Regulatory Impact Statement

Repeal of the voluntary repayment bonus as part of the Student Support package for Budget 2012

Agency Disclosure Statement

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

It provides an analysis of an option to repeal the student loan voluntary repayment bonus. This option is part of the student support budget package for 2011 that aims to improve the value of the Student Loan Scheme to the Government while still ensuring that the Scheme is contributing to tertiary education priorities.

The proposed option to repeal the voluntary repayment bonus considered in this Regulatory Impact Statement does not impact on business costs, impair private property rights, or override common law principles.

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Status quo – Student support system

The Government spends a significant amount of money each year to fund tertiary education. In 2010/11, the Government spent $2,279 million on tuition subsidies, $1,564 million on new student loan lending, and $624 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 1993/4 and 2010/11.

Government introduced broad-based student allowances in 1989 with the objective of increasing participation for those whose income was a barrier to accessing tertiary education. Allowances were introduced in an environment of low participation and in a time of zero, or very low, fees. They have an important role in lowering the total cost of tertiary education for students who face significant financial barriers to education, and for those students who may not recognise the future benefits of tertiary study.

Student Loan Scheme

The Student Loan Scheme was established in 1992 as part of wider tertiary education reforms, which moved New Zealand's tertiary education system from an elite model, where the Government subsidised a small number of students at a higher rate, to a model with more open access and where a large number of students are subsidised. Private contributions to tertiary education were introduced to make the expansion of participation affordable for Government. The Student Loan Scheme was introduced to ensure that finance was not a barrier to participation.

The Student Loan Scheme is a significant and growing asset on the Crown's accounts. 958,000 people have taken out a student loan since the Scheme began in 1992, borrowing a total of $15,486 million.

New Zealand-based borrowers generally have high repayment compliance. Systems make it easier for borrowers in New Zealand to repay – mostly via deductions from their earnings. Inland Revenue can more readily keep in contact with New Zealand-based borrowers. In addition, New Zealand-based borrowers face no interest charges, so, once they leave study, their loans cannot increase, as long as they do not incur penalties.

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; 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.

One of the objectives of the voluntary repayment bonus is to adjust the student support system to contain the Government's tertiary education expenditure by encouraging faster repayment of debt. This, in turn, aims to improve the student support system's performance by allowing re-investment in priorities, while maintaining the interest-free policy on student loans.

The proposal set out in this Regulatory Impact Statement (RIS) is part of a package of the student support package for Budget 2012 that seeks to:

- encourage greater contribution to tertiary education costs from students who can most afford to pay and who are more likely to receive higher levels of private return from their study; and
- reduce unnecessary borrowing.

The proposal aims to address the increasing cost of the Scheme to the Crown and the taxpayer, and thereby achieve a fairer distribution of benefits and costs between current and future taxpayers.

The voluntary repayment bonus is part of a wider student support package and is not a stand-alone policy. The voluntary repayment bonus does not appear to be improving the value of the Student Loan Scheme. The bonus aims to encourage borrowers who are slow to repay to pay off their loan more quickly. However, many borrowers who were already paying back their loans quickly were also claiming the bonus. The bonus is also encouraging some students to borrow, when they do not need to do so. In 2011, 2,611 borrowers repaid their student loans in the same year they borrowed, receiving $1.8 million in bonuses (from approximately $13 million of annual bonus payments). This resulted in a cost to the Government.

Therefore, other initiatives, including those in the Budget 2012 student support package, will be more effective than the bonus scheme for improving student loan repayments. These include:

- increasing contact and tracking of overseas-based borrowers and using social media campaigns
- overseas-based borrower compliance initiatives such as requiring a contact person, tracking and tracing to initiate contact with borrowers to make repayments, and media campaigns targeting overseas based borrowers
- increasing the student loan repayment rate from 10 cents to 12 cents in the dollar freezing the repayment threshold and broadening the definition of income for repayment purposes.

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. 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.

Regulatory impact analysis

Changes to the voluntary repayment bonus policy

Reduce unnecessary borrowing

The voluntary repayment bonus, introduced in 2010, aims to encourage borrowers to make extra payments in order to repay their loans earlier. The voluntary repayment bonus is a 10% bonus borrowers can receive for making voluntary repayments that total $500 or more in a tax year (1 April to 31 March).

The policy aims to encourage borrowers to make extra repayments to repay their loans more quickly, particularly for New Zealand-based borrowers who have interest-free loans. The longer borrowers take to repay their loans, the more expensive the borrowing is to the Crown. A second objective is to lower the cost to the Government of the Student Loan Scheme.

Only borrowers who are up-to-date with their loan repayments and have an opening loan balance of $550 or more at the start of the tax year are eligible to receive the bonus. Repayments made to StudyLink do not qualify for this bonus. The policy was designed this way to ensure that borrowers did not borrow for more than they needed in anticipation of a bonus and to minimise implementation costs.

As part of system changes supporting the Student Loan Scheme Act 2011, from April 2012, StudyLink no longer holds any portion of a borrower's loan balance. Instead, these balances are passed on to Inland Revenue in near real time.

Option 1 – Status quo

Currently, only repayments made to Inland Revenue are eligible for the voluntary repayment bonus. Although StudyLink can also accept repayments, repayments made to StudyLink are not eligible for the bonus.

Until 31 March 2012, a borrower's loan balance was held by StudyLink for the year of study and then transferred to Inland Revenue in the following February or March. Borrowers could not claim the bonus in their first year of study as they would not have the required opening balance of $550 or more. The implementation of a near real-time transfer of loan balances between StudyLink and Inland Revenue from April 2012 means that all current borrowers have a balance of $550 or more by 1 April 2012 and, therefore, qualify for the bonus. This would undermine the original policy intent that borrowers could not receive a bonus while studying and provide students with an incentive to borrow more than they need.

Option 2 – Not allowing borrowers to receive a bonus in the same tax year as they draw down the loan

This option would prevent borrowers from receiving a bonus in the same year they drew down their loan, beginning 1 April 2013. Analysis of payment and loan transfers suggests that some borrowers may be borrowing more than they need, in expectation of a bonus.

It is possible that students seeking to "game" the system could borrow and quickly repay their loan, effectively receiving a discount on their annual fees. In 2010 and 2011, there was a cohort of borrowers whose total borrowing equalled their repayments for the year. Evidence shows that approximately 2,600 borrowers in 2011 benefitted from an estimated total of $1.8 million in bonuses on loans which they may not need to have borrowed.

Option 3 – Include voluntary repayments made to StudyLink in the bonus calculation

Since the voluntary repayment bonus was introduced in 2010, there is a cohort of borrowers who have continued to make voluntary repayments to StudyLink, despite these payments not being eligible for the bonus. In the 2010 calendar year, there were 10,656 voluntary repayments made through StudyLink with a total value of $4.1 million. Including these payments in the calculation of the bonus, either through directing all payments to Inland Revenue or making legislative changes to include payments made to StudyLink, would increase the amount of bonuses paid by approximately $0.4 million per annum.

This would undermine the original policy intent to encourage more voluntary repayments from borrowers who have finished study, and it provides students with an incentive to borrow more than they need.

This option would safeguard borrowers against the risk of repaying the "wrong" agency and remove the administrative cost and complexity of involving both agencies in maintaining a repayment service.

Option 4 – Repeal the voluntary repayment bonus

This option would repeal the voluntary repayment policy from 1 April 2013.

There are uncertainties about the impact of the voluntary repayment bonus as we do not have a robust time series of voluntary repayments and available data does not yet show a steady state for the policy. However, the level of savings from the voluntary repayment bonus is lower than originally estimated, and the bonus may not be providing good value to the Government. In particular:

- *the bonus benefits any borrower who repays in the final 3.4 years of their loan term* as opposed to 1.5 years in the original estimates. Based on median New Zealand-based repayment times, this means that repayments in the final half of the loan term are a cost to the Government
- *most people making voluntary payments appear to have loans that are low cost* to the Government (for example, those with larger incomes in relation to their loan debt)
- *many borrowers appear to be making voluntary repayments to fully repay their student loan* (this benefits them, and costs the Government). These repayments also tend to be much larger than those made part way through the loan repayment period
- *take-up by borrowers overseas is relatively higher than expected*
- *a small number of borrowers are repaying student loans in the same year they borrow* to receive a bonus ($1.8m in bonuses in 2011)
- *the bonus is resource-intensive to administer*.

Removing the voluntary repayment bonus may risk sending signals that are inconsistent with the Government's other initiatives to encourage faster repayments. However, the secondary objective of the bonus is to reduce the costs of the scheme to the Government. The Government has also introduced several more policies to incentivise or increase repayments which are more certain to increase the value of the Student Loan Scheme. These include

- increasing contact and tracking of overseas-based borrowers and using social media campaigns
- overseas-based borrower compliance initiatives such as requiring a contact person, tracking and tracing to initiate contact with borrowers to make repayments, and media campaigns targeting overseas based borrowers
- increasing the student loan repayment rate from 10 cents to 12 cents in the dollar

- freezing the repayment threshold and broadening the definition of income for repayment purposes.

Proposal	Part of problem addressed	Options	Preferred option	Policy savings, operating costs	Borrowers affected Impact on affected borrowers of option being progressed
Changes to voluntary repayment bonus	To improve the value of the Student Loan Scheme	Option 1 – Status quo Option 2 – Not allowing borrowers to receive a bonus in the same tax year as they draw down the loan Option 3 – Include voluntary repayments made to StudyLink in the bonus calculation Option 4 – Repeal the voluntary repayment bonus	Repeal the voluntary repayment bonus	Option 2 – Savings: $1.6m-$1.8m (per year) would no longer be paid out to borrowers who made voluntary repayments in a tax year where they also drew down on their loan Option 3 – Costs: Up to an additional $0.4m per annum would be paid out in bonuses Option 4 – Savings: $39.514 (over 5 years) No costs	Option 2 – approximately 2,600 borrowers in 2011 who made a voluntary repayment in the same year they drew down their loan would no longer be eligible for the bonus Option 3 – approximately 10,000 students who voluntarily made repayments to StudyLink in 2010 would now receive the bonus Option 4 – approximately 31,000 borrowers would no longer receive a bonus beginning 2013

Consultation

Government agencies involved with consultation on this Regulatory Impact Statement included Inland Revenue, Ministry of Social Development, and the Treasury. Time constraints limited the time available for consultation.

Conclusion and recommendations

The voluntary repayment bonus does not appear to be improving the value of the Student Loan Scheme. The bonus aims to encourage borrowers who were slow to repay to pay off their loan more quickly. However, many borrowers who were already paying back their loans quickly are also claiming the bonus. The bonus is also encouraging some students to borrow, when they do not need to do so. This results in a cost to the Government.

Government has also introduced several policies to incentivise or increase repayments that are more certain to increase the value of the Student Loan Scheme.

For these reasons the voluntary repayment bonus will be repealed from 1 April 2013.

Implementation

Inland Revenue is able to implement the repeal of the voluntary repayment bonus at no additional administrative cost from the 1 April 2013 tax year.

Repealing the voluntary repayment bonus requires an amendment to the Student Loan Scheme Act 2011.

Monitoring, evaluation and review

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 the proposal in respect of the Student Loan Scheme.

The 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.