

Business, Innovation and Skills Committee

Oral evidence: [Student Loans](#), HC 930 Tuesday 17 December 2013

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Written evidence from witnesses:

– Bahram Bekhradnia, Director, Higher Education Policy Institute (HEPI) and Dr Andrew McGettigan, Author and Expert on University Funding, Independent Researcher

– Toni Pearce, President, National Union of Students

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Members present: Mr Adrian Bailey (Chair); Mr William Bain; Mr Brian Binley; Paul Blomfield; Mike Crockart; Caroline Dinenage; Rebecca Harris; Ann McKechin; and Nadhim Zahawi

Questions 1-93

Witnesses: **Bahram Bekhradnia**, Director, Higher Education Policy Institute, **Dr Andrew McGettigan**, Author and Expert on University Funding, and **Toni Pearce**, President, National Union of Students, gave evidence.

Q1 Chair: Good morning and welcome. I should explain that in the temporary absence of one of our witnesses, we took the opportunity to complete another piece of business, but now we have the complete team here, so we can start. Can I welcome you and thank you for agreeing to give evidence at this inquiry? Just before we start the questioning, if you could introduce yourselves for voice transcription purposes that would be very helpful.

Toni Pearce: Hi, I am Toni; I am the President of the National Union of Students.

Bahram Bekhradnia: I am Bahram Bekhradnia; I am Director of the Higher Education Policy Institute.

Dr McGettigan: I am Andrew McGettigan.

Q2 Chair: To start with a fairly general question—well, my first one is not that general. It is, in fact, to you, Toni. Taking your written evidence, you said that, in principle—I quote—you do not believe that “the loan book, a public asset, should be sold into private hands”. Could you just explain what the reasoning is for that assertion?

Toni Pearce: Absolutely. I think that the really important thing here is the way that people feel about where they borrow money from and who they owe money to. Particularly the compact that individuals, and students particularly, feel that they have with the state when

it comes to higher education funding is really important. Although in many ways the funding system itself undermines that, a compact between the student and the state is really important in terms of who pays for their education. A lot of my members' concerns are about who they owe their money to and who they are paying, and whether that is going to benefit private interests or whether it is going to fund education. That is a really difficult and tough concern for them.

Q3 Chair: Could you not accept that it is in the best interests of students and the system overall to have an efficient process to collect debt, and that the NAO found that the Government could find a more efficient collection of debt by employing a private company?

Toni Pearce: On your first point, I do think that it is definitely in the interests of students, and of taxpayers more generally, that there is an efficient way of collecting student debt. I do not necessarily believe that an efficient way of collecting student debt is to sell off an asset for less than it is worth to benefit a short-term political interest. If we look more carefully at efficiency specifically, I would suggest that the most efficient way of collecting debt or tax or payment from an individual is through a PAYE or a tax system, and if that system is not efficient, I would have real questions more fundamentally about how we collect money from individuals who owe money to the state.

The other thing I would be really concerned about is the tactics that private interests might employ, working on behalf of the Government or the state, to recoup that money. I would be really worried about individuals facing bailiffs or more aggressive debt collection tactics by a private interest working on behalf of the state. I have not felt reassured that that has been considered, explained, communicated or talked about.

Q4 Chair: In a previous incarnation, I was chair of a very large local authority finance department, and we used private bodies to collect debt. Provided you get the balance right—and there is no God-given reason why they should not be able to—a public organisation employing the private sector, with the appropriate regulation, may well be able to deliver more effectively. Would you not accept that?

Toni Pearce: That is probably hypothetically possible. I do not know if that has been explored, communicated or tested in this example. I do not know that there is any evidence to suggest that this system would be more efficient, and I genuinely believe that students more broadly and more deeply have a greater concern about where their money sits, where their money is being invested and who they are investing it with.

Chair: Yes, I am sure that there are some students there, but if they are not, shall we say, paying the money, in some cases, then I think they have rather lost that right to be concerned. However, we have probably explored this issue as fully as we can.

Q5 Mr Binley: I just want to understand a little more. I am not quite sure whether your objection is to the hard-faced men in the City, or whether your concern is that heavies might be sent round to knock on the door in order to reclaim the money. I am not quite sure where your argument is really coming from.

Toni Pearce: Firstly, I suppose any objections I have to hard-faced men in the City are probably outside of this concern. I think that the funding of higher education and education generally should be done through a compact between the state and the individual, and that is a system that this was designed to deliver. When you sell off a huge chunk of that system for much less than it is worth to a private investment company, you change that relationship and you change the terms of that relationship, because your relationship is not with the

state any more; it is with investors. There is a real feeling of concern, and all I can do here is try to convey the feeling of concern that I get from my members.

Q6 Mr Binley: I have only heard you mention the taxpayer once. They have a concern too, and they have a real concern that this money is not being collected, and that many people are not paying back what they are borrowing. It is a straightforward situation of people borrowing and needing to pay it back, and our only issue is how we ensure that happens as effectively as possible in the interests of the taxpayer.

Toni Pearce: I am a taxpayer and I am interested in making sure that that money is recouped, partly because I am interested in the finances of the country and I am interested in our economic situation. However, I do not believe that it is in my interests or the interests of the taxpayer to sell off a chunk of student loans for much less than they are worth and to bring in a small amount of that money to fix a short-term financial or political problem; I do not think that is in my interests. With the lack of consultation with taxpayers or students before this is done, and the lack of understanding about this happening, you would be hard-pressed to find out what the feeling is from the taxpayer generally.

Mr Binley: Or the student body, actually, but never mind.

Q7 Chair: Could I just mention as an aside that certainly I and Members of this Committee have been very concerned in another context about the under-valuing of national assets being sold off, but I have not found any evidence that this is the case here. In fact, if anything, the evidence appears to go the other way. However, could I just make the point to you that the Student Loans Company has employed, if you like, debt management or debt collection companies to get loans from abroad, because obviously HMRC has no writ there. Do you object to that?

Toni Pearce: What I object to is a lack of understanding about how this private company or any private company would use those tactics. This is about transparency and an understanding of how this works, and I think that not necessarily students but people who take out these loans that have been sold do not understand that and have not been communicated to about how that will work. I do have concerns about the welfare of people who, for whatever reason, whether that is disability or mental health problems or long-term unemployment, are not able to meet these payments and do not understand the system that requires you to defer annually your loan repayment when we have changed since then the loan system of higher education several times. For a lot of people, maybe that is difficult to understand.

Q8 Chair: I just fail to see how somebody who has taken out a loan can object to legitimate ways of collecting the unpaid loans from other persons who have taken out loans, and that there is a, shall we say, overriding responsibility to provide value to the taxpayer of whichever body happens to own that loan book. Would you not accept that there is that?

Toni Pearce: There is an overriding responsibility to collect that money back. There is an overriding responsibility to give taxpayers value for money in terms of these assets, and I do not think, personally, that that is what has happened. Yes, the employment of legitimate debt-collection tactics is of course acceptable, but I have asked the question several times about how this would be done and whether we have an idea of how these private companies work and what their ethic is and what their values are. In fact, they are acting on behalf of Government when they collect these debts, whether that loan has been sold or not.

Q9 Chair: It does seem to me that you are being rather presumptuous, but can I now talk to Dr McGettigan. This is really about the calculation of the loans and the loan book. You have suggested,

in calculating returns from the sale of the loan book, that the Government have neglected to include the loss of £1.7 billion in lost revenue from repayments. Can you just explain that?

Dr McGettigan: Could I clarify? We are talking about two different loan book sales here? I think your questions to Toni were about the sale of the remaining tranche of the mortgage-style loans, where the question of value for money is quite different, because we are talking about very different kinds of loans that were not collected through HMRC. The sale of loans that we are talking about now is of the ones announced formally in the spending round and recently reaffirmed in the Autumn Statement. The main issue there is that the declared proceeds of this sale projected over the five years, starting in 2015-16, as outlined in table 2.5 of the Autumn Statement, are gross proceeds. They are not net proceeds, so what is not included in those tables is the income stream you have sold to the private provider. There is another £1.7 billion from 2016-17 and 2017-18 and 2018-19 that you have to net out of that gross calculation, because that is precisely what you have sold to the purchasers. There will then be subsequent repayments in future years that are also now going to the purchasers and not to the Government.

Q10 Chair: Can I just get it clear in my own mind? You are saying that the Government have based their financial projections on the figures that presumably they would get theoretically if there was no loss of repayment by virtue of people not reaching the income threshold or defaulting or what?

Dr McGettigan: No, there are projections based on the OBR and figures that BIS had provided to the OBR showing what a graduate repayment is likely to be in future years, so we send the loans out into the world and we model repayments coming back. We have figures that you can see in the *Economic and fiscal outlook* from the OBR that were published in June. They show what the projections for repayments are expected to be up to 2017-18. They have to be revised down because you have sold part of that income stream, and that is what I am saying is missing from table 2.5 of the Autumn Statement. It shows gross proceeds, not net proceeds, because you have said how much money we are getting in from the private sector for purchasing the loans, but you are not showing how much income you previously thought you were getting in that is now going to other hands.

Bahram Bekhradnia: Just to clarify that, I do not think Andrew is saying that the Government have not taken that into account in their calculations. The Government have not shown that in what they have shown us of the consequences of the sale. That, I think, is what is being said there.

Q11 Paul Blomfield: That suggests that is significant misrepresentation of the benefits. Can you just quantify that?

Dr McGettigan: According to the calculations that you can do on the basis of what is in the OBR's *Economic and fiscal outlook* published in December, £200 million is missing from 2016-17, £500 million from 2017-18 and £1 billion from 2018-19. The years after, 2019-20 and 2020-21, there is another billion. Effectively, you are getting the proceeds up front for the sale, but what the private sector is buying is a future income stream, and that is what is not being factored into the impact assessment here. I am saying that that is for the five-year period; there are long-term implications of this that are not being considered at all.

Q12 Chair: You are saying that it is not just that they have miscalculated the amount; they have not included it at all.

Dr McGettigan: It is omitted. I will go so far. I do not know whether it is a presentational decision to omit it or if they have misunderstood the nature of financial assets. That is a question you will have to put to the Treasury. The thing is it looks like they are pretending

they have sold a physical asset and you just have the money in but you no longer have the physical asset. However, the valuation of financial assets is you are selling something that gives you a future income stream, and in this case we are talking about loans with 30-year or 35-year lifetimes. Therefore, if you sell an income stream on that basis there is a long-term implication here, and I am saying they have got the short-term presentation wrong; who knows what they got wrong about the long-term presentation?

Q13 Chair: They have not included the income stream, whether it is discounted for other factors or not.

Dr McGettigan: Yes.

Q14 Mr Bain: From what you have just said, it would appear that over the five-year period of the OBR forecast, there is no net benefit to the taxpayer at all. Would that be a fair representation of what you have just said?

Dr McGettigan: There is a net benefit in the short term, because you are getting cash up front. What I am saying is that that is mis-presented and, in fact, there is an extremely important point, which is you are only showing the time frame up to 2018-19. On that point, yes, you get more cash in and you can say that you are reducing net debt as a result of the sale as well as covering the additional loan outlay. The problem is once you start looking at 2019-20 and 2020-21, those figures suddenly change dramatically because your sale proceeds have run out, you are issuing £2 billion of extra loans and you have £1 billion less of income than you had previously. You have to find a net £3 billion to cover the expansion. You have lost the repayments, you are issuing more loans, the sale proceeds have run out and then you have to start thinking about what happens subsequently. If you only show the first four years or the first five years, you can just about make some claims, but they are not as good as they look and the long-term implications are what you should really be focusing on.

Q15 Mr Binley: Can I just ask a supplementary, as a very simple businessman? Are you saying that the people who bought the loans in the first place are getting a better deal than the Government have suggested they are getting?

Dr McGettigan: There are two different loans, but I will answer that question because it is important.

Mr Binley: It is an important question.

Dr McGettigan: There are two loan sales at issue. There are the loans that were sold in 1998 and 1999.

Mr Binley: I understand that.

Dr McGettigan: The Government have subsidised that purchase and, according to the accounts published in 2012-13, that subsidy is currently valued at £250 million. In order to get in £2 billion of cash up front, effectively £3 billion in today's prices, the Government were prepared to lose £250 million over the long run. It is more than expected, but yes, that is the nature of these sales. You have to compensate the purchasers for the lack of control over the terms and conditions, and if RPI and interest rates move in the way they have, there are contracts that say, in the event of certain circumstances, future payments have to go from the Government to the purchasers to compensate for the fact that they cannot control these terms and conditions. With the mortgage-style loans, the issue is largely the very high repayment threshold. The repayment threshold on the mortgage loans that have

just been sold is £28,775, so no one starts repaying them until they earn over that.

Obviously, that makes a huge difference to the value of that loan in terms of how much income you are going to get from it.

Here, what I have just been talking about in answer to Paul's question and Adrian's question is the sale of the much, much bigger income-contingent repayment loans, where there is a projection that the Government will try to raise £10 billion to £12 billion over the next five years. That may involve selling up to £20 billion worth of loans in face-value terms, so you could be shifting almost the entire stock of loans issued prior to 2010, in order to raise that kind of sum. Again, you will need to compensate purchasers for the current interest rate terms. Those graduates who borrowed money to go through university have interest rate terms that say interest accrues at the lower of RPI or bank base rates plus one. Bank base rates have been 0.5% since 2009. That means there is an effective interest rate on those loans of 1.5% whereas RPI is currently 3.3%. No purchaser is going to buy an investment that is earning lower than RPI inflation. Therefore, you have to devise a contract to get round that, and that will involve payments.

We are not talking about lost repayments now; we are talking cash payments the Government will make to purchasers in 2030 or 2040, so well beyond the horizons of things like the *Economic and fiscal outlook* and the Autumn Statement. That is where the value-for-money question becomes crucial, because you have to say, "How much do I get up front, how much repayment income am I selling and what subsidies am I committing a future Government to pay?" It is extremely difficult for anybody to make an accurate projection of that, for obvious reasons. Value for money is not going to come down to a test where you can say, "Okay, that is value for money and that is not". It is going to be a whole series of judgments and that is the place for a Committee like this to interrogate how that is being put together.

Q16 Chair: Can I just make it clear, first of all, that the loan book that is being sold is the old loan book? I think everybody needs to be clear on that. What we are talking about in the Autumn Statement is the projected sale of the current loan book. I do understand that BIS has said a final decision to go ahead with the sale has not yet been taken. Any decision will require a full assessment of the value for money to the taxpayer of selling the loans against the cost to Government of retaining them. What is your assessment of that? Do you think it is worth selling them?

Dr McGettigan: There is no way that the Government will get more money than it is worth. The problem is what the upfront price will be, what the assessment of the fair value of the income stream associated with the loan asset is and what the terms of the contract are. What are you committing future Governments to pay to compensate purchasers when certain macro-economic conditions move against the purchasers? In that case, it will undoubtedly lose money in the same way that the other sale has lost money. It is just about what the short-term benefits are. Everything we are being presented with from the Treasury is the short term benefit: how does this change the net cash position in the short term? How does this change the public sector net debt in the short term? What does this mean for the short-term expansion—unsustainable expansion—of higher education numbers? Everything about the sale has been presented in the short term. The question of value for money is the long term.

You are not going to sell an asset for more than it is effectively worth to the Government, so the detail is going to be about what else is being committed. The upfront price might look quite good. The upfront price in 1998 or 1999 looked like the face value of the loans; it was £1 billion up front for what was valued at slightly over £1 billion. It is about what other payments go the other way to compensate the purchaser; that is where the real question of value for money lies. Nobody in 1998 or 1999 would predict what interest rates would be in 2009 and subsequently. That moved against them, so the deal ended up worse than even they thought they were going to lose on it. That is where the real test is and, again, it is a question of long-term responsibility. We have a long-term financial asset here, but short-term politics is driving things that make the headline statistics look better. Obviously, we

have a Government who presented macro-economic competence to the public through the deficit and the debt. That is short-term accounting driving long-term economic decisions.

Q17 Nadhim Zahawi: Andrew, you mentioned the one historic example where you said the Government brought in about £2 billion—£3 billion in today's money—but the additional cost was £250 million, is that right?

Dr McGettigan: The initial projected net present value of the subsidy on those two sales was thought to be about £125 million to £130 million, so at the time the decision was made it was estimated that there would be a long-run loss on the sale.

Q18 Nadhim Zahawi: I am a bit slow on this, so just help me out here. Initially, the projected net present value of bringing in that money, the £2 billion, was £125 million.

Dr McGettigan: £125 million loss, yes.

Q19 Nadhim Zahawi: Let us call it additional cost. You bring £2 billion in; it is going to cost you an additional £125 million.

Dr McGettigan: In the long run, yes.

Q20 Nadhim Zahawi: In the long run. That was wrong. It went up to £250 million.

Dr McGettigan: It is £250 million in the accounts in today's net present value. If we went back, it would be £170 million or £180 million, so it is £40 million or £50 million worse than they thought, but the liability is now £250 million in the accounts.

Q21 Nadhim Zahawi: Right, so £250 million liability, but it brought us in £2 billion.

Dr McGettigan: Yes.

Q22 Nadhim Zahawi: You think that is bad.

Dr McGettigan: This is the decision you are making. If you are running a company, you can obviously make these kinds of decisions. You think, "Okay, I am getting £2 billion up front, effectively let us say £3 billion up front, but I am going to lose £3.25 billion. That is my cash outflow over the run—£3.25 billion—so I am making a loss on the deal but I have the money now."

Q23 Nadhim Zahawi: And you think that is not such a good thing.

Dr McGettigan: Why would the Government be using this kind of business method?

Q24 Nadhim Zahawi: Forget the Government. Do you think it is a good idea that you bring in £2 billion or £3 billion now—

Dr McGettigan: Now we are talking about £10 billion or £12 billion and in five years' time we will be talking about the new loans issued, which are worth £15 billion every year. What is the scale of loss then, on that? That is the question I would put to you. When we start talking about hundreds of millions, or maybe a billion, lost in the long run, at what point do we say, "Why are the Government doing this?" There is no liquidity constraint. You can issue bonds if you need this money. I think it is bad for Government; it makes sense for a business with expansion plans.

Q25 Nadhim Zahawi: Right, so it does make sense in some circumstances.

Dr McGettigan: If you are Starbucks and you want to open up a load of new chains and you need cash up front to make an investment, that is an investment decision. We are not talking about that circumstance here.

Q26 Nadhim Zahawi: Right, so you think for Government it is a bad idea.

Dr McGettigan: Yes. This is a long-run asset, which particularly—look, if you are a Government committed to growth why do you sell an asset that is index-linked to graduate earnings? You would almost say, instead of the points that Toni Pearce has said, if the Government really are committed to growth you would tie them into these assets, because that is basically the test of the commitment. You sell them because you are worried about the repayments going the other way: that you do not believe in graduate earnings.

Nadhim Zahawi: Not necessarily. You might want to bring in cash up front.

Mr Binley: Absolutely.

Q27 Nadhim Zahawi: That is your assumption.

Dr McGettigan: You can issue a gilt if you need—

Q28 Mr Binley: You simply disagree with the strategy they are undertaking.

Dr McGettigan: Yes. In your value-for-money test, it cannot basically pass it if you think that you are going to get—

Mr Binley: No, I understand that. If you can distil it down to that level, I understand that.

Q29 Nadhim Zahawi: That is very helpful. In your written submission you said that, for the sale of loans to represent value for money and not lead to detrimental conditions for the borrowers, a synthetic hedge will be used. Can you explain the structure of the sale of a student loan book and outline what a synthetic hedge on that means?

Dr McGettigan: Yes. The issue around the previous iteration of the income-contingent repayment loans is the interest rate terms; the borrower—the graduate—is paying interest of the lower of RPI or the bank base rate plus one. One of the proposals that Rothschild was making to Government was you go back and you change the terms of the interest rates for borrowers. That has been done for the 2012 loans. Those interest rates have been changed in primary legislation, so this does not apply to loans issued to those who started since 2012, just to clarify that.

If you are not going to go back and use primary legislation to change the terms on existing borrowers in order to effect the sale, because no purchaser wants below-inflation interest, you have to construct artificially, synthetically a contract that replicates for the purchaser as if the Government had done this—as if the Government had gone back to borrowers and changed their interest rate terms. You do not ask the borrowers to make the additional payments at the end of the loans that they would have made had interest rates been changed; the Government make those payments. It does not bother the purchaser; they just get the income stream. Whether it was from the borrowers or from the Government, they still get the income stream. Therefore, it is hedging the purchasers against movements of interest rates against inflation; it is synthetic because it artificially recreates the changes for existing borrowers; the purchaser gets the income, it is just the income is coming as a cash subsidy from Government, not from repayments from the borrowers. That is the contractual

structure of the deal, which would be crucial for assessing value for money in the long run. Because it is interest rates and these are long loan lifetimes, you are really only going to see the effect of lower interest rates at the end of the loan lifecycles, because people who had benefit from low interest rates will pay off their loans earlier, effectively. What you are saying is the Government will step in and make those extra payments to the purchaser at that point. We could be talking about the end of the 2030s, early 2040s, so we really are talking about things that no one here is in a position to do anything other than speculate on. All I am saying is that that is there, and it is a long-range commitment; how do you assess the value for money of that?

Q30 Nadhim Zahawi: A supplementary to everyone: the Government sold the old loan book for £160 million. The Government had valued it at £81 million to £128 million. What do you think the buyers valued or knew that the Government did not?

Dr McGettigan: For assessing this sale, the face value of these loans is £890 million, so it is quite small. They got £160 million for it. The question was: what was the fair value? The fair value is about how the Government are estimating what income stream they are going to get from these remaining loans. Importantly, it is not disaggregated in the accounts. It is wrapped up with the income-contingent repayment loans. You get a statement in the accounts of face value: we know what the price is; we do not know what the Government's assessment of fair value is from reading the account. Most people would say had they got more than £200 million they would have done a good deal there, because these are now ageing loans and most people have already repaid their loans from this tranche. It is 69% or 70% of the people on this tranche of loans have already repaid; we are only talking about the last remaining bits of loans. These are ageing; the conditions are moving against the Government; the value has to be written down every year. On value-for-money terms you could argue the disposal was not too bad. However, you might have lost £20 million to £30 million. Was that your question?

Nadhim Zahawi: Yes.

Dr McGettigan: Again, it is a judgment call. You think about the risk of the way it is moving; it may be better to sell it, and a better deal for Government than keeping it on the books.

Q31 Mr Binley: Nobody has mentioned inflation in this whole thing, but that has to be a major consideration and a judgment that is very difficult to make.

Dr McGettigan: It is pretty much written into all the projections, because various variables in the loans move with inflation.

Q32 Mr Binley: Explain how that was written in on the long term that you are talking about. I lived through the period when we had inflation of close to 27%. I do not know how you write that sort of change in the value of money into the system you are talking about. Can you help me by explaining that?

Dr McGettigan: Do you mean the fundamentals of the loan scheme or the contract?

Q33 Mr Binley: I want to know how you relate the potential for inflation over the length of time you are talking about. I need to understand that a little more.

Dr McGettigan: One example would be that the interest rate that borrowers pay for the loan sale we are talking about is the lower of bank base rate or RPI, so inflation is written into the interest rate there.

Q34 Mr Binley: I understand that, so that is the simplistic view of how you deal with that.

Dr McGettigan: Any kind of contract will be written as inflation rates against interest.

Mr Binley: I understand that. I just wanted you to confirm that on the record and you have done so, and I am grateful.

Q35 Caroline Dinenage: As we have already discussed, the Government have announced their intention to sell the rest of the loan book. These are more complex loans, so what are the factors that will affect the value of the income-contingent loans? This is for everybody.

Dr McGettigan: It is probably best if you answer that one.

Bahram Bekhradnia: To the purchaser and the Government?

Caroline Dinenage: Yes.

Bahram Bekhradnia: The things that the Government will have to take into account, I suppose, are what they would expect to get back from these loans and what the purchaser is proposing to pay for the loans. They will have to make a balanced judgment about whether that represents value. The other factor, I suppose, is how badly they need the money now. I rather fear that the judgment about value for money will be driven by the second of those considerations. The Department has said two things. One is that it will increase student numbers by 60,000 a year; secondly, that it will pay for that by selling the loan book; but, thirdly, that it will not sell the loan book if it does not represent good value for money. The unanswered question, and the question that I fear might drive this, is what will happen to the commitment to a 60,000 expansion per year if it does not sell the loan book because it does not believe that it will represent good value for money? Does that commitment stand or will that commitment fall? That is question that I hope you will put to the Minister when he comes to see you.

Q36 Caroline Dinenage: On that, in your written memorandum you said that the future repayments from income-contingent loans were more uncertain than repayments from mortgage loans, so this coming sale will be more difficult and the net proceeds are likely to be proportionately lower. Can you just explain that?

Bahram Bekhradnia: It is partly what Andrew said. It is like a mortgage repayment loan: you are committed to paying from the moment you have taken the loan, or from the moment that you graduated. Therefore, the income to the purchaser will be clear and more certain than an income-contingent loan where, as we have seen already in the last two or three years, graduate earnings have been lower than had been forecast. If this were repeated, the income to the purchaser would be less than had been forecast. That is why they are more uncertain and more risky; there are more variables that could go against the purchaser. That is why there will be a bigger discount, almost certainly, on those loans than there was on the previous loans.

Dr McGettigan: The crucial difference is that the mortgage-style loans are fixed-period repayment loans. Once you cross the earnings threshold you repay what you have borrowed in 60 monthly payments, so you pay the balance in five years, as you would on a normal loan; you just do not start paying until you cross the repayment threshold. With the income-contingent repayment loans, you cross the repayment threshold, but how far you are above that repayment threshold determines how much you repay monthly. It is not just that you cross it and then you pay it off in 60 equal payments. You cross it and then you make payments in relation to how far you are above the threshold. Therefore, the key issue is that

many borrowers, even once they have crossed the threshold, may not clear their balance, because they may be making mandatory payments lower than the interest accruing on their account, or they may have borrowed £40,000, their repayments are very small each month and so they never catch up with that. That is the additional variable. Graduate earnings are not just a threshold that then you pay back the debt you have borrowed. Graduate earnings are the threshold that determines what you are repaying and the debt account is doing something else.

Bahram Bekhradnia: Fundamentally, the income to the purchaser is less secure and sure than the other sort of loans and therefore the price they are prepared to pay and the discount they are going to require will be greater.

Q37 Caroline Dinenage: Have any of you or will any of you be producing your own valuation of the assets in the sale?

Dr McGettigan: We cannot unless we see the contractual terms, and they will not do that for commercial confidence, so that is the sort of thing that you guys should be doing in a closed evidence session. We are not going to be given that information.

Bahram Bekhradnia: The previous Government did not when they sold their loan book and this Government will not, for understandable reasons.

Q38 Chair: I accept what you say about the contractual terms. What do you think should be included in those contractual terms to maximise the benefit to the taxpayer and value for money?

Dr McGettigan: Unless you have particular terms in the contract you will not get a sale at all, so it is a binary position: you have to put something in the sale in order to get it sold. The kind of thing you have to put in the sale makes the value-for-money assessment too complicated and almost impossible, and therefore it is just a bad deal in that sense. It is a hit-and-hope policy. You are basically taking a punt on something.

Q39 Chair: Is it a fair summary of what you are saying that the details of the contract will be such that if it is attractive enough for the private sector to buy it, it will not generate value for money to the taxpayer?

Dr McGettigan: The question is: why would you buy what the Government are trying to sell? You do it only if the deal moves in your favour. The Government will accept a certain level of loss on this, and that is the problem. There is no sale without your giving the private sector what they want. If you go back to the story we ran in *The Guardian* in June, the Rothschild review says the Government is best placed to take the inflation risk. Private purchasers will not touch this. You have to subsidise the sale to give them the guarantee against the risks they do not want to see. The Government have to commit to picking up that risk.

Bahram Bekhradnia: That subsidy may be worth it to the Government to get, as has been said already, the short-term benefit, but the problem for the Government is that they do not know what it is going to cost them. They do not know what they are letting themselves in for, so, as Andrew said, it is a bit of a punt for the Government, of quite a significant size.
Oral evidence: Student Loans, HC 930 13

Q40 Caroline Dinenage: Toni, why does the NUS get involved in this when the loans are only repaid after graduation and, in some cases, a really long time after graduation?

Toni Pearce: It is in my members' interests to know what they will be paying for their education. It is a legitimate interest for students to have in the future cost of their education.

Q41 Caroline Dinenage: However, it does not affect them in the sense of what they are paying back.

Toni Pearce: The idea that the next tranche of the student loan book can be sold, and the potential for that to change the terms and conditions and to change, effectively, the amount they would have to pay back, does affect my members at the moment.

Q42 Caroline Dinenage: Have you heard anything that would suggest that when it is sold the terms and conditions would be subject to renegotiation as well?

Toni Pearce: That is one of our real concerns, because the terms and conditions for this set of student loans are not fixed at the time that you take your loan out. Although we had assurances from the Government, which were very welcome, at the sale of the tranche of the student loan book that has just been sold that they would not be changed at the point of sale, what we would want to see is those terms and conditions fixed at the point at which you take out a loan. To then have your terms and conditions change—clearly there will be an impact from changes in inflation and interest rates, but the fundamental terms and conditions could be changed by the Secretary of State without any parliamentary process and without scrutiny. I do not think that is acceptable, and my members absolutely do not think that that is acceptable.

Q43 Caroline Dinenage: Andrew, in your written submission you draw attention to the IFS report, which suggests the claim that public debt will be reduced “is ‘economically nonsense’ as selling an asset for what it is worth does not improve public finances”. We have already discussed this a little bit, but just to put it on record, are you concerned that the Government are hijacking future public finances by selling a steady income stream for a quick buck?

Dr McGettigan: Everything we have seen in the presentation of the sale is short-termist. All the tables only run up to 2018-19, and even they do not have the full detail. We do not have the impact for the BIS budget, for example, beyond 2015-16. Everything that has been done so far smells of short-termism. There is a suggestion that is coming out from some quarters that when we hit 2019-20 we can sell another bit of the loan. You then have to really start worrying what we are talking about, because, if we were in a position to sell the latest iteration of the income-contingent repayment loans, we would be doing so. In the 2011 White Paper, at the end of Chapter 1, in sections 1.43 to 1.45, the Government said they wanted an ongoing solution for the new loans issued and they were confident they could do so. We are now talking about the fallback option, which is the retrospective sale that they did not want to do. If we were in a position to say with confidence that we could sell the new loans that they are issuing—and those will be £15 billion per year from 2015-16, so this £10 billion that we are going to raise over five years is going to be dwarfed by one year's new issue—we would be doing it now. It is entirely speculative that this planned expansion could be funded by future loan sales past 2020. Financial engineering might be needed to sell these much, much larger cohorts of £15 billion at a time—in Oral evidence: Student Loans, HC 930 14

the sale we are talking about there is probably £2 billion of face value in the first sale; you might raise £1.5 billion. After 2015-16, the OBR says we are issuing £15 billion in loans a year, £17 billion in loans a year. You cannot sell those in the same way as this current sale. It is inherently short-termist and speculative at the moment, and the detail we have is just shoddy. That would be my answer to whether it is a quick buck now. Everything about it is the wrong way to go about it, and it is all for short-term, presentational boost.

Q44 Mike Crockart: This is a question to Mr Bekhradnia. In his Autumn Statement, the Chancellor announced that the Government would remove the cap on student numbers at publicly funded higher education institutions in England by 2015-16. How will that feed through to the size of the student loan book going forward?

Bahram Bekhradnia: The feed-through to the loan book will be quite direct. Those students will be entitled to loans, they will take the loans, and that will enhance the loan book pro rata.

Q45 Mike Crockart: I was looking for a little more detail than that in terms of sizes and things like that.

Dr McGettigan: I have the details here if you would like them.

Bahram Bekhradnia: Yes, go on, Andrew.

Dr McGettigan: Okay. If you look at table 4.3.1 of the Office for Budget Responsibility's *Economic and fiscal outlook*, the cash outlay of new loans goes from £10.1 billion in 2013-14 to £17.4 billion in 2018-19. Roughly £2 billion of that is to do with this expansion. That is an additional £2 billion of loans, and that would be the impact on the loan outlay. The other issue is that there are still grants in the system, there are maintenance grants to students, and there are still some residual grants to universities for certain subjects. That has been quantified in the Autumn Statement at £720 million in 2018-19. We do not have confirmation that that is going to be additional resource from BIS or if that is going to come from elsewhere. That is the only way at the moment we are able to even put some detail on what was announced in the Autumn Statement. What should be there is not there and both the IFS and the OBR have made that clear.

Bahram Bekhradnia: There is another impact as well, and I wonder if this is what you were talking about. That will have an impact in due course on the BIS budget of £700 million a year in terms of the loan subsidy that is recognised by the Government, and another £700 million-odd in terms of the grants that go through HEFCE and to students, so there is also the budget outlay that they have as well.

Toni Pearce: I suppose the other point is that you cannot just magic places out of nowhere and you cannot just create capacity in institutions and universities without spending money. We would have to find places for these people to live. We would have to spend capital on places for them to study and lots of universities in the last couple of years have over-recruited and have students living in hotels and Travelodges at the beginning of the year, because they do not have the capacity to house them. That is also a huge issue. How do we maintain that level of expansion in the public higher education system? I think there would be an extra cost in adding that capacity. Oral evidence: Student Loans, HC 930 15

Dr McGettigan: There is a further uncertainty, which is that any sale proceeds are not expected to appear until the end of 2015-16. This expansion of an extra 30,000 and an extra 60,000 is supposed to happen in 2014-15 and 2015-16, so universities will be recruiting for these additional places, particularly the extra 60,000 in 2015-16, before we even know if we have the loan proceeds. It is very, very unclear and very uncertain for universities, which want long-term, sustainable financing in order to make these kinds of plans, as Toni has rightly pointed out.

Q46 Mr Bain: If I could perhaps just pursue the last point that Andrew raised in a bit more depth, surely the issue is that the taxpayer for that interim period perhaps of four years gets a one-off hit, but the liability to the taxpayer in terms of providing some of the funding for the extra places is an ongoing commitment. Does that not, frankly, make the case that the IFS have put, that it does not make any sense to argue you can fund the expansion purely by selling off this tranche of student debt?

Bahram Bekhradnia: That is the case that Andrew was making earlier: that we know where the money is coming from for the first four or five years, but the money runs out after five years and then we have a lack of clarity about what will follow. However, there have been quotes from Government officials to the extent that, "Well, there are plenty more loans; we can sell more loan books." That is what begins to make it look a bit like a Ponzi scheme, in that you are relying on continuing sales of assets in order to meet short-term liabilities.

Dr McGettigan: What is particularly missing in terms of this question is that we have the Autumn Statement scorecard, we have additional resource for 2014-15 and 2015-16, and then the three subsequent years there is no additional resource shown for the BIS Departmental budget. We can talk about what is happening at the national accounts level of cash flows in and out from loan sales, but that additional resource that you would need for these extra places, grants and also write-off of loans, the non-repayment of loans, are not shown in the Departmental budget. At the moment, until we get confirmation that the taxpayer is picking up that extra resource and BIS is getting the extra money to fund those places, everything is still open to interpretation, and it is very hard to know what is going on there. Are the savings going to have to be made elsewhere from the budget? That is what the IFS suggest in their reading of the scorecard.

Bahram Bekhradnia: Do the OBR also not say that there will have to be savings made elsewhere in Government expenditure in order to enable this? That is in the OBR report, I think.

Q47 Mike Crockart: I am going to try to get a bit more information about what you described as a Ponzi scheme—

Bahram Bekhradnia: Potentially.

Mike Crockart: We are creating new assets and new students coming on and new income-contingent liabilities, so I am just looking for a bit more information as to why that does not stack up. Is it because of the size of the loans that you would be looking to sell off and therefore the value would be less, or the fact that it is a continuing stream? What is it that makes that not stack up, since that seems to be what the Department is relying on?

Dr McGettigan: The main issue is this: at the moment, if the idea is to sell whole cohorts—the remaining debt of people who graduated in 2001 as a whole cohort—then you would be selling it to pension funds and insurance companies. You need a pretty big balance sheet to take that. For the kind of cohorts we are talking about, it is going to be roughly £1 billion in the early years, but with that amount of debt climbing rapidly. I think the last Student Loans

Company report says that the debt of people graduating in 2012 is about £5 billion. The problem is that the debt of people graduating in 2017 is going to be £10 billion and when you have expanded it—I read out those figures from the OBR, up to £7 billion. There is not going to be one company that can purchase a cohort. You are going to have to do a different kind of financial engineering here. You are going to have to do something much more sophisticated to create an investment-grade product out of the student loan book. It is much riskier. You are going to have to tranche it in some way. We are going to get into all manner of dealings with the kind of financial engineering that people might have some vague understanding of from the basis of the great financial crash. We are going to have to have a very sophisticated originate-to-distribute model. The practicalities of that are huge and that is why pretty much the Government abandoned the idea to do it. With these new loans now, it takes a whole different level of financial engineering. You also have to ask how much market appetite there is. If we have sold them £10 billion to £15 billion-worth of these assets anyway and we are going to go along with what looks like a much riskier asset—bigger debts, longer lifetimes, more uncertainty, more volatility—how much appetite is there going to be to buy it?

Q48 Mike Crockart: However, there will be different terms for the new loan book, so there is less risk in that for potential investors, is there not?

Dr McGettigan: Depending on how you structure it, and then there is a whole other can of worms there to discuss, but there are two major practical problems. Is there a market there to buy what you are going to try to sell after 2020, after you just sold them £15 billion worth of stuff? Can you create a different kind of product, because this solution will not work then? There are those two practical impediments, and people just do not know. We will not know the answer to some of those questions about market appetite until a few years further down the line if this sale has gone ahead. It is that, in my eyes, that makes it speculative. You are basically saying, “We will come up with something”, but there are impediments here that have to be overcome. It is still not clear that the impediments to this proposed sale can be overcome, let alone the sale of these much larger, much riskier coalition loans.

Q49 Mike Crockart: I was with you right up to the point at which you said “larger, more risky”. It certainly is larger, but it is debatable whether it is more risky, surely.

Dr McGettigan: No, because you have a higher repayment threshold. If the repayment threshold is £21,000, rather than—

Q50 Mike Crockart: A different structure of loan that does not potentially give returns less than RPI.

Dr McGettigan: You have removed that impediment, because primary legislation was used to remove the interest rate impediment. Now the question is—

Q51 Mike Crockart: Surely that makes it less risky.

Dr McGettigan: However, you have much bigger debts, you have a higher repayment threshold, the interest accruing on those debts, all these things. It becomes more volatile. There is a lot of Oral evidence: Student Loans, HC 930 17

virtue in income-contingent repayment loans. It is just, once you start off with £40,000 debt, the volatilities in it over 30 years become very unpredictable.

Toni Pearce: I suppose that unpredictability is interesting, particularly in terms of BIS's own forecasts for the RAB charge of this loan book. The changing of the estimation from 33% to between 35% and 40%, with some estimates putting it at almost 40%, I think just shows the unpredictability and, I suppose, that risk of what happens if graduate earnings do not stack up to what you expect them to be. I guess one of the fundamental miscalculations about how we measure that future risk and the future amount that people will or will not repay is that when these were first forecast, they were forecast on the basis that equal numbers of men and women would go to university and on the basis that women would have lower graduate earnings. However, we know that more women year on year go to university and that has had a huge impact on what the forecast of the RAB charge is. When you are making such fundamental miscalculations at the very beginning, I find it quite concerning, and I would suggest that a prospective investor or purchaser of a loan book would find it quite difficult to believe an estimate given by BIS as to what the RAB charge of these loans might or might not be in the future.

Dr McGettigan: I would just draw your attention to the matter of emphasis that the Comptroller and Auditor General put in the BIS accounts this year, which entirely relates to the valuation of the loan book: volatility, uncertainty. You read the last few years of accounts, and things are moving around even with the loan books that have already been issued. The much larger, much more complex ICR loans are going to be very difficult to have a fair value on the accounts, and the pricing of them is going to be even more difficult than the pricing of these ones.

Q52 Paul Blomfield: This is a related question on student recruitment and number controls, and it is on the reports we saw recently, and the Government action subsequently, in relation to recruitment of HNC and HND students at private colleges. There have been a number of warnings given to the Government, including one from this Committee, on this area over the last couple of years and yet the Government were fairly robust in brushing those aside until the national reports in mid-November that there was a looming black hole in the BIS budget of £330 million, and now we have seen some action. Were you surprised that those warnings were disregarded at an earlier stage, and what lessons do you think we can draw from that?

Bahram Bekhradnia: The answer to the first is yes, up to a point, but do not forget it is a very important element of Government policy to increase the numbers in private and FE colleges just to increase the diversity of what is provided, so I do not think we should underestimate that. What is really of concern and of some interest as well is that the announcement recently has not been that there would be an additional 60,000 places; it is that the cap would be removed and that there will be no control over student recruitment in the future. That has a huge implication for Government expenditure. As long as each loan that is given is subsidised, then that is a significant cost. Not since the early 1990s has the Treasury agreed to an open chequebook in terms of recruitment, and, given the fees that students pay, there is a huge incentive there for universities and colleges, private or public, to recruit. It is surprising that this should have been agreed. There must be a great danger not just that private universities but that public universities will go out and recruit. The only control that is mentioned in what we have seen is that, if there is any evidence that quality is suffering then the Government might step in. It is very uncertain how that would be

Oral evidence: Student Loans, HC 930 18

done. I suspect that that was, in part anyway, directed at the private institutions and intended to somehow control the recruitment that they might engage in, but it is not just them. Public universities will go to Europe; they will recruit for all they are worth. There is a real risk here to public finances. The Government are taking a bit of a chance.

Toni Pearce: One of our real concerns is the amount of recruitment of HNC and HND students by for-profit providers and the idea that a public funding system for higher education would be going to provide essentially a subsidy for a for-profit provider. I want to be really clear here about the difference between private not-for-profit providers and private for-profit providers, because that is important. I have a fundamental objection to providers making a profit out of education and out of a public subsidy paid for by the taxpayer. I find that uncomfortable. What I find even more uncomfortable is that there seem to have been no steps to look at how we regulate the way in which for-profit, private or public providers operate in the market—even looking at quality and how you ensure the protection of students if it does not work out with a provider? How do you ensure that quality is provided at an institution? What we have seen is that there have been no steps to support those students, and we then end up with this kind of black hole in finances, where for-profit providers have been able to take on and hugely recruit numbers of HNC and HND students. I think that that is incredibly concerning, both for students, as a matter of quality of provision, but also for the taxpayer.

Q53 Rebecca Harris: That is quite an interesting area, and I am bringing it back to something slightly narrower, but the National Audit Office looked at the various performance targets and reporting of the current collection by the Government of student loans, and observed that the Government do not target the amount of money they collect each year; it is not one of their targets. Do we think that that should be a target, and is it feasible in terms of the Government's collection?

Bahram Bekhradnia: I cannot help you on that. I do not know if my colleagues can.

Toni Pearce: I do not know. I think that it is probably up to the scrutiny of parliamentarians, I would suggest, or to the Department, BIS, as to how they scrutinise the Student Loans Company and how efficiently it is doing its job. What I would go back to arguing, as I did at the beginning, is that if we think that there is a more efficient way of collecting debt from graduates, why are we not making our system more efficient? That is what my main question would be, and I do not necessarily think at the moment it is as efficient as it could be.

Q54 Rebecca Harris: It goes back to the difficulty of predicting the economic performance of the country. The question for Toni is a quite simple one: what financial advice does the NUS give to students considering a student loan at the moment?

Toni Pearce: The financial advice we would give them is to be very clear about the system, and the terms and conditions of the system: that you do not start repaying until you meet the repayment threshold, and that you have access to the system if you are a part-time student—the facts, I suppose, of the system. For different reasons I would neither encourage nor discourage people from choosing to study somewhere because of finances; for instance, no, you should not go to university just because it is a good financial deal if what you want to do is go and study a vocational course in a college, but, no, you should not be stopped from going to university or choosing which university you want to study at based on a financial decision. I think there is still confusion about that. Oral evidence: Student Loans, HC 930 19

There is a lot of confusion about the future of what those repayments are, and there is a lot of confusion about how easily and how quickly, and with such a lack of scrutiny, your terms and conditions could change. I think students are quite surprised by that: that you could be in a more fixed, not as generous, position with your terms and conditions with a high-street bank than you would be with the Government, based on the changes in terms and conditions.

Q55 Rebecca Harris: Do you think that students fully understand the terms of the loans that they are taking out?

Toni Pearce: I think that is difficult. It is much easier for those students who have a great deal of social capital, and access to parents who, I suppose, could sit in this room and understand the conversations that we are having today than it is for people whose families have not been to university, maybe do not have the kind of time or the social capital to be able to understand how that system works. It is a complex system, and I think that there are people who do not understand it, but the NUS is absolutely trying to support people to understand it.

Q56 Rebecca Harris: Do you see that as a role of the NUS for those who might not be so knowledgeable?

Toni Pearce: Absolutely.

Q57 Rebecca Harris: How many complaints do you get from graduates about being chased for loans?

Toni Pearce: The NUS does not operate as a complaints body at all. I can go away and find you the number of complaints we have had, but we do not handle complaints on behalf of students, so we do not arbitrate.

Rebecca Harris: You do not have a sense of it.

Toni Pearce: I do not know—

Chair: I do think this would be quite helpful information to have. You and others have talked about a more efficient collection system of loans. It would be quite helpful to get feedback, in effect, on where it is hurting or where it is benefiting, and so on. Any information you have got on that I think we would welcome as supplementary evidence to this inquiry.

Q58 Mr Binley: I have a straightforward point, really. The National Audit Office maintains that over three quarters of overdue repayments from income-contingent repayment borrowers living overseas has been overdue for between one and four years. It seems to be a pretty risky area, quite frankly, but we want foreign students to come to our universities, and so forth. What should the Government do to chase these loans harder? Is there a more efficient way of doing that than perhaps we are doing at the moment? I do not believe the Government—and this is why we are selling the stuff off—could get the money in anyway, but that is by-the-by.

Dr McGettigan: They do not change the repayment terms with the sale of these ones. The deal is that the Student Loans Company and HMRC will still collect the repayments on income-contingent repayment loans. For the mortgage-style loans, the collection is being sold, but not the income-contingent loans.

Q59 Mr Binley: That was not my question. My question is: do the Government get the money from people who are not paying overseas?

Bahram Bekhradnia: You will find it very difficult to do so, and any Government would find it difficult to do so; that is inherent in the system. It is collected in this country through the taxation system; students overseas do not pay. I would not even describe it as a flaw in the system; it is part of the system. We are part of the European Union: these are only European students; these are not overseas students in the sense that Theresa May defines overseas students. These are European students, and part of being a member of the European community is that they can come here.

Q60 Mr Binley: So we should take the hit?

Bahram Bekhradnia: I do not see what else you can do, unless you are prepared to appoint large numbers of debt collectors overseas in each of the 25 or 26 different countries, chasing these students through the courts in those countries. I do not think there is much more you can do. Certainly the Government have tried to get deals with tax collection systems in other countries, and they will not any more than our tax collectors would collect tax on behalf of other Governments in this country. I think it is inherent in the system.

Q61 Chair: Can I just pick this up, because it is quite serious? I understand that that the RAB charge on EU students amounts to something like 70%, as opposed to 40% for domestic students. I also believe that other countries have got models where they are more effective in chasing up students and getting these repayments back in. Have you looked at any other systems that could be more efficient?

Bahram Bekhradnia: No, I have not, sir, but I am rather surprised by what you say, because few other countries have student loans anything like the ones that we have here, and they may have constructed the thing in the first place differently, but I would be very surprised—

Chair: The US obviously has, and I believe has a more effective system.

Bahram Bekhradnia: I do not know.

Dr McGettigan: I think we should emphasise that this is a very small number of borrowers. In the figures I am looking at here from the NAO, there are 42,000 EU-domiciled borrowers out of a total of 3 million borrowers. Most of them will only have taken out tuition fee loans; they will not have had maintenance grants, because they would have to have been resident in this country for three years to get entitlement to those, so they are borrowing lower amounts. There is an issue here, but the scale of it needs to be borne in mind.

Q62 Chair: Are you saying in effect that, given the small scale of it, it probably does not justify the extra investment?

Dr McGettigan: I would reinforce Bahram's point. Unless we suddenly see huge changes—the real issue is what is happening at the HNC/HND level, because that is EU borrowers coming in and doing those qualifications, but from the data I have seen on it

Bahram Bekhradnia: Chairman, may I say that I am sorry; I will have to leave you in about three minutes, because I have another commitment to go to.

Mr Binley: We will subpoena you.

Q63 Chair: It is not very satisfactory from our point of view. Were you given a time limit? I realise we were late starting, but that, again, was not the fault of the Committee.

Bahram Bekhradnia: I understand, Chairman. I was asked to come at 9.30 and told I would be here for an hour or a bit longer, so I apologise.

Chair: What we will do in your absence, if we have any specific questions, is write to you and we would welcome a response.

Q64 Nadhim Zahawi: The NAO goes on to report that 43% of the 368,000 borrowers with no employment record had not provided information to confirm whether or not they were earning enough to repay. Are you confident that non-responders are not avoiding making repayments, and what recommendations would you make to the Government to improve its information on these individuals?

Bahram Bekhradnia: Are you talking about EU students or more generally?

Q65 Nadhim Zahawi: No. The 368,000 that are non-responders.

Bahram Bekhradnia: The answer is no, I am not at all confident. I suspect that a lot of them are avoiding it. I am sure the Government are doing what they can; they can devote more resource to chasing them. It is an issue.

Q66 Nadhim Zahawi: Is there anything else you would recommend?

Bahram Bekhradnia: No, I have not looked at that question.

Q67 Nadhim Zahawi: Andrew, do you want to come in here?

Dr McGettigan: It is an issue of management of collection, which we are not really in a position to comment on, I would say. This relates to the previous question from Rebecca Harris: in the shortfall between estimated repayments, how much of that is to do with misprojecting amounts receivable, and how much is to do with poor collection performance? It comes back to the issue of the sale, because the proposal is that the Student Loans Company and HMRC would continue to be the collectors, and unless you improve this performance—you also have a service agreement between any purchaser, and Student Loans Company and HMRC; there will be targets in that service agreement, and there will be money, again, moving in other directions as a result of the sale. I would say this is a crucial thing to get sorted, and really ought to be a priority, so that everybody is confident on it before we start talking about a sale. I take that to be the tenor of the National Audit Office report.

Bahram Bekhradnia: May I make a phone call and I will be back with you, I hope?

Chair: Yes, that would be helpful.

Dr McGettigan: I would take that to be the tenor of the National Audit Office report: that if you cannot predict accurate repayments and what is collected, how can you assess a fair price? Let us get this fixed and then start talking about a sale.

Q68 Nadhim Zahawi: Toni, do you want to add anything to that?

Toni Pearce: No. I think that Andrew has covered it.

Q69 Paul Blomfield: Thank you, Chair. I am going to look at forecasting in general, and really the sustainability of the system. I was going to ask Bahram, but I am sure, Andrew, you can pick up on this: in HEPI's written submission, there is some detail in terms of the disagreement with the Government's assumptions, particularly in relation to future earnings, which is an issue we have exercised to some degree. I am conscious that when we started down this road the Government were projecting a RAB charge of 32%. HEPI was saying, if I remember right, 38%. We are now moving towards HEPI's projection, at 35% at the moment. I just wonder if you could help us unpick—shall I go back on that?

Bahram Bekhradnia: I am sorry; I got the tail end of that.

Paul Blomfield: I will just go back; it is about the RAB charge and the sustainability of the system. We started off with the Government projecting 32% RAB charge; I think you were projecting 38%, if I remember rightly? We are now incrementally moving towards your projection, although it was fairly casually dismissed at the time. I wondered if I could dig into the disagreements that you have with the Government's assumptions.

Bahram Bekhradnia: Very well. In fact, I read in the NAO report, although we did not pick this up in ours, that the original Government projection was 28% RAB charge. It then went to 30% in the White Paper. It was 32% this time last year, or thereabouts, when the Minister for Universities—or was it Vince Cable?—came here, and now they are saying 35% to 40%. I see London Economics are saying it is close to 40% as well.

It is not that we have produced a different RAB charge; what we did was to take the Government's model and plug in different assumptions to those that they had, to see where it was sensitive to different assumptions. The biggest reason for its change up to now has been that the earnings that graduates have are rather lower than the Government assumed, and that makes a big difference between last year and 2016, because the repayment threshold is fixed at £21,000. If people are earning less than had been assumed, then less money is coming in, and then when the repayment threshold starts going up after that, that has a knock-on effect.

That is a large part of the reason for the Government's increase in its estimate of the RAB charge since then. What has not changed yet, but we think really needs to change, is the assumption that, whatever the earnings growth in future, it will be spread equally among the population. That has never happened in the recent past, and there is no reason to think that it will in the future. This is where we did the modelling: if you assume that high earners will increase their earnings rather faster and rather more than low earners, which is what has always happened in the past, then that has a dramatic impact on the RAB charge. As far as we understand it, the Government's modelling has not been changed in that respect.

Q70 Chair: Can I just clarify that: are you saying that basically they pay off their loans earlier, so there will not be the same level of interest payments?

Bahram Bekhradnia: There are two things: they pay off their loans earlier, but the main thing is that the low earners are not increasing their earnings by as much as the model had assumed, and therefore they will pay back less. What we said explicitly in our submission is the fact that high earners are earning more does not mean they will pay off more, but the fact that low earners are earning less means that they will pay off less, and that has a very significant impact on the RAB charge. I am not sure that any of the other modelling has yet incorporated that.

Dr McGettigan: Could I just make a supplementary point? One issue is how good are we at estimating the RAB charge? The other question is how does that impact upon Departmental budgets and the accounts? The revision to the RAB charge from 30% to 35% has largely been covered by reserve claims to the Treasury, and the Treasury has provided about £7 billion of

additional resource to this over the last three financial years to cover those movements in RAB.

The problem is that what is likely to be more urgent is over-recruitment. The RAB is not just a percentage estimate of non-repayment; how much money do you put in the budget to cover it? Over-recruitment is going to have a bigger impact more quickly, particularly with private providers as one part of this, because you have got to lay out more money than you expected; you have got to put that in. David Willetts yesterday said that BIS was facing a major fiscal challenge with its budget. That is not because of the RAB charge moving due to macro-economic conditions. BIS cannot control what the bank base rate is, so you have got an additional reserve to cover the amortisation there, but if it cannot manage the recruitment numbers then the Treasury will take a different opinion on whether there should be additional resource. That is what is really crucial here: to have those two distinctions in mind. One thing is: how good are we at projecting estimated repayment over 35 years? We know that is going to be inherently volatile. The problem is: what have we budgeted for and how is it appearing in the accounts? That is where I think we are facing problems at the moment.

Bahram Bekhradnia: Just to clarify, the under-estimation of the RAB charge has an immediate impact on the BIS budget of probably about £1 million a year.

Q71 Paul Blomfield: Andrew, I fully accept that point in terms of recruitment, but I am interested to probe a little bit on the RAB charge, because it has been at the centre of the debate. Your early projections were rubbished.

Bahram Bekhradnia: Yes.

Paul Blomfield: And have proved right.

Bahram Bekhradnia: Yes.

Q72 Paul Blomfield: You have talked about the different factors you put into the modelling, and obviously talked about earnings. Were there any other factors that you put into the modelling that we ought to understand?

Bahram Bekhradnia: Earnings are interesting. Lower earnings being budgeted up to 2016 make a significant difference. Lower earnings beyond 2016—and we have modelled this—make much less, if any, difference, and that is because lower earnings will bring down the threshold at which repayments start to be made, so do not have that much of an impact. The other assumption that we queried was the level of the loan that was made; to be honest, the Government got that right, pretty much spot on, in terms of the average loan, so that was one potential area for an increased cost that has not yet materialised.

Q73 Paul Blomfield: Do you agree with the NAO that institution attended and subject studied affect the probability of non-repayment as well?

Bahram Bekhradnia: Yes, certainly. It will. Bankers, economists and doctors will pay back more, more rapidly, and are less likely to default. In fact, the NAO has a table in its report showing the likelihood.

Q74 Paul Blomfield: I think I am right in saying that the Government have not used that data in evaluating the RAB charge; why do you think that is?

Bahram Bekhradnia: In calculating the RAB charge? I think that would make the whole thing even more difficult, to be honest, and put in even more levels of uncertainty. There is a

different point here, and that is that if you start to look at different RAB charges for different types of students, attending different types of universities, different genders—of course, females have much higher RAB charges than males—different social classes repay at different rates, then you get into very difficult territory. There is evidence that the Government intend to get into this territory of different loan entitlements for different students, attending different courses, at different universities, and perhaps different levels of subsidy. It becomes, I think, very difficult, and you begin to undermine some of the very fabric of the university system.

Q75 Paul Blomfield: I am conscious of time, but I think Andrew and Toni were looking as if they wanted to come in on that point.

Dr McGettigan: It would be very useful if the National Audit Office stripped medicine out of its figures for the Russell Group; it is clear that medicine should be treated differently, and the Russell Group figures seem a bit distorted on repayment for that. Once we start segmenting the RAB charge by different institutions, different courses, different kinds of person starting those courses, this would basically come back to the very first point that Toni made, which is that the manner in which you fund education has a bearing on educational practices, and you cannot just plug out one system of financing and expect what goes on in the classroom, the lecture theatre and the seminar room not to change. I would also point out that this is precisely the kind of data that the financial advisers, who want to tranche the loan book for different prices of different categories of loan, would also be looking at. All these things dovetail in a way that means we are sleepwalking into something that really might change the very nature of the relationship between universities and students

Chair: Can I bring in Brian? To a certain extent your line of questioning has been pre-empted, but I am sure you can pick something out.

Q76 Mr Binley: Let us do it for the fun of it; it is so enjoyable, Mr Chairman. To Bahram, my main question is: you have studied the Government's model in some detail. Can you outline the main differences between the Government's in-house model, which they created, and the one they paid Deloitte £400,000 for?

Bahram Bekhradnia: I cannot; I am sorry.

Mr Binley: Can somebody? I knew this would be fun.

Dr McGettigan: I think they decided the Deloitte one was not fit for purpose, so that is £400,000—

Bahram Bekhradnia: Yes, but what is the difference?

Dr McGettigan: The difference is set out in the NAO's report.

Mr Binley: I can point our worthy Clerk to that particular answer.

Dr McGettigan: It is in the tail end of section 4.

Chair: Okay. We can dig that out ourselves.

Q77 Mr Binley: That is very helpful, thank you. I am not sure the other questions are worth asking either. You have rerun the model to allow for your assumptions; please would you outline what lessons you have learned? Do you want to write to us?

Bahram Bekhradnia: What lessons we have learned? The main one is the one that I mentioned: that the model is okay—I have got no problem with the model—but it is the assumptions that go into it, and the parameters. The main one is the dispersion of income growth, which there is no basis for. To take the mean and apply that to the model, when that is known not to apply seems to be a bizarre thing to do. It would be much better if they were to make a more realistic assumption about the dispersion of income growth.

Q78 Mr Binley: You just question their judgment again?

Bahram Bekhradnia: On that, most certainly, yes.

Q79 Mr Binley: This all comes down to a punt, does it not really, at the end of the day?

Bahram Bekhradnia: To be honest, no, that does not. We have evidence for how income growth has varied over the last 50 years—

Mr Binley: I understand that.

Bahram Bekhradnia: I think they should make use of the evidence that exists.

Q80 Mr Binley: Sure, but the basic judgments come down to a punt, and that was one of the words you used way back in the session. Let me ask the final one, just for the fun of it, as they say, because it is here. Have you told the Government about any improvements that you have made to their model and, if you have, how has the Department responded? This is a real curtain-closer.

Bahram Bekhradnia: Of course we have.

Mr Binley: I thought you would have.

Bahram Bekhradnia: We publish everything that we produce and even what we think. The response of the Government was to describe our analysis as “eccentric”, as the Minister did in the House of Commons. The Minister for Universities wrote in *The Independent* that we had taken the most pessimistic assumption possible on every parameter; actually, a year later, he has moved very close to where we were. The Secretary of State came here, I think to your Committee a year ago, and expressed astonishment that anybody could think that the student fee increase would impact on inflation and therefore eventually on pensions, and a week later the Office for National Statistics published the inflation rate and said that 0.2 percentage points of that inflation rate were—

Chair: He also described the Royal Mail share price as “froth”.

Bahram Bekhradnia: Whatever, but in relation to our business, we do an honest job and we say what we think is right, and unfortunately Ministers are protected by armour, and so it takes a Committee like this to try to get behind that armour.

Mr Binley: We sometimes do.

Dr McGettigan: I would just say again I think it is the accounting that I would be more concerned about: how you account for the RAB charge change two or three years ago; the accounts for how you treat the amortisation of loans were changed last financial year. It is very hard to follow these fluctuations through the accounts and what is going on, and the various notes that I have put in the written submission—particularly note 32 and note 20—

there are no workings there; you get these figures, but there is no real way to assess what that movement of £30 million meant, and what that movement of £70 million meant.

Q81 Mr Binley: You are crystal-ball gazing, are you not, all the time?

Dr McGettigan: You would like to be able to see the assumptions. This is what HEPI was able to do with the estimated repayments, but what is happening in their books we do not see the workings; we do not see the assumptions.

Q82 Mr Bain: Earlier this year, the Department asked the Student Loans Company to carry out a strategic review of its collection process; that is the first such review that occurred in four years. The Student Loans Company identified the following three strategic objectives: the first is to implement measures to maximise collection of repayments due, and information about those who are or who are not repaying in order to allow accurate forecasting; the second was to improve customer service while making it easier for borrowers to understand their repayment arrangements and to fulfil their repayment obligations; and the third was to improve the efficiency of the Student Loans Company's collections operation.

Now, it is interesting that the Student Loans Company has not yet specified the overall performance improvements that it is seeking to obtain from having gone through this strategy. Can I put to all members of the panel this question? What measures do you think would be beneficial to maximise collection rates?

Bahram Bekhradnia: I think the first and third of those objectives are to some degree in conflict. Maximising income can be done, as we said earlier, but in some cases at huge cost. If you are going to appoint lawyers in Bulgaria to chase through the Bulgarian courts the non-payers from Bulgaria, and repeat that for every one of the other 25 countries, you are engaging in a huge operation at huge cost. I am not sure it would be efficient. I am not sure that measures to maximise your income is necessarily a wise thing to do, but, on the other hand, I think you probably have to appear to be attempting to maximise your income in order to encourage people to repay.

Dr McGettigan: I would agree with what the NAO suggests, which is that you need a clear understanding of what is receivable and what is received, so that you know what repayments you ought to be getting, and things on defaulting and so on are clearer. There is an inevitable lag with income-contingent repayment loans, because you have to determine what people's earnings were in a year before you can determine what is due from them. With graduate employment churn at the moment, that is not a straightforward matter, so there are inevitably going to be some lags in this, and determining those issues is going to be much more complex than it is for the fixed-period repayment loans—the old mortgage-style loans—where the debt is paid off in 60 tranches, and you set up a direct debit once you have gone over the repayment threshold. Here, with the mandatory repayments being determined by what people were earning, not just the debt borrowed, everything becomes more complicated.

Q83 Mr Bain: It is a very interesting point this one, because if we look at what has happened over the last three to four decades, particularly for employees in the lower half of the income scale, the share of the economy that has gone in wages to them has declined over that period. There is no evidence that it is going to suddenly pick up in the next 10, 20 or 30 years either, without big changes in Government policy. What impact do you think that has on the Student Loans Company when it is evaluating how much income it is likely to be able to get back?

Dr McGettigan: Technically, those estimates are being done elsewhere; they are being done at BIS or the OBR, or some mix of the two. Again, it comes back to how this then translates

into budgets and accounting. What are the pressures? How much information lag—clearly everyone is in agreement that if there are concerted efforts to avoid payment, that is a different matter from predicting what the macro-economy is going to look like so you can accurately assess what repayments are going to look like. The NAO is right in saying, “We do not know here what in the short term is due to what”. Is it poor collection performance, or is it poor ability to predict the macroeconomic conditions?

Toni Pearce: I would agree with what both Bahram and Andrew said, but there is another role that strategically the Student Loans Company inevitably will have to see itself playing, in the absence of an HE bill, and with it being the body that has the power to designate courses at private providers. When we see a black hole in finances created by over-recruitment at for-profit providers that have been designated by the SLC to have access to the public loan book, the SLC needs to see one of its priorities as stepping up to strategically address that issue of where we designate access to the student loan book, particularly for private providers. If it was given more power, or if it was able to use that power more effectively, perhaps we would not have found ourselves in the situation we have done with private HNC and HND over-recruitment.

Q84 Mr Bain: Are all or any of you confident that the people who are taking out these loans understand fully what they are getting into? Do they understand the obligations that they are going to have to meet in terms of repaying these loans? Is that something that you are picking up?

Toni Pearce: It is similar to the question earlier. I would hope that the majority of students who take out loans understand what they are getting themselves into. The real key is what they are getting themselves into at that point in time. What they do not know, and what they cannot know and nobody can predict, is what might happen to the terms and conditions of their loan in the future. I suppose that it is really concerning, particularly for somebody who is debt averse, or who does not understand the technicalities of debt or finance, to be told, “This is a set of terms and conditions, so you should learn what they mean, but they could change at any time, and it probably will not be a very public change.”

Dr McGettigan: It is worth stressing that the details of the loans are administrative matters for the Secretary of State to determine, so you have got the repayment threshold, the rate above the threshold, the interest rate, and the write-off period, which are all matters that do not need primary legislation to change; it is a secondary matter. Page 8 of *Student Loans - A Guide to Terms and Conditions* says, “You must agree to repay your loan in line with the regulations that apply at the time the repayments are due, and as they’re amended. The regulations may be replaced by later regulations.”

These students do not have fixed terms and conditions; they are exempt from the Consumer Credit Act of 1974. That is a big change from the old mortgage-style loans, where the terms were fixed and they were included in that agreement. If you are going to try to collect more from people, and make more of an issue of whether they have understood the terms and conditions, you have got to fix the terms and conditions when people take out the loans. You cannot have this situation where terms and conditions can be amended later. There has to be give and take here from Parliament and from the Government on this.

Bahram Bekhradnia: I would agree with both those points. I think that one of the things the Government have done well is to sell but also explain the financing system, but nevertheless it remains the case that the terms of the loans are changeable.

Q85 Mr Bain: Final point: the NAO recommended in its report that the Student Loans Company should use debt collection agencies to improve the efficiency of the collection operation. What are your reflections on that recommendation?

Bahram Bekhradnia: As has been said already, I think that if a loan is due and has not been paid then the Student Loans Company needs to take steps to collect it. I would not bring in a debt collection company as the first thing to do, but it is a tool in their armoury. I would not pick it out—

Chair: Okay, fairly short answers on this, because I want to bring in Andrew.

Bahram Bekhradnia: That is my answer.

Dr McGettigan: I am not qualified to say more on that, really. It is a debt to be collected if it is in default. If the SLC cannot determine that, then that is a question, again, for what kind of competence does lie at the heart of the SLC.

Toni Pearce: I think I have probably already answered that question.

Q86 Ann McKechin: Can I just ask for the record whether any of you were formally consulted when the SLC reviewed its strategy? Could you give us some idea of what recommendations you would make now to the Government in considering their future higher education financing policy and strategy, on the basis that their policy around fees is going to remain constant? That might not be the case, but let us try it on that basis.

Bahram Bekhradnia: We were certainly not consulted, and my advice to the Government would be to look again at the balance between state funding and student funding. I would not necessarily accept that fees, the way they are constructed at the moment, would be the way forward. I think there is a case for looking at other forms of student-based funding.

Q87 Ann McKechin: You would be talking perhaps of a graduate income tax?

Bahram Bekhradnia: Perhaps. The NUS had a policy on this a couple of years ago—I do not know if it still does—but it probably would be a good idea to take it out, dust it off and look at it again.

Q88 Ann McKechin: Toni?

Toni Pearce: Yes, we still do. We still have a policy of a graduate tax, and specifically for us that goes back to my first point from today about that compact between the individual and the state, and about a very clear and transparent understanding about what the state's contribution is up front. The state should not hide away in finances what its contribution will be, maybe via a private investment company. I think a real transparent compact between state and individuals, and potentially employers or private interests. On the strategic review of the Student Loans Company, I do not know if we were formally consulted, but we are represented on their steering or advisory group.

Q89 Ann McKechin: Andrew, do you agree that a graduate income tax would be a better way?

Dr McGettigan: There are too many qualification points—

Q90 Chair: This is a very big debate that we have not really got time to go into. Could I just put it to you: you have raised very serious issues about the long-term sustainability of the model that has been created. If you could put on a scale of one to 10—one being improbable, and 10 certain—what would you put as the likelihood of a new model having to be introduced, say, in five years' time?

Dr McGettigan: The key issue is that you have got everything in place to tweak the model; that is what we have seen. We have seen tweaking to the basic idea of income-contingent

payment loans over the last 15 years. The difficulty you have is you can generate more repayments by freezing the repayment threshold in 2017; you could abandon the promise of the Liberal Democrats to uprate that threshold in line with earnings. As I understand it, the regulations still have not been made that commit to that uprating. That would generate more repayments; it would change the sustainability of the scheme. Nicholas Barr has made that recommendation. The problem is, as soon as you change something like the repayment threshold, you are changing the distribution of repayments; you change whether it is progressive or regressive. You are not going to solve the balancing of these two issues—sustainability, progressive and regressive—without bringing in more public funding.

Q91 Chair: Okay, can you come back to my question? What do you think the chances are?

Dr McGettigan: That would be my answer to you. The policy ostensibly is—

Bahram Bekhradnia: He wants a number.

Dr McGettigan: I think the repayment threshold is going to be frozen. Given that the regulations to uprate it have not been made yet, that makes it very probable, and that will improve the sustainability, but change—

Q92 Chair: Okay, you still have not given me a number; you are worse than a politician for evading—

Dr McGettigan: I would say 9 or 10; that is the most likely thing. It is easy to do, but it has effects.

Bahram Bekhradnia: There are two questions there, Chairman. The one that Andrew answered is whether the existing system will be modified in order to make it more sustainable. It could be. The answer to that is 10. It is bound to. I do not think it is sustainable. However, there is another question that underpins Ann's point: is the present general arrangement satisfactory and sustainable, or will it be changed, for example, by bringing in a graduate tax or by other mechanisms? I would have thought the answer to that must be about 5.

Toni Pearce: I worry that it is a kind of quantum theory question, in that, if I say 10 it will actually become zero. I would wish that it would be 10, and I think in terms of sustainability, and particularly economic and fiscal sustainability, it should be 10.

Chair: Yes. We accept there may be adjustments that would alter your calculations, but I am talking about at the moment.

Q93 Paul Blomfield: I do not want to open up a whole new area of discussion, but I read recently that the SFA is potentially looking into the scrapping of the 24+ advanced learner loan scheme. While we are talking about sustainability of loans models, I wondered whether you thought a review would be timely and necessary.

Dr McGettigan: Of the other loans?

Paul Blomfield: Of the 24+ advanced learner loans, yes.

Dr McGettigan: My understanding is that the take-up on that has been so poor that you will have to come up with something else, but it is not my area.

Toni Pearce: Yes, for us, absolutely, the review is incredibly welcome. The last figures we saw were that around 70 people had applied for a loan to take out an apprenticeship over the age of 24. If you have a growth agenda, particularly one built around apprenticeships and skilled growth, it is really damaging to implement a frankly unsustainable higher education model into an even more unsustainable further education model. The RAB charge in further education is something like 60% or 65%, I think. I do not think that that is a good deal for students or the taxpayer, and I am hopeful that the review will come as quickly as possible.

Chair: Bahram?

Bahram Bekhradnia: Nothing to add to that, no. Oral evidence: Student Loans, HC 930 31

Chair: Okay, that concludes our questions. Thank you; it has been a rather longer session than I expected, but there are some very detailed and serious issues involved. It may well be that, on looking through the evidence, we will pick out further questions and lines of questioning that we think may need to be pursued, and we will write to you and would welcome your response to that. Similarly, if you feel there is a question or an issue that we did not adequately question you on then please feel free to write back to us with supplementary evidence. Can I thank you very much for your attendance today? We will be using the information you have given us in our interview with the Ministers after the New Year. Thank you very much.