps or reminders to ensure that the obligations delegated to Sponsors or Servicers were performed as required.

With five Relationship Managers in three separate locations, it was critical to have policies and procedures to ensure consistency in monitoring and oversight of Sponsors and Servicers.

In response to Wells Fargo’s comment that it was not required to maintain documentation of its oversight –

- The Tickler System provided Relationship Managers with reminders of the activities that were reoccurring or had specific due dates. However, the Tickler System did not serve as sufficient evidence of the actual monitoring performed by Wells Fargo.
• Wells Fargo’s practice of maintaining documentation on a “short-term basis” was not reasonable under the circumstances, and not consistent with the record retention requirements contained in 34 C.F.R. § 682.414(a)(4)(ii)(L), which require FFEL Program lenders to keep “[a]ny additional records that are necessary to document the validity of … reports submitted under this part” for not less than 3 years following the date the loan is repaid by the borrower or not less than 5 years following the date the lender receives payment in full from any other source.

Wells Fargo should have maintained documentation of its oversight until the respective LPP Program had ended and all required reports, including the attestation engagement report of the Custodian’s compliance with the MPA, had been submitted to, and accepted by the Department. In addition, the MASDR’s include data fields that contained carry-over information (for example, the participation interest’s beginning balances, opening participation yield balance, opening participation certificate balance) from the prior month’s MASDR. As such, Wells Fargo should have maintained documentation regarding such information should it have been needed in subsequent months.

In response to Wells Fargo’s assertion that it aptly oversaw the activities of its Servicers, our conclusions were adequately supported. Specifically –

• Regarding the mistakenly identified security interest, our conclusion was based on a sample of 24 purchases of participation interests, which disclosed 1 error, and discussions with Wells Fargo officials. Had we reviewed all 199 purchases, for which Well Fargo served as Custodian, additional matters may have come to our attention. In addition, while the Department may not have had a formal procedure to rescind a Security Release Certificate, Wells Fargo could have easily rescinded the submitted Security Release Certificate through a phone call or email to the Department.

• Regarding the timeliness of deposits made by Servicers, our conclusion was based on a review of 6 months of collections for two of the eight Sponsors and discussions with Wells Fargo officials. Wells Fargo stated that it used lockboxes to collect borrower payments. However, Wells Fargo should have reviewed reports prepared by Servicers detailing the dates a borrower payment was received by the Servicer and the date the Servicer remitted the payment to the Collection Account. As we noted in the finding, the information received by Wells Fargo from Servicers did not contain sufficient information for Wells Fargo to determine if the Servicers made timely deposits to the Collection Accounts.

While our audit did not identify any harm to the Federal interest, Wells Fargo’s lack of sufficient monitoring and oversight could have subjected Federal funds to unnecessary risks.
OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of the audit were to determine whether Wells Fargo, as Custodian, (1) had adequate controls to ensure its management of the Collection Account complied with the terms and conditions of the MPA and applicable Department guidance; and (2) provided reasonable oversight of Sponsors and Servicers to ensure compliance with the terms and conditions of the MPA and applicable Departmental guidance. The scope of our review covered Wells Fargo’s controls and oversight activities during the 2008-2009 LPP Program for the period August 15, 2008, through October 31, 2009. We also reviewed 20 loans from the 2009-2010 LPP Program to confirm that legal title to the loans was held in Wells Fargo’s name. Our audit was limited to reviewing Wells Fargo’s management of Collection Account funds, Wells Fargo’s oversight and monitoring of Servicer activities, and Wells Fargo’s monitoring and oversight of delegated duties.

To accomplish our objectives, we —

- Met with various Department officials from the Office of General Counsel and FSA to obtain background information about the LPP Program and the Custodian’s role in the program.

- Reviewed the agreed-upon procedures audit reports for the eight Sponsors for the 2008-2009 LLP Program.


To evaluate Wells Fargo’s controls for managing Collection Account funds, we —

- Reviewed and gained an understanding of relevant laws, regulations, guidance, and agreements, which included (1) ECASLA; (2) “Notice of terms and conditions of purchase of loans under the ECASLA,” published in the Federal Register on July 1, 2008 (73 Federal Register 37422); (3) the Department’s Electronic Announcements; (4) the Department’s LPP Program Frequently Asked Questions; (5) the MPA and applicable adoption agreements; (6) ESAs; and (7) Custodian Agreements.
Interviewed officials at Wells Fargo’s Corporate Trust Division, including the Student Loan Product Manager and the five Relationship Managers responsible for routine Collection Account management activities.

Reviewed Wells Fargo’s procedures for managing Collection Account funds, including procedures for managing the flow of funds for a PPR, loan redemption, loan sale, Servicer deposits, and investment of Collection Account funds.

Gained an understanding of how funds flowed through the Collection Account and evaluated Wells Fargo’s compliance with applicable guidance and agreements by reviewing 2 months of Collection Account entries for each of the two Sponsors, MHEAC and SCSLC. From a total of 22 monthly Collection Account statements, we judgmentally selected 4 Collection Account statements. We reviewed the January 2009 and September 2009 Collection Account statements for both SCSLC and MHEAC to evaluate account activity during the beginning and ending months of the program year.

Compared all 24 PPRs submitted for two Sponsors (16 PPRs for MHEAC and 8 PPRs for SCSLC) obtained from both Wells Fargo and the Department to verify the accuracy of the purchase price with each PPR.

Compared the information in the Collection Account statements to the information in the MASDRs for two Sponsors, MHEAC and SCSLC, for all months during the 2008-2009 LPP Program.

Compared the participant’s yield calculations, which were verified by Wells Fargo, with the Department’s yield calculations and verified the yield payments made from the Collection Account for four of eight Sponsors. We judgmentally selected MHEAC, SCSLC, ISLLC, and SLM ECFC to review because those Sponsors had the highest volume of cumulative participation interest purchased during the 2008-2009 LLP Program.

Reviewed the Semiannual Reports for the money market funds used to invest Collection Account funds for all eight Sponsors to determine whether Collection Account funds were invested in Permitted Investments.

Verified that for all four put option transactions (that is, sales of the underlying loans to the Department) for MHEAC, the Department’s Bill of Sale amounts, and the total loan counts matched information contained in weekly status reports issued by the Department and deposit amounts to the Collection Account.

To evaluate whether Wells Fargo provided reasonable oversight and monitoring of its Sponsor and 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.
- Obtained an understanding of Wells Fargo’s process for monitoring its Sponsors and Servicers.
- Interviewed the Student Loan Product Manager and five Relationship Managers regarding monitoring and oversight of the Sponsors and Servicers.

SCSLC did not execute any put option transactions. SCSLC redeemed its loans.
- Reviewed Wells Fargo’s Corporate Trust new business acceptance meeting agendas, corporate trust account tickler reports, and ESAs for its seven Servicers.

- Reviewed emails, Collection Account statements, and other supporting documentation relating to 6 months of borrower payment deposits for two Sponsors, MHEAC and SCSLC, to verify that funds were deposited into the Collection Account within 2 business days.

To determine whether loans were subject to a security lien, we interviewed Department officials to determine how loans subject to a security lien are identified in the FMS, and reviewed FSA’s Lender’s Request for Payment of Interest and Special Allowance Participation Interest Lien Holder Statistics\(^\text{16}\) report for the 2008-2009 LPP Program.

To evaluate whether Wells Fargo held title to the loans\(^\text{17}\) while they were subject to the LPP Program, we obtained the October 2009 Monthly Loan Schedules for the 2009-2010 LPP Program for two Sponsors, MHEAC and SCSLC, which contained 12,166 loans and 154,800 loans, respectively. From this population of loans, we randomly sampled 50 loans. Of those 50 loans, we selected a judgmental sample of the first 20 loans (10 MHEAC loans and 10 SCSLC loans), and reviewed the National Student Loan Database System to verify that the loans were held in the Custodian’s name.

**Sampling Methodology for Sponsor Relationships**

Wells Fargo’s eight Sponsor Collection Accounts were managed by five Relationship Managers in three separate geographical locations. In reviewing the eight Sponsor relationships, we judgmentally selected two Sponsors for testing, MHEAC and SCSLC, because both the Relationship Managers and supporting documentation were located in Jacksonville, Florida.

**Data Reliability Assessment**

During the audit, we relied in part on computer-processed data contained in Wells Fargo’s SEI system, an asset management and investment accounting system, which Wells Fargo uses to maintain Collection Account activity for its eight Sponsors. We tested the accuracy and completeness of the data by comparing Wells Fargo’s records to source documents maintained by the Department along with documents transmitted by two Sponsors, one of which was also a Servicer. Based on these tests and assessments, we concluded that the data were sufficiently reliable for use in meeting our audit objectives.

Our audit work was completed in Jacksonville, Florida and Atlanta, Georgia. We conducted our fieldwork in Jacksonville, Florida, from November 2009 through January 2010. An exit conference was held with Wells Fargo officials and staff on July 22, 2010.

\(^{16}\) A Department report, generated as needed, to determine whether any participation requests had any loans identified with liens.

\(^{17}\) We reviewed 20 loans for the 2009-2010 academic year that participated in the 2009-2010 LPP Program to determine whether Wells Fargo held legal title of the loans. Because all of the loans in the 2008-2009 LPP Program were either redeemed by the Sponsors or sold to the Department under the ECASLA LPC Program at the time of the audit, we were unable to evaluate academic year 2008-2009 loans for this purpose.
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.

**ADMINISTRATIVE MATTERS**

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 actions 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 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 12E1  
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/  
Denise M. Wempe  
Regional Inspector General for Audit

Appendices

Electronic cc:  
Tricia Heintz, Vice President, Student Loan Products, Wells Fargo  
Tim Carlin, Managing Counsel, Wells Fargo  
Tom Levandowski, Wells Fargo  
William J. Taggert, Chief Operating Officer, FSA  
Eduardo Ochoa, Assistant Secretary for Postsecondary Education
### Appendix A - Acronyms and Abbreviations Used in this Report

<table>
<thead>
<tr>
<th>Department</th>
<th>Description</th>
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<tbody>
<tr>
<td>EA</td>
<td>Electronic Announcement</td>
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<tr>
<td>ECASLA</td>
<td>Ensuring Continued Access to Student Loans Act of 2008</td>
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<tr>
<td>ELT</td>
<td>Eligible Lender Trustee</td>
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<td>ESA</td>
<td>Eligible Servicing Agreement</td>
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<tr>
<td>FAQ</td>
<td>Frequently Asked Questions</td>
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<tr>
<td>FFEL Program</td>
<td>Federal Family Education Loan Program</td>
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<td>FMS</td>
<td>Financial Management System</td>
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<td>FSA</td>
<td>Federal Student Aid</td>
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<tr>
<td>Great Lakes</td>
<td>Great Lakes Education Services</td>
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<tr>
<td>HEA</td>
<td>Higher Education Act of 1965, as amended</td>
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<tr>
<td>ISLLC</td>
<td>Iowa Student Loan Liquidity Corporation</td>
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<tr>
<td>LPC</td>
<td>Loan Purchase Commitment Program</td>
</tr>
<tr>
<td>LPP Program</td>
<td>Loan Participation Purchase Program</td>
</tr>
<tr>
<td>MASDR</td>
<td>Monthly Aggregate Settlement Date Report</td>
</tr>
<tr>
<td>MHEAC</td>
<td>Mississippi Higher Education Assistance Corporation</td>
</tr>
<tr>
<td>Monthly Loan Schedule</td>
<td>Monthly Loan Schedule and Custodial Certification</td>
</tr>
<tr>
<td>MPA</td>
<td>Master Participation Agreement, dated July 25, 2008</td>
</tr>
<tr>
<td>PHEAA</td>
<td>Pennsylvania Higher Education Assistance Agency</td>
</tr>
<tr>
<td>PPR</td>
<td>Participation Purchase Request</td>
</tr>
<tr>
<td>SCSLC</td>
<td>South Carolina Student Loan Corporation</td>
</tr>
<tr>
<td>SLM ECFC</td>
<td>Sallie Mae Education Credit Finance Corporation</td>
</tr>
<tr>
<td>Student Loan Product Manager</td>
<td>Vice President, Wells Fargo Student Loan Product Manager</td>
</tr>
<tr>
<td>Weekly Loan Schedule</td>
<td>Weekly Loan Schedule and Custodial Certification</td>
</tr>
<tr>
<td>Wells Fargo</td>
<td>Wells Fargo Bank, National Association</td>
</tr>
</tbody>
</table>
### Appendix B: Custodian Duties and Obligations under the MPA

<table>
<thead>
<tr>
<th>MPA Section</th>
<th>Duties and Obligations of Custodian</th>
</tr>
</thead>
<tbody>
<tr>
<td>§4</td>
<td>Delivery of Loans to Custodian; Purchase and Sale of Participation Interests</td>
</tr>
<tr>
<td>§4(b)</td>
<td>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 the put option, (iii) for servicing purposes, and (iv) when permitted by Department in writing.</td>
</tr>
<tr>
<td>§4(c)</td>
<td>On the purchase date, (i) the Custodian receives the 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.</td>
</tr>
<tr>
<td>§4(e)</td>
<td>The Custodian holds the promissory notes in its name. If a master promissory note is for both eligible and ineligible loans, book entry is used by the Custodian.</td>
</tr>
<tr>
<td>§5(a) thru (e)</td>
<td>Participation Certificates; Loan Schedule and Custodian Certificates</td>
</tr>
<tr>
<td>§5(a) thru (e)</td>
<td>On or prior to the purchase date, the Custodian issues a Class A certificate to the Department and a Class B certificate to the Sponsor. Loan Schedules and Custodial Certificates are included with the Class A and B certificates.</td>
</tr>
<tr>
<td>§7</td>
<td>Subsequent Disbursements</td>
</tr>
<tr>
<td>§7</td>
<td>The Custodian shall make scheduled disbursements (with the Sponsor providing the necessary funds) on loans and shall issue participation interests in such disbursements.</td>
</tr>
<tr>
<td>§8(b)(1)</td>
<td>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 interest.</td>
</tr>
<tr>
<td>§8(b)(2)</td>
<td>The Custodian submits to the Department an audit of the Custodian’s activities, conducted by an independent public accountant and performed in accordance with guidance issued by the Department.</td>
</tr>
<tr>
<td>§10(c)</td>
<td>The Custodian is required to make various representations and warranties.</td>
</tr>
<tr>
<td>§11(a)</td>
<td>The Sponsor establishes a Collection Account at the Custodian for all payments and proceeds and invests only in Permitted Investments.</td>
</tr>
<tr>
<td>§11(b)</td>
<td>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.</td>
</tr>
<tr>
<td>§11(d)</td>
<td>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.</td>
</tr>
<tr>
<td>§12(a)</td>
<td>The Custodian enters into an Eligible Servicing Agreement with a Servicer.</td>
</tr>
<tr>
<td>§12(c)</td>
<td>In addition to customary terms and conditions, the Eligible Servicing Agreement shall include (but is not limited to):</td>
</tr>
<tr>
<td></td>
<td>• 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.</td>
</tr>
<tr>
<td></td>
<td>• A provision that the Servicer will deposit all collections into the Collection Account within 2 business days after receipt.</td>
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<tr>
<td></td>
<td>• 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.</td>
</tr>
<tr>
<td></td>
<td>• A provision that the Servicer shall provide documents and information to the Custodian to enable the Custodian to oversee the Servicer.</td>
</tr>
<tr>
<td>§12(d)</td>
<td>The Custodian shall ensure that the Servicer shall be responsible for segregating, marking each loan as owned by the Custodian, and remitting all loan payments to the Custodian.</td>
</tr>
<tr>
<td>MPA Section</td>
<td>Duties and Obligations of Custodian</td>
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<tr>
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</tr>
<tr>
<td>§13</td>
<td>Enforcement of the Servicing Agreements</td>
</tr>
<tr>
<td>§13(a)</td>
<td>The Custodian shall enforce the servicing agreements and cause the Servicer to specify whether deposits to the Collection Account are principal or interest.</td>
</tr>
<tr>
<td>§13(d)</td>
<td>The Custodian shall notify the Department if the Servicer is in default.</td>
</tr>
<tr>
<td>§13(e)</td>
<td>The Custodian shall not waive default by the Servicer without the Department’s consent.</td>
</tr>
<tr>
<td>§15</td>
<td>Redemption; Put Option; Termination</td>
</tr>
<tr>
<td>§15(a)</td>
<td>The Custodian calculates the redemption payment for Class A interests to be paid by the Sponsor to the Department.</td>
</tr>
<tr>
<td>§15(b)</td>
<td>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 Sponsor, and (iv) cancel Class A and B participation interests.</td>
</tr>
<tr>
<td>§15(c)</td>
<td>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 the net amount due the Sponsor, (ii) deposit funds into the Collection Account, and (iii) distribute funds in the Collection Account per §11.</td>
</tr>
<tr>
<td>§15(e)</td>
<td>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.</td>
</tr>
<tr>
<td>§15(f)</td>
<td>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.</td>
</tr>
<tr>
<td>§17</td>
<td>Custodian Events of Default; Removal of Custodian</td>
</tr>
<tr>
<td>§17</td>
<td>The Custodian may be removed upon an event of default and a successor Custodian named.</td>
</tr>
<tr>
<td>§18</td>
<td>Delegation of Duties by Custodian</td>
</tr>
<tr>
<td>§18</td>
<td>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 §§18; and (v) holding and disbursing all collections and redemption payments. If the Custodian delegates its obligations, it shall take steps to ascertain that the delegee is properly performing the obligations.</td>
</tr>
<tr>
<td>§23</td>
<td>Tax Matters</td>
</tr>
<tr>
<td>§23(a)</td>
<td>The agreement is a partnership.</td>
</tr>
<tr>
<td>§23(b)</td>
<td>The partnership’s Fiscal Year End is December 31. The Custodian shall prepare Schedule K-1 (Form 1065) for the Department and the Sponsor.</td>
</tr>
<tr>
<td>§23(c)</td>
<td>The Custodian shall establish and maintain a separate capital account for each partner. The partnerships income, gains, losses and expenses shall be allocated among the capital accounts.</td>
</tr>
<tr>
<td>§23(d)</td>
<td>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.</td>
</tr>
</tbody>
</table>

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18 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 can delegate the submission of the Weekly and Monthly Loan Schedules to the Servicer.
Appendix C: Wells Fargo’s Comment to the Draft Report

November 19, 2010

VIA EMAIL AT Denise.Wempe@ed.gov

Denise M. Wempe
Regional Inspector General for Audit Services
61 Forsyth Street SW, Suite 18T71
Atlanta, Georgia 30303

Re: ED-OIG/A04-J0019

Dear Ms. Wempe:

Thank you for affording Wells Fargo Bank, N.A. (“Wells Fargo”) the opportunity to respond to the September 21, 2010 Draft Audit Report (“Draft Report”) produced by the Department of Education’s (“Department”) Office of the Inspector General (“OIG”) concerning Wells Fargo’s “Management of Collection Account Funds and Oversight Activities under the Ensuring Continued Access to Student Loans Act (“ECASLA”) Loan Participation Purchase (“LPP”) Program.” As discussed more fully herein, Wells Fargo respectfully submits that the OIG should revise the Draft Report as set forth below.

Although Wells Fargo understands that this response will be made public as an attachment to the final report issued by the OIG, we ask that any exhibits to this response be withheld from release. The information is proprietary and could do economic harm to Wells Fargo and is merely provided for the sole purpose of addressing the issues in the Draft Report.

Background

Wells Fargo is pleased with the OIG’s overall finding that “Wells Fargo had controls to reasonably ensure that its management of Collection Account funds complied with the terms and conditions of the MPA and applicable Department guidance.” Draft Report, at 4. We believe this conclusion is an accurate reflection of the impressive work that Wells Fargo staff did in managing the accounts consistent with ECASLA requirements. As the OIG no doubt recalls, the Department established the ECASLA programs under trying circumstances. ECASLA became law on May 8, 2008 and the Department first announced the parameters of the LPP Program in a May 21, 2008 Dear Colleague Letter. After publishing the general program terms in the Federal Register on July 1, 2008, the Department published the governing contract – the Master Participation Agreement (“MPA”) – on July 25, 2008. This timeline provided program participants (including custodians such as Wells Fargo and student lenders) with roughly two weeks to digest and implement the LPP terms before student lenders were required to begin originating loans for the 2008-2009 academic year. As history bears out, the LPP Program was highly successful and, thanks to the cooperation and concerted efforts of the Department and the
program participants, students received their loans in a timely manner and the federal interest was protected.

Due to this expedited schedule, the Department modeled the LPP Program and the requirements placed on Custodians on commercial student loan securitizations. Although the Department made numerous interpretive and procedural revisions to the LPP Program, these revisions were also consistent with typical student loan securitizations. While these changes came in many forms – whether through official guidance, webinar presentations or emails sent directly to program participants – the Department and every participant in the program used their best efforts to work through issues and ensure that students received their loans in a timely fashion.

The OIG Draft Report

Given the trying circumstances in which Wells Fargo operated we take issue with the OIG’s Draft Report that states Wells Fargo “did not (1) have sufficient policies and procedures to ensure consistent monitoring and oversight of the 2008-2009 LPP Program; (2) maintain sufficient documentation of its monitoring and oversight; (3) ensure that a Servicer accurately identified loans subject to a preexisting security interest on the Weekly Loan Schedule; and (4) verify that Servicers remitted borrower payments within 2 business days of receipt.” Draft Report, at 4-5. The Draft Report also “recommend[s] that the Chief Operating Officer for Federal Student Aid (FSA) hold Wells Fargo responsible, to the extent permitted under Section 14(b) of the MPA, for any liabilities associated with the [OIG’s] finding.” Draft Report, at 10.2

The OIG’s conclusions are, unfortunately, based on misunderstandings of what is commercially reasonable in student loan trust practice, and of what the MPA actually requires. Indeed, while there may be merit to the OIG’s suggestions for monitoring service compliance, there is nothing in the MPA that mandates that those methods be used or suggests that the methods employed by Wells Fargo are insufficient to the task. To the contrary, the tools used by Wells Fargo to measure the performance of delegated functions in the LPP Program are the same tools commonly used by Wells Fargo in commercial student loan financings. The procedures Wells Fargo employed, such as the use of a tickler system and various account maintenance tools, are used throughout the industry. Our more general trust-related procedures have been reviewed by the Office of the Comptroller of Currency for their sufficiency. This is clear evidence that Wells Fargo utilized policies and procedures that were reasonable under the circumstances. As such, Wells Fargo respectfully requests that the OIG revise the Draft Report as discussed herein.

1 For example, the Department offered at least two rounds of interpretive guidance associated with the MPA subsequent to the program start date (the last round of guidance was issued on November 1, 2008 – roughly three months after the program began). The Department also revised the required data fields for the Loan Schedule and Custodial Certification on numerous occasions - each time changing the loan-level data necessary to report to the Department. In addition, the OIG issued the audit guide for the 2008-2009 MPA on April 26, 2010 (“Audit Guide”), roughly twenty months after the MPA was issued and seven months after the 2008-2009 LPP ended.

2 The Draft Report also erroneously states that “Wells Fargo did not provide the external audit reports documenting independent reviews.” Draft Report, at 10. During the OIG investigation period, Wells Fargo provided the OIG with SAS 70 and applicable servicer audits to demonstrate the independent review of each servicer’s processes for borrower payments. In addition, On October [18], 2010, after receiving the Draft Audit, Wells Fargo sent the SAS 70 and applicable servicer audits to the OIG again. If the OIG revises the Draft Report related to a review of this documentation, Wells Fargo hereby requests the right to respond to any OIG revisions.
A. Wells Fargo’s Policies and Procedures Were Commercially Reasonable, Consistent with the LPP Program Agreements and Ensured Consistent Monitoring and Oversight

The Draft Report rightly notes that it is “critical to have policies and procedures to ensure consistency in monitoring and oversight.” Wells Fargo agrees. As a trust department with a longstanding involvement as a trustee in the student loan industry, Wells Fargo knows of the importance of policies and procedures and relies on them every day. In stating that the procedures are insufficient, the Draft Report exhibits a misunderstanding of the nature of the procedures in place and how valuable they are to ensuring oversight. In addition, the OIG’s conclusion misstates the standard required of Wells Fargo’s oversight duties which, in fact, was merely that Wells Fargo “shall take those steps that are reasonable under the circumstances to ascertain whether such delegee is properly performing the delegated obligations.” MPA at 39. As such, this finding should be revised.

First, Wells Fargo has a significant number of policies and procedures related to acceptance and administration of trust accounts, such as the custodial accounts at issue here. They are oriented as to trust generally and have been used in connection with student loan trusts for well over a decade. These policies cover client account acceptance, establishing required trust accounts, general account management, and procedures to identify and address defaults and are in compliance with regulations issued by other agencies that oversee Wells Fargo, such as the U.S. Department of the Treasury, the Federal Reserve Bank and the Office of the Comptroller of Currency. Wells Fargo provided copies of these procedures to the OIG audit team.

In addition, while the Draft Report correctly notes that Wells Fargo uses a “Tickler System,” (as set forth in the written Account Control Tickler Standards) to ensure that key account activities occur, the Draft Report incorrectly concludes that the Tickler System “related to the 2008-2009 LPP Program did not include adequate steps or reminders to ensure that the obligations delegated to the Sponsors and Servicers were performed as required.” Draft Report at 6. While it is true that the Tickler System only addresses duties that are reoccurring or have specific date/timelines, it is still an effective tool in maintaining compliance. In fact, many of the duties cited as not being addressed by Ticklers were, in fact, addressed. For example, while the Draft Report suggests that the Ticklers “did not address” “creating and delivering the Weekly and Monthly Loan Schedules,” Draft Report, at 6, these were responsibilities largely related to creating the Monthly Aggregate Settlement Date Report (“MASDR”), for which the OIG acknowledges there was a Tickler, Draft Report, at 6. Wells Fargo delegated to the lender ("Sponsor") the requirement to file partnership tax forms for the custodial facility. As the OIG notes, there is a Tickler associated with preparing and mailing the Schedule K-1 and other information associated with tax preparation. Draft Report, at 6. In addition, the Tickler

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3 Annexed as Exhibit A to this response is a copy of those procedures that were previously provided to the OIG.
4 Specifically, the Draft Report cites as examples the non-delegable duties of a custodian: “(1) ensuring legal title of the loans are held in the Custodian’s name; (2) calculating redemption payments; (3) issuing and authenticating participation certificates; and (4) creating and delivering the Weekly and Monthly Loan Schedules.” Draft Report, at 6. Importantly, although these duties are non-delegable, a custodian, such as Wells Fargo, may reasonably rely on a delegee’s performance of delegable duties to perform a custodial duty. MPA, at 39 (Section 18).
5 As set forth in the EA 53 – March 13, 2009 “Loan Schedule And Custodial Certification Data File Fields – Definitions And Submission Procedures Loan Information” – the MASDR included information for each loan in the custodial facility including, but not limited to, data related to the borrower identity, disbursed amount, past and future disbursement dates, guarantor, loan type and number of loans in the custodial facility.
associated with filing the Monthly Rolling Forecast Report required Wells Fargo to calculate actual originations and disbursements (as well as forecast anticipated originations and disbursements). This served as an independent check on Sponsors that were delegated the responsibility to originate and make all disbursements on student loans. Also, Wells Fargo’s work on verifying the participant’s yield – for which the OIG has acknowledged there was a Tickler, Draft Report, at 6 – could not have been conducted without knowing the value of loans in the custodial facility.

Furthermore, for those duties defined by the MPA which do not have specific deadlines (such as redemptions or issuing participation certificates), Wells Fargo exercised oversight and control on an as needed basis by referring to the MPA and performing duties in accordance therewith. Thus, for example, Wells Fargo issued participation certificates when participating lenders (“Sponsors”) sold participations to the Department. Similarly, the Weekly Loan Schedule was part of the Participation Purchase Funding Requests and was developed when Sponsors requested a purchase of loan participations. This activity happened at indeterminate times as dictated by Sponsors. On those occasions, Wells Fargo, in accordance with the MPA, utilized the required participation certificate forms (Exhibits C and D of the MPA) and included a schedule of the loans subject to the participation. Similarly, when Sponsors redeemed the Department’s participation interests, in accordance with the MPA, Wells Fargo would collect any redemption payments and remit such payments to the Department as required.

It is unclear why the Draft Report suggests that Wells Fargo should have developed new procedures beyond the clear dictates of the MPA (as modified by Department guidance) for these as needed functions. Wells Fargo personnel were trained about the requirements of the MPA and attended each of the Department’s numerous webinars related to the LPP Program. Wells Fargo also disseminated all Department program guidance, including each of the electronic announcements. In sum, Wells Fargo acted in accordance with the MPA, as supplemented by Department guidance, electronic announcements, webinars and other Departmental communications.

It is also not clear why additional Wells Fargo-procedures were desirable. Indeed, given the short time frame associated with program implementation, and the then-anticipated one-year program duration, Wells Fargo reinterpretations of the MPA would likely have been an inaccurate reflection of the actual language of the MPA. Further, although it is completely understandable that the Department had to revise the LPP Program throughout the 2008-2009 year – including in multiple rounds of official interpretive guidance and in informal emails to program participants – any policies Wells Fargo enacted would have needed multiple revisions as well. Such lack of consistency could have created problems far greater than relying on the specific dictates of the MPA.

Most importantly, however, is that Wells Fargo’s oversight of delegated functions need only be “reasonable under the circumstances.” MPA at 39. In this regard, Wells Fargo performed in a manner consistent with its oversight of other student loan trusts. For example,

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6 See EA 53 “Loan Schedule And Custodial Certification Data File Fields - Definitions And Submission Procedures Loan Information,” at 1 (March 13, 2009) (“The format of Loan Schedule and Custodial Certification will be used for two reporting purposes: 1) as a part of the Participation Purchase Funding Requests (the “Weekly Loan Schedule”), and 2) to report the total pool of loans supporting the Class A Participation Certificate held by the Department as of month end (the “Month-End Loan Schedule”).
while loan servicers were delegated the responsibility of servicing the student loans, Wells Fargo
did not serve as a shadow servicer. It is not reasonable to expect that it would. As is the case
with all student loan trusts, Wells Fargo reviewed servicer audits to gauge regulatory compliance
before the engagement – to assess the quality of the servicer – and as such audits were conducted
during and after the engagement – to assess performance. Many of the servicers associated with
the loans in the custodial accounts, including Great Lakes, PHEAA/AES, Sallie Mae, and Iowa
Student Loan Liquidity Corp., were previously deemed “Exceptional Performers” by the
Department – until October 1, 2007 when that program was eliminated pursuant to the College
Cost Reduction Act of 2007 – and were some of the largest student loan servicers in the country.
Indeed, three of the four servicers have subsequently been chosen to be student loan servicers for
the Department.

The Draft Report mentions that the Tickler System did not “ensure[] legal title of the
loans held in the Custodian’s name.” While it is true that the Tickler System did not address this
issue, Wells Fargo addressed it through other means that were consistent with the MPA. Thus,
as was consistent with typical bank trust procedures, the bank relied on the legal documents
evincing transfer of title – the standard forms that (i) transferred legal title to the Wells Fargo as
custodian, (ii) released any liens, and (iii) included Sponsor certification that there were no
remaining security interests on the loans that would impair the transfer of legal title. All of these
forms were drafted by the Department and were not subject to change.

Additionally, beyond the process of collecting security releases, it should be recalled that
Sponsors made numerous representations to the Department that Wells Fargo had clear legal title
to the loans that the Department purchased. The Participation Purchase Request form, Exhibit B
to the MPA, specifically incorporates the lender’s representation (located in Section 10(a) (viii)
of the MPA) that the lender:

has, or, for Loans already transferred to the Custodian, had at the time of such
transfer, all requisite power and authority to hold each Loan, to transfer each
Loan, and to execute, deliver and perform, and to enter into and consummate, all
transactions contemplated by this Agreement, (2) has duly authorized the
execution, delivery and performance of this Agreement, and (3) has duly executed
and delivered this Agreement.

MPA, at 25 and B-1. Further, pursuant to section 10(b)(1) of the MPA, Sponsors “represent and
warrant to the Department as to the Eligible Loans subject to any Class A Participation Interest”
that

[a]t the time of transfer of title to the Custodian, the Sponsor or the Eligible
Lender Trustee (as applicable) has good and marketable title to, and the Sponsor
and Eligible Lender Trustee together are the sole owners of, the Loans, free and
clear of any security interest or lien (other than an interest or lien that will be
released simultaneously with the purchase of the related Class A Participation
Interest pursuant to a Security Release Certification).

MPA, at 27. Lastly, as required by the Department, servicers were required to note on NSLDS
that loans held in a custodial facility overseen by Wells Fargo were owned by Wells Fargo.
Thus, on all subsequent loan schedules received from the servicer, Wells Fargo was noted as the title holder of the loan.

The process Wells Fargo engaged in cannot be said to be unreasonable. Indeed, Wells Fargo obtained security releases and lender certifications of clear title using Department-drafted forms, and loan servicers independently recorded the loans as owned by Wells Fargo in the Department’s NSLDS system. In fact, this process is both reasonable under the circumstances and consistent with the process for transferring legal title to newly originated loans in general student loan practice.7

In short, Wells Fargo’s procedures and oversight were reasonable under the circumstances and adequately ensured the Department’s interests were protected. Indeed, the procedures were consistent with Wells Fargo’s oversight of other student loan trusts. As such, Wells Fargo’s exercise of oversight was consistent with the MPA.

Recommendations

Wells Fargo does not agree that its policies and procedures were inadequate to effectively monitor servicers and Sponsors. We recommend that the OIG revise the Report to reflect that the standard for oversight under the MPA was “reasonable under the circumstances.” We also recommend that the OIG revise this finding to reflect:

- more clearly the procedures and policies that were in place;
- the industry standards for oversight of student loan trusts;
- that Wells Fargo’s procedures were consistent with industry practice and that Wells Fargo followed such procedures;
- the risks associated with developing new policies for the LPP Program, which was originally designed to be for one year only and for which, the Department made numerous interpretive and procedural revisions; and
- that Wells Fargo’s policies and procedures were adequate and reasonable for overseeing the activities of the servicers and Sponsors.

B. Wells Fargo Was Not Required to Maintain Documentation of its Oversight

The Draft Report argues that “without documentation of monitoring activities, Wells Fargo could not demonstrate that it took reasonable steps to ascertain that the Sponsors and Servicers properly performed the delegated responsibilities.” Draft Report, at 6. As discussed, Wells Fargo has a reasonable process for ensuring compliance, which included reliance on well-established policies, and the Tickler System – like a calendar entry – serves as written evidence of monitoring activity. In addition to the Ticklers, as stated to OIG personnel during the audit investigation, Wells Fargo did maintain, on a short-term basis, documentation related to yield calculations and other compliance issues. However, once the Department accepted a report and remitted funds to the account, there was no need to retain, for example, previously calculated yields. Indeed, account reconciliation was performed prior to transfer of funds and, given the

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7 For the avoidance of doubt, it should be noted that there is no title search mechanism for student loans. Additionally, UCC statements do not specifically list each loan that is subject to a security interest. It is common to use forms such as those provided by the Department, as the means for releasing security interests in pools of loans.
monthly changes in account volume, the information contained on previous schedules was superfluous and not needed for future consultation.

Moreover, there is nothing in the MPA that requires, or even suggests, that Wells Fargo was expected to document its monitoring activities. Indeed, the MPA merely requires that “the Custodian shall take those steps that are reasonable under the circumstances to ascertain whether such delegee is properly performing the delegated obligations.” MPA, at 39. Here, Wells Fargo followed its established student loan trust procedures to ensure proper oversight, and augmented those procedures with the exact language of the MPA. Staff involved with monitoring the LPP Program was trained in the requirements of the MPA, attended Department webinars and reviewed all Department program updates and guidance. As such, Wells Fargo’s activities should certainly be described as reasonable.

Also, Wells Fargo would like to correct a point of confusion. The Draft Report states that “the tickler listing included reminders instructing the Relationship Managers to verify the yield calculations, not calculate them.” Draft Report, at 6. In fact, Wells Fargo Relationship Managers explained to the OIG audit team that they calculated the participant’s yield and average daily principal balance and did not delegate such duties to the Sponsors or servicers. The Tickler, in referencing the need to verify the amounts, also serves as its own reminder to calculate the yields.8

**Recommendations**

Wells Fargo does not agree that the documentation of its oversight activities was inadequate or even required under the MPA. We recommend that the OIG revise the finding to:

- reflect that the Department did not place a specific requirement on Wells Fargo or any other custodian to maintain records of its compliance activities, exception reports or reconciliations of yield calculations, average daily principal balance, or documentation of account balances made obsolete by subsequent balance modifications;
- note that Wells Fargo did, in fact, document its compliance activities by retaining evidence from its Tickler System;
- note that requiring maintenance of such records is not consistent with common industry practice and is, therefore, not “reasonable under the circumstances” of the program, which is the relevant standard under the MPA; and
- reflect that, since the Department’s calculation of balances and yield was used in all cases, the Department was not harmed in light of Wells Fargo not maintaining obsolete accounting documentation related to the calculation of yields and balances.

C. Wells Fargo Aptly Oversaw the Activities of its Servicers

The OIG Draft report cites two reasons for calling into question Wells Fargo’s oversight of servicers in the LPP Program: (1) in one instance, Wells Fargo mistakenly identified a security interest in a pool of loans for which the lender, after informing Wells Fargo of the security interest, extinguished the security interest immediately prior to selling the loans into the custodial

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8 It should be noted though, that notwithstanding Wells Fargo’s efforts to calculate and verify the yield and average daily balance, the Department independently calculated yield and any discrepancies in the calculations were resolved by using the Department’s calculations.
facility and (2) Wells Fargo did not adequately verify that loan servicers remitted borrower payments to the custodial account within two days of receipt. Draft Report, at 5, 7, 8-10. It is respectfully submitted that, putting aside the accuracy of these representations, even if true, they do not support so broad a conclusion. The representations, however, do not fully capture the facts.

Wells Fargo monitored servicer compliance in a manner that was reasonable under the circumstances. The policies and procedures used to oversee servicer compliance in the LPP Program are largely the same as those used in any student loan securitization. Indeed, this makes sense considering the similarity between the requirements placed on custodian in the LLP Program and trustees in a student loan securitization. These requirements include:

- confirming the proper servicing of loans – which Wells Fargo assesses by reviewing servicer audits and SAS70 reports, and ensuring that payments are received and deposited through daily monitoring of deposit reports from each servicer;
- providing reports and account statements;
- obtaining documentation concerning encumbrances on loans in the trust/custodial accounts; and
- having a record on loans within a given trust/custodial account – which Wells Fargo does by working with Sponsors and the servicers, obtaining initial lists of loans associated with an account and monitoring transfers of loans in and out of the account (by reviewing information provided by Sponsors and servicers and reconciling the information).

These activities ensured that funds deposited in the collection account were accurately captured and recorded and that the assets themselves – the student loans – were not compromised.

Out of the 199 participation purchase requests made by Wells Fargo-managed custodial accounts, the Draft Report references one request, representing .0089% of the total volume in Wells Fargo custodial accounts, as evidence of inadequate supervision of servicers. In the cited case, a lender was attempting to sell participation interests to the Department. This required the submission of information from Wells Fargo and the loan servicer to the Department to effectuate the sale. Wells Fargo confirmed with the lender that the loans were encumbered and, as such, prepared a Security Release Certification Form to notify the Department of this encumbrance. This would, among other things, notify the Department that the proceeds of the sale – which typically arrived in the custodial account between two and seven days after submitting the purchase request – would be transmitted to the party with the lien on the loan portfolio. Subsequent to confirming the encumbrance with the lender, and contemporaneous with Wells Fargo’s disclosure to the Department of the existence of the encumbrance, the Sponsor extinguished the encumbrance using its own funds. The Sponsor then notified the servicer of the change, and the weekly loan schedule submitted by the servicer to the Department was corrected to show that there was no encumbrance on the loans to be sold to the Department. These events all took place within a matter of hours on July 14, 2009. At no time, however, was the Department’s position harmed. The Department essentially received extraneous information about a prior, extinguished encumbrance. The Department received correct information from the servicer, through the weekly loan schedule, that no encumbrances existed on the loan portfolio and no financial impact resulted to the Department.
It is respectfully submitted that this isolated situation cannot justify the OIG’s conclusion. In fact, the servicer was correct in not noting there was an encumbrance and the issue is not one of servicer oversight. Because the servicer notified the Department of the proper status of the loans, Wells Fargo believed that the Department was properly notified. Further, because the servicer’s notice came after Wells Fargo’s original notice, Wells Fargo believed that the Department would accept the servicer’s information, which was submitted later in time, as updated and correct. Indeed, the Department has not set up any procedure to rescind a submitted Security Release Certificate (Exhibit G to the MPA). As such, there was little Wells Fargo could have done. Moreover, this is not an issue of servicer oversight but rather of the Department not establishing rules on what to do in this, admittedly rare, circumstance.

Equally problematic are the OIG’s conclusions concerning Wells Fargo’s oversight of the requirement that the servicer deposited loan payments within two days of receipt of such payment. First, the OIG should consider the nature of the lockbox. A lockbox – which is used in nearly every securitization known to Wells Fargo – is a dedicated account at a large commercial bank that is designed to receive payments from borrowers. Payments are not accepted for deposit if there is an issue with the method of payment – the check is non-negotiable, for example. In all other instances, however, the funds are accepted for deposit into the custodial facility as soon as they are received. This is the same process that is used in all other securitizations and is highly automated. Considering the high quality of the loan servicers and the routinized nature of the process, there is a high confidence level that payments will be timely deposited.

In addition, Wells Fargo placed the Sponsor in charge of monitoring this requirement. This was proper because, unlike Wells Fargo and other Custodians, only the Sponsor and the Department, had access to the lockboxes in which deposits were made by the servicer. By requiring Sponsors to monitor this requirement, Wells Fargo reasonably placed risk control in the hands of those in a position to most effectively exercise that responsibility. In addition, because untimely deposits only adversely impact the Sponsor, the Sponsor has a financial incentive to ensure funds are deposited quickly. This is because deposited payments – and any investment income such payments yielded – reduced the outstanding participation account balance and, as a result, lowers the yield owed to the Department.

In addition to reasonably assigning to the Sponsor a duty to oversee immediate remittance of borrower payments into the collection account, Wells Fargo engaged in oversight on this issue. For example, as is the case in commercial student loan trust accounts, which routinely have the same two-day deposit requirement, Wells Fargo monitored the flow of deposits to ensure that deposits were generally being made timely. Each day, Wells Fargo personnel received and reviewed deposit reports sent by the servicers. These reports, which were received one day prior to the anticipated receipt of funds in the custodial account, would set forth, among other items, the date the funds were received from the borrowers, the aggregate amount to be deposited and the anticipated date of the deposit into the custodial account. Reviewing these deposit reports was a crucial daily activity, as Wells Fargo personnel would utilize these reports to verify that the deposit arrived in the amount stated. Of course, if the deposit was lower than anticipated or nonexistent, Wells Fargo would have inquired further as to the reason for the change in deposit flow. In the course of reviewing these deposit reports, Wells

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9 See MPA, Sec. 9(b)(viii), at 23 (“List of Lockboxes. The Sponsor shall have delivered to the Department a list of lockboxes and copies of lockbox servicing instructions, to the extent not already provided.”).
Fargo was able to verify the timeliness of incoming remittances. Annexed hereto as Exhibit B is a copy of one such deposit report. In addition, Wells Fargo personnel would utilize these deposit reports in the course of verifying data in the Monthly Aggregate Settlement Date Report.

Of course, as discussed, the Sponsor is the party that stands to lose if payments are not timely deposited. Indeed, “[b]ecause 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.”10 Even still, the process Wells Fargo established was completely reasonable under the circumstances and adequately ensured the timeliness of the payments. In fact, the process described is quite similar to Wells Fargo’s process with other student loan trusts for which there is also a two-day deposit requirement.

**Recommendations**

Wells Fargo does not concur with the finding that Wells Fargo did not adequately oversee the delegated functions of the Sponsor or servicers. We recommend that the OIG revise the findings to reflect:

- that the appropriate standard for monitoring deleeges is “reasonable under the circumstances” as set forth in the MPA;
- the activity Wells Fargo undertook with regard to monitoring servicers and Sponsors in general and specifically with regard to ensuring timeliness of deposits;
- that, even though Wells Fargo acted properly in its oversight of the remittance of borrower payments, the Department was not and could not have suffered harm if a deposit was made beyond the two-day window; and
- that only one of the 199 purchase requests suffered from a miscommunication concerning security releases and that, in light of the correctly filed loan schedule, the Department was not harmed due to the miscommunication, and that in either case Wells Fargo acted reasonably under the circumstances.

**Conclusion**

Wells Fargo has participated as an ELT in the FFEL program for many years. Throughout, Wells Fargo has attempted to set the standard for providing ethical client services and maintaining compliance with published government standards and regulations. Indeed, Wells Fargo has been a leader within the American Banker’s Association subcommittee on Corporate Trust in promoting such compliance standards. Recently, Wells Fargo assisted the subcommittee in helping develop procedures designed to implement the standards proscribed in the Department’s October 2, 2009 letter on the “Responsibilities of Lenders Serving as Eligible Lender Trustees under FFELP.” Wells Fargo was also proud to participate in the ECASLA program. During the period of financial turmoil over the past few years, Wells Fargo worked with the Department, and changed course as needed, to make sure that students received loans to continue their education. It is with this background that Wells Fargo has approached this response.

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In sum, the Draft Report seeks to impose a standard that is not specified in the MPA. The MPA requires that Custodians such as Wells Fargo oversee delegees “reasonably under the circumstances.” It is respectfully submitted that Wells Fargo’s oversight activity was reasonable under the circumstances because it was consistent with standard commercial practices for student loan trust accounts (practices that the Department embraced in constructing the ECASLA Program). The flux in which Sponsors, Custodians, servicers and the Department operated further underscores that the oversight activities described were certainly “reasonable under the circumstances.” The standard to which the OIG seeks to hold Custodians at this late date is beyond that described in the MPA or in any of the many webinars and electronic announcements promulgated by the Department.

Thank you again for the opportunity to respond to the Draft Report. We would be happy to schedule a meeting with you to discuss these issues. If you have any questions or would like to speak with us for any reason, feel free to contact Tom Levandowski at 612-667-0628 or via email at Tom.Levandowski@wellsfargo.com.

Sincerely,

/s/
Timothy J. Carlin
Managing Counsel, Wells Fargo & Company

cc: Tricia Heintz, Wells Fargo
cc: Tom Levandowski, Wells Fargo
cc: Andrew Eskin, DLA Piper