Department for Business Innovation & Skills

HIGHER EDUCATION

Consultation on potential early repayment mechanisms for student loans

JUNE 2011

Contents

Student finance reforms

We have committed to ensuring that higher education in England is affordable for everyone. No-one eligible for support needs to pay for higher education up-front. Loans to cover both tuition and living costs are available for all eligible full-time first-degree students which only need to be repaid once they are earning more than £21,000 per year. Any outstanding balance will be written off after 30 years.

Under the new system, which will be a form of graduate tax, there will be a much stronger link between the benefit individuals derive from higher education and the overall contribution they make to the higher education funding system. Graduate contributions will be based on a variable rate of interest related to income and capped at up to RPI +3 per cent. We intend that those who earn more will pay more but still less than they would have to pay if borrowing on commercial terms.

Graduates who become high earners will contribute the full cost of their tuition. This is because they will have a sufficiently high income to have repaid their loans before the end of the 30 year write-off period and because their rate of interest, which is determined by income, will be higher than the cost to government of borrowing the money. Because of the contribution that these high earners make, the Government will be able to offer significant protection to those who do not earn high wages or who have periods out of employment. We estimate that up to one quarter of graduates – those with the lowest lifetime earnings – will pay less overall than people under the current system do now.

Why we are consulting on early repayment mechanisms

We are committed to the progressive nature of the repayment mechanism. It is therefore important that those on the highest incomes after graduation are not able unfairly to buy themselves out of this progressive mechanism by paying off their loans early. That is why we are consulting on potential early repayment mechanisms – similar to those paid by people who pre-pay their mortgages. These mechanisms would need to ensure that graduates on modest incomes who strive to pay off their loans early through regular payments are not penalised. For example, a five per cent levy might be charged on additional repayments each year over a specified amount such as £1,000 or £3,000. Alternatively, those on higher incomes (e.g. over £60,000) who made an additional repayment could be required to pay a five per cent levy on this sum.

Through this consultation, we are seeking views on the type of early repayment mechanism that should be in place. We would particularly like to hear from:

- students and their families;
- student representative bodies;
- employers;
- experts in the field of student finance; and
- higher education institutions.

Following this consultation, we will consider the responses and make a decision about what type of early repayment mechanism to implement; this will take into account any operational implications identified. We aim to respond in autumn 2011 with the full details of any proposal. Any necessary changes to legislation would be brought forward in spring 2012, with the aim of implementing any new mechanism for new students taking out loans from academic year 2012/13.

The existing mechanism for early repayment of student loans

Some borrowers choose to repay more of their student loan than they are statutorily required to do in a given period. For example, where a borrower opts to make payments above the standard repayment rate set out in regulations, or where individuals earn under the repayment threshold but nonetheless wish to pay down their balance.

Since the introduction of income contingent student loans in 1998, there have been no regulatory barriers or incentives against or in favour of voluntary early repayments. Early repayment is specifically allowed under regulation 15(1) of the Education (Student Loans) (Repayment) Regulations 2009 that states:

“A borrower may repay all or any part of a student loan to the Authority or loan purchaser at any time, by making direct payments to the Authority.”

Borrowers are entitled to repay any amount of the outstanding balance of their loan at any time in addition to their statutory repayments – made via the tax system and direct to the Student Loans Company (SLC) – but there are no particular charges or incentives for doing so. In fact, any individual (for example, a relative) can contribute towards a borrower’s outstanding balance, so long as they are able properly to identify the individual account they wish to credit. This requires nothing more than access to the borrower’s student loan customer reference number, which is generated by SLC when the borrower first applies for student finance. Repayments can be made over the phone, by cheque or via the SLC’s web-based customer portal.

Voluntary early repayment of student loans currently forms a significant part of the total volume of repayment. Many individuals choose to make early repayments despite student loans attracting no real rate of interest or, as in current circumstances, a negative real rate of interest. In 2008-09 (with interest set at RPI), of the total £939 million repayments received by Government, £329 million were voluntary early repayments.

The SLC’s preliminary analysis of current early repayments shows that:

- some 225,000 early repayments have been made since 2000;
- in 2008, over 50,000 repayments were made with a median value of £900;
- early repayments were made by borrowers with a median salary of £18,400;
- the median age for making early repayments is 25;
- of those making early repayments, higher earners tend to repay more;
- the most frequent payment is of the whole balance, but almost as common is a payment of ten per cent or less of the balance;

- when the interest rate falls there is a tendency for the value of early repayments to fall as well; and we can predict that when the interest rate increases so does the propensity to repay early.

The majority of early repayments are from young graduates who are not high earners, though high earners tend to repay more.[1]

The case for maintaining the existing mechanism is that:
- it is simple; and
- it allows graduates on modest incomes to pay off their loans early.

The case against the current mechanism is that:
- those on higher incomes who are able to afford to pay off their loans early will be able to avoid making their full contribution towards the progressive system.

A more progressive mechanism for early repayment of student loans

Our reforms of student finance will create a system that is both financially sustainable and progressive. We are interested in potential early repayment mechanisms – similar to those paid by people who pre-pay their mortgages – that would help to maintain the overall progressive nature of the new system. Any mechanism would need to ensure that graduates on modest incomes who strive to pay off their loans early through regular payments are not penalised.

Options for a more progressive mechanism include:

A) Early repayment charges for high payers

- SLC would charge a percentage levy on payments above a specific limit (e.g. five per cent on repayments over £3,000 per year or percentage of outstanding balance).
- This mechanism would seek to retain the progressive contribution to the student finance system from those who make large-scale repayments on the assumption that these individuals have access to family or personal resources due to pre-existing wealth or high earnings.
- This measure would not be based on earnings, however, and would inevitably catch some low-earners. This means its overall impact on the progressive nature of the system is difficult to determine.
- This would create a disincentive for early repayment but may stimulate a large volume of payments at the threshold as individuals with access to money pay down loans incrementally over a period of years; some high wealth individuals may still be able to avoid contributing overall to the mechanism if the threshold is not set at an appropriate level.

[1] All available evidence is based on borrowers' behaviour under the current system in which a real rate of interest is not charged, and the amount borrowed is lower than the amounts individuals are likely to borrow in future. It should also be noted that we do not know the source of funding for those repaying their loans early.

B) Early repayment charges for high earners

- This mechanism would penalise early repayment based on an individual's earnings. Those on higher incomes (e.g. above £41,000 or an even higher level) who make an additional repayment would be required to pay a percentage levy on that sum.
- It would seek to maintain progressiveness by ensuring that whilst high-earners repaying early may be able to avoid interest on long-term payment, they are still required to make a contribution to sustaining the student finance system overall.
- This option is better targeted as it is based on an individual's actual earnings (a suitable proxy for their personal gain from higher education) rather than any assumptions about their personal wealth.
- This would create a disincentive for all high-earning individuals to repay early. However, it would not disallow early repayment for low-earners with access to large amounts of ready cash from other sources; such individuals could repay early whilst attracting no charge on their repayments.

C) Hybrid mechanism

- This option would combine elements of Options A and B, linking charges to the amount repaid early in a given period as well as an individual's earnings.
- For example, individuals would incur a charge for making payments over a certain income threshold (e.g. above £41,000 per annum) or if they pay off an amount over an absolute limit or threshold relative to their outstanding balance.
- This option would capture low-earning, high-wealth individuals as well as high-earners.

The case for a more progressive mechanism is that:

- it would help guarantee that those who benefit most from higher education would contribute most to its overall long-term affordability; and
- it enables the Government to provide sustainable protection for those who go on to become low earners funded by guaranteed net contributions from high earners.

The case against a more progressive mechanism is that:

- it would impose an additional administrative burden on the SLC;
- it adds complexity for borrowers and their families;
- a mechanism that discourages and significantly reduces early repayment could negatively impact on Government's ability to monetise the student loan book.

What are the implications for borrowers, employers, the higher education sector, and delivery partners?

Borrowers and their families

Introduction of a more progressive early repayment mechanism would change the relationship between borrowers in repayment and the SLC. Depending on the option implemented, high-repaying graduates and/or high-earning graduates in repayment, and their families will be affected.

Government must also respond intelligently and sensitively to the needs of student loan customers. It is clear that we must avoid implementing an over-complicated mechanism that is not readily understood by or accessible for all customers.

We welcome input from current and potential student loan borrower's and their families.

Employers

Primarily the student loan relationship exists between Government and the individual borrower; ultimately borrowers are liable for repaying their student loans. However, employers play a key role in facilitating this relationship by collecting statutory repayment on behalf of Government. Some employers also offer additional financial assistance with the costs of student loans following graduation to attract graduate talent. BIS welcomes such schemes, as they recognise the value that our highly skilled graduates can bring to their future employers.

How employers assist employees with student loan repayment

GSK recently committed to repay new graduate recruits' post-2012 tuition fee loans; this scheme would open in 2010 and is contingent on staff staying with the company for two years.

Microgen, an LSE-listed software and services company, announced its intention to match its employees' student loan repayments up to a limit of £3,000 per year from April 2011. This will cost Microgen an additional £60,000 per year.

Simplyhealth, a healthcare provider, has offered a similar scheme as part of its reward package for employees since 2008.

We are keen to ensure that an early repayment mechanism does not unduly increase the administrative burden for employers or discourage them from recognising the value of highly skilled graduates through assistance with student loan costs.

That is why we want to hear employers' views on the implications of a more progressive early repayment mechanism, and how such a mechanism could be designed to minimise burden on employers.

Higher education providers

Early repayment mechanisms overwhelmingly apply to borrowers who have left higher education rather than prospective students and those in higher education; therefore we do not anticipate any mechanism having significant impacts on the behaviour of borrowers during study.

However, the introduction of a more progressive early repayment mechanism may alter the behaviour of graduate borrowers; and this could, in turn, change the relationship between universities and their alumni.

As such, we seek higher education institutions' views on the mechanisms proposed.

Delivery partners

Government must also consider the operational implications and our ability to implement early repayment mechanisms. The SLC will provide the administrative function for any early repayment mechanism and a more complex arrangement would place additional burden on their systems and staff and require the provision of new functions and customer services.
Some types of early repayment mechanism could be administered independently by SLC. However, other mechanisms could require more complex administrative arrangements for both SLC and HMRC, with whom SLC work closely on the collection of loan repayments. Overall, any mechanism must be workable and generate value for money for the taxpayer; the costs of implementing any mechanism must also be weighed against the benefits to Government. The operational implications will be a factor to be taken into consideration in reaching a decision on an early repayment mechanism.

Questions for consultation

1. Should BIS introduce a more progressive mechanism for early repayment of student loans?

2. If BIS should introduce a more progressive mechanism, which model best delivers BIS' stated aims of ensuring the progressiveness and sustainability of the student finance system?

3. How would a more progressive early repayment mechanism affect you or your organisation's perception of, and relationship with, the student finance system?

Confidentiality and data protection

Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FoIA), the Data

Protection Act 1998 (DPA) and the Environmental Information Regulations 2004. If you want information, including personal data that you provide, to be treated as confidential, please be aware that under the FoIA, there is a statutory Code of Practice with which public authorities must comply and which deals among other things with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic disclaimer generated by your IT system will not, of itself, be binding on the Department.

Help with queries

Questions about the policy issues raised in the document can be addressed to: The Higher Education White Paper team, Higher Education Directorate, Department for Business, Innovation and Skills, 1 Victoria Street, London SW1H 0ET. E-mail: HE.consultation@bis.gsi.gov.uk.

If you have any comments or complaints about the way this consultation has been conducted, these should be sent to the address above.

The principles of the Code of Practice on Consultations can be found at www.bis.gov.uk/policies/better-regulation/consultation-guidance

This publication is also available on our website at http://www.bis.gov.uk/HEreform

Any enquiries regarding this publication should be sent to:

Department for Business, Innovation and Skills
1 Victoria Street
London SW1H 0ET
Tel: 020 7215 5000

If you require this publication in an alternative format, email enquiries@bis.gsi.gov.uk, or call 020 7215 5000.

URN 11/944