

Higher Education: consultation on potential early repayment mechanisms for student loans

University Alliance response, September 2011

1. University Alliance is a group of 23 major, business-engaged universities committed to delivering world-class research and a high quality student experience. Our aim is to deliver evidence-based policy and research and foster close links with Government and business in order to improve higher education policy for the benefit of the economy and society.

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

2. We support the government's aim to ensure that any repayment system maintains the overall sustainability and progressive nature of the new student finance system.

Any student finance system should ensure the following principles are met¹

3. For students
 - the system should maintain access to university for all qualified students
 - no up-front cost, making HE free at the point of supply
 - the system should drive quality and value for money
4. For graduates
 - there should be a maximum liability of repayments for graduates
 - contributions should be on an income-contingent basis so that they relate to earnings and not maximum contribution level
 - low earners and low lifetime earners should be protected
5. For universities
 - the system should bring genuine additional income to universities²
 - further investment possible to improve the student experience
6. For Government
 - the system must be both affordable and sustainable
7. For business
 - the system should enable investment in future high-level skills needs
8. For the public
 - the system should be easily understood and well communicated

¹University Alliance, Proposal for a Graduate Contribution Scheme in England, April 2010

²A baseline should be established, see University Alliance, The impact of fees: A review of the evidence, January 2010

Clear communication is essential

9. As coverage of the reforms to student finance has shown, there is still a significant level of confusion about graduate contributions. If new conditions for early repayment are introduced, it is essential that an effective communication strategy is put in place so that the changes do not deter any students from entering higher education. The campaign recently launched by BIS is an important step forward but, given how ingrained misunderstandings about debt and risk have become, sustained and multi-stranded effort in this area will continue to be critical.

Necessary characteristics of the repayment mechanism

10. The loan system contains considerable insurance elements for graduates. The insurance covers actuarial risks, the 30 year amnesty, interest relief and payment holidays in years of low income (not all repayments will be picked up later because of the amnesty). Graduates contribute to the cost of providing the insurance whenever they pay interest above the government's cost of borrowing. In the present scheme for 2012 onwards, this happens when incomes exceed about £36k. Early repayment of the loan would mean that graduates receive the benefits of this insurance without contributing towards its cost.
11. However, early repayments remain desirable and are to be encouraged by government for two main reasons:
 - It is important to encourage the principle of repayment of debts as a good thing.
 - If someone pays off their loan, the government has a cash-flow advantage, and a reduced risk of default (for actuarial reasons or the 30-year amnesty) and a reduced likelihood of needing to provide an interest subsidy compared with its own cost of borrowing.
12. With this in mind, to maintain the progressive nature and sustainability of the student finance system, an early repayment mechanism should be introduced that:
 - ensures graduates, including those who repay their loans early, have appropriately contributed to the cost of providing the insurance elements of the loan
 - does not act as a disincentive for any individuals wishing to repay all, or part, of their loan early

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?

13. To ensure the sustainability of the student finance system the critical issue that must be addressed is that of the link between public funding and the number of student places that can be provided. The White Paper seeks to address it with proposals such as the creation of a core and margin and uncapping student number controls for AAB+ and equivalent students. These proposals introduce dynamism but, because of the constraints on public finances, result in the removal of numbers from the mainstream of the sector in order to achieve growth of new providers. In the longer term, it is critical that we continue to explore how total growth of the sector can be achieved so that all types of providers can grow where there is strong demand from students – including well-established, popular, mainstream universities offering high levels of value for money for both private and public investment.
14. Can we achieve the separation of some undergraduate numbers from Government subsidy in order to grow the system and achieve a real market in higher education? If we are going to be able to produce the number of graduates we need to stay globally competitive this issue needs to be revisited. Ultimately we need to consider ways to reduce the Government's long-term costs (subsidy reduced) and short-term cost (up-front sale of loan books/encourage up-front and early repayment).

Option A

15. Taking into account the principles stated above, BIS' aims of progressiveness and sustainability and our central concern of ensuring the system is clear and easily understood; of those offered, option A is the preferred model.
16. The percentage charged and the specific limit must be carefully modeled to ensure that there is still a benefit to making early repayments. Charging a certain percentage (e.g. 5%) on all overpayments of fixed limit (e.g. £3000) per year would be the clearest mechanism to communicate. A mechanism that introduces a charge on payments over a certain percentage of the remaining loan could unnecessarily increase the complexity of the system without adding additional benefit.

Alternative model - Minimum interest requirements

17. Professor John Craven, Vice-Chancellor of the University of Portsmouth, has suggested that the following model could be clearly communicated, would maintain the progressive nature of the system and would contribute to the sustainability of the system. The advantage of this model over option A is that there is clearly no disincentive for individuals wanting to repay early, lower earners will not be unfairly 'caught' and no-one will avoid contributing to the cost of the insurance element of the student finance system.

18. His suggestion requires that every graduate should pay at least 15% (or some other figure decided on after modeling) real interest on their initial loan. Interest would continue to accrue as in the present scheme, but no-one could finally pay off their loan without paying at least 15% in total.
19. Most of those who repay through the formula will reach a point where they have paid 15% real interest in total, and they could then repay their remaining balance with a non-formula payment without additional cost.
20. Graduates can make small non-formula repayments without any penalty. They would only pay a penalty if they fully paid off their loans sufficiently quickly that they have not paid 15% real interest in total. The penalty is only explicit in the year in which the loan is fully paid off.

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

21. We support the government's aim to ensure the any repayment system maintains the overall sustainability and progressive nature of the new student finance system. Our previous publications have highlighted the fact that perception of cost can be as much of a barrier as cost itself.³It is therefore of critical importance that an effective communication strategy is put in place so that changes to the student finance system do not deter any students from entering higher education.

³University Alliance, The Impact of Fees: a review of the evidence, January 2010