Response to Department of Business Innovation & Skills:

Freezing the student loan repayment threshold

The Money Charity is the UK's leading financial capability charity.

We believe that being on top of your money means you are more in control of your life, your finances and your debts, reducing stress and hardship. And that being on top of your money increases your wellbeing, helps you achieve your goals and live a happier more positive life as a result.

Our vision is for everyone to be on top of their money as a part of everyday life. So, we empower people across the UK to build the skills, knowledge, attitudes and behaviours, to make the most of their money throughout their lives.

We believe financially capable people are on top of and make the most of their money in five key areas:

- Planning (including budgeting)
- Saving
- Debt
- Financial services products
- Everyday money (including wages, cash, bank accounts)

Introduction

1. Student Loans have not often been out of the news since the current system was introduced in 2012. The idea of burdening students with tens of thousands of pounds of debt has been vehemently opposed by many. When this system was introduced, government ministers were keen to point out that the debt itself was not as important as the repayment terms. Because students would only repay over a certain threshold, at a set rate, this was not so different from a graduate tax, and should not be thought of like other debt. David Willets set out the following:

   "…our graduate repayment scheme is closer to – it's not exactly the same – but it's closer to the income-tax end of the scale than the credit-card end of the scale[1]."

2. There is some merit to this argument. Many of the scare stories were disproportionate to what the loans would actually do to graduates' finances. But this defence is only sustainable if students and graduates can trust the terms and conditions loans are offered on. The partial sale of the student loan book and the changes proposed in this consultation begin to undermine this trust.

3. The ability to plan is a central part of financial capability and going to university is a huge financial decision. English students entering university in 2016/17 year will potentially have more than £50,000 of debt when they leave. Regardless of the terms and conditions, this is nearly half the average mortgage, so may deter people from going to university on purely financial grounds. If terms and conditions have changed, and might do so again, £50,000 becomes a lot more frightening and undermines people's capacity to plan for the long term.

4. If the threshold and rate at which that sum is payed back is subject to the whim of any incoming government, prospective students will rightly fear this debt and existing debtors will live in insecurity.

[1] http://www.theguardian.com/politics/2011/nov/20/david-willetts-university-student-loans-debt

Question 1: Please could you provide your views, stating reasons and providing supporting evidence, on;

Keeping the threshold of £21,000 the same for all post-2012 borrowers until April 2021

5. We oppose this option fundamentally, and set out our reasons for doing so below.
6. Holding the student loan repayment threshold at £21,000 until 2021 would be a dangerous breach of trust between the government and holders of student loans, setting a precedent that will place a generation of graduates in financial uncertainty. Students were told on the introduction of the current system that:

   'We will increase the repayment threshold to £21,000, and will thereafter increase it periodically to reflect earnings. The repayment will be 9% of income above £21,000, and all outstanding repayments will be written off after 30 years[2].'

   These promises were the defence of the initial system, the features that meant that student debt was not like credit card debt and was more like a tax.

7. Freezing the threshold sounds undramatic, and while it will have significant effects is not likely to prompt as much opposition as a change to the rate off repayment. But this first change to terms and conditions will be seen as a thin end of the wedge, giving current and future borrowers ample reason to fear that repayment rates will change as well.

8. When debts are tens of thousands of pounds, the uncertainty will necessarily result in financial insecurity and undermine people's ability to plan.

9. The change will deter students, particularly those from low income households. Not only government ministers, but high profile defenders of the student loans system such as Martin Lewis claimed that people should not think about the money borrowed but the terms at which the sum would be be replayed:

   'Student loans are really a 9pc marginal rate tax'[3].

   These arguments have meant that up until now, students from low income households have not been deterred from attending university[4]. However, if over the 30 year duration of a loan, borrowers cannot trust that thresholds and repayment rates will remain as initially agreed, the sum borrowed becomes much more important. The government wants people to consider the actual terms and rate of repayment when taking a student loan, rather than the sum borrowed. But the threat of a change in the terms and conditions means families will have to consider the sum – the more they owe, the greater their exposure to any detrimental change.

10. If these loans were made by a private lender, the changes would lead the FCA to define them as an '*unfair contract*'. A lender offers an unfair contract if it:

---

[2] https://www.gov.uk/government/speeches/statement-on-higher-education-funding-and-student-finance--2
[3] http://www.telegraph.co.uk/finance/personalfinance/10245550/Martin-Lewis-Time-to-stop-calling-student-loans-a-loan.html
[4] https://www.ucas.com/corporate/data-and-analysis

'Change[s] the terms of the contract, without transparently setting out the circumstances in which they may do so.'[5]

While the government did reserve the right to change the terms of loan contracts, it has never set out the circumstances in which it would choose to do so.

11. Because the Government would not allow a private sector lender to change the terms and conditions of a loan after it had been made, and the ability of the government to do this on student loans has not been well advertised. Families and students will be used to the regulated practice in the financial sector, will not foresee this change and will reasonably have planned on the basis of the current terms and conditions.

12. This change will disproportionately affect lower income graduates. The choice the government will be making if it takes option 1 is to shift the cost from the tax system at large, where the rates are progressive, to graduates. As the impact analysis set out in the consultation paper shows, those earning just above the threshold will pay the same additional £306 a year by 2021 that those on considerably higher incomes do - a regressive affect. This will be compounded by the savings that higher income graduates will get by paying off their loan faster and accruing less interest. The progressive nature to the current student loans system was stressed repeatedly in its defence back in 2012. David Willets claimed then that:

    'The Government is committed to the progressive nature of the repayment system'[6]

    If this remains the case, option 1 would undermine this commitment.

13. The fear of debt will be exacerbated by this kind of change, making families' financial decision making much harder. Scare stories, which government spokespeople and the Student Loans Company were previously able to justifiably debunk will become much more convincing. Parents may make misinformed decisions to save up for their children's tuition fees or encourage their children not to attend university simply because they fear further changes, even if these never materialise.

14. The government appears to have chosen freezing the threshold as its means of cost reduction simply because it sounds undramatic and its consequences are opaque, not because it would be the fairest way of doing so. We would not support any change to the terms and conditions of existing loans, but if this is done, it ought to be done on the same progressive principles claimed on the system's introduction, not simply in the way that creates the least opposition.

15. Like so many things in life, breaking a promise is hardest the first time. It seems unlikely that the fiscal situation will be significantly looser in 2021 and a continuation of the freeze will not be as politically difficult as it is today. Students repay their loans for up to 30 years, so deserve clarity over a longer period than five years.

---

[5] https://www.the-fca.org.uk/unfair-contract-terms?field_fcasf_sector=221&%20field_fcasf_page_category=unset
[6] https://www.gov.uk/government/speeches/statement-on-higher-education-funding-and-student-finance--2

For borrowers starting in September 2016 (and subsequent intakes), from April 2020 keeping the threshold at the same level as existing borrowers for a further five years

16. This *stream not stock* approach would avoid breaking trust with people who have already taken out loans. So the Money charity cannot object to it on financial capability grounds. However, there are equality issues to this option which can be found in our answer to question 3.

Allowing the threshold to rise by earnings

17. Keeping the promise to raise the threshold is the right principle. It would maintain trust and underline the positives of the current system. For these reasons, option 3 is the choice that The Money Charity can support.

18. The claim that changes to the student loan system's terms and condition need to occur in order for it to be affordable are contingent on there not being political will to continue to make up the shortfall through general taxation.

19. Shortfalls in loan repayments against projections stem from inaccurate forecasting. To make lower income graduates pay disproportionately for this mistake is unjustified.

20. The other two options above would essentially allow fiscal drag to bring lower paid graduates into repayment – a situation akin to imposing tax on this group. We do not see any reason aside from the cosmetic for taking these options rather than simply continuing to fund shortfalls through the tax system, or even imposing a higher rate of tax. Doing this would not undermine trust in the student loans system system and increase the fear of debt in the same way.

Question 2: What risks and impacts do you think that holding the threshold at the same level for five years would have for;

Current students/ borrowers?

21. Retrospective changes for students who agreed their loans between 2012 and 2016 will worsen the financial position of low and middle income graduates while allowing their high-income peers to pay their loan off faster, accruing less interest.

22. Just as importantly as the material consequences of the change, the breach in trust will leave this cohort uneasy about financial planning. For them, the possibility of further changes, perhaps significant, to the rates and thresholds will loom. This insecurity is likely to affect savings, house purchases and other large financial decisions.

23. The ability to borrow will be affected both through the diminished post-tax income of graduates and the uncertainty about terms and conditions going forward.

24. Higher wage growth than predicted may lead to a larger fiscal drag than is projected.

25. On a wider level, if every time a government makes a promise and revises it because their projections were wrong, trust in the state will be undermined.

Prospective students/new borrowers?

26. As previously argued, the 2012 system may not have undermined the growth in student numbers or the expansion of access for low-income students, but continually growing loans and worsening terms and conditions will eventually do this.

Employers of borrowers with loans?

27. To some extent, employers have to take into account the amount they have to pay their employees to live. With worsening terms and conditions of the loans, there will be more pressure on employers to make up the shortfall.

28. As a result, adding the larger student loan repayments to PAYE will make graduates less competitive in the workplace - they will need £306 a year by 2021 on top of what a non-graduate is paid in order to receive the same take-home wages.

The Tax-payer?

29. Tax payers will benefit - provided they are not one of the lower income graduates who will pay the most as a result of this change. But this will come at the cost of a regressive change and a breach of trust that undermines confidence in the SLC and government more generally.

Questions 3: Can you identify any equality issues introduced by these possible changes?

30. The key equality issues introduced option 1 are as follows:
    a. Shifting the burden of meeting the shortfall in receipts from general taxation to graduates, particularly lower income ones.
    b. Allowing higher income graduates to pay off their debts quicker, accruing less interest.

31. Option 2 would be regressive and would be seen as foreshadowing further deteriorations in terms and conditions. This would also exacerbate the generational unfairness that already exists in the student loans system: making today's and tomorrow's students pay while previous cohorts either received free education or had smaller loans.

32. Because the shortfall in the student loan book is currently made up by the taxpayer, (many of whom are older graduates), the current situation in some way compensates for this generational unfairness. To shift more cost onto future graduates would compound it.

33. The current system might not yet have reached the point where it prevents students from low-income families from attending universities, but continuously growing loans and worsening terms for new students will test people's limits and, at some point, will undermine the government's aim of encouraging this group into higher education.

Question 4: Do you think the Government could mitigate the impact of the proposed change on borrowers?

34. The problem with having broken trust with option 1 is that future promises not to further worsen the terms and conditions of the loan will not be believed unless they are written into law. For this reason we would ask that if there is a change, the loans are treated as they would be if they were commercial arrangements – graduates should be assured that the terms they borrowed on will not change. This can only be done by writing this into law.