Audit Report

OIG-17-008

SAFETY AND SOUNDNESS: Financial Institutions' Private Student Lending Activities

November 14, 2016

Office of Inspector General

Department of the Treasury

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Abbreviations

Bulletin 2000-20	Bulletin 2000-20: Uniform Retail Credit Classification and Account Management Policy
MRA	matter requiring attention
OCC	Office of the Comptroller of the Currency

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OIG

Audit Report

The Department of the Treasury
Office of Inspector General

November 14, 2016

Thomas J. Curry
Comptroller of the Currency

This report presents the results of our audit of the Office of the Comptroller of the Currency's (OCC) supervision of financial institutions' higher education student loan lending activities. Student loan debt stood at $1.36 trillion as of March 2016, and is second only to mortgage debt as the largest form of consumer debt in the United States. The Federal Government backs approximately $1.26 trillion or 92.5 percent of outstanding student loans. The remaining 7.5 percent of the higher education student loan market is made up of about $102 billion of private student loans[1]. While private student loans have a small share of the total outstanding student debt, they are an important part of the market given their disproportionate use by high-debt borrowers.

Our audit objective was to assess the adequacy and effectiveness of OCC's supervision over financial institutions' risk management controls and practices in place to mitigate losses in their private student loan portfolios. To accomplish our objective, we interviewed OCC personnel involved in supervising these activities and reviewed relevant OCC documentation. The scope of our audit ranged from January 1, 2007 through December 31, 2013. We conducted our fieldwork between August 2014 and July 2016. Appendix 1 contains a detailed description of our objective, scope, and methodology.

In brief, we concluded that OCC effectively supervised financial institutions' private student lending activities for the banks included in our audit sample. Specifically, we reviewed 3 out of 8 large banks and 3 out of 8 mid-size and community banks under OCC's

[1] Private student loans are consumer loans offered to borrowers to fund undergraduate, graduate, and other forms of postsecondary education.

supervision that had private student loan portfolios during the 2007 through 2013 timeframe. For 4 out of the 6 banks sampled, OCC conducted specific procedures related to the banks' private student loan portfolios. Based on our review, we found that OCC determined that the four banks complied with applicable guidance. In addition, OCC considered all matters requiring attention (MRA) relating to the banks' private student loan portfolios resolved by the banks' corrective actions. For the remaining two banks sampled, OCC assessed the retail credit portfolios as a whole and did not identify MRAs related to the banks' private student loan portfolios.

We are not making any recommendations to OCC as a result of our audit. We provided a draft of this report to OCC management for its review. OCC reviewed the report and had no comments.

Background

After 2008, the financial crisis, high unemployment, weaker loan performance, and reduced availability of funding all contributed to a lower market share in the private student loan market. Of the borrowers graduating around the time of the financial crisis with over $40,000 in student debt, 81 percent used private student loans. The unemployment rate for private student loan borrowers in 2009 was 16 percent, causing default rates to spike significantly.

Large, mid-size, and community banks have a long history of participation as lenders and servicers of Federal and private student lending programs. Large bank participation in the private student lending market is highly concentrated, with only eight OCC-supervised lenders holding portfolios of $500 million or more. Of the eight banks, four have ceased making new private student loans since 2008 due primarily to concerns about portfolio performance and liquidity. For mid-size and community banks, there are eight banks with outstanding private student loans in their portfolio, however, only two are still originating private student loans.

Banks that offer student loans are encouraged by OCC to work with troubled borrowers, offering prudent forbearance, workout, and modification programs. Banks are also required to ensure the integrity of their books and records by reporting the volume and nature of transactions accurately. These options and responsibilities are not mutually exclusive, and together promote a safe and sound banking system. OCC's Bulletin 2000-20: *Uniform Retail Credit Classification and Account Management Policy* (Bulletin 2000-20), issued June 12, 2000, provides examiners with general guidance regarding loan extensions, deferrals, renewals, and rewrites; however, this guidance does not specifically address private student loan workout and forbearance practices. To address those issues, OCC issued supplemental guidance[2] that interprets Bulletin 2000-20 in the context of private student lending and describes OCC's minimum expectations for managing forbearance, workout, and modification programs.

Responsibilities of OCC

OCC performs safety and soundness examinations of banks on an ongoing basis. For supervisory purposes, OCC designates each bank as a large, mid-size, or community bank. Large and mid-size banks are supervised through OCC's headquarters office, which follows a supervisory process detailed in its Large Bank Supervision booklet.[3] Examinations are performed on a 12-month supervisory cycle. Community banks are supervised under the oversight of district deputy comptrollers, who follow a supervisory process detailed in the Community Bank Supervision booklet.[4] In smaller National bank affiliates, community banks, and Federal branches and agencies of foreign banks, there is flexibility in both when and how examination activities are performed during the 12 or 18-month supervisory cycle.

[2] Chief National Bank Examiner Policy Guidance 2010-02: *Policy Interpretation: OCC Bulletin 2000-20 - Application to Private Student Lending* issued Aug. 4, 2010.
[3] Comptroller's Handbook: *Large Bank Supervision* (Jan. 2010).
[4] Comptroller's Handbook: *Community Bank Supervision* (Jan. 2010).

Audit Results

OCC Effectively Supervised Financial Institutions' Private Student Lending Activities

OCC employs a risk-based supervisory philosophy focused on evaluating risk, identifying problems, and ensuring banks take appropriate corrective action. As part of this approach, examiners can tailor examination activities to the level of risk within any given examination area. OCC determined that the overall risk of private student lending activities is low, primarily because of the size and performance of the portfolios. However, according to OCC officials, when concerns arise relating to these activities at a specific bank, OCC expands its procedures as part of its safety and soundness examinations. Based on our review of OCC's risk assessment and documentation, we concluded that OCC performed effective ongoing supervision of financial institutions' private student lending activities.

We sampled 3 out of the 8 large banks and 3 out of the 8 mid-size and community banks OCC supervises that had private student loan portfolios during the 2007 through 2013 timeframe. We selected banks that were still originating private student loans and banks that were no longer originating these types of loans. Our sample also included banks with smaller and larger private student loan portfolios. We found that OCC performed effective ongoing supervision procedures for the six banks in our sample. Because we used a non-statistical sampling technique to select the banks, we did not project the results of our testing to the total universe of banks that had private student loan portfolios.

More specifically, for 4 out of the 6 banks, OCC conducted specific procedures relating to the banks' private student loan portfolios during full scope examinations, targeted examinations, and ongoing supervision. For example, OCC reviewed the banks' management information systems and independent assessments and determined that the banks complied with Bulletin 2000-20, which provides examiners with general guidance regarding extensions, deferrals, renewals, and rewrites of banks' retail loans. As mentioned above, OCC issued supplemental guidance that interprets Bulletin 2000-20 in the context of private student lending and describes OCC's minimum expectations for managing forbearance, workout, and modification programs. The supplemental guidance provides some examples of practices and policies that generally would be acceptable as part of a controlled and documented program. These examples included grace and extended grace periods, loan modifications, and in-school deferments.

Other areas for these four banks' private student loan portfolios that OCC assessed during examinations included credit risk management, underwriting, loan collection, loss mitigation, and loan forbearance. For 3 out of the 4 banks, OCC identified MRAs relating to the banks' private student loan portfolios. The MRAs addressed issues such as liberal forbearance practices, administration of forbearance policies and practices, noncompliance with guidance, and insufficient board and management reports. However, based on our review of subsequent reports of examinations, compliance with supervisory letters, and examiner workpapers, we found that OCC considered the corrective actions taken by the banks to have resolved the MRAs.

For the remaining two banks in our sample, during its examinations OCC assessed retail credit portfolios, which includes private student loans, as a whole. An OCC official stated that the student loan portfolios for these banks were considered low risk because of the asset size; and therefore, there were no specific procedures performed relating to the private student loan portfolios. According to OCC's Handbook for Bank Supervision Process,[5] the type, depth, and frequency of activities undertaken should correspond to the level of risk in each bank and statutory requirements. However, the handbook further states that examiners should employ some periodic baseline transaction testing to validate key control functions and systems, even if those areas are considered low risk. An OCC official told us that periodic baseline testing includes conducting sufficient review of the activity in order to confirm the level of risk the area represents. The official further stated that the frequency of reviews of a particular activity is determined as part of the supervisory strategy based on the risk profile. In addition, certain activities can be insignificant and not specifically addressed

[5] Comptroller's Handbook: *Bank Supervision Process* (Sept. 2007).

in the risk profile or strategy. In these circumstances, OCC relies on internal exception reports and audit reports to monitor activity in these areas. That said, review of the banks' internal documents could prompt OCC examiners to review the student loan portfolio if concerns arise.

Specifically, for the two banks in our sample, OCC reviewed internal bank documents, including internal audit reports, management information systems, enterprise risk management systems, credit review reports, and board meeting minutes. In addition, OCC did not identify any MRAs related to the banks' private student loan portfolios during its examinations. As a result of its review of these internal documents and systems and its examinations, OCC did not expand its procedures relating to the banks' student loan portfolios, nor did it assess compliance with Bulletin 2000-20 or the supplemental guidance. According to an OCC official, there is no statutory or explicit policy requirement for examiners to test compliance with the bulletin and the supplemental guidance unless there is more than a nominal volume of retail lending.

During the 2007 through 2013 timeframe, OCC examiners followed the Retail Lending Examination Procedures Handbook,[6] Bulletin 2000-20, and the Bulletin 2000-20 supplemental guidance, which all relate to retail lending as a whole. We noted that there was limited specific guidance relating to student lending. However, subsequent to the timeframe covered by the scope of our audit, OCC issued a Student Lending Handbook[7] for OCC examiners to use in connection with their examination and supervision of National banks and Federal savings associations engaged in private student lending. The handbook provides (1) guidance to examiners on assessing the quantity of risk associated with private student lending and the quality of student lending risk management and (2) information on unique aspects of student loans and industry practices. Additionally, it highlights the differences between Federal student loans and private student loans.

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6 Comptroller's Handbook: *Retail Lending Examination Procedures* (Dec. 2004).
7 Comptroller's Handbook: *Student Lending* (May 2016).

We provided a draft of this report to OCC management. OCC reviewed the report and had no comments.

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We appreciate the courtesies and cooperation provided to our staff during the audit. If you wish to discuss the report, you may contact me at (202) 927-8783 or Alicia Weber, Audit Manager, at (202) 927-5811. Major contributors to this report are listed in Appendix 2.

Katherine E. Johnson
Audit Director

The objective of this audit was to assess the adequacy and effectiveness of the Office of the Comptroller of the Currency's (OCC) supervision over financial institutions' risk management controls and practices in place to mitigate losses in their private student loan portfolios. The scope of our audit ranged from January 1, 2007 through December 31, 2013. We conducted our fieldwork in Washington, D.C. between August 2014 and July 2016.

To accomplish our objective, we performed the following procedures.

- We reviewed OCC's internal supervisory guidance for examiners as it relates to National bank and Federal savings association private student lending activities.

- We reviewed OCC's Comptroller's Handbook.

- We selected a sample of 3 out of 8 large banks, and 3 out of 8 mid-size and community banks that had a private student loan portfolio during the scope of our audit. We selected banks that were still originating private student loans and banks that were no longer originating these types of loans, as well as banks with smaller and larger portfolios. The sample selected was non-statistical because the universe was determined to be low risk. Non-statistical sample results were not projected to the total universe.

- We reviewed relevant supervisory files and records from 2007 through 2013, for our sample of large, mid-size, and community banks, including reports of examination, supervisory strategies, core assessments, supervisory letters, conclusion memos, formal and informal enforcement actions and other documents supporting OCC's supervision and monitoring of private student loan portfolios.

- We interviewed OCC officials and examiners.

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 objective.

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