

INSOLVENCY, CREDITORS' RIGHTS & FINANCIAL PRODUCTS

>>ALERT

RECENT ACTIONS AGAINST NAVIENT MAY EXPOSE PROBLEMS CONTRIBUTING TO THE STUDENT LOAN DEBT CRISIS

On January 18, 2017, the Consumer Financial Protection Bureau (CFPB) filed suit against the nation's largest student loan servicer, Navient Corporation, alleging a litany of bad acts in the servicing of private and federal student loans that, if true, would mean shoddy and suspect practices may have already robbed students and their families of the opportunity for financial stability and success. Though it is uncertain whether the lawsuit will continue to be prosecuted under President Donald Trump's administration, if the alleged misconduct becomes viewed as contributing to the nation's student debt problem, the tide may turn in favor of borrowers in the legislature and the courts, including bankruptcy courts.

ACTIONS AGAINST NAVIENT

Navient, formerly part of Sallie Mae, services and manages the loans of more than 12 million borrowers – totaling over \$300 billion in student loans – pursuant to its contract with the U.S. Department of Education. In its complaint, the CFPB alleges, among other things, that Navient:

- >> Steered struggling student borrowers toward paying more on their loans;
- >> Obscured information student borrowers needed to maintain lower payments;
- >> Deceived private student loan borrowers about what was required to release their co-signer from loans; and
- >> Failed to adequately process payments made by student borrowers and cosigners.

THE BOTTOM LINE

It is uncertain how the Trump administration will deal with the student loan problem. On the one hand, his negative views of the current head of the CFPB and even regulation generally are well documented. But on the other hand, he has proposed more borrower-favorable income-based repayment plans that would allow for earlier extinguishment of debt versus current plans. Further, Trump's inauguration speech struck a decidedly populist tone that would suggest support for the student loan borrower. Ultimately, even if the CFPB under Trump does not have an interest in pursuing the lawsuit, we may see state attorneys general pick up the charge in actively pursuing claims against student loan servicers.

The CFPB charges that Navient violated the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Fair Credit Reporting Act, and the Fair Debt Collections Practices Act. The CFPB seeks redress for consumers allegedly already harmed by Navient (in the form of, among other things, civil monetary penalties), and to keep Navient from continuing its alleged illegal conduct and harming new consumers.

On the same day, the Attorneys General of Illinois and Washington also filed suit against Navient, claiming deceptive and predatory practices in the company's loan servicing and collection activities. The Illinois Attorney General further alleges that Sallie Mae made "expensive subprime loans that it knew were going to fail." The state suits seek a combination of loan discharges, restitution and civil penalties.

>> continues on next page

Navient has denied all of the allegations against it, but the suit itself could have wide-reaching consequences to the student loan industry, regardless of the outcome. For example, prior to 2007, few if any knew how overburdened, outmanned and poorly equipped subprime mortgage servicers were to deal with widespread defaults. When the housing market crashed, the issues came to light. State attorneys general and private litigants argued that servicing operations in many cases actually exacerbated the subprime crisis and investor losses through misinformation to borrowers, misapplied payments and failures in implementing loan modification procedures. If the CFPB's allegations against Navient bear out, it may come to light that servicers are similarly contributing to student loan delinquencies by misinforming and misleading borrowers, including by pushing borrowers toward more costly forbearance programs instead of income-based payment plans.

EFFECTS ON LOAN DISCHARGES

Depending on how the case proceeds and public reaction evolves, more borrowers may attempt to discharge their student debt and more courts may be willing to allow it. Currently, student loans are not dischargeable in bankruptcy, unless they pose an "undue hardship." That exception is commonly perceived to be nearly impossible to overcome. However, although it is a tough standard, it is not impossible to meet. More importantly, because it is not a defined term in the Bankruptcy Code, it is subject to interpretation by a judge whose rulings may reflect the current times and public sentiment.

Thus the growing concern over the amount of delinquent loans and their perceived unshakeability could reach a new level in the wake of the allegations against Navient.

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