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Dear Dame Meg

Financial sustainability of the higher education sector in England

I am writing to you and the committee to outline what the Office for Students (OfS) is doing to understand the pressures faced by universities, colleges and other higher education providers. This responds to the recommendation made by the committee in its report on 'Financial sustainability of the higher education sector in England' in June 2022.

Our approach to financial sustainability and protecting students

The OfS regulates higher education providers in England. To register and stay registered with the OfS, each provider must show that it is financially viable and sustainable. Registered providers are required to submit detailed information about their financial performance and strength at least once a year, covering the most recent audited year and forecasting ahead for the following five-year period. Each provider also returns qualitative information in the form of a written commentary and reports from its external auditors. We use this, alongside other information we hold, to assess the viability and sustainability of each provider.

The OfS is required to operate a risk-based regulatory system which focuses attention on those providers that present most regulatory risk. This means that we target our detailed assessment on providers where indicators suggest that there may be increased financial risk, and on other providers where we have existing specific concerns. In our detailed assessment we consider disclosures in a provider's audited financial statements, the credibility of its financial information and any interdependencies between the provider and other entities.

Our approach allows us to tailor our engagement with a provider on the basis of our judgement of risk. For example, where we identify financial risk we routinely engage informally with a provider's senior staff – vice-chancellor, finance director, or chair of governing body – to test our understanding of its financial position, the risks in its operating environment, and the credibility of any steps it is taking to remain sustainable.

Where we consider that risk remains high, we use our formal powers. These range from requiring additional and more frequent reporting from a provider on its financial position to the imposition of legally-binding requirements to take specified steps to ensure students could continue on their

course if a provider is no longer able to operate. In the most recent year, we have imposed formal enhanced monitoring requirements (or retained existing such requirements) on ten providers in relation to their financial position. We have imposed formal student protection directions, or required orderly exit plans, five times since the OfS began operating in 2018. In all cases, our interventions are designed to protect the ability of students to complete their course with their original provider or, if that is not possible, elsewhere. Since the OfS began operating, one registered provider – a drama school – has closed because it was not financially viable. In that case, we worked with the drama school, government, other drama schools and with other stakeholders to find alternative study options for students. All students were offered the opportunity to continue on their course without disruption with the support of another drama school. As of 8 July, 268 students (94 per cent) had transferred to that drama school.

Our current analysis of the financial position of the sector

We regularly publish reports[1] setting out our analysis of the financial sustainability of the sector, and of different types of providers. We report on the trends we see in the current and forecast position of providers and on our analysis of current and likely future challenges facing the sector.

Our most recent report sets out our view that the overall aggregate financial position of universities, colleges and other registered higher education providers is currently sound. This is despite the many operational and financial challenges arising from the coronavirus pandemic and increasing costs for providers and students. The report shows that, across the sector as a whole, universities and other higher education providers project:

- Total income to grow from £37.31 billion recorded in 2020-21 to a forecast £45.72 billion in 2024-25.
- A reduction in borrowing, both in cash terms and as a percentage of total income. Providers forecast £13.78 billion of external borrowing in 2024-25 (compared to £14.10 billion in 2020-21).
- A reduction in the aggregate surplus in the sector (adjusted to exclude pension provision adjustments) in the coming years. A surplus of £1.74 billion (4.7% of total income) was recorded in 2020-21. This is forecast is to fall to £896 million (2.2% of total income) in 2021-22 before recovering to £1.67 billion (3.7% of total income) in 2024-25.
- Cash flow from operating activities to decline in the short term before picking up to approximately pre-coronavirus levels over the longer term.
- Expenditure to increase at an overall higher rate than income during the period, with a warning that inflationary pressures are likely to be more significant than universities have forecast.
- On international students, the report notes that 'The sector, and some providers in particular, continue to be reliant on recruitment of students from China. Any event that reduces the flow of such students to the UK is likely to have a significant impact. The number of Chinese students studying at English higher education providers showed no growth in 2020-21, whereas the number of Indian students studying at English providers was almost 50 per cent higher than the previous year.'

The sector's performance in aggregate does not reflect the picture for individual providers. We see significant variation in financial performance and strength. To protect their longer-term sustainability, all providers will need to continue to adapt to uncertainties and financial risks.

[1] https://www.officeforstudents.org.uk/publications/financial-sustainability-of-higher-education-providers-in-england-2022-update/

Financial challenges could affect individual providers differentially and each will have its own mitigating options.

We are not concerned about the short-term viability of most providers, although we are monitoring the risks of some more closely. Based on the information currently at our disposal we consider that the likelihood of multiple providers closing unexpectedly due to financial failure remains low now and in the short term. However, we continue to monitor the sector and individual providers given the challenges they face.

Our plans for further development of our work on financial sustainability

We recognise there is more the OfS can do to understand the financial viability and sustainability of the sector and the pressures faced by providers. We accept the committee's view that we should also do more to demonstrate to universities and students that we understand these issues and take them into account in our regulation. Our plans for further development fall into three areas.

First, we are developing our modelling capability to identify system-level risks that may affect the financial sustainability of some or all providers. For example, we are seeking a more sophisticated understanding of the range of possible impacts of fluctuations in student recruitment, reliance on income from international students, and exposure to increasing pension costs. In parallel we are refining our risk-based regulation of individual providers so our interventions are targeted, timely and effective. We are also finalising for publication our new Key Performance Measures which include a measure of the impact on students where a provider ceases to operate.

Second, we are testing our understanding of the context in which providers are operating and the pressures that may arise from the operating environment for different providers. We already engage regularly with sector representative bodies, finance directors, the sector's lenders and other relevant stakeholders. We plan to supplement this by holding an annual series of roundtable discussions with groups of finance directors from different types of provider. We will seek their views on the pressures they face, the challenges in responding to these, and the actions the OfS could take to ensure its regulation of financial risk is transparent and effective. We would expect to publish our learning from these sessions to show how it has influenced the development of our approach. In addition, we are currently seeking structured feedback from the providers we regulate about the OfS's approach and performance more generally. We plan to use this to assess the effectiveness of our communications and engagement with providers and identify ways to improve it.

Third, we are improving the way we explain our approach to regulating financial sustainability and demonstrating how we have addressed risk in individual providers. We will publish case studies to show how we make judgements about risk and the actions we then take in response. We expect these case studies to be helpful to providers, offering reassurance to those without significant financial risk that they are unlikely to be subject to increased regulation, and showing those facing increased risk how we would use our powers in a targeted and proportionate way.

Our wider regulation of the things that matter to students

We know that the financial sustainability of their provider is important to students, but we recognise that for most students this is not their main concern. This is why our new strategy[2] focuses on driving a step change in our approach to regulating quality. The quality of their course and the

[2] https://www.officeforstudents.org.uk/about/our-strategy/

outcomes they achieve are the things that matter most to students. We have recently completed a series of public consultations[3] and can now:

- Set minimum requirements for student outcomes – relating to the proportion of students who continue on their course after the first year; the proportion who complete their course; and the proportion who go on to professional jobs or further study. We will begin to take action in the autumn where we have concerns that these requirements are not met by individual providers.
- Open investigations where the information we hold suggests that a provider may not be delivering a rigorous high quality academic experience, supporting its students to succeed, or awarding credible qualifications that stand the test of time. We announced in May our first group of investigations focused on business and management courses in eight universities and we expect to report our findings later in the year.
- Assess all providers through a refreshed Teaching Excellence Framework (TEF) to identify where students can find excellent learning, teaching and assessment in the sector. We expect to publish new TEF awards for each provider in 2023 to ensure that students thinking about what and where to study can take them into account in their decisions.

In addition, we are undertaking a review of the ways in which higher education providers are approaching blended or 'hybrid' learning. We expect to report at the start of the next academic year on the approaches that we think may comply or not comply with our quality requirements.

Our revised KPMs will measure and provide transparency in relation to the success of these interventions to improve quality across the sector. As Nicola Dandridge explained to the committee when she gave evidence in April, we have reviewed our Key Performance Measures to reflect our new strategy, including consideration of how we can most appropriately capture value for money. We have decided to adopt a basket of measures to reflect different aspects of value for money. Initially we will look at three sub-measures, and plan to consider further additions over time. The three measures are a) students' perceptions of value for money, b) final year students' responses to National Student Survey questions on aspects of quality, and c) a measure on student outcomes. We have chosen these measures because they capture students' views as well as the underpinning factors of value for money identified in previously commissioned research.[4] In future, we will consider measures that better capture the perspectives of other stakeholders.

I hope the committee is reassured by the actions we are taking and I would be happy to discuss these further if the committee would find that helpful.

Yours sincerely

Susan Lapworth
Interim Chief Executive

cc: Andrea Jenkyns MP

[3] https://www.officeforstudents.org.uk/publications/student-outcomes-and-teaching-excellence-consultations/
[4] See 'Value for money: the student perspective', 2018, page 16. Available at: https://www.officeforstudents.org.uk/news-blog-and-events/press-and-media/new-research-shines-spotlight-on-student-perceptions-of-value-for-money/