



National Audit Office

Report

by the Comptroller
and Auditor General

Department for Business, Innovation & Skills

Student loan repayments

Key facts

£46bn

total value of
outstanding student
loans, March 2013

£55bn

total student loans
paid out since scheme
introduction in 1990

35%

the proportion of new
loans BIS does not
expect to be repaid

- £200 billion** projected value of outstanding student loans by 2042
- £21,000** earnings threshold for new loans above which borrowers begin repaying
- £1.4 billion** total repayments collected in 2012-13
- £27 million** total spent by the Student Loans Company and HM Revenue & Customs on maintaining and collecting repayments in 2012-13
- 82 per cent** proportion of repayments collected through the UK tax system in 2012-13 (the rest is collected by the Student Loans Company)
- 50 per cent** estimated proportion of borrowers with new student loans who will not fully repay
- 8 per cent** gap between forecast and actual repayments collected, 2011-12

Summary

1 The government introduced student loans in 1990 to support students, initially for living costs but extended to include tuition fees from 2006. The Department for Business, Innovation & Skills (BIS) is responsible for ensuring that there is an effective and efficient system for collecting student loan repayments from English borrowers and from EU borrowers attending English universities. The Student Loans Company (SLC) and HM Revenue & Customs (HMRC) operate the system for collecting loan repayments.

2 In 1998, the government introduced income-contingent repayment loans, where the level of repayments is based on earnings. The loans previously issued between 1990 and 1998 are known as mortgage-style loans, as borrowers repay a fixed monthly amount over a fixed period. For both loan types, borrowers do not repay unless they earn above a specified threshold. Using its tax systems, HMRC collects repayments on income-contingent repayment loans from borrowers who are working in the UK. The SLC collects all mortgage-style loan repayments and repayments on income-contingent repayment loans from borrowers who are working overseas.

3 The value of loans paid out is substantial and the level of outstanding loans is set to rise significantly. Between 1990 and March 2013, the SLC paid out approximately £4 billion of mortgage-style loans and £51 billion of income-contingent repayment loans. By March 2013, the SLC and HMRC had collected £7 billion of income-contingent repayment loans and £3 billion of mortgage-style loans. The government introduced further changes in 2012, including:

- higher tuition fees funded through student loans;
- a higher earnings threshold of £21,000;
- earnings-dependent interest rates; and
- an increase in the repayment period from 25 to 30 years, after which any remaining balance is written off.

BIS forecasts that these changes will increase the total value of outstanding loans from £46 billion in 2013 to approximately £200 billion by 2042, in 2013 prices. The number of borrowers due to repay is projected to increase from 3 million in 2012-13 to 6.5 million by 2042. The loan book is therefore becoming a substantial public asset.

4 In designing its higher education funding policy, the government anticipated that a proportion of the loans would not be repaid. Repayments for income-contingent repayment loans are based on earnings, so will not be repaid in the same way as conventional loans. At March 2013, the total value of outstanding loans was £46 billion (including interest accrued), but BIS only expects £31 billion to be repaid. BIS forecasts that the proportion of new loans issued in 2013 that will not be repaid is 35 per cent. Following the changes that the government introduced in 2012, students can borrow more and repay more slowly due to the higher earnings threshold, so a greater proportion of borrowers will not repay in full before their loans are written off. BIS estimates that up to half of borrowers with post-2012 loans will not earn enough to fully repay their loans.

5 We examined whether the approach for collecting student loans is maximising the value of the loan book for the taxpayer. In Part Two we examine performance and whether the accountability arrangements incentivise the SLC and HMRC to maximise collections. In Part Three we assess whether there is a robust collection strategy to recover the loans. In Part Four we examine whether BIS can accurately forecast future loan repayments. In Appendices One and Two we set out our audit approach and evidence base.

6 Our report focuses primarily on the much larger income-contingent repayment loans but also covers mortgage-style loans. In November 2013, the government announced the sale of its outstanding mortgage-style loans. The report does not assess the SLC's IT systems. It covers only English loans for which BIS is responsible. The administrations of Wales, Scotland and Northern Ireland are responsible for loan repayments from their borrowers, or from EU borrowers attending university in their geographical areas. All four administrations use HMRC's tax systems to collect repayments.

Key findings

The collection targets set by BIS

7 In 2012-13, the SLC met three out of four targets for collecting income-contingent repayment loans. BIS has set the SLC targets to ensure that as many borrowers as possible are 'in a repayment channel'. This means that the borrower is either repaying on time or not earning enough to repay. For example, in 2012-13, 99.1 per cent of UK resident borrowers were in repayment channels, compared with a target of 98.5 per cent. Of UK borrowers living overseas, 71.5 per cent were in a repayment channel compared with the 73.5 per cent target (paragraphs 2.2 to 2.4).

8 However, BIS has not set a target for amounts collected. BIS considers it would not be meaningful to set the SLC or HMRC an annual target for amounts collected because the level of repayments is affected by graduate earnings and economic factors. While the government publishes an estimate of expected annual repayments and BIS reports actual amounts collected, these figures are reported separately and are not easily understandable. Despite the substantial amounts involved, BIS does not analyse annually whether loan repayments collected differ from its forecasts, or account for any differences (paragraph 2.13).

9 There are no targets for measuring some important areas of performance. Over three-quarters of overdue repayments from borrowers living overseas have been overdue for between one and four years. BIS has not set the SLC a target to reduce levels of older debt for income-contingent repayment borrowers who are behind in repayments. For comparison, private debt collection agencies routinely measure and aim to minimise old debts (paragraph 2.13).

Strategy for maximising the value of the loan book

10 The SLC, BIS and HMRC work together in a joined-up way, and have invested in improving collection processes. The three organisations communicate frequently, including formally through governance boards that also involve the devolved administrations. Since 2008, the SLC and HMRC spent a total of £7 million in improving processes and there is evidence that some initiatives have led to increased repayments and improved customer service. We found that the SLC's approach to managing its processes compares well with other government departments. The SLC has clearly mapped out its processes, and staff understand them. There are opportunities for staff to suggest improvements, and evidence shows that appropriate suggestions have been implemented (paragraphs 3.2 to 3.4).

11 However, the SLC, BIS and HMRC have lacked a jointly-owned strategy for improving collection performance. In 2013, the SLC carried out a strategic review of its repayment collection process, the first review since 2009. The review identified activities to improve performance. However, it does not yet state the level of increased collections the SLC aims to achieve, how individual initiatives are expected to contribute to this improvement, and in what timescale. The SLC has begun to prioritise its initiatives, but has not yet carried out detailed cost-benefit analysis. Although the SLC is developing its strategy, we would have expected BIS, the SLC and HMRC to have had a strategy that they regularly refreshed to reflect the performance improvement they aimed to achieve annually (paragraphs 3.6 to 3.7).

12 BIS has not done enough to establish whether borrowers with no current employment record are earning enough to repay their loans. The majority of borrowers are UK PAYE taxpayers, and their repayments are collected without difficulty. There are two groups, however, where performance is less clear. Firstly, those who are recorded as no longer paying tax and, secondly, those who have never had a tax record: and where in both groups the SLC has no other information on their current earnings. There are three issues here:

- While many of these borrowers may not be earning enough to repay, BIS and the SLC have carried out little analysis to confirm the numbers that might be expected in these categories. Analysis of research conducted by other organisations indicates that some of these borrowers may be working overseas or in the hidden economy. Given the current and projected size of the loan book, BIS has not done enough to understand these categories and establish the level of repayments that might be missed (paragraphs 2.9 to 2.10).
- BIS counts the borrowers who have previously paid tax towards the SLC's 'in a repayment channel' target. A past tax record means that HMRC should identify them if they become employed in the UK, which leads the SLC to categorise these borrowers as not earning enough to repay. But the SLC does not have evidence that they are not, for example, working overseas. If these borrowers are not counted as being in a repayment channel, the proportion of borrowers in a repayment channel falls from 99 to 86 per cent (paragraphs 2.8 and 2.11).
- In March 2013, 157,000 borrowers had had no employment record for over a year. The SLC writes to these borrowers at least annually but takes limited further action to pursue them as it judges this would not be cost-effective. By improving information on borrowers, it could make more informed judgements about where to invest to maximise recovery (paragraphs 3.15 to 3.18).

13 The SLC has faced challenges in collecting mortgage-style loans. Two tranches of mortgage-style loans were sold in 1998 and 1999, leaving a residual loan book of poorly-performing loans. While the SLC tried to contact all borrowers with overdue repayments, BIS and the SLC decided not to pursue litigation for debts where they judged there would be a low likelihood of recovery. Consequently, some borrowers neither made repayments nor acknowledged their debt within a six-year period. As a result, £127 million may become 'statute-barred' meaning that the borrowers would not legally have to repay the loans. BIS informed us that, to date, £2 million has become uncollectable because of this issue (paragraph 2.5).

14 The SLC is not maximising recovery of overdue repayments on income-contingent repayment loans. For borrowers living overseas, the SLC collects repayments directly rather than through the tax system. At March 2013, 14,000 borrowers living overseas were behind on their loan repayments. While recognising this group is small compared to the total number of borrowers, the SLC could take a more targeted approach to collection of these arrears. For example, it does not prioritise these debts by value or age, or tailor its collection approach by previous repayment behaviour or likely ability to repay. The SLC has successfully used debt collection agencies to improve returns but currently uses agencies to recover only the most difficult to collect debt (paragraphs 3.13 to 3.14).

Forecasting repayments

15 BIS's projections of annual loan repayments have consistently been higher than amounts collected. Reliable forecasts of repayments are required for a robust valuation of the loan book. BIS forecasts repayments by using information about graduate earnings to estimate how much of their loans borrowers will be able to repay and how quickly. BIS has faced difficulties in accurately forecasting repayments of these complex loans, and in 2009-10 forecasts were nearly 20 per cent higher than amounts collected. BIS has since improved its forecasting methods but still consistently over-forecasts how much it expects to collect annually by around 8 per cent. For example, in 2011-12, BIS's forecast was £111 million higher than the amount collected. BIS has not explained differences between actual and forecast repayments (paragraphs 4.6 to 4.7).

16 BIS recognises that it needs to improve its forecasting. BIS aims to improve forecasting by using more detailed information on borrowers' earnings to project future earnings and repayments. Its current modelling does not include factors that can affect how quickly a borrower's salary will rise, such as the subject they studied or the university they attended. Analysis of the data indicates that there is a correlation between these factors and future earnings (paragraphs 4.12 to 4.15).

Conclusion on value for money

17 Using HMRC's existing tax system brings clear benefits for efficient collection from borrowers who work and pay tax in the UK. BIS, the SLC and HMRC also work together in a joined-up way. But BIS needs to make better use of data to drive its collection strategy and better understand where it could invest to maximise the value of the loan book. Differences between actual and forecast loan repayments indicate that the loan book is not performing as BIS expected.

18 Given the expanding size of the loan book, BIS now needs to take a more energetic and thought through approach to maximising its value to the taxpayer, irrespective of whether it chooses to retain the whole loan book or sell tranches to investors at anything like a fair price. Until BIS has a robust strategy for maximising collection, improves its information on borrowers, and can more accurately forecast how much should be collected each year, it is not well placed to secure value for money.

Recommendations

19 BIS urgently needs to understand how the loan book is performing and how it will perform, when the value of outstanding loans is projected to increase substantially. Our recommendations are set out below:

- a** **BIS should publish a transparent and readily understandable forecast for the amount it expects to be collected each year and report on any variance.** We recognise that the amounts collected may, in part, differ from forecast due to fluctuations in the economic climate and therefore be beyond BIS's direct control. However, it is important for BIS to explain to what degree it is able to track and account for such variances and demonstrate that it has a good understanding of how the loans are operating.
- b** **BIS does not currently set a collections performance target to incentivise the SLC and HMRC to maximise recovery of repayments.** To improve accountability, BIS should do the following:
 - Ensure targets are transparent and that performance is reported accurately against them.
 - Develop a collections strategy and identify specific compliance activities with the SLC and HMRC to deliver against this target. This could include pursuing overdue repayments, establishing whether borrowers are due to repay and reducing the level of older debt.

- c BIS lacks sufficient information on whether borrowers with no current employment record are earning enough to repay their loans.** In particular, BIS should do the following:
- Carry out analysis to better understand the circumstances of borrowers in this category, particularly those who remain without a UK employment record for longer periods, and to assess the level of repayments that may be lost.
 - Work with other government departments to develop a strategy for sharing data that provides opportunities to gain information on the circumstances of specific borrowers, for example those who have not had an employment record for long periods. Given the projected size of this public asset, other departments should consider how they can support BIS and the SLC.
 - Target borrowers where there is a greater risk that they could be avoiding repayment. For example, those whose degree subjects or universities indicate they are more likely to be earning above the threshold or pursuing careers overseas.
- d Around 14,000 borrowers living overseas are currently behind in their loan repayments.** While this group is small compared to the total number of borrowers, the SLC could learn more from other organisations that collect debt. For example, it could explore whether the following actions could improve efficiency:
- prioritising debts by, for example, value of arrears, total value of loans outstanding, age of debt;
 - tailoring its approach by analysing borrowers' previous repayment behaviour; and
 - using debt collection agencies more, particularly those with experience in pursuing debtors living overseas.