

To *David Willetts*  
From *XXXXXXXXXXXXXXXXXXXXXXXXXXXX (s40)*  
Date 21.03.2011

## Handling of Student Loan Borrowers with two types of loans

### Issue

1. From April 2016, it will be possible for student loan borrowers to be liable to make repayments for both pre-2012 and post-2012 loans. A decision is required on how repayments collected over £21,000 are apportioned.

### Timing

2. Routine: response required by Friday 25 March, in time for any potential questioning on this issue during Committee sessions of the Education Bill.

### Recommendation

3. That you agree that:
  - Student loan deductions collected between £15,000 to £21,000 will be used to repay the pre-2012 Income Contingent Repayment (ICR) loans; and
  - Any deductions made over £21,000 will repay post-2012 ICR loans

### Coalition Considerations

4. These particular terms and conditions are not covered by the Coalition Agreement.

### Background

5. After April 2016, some ICR borrowers will hold loans under both the pre-2012 and post-2012 arrangements (i.e. different repayment thresholds and interest rates on outstanding loan balances). We need to make decisions now about how we treat the repayments in order to maximise the time available for the SLC and HMRC to implement operational changes, and set out clearly the position and terms for borrowers affected in advance of the issuance of loans.
6. Initial rough estimates suggest that there will be around 100,000 borrowers in this position in total. Examples of those who will be affected are those who:
  - withdraw from study prior to AY 2012/13 and re-enrol in AY2012/13 or later; or
  - pursue a 'top-up' degree from AY2012/13 or later following a substantive break in their studies (i.e. finished their first lower level course in AY2011/12 or earlier); or
  - enrol on a PGCE or equivalent Lifelong Learning Sector Initial Teacher Training (ITT) course in AY 2012/13 and beyond, having completed their undergraduate course in 2011/12 or an earlier academic year.

### Analysis

7. The recommended option entails repayments been collected as normal at 9% of income over £15,000 by employers, and the sum being passed through HMRC to the SLC in the normal way. However, SLC will then divide the sum collected by apportioning the deductions up to £21,000 to the pre-2012 loan, and any excess will be apportioned to the post 2012 loan. Once one loan is paid off or written off, employers will be asked to continue deductions above the appropriate threshold and all deductions will pay off the remaining loan balance until it is repaid in full or written off.

8. In practice this means that repayment for both loans commences at the appropriate threshold and affected borrowers will not be expected to repay any more on a monthly basis than if they only held only the pre-2012 loan. This means that monthly repayments will effectively be 9% of income over £15,000 ensuring we maintain the truly income contingent terms of student loans.
9. The recommendation represents a fair balance, and does not prioritise either loan. This means that we do not allow borrowers to 'escape' their pre-2012 loan obligations (by only seeking repayment at the higher post-2012 income threshold. Conversely, we will not be seen to deny borrowers the opportunity to repay their higher interest post-2012 loans when their income reaches £21,000 which will attract a real rate of interest.
10. We have considered other options which are discussed in more detail at Annex A. A brief outline is given below:
- a) Prioritisation of post-2012 ICR loan
    - Repayment of post-2012 loan prioritised
    - Would undermine cash receipts from loans issued to these individuals.
  - b) Prioritisation of pre-2012 ICR loan
    - Prioritises the lower interest pre-2012 loan held by borrowers
    - Presentationally unfair and onerous for borrowers as it would not allow them to pay off the part of their borrowing which is accruing interest at the higher rate
  - c) Simultaneous repayment of both loans
    - Inequitable and administratively burdensome for HMRC, SLC and employers
    - Simultaneous full repayment of loans could mean borrowers making higher monthly payments ie 9% of income over £15,000, and then a further 9% of income above £21,000 which is unfair.
  - d) Borrower and/or SLC is given flexibility over how to prioritise repayments
    - administrative difficulties and increased costs for SLC through increased process, ICT development costs and customer contact at SLC;
    - does not guarantee fair treatment for all borrowers and some may unnecessarily incur higher costs than other borrowers
11. **Annex A** also provides the financial implications of the options. To judge the fairness of options, including the recommendation, for both the individual and the taxpayer, we have considered whether any of the options result in borrowers of differing incomes (low, medium and high) incurring a significant overall repayment advantage or disadvantage.
12. The analysis confirms that the recommendation ensures fair and consistent treatment for affected borrowers of differing incomes; this ensures the option is fair for individuals, whilst protecting the taxpayer.
13. A blanket application of this principle to all affected borrowers will minimise resources required to develop new systems and processes at Student Loans Company (SLC). SLC also believe that such an approach reduces complexity for borrowers and consequently the requirement for customer contact which contributes to reducing costs. SLC advises that implementation of the recommended option is achievable with some changes to how loans are handled and presented, as well as re-training for SLC staff.
14. This option is attractive to HMRC as it is simple and only involves repayments being collected through a single threshold in these situations. Employers would have some additional stop and start notices to administer when collection moves to the borrower's

later loan; however having to administer repayments on more than one loan simultaneously would impose much greater burdens.

### Resource implications

15. The recommended option is in line with Spending Review 2010 (SR10) assumptions.
16. Based on the estimate of 100,000 affected borrowers, analysis (see **Annex A**) suggests that choosing the recommended option over Option 4 (which appears to be the most financially advantageous option), means that BIS would forego a total saving of around £100m or £1,000 per borrower. However, this would be a windfall saving to the Exchequer (i.e. not assumed in the SR10 settlement) and will only accumulate over the full lifetime of the loans rather than the short to medium-term. In the short-term it would be off-set by additional cash costs to BIS of systems changes at the SLC and HMRC, and further compliance costs for employers. The equivalent figures for Options 2 & 3 are a cost of £900m (due to the amount of pre-2012 loans that middle-earners will see written off) and a saving of £50m respectively.

### Legal

17. Recommended option would require changes to the repayment regulations. The recommendation does not create additional legal risk for BIS.

### Press and Stakeholder Handling

18. Press Office does not think it is necessary to make a proactive announcement about repayment arrangements for those students who have used the pre and post-2012 ICR student loan schemes. We have drafted the following lines for use on a reactive basis:
- Repayment arrangements have been designed to ensure that graduates who took out student loans under the current and post-2012 schemes are not disadvantaged.
  - From April 2016 there will be a group of former students who will be required to make repayments to loans taken out under the pre-2012 and post-2012 schemes.
  - This group will include students who withdrew from study prior to 2012 but have subsequently re-enrolled; have been studying towards a 'top-up degree' from 2012 after a long break in their studies; and those who have enrolled in a post-graduate certificate of education or equivalent initial teacher training course from 2012 after having completed an undergraduate course prior to 2012.
  - The pre and post-2012 schemes have different repayment thresholds: £15,000 for those who began studying prior to 2012; and £21,000 for those who began studying from 2012.
  - From April 2016, when the first group of affected graduates begin to make repayments arrangements have been determined to ensure they are not expected to repay any more on a monthly basis than if they only held a pre-2012 loan.
  - Under these arrangements graduates will continue to make repayments at 9% of income as usual, with repayments on income between £15,000 and £21,000 going towards their pre-2012 loan and repayments on income above £21,000 going towards their post-2012 loan.

### Special Advisors

18. SpAds have not had advance sight of this submission; however, their views and comments are welcomed.

**Cleared by:** xxxxxxxx xxxxxxxx, xxxxxxxx xxxxxxxx (s40)

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## ANNEX A – Repayment & Policy Analysis of options

### Methodology

1. Total repayments for the recommendation (highlighted in pink) and three other options have been forecast for low, medium and high earning borrowers (see 'earnings') who hold pre and post-2012 loans on two borrowing scenarios (see 'scenarios'). See tables 1 & 2.
2. Comparing the forecast repayments across the all four options under both borrowing scenarios modelled, we have sought to identify the option which is fairest for all groups of borrowers – low, medium and high.
3. This means identifying the option which results in no particular extreme benefits or disbenefits for any particular group, whilst maintaining a reasonable return for the taxpayer.
4. Alongside this numerical analysis, policy arguments for and against each option have been considered.

### Why is the recommended option fairest for borrowers and taxpayers?

**NB:** All amounts in the tables below have been discounted to allow like-for-like comparison of the present value of each option. This does not reflect the total time borrowers spend in repayment which differs across the options.

#### Scenarios:

Two scenarios have been examined to illustrate the impact of the options.

##### Scenario A:-

A borrower who takes out loans of £7,000 in 2008, enters repayment in 2010, repays for 2 years before taking out further loans of under the new system - £13,000 in 2012, £13500 in 2013 and £14,000 in 2014 - entering repayment on those loans in 2016. This might be someone who drops out of their first course and then returns to complete a first degree course.

##### Scenario B:-

A borrower who takes out loans of £7,000 in 2008, £7,500 in 2009, £8,000 in 2010, enters repayment in 2012, repays for 2 years before taking out further loans under the new system of £14,000 in 2014, entering repayment on those loans in 2016. This might be someone who completes a first degree then returns to take a PGCE.

#### Scenario A

<b>Earnings</b>	<b>Low</b>	<b>Med</b>	<b>High</b>
<b>Option</b>	<b>Total repayments</b>		
<b>1. Recommended option</b>	£3,455	£29,624	£46,859
<b>2. Collecting above £21k only, and reducing the post-2012 loan balance only</b>	£3,455	£24,985	£42,249
<b>3. Collecting above £15k, and reducing the pre-2012 loan balance only</b>	£3,455	£27,047	£47,784
<b>4. Simultaneous repayment of both loans</b>	£3,455	£29,879	£47,294

## Scenario B

<i>Earnings</i>	Low	Med	High
<b>Option</b>	<b>Total repayments</b>		
<b>1. Recommended option</b>	£3,887	£26,004	£29,008
<b>2. Collecting above £21k only, and reducing that loan balance only</b>	£3,887	£12,382	£28,143
<b>3. Collecting above £15k, and reducing that loan balance only till paid off</b>	£3,887	£27,127	£31,223
<b>4. Simultaneous repayment of both loans</b>	£3,887	£27,524	£30,499

- Option 1 (the recommendation) appears to produce a ‘best fit’ of reasonable outcomes across both scenarios and the range of earnings profiles modelled ensuring that neither the taxpayer nor borrowers are put at a significant advantage or disadvantage. It also maintains integrity of the income threshold for both loans whilst ensuring that the borrower is not forced to prioritise either loan at any stage which neutralises potential accusations of unfairness by BIS.
- Option 2 appears to leave the medium and high-earner significantly better off. This is because whilst they repay their post-2012 loans their pre-2012 system loans benefit from interest subsidy for many years, before they are then repaid in full. This is at odds with our aim of creating a progressive system because it is likely to grant subsidies to better off graduates. In addition, this option is unsound financially (and therefore unfair on the taxpayer) because it minimises repayments from individuals affected, due to the higher £21,000 threshold on the post-2012 loan. This undermines cash receipts from loans issued to these individuals.
- Option 3 does not offer particularly extreme results. However, it is the least beneficial for high earners, because they accumulate more real interest on their new loans while repaying their old ones. This could be viewed as progressive; however, it seems disproportionate when viewed against the other proposed options. This option carries the serious risk of being perceived as unfair and overly onerous for borrowers as it would not allow them to pay off the part of their borrowing which is accruing interest at the higher rate (RPI to RPI +3%).
- Option 4 means that we treat the 2 loans as separate accounts, and deduct 9% of income over £15,000, and 9% of income above £21,000, thereby repaying the loans simultaneously, but effectively deducting 18% of their income above £21,000). This is because their income over £21,000 is double-counted for student loan repayment purposes. Consequently, affected borrowers would make higher monthly payments than an individual with one loan under either regime; this would put medium and high-earners at serious disadvantage, in particular. This means repayment would occur at a much higher rate for affected borrowers than other types of borrowers which is clearly unfair and likely to attract serious criticism. It is clearly indefensible and entirely at odds with our wider policies on student finance which will see the vast majority of borrowers paying off less each month than under the current system. This option would also entail additional administrative complications for both HMRC and graduate employers, who would have to identify which borrowers were affected and apply special arrangements and calculations to their PAYE or self-assessment tax collections. This option is therefore highly undesirable.

5. We have also considered allowing borrowers the choice of how to prioritise repayments. This has not been modelled as we cannot easily predict borrower behaviour under such an option. We have also considered apportioning the payments between £15k and £21k to the pre 2012 account, and then apportioning the balance of the deductions over £21k between the 2 accounts.

Both options are not recommended because of administrative burden and increase in costs for SLC. Granting borrowers flexibility to choose which loan to re-pay first and how to distribute repayments across their outstanding loan balances will increase process and ICT development costs at SLC, and the volume of SLC's customer contact which itself generates additional, avoidable demand on limited resources. Additionally, a flexible approach does not guarantee fair treatment for all borrowers in all circumstances.

## **Earnings**

For each scenario and option, three graduate earnings profiles are considered. RPI is assumed to be 2.75% and average earnings growth 4.75%:

- Low – Earns just above the old threshold for 2 years before returning to higher education, then earns £19,000 in 2016 increasing at 3.5% each year. This graduate will never earn above the new system threshold.
- Medium – Earns just above the old threshold for 2 years before returning to HE, then earns £23,000 in 2016 increasing at 7% each year. This graduate will earn above the new system threshold every year. This graduate could repay both loans in full depending on which example/option is chosen.
- High – Earns just above the old threshold for 2 years before returning to HE, then earns £27,000 in 2016 increasing at 10% each year. This graduate would repay all loans in full.