

Credit Action and Student Loan Repayment

Abstract

Credit Action has recently undertaken research into the way that income contingent student loans are repaid. From conducting this research Credit Action is concerned that a government subsidised loan does not meet the criteria required by a commercial loan. Identified below are the three main problems with the current repayment system:

- i- Statements sent to graduates in repayment status, often lack regularity and relate to previous repayment periods.*
- ii- Because of the relationship between SLC and HMRC, SLC cannot provide up to date loan balances and students can potentially overpay.*
- iii- The interest rate applied to loan balances is announced in March and then not applied until the following September. Also this year when the RPI turned negative, the interest rate applied to student loans was not similarly changed.*

Introduction

Increasing levels of financial education and financial capability have been hot topics in the UK in recent years. Organisations like Citizens Advice have been advocating clearer and fairer regulations and information to safeguard consumers and Pfeg has been advocating the compulsory teaching of financial capability in schools. The Financial Services Authority's (FSA) Moneymadeclear programme, the government's Financial Inclusion Taskforce, and the revisions to the Consumer Credit Act in 2006 have all been designed to increase levels of financial capability in the UK, increase transparency in financial information, and educate the UK population on money matters.

Credit Action is pleased that progress is being made and efforts are being taken at different levels to increase levels of financial capability, and to make the world of money and finance less jargon laden, more transparent and simpler to consumers.

One area where Credit Action is undertaking work to promote financial capability is with the student population. Credit Action provides a Student Moneymanual to every student that gets accepted onto a university or college course, providing information on all aspects of student finance, but also with information and tips on the importance of budgeting, and how to use credit wisely. A credit product that the majority of students are familiar with is the student loan, which is now available to students for both tuition fees and living costs.

In 2008 there were approximately 1.09 million British full-time undergraduate students in the UK¹ and a key question for these students and for students who will be starting university in September is 'how can I afford to go?' Student finance, in the form of loans, grants and bursaries is not a new phenomenon, but it is one that is often changing, bringing in new products and services to suit the student population. Of the undergraduate students studying full-time in England in 2008, approximately 80% of those eligible had taken out a loan for maintenance². Separate research conducted by NUS and HSBC in 2008 interviewed a sample of students and found that 3 in 4 prospective students planned to take out such a loan to cover their living expenses. It seems true to say that 'taking out a student loan is an almost universal step for students'.³

Credit Action believes it is vital that a financial product being used by such a large proportion of young people, many of them gaining their financial independence for the first time should be clearly administered and repaid in a manner that is clear, simple and easy to understand. As students starting university this September could typically owe £23,500 upon graduation,⁴ it makes sense for students to be able, as easily as possible, to pay back the money they have borrowed. As previously highlighted, as work is being carried out in other areas to increase levels of financial capability, it seems paramount (and indeed logical) to make sure that millions of students are given a financial product which aids their financial capability and which is a good introduction to credit agreements that they may enter into later in life.

Although Credit Action is not critical of the terms of repayment, we are particularly concerned that government subsidised student loans are not required to meet the same criteria and standards in keeping borrowers informed as commercial loans. Credit Action realises that the concerns highlighted here are not the sole responsibility of the Student Loans Company (SLC) and we would be reticent to blame the SLC for these areas which we believe need improvement, or to charge the SLC alone with providing a solution.

An overview of how the current system works⁵

When a student takes out a student loan for maintenance or tuition fees, or both, they are informed by the SLC that they will be sent statements every year, to bring the student up to date on the amount they have borrowed, plus the interest. Statements will continue to be sent to the student on an annual basis. When the student graduates the SLC writes to the graduate telling them how loan repayments will be collected. Graduates are not due to start repaying their loan until the following April. As the loan is income contingent the graduate will not start to repay the loan until they are earning over a certain threshold- at the moment this is set at £15,000 a year. Once earning over this threshold, employers will deduct 9% of graduates' earnings. For example a graduate earning £18,000

¹ http://www.hesa.ac.uk/dox/pressOffice/sfr130/sfr130_table1.pdf

² Student Loans Company, Statistical First Release, SLC SRF 05/2008, 27 November 2008.
<http://www.slc.co.uk/pdf/slcsfr052008.pdf>.

³ NUS/ HSBC Student Research, August 2008, Page 8.

⁴ Push – the university guide estimates this in their Student Debt Survey.

⁵ A more detailed explanation of how the current repayment system operates can be found in Student Loans: A guide to terms and conditions 2009/10.

a year will pay 9% on the amount that they are earning over the threshold, in this case £3,000, which equals repayments of £22.50 a month.

Employers take the loan repayments from the graduate's salary at the time that other deductions, such as tax and national insurance are made. At the end of every tax year these payments are then sent from the graduate's employer onto HM Revenue and Customs (HMRC). HMRC then send this information onto the SLC which then calculates the repayments that the graduate has made to pay off their loan (bearing in the mind the interest that has been accrued on the outstanding balance in the last 12 months.) After this has been done the SLC will send a statement to the graduate detailing their new balance.

The interest rate that is applied to income contingent student loans is tied to the RPI, so that students should never have to repay more than they have actually borrowed in real terms. The interest rate is determined either by using the rate of the RPI in March, or as was introduced for the first time this year, the interest rate is calculated by collating the highest base rate of a number of major banks plus 1%. Whichever is the lower is applied to student loans from the following September.

In light of this being the operational model of the system in theory, Credit Action has identified three key problems with the current loan system in practice, which we believe causes graduates to become disassociated from repaying their debt. As the student loans that have been available to students since 1998 are classified as 'low cost' under section 16 of the Consumer Credit Act 1974, they are consequently excluded from being subject to the conditions that commercial loans are. This prompted us to examine these three areas, particularly asking if the student loan was subject to the Consumer Credit Act, would it satisfy all of its conditions to be a viable credit product.

1. Infrequency of statements

The SLC say that graduate will be provided with an annual statement advising them of their outstanding balance, interest added and, if applicable, any repayments that have been made. However, the SLC is reliant on HMRC to provide information about repayments made, which can then be included in the statement. Yet, this is where student loans first fall foul of the Consumer Credit Act.

The revisions to the 1974 Act made in 2006 specifically mention in Section 6 (section 77 in the 1974 Act) the duty of creditors to provide information to debtors on an annual basis. Indeed this particular section of the act was amended because it was felt that there was detriment to consumers, as there was a lack of transparency in the state of the borrower's accounts.⁶

Yet loan statements are often few and far between. Because of the system of HMRC receiving the payments from a graduate's employer at the end of every tax year and because in England alone there were 1.42 million income contingent loans in repayment status in 2008-2009,⁷ HMRC are clearly inundated with such a large volume. It is normal that a statement for a specific period will

⁶ Explanatory Memorandum to the Consumer Credit (Information Requirements and the Duration of Licenses and Charges) (Amendment) Regulations 2008 No. 1751, 7.3.

⁷ Student Loans Company, Statistical First Release, SLC SRF 02/2009, 25 June 2009, <http://www.slc.co.uk/pdf/slcsfr022009.pdf>.

arrive several months after the repayment period has ended, for instance a statement for the previous tax year, ending in March is not likely to arrive until the summer, meaning that it is already some time out of date. It has also been the case that statements do not arrive at all; one Credit Action employee received no statements in over two years post graduation.

The SLC admit that although it tries to send out statements on an annual basis, this is not always possible because of the repayment system.⁸ Credit Action also appreciates that the SLC does not have an easy job sending statements to a demographic that often moves and does not inform the SLC of the new address.

Credit Action is concerned that a government subsidised loan does not meet the minimum criteria required by a commercial loan. If the SLC was regulated by the Consumer Credit Act, failing to provide statements on a regular annual basis would mean that the agreement was unenforceable and the debtor (the graduate) would not be liable to pay interest on the balance during this period of non compliance.⁹

2. Inability to provide loan balances and the possibility of overpayment

As the SLC cannot provide up to date loan balances, it is possible to overpay a student loan, as the SLC cannot “make sure your repayments will stop at the right time (without your help)”¹⁰ Instead the SLC recommends that as it does not receive repayment details from HMRC until after the end of each tax year, it is important that graduates monitor their own repayments, keeping track of their balance so they know when they are due to finish repaying.

Credit Action believes it is unsatisfactory that graduates are expected to monitor their own repayments to establish how much they owe. Currently a graduate must keep all payslips and track how much has been repaid. Whilst it is possible to do this through the student loans repayment website, this process can be arduous and is poorly promoted.

Section 97 of the 1974 Act details that a borrower can request from their creditor a statement detailing how much would be required to settle their agreement. The content of the settlement statement is prescribed by the Consumer Credit (Settlement Information) Regulations 1983¹¹ which says that the creditor, when issuing this requested statement, must tell the debtor the total amount payable they need to pay to no longer be indebted. Yet because of the rather complicated repayment system, the SLC cannot do this – the second instance where it falls short of the regulations which regulate commercial credit products.

⁸ See www.studentloanrepayment.co.uk.

⁹ Section 77A (as amended) of the 1974 Consumer Credit Act.

¹⁰ Student Loans: A guide to terms and conditions 2009/10, page 23.

¹¹ The Consumer Credit (Settlement Information) Regulations 1983 as amended by The Consumer Credit (Early Settlement) Regulations 2004, Statutory Instrument 2004 No. 1483.

Credit Action also finds a situation where the graduate can overpay on a loan, to be unsatisfactory. Whilst the SLC acknowledges that this situation is unfortunate and that overpayments do occur, they were unwilling to provide exact figures as to the extent of the problem.

Given that the system unfortunately places such an administrative burden on recent graduates in staying up to date with their student loan, we believe they need to be given much better information and assistance than currently. Credit Action would thus call for greatly improved publicity of the student loan repayment website. This could be done simply in partnership with employers potentially by including information in payslips, which would better inform and encourage students to stay on top of their current repayment position. We also support moves by the SLC to give students relatively close to clearing their balance the option to switch to direct debit and thus avoid unnecessary overpayments wherever possible.

3. Interest rate

The SLC and the government both extol the virtues of the student loan by saying that a student will never have to pay back more than they have borrowed as the loan is tied to inflation. However, there are two problems with the interest rate as it stands.

Firstly, the RPI as announced in March is not applied until the following September. This is unclear for graduates as the 'new interest rate' is announced and then not actually applied to their loan balances until six months later. Credit Action believes that it would not be unusual for a graduate to not be aware of the interest rate that they are incurring on their student loan, which is again, an example of graduates not being in control or informed of the amount they owe.

Secondly, the RPI in March this year fell to -0.4%. In light of the conditions attached to the student loan it was hoped that the interest rate as applied from September would reflect the shift from inflation to deflation. However, the government has lowered the rate to 0% which, although is a good rate, has broken the pledge of the student loan- that the student will never have to repay more than they have borrowed. As the RPI is now negative even paying 0% interest means students' purchasing power is being eroded. It would only seem fair and consistent for the government to lower the interest rate, to remain true to the RPI, as it has insisted on doing when the RPI was positive, and for the interest rate on student loans to be set at -0.4%. Credit Action is aware that in the current climate a reduction in the interest rate to -0.4% may have caused grants for new students to be reduced, and realises that balancing the interest rate and the amount of grant available to future students was a difficult decision.

Concluding remarks

Because of the three areas outlined above it is not surprising that many graduates do not know how much they owe, what interest rate they are paying or when they will clear their outstanding balance. From a money education perspective Credit Action finds this very worrying, and would seek to work with government, the SLC and HMRC to help improve the situation.

It is Credit Action's opinion that the three areas outlined above, coupled with the government's desire to see more students in higher education, has created an atmosphere that underplays the significance and importance of the repaying the student loan. In Credit Action's opinion this has contributed to a generation of young adults who do not have a good understanding of how credit products different to that of the student loan work. The unfortunate message communicated by this system to students and recent graduates is that debt, even when it amounts to thousands of pounds, is not a matter for concern such that you don't even require to be well informed about the debt you have. This is a troubling message.

Amendments made to the Consumer Credit Act in 2006 were designed – in part- to make commercial loans more transparent and clearer for the consumer. Therefore for this reason, and given that the government seems otherwise interested in furthering financial capability, it seems only logical to have the £25 billion owed by English students in the form of income contingent loans¹² repaid in a system that has clear and transparent repayment conditions, where graduates are regularly and accurately informed about what they owe, where graduates are charged an interest rate that is consistent with the terms they have agreed to, and where they know when they should be debt free. It is therefore regrettable that this is not currently the case.

Credit Action is aware that the SLC and HMRC are looking to improve the communication between them both, to make things easier for themselves and for students. Although Credit Action welcomes this, the areas outlined above mean that more than increased communication between SLC and HMRC is needed to improve the repayment system. We would like to see the government working to improve this issue as a matter of urgency.

¹² Student Loans Company, Statistical First Release, SLC SRF 02/2009, 25 June 2009, <http://www.slc.co.uk/pdf/slcsfr022009.pdf>.