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Crisis in student loan servicing is building

By Joe Cioffi

When the housing market crashed and the subprime mortgage bubble burst, servicing operations were on the front line to mitigate lender and investor losses. It was soon discovered, however, through government and private lawsuits, and investigations, that improper servicing practices may have actually contributed to the crisis.

Fast forward to today and the allegations leveled by the Consumer Financial Protection Bureau and private litigants against the nation's largest student loan servicer, Navient Corp., tread similar ground. If the allegations are true, poor servicing practices may be a hidden problem permeating the $1.3 trillion in outstanding student loan debt held by more than 44 million borrowers, contributing to rising delinquency rates.

The transgressions alleged in the past against subprime mortgage servicers — robo-signing of foreclosure documents, deceiving borrowers regarding foreclosure alternatives, improper denials of loan modifications to qualified borrowers, and false and inaccurate credit reporting — were widely reported as having devastating effects on consumers' financial lives.

Mortgage servicing problems became widely known through government actions, particularly against the five largest servicers — Bank of America, JPMorgan Chase, Wells Fargo, Citigroup and Ally Financial — resulting in a $25 billion settlement. This was followed by a wave of litigation and investigations involving nonbank and smaller servicers, including Ocwen Financial, Flagstar Bank and Residential Credit Solutions.

Although specific loss mitigation options for student loans and mortgages have inherent differences, the claims against Navient go to the core of servicing activities in general — regardless of asset — and echo the mortgage debacle.

The CFPB and several state attorneys general have alleged that Navi-ent's practices steered struggling borrowers toward paying more than necessary on their loans, obscured information necessary for borrowers to maintain lower payments, misled borrowers regarding requirements to release co-signers and improperly processed payments. Just like in the subprime mortgage servicer actions, at issue is whether there has been a failure to advise borrowers of modification options, as well as improper practices related to modification programs. This time, there are potentially devastating effects on student loan borrowers and their families.

Since the allegations against Navient came to light, multiple private actions, including class actions, have been filed against Navient and borrowers have come forward with their own stories of improper treatment. Borrowers have said they were placed in forbearance pro grams without any explanation of alternative repayment plans or the reporting requirements they had to comply with to avoid costly penalties. Said one single mother in Georgia, "I thought I owed $5,000, but when I looked at my credit report, it said I owed $10,000 with interest and penalties due to my forbearance."

Servicing practices that unnecessarily increase what a borrower owes can directly contribute to delinquencies, as was the case with the subprime mortgage crisis. But other misconduct, such as inaccurately reporting loan status and what a borrower owes to other creditors, can have more insidious effects on a borrower's financial health.

In the mortgage servicing area, the CFPB charged that servicers brought harm to consumers by failing to correct borrower information provided to credit reporting agencies in a timely manner, and leveled the same accusation about the response time to borrower notices on disputed information in credit reports.

More recently, in the student loan area, the CFPB issued a warning to borrowers to watch out for inaccurate reporting of "enrollment status" information. In many instances, borrowers have been incorrectly reported as being in repayment period, resulting in interest accruing earlier than it should, while in other instances there has been a lag in reporting the repayment period has begun. This results in borrowers being already behind in payments when they graduate from school.

This type of inaccurate reporting may be the tip of the iceberg. Other reporting issues, like reporting nonexistent defaults to credit agencies appears to be a problem for borrowers at all stages of repayment. It can sink businesses and personal plans, and the borrower may never see it coming.

For example, a Virginia-based borrower said successive credit reports had inaccurately showed his loan intermittently in and out of default, eventually leading to denial of loans needed to support his business. "I told them [the servicer] about the errors and they would fix them one month and then reinstate them the next and finally my SBA lender gave up waiting for it to get straightened out. I lost my business when I couldn't get that loan."

At this point, the total impact of student loan servicing issues is unclear. Unlike mortgage loan servicers, which were required to adjust their policies and procedures in response to the subprime mortgage era litigation, student loan servicers are just now going under the microscope. It may be too late for servicers to change practices to avoid trouble, but it's never too late to take corrective measures to avoid adding to the already crushing and growing debt burden on student loan borrowers.

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