House of Commons

Business, Innovation and Skills Committee

Student Loans

Third Report of Session 2014-15

Report, together with formal minutes relating to the report

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Summary

This Report makes recommendations to the Department for Business, Innovation and Skills for its policies affecting students residing in England. The Government subsidises higher education in England by offering a specified number of students guaranteed access to loans with favourable terms and conditions. At present, students do not have to start making any repayments on their loans until they are out of higher education and are earning above £21,000 a year. These loans are time limited and any outstanding debt is written off after 30 years. By providing favourable terms and conditions on student loans, the Government loses around 45p on every £1 it loans out.

The administration of these loans, in relation to students who reside in England, is shared by the Department for Business, Innovation and Skills and the Student Loans Company—an Executive Non-Departmental Public Body. Our Report highlights a number of weaknesses in the management of this key financial commitment and we are concerned that Government is rapidly approaching a tipping point for the financial viability of the student loans system.

Forecasting future debt is vital to managing the public finances. In general this is done by using Resource Accounting and Budgeting (RAB). Under this approach, the Government estimates how much it will lose on a student loan at the point it pays out. Our Report uncovers a worrying record of miscalculation of the Department's estimate of the RAB charge. More disturbing, is the fact that independent forecasters have been recommending improvements to the Government's methodology for some years, which the Department has ignored. We recommend that it starts to listen now. The size of this problem is put into stark relief by the fact that the Minister estimates that the size of outstanding debt will increase sevenfold to more than £330 billion by 2044.

The Government is already struggling to collect student loans effectively. We therefore recommended an urgent review of the sustainability of the student loan system. As part of that review, the Government would do well to look abroad for examples of best practice and must come back with a clear timescale for this review.

The student loan-book is an asset that may be sold for financial gain to the public purse. This was done with the mortgage-style student loan-books of the 1990s. The Government has now announced its intention to sell the more recent income-contingent student loans. This could bring a significant financial windfall to the public purse. However, we conclude that the BIS Department has yet to prove that it has sufficient evidence to judge whether or not selling these assets represents good value for money. We recommend that before any sale, the Government demonstrates the costs of the sale, as well as benefits, so that full value-for-money may be assessed.

In the most recent Autumn Statement, the Chancellor of the Exchequer announced the removal of the cap on student numbers. There is agreement that the principle behind the removal of the student numbers cap is a worthy aspiration. The Government's

announcement that the cap will be removed appears to be based on a policy to fund the cost of this through sales of income-contingent student loans. Given the uncertainty around the amount the Government could realise from the sale of income-contingent student loans, it is vital that the Government sets out clearly where and how it will raise the £5.55 billion required to fund this policy for the next five years.

Glossary

AME:	Annual Managed Expenditure
BIS:	The Department for Business, Innovation and Skills
DEL:	Departmental Expenditure Limit
HEFCE:	Higher Education Funding Council for England
HEPI:	Higher Education Policy Institute
HMRC:	Her Majesty's Revenue and Customs
NAO:	National Audit Office
NUS:	National Union of Students
PAYE:	Pay As You Earn taxation
RAB charge:	The Resource Accounting and Budgeting charge
RPI:	Retail Price Index
SLC:	The Student Loans Company
The Department:	The Department for Business, Innovation and Skills

1 Background

Funding higher education

1. There is both a social and economic benefit to having an educated population, and therefore Governments often subsidise the cost to the student of higher education. In the United Kingdom, the UK Government and the devolved administrations do this by paying out loans to students with more favourable terms and conditions attached to them than commercial loans.

2. In 1990 the UK Government issued student loans for students across the UK, structured so that a graduate paid back a fixed amount each month via direct debit.[1] These are referred to as 'mortgage-style' loans because of the structural similarities to mortgage debt. In 1998, the then Government stopped issuing this type of loan and started issuing 'income-contingent' loans in which the amount repaid was related directly to how much the graduate earned. In both cases, however, graduates only made repayments once their earnings reached a set threshold. The National Audit Office (NAO) reported that between 1990 and March 2013, the Student Loans Company (SLC) paid out £4 billion of mortgage-style loans and £51 billion of income-contingent loans.[2]

3. Under the current system, universities can charge up to £9,000 in tuition fees per year. The Government offers every student a tuition fee loan of up to £9,000 and an additional maintenance loan of up to £7,751 (depending on the location of the student and their family income) per year of study. The Government also offers a maintenance grant for students from lower income families. These grants are not repayable, but a student receiving such a grant has a corresponding reduction to their maintenance loan.[3]

4. Responsibility for the administration, maintenance and servicing of the student loan-book is split between three bodies. The Department of Business, Innovation and Skills (the Department) has overall responsibility for student loans. The administration of student loans is the responsibility of the Student Loans Company (SLC), which pays out maintenance loans to students and tuition fee loans to universities on the behalf of students. The majority of student loan repayments (around 82 per cent in 2012–13) are collected by Her Majesty's Revenue and Customs (HMRC), from graduates who are employed within the Pay As You Earn (PAYE) taxation system. The remaining amount is collected by the SLC from graduates outside of the PAYE system (for example, self-employed graduates and those working outside of the United Kingdom).

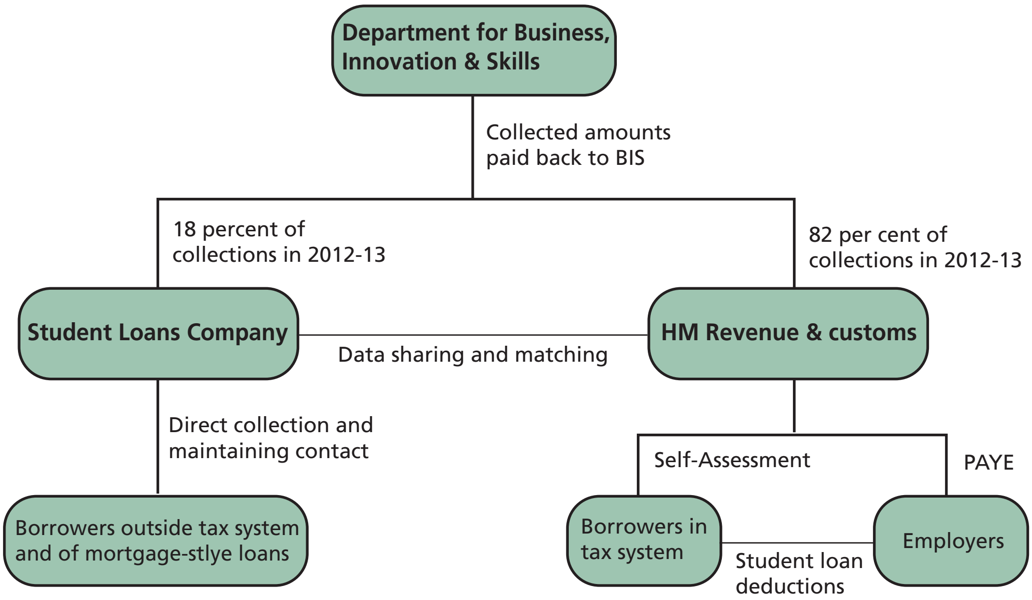
1 For a summary of the development of student loans, see Annex A

2 National Audit Office, *Student loan repayments* (November 2013), para 1.5

3 Government Website, 'Student Finance', accessed 16 June 2014

Figure 1: Overview of the student loan collection system

Overview of the collection system



Source: National Audit Office analysis of Student Loans Company information

The NAO Report on student loan repayments

5. In November 2013 the National Audit Office (NAO) published a Report into the student loans repayment system. The Report focussed on the collection regime of the student loan system and came to the following headline conclusions:

> 1. BIS should publish a transparent and readily understandable forecast for the amount it expects to be collected each year and report on any variance;
>
> 2. BIS does not currently set a collections performance target to incentivise the SLC and HMRC to maximise recovery of repayments;
>
> 3. BIS lacks sufficient information on whether borrowers with no current employment record are earning enough to repay their loans; and
>
> 4. Around 14,000 borrowers living overseas are currently behind in their loan repayments. While this group is small compared to the total number of borrowers, the SLC could learn more from other organisations that collect debt.[4]

The NAO concluded that the Department "urgently needs to understand how the loan book is performing and how it will perform, when the value of outstanding loans is projected to increase substantially".[5]

4 National Audit Office, *Student loan repayments* (November 2013), para 19a–19d

5 National Audit Office, *Student loan repayments* (November 2013), para 19

2 Part one: Student funding policy, strategy and review

Introduction

6. It has been estimated that the level of student debt will increase from £46 billion in 2013 to approximately £330 billion by 2044.[6] The student loan-book will therefore become a significant macro-economic consideration within a generation. In its recent Report, the NAO made four clear recommendations to improve the strategic outlook of the Student Loans Company (SLC).[7] Our inquiry also raised concerns which caused us to scrutinise the role of the SLC.

Systematic factors

The RAB charge

7. Fundamental to the ability of the Government to accurately target, value and redeem outstanding loans, is its ability to forecast repayments into the future. The NAO reported that "BIS's projections of annual loan repayments have consistently been higher than amounts collected".[8] It went on to conclude that "reliable forecasts of repayments are required for a robust valuation of the loan book".[9]

8. The difference between the estimate of the value of future income from students and the original value of the loans is recorded as a cost in full in the year that the loans are given. This cost is also known as an 'impairment' or the 'Resource Accounting and Budgeting' (RAB) charge and provides early recognition, at a total level, of amounts that are expected never to be repaid. In other words, the RAB charge calculates the predicted subsidy that the Government implicitly pays to students through the favourable terms connected to student loans. The RAB charge is presented as a percentage, which may be interpreted as 'if the Government loaned £1 to a student today, on average what percentage of that £1 does it expect not to be repaid?'

Forecasting implications of the RAB charge

9. The Government currently models future repayments by forecasting what proportion of loans issued will never be repaid. However, accurate forecasting of the RAB charge has been a challenge for the Government. The NAO expressed concern when it reported on this and concluded that the Department could not explain the difference between actual and forecast repayments:

6 National Audit Office, *Student loan repayments* (November 2013), para 3 & HC Deb, 18 June 2014, c657W

7 National Audit Office, *Student loan repayments* (November 2013), para 19

8 National Audit Office, *Student loan repayments* (November 2013), para 15

9 National Audit Office, *Student loan repayments* (November 2013), para 15

> BIS has faced difficulties in accurately forecasting repayments of these complex loans, and in 2009–10 forecasts were nearly 20 per cent higher than amounts collected. BIS has since improved its forecasting methods but still consistently over-forecasts how much it expects to collect annually by around 8 per cent.[10]

The NAO estimated that this inability to accurately forecast resulted in the Department collecting £111 million less in repayments than it expected in 2011–12.[11]

10. The President of the National Union of Students, Toni Pearce, voiced the Union's concerns about this, highlighting how much the estimate of the RAB charge had changed over the past two years:

> The changing of the estimation from 33 per cent to between 35 per cent and 40 per cent […] shows the unpredictability and, I suppose, that risk of what happens if graduate earnings do not stack up to what you expect them to be.[12]

11. The Department was aware that its forecasting had not performed well. It told the NAO that it aimed "to improve forecasting by using more detailed information on borrowers' earnings to project future earnings and repayments".[13] Its current modelling does not include factors that can affect how quickly a borrower's salary will rise, such as the subject they studied or the university they attended, despite the fact that the data indicates that there is a correlation between the factors.[14] This weakness in the model has been highlighted to the Department for some time. As far back as 2010, the Higher Education Policy Institute (HEPI) reported that the Government had significantly under-estimated the RAB charge. In October 2012, HEPI published its own analysis, which produced a RAB charge of around 40 per cent (12 percentage points higher than the Department's estimate at the time). The Secretary of State, in response to that work, strongly refuted HEPI's findings:

> We do not accept that they are right. We are in the world of forecasting, and by definition nobody is right about forecasts. We had the HEPI view put to us two years ago, when we were thinking of the current changes, so we are aware. But they are an outlier in this whole debate.[15]

That view was confirmed by Martin Donnelly, Permanent Secretary at BIS:

> It is worth making the point that there is a roughly 10 per cent difference at the moment, and these figures do move around. But HEPI argued that 40p of every pound loaned would never be repaid, which is very significantly

10 National Audit Office, *Student loan repayments* (November 2013), para 15

11 National Audit Office, *Student loan repayments* (November 2013), para 15

12 Q51

13 National Audit Office, *Student loan repayments* (November 2013), para 16

14 For example: Business Innovation and Skills Research Paper No 112, *The impact of university degrees on the lifecycle of earnings* (August 2013)

15 Oral Evidence taken on 30 October 2012, HC (2012–13) 702-I, Q73

> different from where both we and the IFS are, given that this is not, by definition, precise.[16]

12. The Government now estimates the RAB charge to be 45 per cent, although at the time of our taking evidence it was estimated to be around 40 per cent.[17] Bahram Bekhradnia, Director of HEPI, outlined the developments in the RAB charge:

> The original Government projection was 28 per cent RAB charge. It then went to 30 per cent in the White Paper. It was 32 per cent this time last year, [when the Secretary of State gave evidence] and now they are saying 35 per cent to 40 per cent. I see London Economics are saying it is close to 40 per cent as well.
>
> It is not that we have produced a different RAB charge; what we did was to take the Government's model and plug in different assumptions to those that they had.[18]

13. During our inquiry into the Government's higher education reform in 2011, we drew the Minister's attention to the work of HEPI. The Minister did not accept HEPI's assessment then, stating that "no one can be certain" about the RAB charge.[19] When he appeared before us in 2014, the Minister conceded that HEPI's research appeared to be more accurate than his own but argued that HEPI had been "right, for the wrong reasons".[20] He elaborated:

> It does not follow that the RAB charge's having got to 40 per cent is because the exact calculations that he made then [in 2012] were correct. The big thing is earnings. Our forecasts, 30 years out, are incredibly sensitive to a change in earnings every six months.[21]

14. However, in evidence to us HEPI cited projected earnings as a specific failing of the Department's model:

> The estimates from the BIS model are insensitive to long term growth in average wages. This is because the projected earnings of former students and the future repayment threshold level are both increased annually in line with average earnings.
>
> […]
>
> It seems likely that, even if the career growth in earnings is maintained on average, the spread will increase. That is, while top earners may see an even

16 Oral Evidence taken on 30 October 2012, HC (2012–13) 702-I, Q81 [Mr Donnelly]

17 Department for Business, Innovation and Skills, *Annual report and Accounts 2013*–14, HC 39, July 2014, page 88

18 Q69

19 Business, Innovation and Skills Committee, Twelfth Report of Session 2010–12, *Government reform of Higher Education*, HC 885, para 72

20 Q149

21 Q149

> bigger growth in earnings over their lifetime, those in the lower range of earnings will not see the growth in earnings over their careers that has been typical, at least for men, for those in 'graduate' jobs in the past. In the USA only high earners have seen increases in real earnings over three decades, and in the UK increasing dispersion of graduate earnings is now being observed. […] If median and low earners earn less than has been assumed then that will reduce the loan repayments, and increase the cost to the Government.[22]

15. Bahram Bekhradnia, Director of HEPI, reinforced his organisation's analytical findings on the Department's modelling of the RAB charge when he gave evidence:

> The biggest reason for [the RAB charge's] change up to now has been that the earnings that graduates have are rather lower than the Government assumed, and that makes a big difference between last year and 2016, because the repayment threshold is fixed at £21,000. If people are earning less than had been assumed, then less money is coming in, and then when the repayment threshold starts going up after that, that has a knock-on effect.[23]

He concluded that the main reason for HEPI's greater accuracy was that the Department's assumption that future earnings growth would "be spread equally among the population" because "that has never happened in the recent past, and there is no reason to think that it will in the future".[24]

16. Toni Pearce, the President of the National Union of Students, highlighted another aspect of the Department's modelling which was open to question:

> One of the fundamental miscalculations about how we measure that future risk and the future amount that people will or will not repay is that when these were first forecast, they were forecast on the basis that equal numbers of men and women would go to university and on the basis that women would have lower graduate earnings. However, we know that more women year on year go to university and that has had a huge impact on what the forecast of the RAB charge is. When you are making such fundamental miscalculations at the very beginning, I find it quite concerning.[25]

17. ***The evidence that we have received, both in this inquiry and previous inquiries, suggests that there has been a persistent miscalculation of the Department's estimates of the RAB charge. The resulting holes in the budget are only just beginning to materialise. Forecasters, particularly HEPI, had and continue to have a more accurate picture of repayments. Despite this, the Department has ignored their concerns. We recommend that, as a matter of urgency, the Department conducts a full review of all the financial assumptions underpinning the Department's RAB model.***

22 Higher Education Policy Institute (SLB 0002) paras 14–15

23 Q69

24 Q69

25 Q51 [Ms Pearce]

Budgetary implications of the RAB charge

18. Student loans are given on "soft terms", in that they have more favourable terms and conditions attached to them than if students were to borrow the money commercially. They are, therefore, effectively subsidised.[26] This subsidy arises from two elements: the interest rate being lower than the Government's cost of borrowing capital (for pre-2012 loans) and 'policy write-offs', for example, the fact that all loans are written off after 30 years. As we mentioned earlier in this Report, the RAB charge provides early recognition, at a total level, of amounts that are expected never to be repaid. BIS has been given a ring-fenced budget within its Resource Departmental Expenditure Limit (Resource DEL) for these impairments each year, which has been set by the Treasury, based on a target level of impairments.[27] The target level of impairments is not currently published. If the assumptions made in the BIS student loan repayment model (the RAB charge) are revised, there can be further impairments of historic loans in following years. For example, in 2013–14, the Department received £6.7bn from HM Treasury to allow for additional impairments of new and existing student loans, of which £3.4bn was utilised.[28] The Treasury has therefore been keen to provide BIS with some incentives to take measures to keep these costs under control over the medium and longer term, rather than simply look to Treasury to make up the shortfall.

19. As a result, impairments to post-2012 student loans above HM Treasury's target are now charged to DEL over 30 years, spreading these costs to budgets that BIS must manage itself. The Chief Secretary to the Treasury, Danny Alexander, stated that this would "improve the incentives for managing the long-term costs of new student loans".[29] If BIS then fails to take action to revise its policies around student loans, there is a risk that impairments of the student loan book will adversely impact other, unrelated BIS budgets.

20. Annex B sets out how student loans are accounted for, and where responsibility for risk lies. Adjustments made to previously issued loans, to ensure the carrying value of these loans is not greater than the value of estimated future cash flows, is known as the stock charge.[30] The level of actual loans and repayments every year is recorded in the Annual Managed Expenditure (AME), where the budgets are not subject to a fixed annual limit and therefore the risk lies primarily with Treasury rather than the Department. The level of actual repayments only affects the Department's DEL budget in so far as it alters projections for future repayments over the long term.

21. **We support the Chief Secretary to the Treasury's ambition of improving the incentives for managing the long term costs of new student loans, and encourage the Treasury to look for further ways to strengthen these incentives. However, we are**

26 HM Treasury, *Consolidated Budgeting Guidance from 2014-15* (February 2014), para 8.9

27 HM Treasury, *Consolidated Budgeting Guidance from 2014-15* (February 2014), para 8.14

28 Department for Business, Innovation and Skills, *Annual report and Accounts 2013*–14, HC 39, July 2014, page 88

29 Correspondence between HM Treasury and Sir Alan Beith, 15 January 2014

30 Department for Business, Innovation and Skills, *Annual report and Accounts 2013*–14, HC 39, July 2014, page 88

concerned that the current arrangements may have an adverse impact on unrelated BIS budgets in the medium term.

22. ***In order to improve transparency and accountability, we recommend that the Department publishes HM Treasury's targets for impairments for student loans alongside reports against actual performance.***

Monitoring and reporting of the Student Loans Company against targets

23. The organisations and agencies responsible for student loans are subject to a series of targets set by the Department. The NAO's Report stated that the Department set:

> Adequate targets for HMRC designed to incentivise quick and accurate information processing and repayment collection through the tax system, and HMRC met all of these targets in 2012–13. These targets have become tougher since 2010–11, and HMRC has consistently met them.[31]

24. In respect of the Student Loans Company, the NAO found that:

> In 2012–13, the SLC met three out of four targets for the percentage of borrowers in a repayment channel. […] In 2010–11 and 2011–12, the SLC met all income-contingent repayment collection targets.[32]

However, the NAO concluded that, although the SLC may have met its targets, they were not fit for purpose. It is a key target for the SLC to have 98.5 per cent of borrowers in a Repayment Channel, which the Department describes as any borrower that it considers to be "either repaying on time or not earning enough to repay".[33] The NAO found that the SLC was counting a substantial number of borrowers as being in a Repayment Channel despite not having current information on either their employment status or whether or not they should be repaying. The NAO pointed out that, as a result, a large number of borrowers may have been incorrectly categorised:

> While the SLC met most of the targets that BIS set in 2012–13 for income-contingent repayment loans, performance against targets does not present a complete picture of repayment performance. At March 2013, BIS and the SLC had recorded 36,400 borrowers as not in a repayment channel due to a lack of earnings information. However, a further 368,000 borrowers also had no current UK employment record (but had paid tax in the past), and had not yet provided other earnings information that would allow the SLC and HMRC to establish whether they were earning enough to repay.[34]

25. The NAO estimated that, had the SLC classified graduates that it had no current employment information on as being outside of a Repayment Channel, its performance

31 National Audit Office, *Student loan repayments* (November 2013), para 2.4

32 National Audit Office, *Student loan repayments* (November 2013), para 2.3

33 National Audit Office, *Student loan repayments* (November 2013), para 7

34 National Audit Office, *Student loan repayments* (November 2013), para 2.6

against such targets would be reduced from 99.1 per cent to 86.4 per cent in 2013, clearly missing its target. If fully repaid or cancelled accounts were also removed from the Repayment Channel that figure would fall to 84 per cent.

Table 1: Design of collection performance targets

Repayment status	As reported by SLC	If no employment record treated as not in repayment	Also removing fully repaid or cancelled accounts
UK resident borrowers in a repayment channel	2,875,259	2,507,225	2,069,643
UK resident borrowers not in a repayment channel	27,124	395,158	395,158
Proportion of borrowers in a repayment channel	**99.1%**	**86.4%**	**84.0%**

Source: National Audit Office analysis of Student Loans Company data

The NAO concluded that "the way BIS has designed the targets means that reported performance is potentially misleading".[35]

26. **For the NAO to conclude that the targets set for the Student Loans Company by the Department may have been misleading is a damning finding. It is obvious to us that the Department must address this as a matter of urgency.**

Targeting repayments

27. The NAO recommended that a more accurate target for the SLC would be the amount of repayment money collected in a year. This would provide greater clarity, and assist in the performance measurement of the SLC. However, such a target would be subject to factors outside of the control of the SLC. For example, borrowers do not make any repayments until they earn an income above a specified amount (currently £21,000 a year). This means that the SLC is dependent on positive macro-economic conditions (specifically, higher employment) to increase repayment amounts. If unemployment rose, repayments would fall. The NAO summarised this concern:

> We recognise that the amounts collected may, in part, differ from forecast due to fluctuations in the economic climate and therefore be beyond BIS's direct control.[36]

28. However, the NAO was clear that "BIS should publish a transparent and readily understandable forecast for the amount it expects to be collected each year and report on any variance".[37] When he came before us, David Willetts, the Minister for Universities and

35 National Audit Office, *Student loan repayments* (November 2013), para 2.8

36 National Audit Office, *Student loan repayments* (November 2013), para 19a

37 National Audit Office, *Student loan repayments* (November 2013), para 19a

Science, told us that he had accepted the NAO's recommendations.[38] However, it was not clear to us whether this specific recommendation would be implemented in the near future:

> If graduate repayments are lower because average earnings are lower than forecast, that is different from graduate repayments being lower because the Student Loans Company fails to pursue people efficiently. We have to disentangle those different effects.[39]

29. We already have noted that this is a factor in the setting of a financial target, but we believe that the NAO was correct to state that:

> It is important for BIS to explain to what degree it is able to track and account for such variances and demonstrate that it has a good understanding of how the loans are operating.[40]

30. ***The NAO has highlighted under-performance in terms of the collection of loans and the need for an annual target of money collected in a year together with an explanation of any variance. We support that recommendation and look to the Department to set clear targets for the SLC as a matter of urgency and to publish the earnings and collection assumptions behind those targets.***

Cultural factors

31. In February 2014, the Committee of Public Accounts reported that:

> The approach to collecting debt lacks rigour. The Department and the Student Loans Company need to improve the collection of loan repayments. […] The Student Loans Company have not put sufficient energy into identifying those borrowers who have slipped out of contact but should be making repayments. The Department needs a better understanding of performance gaps and how it could address them.[41]

32. We received similar evidence during the course of our inquiry. For example, the President of the National Union of Students expressed her concern that the taxpayer was losing out because the SLC was not collecting debts effectively:

> I am a taxpayer and I am interested in making sure that that money is recouped, partly because I am interested in the finances of the country and I am interested in our economic situation.[42]

She concluded:

38 Q136

39 Q136

40 National Audit Office, *Student loan repayments* (November 2013), para 19a

41 Committee of Public Accounts, Forty-Fourth Report of Session 2013–14, *Student Loan repayments*, HC 886, recommendation 4

42 Q6

> There is an overriding responsibility to collect that money back. There is an overriding responsibility to give taxpayers value for money in terms of these assets, and I do not think, personally, that that is what has happened.[43]

Graduates now living overseas

33. According to the NAO's analysis of the SLC's data, two per cent of borrowers with outstanding student loans are currently working overseas. While this is a very small percentage, it represents an outstanding debt of £400 million.[44] Approximately 25 per cent of that debt is in arrears: around 14,000 graduates living overseas are currently behind on their repayments.[45]

34. The NUS argued that the current systems used by the SLC made it hard for borrowers living overseas to repay debts and arrears:

> At present, any repayments due are based on the borrower's earnings, with the repayment threshold adjusted for cost of living (a lower cost of living means a lower threshold, with the opposite also being true). The borrower must then convert the payments into sterling and make them via bank transfer often at additional expense. We believe this could be made easier if the SLC could open bank accounts in some of the countries where larger numbers of borrowers reside, or utilise services such as PayPal.[46]

35. When we asked the Minister how the Department would improve its collection of debts abroad, he appeared to focus on the same areas of difficulty. He confirmed that the Department was working to improve the procedures to make it easier for graduates to repay:

> We are improving online statements so they can see where they stand. We are trying to make it easier for overseas borrowers to repay through the introduction of PayPal or other electronic overseas repayment methods.[47]

36. While these initiatives are all positive developments, the large amount of outstanding debt from graduates working overseas does not stem from the fact that graduates don't know how to pay, but rather that they are avoiding making payments. The NUS acknowledged this problem:

> Partly through wishful thinking, and partly due to urban myth, borrowers may believe that repayment is not required if you move overseas. None of this is true.[48]

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43 Q8

44 National Audit Office, *Student loan repayments* (November 2013), figure 11

45 National Audit Office, *Student loan repayments* (November 2013), para 3.14

46 National Union of Students (SLB 0006) extract

47 Q139

48 National Union of Students (SLB 0006) extract

37. HEPI compared the English and Australian student loans systems and suggested that both countries consider:

- converting income-contingent debt to mortgage-style debt on leaving the country;
- applying a higher rate of interest or a surcharge on all those going abroad to work for a period of time; and
- taking a joined-up approach with other parts of Government so that non-repayment affects other services.[49]

38. Mick Laverty, the Chief Executive of the SLC, explained to the Committee of Public Accounts how the SLC chased students who had moved abroad and did not pay:

> We would start off by contacting these people and, if they do not respond, tracing them to make sure we have their correct address. If that does not work, we use various trace techniques to contact the family and friends whom they put on their application when they first apply.[50]

He also said that, in some cases, the SLC would use private debt collectors.[51]

39. However, Mr Laverty acknowledged that communications from the SLC were easy to ignore and, with all loans written off after 30 years, there was little incentive for debts to be paid when they were easy to avoid.[52] Despite this, the Minister assured us that the Department was striving to incentivise debtors to begin paying again:

> We are also creating much stronger incentives for them to repay by communicating to them that, if their repayments pause—if we have asked them for information and they are not providing it—they are racking up interest at RPI plus 3 per cent.[53]

40. This appears to go hand in hand with a recent media campaign apparently aimed at such graduates to dissuade avoiding repayments while working abroad.[54] While it was clear that the Minister had good intentions to improve this situation, our findings suggest that more needed to be done. We have heard that in New Zealand, although student loans are usually income contingent, when borrowers move overseas they pay a flat rate based on the

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49 Higher Education Policy Institute, A comparison of student loans in England and Australia (April 2014), para 82

50 Oral evidence taken before the Committee of Public Accounts on 11 December 2013, HC (2012–13) 886, Q162

51 Oral evidence taken before the Committee of Public Accounts on 11 December 2013, HC (2012–13) 886, Q162

52 Student Loans Company, 'Loan Cancellation', accessed 13 June 2014

53 Q139

54 For example:

"Government promises to pursue British graduates living abroad who default on their student loan payments", The Independent, 14 January 2014

"EU graduates 'cannot evade' loan repayments", BBC News, 12 May 2013

"Student loan 'could land you in court' if you move overseas", The Telegraph, 24 May 2012 total outstanding loan.[55] This removes the need for the Government to collect information of the borrower's income and makes the borrower's obligations clear.

41. ***The Government is finding it harder to collect from debtors who have moved abroad and the complicated structure of income-contingent loans adds to that difficulty. We therefore recommend that the Government assesses whether converting income-contingent debt to mortgage-style debt for borrowers leaving the country would aid collection of outstanding student loans.***

Absence of information

42. A common thread in our inquiry and that of the Committee of Public Accounts was the lack of a solid evidence base on the data underlying the student loan-book. Specifically, the NAO reported that the Department lacked "sufficient information on whether borrowers with no current employment record are earning enough to repay their loans".[56] The NAO made three recommendations to the Department:

> 1. Carry out analysis to better understand the circumstances of borrowers in this category, particularly those who remain without a UK employment record for longer periods, and to assess the level of repayments that may be lost.
>
> 2. Work with other government Departments to develop a strategy for sharing data that provides opportunities to gain information on the circumstances of specific borrowers, for example those who have not had an employment record for long periods. Given the projected size of this public asset, other departments should consider how they can support BIS and the SLC.
>
> 3. Target borrowers where there is a greater risk that they could be avoiding repayment. For example, those whose degree subjects or universities indicate they are more likely to be earning above the threshold or pursuing careers overseas.[57]

43. Our inquiry also considered this matter. The Director of HEPI, Bahram Bekhradnia, had some sympathy for the size of the Department's task, but told us that more could be done with additional resources:

> I suspect that a lot of them [the individuals] are avoiding it. I am sure the Government are doing what they can; they can devote more resource to chasing them. It is an issue.[58]

55 Inland Revenue New Zealand, 'Repayment obligations for overseas-based borrowers', accessed 19 June 2014

56 National Audit Office, *Student loan repayments* (November 2013), para 12

57 National Audit Office, *Student loan repayments* (November 2013), para 19c

58 Q65

44. The lack of detailed information was also highlighted when Martin Donnelly, Permanent Secretary in the Department, Luke Edwards, Deputy Director of HMRC, and Mick Laverty, Chief Executive of the SLC, gave evidence to the Committee of Public Accounts. When questioned, they were unable to give detailed information on:

- How many people were currently making repayments[59]
- Whether or not information about fraud was shared with other departments[60]
- How much money was owed by British students abroad[61]
- How much was owed by EU-students[62]
- The names of people who owed money who are abroad[63]
- The country where the biggest outstanding debt was.[64]

45. The Committee of Public Accounts concluded that:

> The Department and the Student Loans Company have not put sufficient energy into identifying those borrowers who have slipped out of contact but should be making repayments. The Department needs a better understanding of performance gaps and how it could address them.[65]

When he gave evidence to us, however, the Minister tried to reassure us that the Department would improve this "by collecting information promptly, keeping in touch with people who have borrowed, and being energetic in reclaiming it".[66]

46. **It is clear from our evidence and that of the Committee of Public Accounts that the overall approach to collecting student debt lacks rigour. It is the case that the SLC is required to meet targets set by the Department and it is true that the SLC has met most of these targets. However, we conclude that the SLC's targets are not fit for purpose and need urgent review.**

Other factors

International comparisons

47. The box below compares features of the English student loan repayment system with those of Australia, New Zealand and the United States of America.

59 Oral evidence taken before the Committee of Public Accounts on 11 December 2013, HC (2012–13) 886, Q149

60 Oral evidence taken before the Committee of Public Accounts on 11 December 2013, HC (2012–13) 886, Q157

61 Oral evidence taken before the Committee of Public Accounts on 11 December 2013, HC (2012–13) 886, Q161

62 Oral evidence taken before the Committee of Public Accounts on 11 December 2013, HC (2012–13) 886, Q172

63 Oral evidence taken before the Committee of Public Accounts on 11 December 2013, HC (2012–13) 886, Q170

64 Oral evidence taken before the Committee of Public Accounts on 11 December 2013, HC (2012–13) 886, Q179

65 Committee of Public Accounts, Forty-Fourth Report of Session 2013–14, *Student Loan repayments*, HC 886, conclusion 4

66 Q154

Table 2: Comparison of similar student-loan collection regimes

	England	Australia	New Zealand	U.S.
Repayments based on	Earnings	Earnings	Earnings	Choice of repayment plans—fixed or earnings
Repayment term	Thirty years, then remainder written off	Not written off until death or bankruptcy	Not written off until death or bankruptcy	Usually 10 years, income contingent loans written off after 25 years
Repayments: borrowers in country	Collected through tax system	Collected through tax system	Collected through tax system	Repaid to loan servicers
Repayments: borrowers overseas	Repaid directly to Student Loan Company	None owed	None owed for first three years, then repaid directly to Inland Revenue Department (IRD)	Repaid to loan servicers
Interest rate	Based on inflation and borrower earnings	Based on inflation	None while living in New Zealand, set annually by IRD for overseas borrowers	Fixed for the life of the loan

Source: Business, Innovation and Skills Committee analysis of NAO Student Loans Report and U.S. Student Loans website

48. The U.S. Department of Education uses loan servicer companies to collect student loan payments, respond to customer service inquiries and perform other administrative tasks.[67] There are 11 such companies currently administering the Direct Loan Program and the Federal Family Education Loan Program.[68] The Department monitors survey results and dozens of financial metrics, including default rates, for all loan servicing contractors.[69] These are used to assess the servicers' performance and determine the proportion of loans to allocate to each servicer.[70] The servicers have performance-based contracts so that they compete against each other for a share of the allocation of new borrowers to service. Greater performance results in a larger allocation of new borrowers and therefore more income from the Department of Education.

49. The U.S. Department of Education also contracts with 23 collection companies to try and recover defaulted loans. The allocation of defaulted loans again depends on the collectors' performance. However, there has been some criticism that "the Department has

67 Federal Student Aid (An Office of the U.S. Department of Education), 'Repay your loans', accessed 19 June 2014

68 Federal Student Aid (An Office of the U.S. Department of Education), 'Loan Servicers', accessed 19 June 2014

69 Federal Student Aid (An Office of the U.S. Department of Education), *Annual Report 2013* (December 2013), page 37

70 Fedloan Servicing, 'School FAQ', accessed 19 June 2014

created financial incentives for its contractors that encourage high collections at the expense of borrower rights".[71]

50. ***It is regrettable that the Government did not do more to learn from examples of best practice overseas. The Government should examine examples of good practice overseas, including in the United States of America, in order to assess whether elements could be incorporated into the working culture of the SLC.***

Removing the cap on the numbers of students

51. The issues that we have highlighted in this section could be addressed satisfactorily in a contained environment, as is currently the case. The Higher Education Funding Council for England (HEFCE) explained:

> When universities and colleges recruit new students, they cannot simply take as many as they might like. This is because the Government needs to control the level of publicly-funded student loans and grants for fees and maintenance.[72]

52. It may be sensible to control Government spend on students, especially when the Minister said that the Government "estimate[s] that around 60 per cent of students supported under the post-2012 funding system will benefit from having some or all of their loan written off".[73] However, that control on spending is due to be abolished. In 2014–15, the number of HEFCE fundable places for students will be 264,363. Students who achieve ABB grades at A-level (or equivalent in certain other qualifications) are not included in that number control and it is assumed that approximately 119,000 students will achieve these grades and will be exempt from the student number controls.[74] In the 2013 Autumn Statement, the Chancellor of the Exchequer announced that the Government would remove the cap on student numbers at publicly-funded higher education institutions in England in 2015–16.[75] He described the cap—designed to control the level of public-funding on student loans—as "arbitrary".[76]

53. There is general support across the political spectrum for the educational, economic and social benefits of removing the cap on the number of students. Indeed, as the Chancellor stated, "each year, about 60,000 young people who have worked hard at school, got the results, want to go on learning and want to take out a loan to pay for it are prevented from doing so".[77] However, there is a cost attached to the removal of the cap.

71 Ryder Law firm, 'Student Loan Collections Under Fire', accessed 19 June 2014

72 Higher Education Funding Council for England, 'Student numbers and high grades', accessed 13 June 2013

73 "Six in 10 students will have their debts written off", The Telegraph, 5 April 2014

74 Correspondence between the Higher Education Funding Council for England and the Secretariat for the Business Innovation and Skills Committee, 9 June 2014

75 HM Treasury, *Autumn Statement* 2013, Cm 8747, December 2013, para 1.194

76 HC Deb, 5 December 2013, col 1110

77 HC Deb, 5 December 2013, col 1110

The Government subsidises students and therefore the removal of the cap eliminates any control over the level of subsidy.

54. **The arrangements for the efficient collection of the student loan scheme are not working and the current system of 'debt' and 'repayment' is not being managed effectively. It is clear that an overhaul of the system is needed, especially in light of the Minister's assessment that the level of student debt will increase to approximately £330 billion by 2044.**

55. ***The Student Loans Company should be fair but robust in fulfilling its duty to achieve value for money and must demonstrate a strategic shift to a more dynamic culture in its duties to achieve the best value for the taxpayer through the most efficient collection of repayments. The Department should assist with this by realigning the formal targets to demonstrate this expectation and drive through a change of culture.***

56. ***The United Kingdom is approaching a tipping point for the financial viability of the student loans system and the removal of the cap on student numbers will put even greater pressure on the system. There is a need for an urgent review of the sustainability of the system. We recommend that, in its response to this Report, the Government must come back with a clear timescale for this review.***

3 Part two: Sales, announcements and budgets

Historical sale of the mortgage-style loan-book

Background

57. The Government categorises the student loan-book as an asset and, as such, is able to sell that asset to raise money. The Government sold part of the loan-book previously in 1998 and 1999. In November 2013, the Government announced that it had successfully sold the last of mortgage-style student loans with a book-value of £890 million to a private buyer for £160 million:

> The Government has announced the sale of outstanding student loans owed by around a quarter of a million borrowers for £160 million. The sale relates to the remaining 17 per cent of mortgage-style loans taken out by students who began courses between 1990 and 1998.
>
> Erudio Student Loans was selected as the successful bidder through a competitive process. Its offer was judged to represent the best value for money for the tax payer and the price paid exceeds the estimated value to the Government of retaining the loans.[78]

At the time of the sale, the Minister stated that the primary objective was to bring in money for the Government, although he also acknowledged that the private sector may also be better placed to collect the loans:

> The sale of the remaining mortgage style student loan book represents good value for money, helping to reduce public sector net debt by £160 million. The private sector is well placed to maximise returns from the book which has a deteriorating value.[79]

58. The notional value of the loan-book was £890 million. The Minister told us that selling the loan-book at a £730 million discount represented value for money because the headline figure did not signify its true value:

> In reality, most of these mortgage loans were not in repayment, or people who had the debt were below the earnings threshold. We were always very realistic that this last tranche of residuals were the least-well-performing mortgage loans and their actual commercial value would be significantly below their face value.[80]

78 Department for Business, Innovation and Skills & The Shareholder Executive press release, *Sale of mortgage style student loan book completed*, 25 November 2013

79 Department for Business, Innovation and Skills & The Shareholder Executive press release, *Sale of mortgage style student loan book completed*, 25 November 2013

80 Q95

59. Dr McGettigan, an independent academic commentator, was concerned that, despite the lower level of true value, the Government had sold future income streams at a discount to fund short-term dividends. The 1998 and 1999 sales passed a combined £2 billion of loans to the private sector.[81] Commenting on those sales, Dr McGettigan argued that the Government subsidised that purchase "in order to get in £2 billion of cash up front, effectively £3 billion in today's prices".[82] To facilitate this the Government was "prepared to lose £250 million over the long run".[83]

60. He told us that this was also the case in the 2013 sale and the Government had, again, sold a steady income stream of repayments in return for an immediate windfall. The amount that the Government would have received, however, depended on the different assessments about how much of the £890 million would ever be repaid.

61. Dr McGettigan believed that the Government's short-term ambitions had driven the sale, despite the fact that value for money would be judged in the long term:

> It is just about what the short-term benefits are. Everything we are being presented with from the Treasury is the short term benefit: how does this change the net cash position in the short term? How does this change the public sector net debt in the short term? What does this mean for the short-term unsustainable expansion of higher education numbers?[84]

62. When commenting on the 2013 sale, the Minister told us that "everybody came away with a good deal, and we certainly got value for money for the taxpayer".[85] This raised the question of how a private company is able to realise additional value from these hard-to-recover loans and make a profit. We asked the Minister why the Government could not have done the same. He told us that this was because of the greater expertise found in the private sector:

> The companies that specialise in underperforming loans, already have an infrastructure in place and know how to handle them, they may be able to put in time, effort and expertise that the Student Loans Company does not possess and do a better job than the Student Loans Company could have done.[86]

63. The Minister went on to tell us that the secondary benefit to the Government was that this enabled it to realise the vision for the SLC to focus solely on issuing and administering repayments for the income-contingent loans:

81 Department for Business, Innovation and Skills & The Shareholder Executive press release, *Sale of mortgage style student loan book completed*, 25 November 2013

82 Q15

83 Q15

84 Q16

85 Q95

86 Q96

> We want the Student Loans Company to focus on its core task, which is delivering a high-quality service to students when they apply for loans, and administering the big asset: ensuring repayment of the income-contingent loans. It was never going to be a priority use of staff or resource for the Student Loans Company to chase the last remaining underperforming mortgage loans.[87]

64. **It is clear that the private sector can see a profit in collecting student loan debts that the Government cannot. These findings reinforce our previous conclusions on the performance of the SLC's debt collection. It also lends weight to the Minister's ambition for the Student Loans Company to be removed from this aspect of the student loan system for mortgage-style loans which may be extended to the income-contingent loans.**

65. ***We recommend that the Department outlines what rate of repayment it was achieving on the £890 million of mortgage-style loans which have now been sold. This may then be used as a benchmark to consider the future sales of income-contingent loans. We further recommend that the Minister sets out the minimum level of performance he expects of the SLC in pursuing the income-contingent loans before he would consider moving all debt collection to the private sector.***

Terms and conditions

66. The National Unions of Students (NUS) believed that selling the student loans broke the deal between Government and Students:

> The really important thing here is the way that people feel about where they borrow money from and who they owe money to. Particularly the compact that individuals, and students particularly, feel that they have with the state when it comes to higher education funding is really important.[88]

However, of more importance to the NUS was the fact that the terms and conditions of loans would be changed by the private sector owners. Its concerns were based on the fact that "the terms and conditions for this set of student loans are not fixed at the time that you take your loan out".[89] The NUS went on to state that "the fundamental terms and conditions could be changed by the Secretary of State without any parliamentary process and without scrutiny".[90] The wording attached to the loans confirmed this:

> When you take out a loan, you'll sign a declaration form which will be a contract. This states that you've read and understood the terms and conditions. You must agree to repay your loan in line with the regulations

87 Q96

88 Q2

89 Q42

90 Q42

> that apply at the time the repayments are due and as they're amended. The regulations may be replaced by later regulations.[91]

67. We asked the Minister why he had reserved the right to change the terms and conditions of student loans. He told us that "successive Governments have always had the power to change the loans",[92] but offered the reassurance that the selling of the loan book actually made it more unlikely that the terms would change, because they were essentially locked into the terms of the sale:

> If anything, it makes it very unlikely they would ever be changed, because at that point you have written a contract with the private purchaser on the basis of setting out the terms of the loan.[93]

68. The Minister addressed the concerns of the NUS by saying that "the best thing they should look for is the sale of any loans, because it is pretty likely that the contracts written at the time of the sale of the loans will specify the terms".[94] It should also be noted that the press release announcing the 2013 sale clearly stated that "borrowers will remain protected and there will be no change to their terms and conditions, including the calculation of interest rates for loans".[95]

69. ***The Minister has been clear in his public statements that the Department would not change any of the terms and conditions attached to the loans as a result of any sale. While it is the case that Ministers will retain the power to change the terms and conditions, this is not a new provision. We recommend that there should be no change in the terms and conditions of existing student loans without parliamentary approval.***

Proposed sale of the income-contingent loan-book

70. Following the 2013 sale of the remaining mortgage-style loans, the Government announced its intention to sell a large number of the newer, income-contingent loans:

> The Government has now identified further assets with the potential for sale and the target for the sale of corporate and financial assets will be increased from £10 billion to £20 billion between 2014 and 2020.[96]

71. The Government expects to raise £12 billion over the next 5 years by selling tranches of the income-contingent loan-book.[97] However, we heard evidence that the Government may struggle to find the necessary demand for these loans in the private sector. Dr McGettigan, an independent academic commentator, believed that no private investor

91 Student Finance England, *Student Loans—A guide to terms and conditions 2013–14*, section 3

92 Q121

93 Q121

94 Q122

95 Department for Business, Innovation and Skills & The Shareholder Executive press release, *Sale of mortgage style student loan book completed*, 25 November 2013

96 HM Treasury, *Autumn Statement* 2013, Cm 8747, December 2013, para 1.92

97 HM Treasury, *Autumn Statement* 2013, Cm 8747, December 2013, table 2.5

would buy the debt, without specific assurances from the Government on the interest rate connected to those loans. This stems from the fact that the interest paid on student loans is the lower of two benchmarks, either:

> 1) 'Bank Rate + one percentage point' (currently 0.5+1=1.5 per cent); or
>
> 2) 'Retail Price Index' measure of inflation (currently 2.6 per cent)[98]

Dr McGettigan explained that this meant the amount of interest that students had been paying recently was below the Retail Price Index (RPI) and that no private investor would ever buy an asset that paid a dividend lower than inflation.[99] Dr McGettigan believed that the Government would need to introduce a 'synthetic hedge' into the deal for it to be attractive to investors. A 'synthetic hedge' would mean that the Government would enter into a contract to pay the difference between what the investor received in interest on the loans and the level of inflation. Dr McGettigan explained that:

> The loans would be sold with the interest rate cap in place, but the Government would compensate purchasers by entering into a contractual obligation to make additional payments after the sale to cover the differential between the cash flow actually received for the relevant cohort and the estimated cash flows that would have been received had the Base Rate cap been removed at the time of sale.[100]

72. The Government's advisors on this sale, Rothschild, agreed. When they reported to the Government in 2011, the investment bank outlined two options for the sale, with a 'cap' on interest rates or without a 'cap':

> If the Base Rate[101] + 1 per cent cap is removed, investors seemed comfortable that substantial demand exists, and at a reasonable price.
>
> […]
>
> However, the Base Rate + 1 per cent cap cuts demand dramatically, both for retail and institutional investors. With the cap in place early indications suggested that demand may be £1bn–£2bn (over a programme of issues of 12–18 months) and with a commensurate increase in pricing relative to the uncapped option.[102]

73. The latter estimate is far lower than the Government's ambition to raise £12 billion in tranches of loans. In order to counter this, the Department confirmed that it was looking into the feasibility of a 'synthetic hedge' to transfer inflation risk from private investors to the Government in an attempt to bolster demand for the debt. The Minister told us that

98 Office for National Statistics, 'Consumer Price Inflation, June 2014', accessed 15 July 2014

99 Andrew McGettigan (SLB 0001) extract

100 Andrew McGettigan (SLB 0001) extract

101 Also known as the Bank Rate

102 Rothschild, *Report to the Department of Business, Innovation and Skills* (2011), extract

this was “exactly what our advisers are looking at”.[103] Michael Harrison, the Executive Director of the Shareholder Executive, elaborated that the terms would vary with each tranche of sales:

> We cannot possibly sell all of the [income-contingent] loans, which have a face value of £45 billion, in one go, so we need to think about how the sales will be segmented—that is, in terms of a multi-stage sale process, which loans are sold and when, and what markets we target. Those are the things we are principally going through at the moment, together with the commercial preparatory work that we need to do for a very large sale.[104]

74. When we asked the Shareholder Executive to comment on Rothschild’s findings, its Executive Director told us that the research was now out-of-date but assured us that new work was underway:

> The Rothschild report was in November 2011 and that formed the basis of the feasibility work, which took us into this new phase.[105]

The Shareholder Executive wrote to us and confirmed that:

> The Rothschild report was part of a feasibility study to establish proof of concept and feasibility for the sale 3 years ago, and to put forward an outline business case. The Government has now stated its intention to realise value for the taxpayer through a sale, and we have now moved to the sale preparation phase—this includes looking at options for structure of the sale and routes to market. The Shareholder Executive is revisiting all those assumptions with its new advisers, Barclays, in conjunction with Rothschild, to make sure it does get the right structure for the current market conditions, which have moved on quite a lot from three years ago. Indications three years ago was that investors would be more interested in an asset that yielded certain RPI-linked returns, rather than uncertain ones (due to the base rate cap). Market conditions are more favourable, and we therefore need to consider the structure of the sale in light of these. No decision has been taken yet.[106]

75. The current position, is respect of future sales, raises two significant concerns. First, that the Government will discount the sale in order to enjoy an immediate windfall, in much the same way as it did with the mortgage-style loans. This may be economically acceptable but needs to be based on an accurate judgement on the comparative value of a steady income stream against an immediate dividend. Second, that the Government will guarantee to a private investor that if the interest received on student loans fell below inflation, it would pay the difference. This would introduce a condition to the sale that

103 Q130

104 Q130 [Mr Harrison]

105 Q129 [Mr Harrison]

106 Correspondence between the Shareholder Executive and Business, Innovation and Skills Committee secretariat, 16 June 2014

commits it, and any future Government to pay an unquantified amount of interest. The amount may be negligible but it could be substantial. It is crucial that the Government's analysis covers both of these points comprehensively so that it knows what the cost of the sale is to the taxpayer, as well as the dividend.

76. The Committee of Public Accounts sought reassurance from the Permanent Secretary for the Department that the sale of income-contingent loans would not go ahead until these issues were resolved. He was clear that "if buyers are not prepared to pay a price which is value for money for the taxpayer, the sale will not take place".[107] The Minister agreed:

> If there came a point when people said either that the market is saturated with these, or people do not want to buy them anymore and so it is bad value for money, at that point the Government would not go ahead.[108]

77. Despite this, we remain concerned that the assumption from the Government is that the sale will go ahead. We were drawn to the 2013 Autumn Statement when the Chancellor of the Exchequer appeared to be in no doubt that the sales would go ahead:

> The book will be disposed of in a number of tranches, with a first sale intended to occur by the end of financial year 2015–16. Over a 5 year period, the sale is expected to generate between £10 billion and £15 billion in sale revenues, with a central estimate of around £12 billion.[109]

78. **The Government appears to have committed itself to the sale of the income contingent loans before it has fully assessed the financial viability of such a move. Demand for these assets is untested and without the introduction of a synthetic hedge would only realise around £2 billion of the £12 billion return expected by Government. While demand would increase with the introduction of a synthetic hedge, this would come with an additional long-term cost to Government, which has yet to be quantified.**

79. ***The Government has told us that it has moved to the sale preparation stage with more up-to-date analysis underway. This analysis must produce a succinct but penetrative assessment of the market and we recommend that it be done as a matter of urgency. Without such an analysis, there is no guarantee that the Government will make any of the financial returns that it claims. We further recommend that if the Government proposes to introduce a 'synthetic hedge' or similar it must share its scenario testing and specifically publish its estimate of the best-case and worst-case costing scenarios for this policy.***

107 Oral evidence taken before the Committee of Public Accounts on 11 December 2013, HC (2012–13) 886, Q77

108 Q126 [Mr Willetts]

109 HM Treasury, *Autumn Statement 2013*, Cm 8747, December 2013, para 1.92

Linking the student-loans to the removal of the cap on student numbers

80. In his Autumn Statement, the Chancellor of the Exchequer announced that the removal of the student numbers cap would be financed by the sale of income-contingent student loans:

> The Government expects the extra cost of student grants and teaching grant to be around £720 million a year in 2018–19. The 2010 higher education reforms mean that students only pay back the full amount of their loan if their lifetime earnings are high enough. This means that there is an implicit subsidy in the loans. Based on current assumptions the government estimates that the cost of the extra implied subsidy in the medium term will be around £700 million a year. This expansion is affordable within a reducing level of public sector net borrowing as a result of the reforms to higher education finance the Government has enacted. The additional outlay of loans over the forecast period will be more than financed by proceeds from the sale of the pre-reform income-contingent student loan book.[110]

This was summarised in the Autumn Statement supporting documentation. Using the figures from table 2.5 of the Autumn Statement, the Government has estimated that the cumulative cost of abolishing the cap on student numbers between 2013–14 and 2018–19 to be £5.55 billion:[111]

Table 3: The impact on central government Net Cash Requirement of policy decisions

Financial transactions: impact on central government Net Cash Requirement[1]

				£ million			
	Financial transactions	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**
i	Higher education: abolish the cap on student numbers	0	-180	-600	-1,170	-1,670	-1,930
ii	Gross proceeds from the sale of the student loan book[2]	0	0	+2,300	+2,300	+2,300	2,300
iii	Green investment bank[3]	0	0	-800	0	0	0
iv	Start Up loans	-10	0	-10	-40	-50	-50
v	Affordable rent to buy[3]	0	0	-300	-180	0	0
vi	Unlocking large housing sites[4]	0	-60	-255	-255	-255	-255
	TOTAL POLICY DECISIONS	**-10**	**-240**	**+335**	**+655**	**+325**	**+65**

1 Costings reflect the OBR's latest economic and fiscal determinants.

2 the Government expects to receive c. 12billion in proceeds over 5 years, with a first sale by 2o15-16. the proceeds are evenly distributed across a 5-year period for modelling purposes.

3 These financial transactions were previously announced at Spending Round 2013.

4 This measure was announced at Spending Round 2013, and is being extended at autumn Statement 2013.

Source: HM Treasury, Autumn Statement 2013, Cm 8747, December 2013, table 2.5

110 HM Treasury, *Autumn Statement 2013*, Cm 8747, December 2013, para 1.203

111 HM Treasury, *Autumn Statement 2013*, Cm 8747, December 2013, table 2.5

81. When he came before us, the Minister explained the Government's thinking:

> This is how it is done. When we are planning to sell assets, we identify them in Government documents as assets we intend to sell, and that enters the fiscal arithmetic when there is a reasonable certainty that they will be sold.[112]

We asked whether any contingency planning had been done to prepare for the event that the accounting officer found that the loans would be better off in public hands.

82. The Director of Higher Education, Matthew Hilton, told us that no contingency planning had been done, but that the policy decision had been made so the funding would be found by HM Treasury:

> It would be fair to say that the Treasury do intend to underwrite this policy. If there is a shock to their expected budgets that changes some of the planning that they have in hand, we would have to sit down and talk to them, as would any Department; but there is no logical flow through from a decision on the loan book to a decision on the expansion of HE budgets.[113]

The Chancellor of the Exchequer appeared to disagree when he stated that "the additional outlay of loans over the forecast period will be more than financed by proceeds from the sale of the pre-reform income-contingent student loan book".[114]

83. This inconsistency from within the Government has left us unclear as to how closely these policies are linked. The Minister wrote to us after he gave evidence and said that "the announcement on removing the cap on student numbers is fully funded".[115] He explained:

> There are three types of expenditure which impact on Higher Education budgets and *all are fully funded as part of the Autumn Statement announcement* [Minister's emphasis]. These are:

- Grants such as HEFCE teaching grant and maintenance grants for student support
- Outlay of loans to students
- The RAB charge[116]

84. ***Given that the Chancellor of the Exchequer has linked the removal of the student numbers cap to the sale of the income-contingent loan-book, we seek clarification from the Department whether the removal of the cap is dependent on the sale of the loan book.***

85. ***If the policy is not dependent on the sale, the Government must set out in its response where it will raise the £5.55 billion between now and 2018–19 required to remove the cap without putting an additional burden on the taxpayer.***

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112 Q111

113 Q113

114 HM Treasury, *Autumn Statement 2013*, Cm 8747, December 2013, para 1.203

115 Department for Business, Innovation and Skills (SLB 0007) extract

116 Department for Business, Innovation and Skills (SLB 0007) extract

Presentation of data

86. It is essential that Government is seen to be transparent and that it presents information around student loans in a clear and understandable way. The presentation of data on the future sale of student loans was criticised by Dr McGettigan:

> The main issue there is that the declared proceeds of this sale projected over the five years, starting in 2015–16, as outlined in table 2.5 of the Autumn Statement, are gross proceeds. They are not net proceeds, so what is not included in those tables is the income stream you have sold to the private provider. There is another £1.7 billion from 2016–17 and 2017–18 and 2018–19 that you have to net out of that gross calculation, because that is precisely what you have sold to the purchasers. There will then be subsequent repayments in future years that are also now going to the purchasers and not to the Government.[117]

87. The Minister assured us that he "did not commit the kind of schoolboy howler that Mr McGettigan claims" but that "different elements of the calculation [were] to be found in different Autumn Statement documents".[118] The Minister conceded that it would be more helpful if all of the information was presented in a single space and has subsequently submitted that information to us: [119]

Table 4: Relaxation of Student Number Controls: Impact on Public Finances: Grants for teaching and maintenance—funded by HM Treasury

(£m)	Costs					
Year	13-14	14-15	15-16	16-17	17-18	18-19
HEFCE and maintenance (inc Barnett consequence)	0	-120	-290	-	-	-720

Source: Department for Business, Innovation and Skills (SLB 0007) table 1

Table 5: Relaxation of Student Number Controls: Impact on Public Finances: Student loans (cash)—costs offset by planned loan-book sale

(£m)	Costs					
Year	13-14	14-15	15-16	16-17	17-18	Total
Outlay of loans*	0	-180	-600	-1,170	-1,670	-3,620
Gross proceeds from ICR Sale **	0	0	+2,300	+2,300	+2,300	+6,900
Revisions to student loan repayments compared to March 2013 forecast***	-300	-200	-200	-400	-700	-1,800
Net impact	-300	-380	+1,500	+730	-70	+1,480

* Figures from table Autumn Statement 2013. Table 2.5.
** the government expects to receive c.£12 billion in proceeds over five years, with a first sale by 2015-16. The proceeds are evenly distributed across the five year period for modelling purposes. Figures from Autumn Statement 2013 Table 2.5.
*** This incorporates a number of revisions to the repayment forecast, including lower repayments due to the sale of tranches of the student loan book. figures fron OBR Economic and fiscal Outlook report December 2013. Table 4.32.

Source: Department for Business, Innovation and Skills (SLB 0007) table 2

117 Q9

118 Q114

119 Q114

88. ***The Government could have been clearer in the presentation of its figures on the policy of the loan book-sale and student numbers. We recommend that, in future, the Government clearly presents the net financial outcome of any such policy, rather than spreading the figures around different tables across large official documents.***

Conclusions and recommendations

Forecasting implications of the RAB charge

1. The evidence that we have received, both in this inquiry and previous inquiries, suggests that there has been a persistent miscalculation of the Department's estimates of the RAB charge. The resulting holes in the budget are only just beginning to materialise. Forecasters, particularly HEPI, had and continue to have a more accurate picture of repayments. Despite this, the Department has ignored their concerns. **We recommend that, as a matter of urgency, the Department conducts a full review of all the financial assumptions underpinning the Department's RAB model.** (Paragraph 17)

Budgetary implications of the RAB charge

2. We support the Chief Secretary to the Treasury's ambition of improving the incentives for managing the long term costs of new student loans, and encourage the Treasury to look for further ways to strengthen these incentives. However, we are concerned that the current arrangements may have an adverse impact on unrelated BIS budgets in the medium term. (Paragraph 21)

3. In order to improve transparency and accountability, **we recommend that the Department publishes HM Treasury's targets for impairments for student loans alongside reports against actual performance.** (Paragraph 22)

Monitoring and reporting of the Student Loans Company against targets

4. For the NAO to conclude that the targets set for the Student Loans Company by the Department may have been misleading is a damning finding. It is obvious to us that the Department must address this as a matter of urgency. (Paragraph 26)

Targeting repayments

5. The NAO has highlighted under-performance in terms of the collection of loans and the need for an annual target of money collected in a year together with an explanation of any variance. **We support that recommendation and look to the Department to set clear targets for the SLC as a matter of urgency and to publish the earnings and collection assumptions behind those targets.** (Paragraph 30)

Graduates now living overseas

6. The Government is finding it harder to collect from debtors who have moved abroad and the complicated structure of income-contingent loans adds to that difficulty. **We therefore recommend that the Government assesses whether converting income-contingent debt to mortgage-style debt for borrowers leaving the country would aid collection of outstanding student loans.** (Paragraph 41)

Absence of information

7. It is clear from our evidence and that of the Committee of Public Accounts that the overall approach to collecting student debt lacks rigour. It is the case that the SLC is required to meet targets set by the Department and it is true that the SLC has met most of these targets. However, we conclude that the SLC's targets are not fit for purpose and need urgent review. (Paragraph 46)

International comparisons

8. It is regrettable that the Government did not do more to learn from examples of best practice overseas. The Government should examine examples of good practice overseas, including in the United States of America, in order to assess whether elements could be incorporated into the working culture of the SLC. (Paragraph 50)

Removing the cap on the numbers of students

9. The arrangements for the efficient collection of the student loan scheme are not working and the current system of 'debt' and 'repayment' is not being managed effectively. It is clear that an overhaul of the system is needed, especially in light of the Minister's assessment that the level of student debt will increase to approximately £330 billion by 2044. (Paragraph 54)

10. The Student Loans Company should be fair but robust in fulfilling its duty to achieve value for money and must demonstrate a strategic shift to a more dynamic culture in its duties to achieve the best value for the taxpayer through the most efficient collection of repayments. The Department should assist with this by realigning the formal targets to demonstrate this expectation and drive through a change of culture. (Paragraph 55)

11. The United Kingdom is approaching a tipping point for the financial viability of the student loans system and the removal of the cap on student numbers will put even greater pressure on the system. There is a need for an urgent review of the sustainability of the system. We recommend that, in its response to this Report, the Government must come back with a clear timescale for this review.(Paragraph 56)

Historical sale of the mortgage-style loan-book

12. It is clear that the private sector can see a profit in collecting student loan debts that the Government cannot. These findings reinforce our previous conclusions on the performance of the SLC's debt collection. It also lends weight to the Minister's ambition for the Student Loans Company to be removed from this aspect of the student loan system for mortgage-style loans which may be extended to the income-contingent loans. (Paragraph 64)

13. We recommend that the Department outlines what rate of repayment it was achieving on the £890 million of mortgage-style loans which have now been sold. This may then be used as a benchmark to consider the future sales of income-contingent loans. We further recommend that the Minister sets out the minimum level of performance he expects of the SLC in pursuing the income-contingent loans before he would consider moving all debt collection to the private sector. (Paragraph 65)

Terms and conditions

14. The Minister has been clear in his public statements that the Department would not change any of the terms and conditions attached to the loans as a result of any sale. While it is the case that Ministers will retain the power to change the terms and conditions, this is not a new provision. We recommend that there should be no change in the terms and conditions of existing student loans without parliamentary approval. (Paragraph 69)

Proposed sale of the income-contingent loan-book

15. The Government appears to have committed itself to the sale of the income contingent loans before it has fully assessed the financial viability of such a move. Demand for these assets is untested and without the introduction of a synthetic hedge would only realise around £2 billion of the £12 billion return expected by Government. While demand would increase with the introduction of a synthetic hedge, this would come with an additional long-term cost to Government, which has yet to be quantified. (Paragraph 78)

16. The Government has told us that it has moved to the sale preparation stage with more up-to-date analysis underway. This analysis must produce a succinct but penetrative assessment of the market and we recommend that it be done as a matter of urgency. Without such an analysis, there is no guarantee that the Government will make any of the financial returns that it claims. We further recommend that if the Government proposes to introduce a 'synthetic hedge' or similar it must share its scenario testing and specifically publish its estimate of the best-case and worst-case costing scenarios for this policy. (Paragraph 79)

Linking the student-loans to the removal of the cap on student numbers

17. Given that the Chancellor of the Exchequer has linked the removal of the student numbers cap to the sale of the income-contingent loan-book, we seek clarification from the Department whether the removal of the cap is dependent on the sale of the loan book. (Paragraph 84)

18. If the policy is not dependent on the sale, the Government must set out in its response where it will raise the £5.55 billion between now and 2018–19 required to remove the cap without putting an additional burden on the taxpayer. (Paragraph 85)

Presentation of data

19. The Government could have been clearer in the presentation of its figures on the policy of the loan book-sale and student numbers. We recommend that, in future, the Government clearly presents the net financial outcome of any such policy, rather than spreading the figures around different tables across large official documents. (Paragraph 88)

Annex A: Timeline of student loan policies

- **1990:** Student loans introduced to support students.
- **1990–1998:** 'Mortgage-style' loans issued. Borrowers earning above a threshold amount repay a fixed monthly amount over a fixed period. Approximately £4 billion paid out.
- **1998 & 1999:** Two sales passed a passed a large proportion of mortgage-style student loan-book to the private sector.
- **1998–present:** 'Income-contingent' loans issued. Repayments and interest charges depend on borrowers' earnings. Borrowers only repay once earning above a set threshold. Approximately £51 billion paid out to date.
- **Nov 2013:** The Government announced the sale of the remaining mortgage style loans to a private investment consortium. Book value of £890 million sold for £160 million.
- **Nov 2013:** The National Audit Office (NAO) published a report on student loan repayments. It published a review of the processes behind collection and made recommendations to improve.
- **Dec 2013–present:** The Government confirmed that the Department was preparing to sell early cohorts of the income-contingent repayment loan book. This sale should depend entirely on the Department's ability to prove value for money, and the Permanent Secretary, as Accounting Officer, will take a sale decision in due course.
- **Jan 2014:** The Business, Innovation and Skills Committee conducted an inquiry into student loans.[120]

120 Source National Audit Office and Business, Innovation and Skills Committee analysis

Annex B: Student loans accounting entries from 2013–14

As with all government Departments, BIS' budget is split into resource (short-term) and capital (long-term). Each of these categories is further split into DEL (where risk lies primarily with the Department) and AME (where risk lies primarily with Treasury). The accounting treatment of student loans is important because it determines whether there are sufficient incentives for managing the long term costs of student loans.

Table 6: HM Treasury Consolidated Budgeting Guidance

	Parliamentary Control			Accounts	
	Resource DEL	Resource AME	Capital AME	Expenditure	Student Loans Asset
Loans issued	+ impairments of issued loans		cash value of the loans issued	impairment	cash value - impairment
Interest receivable		- interest receivable	Interest receivable (capitalised because it is effectively new lending)		+ interest receivable
Unwinding the discount		- discount unwound at the government's long term cost of borrowing (2.2 per cent per year)			+ discount unwound
Repayment of student loans			- cash repayment of loans or capitalised interest		
Particular loan written off	No entries				
Revaluation or impairments (pre-2012 ICR loans)	Additional impairment (cost)			+ impairment	- impairment
Revaluation or impairment – first year (post-2012 loans)	1/30th of impairment (each year for 30 years)	29/30th of impairment		+ impairment	- impairment
Revaluation or impairment– subsequent years (post - 2012 loans)	1/30th of impairment (each year for 30 years)	- 1/30th of impairment (each year for 30 years)			

Source: Business Innovation and Skills Committee analysis of HM Treasury, *Consolidated budgeting guidance 2014–15*, paras 8.9–8.20

Negative entries are shown in green

Formal Minutes

Tuesday 15 July 2014

Members present:

Mr Adrian Bailey, in the Chair

Mr William Bain	Rebecca Harris
Mr Brian Binley	Ann McKechin
Paul Blomfield	Robin Walker
Mike Crockart	Nadhim Zahawi
Caroline Dinenage	

Draft Report (*Student Loans*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 88 read and agreed to.

Summary agreed to.

Annexes agreed to

Resolved, That the Report be the Third Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Tuesday 22 July at 10.00 am

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the Committee's inquiry page at www.parliament.uk/bis.

Tuesday 17 December 2013	*Question number*
Bahram Bekhradnia, Director, Higher Education Policy Institute, Dr Andrew McGettigan, Author and Expert on University Funding, and Toni Pearce, President, National Union of Students	Q1-93
Tuesday 14 January 2014	
Rt Hon David Willetts MP, Minister for Universities and Science, Matthew Hilton, Director, Higher Education, and Michael Harrison, Executive Director, Shareholder Executive, Department for Business, Innovation and Skills	Q94-167

Published written evidence

The following written evidence was received and can be viewed on the Committee's inquiry web page at www.parliament.uk/bis. INQ numbers are generated by the evidence processing system and so may not be complete.

1 Andrew McGettigan (SLB0001)
2 Department For Business, Innovation And Skills (SLB0007)
3 Higher Education Policy Institute (SLB0002)
4 National Union Of Students (SLB0004)
5 National Union Of Students (SLB0006)
6 Professor Neil Shephard (SLB0005)

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the Committee's website at www.parliament.uk/bis.
The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2014–15

First Report	Royal Mail Privatisation	HC 539-I/II
Second Report/First Joint Report	Scrutiny of the Government's UK Strategic Export Controls Annual Report 2012, the Government's Quarterly Reports from October 2012 to September 2013, and the Government's policies on arms exports and international arms control issues	HC 186
Third Report	Student Loans	HC 558

Session 2013–14

First Report	Women in the Workplace	HC 342-I/II/III(*Cm 8701*)
Second Report/First Joint Report	Scrutiny of Arms Exports and Arms Control (2013): Scrutiny of the Government's UK Strategic Export Controls Annual Report 2011 published in July 2012, the Government's Quarterly Reports from October 2011 to September 2012, and the Government's policies on arms exports and international arms control issues	HC 205
Third Report	The Kay Review of UK Equity Markets and Long-term Decision Making	HC 603(HC 762)
Fourth Report	Consultation on a Statutory Code for Pub Companies	HC 314
Fifth Report	Open Access	HC 99-I/II(HC 833)
Sixth Report	Draft Consumer Rights Bill	HC 697-I/II/III
Seventh Report	Payday Loans	HC 789

Session 2012–13

First Report	The Hargreaves Review of Intellectual Property: Where Next?	HC 367-I/II(HC 579)
Second Report/First Joint Report	Scrutiny of Arms Export Controls (2012): UK Strategic Export Controls Annual Report 2010, Quarterly Reports for 2010 and January to September 2011, the Government's review of arms exports to the Middle East and North Africa, and wider arms control issues	HC 419
Third Report	Post Office Network Transformation	HC 84(HC 678)
Fourth Report	Overseas Students and Net Migration	HC 425(*Cm 8557*)
Fifth Report	Apprenticeships	HC-I/II/III(HC 899)
Sixth Report	The Insolvency Service	HC 675 (HC 1115)

Seventh Report	Too Little, Too Late: Committee's observations on the Government Response to the Report on Overseas Students and Net Migration	HC 1015(*Cm 8622*)
Eighth Report	Pre-appointment hearing of the Government's preferred candidate for the post of Groceries Code Adjudicator	HC 1011
Ninth Report	Local Enterprise Partnerships	HC 598

Session 2010–12

First Report	The New Local Enterprise Partnerships: An Initial Assessment	HC 434 (HC 809)
Second Report	Sheffield Forgemasters	HC 484 (HC 843)
Third Report	Government Assistance to Industry	HC 561
Fourth Report / First Joint Report	Scrutiny of Arms Export Controls (2011): UK Strategic Export Controls Annual Report 2009, Quarterly Reports for 2010,licensing policy and review of export control legislation	HC 686
Fifth Report	Government Assistance to Industry: Government Response to the Committee's Third Report of Session 2010–11	HC 1038
Sixth Report	Is Kraft working for Cadbury?	HC 871
Seventh Report	Rebalancing the Economy: Trade and Investment	HC 735 (HC 1545)
Eighth Report	Trade and Investment: China	HC 1421 (HC 1568)
Ninth Report	Time to bring on the referee? The Government's proposed Adjudicator for the Groceries Code	HC 1224-I
Tenth Report	Pub Companies	HC 1369-I/II *(Cm 8222)*
Eleventh Report	Time to bring on the referee? The Government's proposed Adjudicator for the Groceries Code: Government Response to the Committee's Ninth Report of Session 2010-12	HC 1546
Twelfth Report	Government reform of Higher Education	HC 885-I/II/III (HC 286)
Thirteenth Report	Pre-Appointment Hearing: Appointment of Director of the Office for Fair Access	HC 1811
Fourteenth Report	Debt Management	HC 1649 (HC 301)
Fifteenth Report	Stamp Prices	HC 1841-I/II