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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Regulatory Impact Statement

Student Support Package for Budget 2013

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by the Ministry of Education.

It considers options that improve the value of the student support system to the Government, while also ensuring that the Student Loan Scheme and student allowances are contributing to tertiary education priorities.

The following changes have been analysed:

- targeting student allowances and/or loans on the basis of returns to study and on initial years of study by removing or reducing entitlement through progressive decreases based on age and/or weeks of study

- extending the current student loan and student allowances stand-down period for permanent residents and Australians from 2 years to 3 years to increase our confidence that permanent residents will stay in New Zealand when they finish their study and repay their student loans

- increasing repayment obligations for overseas-based borrowers to speed up repayments

- making it an offence for a borrower to knowingly default on an overseas-based borrower repayment obligation so that an arrest warrant can be requested to prevent the most non-compliant borrowers from leaving the country from 1 July 2013

[6]

- putting in place an ongoing information-sharing agreement between Inland Revenue and Internal Affairs to obtain further contact details from overseas-based borrowers and liable parents when they renew or apply for their passport

[6]

Ben O'Meara

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22 March 2013

Executive Summary

The Government spends a significant amount of money each year to fund tertiary education. Spending on student allowances has increased by 69% since 2007/2008. In addition the number of student loan borrowers going overseas and into default continues to increase.

The tertiary environment has changed significantly since the early 1990s, when student loans and allowances were introduced. The design of student allowances has not been reviewed since student loans became more subsidised, with interest subsidies and interest-free loans.

The fiscal environment requires effective use of constrained resources. The objective of proposals in this paper is to adjust the student support system to contain tertiary education expenditure and improve its performance, while maintaining interest-free student loans. The proposals seek to address the increasing cost of Student Support to the Crown and the taxpayer, and thereby achieve a fairer distribution of benefits and costs between current and future taxpayers.

The main policy levers available to the Government to achieve this are:

- to target access to the student support system (i.e. Student Loan Scheme and student allowances)
- to introduce new methods to encourage or require student loan repayments.

The proposed package of changes outlined in this Regulatory Impact Statement (RIS) has been designed to achieve the objectives outlined above. The changes proposed are:

- targeting student allowances more tightly on the basis of returns to study and to initial years of study and increasing the contribution that people make to their tertiary education, for example by:
 - removing student allowances eligibility for those over a certain age (e.g. 65 years)

[6]

- improving repayments from overseas-based borrowers and increasing personal responsibility for debt repayment, for example by:
 - extending the student loan and student allowance stand-down period for permanent residents and Australians from 2 years to 3 years from 1 January 2014
 - adjusting the overseas-based borrower repayment regime, from 1 April 2014 for 2014/15 and beyond, by introducing:
 - i. a fixed repayment obligation for overseas-based borrowers at no less than the rate they pay when they leave New Zealand
 - ii. additional repayment thresholds for overseas-based borrowers
 - making it an offence for a borrower to knowingly default on an overseas-based borrower repayment obligation so that an arrest warrant can be requested to prevent the most non-compliant borrowers from leaving the country from 1 July 2013
 - putting in place an ongoing information-sharing agreement between Inland Revenue and Internal Affairs to obtain further contact details from overseas-based borrowers and liable parents when they renew or apply for their passport.

Status Quo – Student Support System

The Government spends a significant amount of money each year to fund tertiary education. In 2011/12, the Government spent \$2,255 million on tuition subsidies, students drew \$1,586 million on new student loan lending, and the Government paid \$649 million on student allowances. Tuition subsidies, student loans, and student allowances combined have represented between 6% and 7% of core Crown expenditure in each year between 1994/5 and 2011/12.

New Zealand spends slightly more on tertiary education than most other OECD countries, as a proportion of GDP, but this has been declining over the past three years.¹ When public subsidies to households are excluded (including student loans, scholarships and grants) New Zealand's public expenditure on tertiary education as a percentage of GDP (1.1 percent) is currently the same as the OECD average.

OECD countries spend, on average, 20.5% of their public budgets for tertiary education on financial aid to students. New Zealand spends more than double this proportion (43.1%), and is second behind the UK (54.2%) on the proportion of total public tertiary education expenditure that goes on supporting students.

The student support system is designed to reduce financial barriers to participation in tertiary education. The Student Loan Scheme provides broad access to upfront finance with repayments to be met from future earnings, while allowances aim to address the financial barriers to study for low-income groups, students with very little upfront cash or family resources, and those who may heavily discount the future benefits of qualifications. They also provide additional living costs support for students with higher financial needs, for example those with dependants. Loans involve a lower level of government subsidy than allowances, so they are a means of managing the trade-offs between access to study and affordability for Government.

In the context of the current economic downturn, the objective of recent student support Budget policy changes has been to improve the value for money of student support expenditure, particularly as the Government is committed to providing near universal student loans and maintaining high levels of tertiary education participation.

Student Allowances

Government expenditure on student allowances has increased significantly in recent years – from \$385 million in 2007/2008 to \$649 million in 2011/12 (a 69% increase). The number of students receiving an allowance has also increased, particularly since 2009, due to policy changes and the effects of the recession, including higher tertiary enrolments due to increased unemployment.

In addition, the design of student allowances has not been reviewed since student loans became more subsidised, with interest subsidies and interest-free loans.

Allowances play an important role, as supplementary support to student loans:

- to assist people to enter tertiary education who have very little upfront cash or family resources
- to provide additional support for students with higher financial needs, for example, those with dependants who do not have the means to meet their costs independently

¹ OECD, *Education at a Glance*, 2012.

- to provide additional support in initial years of study for those who may not recognise the future benefits of tertiary study
- to reduce barriers for people who lack prior educational achievement by enabling them to gain initial qualifications.

Student allowances are not well targeted to those in most need. Policy changes to the parental income threshold mean that the original intent of allowances as a mechanism to support students from low income backgrounds has broadened to include middle income families. Some student allowance recipients are likely to earn higher incomes as a result of study, and would have undertaken tertiary study regardless of student allowance eligibility.

In Budget 2012, we made changes to student allowances to begin shifting the focus of support back to students from lower income backgrounds by freezing student allowance parental income thresholds. We also tightened the targeting of the scheme so that it centres more on students in their initial years of study by removing eligibility for postgraduate study and long programmes.

There is room to improve the targeting of student allowances. For example, some recipients are likely to earn higher incomes as a result of study and would have undertaken tertiary study regardless of student allowance eligibility (i.e. representing dead-weight costs).

For example, for students over 24, targeting based on personal income while studying full time is not a good proxy for need – people are forgoing income to invest in study that will lead to jobs with higher incomes in the future. In 2011, 68% of all student allowance recipients studied at levels seven and above. Our research shows that, five years after finishing study, the median earnings of young people who complete a bachelors degree is 53% above the national median earnings.²

Students may also come from high income families (a student under 24 with parental income approaching \$90,000 per year can receive a partial allowance for up to 5 years³ to study at degree level) currently there is limited means of determining those who may have other resources at their disposal.

Student Loan Scheme

The Student Loan Scheme is a significant and growing asset on the Crown's accounts. Since its establishment in 1992, 1.1 million New Zealanders have used the loan scheme, borrowing a total of \$17,155 million.

The most significant component of the cost of new lending to Government is the time value of money (the value of loans decreases over time as a result of inflation, and this cost is not off-set through an interest charge to borrowers). The other components, in order of significance, are:

- borrowers who do not meet their repayment obligations (primarily overseas-based borrowers)
- borrowers with low life-time earnings who do not have a repayment obligation

² Mahoney P, et al (2013). *Moving on up – what young people earn after their tertiary education*. Wellington; Ministry of Education.
http://www.educationcounts.govt.nz/publications/tertiary_education/115410

³ 200 weeks typically equates to 5 years of full-time study, not including summer school.

- death and bankruptcy.

Problem Definition and Objectives

The tertiary environment has changed significantly since the early 1990s, when student loans and allowances were introduced. The fiscal environment requires effective use of constrained resources. The Government's focus for tertiary education has now moved from participation to completion of qualifications and the quality of those qualifications, including employment outcomes.

Recent Budget changes have reduced the costs of the Student Loan Scheme. Prior to Budget 2010, the cost of lending was 47.39 cents in the dollar. The cost of lending following Budget 2012 is 39.09 cents in the dollar. The development of proposals for Budget 2013 sits within a wider 2012/13 student loan work programme agreed to by Ministers in August 2012. Policy items on the work programme include exploring:

- current eligibility settings and whether any further changes are needed, given the primary objectives of the performance framework
- the analysis of long-term non-repayment groups.

The objective of these proposals is to adjust the student support system to contain tertiary education expenditure and improve its performance, while maintaining interest-free student loans.

The main policy levers available to the Government to achieve this are:

- to target access to the student support system (i.e. Student Loan Scheme and student allowances)
- to introduce new methods to encourage or require student loan repayments.

Budget 2013 Package

- The proposed Budget 2013 package aims to improve the value of student support spending by:

Targeting more tightly on the basis of returns to study and initial years of study and increasing the contribution that people make to their tertiary education by:

- removing student allowances eligibility for those over a certain age (e.g. 65 years)

[6]

Improving repayments from overseas-based borrowers and increasing personal responsibility for debt repayment by:

- extending the student loan and student allowance stand-down period for permanent residents and Australians from 2 years to 3 years from 1 January 2014
- adjusting the overseas-based borrower repayment regime, from 1 April 2014 for 2014/15 and beyond, by introducing:
 - a fixed repayment obligation for overseas-based borrowers at no less than the rate they pay when they leave New Zealand
 - additional repayment thresholds for overseas-based borrowers
- making it an offence for a borrower to knowingly default on an overseas-based borrower repayment obligation so that an arrest warrant can be requested to prevent the most non-compliant borrowers from leaving the country from 1 July 2013
- putting in place an ongoing information-sharing agreement between Inland Revenue and Internal Affairs to obtain further contact details from overseas-based borrowers and liable parents when they renew or apply for their passport.

The proposals set out in this Regulatory Impact Statement (RIS) seek to:

- target student allowances more tightly on the basis of returns to study and to initial years of study and increase the contribution that people make to their tertiary education
- improve repayments from overseas-based borrowers and increasing personal responsibility for debt repayment.

The options above also seek to address the increasing cost of the Student Loan Scheme to the Crown and the taxpayer, and thereby achieve a fairer distribution of benefits and costs between current and future taxpayers.

These options have been developed within an interest-free student loan policy environment. This is a significant constraint on the options available to contain Government expenditure and improve the performance of the Scheme. In addition options have been developed as part of a Budget sensitive process which is a significant constraint on consultation. Key agencies involved with the Scheme – Inland Revenue, the Ministry of Social Development, and the Treasury – have been consulted on the proposals and this RIS.

One area of low value lending relates to borrowers whose incomes are insufficient to make progress in repaying their loans. These borrowers are likely to remain a concern following recent Budget changes. Many have studied below degree level, predominantly at levels three and four. The 2011 analysis of the Student Loan Scheme identified low labour market returns are strongly associated with being over 50, a non-New Zealand citizen, and studying below degree level. Therefore, changes focus on improving the value of lending based on these characteristics.

Any modifications to the student support system need to take into account the intention of student loans and allowances, which is to remove financial barriers to accessing tertiary education. Any changes would also need to be considered in the context of the Government's goals for tertiary education, particularly participation and achievement for the priority groups identified in the Tertiary Education Strategy 2010-2015.⁴

Specific mechanisms for restricting access to student support and increasing repayment methods, and options within each, are discussed below. The conclusion section contains a summary table.

Savings estimates

Savings and costs included are for each independent initiative and do not take account of interdependencies. In contrast, the final savings and costs for Budget 2013 initiatives, included in the 2013 Student Support Cabinet Paper, do include interdependencies between initiatives. For this reason, the savings and costs for initiatives included in the final Budget Cabinet paper may differ from those contained in this Regulatory Impact Statement.

⁴ Young people aged under 25, Māori students, Pasifika students.

Regulatory Impact Analysis

Targeting on the basis of returns to study, initial years of study and increasing the contribution that people make to their tertiary education

- Encourage a greater contribution to the cost of tertiary education from students whose study provides a low return to taxpayers
- Target student allowances more closely to initial years of study

Option 1 - Status quo

Generally all people irrespective of age are entitled to government assistance to support their participation in tertiary study (tuition subsidies, student allowances, student loans).

There are some instances where people are treated differently at certain ages, which include:

- older student allowance recipients (i.e. those 24 and over) are generally paid higher rates of allowance than younger recipients (to help meet the increased obligations and commitments of older people)
- older student allowance recipients (i.e. those 24 and over) are not parentally income tested (as there is no expectation that parents will support them)
- no student allowance for those who are in receipt of National Superannuation (to avoid double-dipping)
- loan borrowers aged 55 and over cannot borrow for living costs or course-related costs (to reflect diminished public and private returns on the education investment).

The longstanding limit to how long a student can receive a student allowance (200 weeks) now operates alongside a lifetime limit on how much study a student can borrow for (7 EFTS).

These current settings do not align well with the intended objectives for the student allowance scheme, particularly for people aged 24 and over. Allowances are not well targeted in terms of supporting study at lower levels, and students from low socio-economic backgrounds. Some student allowance recipients are likely to earn higher income as a result of study, and to have undertaken tertiary study regardless of student allowance eligibility.

Data about student allowance recipients show that certain trends which are steady among younger age groups begin to distort among older age groups. A significant proportion of older people who are receiving a student allowance are permanent residents: between the ages of 30 and 54 there is a steady proportion of approximately 22% which increases steeply after age 55 to 30.8%, reaching 45.6% of recipients aged 60 - 64. In the group aged 65 and over, 82.3% of student allowance recipients are permanent residents.

Significant over-representation of permanent residents at older ages suggests some may be accessing the allowances to undertake study, where the benefits are not well aligned to the objectives of the student allowances scheme. There are also similar trends of increases of older people at secondary schools, studying at low levels. One of the key reasons for providing student support is to enable people to invest in their future, including their future in the workforce.

Study undertaken by these students is unlikely to have significant economic benefits for New Zealand, as these people are unlikely to enter the labour market. Study with high associated social benefits (for example improving English-language skills) could be achieved through part-time study (not eligible for an allowance) or adult and community education.

Currently, students undertaking part-time part-year study can only borrow for their compulsory fees. The study status of student loan borrowers is determined according to the EFTS weighting of their course of study and the length of their course in weeks. Part-time part-year study requires a minimum EFTS load of 0.25 EFTS.

The Government's return on investment is lower for part-time study than for full-time study. There are two types of low value lending within this group: those associated with poor repayment performance and low labour market returns (e.g. part-time courses for personal development) and those who may not need the current level of subsidy in order to participate in tertiary education (e.g. people who are working full-time and studying small amounts of study). Poor labour market returns and repayment performance for this group are due, in part, to lower completion rates for part-time study than for full-time study.

Option 2 – Remove eligibility for student loans and/or student allowances for people over a certain age (e.g. 65). [6]

Options available would remove eligibility for student loans and / or allowances by removing eligibility for people over a certain age (for example age 65, [6]

Considering that student loan living costs are no longer available to people aged [6] and over, the rationale for retaining eligibility for (the more highly subsidised) student allowances is not strong. This group still has access to interest-free course fees (which act as a backstop and require a greater contribution to the cost of education from the borrower than allowances) as well as tuition subsidies to support their study.

An upper age limit of 65 for student allowances (and indexed to any increases to the age at which people become eligible for superannuation) would reduce the amount of support provided for study with low economic returns.

Those affected would still have access to tuition subsidies (covering approximately 75% of the cost of tuition) and interest-free student loans for course fees – this depends on what loan options are progressed.⁵ New Zealand Citizens with access to New Zealand Superannuation would effectively not be disadvantaged, as there is already a restriction on receiving both forms of support simultaneously.

Options in this category would likely increase use of welfare benefits by affected students, [6]

This would reduce overall savings to Government.

Changes made during Budget 2011 are projected to remove or reduce borrowing by approximately 75% of borrowers aged 55 and over. As the number of older people in the workforce continue to increase opportunities for upskilling and retraining will be important.

[6]

Option 3 – Reduce eligibility for student allowance

Available options would:

[6]

- and/or further lower the tertiary lifetime limit (e.g. to 120, [6] weeks down from 200 weeks) for people over a certain age (e.g. people aged over 55, 40, [6]

Unlike younger learners, it is possible for mature students to have already received taxpayer support to gain tertiary qualifications. Given the constrained nature of tertiary education expenditure, this raises questions surrounding reasonable levels of support for subsequent qualifications and for types of further study (e.g. up-skilling due to labour market demands vs. further study for non-vocational purposes).

It may be difficult to identify, using a broad approach (such as targeting by level of study), who is studying for which purpose. The existing 7 EFTS loan and longstanding 200 week allowance lifetime limits attempt to address these issues by limiting entitlement and encouraging wise study choices.

The main advantage of using lifetime limits to target student allowances is that these are a simple means by which previous access can be measured. In the absence of creating a more complex and costly administrative system, it can be used as a rough proxy for existing qualifications, or the amount of prior education a person has already received government support for. This is a method of ensuring everyone receives a fair share of subsidy. Lifetime limits are also more flexible in responding to people's individual study needs and a more effective way of targeting than age alone.

[6]

supported by evidence that suggests that a student's first year in tertiary education is the most important for ensuring their success).⁶

A reduced length of support put in place from a certain age would continue to enable people (particularly those who have not previously accessed student support) to add to their skills later in life to allow them to continue to participate in the labour force. Options in this category recognise that the public returns to New Zealand of investment in degree level study decrease as people age and their remaining time left in the workforce decreases.

Māori (a priority learner group) are over-represented among older allowance recipients. This reflects that Māori tend to study at later ages. Māori also tend to have children at earlier ages which may lead to them delaying the start of their study. Of recipients aged 35 and over, Māori make up 19.5% compared to around 10% of allowance recipients overall. In 2012 there were 2,569 allowance recipients aged 35 and over who identified as Māori.⁷

Māori also tend to access the student allowance for a shorter duration of time. Data from 2004 – 2011 shows that 88.8% of Māori student allowance recipients accessed the allowance for 80 weeks or less and used an average of 40.10 weeks (14.6% lower than the overall average). While younger age bands may have a negative impact on Māori learners, the impact from a reduced lifetime limit on current patterns of access is likely to be minor.

[6]

⁶ Jacques van der Meer, Austina Clark and Chikako van Koten *Establishing Baseline Data: using International Data to Learn More About Completion Factors at One New Zealand University*. Journal of Institutional Research, 2008. Jacques van der Meer *I don't even know what her name is: Considering the challenge of interaction during the first year*. Studies in Learning, Evaluation Innovation and Development, 2009.

⁷ This figure does not include people identifying as both Māori and another ethnicity

[6]

Improving repayments from overseas-based borrowers (OBBs) and increasing personal responsibility for debt repayment

- Reduces high risk spending
- Reduces unnecessary and high-risk borrowing
- Support existing initiatives to increase debt repayment from overseas based borrowers and increase personal responsibility for debt repayment

Option 1 - Status quo

Currently there is a two year stand down period for permanent residents before they can access the student allowance or the Student Loan Scheme. This aligns with the two year stand down period before permanent residents can access the unemployment benefit.

As outlined, the data indicates that a number of people may be accessing student allowances to undertake study, where the benefits are not well aligned to the objectives of the student allowance scheme. Significant over-representation of permanent residents at older ages suggests some may be accessing the allowance as an alternative to other forms of living support. There are also similar trends of increased numbers of older people at secondary schools, studying at low levels and supporting dependant partners.

While non-citizens who remain in New Zealand after study represent good value investment and lending for the Government, those who go overseas are more likely to default on their student loans than borrowers who are New Zealand citizens. Our research indicates that permanent residents and Australians are more likely to go overseas than New Zealand Citizens and are less likely to return.⁸ As at 31 March 2011, of the proportion of overseas-based borrowers who were in default, 29.3% were Australian citizens, 14.5% were Chinese citizens and 12.6% were New Zealand citizens.

Student allowances provide a higher level of support than student loan living costs, and do not need to be repaid. There is a question as to whether obligations for student allowance recipients are set at the right level.

Currently the only non-administrative obligation on student allowance recipients is to pass more than half of their study load. Options exist to strengthen obligations by ensuring that student allowance recipients who are in serious default on a student loan meet their repayment obligations.

In general 85% of student allowance recipients also have a student loan. As at April 2012, approximately 64,000 student allowance recipients had also borrowed from the Student Loan Scheme in 2012 (for fees, course related costs, or living costs to top up a partial allowance). Of these, 3.3% (2134 recipients) were in default on previous student loan borrowing. Just under half of these borrowers (940 allowance recipients) are in default of over \$500, with 76 recipients in default of over \$6000, and 27 in default of over \$10,000.

Our analysis of the Student Loan Scheme has identified three broad types of borrower groups that represent low value lending. These are those:

⁸ Smyth,R and Spackman,D (2012) Going Abroad. Wellington: Ministry of Education.

- whose labour market returns are insufficient to make progress in repaying their loans (including borrowers under the repayment threshold, borrowers with large student loans who have poor labour market outcomes, and those who use loans for non-educational purposes)
- who go overseas and do not repay (who may or may not have high incomes)
- who would still participate in tertiary education if the government subsidy on student loans was reduced (for example, while lending to this group may be high value, it may be unnecessary).

Overseas-based borrowers comprise a high proportion of long-term compliance costs. Under current valuation assumptions, if all overseas-based borrowers were compliant (still allowing for death and bankruptcy write-offs) the value of new lending would increase by 3 cents in the dollar.

Overseas-based borrowers have much lower repayment compliance, slower repayment times, and potentially lower repayment obligations than New Zealand-based borrowers. The higher domestic compliance is largely due to compulsory collection through the income tax system and sanctions which are more easily enforced when non-compliance occurs.

As at 30 June 2012, there were 701,232 borrower accounts held by Inland Revenue. Of these borrowers, 101,095 (14%) were overseas based. However, these borrowers represented 58% of all borrowers with overdue payments (53,471) and had 80% of all overdue debt (\$409.5m).

Table 1: Overdue student loan repayments at 30 June

| Overdue Repayments | 2011 \$million | 2012 \$million | % change |
|----------------------------|---------------------------|---------------------------|---------------------|
| <i>Borrowers based</i> | | | |
| -in New Zealand | \$122.8 | \$102.6 | -16.4% |
| -overseas | \$288.9 | \$409.7 | 41.8% |
| Total | \$411.7 | \$512.3 | 24.5% |
| <hr/> | | | |
| <i>Number of borrowers</i> | | | |
| -in New Zealand | 49,803 | 38,577 | -22.5% |
| -overseas | 50,264 | 53,471 | 6.4 |
| Total | 100,067 | 92,048 | -8.0% |

Source: Student Loan Scheme Report, 2012

The number of borrowers going overseas and into default continues to increase with the default levels having climbed to \$421m by 31 December 2012 and \$423m by 31 January 2013.

The high level of default is primarily due to a significant portion of borrowers not meeting their obligations of keeping Inland Revenue up to date with their contact details and making payments. Evidence to date from the OBB collection initiatives (OBBCI) reflects the importance of maintaining contact with overseas-based borrowers. Inland Revenue have had a 70% compliance rate among borrowers it has contacted as part of this initiative.

Currently there is a three-stepped repayment regime for OBBs based on their loan balance, while the regime for those based in New Zealand is income-contingent. Unless they are on a repayment holiday, OBBs are required to make repayments every six months (September and March). Interest is charged from the day the borrower leaves New Zealand.

| Loan Balance | Amount due per year |
|---------------------------|---------------------|
| <= \$1,000 | The whole balance |
| >\$1,000 and <= \$15,000 | \$1,000 |
| >\$15,000 and <= \$30,000 | \$2,000 |
| >\$30,000 | \$3,000 |

The current overseas-based borrower regime strives to strike a balance between a borrower's ability to repay and quick repayment of student loans. For borrowers who are compliant with their student loan obligations, Inland Revenue currently automatically reduce their repayments based on their loan balance.

However, for about 14% of overseas-based borrowers (i.e. those who have a student loan balance over \$50,847) the amount due per year means that the compulsory repayments they make will not exceed the interest charged on their loan. These 14,581 borrowers will continue to see their student loan balance increase.

Option 5 - Change eligibility based on residency status⁹

Available options would restrict eligibility for student allowances by either:

- extending the current student loan and student allowance stand-down period for permanent residents and Australians from 2 years to 3 years from 1 January 2014 to increase our confidence that permanent residents will stay in New Zealand when they finish their study and repay their student loans; and/or

[6]

Australians and permanent residents are more likely to move overseas and not return. There are also many permanent residents committed to staying in New Zealand (some of whom are not able to obtain citizenship because of laws in their country of origin). The stand-down period aims to distinguish between those who intend to stay from those that intend to leave. The mechanism for targeting on this basis is 'front-loaded'; permanent residents who demonstrate a commitment to New Zealand are not treated any differently from citizens after a certain point.

Extending the stand-down period for permanent residents and Australians would mean that migrants will need to have lived in New Zealand for at least three years, be ordinarily in New Zealand, and have held a residency class visa under the Immigration Act 2009 for at least three years to qualify for a student loan or allowance. This option would apply to both the student allowance and Student Loan Scheme to maintain consistency. Restricting eligibility from permanent residents would reduce support for study with relatively low benefit to New Zealand without disadvantaging New Zealand citizens.

A consequence of this proposal is that it would move student support policy out of alignment with the benefit system. Options in this category may result in greater take

⁹ 'Permanent Resident' includes Australian citizens but does not include students who hold refugee status, protected persons status, or persons sponsored by a family member who held refugee status or protected person status when they entered NZ.

up of other forms of assistance such as the unemployment benefit reducing overall savings, but would signal an expectation that people commit to New Zealand before undertaking study.

[6]

Option 6 – Adjust the overseas-based borrower repayment regime

Options available would improve repayments from overseas-based borrowers and increase personal responsibility for debt repayment by:

- adjusting the overseas-based borrower repayment regime to improve the long-term sustainability of the scheme by speeding up repayments of compliant overseas-based borrowers and ensuring they can make progress on their loans – by:
 - adding higher repayment thresholds for overseas-based borrowers with larger student loans post legislation enactment
 - fixing the repayment obligation for overseas-based borrowers at no less than the rate they pay when they leave New Zealand from 1 April 2014 for the 2014/15 tax year
- introducing border restrictions for non-compliant borrowers as a sanction for non-compliance by 1 April 2014 for the 2014/15 tax year and beyond.

Increasing overseas-based borrower repayments

Increasing the repayment amounts due each year would ensure that overseas-based borrowers repay their loans faster and that more borrowers will make repayments that would at least cover interest on their loans. Available options would make changes to the thresholds and repayment obligations of overseas-based borrowers to speed up repayments for compliant borrowers by:

- a. adding two additional steps to the current overseas-based repayment regime with larger amounts due per year from 1 April 2014, as set out in Table 2. This would ensure that a larger proportion of compliant borrowers are required to make payments that at least cover the interest on their student loans.

Table 2: Proposed repayment obligations for overseas-based borrowers

| Loan Balance | Amount due per year |
|---------------------------|----------------------------|
| <= \$1,000 | The whole balance |
| >\$1,000 and <= \$15,000 | \$1,000 |
| >\$15,000 and <= \$30,000 | \$2,000 |
| >\$30,000 and <= \$45,000 | \$3,000 |
| >\$45,000 and <= \$60,000 | \$4,000 |
| >\$60,000 | \$5,000 |

- b. introducing a fixed repayment obligation for overseas-based borrowers set at no less than their annual obligation at the time they leave New Zealand. This obligation would remain until their loan is repaid. Commercial loans operate on the same basis. As indicated in Table 1, a borrower with a loan balance of \$16,000

would need to repay \$2,000 a year until they are debt-free (that is, their obligation would not reduce as their loan balance reduces as is currently the case). Borrowers already overseas when the change is made would be fixed on the repayment rate they are currently on, not the one they had when they left New Zealand.

These changes would apply from 1 April 2014 for the 2014/15 tax year.

Proposals to change the overseas-based borrowers regime fall into a broader package of policy changes that are designed to improve collection from overseas-based borrowers and increase borrower responsibility for debt repayment, including the recent overseas-based borrower collection initiatives (OBBCI).

The changes for overseas-based borrowers proposed in this paper are intended to complement other initiatives already in place, by encouraging those people who are not currently meeting (or aware of) their obligations, to take notice of their responsibilities as borrowers and take compliance more seriously.

This policy change is intended as a long term measure to improve sustainability. Based solely on current levels of compliance, projected debt levels will increase. However the current initiatives which form the OBBCI are designed to improve levels of compliance in the future. Proposed changes to the repayment regime will pay dividends over the long-term provided compliance increases, and will improve the overall sustainability of the Student Loan Scheme as a whole.

There is a specific rationale for introducing additional thresholds for overseas-based borrowers with very large balances, as the rates that are currently paid by many of these borrowers are not sufficient to service their interest payments. The new policy will reduce the proportion of compliant borrowers who do not cover their interest payments on their student loans from 14% (potentially up to 14,581 borrowers) to about 3.5% (potentially up to 3,758 borrowers).

The proposed regime would increase the repayment obligations for overseas borrowers, a large proportion of whom are already in default. The proposed changes will therefore increase the rate of growth of default unless these borrowers start to meet their repayment obligations.

The current level of overseas-based borrower default continues to grow and reached \$423 million by 31 January 2013. By 2015 the level of default is expected to reach \$769 million, excluding the impact of these policies. With the introduction of the new repayment rates and thresholds, borrowers in default will owe an additional \$19 million by 2015. This \$19 million is before the addition of any penalty interest and subsequent compounding.

The growth in the level of default of overseas-based borrowers is largely because approximately 20,000 borrowers with loans were given an amnesty in 2007 and have not repaid anything since. These borrowers have large loan balances and their repayment obligations will increase with the addition of new repayment thresholds and rates. Unless compliance among this group of borrowers improves significantly, the rate of growth of default for these borrowers will accelerate.

Although the OBBCI is making good progress collecting from non-compliant borrowers, the rate at which the default amounts of overseas borrowers is growing is faster than the rate at which compliance is increasing. Increasing the repayment

obligations of these borrowers will mean that it will take longer to slow and eventually reverse the rate of growth of overseas default amounts.

The impact of this policy on the compliance of overseas-based borrowers is uncertain, particularly given the impact on compliance of the OBBCI is difficult to predict. However there is a risk that some previously compliant borrowers with balances greater than \$45,000 will stop repaying or repay less than their obligation because of the higher repayment rate.

Officials have also stated that they do not expect the faster recovery of loans from compliant borrowers under this proposal to generate any savings in the short term. This is because for compliant borrowers the interest on their loans is approximately equivalent to the Crown discount rate, so faster repayments do not generate any significant improvement in the value of the loan book. For those borrowers that remain non-compliant the new policy simply increases their outstanding level of default.

In the absence of income information, the current overseas-based borrower regime bases repayment obligations on current loan balances. Imposing a repayment floor for overseas-based borrowers means that repayment obligations will be based on a historic loan balance - the balance when the borrower left New Zealand. This creates an inequity whereby two loan borrowers with the same loan balances may have different repayment obligations if one of the borrower's loan balances was historically higher.

Option 7 – Border restrictions

This option would introduce new sanctions for defaulting on student loan repayments for the most non-compliant overseas-based borrowers by either:

[6]

- extending the child support border arrest system to student loan debtors.

When a New Zealand-based borrower falls behind in their payments Inland Revenue has a full suite of tools available to get the borrower back on track. This ranges from reminder letters and phone calls, to deductions from wages or bank accounts through to legal action and bankruptcy in the most serious cases.

As overseas-based borrowers are not within New Zealand's jurisdiction, Inland Revenue has fewer tools available to enforce payment from borrowers living overseas.

Currently approximately 70% of overseas-based borrowers in default become compliant once they are contacted. However the remaining 30% do not respond to requests or late payment penalties and additional leverage is required. At the moment legal action is the primary tool used to borrowers that continuously resist paying. Legal action is effective against resistant borrowers, most will come to an arrangement before the matter reaches the courts, but it is time consuming and expensive.

Officials considered sanctions that focused on two common interactions overseas borrowers have with the New Zealand Government – [6]

[6] and crossing the border into or out of New Zealand.

[6]

Border restrictions

Overseas-based borrowers may still retain a connection with New Zealand, such as friends, family, sporting or business interests, which will lead them to return to New Zealand from time to time. In Budget 2012 a new data matching programme was introduced which would alert Inland Revenue when a borrower with high levels of default returned to New Zealand. New Zealand Customs would send Inland Revenue the borrower's arrival card so that contact could be made.

Introducing some kind of border restriction, such as the power to request arrest warrants, would send a clear message to all borrowers that non-compliance is

unacceptable, and would provide greater leverage over those who temporarily return to New Zealand.

To be effective, such a measure would need to include education for borrowers on the possibility of being stopped at the border. This would deter borrowers from non-compliance at an early stage.

The advantage of border restrictions is that it is a precision measure that can be targeted and applied to the worst cases of default while providing an incentive to the wider group of borrowers to remain compliant.

While a serious step, raising Bill of Rights concerns relating to freedom of movement, there is a similar power under the Child Support Act 1991 which has proven effective against the most non-compliant liable parents.

Under the Child Support Act, Inland Revenue can request the District Court to issue an arrest warrant for a liable parent who is about to leave New Zealand with the intent to avoid their obligations. This power is supported by an information match with the New Zealand Customs Service, which notifies Inland Revenue when serious defaulters return to New Zealand and what their contact details are. Inland Revenue will then contact the defaulter to negotiate repayment, and if the liable parent refuses to comply and is about to leave the country, a warrant for their arrest can be requested.

Introducing similar provisions to the Student Loan Scheme Act would send a clear message to all borrowers that non-compliance is unacceptable and that there are real consequences for ignoring repayment responsibilities. This new sanction would be supported by a communications campaign to ensure that borrowers understood the potential consequences of non-compliance.

Inland Revenue's experience is that the threat of arrest at the border has a significant effect on defaulters' attitudes towards compliance. Very few student loan defaulters are expected to risk arrest for the sake of avoiding their obligations. While student loan obligations are a financial burden that some borrowers may wish to avoid, the factors that can motivate entrenched child support default (i.e. custody and marital disputes) are not present in a student loan context.

For the small number of borrowers who remain non-compliant once the arrest warrant has been issued, Inland Revenue would request information from airlines under section 17 of the Tax Administration Act to determine which flight a borrower is booked on. This information would be provided to Police stationed at the airport who would have to locate the defaulter before they boarded their flight. Police have advised that as this would have to be achieved without photos, often in large crowded areas, this could be difficult and time consuming.

Once the borrower is located at the airport Police would make a judgement as to whether to execute the arrest warrant or not. It is important for Police to use their discretion and the decision to make an arrest may have consequences for other passengers, the airline and airport security. It may not be appropriate, for example, to arrest a single adult accompanying a young child if adequate arrangements cannot be made for the child. If the borrower's bags have already been loaded then the consequences of delaying the flight would be taken into account. It is proper that Police make these decisions as they are in the best position to assess the potential impacts of an arrest.

This proposal may have the appearance of the Police acting as debt collection agents for Inland Revenue. If enacted it would be made clear that police would only act as independent officers of court and execution of these arrest warrants would remain at constabulary discretion.

This proposal would have cost implications for Courts and while the number of expected arrest warrant requests is low the exact number is unknown and the costs to Courts have not been estimated.

This is a precision measure that can be targeted and applied to the worst cases of default while deterring the wider group of borrowers from not complying. As hardship provisions are available to those who cannot afford to pay, this sanction will only apply to those who could pay but refuse to do so. The child support border restrictions provide a precedent that could be leveraged to potentially reduce the costs of implementation.

Legislative amendments would be required for this initiative. The sanction could apply from the date of enactment, however officials recommend delaying implementation until 1 July 2013 so that borrowers who have already made travel plans can address their arrears.

Option 8 - Information sharing agreement between Inland Revenue and Internal Affairs

An ongoing information sharing agreement between Inland Revenue and Internal Affairs to collect quality contact details of overseas-based borrowers would support the prevention and collection of student loan default. An information-sharing match of this nature could also be used to collect contact details for liable parents living overseas who have child support obligations. This process would not require any substantial systems development or testing.

The lack of quality contact details continues to make it difficult to educate borrowers or take enforcement action. Inland Revenue needs reliable and sustainable sources of contact information in order to prevent and address non-compliance.

Borrowers applying for passport renewals provide their contact details to Internal Affairs. These contact details are likely to be extremely accurate as the applicant is relying on them to receive their passport or to respond to any questions that arise during the renewal process.

In 2012 Inland Revenue made a request to Internal Affairs under section 17 of the Tax Administration Act for the details of all passport renewal applications made in the previous three months. This request was made so that the passport renewal process could be evaluated as an on-going source of contact information.

The records were received in early July and were matched against Inland Revenue's files to identify those applicants with student loans. Of the 134,000 renewal applications received over the three month period, 15,927 were identified as student loan borrowers. Of that group 2,938 were overseas-based borrowers, with approximately 50% (1,424) having an overdue repayment obligation. These borrowers had total loan balances of \$83 million, of which over \$10 million was in default.

The contact information received from the match records was provided to the Inland Revenue debt recovery team who used the new information to make contact with the overseas-based borrowers. Based on the results of the test match and the subsequent collection activity, officials have projected what the impact would be if the match were in place for a full year. The following projection assumes a median loan default of \$4,541 and 5,600 successful matches per year (1,400 matches per three-month period):

- \$12.5 million from 2,750 borrowers would be collected
- \$3.5 million from 750 borrowers would be considered for further enforcement action
- \$0.5 million from 120 borrowers would be added back to the loan due to hardship.

The projected amount for enforcement action is the total amount of default that would be considered for more intensive treatment. It is expected that a portion of these cases will not be suitable for further action and of those selected, some will be unsuccessful.

Collection of child support liabilities across international borders is also a significant and complex activity that presents a number of challenges; in particular the time and difficulty associated with locating liable parties offshore due to a lack of quality contact details. As at 30 September 2012, total child support debt (including penalties) was \$2.5 billion, of which more than half (\$1.36 billion) was owed by liable parents living overseas. While the reciprocal agreement with Australia covers \$408 million of this, the remaining \$956 million is either not covered by the reciprocal agreement or is owed by liable parents living outside of Australia.

There is no long-term, low-cost source of high-quality contact information for liable parents while they are based overseas. This is considered a key integrity issue.

The 134,000 records received from Internal Affairs have been reviewed to determine potential matches against child support debtors. 615 cases have been matched against liable parents living overseas, of which 447 are in default with a value of \$17.4 million.

The constraints on using the test match information has meant that the contact details that were matched against these liable parents could not be used to pursue the outstanding amounts. Even without this verification, officials are confident that collecting these additional addresses and contact numbers would have a positive impact on the child support debt book.

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[6]

| Options | Pros | Cons |
|--|--|--|
| Restrict eligibility based on residency status | <ul style="list-style-type: none"> • Improve targeting to those who intend to remain in New Zealand. • Reduces the risk of providing support to people who may leave New Zealand and go into default. • A longer stand-down period will be more aligned to similar overseas jurisdictions, for e.g. the United Kingdom has a 3 year stand-down, and Australia requires citizenship. | <ul style="list-style-type: none"> • Those affected would need to wait an additional year. • Would move student support out of alignment with the welfare system and may increase welfare take up. • The longer the stand-down period the greater the impact on those affected, on welfare system flow ons and potentially on immigration objectives. |
| [6] | | |
| Information matching | <ul style="list-style-type: none"> • Would support the prevention and collection of student loan default. • Could also be used to collect contact details for liable parents living overseas who have child support obligations. • Would signal that Government expects student loan consumption to not exceed | <ul style="list-style-type: none"> • May be challenged on privacy grounds. • Will not target borrowers who either do not have or do not travel on a New Zealand passport. |

¹⁰ Financial hardship can be taken into consideration by IR.

| Options | Pros | Cons |
|---------|--|------|
| | reasonable limits. <ul style="list-style-type: none"> • Would not require any substantial systems development or testing. | |

[6]

Consultation

The Ministry of Education, the Inland Revenue Department and StudyLink developed these proposals. The Ministry of Social Development, the Treasury, and Inland Revenue have been consulted on the proposals in this paper. The Ministry of Justice has been consulted on the student allowances proposals and the arrest warrant proposal.

The New Zealand Police and New Zealand Customs Service have also been consulted on the arrest warrant proposal. The Department of Internal Affairs and the Office of the Privacy Commissioner have been consulted on the proposal for the information sharing agreement between Inland Revenue and the Department of Internal Affairs.

Limited time was available for consultation. We did not consult with sector groups due to the budget-sensitive nature of the proposals.

[8]

Proposed changes to the Student Support Schemes

The Treasury advise they support a broad-based tertiary system with a larger element of private contribution to fund the direct costs of tertiary education. However, given that Ministers have made it clear that certain measures (e.g. interest on Student Loans) will not be considered, they recognise that the scope for future savings under current policy settings is limited to the type of changes outlined in this package.

These incremental changes while generating small savings are likely to have large impacts on specific groups by limiting their access to tertiary education. For example, the savings initiatives proposed include incremental changes to the eligibility to Student Support systems, based on age, and immigration status that limit access to tertiary education.

Conclusion and Recommendations

The recommended outcomes of the options analysis for each proposal are as follows:

Targeting more tightly on the basis of returns to study and initial years of study and increasing the contribution that people make to their tertiary education by:

- removing student allowances eligibility for those over a certain age (e.g. 65 years)

[6]

Improving repayments from overseas-based borrowers and increasing personal responsibility for debt repayment by:

- extending the student loan and student allowance stand-down period for permanent residents and Australians from 2 years to 3 years from 1 January 2014
- adjusting the overseas-based borrower repayment regime, from 1 April 2014 for 2014/15 and beyond, by introducing:
 - a fixed repayment obligation for overseas-based borrowers at no less than the rate they pay when they leave New Zealand
 - additional repayment thresholds for overseas-based borrowers
- making it an offence for a borrower to knowingly default on an overseas-based borrower repayment obligation so that an arrest warrant can be requested to prevent the most non-compliant borrowers from leaving the country from 1 July 2013
- putting in place an ongoing information-sharing agreement between Inland Revenue and Internal Affairs to obtain further contact details from overseas-based borrowers and liable parents when they renew or apply for their passport.

Implementation

Student Allowances

Changes to student allowances, including adjustments to eligibility and entitlement based on age, and increasing the stand down period for permanent residents, require a change to the Student Allowance Regulations 1998. Amendments to the Regulations will be carried out by the Ministry of Social Development during 2013.

Student Loans

Amendments to the Student Loan Scheme Act 2011 will be required to introduce changes to the overseas-based borrower repayment regime. The application date for the new regime would be 1 April 2014. Border restrictions require amendments to the Student Loan Scheme Act 2011 and also require regulations to amend the District Court rules. The restrictions could apply from 1 July 2013.

The information match with the Department of Internal Affairs will be introduced through regulation under the recent Privacy Act 2013. Inland Revenue and Internal Affairs are working with the Office of the Privacy Commissioner to develop an appropriate information sharing arrangement. This process requires public consultation with the representative sector groups. The information match could apply from August 2013.

Monitoring, Evaluation and Review

The Ministries of Education and Social Development will monitor and review the student allowance proposals and report to the Minister for Tertiary Education, Skills and Employment and the Minister for Social Development. The four agencies involved with the Student Loan Scheme (Inland Revenue, the Ministry of Social Development, the Ministry of Education, and the Treasury) will monitor and review proposals in respect of the Student Loan Scheme.

The Student Loan Scheme Governance Group will monitor the overall performance of the scheme changes, including through the Student Loan Performance Framework and report to Ministers on outcomes. The framework indicators are reported regularly to the Minister for Tertiary Education, Skills and Employment and the Minister of Revenue.