The Education (Student Loans) Bill [Bill 4 of 1995/96]

Research Paper 95/115

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This paper examines the background to and the provisions of the *Education (Student Loans) Bill* which received its First Reading on 17 November 1995. The Bill seeks to amend the *Education (Student Loans) Act 1990* to enable the payment of Government subsidies to private sector financial institutions which will provide loans to students in higher education. The Student Loans Company, established by the 1990 Act, will continue to provide loans to students who apply to it in preference to private sector institutions. The Bill is due to receive its Second Reading on 27 November 1995.

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I The current system of student loans

A. Eligibility, repayment rules and loan rates

A new system of student support was introduced from the beginning of the 1990/91 academic year. It has three main elements:

- the continuing availability of a means-tested basic maintenance grant and supplementary allowances for categories such as disabled students and those with dependants;

- a non-means tested Government loan facility offered at nil real interest (i.e. the nominal rate of interest payable on the loan is set equal to the rate of inflation - in real terms an interest free loan); and

- Access funds for certain students facing financial difficulties. These funds are cash limited by the Government and are paid at the discretion of the university or college where the student is studying.

Student loans were introduced by the *Education (Student Loans) Act 1990*. The scheme was based on proposals contained in the White Paper, *Top-Up Loans for Students*.[1] Library Research Note 470[2] outlined the Government's proposals and reactions to them, including alternative proposals put forward by Opposition parties and interested organisations and commentators. Library reference Sheet 89/12[3] gives detailed information on the original Bill's provisions.

The operation of the loans scheme is governed by the *Education (Student Loans) Regulations*.[4] The Regulations cover: the eligibility conditions for loans, loan rates, indexation, repayment requirements, deferment and cancellation of loans. Briefly, students taking full-time courses of higher education below post-graduate level will usually be eligible for a loan if they are aged less than 50 when the course begins and have been ordinarily resident in the UK, the Channel Islands or the Isle of Man, for the three years before the start of the course. Applicants must have a bank or building society account; must not be in default on repayments on a previous loan under the scheme; and must enter into a loan agreement by 31 July in the academic year.[5]

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[1]Cm 520, November 1988

[2]*Student Maintenance Grants and Loans,* 2.10.89

[3]*The Education (Students Loans) Bill,* 27.11.89

[4]SI 1994/3045

[5]HC Deb 3.12.91 c.92W

Students are not required to repay their loans until the April after they finish or leave their courses. Repayments are usually made in the form of fixed monthly instalments; most commonly 60 instalments over five years. Students may defer loan repayments for a year at a time if their income is not more than 85 per cent of national average earnings.[6] The Government announces the deferment threshold for each year in June.

Disabled borrowers may also have their repayments deferred if their income is above the deferment level and they have "major special costs" which are not covered by benefits received, or by their employers, and which take their income below the deferment threshold.

Loans are cancelled in the event of death and if unpaid because of deferment, unless the borrower is in default, the loan is cancelled after 25 years or when the borrower reaches the age of 50, whichever is the earlier.

The loan facility is not subject to a means test and is offered at a nil real interest rate. The maximum loan available in the current academic year is set out below. In the final year of study the loan facility is less than in other years because it is not meant to cover the summer vacation after graduation:

	full year	**final year**
students living away from their parental home and studying: in London elsewhere	 £1,695 £1,385	 £1,240 £1,010
students living at their parental home	£1,065	£780

Since the 1990/91 academic year the grant element of student support has been cut and offset by corresponding increases in loan entitlement. It is the Government's aim that grants and loans should be brought into "broad balance":[7]

> "For 1994/95, the Government will continue to maintain the real value of the funds offered to students through the main rates of grant and loan and supplementary grants, which together will increase by 4% in cash. Reductions in the main rates of grant of 10% against their 1993/94 levels will be offset by increase in loan entitlements. Similar adjustment will be made over the next two years; on present estimates they will bring the grant and loan into broad balance in 1996/97. This shift from grant to loan represents an acceleration of the Government's existing plans."

[6] for example, up until 31 July 1995 ex-students qualified for deferment if their gross income was £1,216 a month or less

[7]DFE PN 30.11.93

In the November 1994 budget the Government announced that the main rates of student grants and loans, as well as the main allowances, would be increased in line with inflation over the next three years; in 1995/96 the loan and grant together has increased by 2.5 per cent. The main grant rate has fallen by around 8 per cent while loan rates have received a corresponding increase.

B. Administration

The scheme is administered by the Student Loans Company Ltd (SLC) which is based in Glasgow. The SLC is wholly owned by the Government; funding for both loans and operations is provided by Government and, accordingly, the company makes neither a profit nor a loss. Within the limits of the financial memorandum between the SLC and Government the company is required to operate as an independent company and, as far as possible, commercially.[8]

The SLC's 1994 Annual Report notes that it has set itself key performance targets in the following areas:

- the payment of loans within 21 days of receipt of an application;

- the approval of 90% of deferment applications within 21 days of receipt of correctly completed applications and to respond to 90% of communications from borrowers within 3 days of receipt; and

- on debt recovery the company set itself a target cumulative scheme default rate of 3.5% and a cumulative company default rate of 6.4%. The default rates achieved were 3.4% and 5.9% respectively. The 1994 "in year" scheme default rate target was 2.7% and the company "in year" default rate target was 4.7%. The default rates achieved were 2.7% and 4.6%. Therefore, the targets were surpassed in all but one case (the "in year" scheme default rate) where the target was achieved.[9]

In addition, Ministers set the following strategic targets for the SLC in the 1994/95 academic year:

- a target of 92% of loans to be paid within the SLC's 21 day performance standard;

- to achieve a Charter Mark award on customer service;

[8]SLC Annual Report 1994, Chairman's statement

[9]the cumulative performance figures include the bad debt from previous years, the "in year" performance figures only include those accounts falling into default within the financial year

- to improve unit costs by 15%;
- to collect 94.5% of all repayment monies due by 31 March 1995.

The 1994 Annual Report notes:

> "The collections performance of the Company has been excellent. At the end of the Company's second year of volume repayment collections, both scheme and company default rate performance targets have been surpassed...In addition to the Company's default rate targets, SLC collected some 94.9% of all repayment monies due by 31 March 1994, against a ministerial target of 93%"

The SLC's policy for recovering debt is:[10]

- to monitor closely all repayments and to take prompt action if any repayment falls overdue;
- to maintain contact with all defaulting borrowers through regular letters and telephone calls to explain the consequences of default;
- to counsel and advise borrowers who are not entitled to defer but who face particular financial difficulties; and
- in fairness to the generality of borrowers and to the taxpayer, to take wilful defaulters to court.

Figures released by the Department for Education and Employment show that in the academic year 1994/95 some 517,000 students received a loan, representing about 55 per cent of those eligible, compared to a take up rate of 28 per cent in 1990/91. The average value of loans issued was £1,040 compared to £390 in 1990/91. Of the 435,000 ex-students who should now be making loan repayments two-thirds have deferred repayment (187,000) and 44,000 are in arrears. A total of £1,279 million was outstanding under the scheme at the end of 1994/95.[11]

The SLC has not been without its administrative problems. At the start of the 1994/95 academic year students faced delays in the processing of their loan applications; Tim Boswell gave the following response to a PQ on this issue in January 1995:

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[10] 1994 Annual Report p.12

[11] DFEE Press Notice 13.11.95 *Statistics of Student Loans in UK 1994/95*

> **Mr. Parry**: To ask the Secretary of State for Education (1)if she will make a statement on the Student Loans Co.; (2) what recent representations she has made to the Student Loans Co. for the improvement of waiting times for student appointments and communication within the service; and if she will make a statement.
>
> **Mr. Boswell**: My right hon. Friend annually sets performance targets for the Student Loans Co., including the payment of loans to students. The company has apologised for its recent failure to maintain its usual high standards. It is conducting a thorough review into recent delays in the payment of loans following the introduction of a simplified repeat application procedure, and the steps necessary to prevent a recurrence. As part of that review, the company will consult widely and the results will be reported to right hon. Friend.

The National Audit Office (NAO) carried out an investigation into the SLC earlier this year the results of which are due to be published shortly. The NAO previously investigated the operation of the SLC in 1991/92 and reached the following general conclusions:[12]

> "The development and implementation of the Government policy for a loans scheme, including the establishment of an operational company to administer the scheme in this relatively short period of time, was a substantial achievement by the Student Loans Company and Department officials, in association with consultants and others. The Company was able to start administering the loans scheme by the Government's deadline of autumn 1990. The Departments and the Company, along with Price Waterhouse, therefore achieved their prime objective. Although costs in certain specific areas were higher than originally estimated, total expenditure on start-up costs remained well within the range that the consultants had estimated. The computerised Central Loans System was ready in time to enable the Company to respond rapidly to the first applications from eligible students for loans in autumn 1990."

The SLC has also faced allegations of corruption concerning the ex-Chief Executive, Ronald Harrison.[13] In 1994 a team from Coopers and Lybrand was called in to investigate these allegations. Tim Boswell reported in January 1995 that the provisional conclusions of Coopers and Lybrand's investigation had been received and that the investigation was nearing completion.[14] The final findings have not yet been made public; they will be reported to the Public Accounts Committee indue course.[15]

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[12]NAO *The Administration of Student Loans*, 1993

[13] see *The Guardian* "Student loan chiefs' perks on taxpayer" 12.9.94; *The Guardian* "Student loans chief admits Paris Perk" 23.9.94; *Guardian* "Student loan chief given the sack" 14.3.95

[14]HC Deb 19.1.95 c.655W

[15] HC Deb 19.1.95 c.655W

II The Government's proposals

A. Background

The *Education (Students Loans) Bill* is "designed to allow private sector financial institutions to enter the student loans system as major players."[16]

Announcing the publication of the Bill the Education and Employment Minister, Eric Forth, said:[17]

> "Students can only benefit from the choice, diversity and competition that these changes would bring. The expertise and experience of the private sector would mean a better loans system overall and a better deal for students.
>
> What we have in mind is a twin track public/private model of subsidised student loans. The main features would be:
>
> - The Secretary of State would pay subsidies to chosen financial institutions to enable them to make loans to students on the same preferential terms as the Student Loans Company.
> - Up to four institutions might be chosen through a competitive bidding exercise. In effect they would bid for levels of subsidy.
> - Private loans would be available from the beginning of the 1996/97 academic year. In due course we would expect most loans to be private ones.
> - There would still be subsidised public loans through the SLC.
> - The twin track would bring choice, diversity and competition to the system. That would lead to improvements in the service to students and, as the market grows, the loan product."

When the Government first mooted the introduction of a student loans scheme its objective was to identify a cost-effective scheme which financial institutions would administer. In late 1988 the Department set up a Working Group on the Administration of Student Loans, comprising officials of the Department and representatives of financial institutions, to consider how such a scheme could be administered and to establish a basis for negotiation with individual financial institutions. In January 1989 the Committee of London and Scottish Bankers (the Committee), a permanent, representative association of the Clearing Banks, formally proposed that a "single vehicle" (subsequently SLC Ltd) should be set up to operate

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[16] DFEE Press Notice 17.11.95 *Student Loans Bill Published*

[17] Ibid

the scheme on behalf of the Government and those financial institutions wishing to participate.[18]

In November 1989 the Government announced that agreement had been reached with the Committee that ten banks would establish a company to undertake preparatory work on the student loans scheme; that the Government had agreed to fund the costs of this preparatory work; and that, in the first academic year of the scheme's operation, participating financial institutions would receive a transaction fee of £12 for their work in processing each student loan application at their branches.[19] Subsequently the ten banks each bought one share in a shell company previously incorporated in July 1989 with an authorised share capital of 100 one pound shares. The company was established as "Student Loans Company Ltd" on 20 November 1989. On 7 December 1989 the Department placed a contract with the SLC for preparatory work which the company was to undertake on the scheme.

However, on 20 December 1989 the Secretary of State informed the House that, in view of the decision of Lloyds Bank in particular not to participate in the scheme, the Chairman of the Committee had informed him earlier that day of the decision of five of the banks to withdraw; that, in the circumstances, the four Irish banks also wished to withdraw, and that arrangements would be made for the SLC to pass into the ownership of Government.[20]

During the Bill's Second Reading in the Lords the Earl of Caithness made reference to the reasons given by the banks for withdrawing from the scheme:[21]

> "I turn now to how the administration will work. The loans scheme will be administered by Student Loans Company Ltd. We saw some advantage in making the expertise and the branch networks of the banks available to help with the administration of the scheme; but the banks decided that there was no commercial benefit for them. In practical terms, the withdrawal of the banks means only that bank branches will not be available to handle loan applications. Thus applications will be made to the company, which will send the money to the students. The company will also collect repayments, and operate the deferment and cancellation procedures. It is well advanced on preparatory work to enable the loans to be made available this autumn, if Parliament approves the Bill."

It appears that one of the driving factors behind current efforts to involve private lenders in student loan provision is the possibility of taking up to £1 billion out of the Public Sector Borrowing Requirement in the 1996/97 academic year. The financial memorandum to the Bill notes that the extent of any overall reduction in public expenditure resulting from its

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[18]NAO *The Administration of Student Loans,* 1993, p.10

[19]Hc Deb 16.11.89 c.388W

[20]HC Deb 20.12.89 cc256-8W

[21]HL 27.2.90 c.604

provisions will depend on the precise arrangements that are made with the financial institutions and the number of students who actually take out loans with private lenders.

B. The Bill

Clause 1 of the Bill seeks to amend Section 1 of the *Education (Student Loans) Act 1990* to allow the Secretary of State to pay subsidy to financial institutions who make "private sector student loans" available to students. The subsidy payments will be made in accordance with arrangements made between the institutions and the Secretary of State. **Clause 1** would also introduce the Schedule to the Bill which would make consequential amendments to the 1990 Act. These amendments would apply to subsidised private sector loans certain of the provisions about loans provided by the Student Loans Company. The Secretary of State will have power to make regulations precluding students from receiving both private and public sectors loans, or limiting the amount of such loans which may be made to students. **Clause 1** and the Schedule extend to Great Britain.

Clause 2 would allow similar provision to be made for Northern Ireland by an Order in Council subject to the negative resolution procedure.

Clause 3 would allow the Secretary of State to incur expenditure by making payments to private sector financial institutions in respect of student loans made by them and in meeting any additional costs of the DFEE arising from such loans.

III Reactions to the Bill

At the time of writing no financial institutions have committed themselves to entering into arrangements to offer subsidised student loans. Those with whom the DFEE is conducting talks are reported to be sceptical about the scheme unless it can be proven to be commercially attractive and offer a high level of security.[22] It has been suggested that incentives on offer to banks include the Treasury making up the difference between commercial rates of interest and the fixed rate charges to students.[23] Given the fact that the banks withdrew from the Government's previous attempt to involve them in the provision of student loans there must be doubts over whether they will be persuaded by these new proposals.

The President of the National Union of Students (NUS), Jim Murphy, issued the following statement on the announcement of the Government's plans for student loans:[24]

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[22]*The THES* "Banks may underwrite new loans" 10.11.95

[23]*The THES* "HM loan arranger" 17.11.95

[24]NUS Press Notice *NUS Condemns plan to make profit from student hardship* 15.11.95

> "Students will be absolutely outraged at the Government's plans to privatise Student Loans and allow others to profit from student hardship. The solution to the disaster of the Student Loans system cannot be to farm out the collective debts of the nation's students to commercial companies.
>
> We find it very hard to believe that the banks would wish to support or invest in such a scheme, which will be hugely unpopular with students and a costly investment. The banks originally refused to support the set-up of the Student Loans Company back in 1990 and it could prove to be commercially unwise for them now to support a private loans system.
>
> Introducing private loans may be the final straw for many students living in hardship, and for many sixth formers and would be students considering the financial implications of going off to college. Thirty per cent cuts to student grants have forced many students to take up the Government's Student Loan of over £1,000 a year. The take-up rate for Student Loans is 55% of eligible students, but over half of graduates with Student Loans are either in default or have deferred repayment on the grounds of low income.
>
> The Government claims to be engaged in a thorough review of higher education and I am disturbed that this shock announcement comes in the middle of a so called period of consultation on education funding.
>
> The Student Loans System has clearly failed and the Government's plans for new legislation acknowledge that the system has cost the country and the tax-payer millions of pounds and will continue to do so. We want an urgent review of the system of student financial support and proper consultation. I will today be contacting the Secretary of State and the Chief Executive of the Student Loans Company to arrange meetings about the Government's new plans."

The NUS has reportedly written to all the major banks requesting them not to get involved in the scheme.[25]

The Committee of Vice-Chancellors and Principals of the Universities of the UK (CVCP) issued a briefing note on the student loans scheme in August 1994 in which it criticised the following aspects of the current scheme:[26]

- **limited eligibility:** postgraduates, part-time and mature students over 50 are not eligible for loans despite increasing numbers of part-time and mature students;

- **fixed payments:** mean that students face a heavier burden of repayments in the early years of their careers. The CVCP supports a move to an income-contingent repayment system;

- **default problems:** the CVCP views the arrangements for collecting loan repayments as inefficient and likely to lead to a growing default problem. The CVCP supports a move to collection via the tax or national insurance system;

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[25] *Independent* "New plan to privatise student loan scheme" 18.11.95

[26] *The Government's Student Loans Scheme*, 1994

- **hidden subsidies:** the CVCP's briefing note points out that, as students do not pay a real rate of interest on loans or begin repayments until the April after their course ends, this represents a hidden Government subsidy of around £250 million a year;[27]

- **administrative burden:** the CVCP argues that the subsidy which the universities receive for each correctly completed eligibility certificate does not cover the full cost of the work involved and, therefore, that the universities are subsidising the SLC.

The CVCP concluded:

> "These limitations suggest that, in its present form, the Students Loans Scheme does not provide an equitable or efficient basis for funding student living costs. The coverage of the scheme is restricted, with important categories of students being excluded. The present short repayment period means that graduates have to sustain a disproportionate burden early in their working lives. This problem can only increase as the direct beneficiaries of higher education make a greater contribution towards the cost of their education in the future. Finally, the present repayment mechanism is more costly and less effective than the main alternatives of collecting payments through the national insurance or tax systems."

The Chairman of the CVCP, Professor Gareth Roberts, issued the following response to the current proposals:[28]

> "It is not important to us who owns the debt. What matters is the repayment mechanism, which as it stands is fundamentally flawed. Graduates should be able to pay back a sustainable percentage of their earnings for as long as it takes to repay their debt. This would encourage more students to take out loans they need.
>
> Students need to know that they can borrow money without fear of being unable to afford the repayments. Only then will the take-up rate improve. The CVCP believes that any system of student loan should be **adequate** to students' needs, **certain, simple** to administer and **socially just.**
>
> Vice-Chancellors have continually urged on the Government the need for a fundamental review of the funding both of student maintenance and tuition. We are disappointed that they have not seen fit to consult us on this latest move, but look forward to being consulted about the future shape of the student maintenance loan system."

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[27]Institute of Economic Affairs *Britain's Student Loan System in World Perspective: A Critique*

[28]CVCP Press Notice *Privatisation of Student Loans - CVCP reaction,* 15.11.95

The acting Chief Executive of the SLC, Sir Eric Ash, is reported to have predicted problems for the SLC in the form of rising unit costs if students turn to private sector institutions for their loans. He has also been quoted as saying:[29]

> "If the banks can choose who they give loans to its likely that they will reject those they regard as less credit worthy. That's inevitable. It will give the company the role of a safety net."

For the Labour Party, David Blunkett is reported to have said that the changes will lead to a "two-tier" loans system with students who are considered to be a high financial risk being forced to borrow from the SLC; he has called for a thorough review of student maintenance.[30]

The Liberal Democrats, rather like the CVCP, are not opposed to moving the ownership of the student loan debt to private lenders but believe that the system as it stands is not equitable to the payers nor secure for the lenders. The Liberal Democrats would also support a review of student maintenance.

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[29] *Financial Times* "Banks could compete as lenders to save £800m" 16.11.95

[30] *Independent* "Banks are sceptical over loan scheme" 16.11.95