Education (Student Loans) Bill

[Bill 44 of 1997/98]

Research Paper 97/91

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On 11 September 1996 the previous Government announced its intention to proceed with the sale of part of the existing student loan debt to the private sector. The new Government is continuing with this process, not least because the sale of these loans 'is a critical element in meeting the Government's manifesto pledge to work within spending plans already announced for the next two years.' The Bill, which was presented on 10 July 1997, will amend the *Education (Student Loans) Act* 1990 to facilitate the sale of a portfolio of public sector student loans to financial institutions. The Bill extends to England, Wales and Scotland; separate provision will be made for Northern Ireland. This paper gives background to the Bill and its intended effect.

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I Summary

Following the failure of an attempt by the previous Government to develop a 'twin-track' public/private model of subsidised student loans[1], on 15 September 1996 Gillian Shepherd, then Secretary of State for Education and Employment, announced that the Government intended to proceed with the sale of part of the existing student debt. At that time the Student Loans Company already had some £2 billion in outstanding loans.

The Pre-Qualification Document was issued by N M Rothschild and Sons Ltd on 20 February 1997; expressions of interest were requested by 14 March 1997.

The new Government announced its intention to proceed with the sale on 10 July 1997. The sale is viewed as essential to meeting the Government's commitment to work within spending plans already announced for the next two years.

The aim of the *Education (Student Loans) Bill 1997/98* is to facilitate the sale by enabling the Government to make subsidy payments to the purchaser(s). It is also intended to safeguard the position of the taxpayers, borrowers and purchasers by preventing certain loan terms from being changed once a loan has been granted.

The Debate on Second Reading is scheduled for 21 July 1997.

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1 *Education (Student Loans) Act* 1996

II The student loans scheme

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.*[2] Library Research Note 470[3] 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[4] gives detailed information on the original Bill's provisions.

The operation of the loans scheme is governed by the *Education (Student Loans) Regulations.*[5] 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.[6]

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2 Cm 520, November 1988
3 *Student Maintenance Grants and Loans,* 2.10.89
4 *The Education (Students Loans) Bill,* 27.11.89
5 SI 1996/1812
6 HC Deb 3 December 1991 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.[7] 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 1997/98 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	 £2,085 £1,685	 £1,520 £1,230
students living at their parental home	£1,290	£945

Since the 1990/91 academic year the grant element of student support has been cut and offset by corresponding increases in loan entitlement. It was the previous Government's aim that grants and loans should be brought into 'broad balance'.[8]

7 For example, up until 31 July 1997 ex-students qualify for deferment if their gross income is £1,316 a month or less.
8 Department for Education press notice, 30 November 1993

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.[9]

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.

In the academic year 1995/96 some 946,000 students were eligible for loans of whom 560,000 took up their entitlement. This represented a take up rate of 59% and an increase in loans paid of 8% over the 1994/95 academic year.[11]

The average individual loan value in 1995/6 was £1,252; by the end of the 1995/96 academic year the total loans paid out under the scheme had reached 2.3 million.[12]

In the 1995/96 financial year Ministers set the SLC the target of collecting 94.5% of all monies due since the beginning of the scheme. The collection rate achieved was 94.2%.[13] The default rate at 31 March 1996 was 7.9% against a target of 6%. The reason given for this failure to meet the target was that 'a greater than anticipated number of accounts fell into default at the start of the financial year 1995/96 repayment cycle as a result of resources having been diverted from collections to deal with the academic year 1994/95 revised application process.'[14]

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9 SLC Annual Report 1996 p.4
10 ibid p.14
11 ibid p.9
12 ibid
13 ibid p.14
14 ibid p.15

At 31 March 1996, of the 437,000 borrowers due to repay their loans 47% had been granted deferment of this obligation.[15]

Borrowers Due to Repay and Repaid in full as at 31 March 1996[16]

Repaid in full	37,077
Repaying	196,431
Overdue (one instalment in arrears)	4,818
In default (two or more instalments in arrears)	20,560
Total	258,886*

*This figure does not include those due to repay but granted a deferment.

15 ibid p.12
16 ibid p.14

III Background to the Bill

In the Queen's Speech on 15 November 1995 the then Government outlined plans to introduce a Student Loans Bill that would enable a 'twin-track' public/private model of subsidised student loans to be created. The *Education (Student Loans) Bill* was presented on 17 November 1995 and received Royal Assent on 29 April 1996; detailed information on this Bill can be found in Library Research Paper 95/115.

In brief, the 1996 Act sought to amend the *Education (Student Loans) Act* 1990 to enable the payment of Government subsidies to private sector financial institutions which would, in turn, provide loans to students in higher education. It was intended that the SLC would continue to provide loans to students who applied to it in preference to private sector institutions.

On 11 September 1996 Gillian Shepherd, then Secretary of State for Education and Employment, announced that the proposed twin-track scheme would not proceed, she stated:[17]

> 'I am extremely grateful to Barclays, NHL and Clydesdale for taking the trouble to put forward bids and for taking part in detailed discussions with us. In the event we have not been able to agree a deal which would meet their requirements at the right price for the taxpayer. But our negotiations with them and others have been vital in demonstrating the feasibility of private sector involvement in student loans and in preparing this new way forward.'

This 'new way forward' was to involve the sale of some of the existing student loan debt and the contracting out of the administrative work of the SLC:[18]

> 'We have been reviewing how we can most effectively achieve our policy objective of transferring the student loans activity into the private sector. Our objective is firmly based. Lending to private individuals is not a natural or desirable function for the public sector to carry out. The Government's policy of transferring provision from the public sector to the private sector has resulted in significant improvements in effectiveness and customer service.
>
> It has also delivered the benefits of risk transfer to the private sector and longer term benefits to the economy as a whole from reducing the size of the public sector. Such changes come in part from dynamic changes which are often hard to identify in advance and impossible to quantify.
>
> Against this background, we have been holding discussions in recent months with a number of financial institutions on the twin-track scheme. We have concluded that in the immediate future our long term goals can best be achieved through the sale of part of the existing student debt and the strategic contracting out of the Student Loans Company.

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17 Department for Education and Employment press notice 294, 11 September 1996
18 ibid

> We believe this will pave the way for private sector lenders to take on responsibility for the provision of student loans.
>
> There is already some £2 billion in outstanding loans, due for repayment over many years, together with further sums from loans in the years ahead. Selling some of this debt will bring benefits from transferring risk to the private sector, while the strategic contracting out of the current loans administration should in turn lead to real improvements in service and effectiveness.
>
> In line with our longer term policy objective of transferring the student loans activity into the private sector, it is our firm intention to go down this route and the Government's policy will be to accept the most competitive private sector tender or tenders. The financing costs involved will reflect the transfer of risk to the private sector.'

On 19 November 1996 Lord Henley, the then Education and Employment Minister, announced the appointment of N M Rothschild and Sons Ltd to advise on the plans to sell some of the loan debt; Lovell White Durrant were appointed as the Government's legal advisors.[19]

When questioned on the expected total income from the sale of the student loan debt and its effect on the Public Sector Borrowing Requirement, the previous Government responded:[20]

> 'The total income is dependent on the outcome of the forthcoming competition and negotiations. The Government's plans assume that some £1,500 million of debt will be sold in each of the three years. The effect on the public sector borrowing requirement and the exact quantum sold will depend on the final structure of the sale.'

N M Rothschild issued the Pre-Qualification Document on the privatisation of the student loan portfolio on 20 February 1997. Mr Charles Keay, an executive director at Rothschild, reportedly stated that the sale would include 'a package of government-backed payments' that would 'be offered to enhance the rate of return on assets to a commercial level'.[21] These top-up payments were deemed necessary as students only pay interest on their loans at the rate of inflation to ensure that, in real terms, they only repay what they borrow. This, and terms such as the deferment of payments and the cancellation of loans on death, meant that returns would be too low to be attractive to the markets; hence top-up payments were required to make the portfolio saleable.

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[19] Department for Education and Employment press notice 390, 19 November 1996

[20] HC Deb 3 December 1996 c.613W

[21] "Government to top up return on student loans", *Financial Times*, 21 February 1997

On the launch of the sell-off competition Lord Henley stated:[22]

> 'The competition beginning today is part of a staged process designed to encourage the widest possible interest in the sale of the debt and so achieve the best possible value for money for the taxpayer. The Pre-Qualification Document is being sent to a large number of leading financial institutions in the UK and world-wide. They have been asked to register their interest and demonstrate the financial and technical capacity to complete the purchase. Financial institutions which pre-qualify will move on the next stage of the competition.
>
> The sale is on course for completion in the Autumn, as envisaged when the Secretary of State made her announcement last year.
>
> Student borrowers have no cause for concern. The sale will not change the terms on which students get loans: they will continue to be offered loans on generous terms, including the right to defer repayments and to pay an interest rate linked to inflation. They will also continue to repay on the same basis as they do now.'

Financial institutions were asked to register expressions of interest by 14 March 1997.

The *Education (Student Loans) Bill 1997* was presented to Parliament on 10 July 1997; David Blunkett, the current Secretary of State for Education and Employment made the following statement on the Bill's purpose:[23]

> 'The sale of student loans is a critical element in meeting the Government's manifesto pledge to work within spending plans already announced for the next two years. This Bill smooths the path for the sales. It puts on a clearer footing my power to make subsidy payments to buyers and provides safeguards for the buyers and the taxpayer. Given the support of the Opposition for this measure I expect the House of Commons to see it as non controversial.'

The Chancellor, Gordon Brown, issued a more detailed statement on the reasons for introducing the Bill:[24]

> 'The overriding policy considerations that have determined the Government's approach to the student loan debt sale are as follows.
>
> The Government is committed to the development of a wide range of public-private partnerships which involve a transfer of risk to the private sector. This sale will shift much of the default risk to the private sector who have much more experience in dealing with credit risks. The sales will enable the markets to establish a clearer understanding of student loans and could in future encourage financial institutions to play a more direct role in the provision of student support.
>
> In addition, the Government was elected on the basis of a manifesto pledge to work within the spending plans already announced for the next two years. This, and our other economic pledges on inflation and taxes, were designed to create the conditions for economic stability and a platform for sustained growth.

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[22] Department for Education and Employment press notice 44, 20 February 1997

[23] Department for Education and Employment press notice 200, 11 July 1997

[24] HC Deb 10 July 1997 cc 607-8W

Going ahead with the student loan debt sale has a critical role in enabling us to keep this pledge. The public spending plans we have inherited include substantial sales of student loan debt in 1997/98 and 1998/99. Given the tightness of our plans generally and in particular the priority we want to give to education programmes, the Government has decided to proceed with the sale.

These overriding objectives were paramount in the decision to proceed with the debt sale. The Government accepts that this will result in the payment of subsidies to purchasers of the debt but intends to accept the most competitive bid following a competitive tendering process. The size of the continuing subsidies cannot be predicted in advance. We will ensure that we achieve the most competitive outcome consistent with these objectives.

IV The Bill

The Bill will amend the *Education (Student Loans) Act* 1990 to facilitate the sale of a portfolio of public sector student loans to financial institutions. The explanatory and financial memorandum to the Bill states that the Bill will also 'safeguard the position of the taxpayer, the borrower and the purchaser by preventing certain loan terms from being changed once a loan has been made'.

Clause 1 will insert a new section (1A) into the 1990 Act to provide for the assignment of public sector student loans. The Secretary of State will be able to make such arrangements 'as he thinks fit' in connection with these assignments, including the payment of subsidy to assignees. The Secretary of State will also have the power, in certain specified circumstances, to repurchase or direct a further assignment of the assigned loans.

The sale price of the loans portfolio and the amount of any subsidy payments are to be determined by competitive tender; the level of subsidy payments will also be affected by the rate of inflation and the default rate of borrowers.

The 'arrangements' may provide for the appointment of an independent person, approved by the Secretary of State, to investigate and report on disputes between the purchaser(s) and the borrower(s) about loans to which the arrangements relate.

Clause 2 will replace paragraphs b and c of Schedule 2 to the 1990 Act to require that the terms of every agreement for a public sector student loan must specify the time and manner of repayments due and the circumstances in which the borrower's liability may be deferred or cancelled. Regulations will prescribe the key terms of an agreement for a public sector student loan and once these terms are specified they may not be changed by further regulations after an agreement has been entered into.

There is also provision to ensure that certain key terms of existing public sector student loans may not be changed.

Clause 3 will replace paragraph 3 of Schedule 2 to the 1990 Act which governs the administration of public sector student loans. The new provisions will ensure that the administration arrangements will be contractual in nature 'rather than operate to confer public law functions.' In effect, once the debt is sold the loan agreements will no longer be regulated by public law provisions as it is not feasible to transfer these rights and obligations to private sector institutions. The loans will, instead, be private sector commercial loans that are regulated by contract.

Clause 4 provides that an Order in Council to make corresponding provision in relation to Northern Ireland will be subject to the negative resolution procedure.

V Responses

At the time of writing few organisations have responded to the proposals.

When the previous Government announced the dropping of the twin-track approach to the provision of student loans in favour of the sale of the student loan debt, the Committee of Vice-Chancellors and Principals (CVCP) issued the following statement:[25]

> 'We are not very concerned with who offers student loans and ends up owning the debt as long as students are not disadvantaged. The involvement of the private sector could, through better marketing, increase the popularity of loans and release public money for other purposes - like replacing the income lost in the damaging capital cuts introduced in last year's Budget.
>
> The CVCP would like to see the current mortgage type-repayment system replaced with a scheme that links repayments to pay levels. That is, a socially equitable income-related loan scheme, yielding genuine additional funds for universities to invest in expansion and quality improvements.'

More recently, the CVCP's submission to the next Public Expenditure Survey has apparently called for the 'bulk of these proceeds [from the sale of the student loan debt] to be used to re-invest in higher education.[26]

Douglas Trainer, the President of the National Union of Students (NUS), reportedly asked for a commitment that any money raised from the sale of the loan portfolio would go to prevent the introduction of tuition fees and bring an end to student hardship.[27]

Don Foster, then Liberal Democrat spokesman for education and employment, reportedly said that the transfer of the loan debt to the private sector must be of long-term benefit to both students and tax-payers and although the Party had no objections in principle, 'the devil may be in the detail.' He called for guarantees of transparent negotiations, a tight regulatory system and equal terms for all students.[28]

There is surprise in some quarters that the Government is proceeding with the sale prior to the publication of Sir Ron Dearing's report on higher education.[29] Dr Nicholas Barr, leader of the London School of Economics' team that specialises in student loans, has been reported as saying: 'the Government might recoup only half the face value of the debt while the existing

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25 CVCP press notice 443, 11 September 1996
26 "Treasury told not to pinch cash", *The Times Higher,* 30 May 1997
27 "Shepherd forced to scrap student bank loans plan", *The Guardian,* 12 September 1996
28 "Tory loans U-turn", *Times Education Supplement,* 13 September 1996
29 Publication is expected later this month.

repayment system remains, but a sale could release an annual 'pot of gold' of £1.6.billion if the repayments were linked to national insurance. Going ahead in a hasty way while there are such high levels of deferment amounts to a waste of tax-payers' money.'[30]

[30] "Blunkett adopts Tory plan to privatise student loans", *The Times*, 12 July 1997

Education

Related Papers include:

95/115	Research Paper - The Education (Student Loans) Bill [Bill 4 of 1995/96]	21.10.95
92/33	Research Note - Financial Support for Students	06.05.92
89/12	Reference Sheet - Education (Student Loans) Bill [Bill 3 of 1989/90]	27.11.89
470	Research Note - Student Maintenance Grants and Loans	02.10.89