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

A Response by Credit Action

Background

Credit Action is a national money education charity (registered Charity in England & Wales No. 1106941) established in 1994.

In January 2009 we also created our dedicated Welsh arm, Credit Action Cymru.

We offer a range of resources, tools and training to help everybody handle their money well, and to inform consumers so that they can make informed decisions about their personal finances.

Credit Action operates at a national level through advocacy, collaboration and partnerships with various groups and companies as well as at a local level through a variety of targeted projects, with a particular emphasis on those most vulnerable to financial difficulties and over-indebtedness. Through its work Credit Action reaches over 650,000 UK citizens every year.

We try and help as many people as possible avoid the pain of debt. However we recognise many contacting us will be in trouble already, so we work in partnership with the major debt counselling charity the Consumer Credit Counselling Service (Registered Charity No. 1016630).

Opening Comments

Credit Action has considerable experience of working closely with young people and university students, and runs a wide range of projects to help them develop the financial knowledge and capabilities necessary for independent living. These programmes include *DebtCred* (which introduces 11-16 year olds to the financial issues that they will need to deal with in the future) and *Future Ready* (which works with 16-19 year olds in colleges and sixth forms in order to equip them with the financial skills that are essential in adult life). We also produce a Student Moneymanual which provides advice and guidance about financial matters to students, and is distributed by UCAS to successful university applicants across the country.

In the 2010-11 academic year we delivered *DebtCred* to 8,600 pupils and *Future Ready* to 6,105 young people, while our Student Moneymanual reached 430,000 university applicants. We also undertake a variety of programmes to help consumers more generally with the financial issues they are likely to face in everyday life, and will therefore remain a source of support for today's prospective students once they reach the point of repayment after graduation.

As an organisation, Credit Action therefore takes a great deal of interest in developments in Higher Education policy, and how such developments are likely to impact on students before, during and after their studies. One of the core objectives of our advocacy work is to see that students and graduates receive a fair deal, and consequently we believe that it is vital that they are able to make loan repayments through a simple and transparent system. We have previously commented on what we perceive to be shortcomings in the existing repayment system, and are keen to engage with Government to ensure that reforms to these arrangements deliver the best possible outcomes for graduates and avoid creating detriment.

The proposed early repayment charge is something that we see as particularly contentious, and in this response we outline our reasons for opposing the introduction of such a mechanism. The focus of our submission is therefore on answering the first of the consultation's key questions.

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

Credit Action has a number of reservations about the proposals put forward by BIS for an early repayment charge for student loans. In our view, there are four issues in particular which represent significant areas of concern.

Firstly, we believe that there are genuine questions over whether the Student Loans Company (SLC) has the capacity to take on the administration of an early repayment mechanism, especially given its poor track record in recent years. Secondly, we find the principle of applying a penalty to those who are seeking to clear their debts to be extremely problematic, and feel that the proposals could hinder efforts to promote constructive attitudes towards debt in the future. Thirdly, we believe that there is a risk that the early repayment mechanism could result in student loans becoming more expensive than some commercial alternatives, which would have implications for the overall viability of the system. Finally, we are also uncomfortable about the prospect of adding further complexity to the student loans system, and the potential impact this could have for borrowers.

We will expand on each of these points in the course of our response. Ultimately, we see the introduction of an early repayment charge as something which has the potential to create considerable levels of detriment for graduates, and would urge Government to explore other options for establishing a progressive system for graduate contributions.

The fact that implementing an early repayment penalty will inevitably place greater pressure on the SLC is, in our opinion, a central weakness of the proposals. The consultation itself admits that introducing this mechanism will 'impose an additional administrative burden on the SLC' (page 6). In recent years, the SLC has had a very poor track-record of delivering a timely and accurate service for graduates. In July 2011 it was reported that 40,500 graduates were overcharged by £22.3 million during the 2010-11 financial year (an average overpayment of £557 per affected graduate).[1]

We ourselves have previously produced a report which concluded that if student loans were subject to the Consumer Credit Act, they would fail to satisfy all of the criteria necessary to be deemed a viable credit product due to several factors.[2] These include:

- The infrequency of the account statements which the SLC is required to send to graduates (commercial lenders must provide borrowers with statements on a regular annual basis, but the SLC does not always meet this standard).
- The SLC's inability to provide borrowers with up-to-date loan balances, leading to an unsatisfactory situation where graduates are have to monitor their own repayments to establish how much they owe (commercial providers must be able to provide borrowers with a statement, upon request, which outlines how much is required to settle an agreement).
- The subsequent risk that graduates may overpay their debt due to a lack of clear information around the precise extent of their obligations.

We recognised in this report that the SLC was not solely responsible for these problems, and that any solution needed to encompass a broader range of organisations as well (for example, improving communication between the SLC and HMRC was identified as a key priority).

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[1] MoneySavingExpert.com, *40,000 urged to reclaim £22m in student loan overpayments* (28 July 2011), available from: http://www.moneysavingexpert.com/news/loans/2011/07/student-loans-company-takes-22m-in-overpayments

[2] Credit Action, *Credit Action and Student Loan Repayment*, available from: http://www.creditaction.org.uk/policy-research/research/credit-action-and-student-loan-repayment.html

However, such issues do illustrate the limitations of the SLC's administrative processes. Consequently, we fear that requiring the SLC to take on the additional burden of overseeing the early repayment mechanism will place it under considerable strain and lead to further negative outcomes for graduates, rather than enabling the SLC to drive improvements in its existing systems.

The very concept of penalising those who seek to repay debt early is also something that we have profound concerns about. While we recognise that the Government's overall aim is to create a progressive system for graduate contributions, and that it views the introduction of an early repayment charge as a way of facilitating this, bringing in such a mechanism will have the end effect of locking many graduates into long-term debt. We seriously question whether this is an appropriate and sustainable foundation for the student repayment system.

Indeed, Martin Lewis of MoneySavingExpert.com (who has campaigned strongly on this issue) pointed out earlier this year that the practice of applying repayment penalties is one that Government has actually been opposed to in a private sector context in recent times, commenting that:

> Only a few years ago commercial lenders were banned from levying harsh redemptive penalties and keeping people locked into loans. This year we've seen regulators forcing personal loan providers to allow individuals to overpay their loans if they want to.
>
> For the government to do the opposite on its own loans, in an even harsher manner, sets a poor precedent.[3]

[3] MoneySavingExpert.com, *Student loans – the seven deadly sins of early repayment penalties* (22 March 2011), available from: http://blog.moneysavingexpert.com/2011/03/22/student-loans-the-seven-deadly-sins-of-early-repayment-penalties/

In Credit Action's view, holding significant levels of debt for an extended period of time should be avoided wherever possible, and consumers should always be encouraged to repay their debts as quickly as they are able to. This is one of the most basic principles of good financial management – since being established in 1994, we have continuously advised those who have come to us for support that they should attempt to pay down debt as soon as they can, a message that we continue to put forward today.

Crucially, one of the great virtues of early repayment is that it enables consumers to avoid the debt multiplier effect created by interest rates. Given that the new system for student loans will see real rates of interest being applied for all those earning over £21,000, we see it as deeply unfair that graduates should be penalised for doing something that in almost all other circumstances makes good financial sense.

Therefore, removing the option of early repayment will not only mean that graduates lose a vital element of control over their personal finances, but will actually disincentivise good financial behaviour. We fear that this has the potential to send a deeply unhelpful message to young people about how to handle debt in the future.

As an organisation, we feel strongly that there needs to be a significant change in the way that we as a society think about and deal with debt. Using the latest available figures, we estimate that total personal debt in the UK stood at £1.451 trillion at the end of July 2011.[4] If this is to be brought down, there needs to be a fundamental culture shift towards repaying debt as soon as you are able to. While this practice has gradually become more widespread following the economic difficulties of the past few years, such a change in outlook still needs to be embedded over the long-term.

An essential aspect of this is ensuring that young people receive strong and consistent messages about how they should approach debt. However, introducing an early repayment charge on student loans (which for many young people will be the first major financial undertaking of their lives) risks

[4] Credit Action, *Debt Facts and Figures – September 2011*, p. 1

instilling the perception amongst a generation of graduates that the early repayment of debt in general is not something to be seriously considered. As already suggested, this is completely at odds with the principles of sound financial management. We are therefore worried that an early repayment penalty has the potential to be severely disruptive to efforts to achieve broader attitudinal changes with regard to debt.

In addition, we are also concerned about the possibility that student loans may become more expensive than certain forms of commercial credit if an early repayment charge is introduced. It has been suggested that if the terms of student loans provided by the Government become too punitive for borrowers, it could potentially mean that prospective students will seek finance from other sources. Martin Lewis for example, in the same piece referred to earlier, has noted that:

> [Under the new student loan system a] combination of higher interest rates and the inability to repay would actually mean some, who know they'll earn more, would be better off with commercial borrowing, such as 0% credit cards or low interest loans without repayment penalties.[5]

If this ultimately proves to be the case, the early repayment charge could prove to be self-defeating. Were it to cause prospective students to begin bypassing Government loans entirely and seeking private finance to pay for tuition then their loan repayments would be completely lost to the state. It is important to recognise that ensuring that student loans offer more favourable terms than the best commercial alternative is in fact crucial to the viability of the entire system, and we are concerned that an early repayment mechanism has the potential to undermine this.

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[5] MoneySavingExpert.com, *Student loans – the seven deadly sins of early repayment penalties* (22 March 2011), available from: http://blog.moneysavingexpert.com/2011/03/22/student-loans-the-seven-deadly-sins-of-early-repayment-penalties/

Finally, we would stress that we are uneasy about the prospect of an early repayment mechanism introducing additional complexity to the student loans system. The consultation itself notes that this is one of the possible disadvantages of the proposals (page 6). Credit Action is committed to educating consumers and supporting them in making informed financial decisions. Consequently, we will always advocate simplicity and transparency around both the terms of a particular financial product and the way in which these are explained to consumers. We therefore feel that Government should be extremely wary of introducing a mechanism which it openly admits will increase the complexity of the student loans system.

In summary, Credit Action has a number of serious concerns about the Government's proposals for an early repayment penalty, as outlined in this response, and we do not believe that such a mechanism should be introduced. If the Government is committed to creating a progressive system for student loans, we would therefore urge it to examine alternative means of doing so.

Contact

For further information on any of the suggestions made in this response, please contact John Davies or Liz Dunscombe by email at office@creditaction.org.uk or by telephone on 0207 380 3390.