Institute and Faculty of Actuaries

Independent thinking from the IFoA

April 2025

think

Student loans: failing students

by **Richard Hartigan**

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Part of the IFoA's purpose is to promote debate within and beyond the profession, and to position our members as leading voices on the biggest public policy challenges of our time.

We aim to showcase the diverse range of expertise and critical thinking both within and outside the profession.

Our 'think' series seeks to promote debate on topics across the spectrum of actuarial work, providing a platform for members and stakeholders alike and sharing views that may differ from the IFoA's house view. In doing this, we hope to challenge the status quo, question the orthodoxy, and shine a light on complex or under-examined issues, thereby stimulating discussion and dialogue to help tackle issues in a different way.

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Introduction

There is a seductive contention that students benefit from their higher education and thus should pay for it. The difficulty with this reductive line of reasoning is that higher education benefits society as a whole, as well as the individual student. In knowledge economies (note: services account for in excess of 80% of the UK's GDP) having a well-educated workforce is critical to the long-term health of not just the economy, but the nation.

Few would object to the UK nation providing free education to those aged five years old to 18 years old. Yet, upon turning 18 years old, young adults are essentially forced to take on quite substantial amounts of debt to access higher education. The sums are eyewatering. Combined tuition fee and maintenance loans for a three-year degree in England can easily exceed £60,000 upon graduation (and the average is £48,470 in England).

This paper neatly sidesteps the issue of whether (and/or to what extent) young adults should pay to access higher education. At a bare minimum, though, if the collective decision is that young adults must pay to access higher education, then we must ensure that the student loan infrastructure to facilitate this is fit for purpose. As I describe in this paper, in many aspects, the current student loan infrastructure is not.

Why should actuaries care? As discussed in the 'broader societal issues' section below there are some exceptional and profound effects resulting from the current student loan infrastructure that impact upon society.

The four nations

England, Wales, Scotland, and Northern Ireland each have a different student loan infrastructure as a result of devolution.

Scotland and Northern Ireland student loan infrastructure is undoubtedly superior to that of England and Wales, and it is notable that Scotland provides free tuition to Scottish students and Northern Ireland provides half-price tuition to Northern Irish students. There is, however, room for improvement based on some of the ideas in this paper.

The student loan infrastructure of England and Wales ranks considerably more poorly (although Wales does offer all Welsh students a grant of at least £1,000 per year).

It is worth noting that as at 31 March 2024, in excess of 90% of the outstanding balance of UK student loans is related to English student loans. Thus this paper focuses on England, but the ideas in this paper are adaptable for all four nations in the UK.

The example student

This paper is too short to do a broad study, and thus focuses primarily on the hypothetical (but typical) student:

- English
- Studying a three-year undergraduate degree in England
- Commencing university in Autumn 2025
- Living away from parents, outside London
- First year tuition fee: £9,535 (fully-borrowed via student loans)
- First year maintenance loan: £10,544 (the maximum for such a student)

The paper will occasionally veer off, though, to highlight poor outcomes for other types of student.

Metrics

Throughout this paper the following questions will be asked about student loan infrastructure:

- Is there consistency across cohorts of students?
- Is there consistency across types of students?
- Does the choice of interest rate make sense?
- Does the point at which loans start to be repaid make sense?
- Does the pace at which loans must be repaid make sense?

Combined tuition fee and maintenance loans for a three-year degree in England can easily exceed £60,000 upon graduation

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Analysis: interest rate charged

The first thing to understand is that there is quite a variety of different plans, with different levels of dysfunctionality:

		England	
	Start <Sep 12	Start Sep 12 – Jul 23	Start >Aug 23
Undergraduate/PGCE/AdvLearner	Plan 1	Plan 2	Plan 5
HESCL	Plan 1	Plan 2	Plan 2
PG (masters or doctoral course)	Plan 1	Plan PG	Plan PG

Plan 1 charges an interest rate at the lower of the Retail Price Index (RPI) set each September at the prior March level and the Bank of England (BoE) base rate+1%.

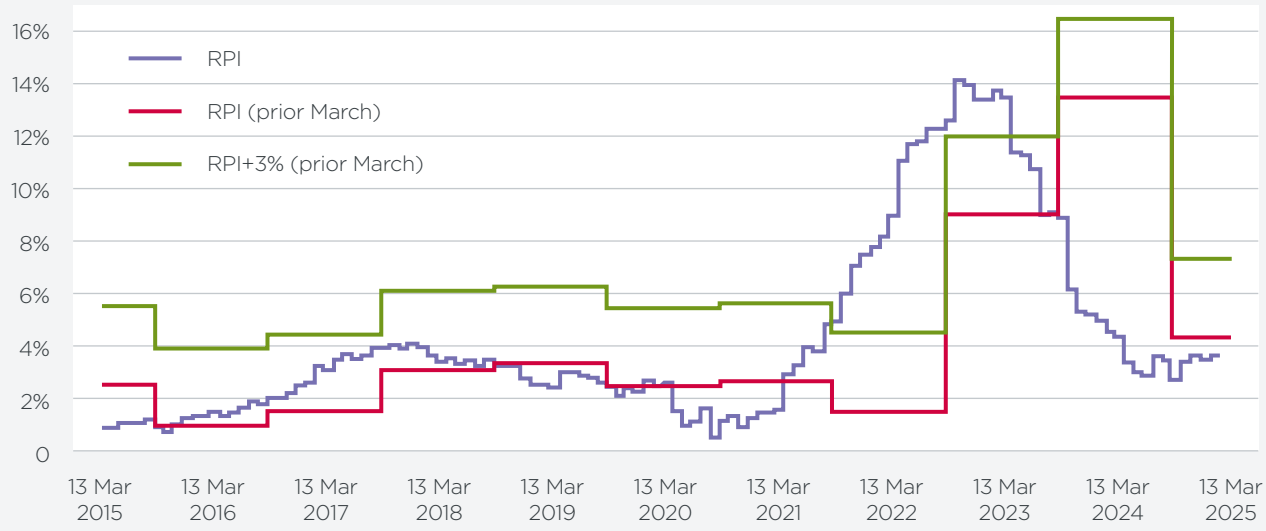
Plan 2 charges an interest rate at the RPI+3% (less for low incomes post graduation). A discretionary interest cap may apply, and indeed did apply between September 2022 and September 2024.

Plan 5 charges an interest rate at the RPI. A discretionary interest cap may apply, and indeed did apply between September 2023 and September 2024.

Plan PG (postgraduate) charges an interest rate at the RPI+3%. A discretionary interest cap may apply, and indeed did apply between September 2022 and September 2024.

One might ask: Why might a discretionary interest cap be necessary for Plans 2/5/PG? The answer lies in the transition away from the beneficial optionality enjoyed by students in Plan 1 (i.e. the lower of the RPI and BoE+1%) to an interest rate in Plans 2/5/PG solely based on the RPI and the resulting extreme volatility in that measure, especially from September 2022 to September 2024. Without that interest cap undergraduate students would have been accruing interest at 13.5% and postgraduate students would have been accruing interest at 16.5%. The discretionary interest cap, when applied, imposed interest rates at no higher than 8%.

Retail Price Index



Source: Office for National Statistics - Retail Prices Index: Long run series: 1800 to 2024.

Consider the Student Loans Company's mission:

"We are a non-profit making government-owned organisation that administers loans and grants to students in colleges and universities in the UK.

SLC is an executive non-departmental public body, sponsored by the Department for Education."

So many questions arise just in relation to the interest rate charged under the current student loan infrastructure:

- The interest cap in Plans 2/5/PG is discretionary, both in timing and quantum: does this provide students with the requisite level of financial comfort?
- Why are students grandfathered into plans depending on the date they started studying? For example, as of the date of this paper, students on Plans 1/5 are paying 4.3%, whereas students on Plans 2/PG are paying 7.3%. Starting university in 2022 (Plan 2: 7.3%) turns out to be a lot worse than starting university in 2023 (Plan 5: 4.3%). An interest rate lottery exists. Even if one accepts the SLC is non-profit-making, there is obviously some degree of cross subsidisation amongst cohorts of students.
- Why anchor to the RPI? The RPI was held not to meet international statistical standards, and the Office for National Statistics (ONS) no longer classifies it as a "national statistic". The answer may lie in the alternatives of CPI and CPIH being (on average) about 1.3% lower for the last 10 years.
- Is any inflation measure fit for purpose for basing an interest rate charged?
- A differential of +3% currently exists for postgraduate students. If the SLC is non-profit-making, how can that be justified?
- The setting of the RPI is done just once per year (each September at the prior March level): how do we ameliorate the risk that a one-off blip in the RPI will be baked in for a full 12 months, as happened from September 2023 to September 2024?
- The Government borrows at (or near) the Bank of England (BoE) base rate. Is the addition of +1% for Plan 1 justified? That is a genuinely open question.
- Most UK homeowners fix mortgage interest rates for two or five years. No such option is offered to students. This feels like an important oversight. In fact, often, a 1-year fixed interest rate linked to the RPI is thrust upon students, frequently to their detriment (as discussed above).

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Analysis: repayments

Plan 1 requires repayment at the rate of 9% once gross salary reaches £24,990.

Plan 2 requires repayment at the rate of 9% once gross salary reaches £27,295.

Plan 5 requires repayment at the rate of 9% once gross salary reaches £25,000.

Plan PG requires repayment at the rate of 6% once gross salary reaches £21,000.

At this point it is worth noting that UK Living Wage is £24,570 and the London Living Wage is £27,008, both based on 37.5 hours per week for 52 weeks per year, as both measures are expressed as hourly rates: £12.60 and £13.85, respectively.

It is worth noting that the figures in the plans above apply to gross salary and, for example, do not permit the deduction of pension contributions prior to applying the repayment rate. This has important implications discussed in the 'broader societal issues' section below.

Plan 5 (that applying to our example student) requires repayment at £25,000, at a point where our example student is barely making the UK Living Wage of £24,570. Obviously things would be considerably worse if our example student moved to London looking for opportunities.

It is puzzling that postgraduate students are required to repay student loans from just £21,000, and equally puzzling that it is at a different repayment rate (6%) than undergraduate students (9%).

The repayment rate of 9% acts precisely as a marginal tax rate would at the point of repayment (£25,000 in the case of our example student). Both the point at which repayment kicks in and the blunt quantum act as severe drags in net income for students post graduation. It is highly unlikely that any sane economist would promote such an extreme increase in the marginal tax rate at £25,000, for fear of severely retarding economic growth.

The point at which UK student loan repayments kick in is far too low. The quantum of repayment at that point is too high and too blunt.

We have an alternative student loan model to consider: the Australian Higher Education Loan Program (HELP).

Referring to the table below, $54,434 equates to about the 33rd percentile of earnings where the repayment rate equals 1%. Even at the median level of earnings (50th percentile ~ $72,500) the repayment rate equals 3%. The repayment rate of 9% (in the UK) would only apply at an Australian level of earnings which equates to about the 85th percentile ($142,101).

2024-2025 Repayment threshold		Repayment % rate
AU$0	AU$54,434	0.00%
AU$54,435	AU$62,850	1.00%
AU$62,851	AU$66,620	2.00%
AU$66,621	AU$70,618	2.50%
AU$70,619	AU$74,855	3.00%
AU$74,856	AU$79,346	3.50%
AU$79,347	AU$84,107	4.00%
AU$84,108	AU$89,154	4.50%
AU$89,155	AU$94,503	5.00%
AU$94,504	AU$100,174	5.50%
AU$100,175	AU$106,185	6.00%
AU$106,186	AU$112,556	6.50%
AU$112,557	AU$119,309	7.00%
AU$119,310	AU$126,467	7.50%
AU$126,468	AU$134,056	8.00%
AU$134,057	AU$142,100	8.50%
AU$142,101	AU$150,626	9.00%
AU$150,627	AU$159,663	9.50%
AU$159,664		10.00%

Broader societal issues resulting from the current student loan infrastructure

Students emerging from higher education are a huge driver of household formation. Household formation drives demand and GDP. These young adults meet and move in with prospective life partners, or simply meet and move in with other like-minded young adults. Ordinarily this is via renting, but many will plan ultimately to purchase a home, get married and raise a family.

Poorly-designed student loan infrastructure retards all these activities. Household formation happens later, purchasing one's own home happens later (if at all), marriage happens later, and children arrive later (likely in fewer number, or perhaps not at all).

In 'think' issue 9: *The population implosion: what choices do we have?* author Dermot Grenham examined low and falling birth rates, noting that the topic was increasingly becoming a topic of media and academic interest.

One need look no further than UK society's collective decision to load young adults with eyewatering levels of debt, then, to rub salt into the wound, fail to design fit-for-purpose student loan infrastructure, as at least one strong element in this birth rate outcome.

A short side-note about another insidious element of poorly-designed student loan infrastructure, of particular interest to actuaries: the design of the UK's current student loan infrastructure does not permit the deduction of pension contributions prior to applying the repayment rate. That is, the point at which repayment kicks in is geared on pure gross salary.

Young adults first entering the workplace are thus actively discouraged from contributing to a pension plan from the first moment of their life of employment, and in any case might be so tempted anyway by the bare economic necessities of paying rent and buying food. The lifelong financial detriment that brings is enormous. Having opted out, there will be strong inertia to opt back in.

It is also worth considering the socio-economic effects of poorly designed student loan infrastructure. Disproportionately, the weight of that poor design falls heavily on students from less well-off backgrounds, and may even permanently discourage such students from setting out on a path to higher education.

The current student loan infrastructure impacts students for a considerable period post-graduation, but there are also some exceptional and profound effects resulting from the current student loan infrastructure that impact upon society: some short term, some medium term, and some much longer term.

Student loan infrastructure: a proposed new model

The UK can do so much better. Any of the following proposals will help by itself, but it is likely only a root and branch analysis and repair of the UK's current student loan infrastructure can truly resolve the current poor design.

1. End the interest rate lottery. All students from all class year cohorts from all types of study (including postgraduate) should be treated identically. There is simply no supportable argument for a student who started university in 2022 paying 7.3% and a student who started university in 2023 paying 4.3%. Almost as poor is the muddle headed idea that postgraduate students must pay more: why?

2. The Government borrows at or near the Bank of England (BoE) base rate. It is highly unlikely that any inflation measure is a fit-for-purpose base for an interest rate, but what is crystal clear is that the RPI is exceptionally unfit for that purpose. The +1% addition to the BoE base rate seems generous for a body (the SLC) that manages nearly £300 billion of student loans. Discretionary interest caps seem ripe for misuse or non-use. This paper proposes an interest rate for all students of BoE+0.25%, capped at 5%. The latter is the approximate 30-year gilt interest rate, as of the date of this paper. Students should not be held hostage to mismanagement of the economy resulting in high interest rates or high inflation.

3. Offer students the opportunity to fix their interest rate for 2/5/10 years.

4. There is also a repayment lottery, both the point at which repayment kicks in and the quantum. All students from all class year cohorts from all types of study (including postgraduate) should be treated identically.

5. The point at which repayment kicks in must be net of pension contributions.

6. There is little intellectual support for setting the point at which repayment kicks in below the UK Living Wage of £24,570. With many graduates likely to find their first employment in London, perhaps the London Living Wage of £27,008 should be preferred. This author goes further. For reasons outlined in the 'broader societal issues' section of this paper, this author proposes £30,000. It is notable that in Scotland the point at which repayment kicks in is £31,395.

7. The Australian HELP student loan model is probably a bit fussy with its hyper-graduated repayment rates. A simplified UK version might be 3% above £30,000, 6% above £40,000, and 9% above £50,000, all appropriately indexed over time.

There is simply no supportable argument for a student who started university in 2022 paying 7.3% and a student who started university in 2023 paying 4.3%.

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Conclusion

It bears repeating: this paper neatly sidesteps the issue of whether and/or to what extent young adults should pay to access higher education. That is a debate worth having.

Turning to the topic of this paper: student loan infrastructure. If the collective decision is that young adults must pay to access higher education then we must ensure that the student loan infrastructure to facilitate this is fit for purpose.

Higher education benefits society as a whole, as well as the individual student. If the proposals in this paper end up costing a little more in the short term than the current student loan infrastructure, then so be it. It will be a critical investment in the long-term health of the UK economy and the UK nation. However, it is not obvious to this author that the proposals would cost more, and in any case the proposals are best to be seen in the light of rectifying prior poor design. The proposals in this paper are one approach; actuaries collectively, with other interested parties, can play a strong role in redesigning student loan infrastructure to balance competing interests while avoiding poor societal outcomes. Students should not be treated by the Government as profit centres.

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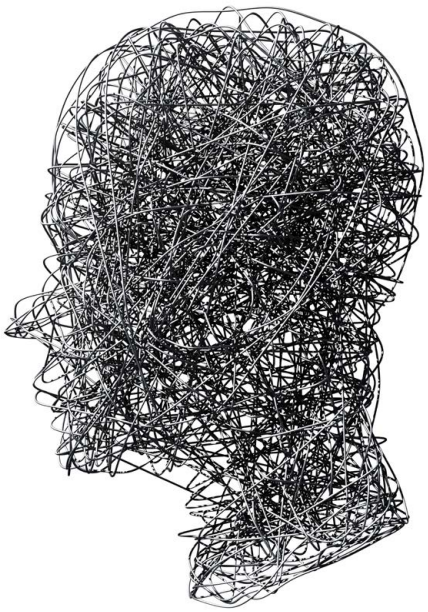

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