Sale of student loans

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Section Social Policy Section

The Government has been gradually selling off the student loan book – so far there have been three sales which have sold off the older 'mortgage-style' loans and now the Government intends to sell off the pre 2012 income contingent loans. This note outlines the student loan system, explains the rationale for the sales and discusses issues around the sale of student loans.

Contents

1 Background: History of student loans

The student loans scheme was introduced by the *Education (Student Loans) Act 1990* and the *Education (Student Loans) (Northern Ireland) Order 1990*. The loans which were introduced in 1990 were fixed term loans and they were repaid in a fixed number of instalments - normally 60, over a set period of time, usually five years; these loans are often referred to as mortgage-style loans. All student loans taken out before September 1998 were fixed term loans.

In 1998 a new form of loan was introduced – the income contingent loan, all loans currently taken out are of this type. These loans differ from fixed term loans in that repayments are based on the income of the graduate not on the amount borrowed, and they are not repaid over a fixed time period. Borrowers repay 9 percent of their income over a set threshold and loans enter repayment status in the April after borrowers finish their course. Repayments continue until the loan is either entirely repaid or until the remaining balance is written off under the rules of the scheme.

Further changes in the student finance system were introduced in the academic year 2006/07 as a result of the *Higher Education Act 2004*. From September 2006 new students attending institutions in England and Northern Ireland could be charged variable tuition fees of up to £3,000. New students, including EU students, were able to take out a tuition fee loan to cover the cost of these fees; this effectively abolished the upfront payment of fees for new students starting courses in 2006 onwards. These changes mean that many students now take out two loans – a tuition fee loan and a maintenance loan to cover living costs.

A further change occurred in September 2012 when tuition fees were raised to a maximum of £9,000 a year. This steep rise in fees increased the size of loans taken out by students and would potentially over time significantly enlarge the size of the student loan book held by the Government.

Further information on student loans including: statistics on their take-up, the total value owed, repayment, public expenditure, arguments for reform and factors that affect loan take-up, are included in library briefing paper by Paul Bolton, SN/SG/1079 Student Loan Statistics 3 July 2013.

2 Sale of student loans

The Government has conducted three sales of the student loan book; all three sales have been of mortgage-style loans; the Government however now intends to sell off pre 2012 income contingent loans.

2.1 Rationale for the sales

The sales have been carried out to help reduce public sector net debt and to pass on some of the risk involved with student loan debt to the private sector.

Student loans become harder to collect with time, a report by the National Audit Office referred to the remaining mortgage-style loans as 'poorly performing' and said that £127 million could become 'statute-barred':[1]

[1] National Audit Office *Student loan repayments*, 28 November 2013, HC 818 p8

> The SLC has faced challenges in collecting mortgage-style loans. Two tranches of mortgage-style loans were sold in 1998 and 1999, leaving a residual loan book of poorly-performing loans. While the SLC tried to contact all borrowers with overdue repayments, BIS and the SLC decided not to pursue litigation for debts where they judged there would be a low likelihood of recovery. Consequently, some borrowers neither made repayments nor acknowledged their debt within a six-year period. As a result, £127 million may become 'statute-barred' meaning that the borrowers would not legally have to repay the loans. BIS informed us that, to date, £2 million has become uncollectable because of this issue (paragraph 2.5).

The Universities Minister David Willetts has said that "the private sector is well placed to maximise returns from the book which has a deteriorating value".[2] The sale of earlier loans will allow the Student Loans Company (SLC) to focus on supplying loans to current students and collecting repayments on newer loans.

In 2010 the government commissioned a report by Rothschild Investment Bank into the sale of loans. This report discussed in two articles in the *Guardian*, "Raise interest rates on old student loans, secret report proposes" 13 June 2013 and "Why privatise student loans?" 16 June 2013.

3 First sales of the student loan book

Two portfolios of loans with a face value of just over £2 billion were sold in 1998 and 1999. These sales were broadly similar with portfolios of just over £1 billion sold to two different bidders. Both portfolios were of mortgage-style loans only. Conditions of the loans were maintained for borrowers and the SLC initially administered the loans and dealt with borrowers. The Government received £1 billion for each of the two sales of the student loan portfolio. The face value of the loans sold was £1.02 billion and £1.03 billion in 1998 and 1999 respectively.

As the interest rate of student loans was below market level at the time of the sales the Government paid a subsidy to the purchasers to reflect this and make the sale attractive to the private sector. The difference between this and the cost that the Government would have incurred by holding on to the loans was the net cost of the sell-off. The Government benefited from the sales of these loans by the transferring of risk to the private sector.

3.1 The *Sale of Student Loans Act 2008*

The *Sale of Student Loans Act 2008* put in place a mechanism for the sale of income contingent loans – previous sales had been of mortgage-style loans only. Library Research Papers 07/78 *Sale of Student Loans Bill* and 07/92 *Sale of Student Loans Bill Committee Stage Report*, gives a detailed assessment of the workings of the Act and the issues of concern discussed during the Act's bill committee stage.

4 Current position

On 26 March 2013 it was announced in the House of Commons that the government would sell off the remains of the old mortgage-style student loans book in England; this action would be co-ordinated with the relevant bodies in the devolved administrations:

2 "Ageing student loans sold to debt firms", *BBC News* 25 November 2013

Student Loan Book Sale

> **The Secretary of State for Business, Innovation and Skills (Vince Cable)**: I am today announcing that the remaining publicly owned mortgage-style student loan book will be offered for sale by the Government under the Education (Student Loans) Act 1990 as amended by the Education (Student Loans) Act 1998. The sale will take place in conjunction with the Scottish Government, the Department for Employment and Learning in Northern Ireland and the Student Loans Company.
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> Mortgage-style loans were available to eligible higher education students who were enrolled between 1990 and 1998. Borrowers are required to repay in fixed monthly instalments over a defined period, typically five or seven years. Interest is charged at a rate equivalent to the retail prices index. Repayments can be deferred for a year at a time if a borrower's income is below the threshold, which is 85% of the national average earnings. Currently the threshold is £27,813. There will be no change to borrowers' terms and conditions as a result of the sale.
>
> The Scottish Government and the Northern Ireland Executive are responsible for loans issued by those respective Administrations and both have agreed the sale. English and Welsh loans are the responsibility of the Department for Business, Innovation and Skills.
>
> There were two previous sales of mortgage-style loans in 1998 and 1999. The remaining loans owned by the Government are mostly either in deferment or in arrears, so total annual repayments are low.
>
> The loans to be offered for sale have a face value of around £900 million but, due to the low level of repayments in relation to the loan book, the market value will likely be significantly lower. The Government recognise that the private sector may improve the collection of repayments using their expertise. Additionally, they will provide operational benefits to the Student Loans Company (SLC) as the significant majority of the administration is transferred to the buyer. This sale will reduce public sector net debt and forms part of a wider effort to maximise the value of Government assets.
>
> We will be assessing all potential buyers against a strict set of criteria and a sale will only proceed if value for money for the taxpayer and borrower protections consistent with the law are assured. The sale will not include any income contingent repayment (ICR) loans, therefore no current students or borrowers who solely took out an ICR loan after September 1998 will be affected.
>
> More details of the sale will be published by BIS in due course. (HC Deb 23 March 2013 c80WS)

On 27 June 2013 Danny Alexander referred to the sale of income contingent pre 2012 student loans in an oral statement, *Investing in Britain's Future*:

> We will take action to sell off £15 billion-worth of public assets by 2020. Some £10 billion of that money will come from corporate and financial assets, such as the student loan book, and the other £5 billion will come from land and property.

Further information on the sale of income contingent loans was given in answer to a PQ on 1 July 2013 (HC Deb 1 July 2013 c525):

Students: Loans

> **Mr Umunna**: To ask the Secretary of State for Business, Innovation and Skills what external advice the Government has commissioned since May 2010 on the future of

the student loan book; when each such piece of advice was commissioned; which firms have provided this advice; when any such reports were passed to Ministers in his Department; what the total cost to the public purse was; and if he will place a copy of each such report in the Library. [162274]

Mr Willetts: In September 2010, the Department for Business, Innovation and Skills commissioned Rothschild to analyse potential options for the future of the Income Contingent Repayment (ICR) student loan book. Hogan Lovells was also commissioned in September 2010 and provided legal advice on potential options. Deloitte was commissioned in January 2011 and provided accounting advice. Officials and Ministers in the Department have since continued to explore the feasibility of options for the student loan book (for loans issued up to 2012) as part of the Government's wider programme of asset commercialisation. Rating agencies have also provided advice in relation to potential options. The cost of the feasibility study to date has been £1.46 million.

This Department has started to prepare for a sale of this loan book, as part of the Government's asset sales programme announced on 27 June 2013.

As this policy is still in development, the 2011 report contains and future reports will contain commercially sensitive information that could damage the value for money Government can achieve from a sale process, and so should not be disclosed at this point.

Concern about the sale of loans has been expressed in the House and EDM 542 Sale of Student Loans tabled on 8 October 2013 has received 54 signatures:

That this House believes that the Government's plans to sell off the student loan book to the private sector would be a grave error; notes that in order to make the student loan book profitable for private companies it would need to be accompanied by either subsidies from the taxpayer or an increase in the financial burden placed on graduates; and opposes any proposal to privatise the student loan book.

5 Sale of remaining mortgage-style loan book in November 2013

On 25 November 2013 the Government announced the sale of the remaining publicly owned mortgage-style loans with a face value of £890m for £160m to Erudio Student Loans Ltd:

The government has today 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 (MS) 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. The private sector is thought best placed to collect the outstanding debt, allowing the Student Loans Company (SLC) to concentrate on administering newer loans.

There is no need for borrowers to take any action and their terms and conditions will not be affected by the sale. The SLC will continue to manage the book until the loans are transferred to Erudio Student Loans in a few months time.

Universities and Science Minister David Willetts said:

> "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.
>
> "The sale will allow the Student Loans Company to focus on supplying loans to current students and collecting repayments on newer loans. Borrowers will remain protected and there will be no change to their terms and conditions, including the calculation of interest rates for loans."
>
> Erudio Student Loans is backed by a consortium led by CarVal Investors and Arrow Global Limited who are experts in consumer debt management.
>
> There were two previous sales of MS loans in 1998 and 1999 which passed £2 billion of the loans to the private sector. Approximately one million borrowers were retained by the SLC following the previous sales and 69 per cent of those have fully repaid their debt. The government has already received £2.9 billion of repayments.
>
> Of the loans sold, approximately 46 per cent are earning below the repayment threshold; 14 per cent of borrowers are still repaying and 40 per cent are not repaying their loans in accordance with their terms.
>
> Speaking on behalf of Erudio Student Loans, Stuart Lammin, Managing Director of CarVal Investors said:
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> "CarVal Investors, along with Arrow Global, is pleased to finalise the acquisition of student loans from the Student Loans Company and the government. We look forward to working with Erudio Student Loans to service these accounts given the consortium's long-term experience in education finance and track record for delivering a high level of service to its customers."
>
> Erudio Student Loans will have to adhere to strict Office of Fair Trading (OFT) guidance about the treatment of borrowers which includes particular protections for vulnerable borrowers and those in financial difficulty. They have also committed to adhering to best-practice guidance issued by the Credit Services Association.
>
> Borrowers who have taken out Income Contingent Repayment (ICR) loans after 1998 will not be affected by this sale. These accounts will continue to be managed by the SLC. The government is in the process of exploring options for the potential future sale of the ICR loan book.[3]

The sale was discussed in an article in the *Guardian* on 25 November 2013:

> The National Union of Students (NUS) and University of London Union (ULU) expressed alarm at the sale and said it made "no economic sense".
>
> Toni Pearce, the NUS president, said the sale was "extremely concerning" and effectively meant the public is subsidising a private company to profit from government debt.
>
> She added: "The impact of this sale won't only affect borrowers, but will affect everybody. The simple fact is that having these loans on the public books would be better off for the government in the long run. Selling off the loan book at a discount to secure a cash lump sum now doesn't make economic sense."

[3] BIS press release Sale of mortgage style Student Loan Book completed, 25 November 2013

Michael Chessum, the ULU president, said privatisation of the loan book stemmed from "a poisonous ideological motive to make students consumers, with a lifetime of increasingly malign debt".[4]

Mr Willets stated in answer to a PQ on 11 December 2013 that the sale would not result in changes to loan terms and conditions:

Students: Loans

Jeremy Corbyn: To ask the Secretary of State for Business, Innovation and Skills what restrictions on future interest rates and debt collection policies were placed on the new owners of the Student Loan Book. [178841]

Mr Willetts: The Government announced the sale of the remaining publicly owned Mortgage Style student loans on 25 November for £160 million to Erudio Student Loans Ltd. There will be no changes to loan terms, including the calculation of interest rates which are fixed at a rate equivalent to the Retail Price Index, as a result of the sale.

Erudio Student Loans must adhere to strict OFT guidance about treating borrowers fairly which includes particular protections for vulnerable borrowers and those in financial difficulty.(HC Deb 11 December 2013 c247)

6 Future sales of income contingent loans

On the Government has confirmed its intention to sell off the pre 2012 income contingent loan book:

Students: Loans

Mr Byrne: To ask the Secretary of State for Business, Innovation and Skills (1) pursuant to line (ii) of table 2.5 of the autumn statement, whether his Department has decided to sell parts of the pre-2012 income contingent repayment student loan book; [180000]

(2) with reference to table 2.5 of the autumn statement 2013, what estimate his Department has made of (a) gross proceeds from sale of the student loan book, (b) surrendered repayment income and (c) net proceeds arising from the sale of the student loan book. [180047]

Mr Willetts: The Government has confirmed its intention to realise value for the taxpayer through a sale of the pre-2012 income contingent repayment student loan book. The expectation is that loans will be sold in a number of tranches over a period of years.

As set out in the autumn statement, 5 December 2013, Official Report, columns 1101-13, the estimate of gross proceeds over the five-year period starting in financial year 2015/16 is £10 billion to £15 billion with a central estimate of £12 billion. In table 2.5 of the autumn statement, this central estimate of gross proceeds is distributed evenly across the relevant years of the forecast period for modelling purposes.

An estimate of overall net impact of the sales, including the impact of lower repayments resulting from loan disposals, is incorporated in the overall forecasts for the public finances produced by the Office for Budget Responsibility in the December 2013 Economic and fiscal outlook report, available at:

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4 "Student unions condemn government sale of loans for £160m", *The Guardian*, 25 November 2013

http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2013/ (HC Deb 16 December 2013 c415)

The National Audit Office report *Student loan repayments*, made the following remarks on the sale of income contingent loans:

> **Selling part of the loan book**
>
> In November 2013, the government announced the sale of the mortgage-style loan book. BIS is also preparing to sell early cohorts4 of the income‑contingent repayment loan book, and will take a sale decision in due course. Income-contingent loans have features that will affect an investor's valuation, such as the following:
>
> - Future graduate earnings are affected by wider economic factors. Repayments are not made over a fixed term, and could be made earlier or later than expected, creating uncertainty in cash flows and recoverability.
> - BIS's current proposal is that the repayment mechanism through HMRC and the SLC will remain the same if the loan book is sold. In this situation, the private buyer would have limited opportunity to use alternative debt-collecting methods to increase expected income and reduce credit risk.
> - The market has not encountered income-contingent loans. Investors may initially overestimate the risks.[5]

The Government has stated that it hopes to conduct the first sale of income contingent loans by the end of financial year 2015/16 (HC Deb 9 December 2013 c6).

7 Business, Innovation and Skills Committee Inquiry

The Business, Innovation and Skills Committee are conducting an inquiry on Student Loans; the inquiry will investigate issues concerning student loans and student recruitment; the Committee will also scrutinise the proposal to sell-off a part of the student loan book. Two evidence sessions have been held on 17 December 2013[6] and 14 January 2014.

Mr Willetts gave further information on the process of a sale in his evidence to the Committee on 14 January 2014:

> The sale would be a multi-staged process, MPs were told, not least because future cohorts of students would create more loans and debts in the future.
>
> Mr Willetts said this was not a "one-off asset" like shares in an industry that was being privatised
>
> [...]
>
> There were further details of how a privatised system could be structured, with one option being described as a "synthetic hedge" - a financial mechanism in which private buyers would be assured a revenue stream at the same time as students could continue borrowing and repaying as at present.

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5 National Audit Office *Student loan repayments*, 28 November 2013, HC 818 p17

6 Business, Innovation and Skills Committee , Oral evidence *, Student Loans* HC 930

Pressed by MPs, the minister and his officials said there was no international example of how such a scheme would operate.[7]

8 Issues

8.1 Impact on interest rates for graduate repayments

Mr Willetts has frequently said that graduates have "no reason to be concerned" about the sale of loans and that the terms and conditions of loans will not be changed retrospectively.[8] Information on the impact of the sale on graduates has been given in answer to PQs:

> **Shabana Mahmood:** To ask the Secretary of State for Business, Innovation and Skills pursuant to the announcement by the Chief Secretary to the Treasury in his oral statement of 27 June 2013, that the Government plans to sell the pre-Browne student loan book, what assessment he has made of the option of altering the terms of loan repayments for those cohorts of graduates. [162970]
>
> **Mr Willetts:** The Government received proposals in 2011 from its advisers that the cap on interest rates on student loans should be removed as part of a possible sale of the loan book. The proposal was dismissed two years ago and will not be taken forward by this Government. (HC Deb 1 July 2013 c526)
>
> **Students: Loans**
>
> **Dr Huppert**: To ask the Secretary of State for Business, Innovation and Skills if he will provide an assurance that there will be no retrospective changes to the terms of student loans taken out before 2012. [163063]
>
> **Mr Willetts**: The Education (Student Loans) (Repayment) Regulations set out the terms and conditions of income contingent student loans for the current year. We have no intention to change retrospectively the terms that were applied in earlier years to these loans. (HC Deb 3 July 2013 c699)

The National Union of Students (NUS) lobbied the government on the issue of interest rate rises following any future sale of income contingent student loans and on 13 September 2013 David Willetts sent a letter to the president of the NUS in which he clarified the government's position.[9] The commitment given in the letter was discussed in an article in the *Times Higher Education* "Sell-off should not change loan book conditions, says NUS head" on 19 September 2013:

> The government may soon guarantee that graduates will not pay more if the student loan book is sold to private buyers.
>
> That is the belief of Toni Pearce, president of the National Union of Students. The NUS leader, who succeeded Liam Burns at the end of June, said that the union was seeking to ensure that current student loan terms and conditions "are written into legislation, particularly if the student loan book is to be sold off".
>
> Speaking to *Times Higher Education*, Ms Pearce said that she had recently met with David Willetts, the universities and science minister, to press the Department for Business, Innovation and Skills over what will happen to the terms and conditions for graduates if the pre-2012 and post-2012 loan books are sold off.

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7 "Student loan sell-off 'won't change repayments'", *BBC News* 14 January 2014

8 "Ageing student loans sold to debt firms", *BBC News* 25 November 2013

9 Letter from Rt Hon David Willetts MP to Toni Pearce president of the NUS 13 September 2013

A report prepared for the government by Rothschild investment bank and submitted in November 2011 looked at the option of asking existing borrowers with pre-2012 loans to repay more so as to make the loans more attractive to private buyers.

Ms Pearce said that the NUS was "waiting on a letter from David Willetts outlining BIS' views" on previous sales of the loan book and on the possible forthcoming sale of pre-2012 loans (those taken out before fees were trebled to £9,000 a year).

"The commitment we've had from both Vince Cable [the business secretary] and David Willetts is that they won't be changing terms and conditions," she said.

Ms Pearce added that she was "really hopeful we get that in writing and get some real clarity".

On 14 January 2014 David Willetts gave evidence to the BIS Committee inquiry on student loans during which he said that following on terms and conditions on loans after a sale:

Mr Willetts, facing questions from the Business, Innovation and Skills Select Committee, gave the clearest signal so far of plans to sell "income-contingent" student loans borrowed after the introduction of tuition fees.

University expansion

There have been previous sales of earlier forms of student loans to private companies, but this would be the first time that the system brought in with tuition fees would face a loans sell-off.

"There is a clear intention to sell, we believe we can do it, but there is a final assessment before we push the button," the minister told MPs.

Mr Willetts said governments had always withheld the right to alter students' terms of repayment, but that the sale of loans should not be seen as meaning that payment rates would change.

The contract with the commercial owner would be expected to specify these terms, Mr Willetts told the committee.[10]

8.2 Attractiveness of the sale to investors

An article in the *Times Higher Education* on 27 June 2013[11] raised the issue of making the sale attractive to investors:

The Rothschild report on how to make the loans more attractive to private buyers contained options for the government including raising interest rates – and thus repayments – for existing graduates who took out loans over the last 15 years, or underwriting the loans with a "synthetic hedge", which would see the government compensating any buyer of the loan book against the risk of lower than expected returns.

Vince Cable, the Lib Dem business secretary, has ruled out the option of increasing interest rates for existing graduates, but has not ruled out the "synthetic hedge".

10 "Student loan sell-off 'won't change repayments'", *BBC News* 14 January 2014
11 "Government banks on £10bn sale of student loan book", *Times Higher Education* 27 June 2013

8.3 Removing the cap on student numbers and the sale of student loans

In the Autumn Statement on 5 December 2013 the Government announced that they would increase the number of student places at publically funded higher education institutions by 30,000 in 2013-14 and remove the cap on student numbers entirely by 2015-16; it is estimated that this will create 60,000 more student places. The Statement said that the removal of the cap would cost £120 million in 2014-15 and £290 million in 2015-16 and would be funded by reforms to the student finance system and the sale of the student loan book.

Mr Willetts in his evidence to the BIS Committee inquiry on student loans said that selling off loans was not a pre-condition of plans to expand student numbers and that the removal of restrictions on student numbers was not dependent on such extra funding.[12]

The Institute of Public Policy Research have questioned the idea of selling assets to fund the removal of the cap on numbers and have suggested that borrowing could be a better way of financing the scheme than selling off assets.[13] The chair of the Public Accounts Committee Margaret Hodge MP has also been sceptical about the use of future sales of student loans to fund abolishing the cap on student numbers.[14]

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12 "Student loan sell-off 'won't change repayments'", *BBC News* 14 January 2014

13 Removing the cap on student numbers: is it affordable? Institute of Public Policy Research 6 December 2013

14 "Student loans guardians savaged by Hodge", *Times Higher Education* 12 December 2013