# Briefing note: Student Loan Scheme valuation as at 30 June 2018

| To:               | Hon Chris Hipkins, Minister of Education  
|                  | Hon Stuart Nash, Minister of Revenue   |
| Date:            | 30 August 2018                         |
| Priority:        | Medium                                  |
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| Round Robin:     | No                                      |

## Purpose of report

This report provides the final results of the valuation of the Student Loan Scheme (the scheme) as at 30 June 2018.

## Summary

The scheme has improved in value by $106m, or about 1%, in the 2017/18 year.

The is mainly due to macroeconomic trends, overseas borrower repayments — overseas compliance is at an all-time high — and a projected increase in the number of borrowers in New Zealand rather than overseas. These were partially offset by continued poor outcomes for low earners, and by more write-offs from deaths and bankruptcies than were expected.

Changes in value can affect Vote Revenue although it remained within appropriation for the 2017/18 year.

The final, audited valuation is included in the Crown accounts and the half-year economic and fiscal update. The scheme’s value is made public in the Inland Revenue and Student Loan Scheme Annual Reports.

From this year, a new accounting standard will make the value of the scheme more volatile.
Recommended actions

The Ministry of Education recommends that the Minister of Education:

a. agree that this report is proactively released

 Agree / Disagree

b. forward this report to the Minister of Finance for his information.

Grant Klinkum
Acting Student Loan Scheme Lead Official
Graduate Achievement, Vocations and Careers
30/8/2018

Hon Chris Hipkins
Minister of Education
13/7/18
Valuation of the Student Loan Scheme

1. The Student Loan Scheme (the scheme) is valued by actuaries contracted by the Ministry of Education.

2. A forecast valuation is used at the Budget Economic and Fiscal Update (BEFU) and gives early warning of shifts in the value of the scheme [METIS 1120886, Student Loan Scheme Forecast Valuation 2018, refers]. This enables provision to be made for any adverse shift in value should that be needed.

3. The final valuation, following auditing by Audit New Zealand, is included in the Crown accounts and the half-year economic and fiscal update. The scheme’s value is made public in the Inland Revenue and Student Loan Scheme annual reports.

4. Changes in value can lead to an appropriation adjustment within Vote Revenue (but not to Vote Tertiary Education or Vote Social Development) to ensure that the scheme is accounted for accurately. Vote Revenue remained within appropriation for the 2017/18 year.

The results of the valuation show improved performance

5. The scheme’s value has improved by $106m, or around 1%:
   - the value of the scheme at 30 June 2018 was $9,195m before revaluation
   - the revalued scheme is worth $9,301m as at 30 June 2018.

6. For comparison, the scheme’s value improved by $62m in the 2016/17 year.

7. The improvement in value is due to:
   - Repayments ($16m improvement): repayments in the past year were $79m, or 8%, higher than expected, which improved the value by $34m. However, this was partially offset by an $18m decrease in value from write-offs for death and bankruptcies being 89% higher than expected.
   - Provision for additional write-offs from deaths and bankruptcies ($50m decrease): given the significant increase in write-offs from deaths and bankruptcies that Inland Revenue has processed and is yet to process, the value of the scheme has decreased by $50m. This decrease is in part due to the estimated effect of clearing a backlog of write-offs due to death, and in part due to a potential increase in the rate of bankruptcies.
   - Macroeconomic effects ($77m improvement): assumed increases in average weekly earnings increased the value by $87m, and an assumed decrease in CPI added $8m to the value of the scheme. However, decreased loan interest rates reduced the value by $18m.
   - Data and modelling changes ($97m improvement): Among these changes are improvements in value due to updated information about overseas repayments ($47m), a projected increase in the number of borrowers in New Zealand rather than overseas ($33m), and updated modelling of domestic repayments ($19m). However, a projected increase in the proportion of borrowers who are low earners decreased the scheme’s value by $87m.
   - Removal of an adjustment for anticipated improvements in low earners’ employment rates ($34m decrease): the value of the scheme was adjusted three years ago in anticipation of improved employment rates for low earners. This improvement has not occurred and the adjustment has been removed, decreasing the scheme’s value by $34m.
Impacts of the first year of fees-free and the $50 weekly increase to student loan living costs

8. The implementation of the first year of fees-free only affects new lending from 1 January 2018 and onwards. This impact has been allowed for in the write-down on new lending and has been accounted for in the policy costings for fees-free in 2018. The valuation also takes into account new lending volumes from the $50 weekly increase to student loan living costs.

9. In spite of the uncertainty of the effect of fees-free on borrower behaviour, there was little adjustment in the scheme’s value from the inclusion of new lending over the year. The valuers noted that this suggests assumptions about the impact of the first year of fees-free were accurate.

Maintaining the scheme’s performance

Increases in write-offs due to death or bankruptcy

10. The amount of write-offs resulting from deaths has increased 147% compared to 2017. We expect this is a one-off increase that is due to the introduction of a data match with the Department of Internal Affairs that has identified deaths which had not been recorded in Inland Revenue’s systems.

11. The amount of write-offs resulting from bankruptcies has increased 62% compared to 2017. This is largely the result of Inland Revenue processing bankruptcy cases more quickly. Inland Revenue has worked closely with NZ Insolvency & Trustee Services to achieve this.

12. In addition, it is suspected that the rate of write-offs due to bankruptcy has increased, but at this time data and analysis is incomplete. The valuers have made a provision of $25m to acknowledge this uncertainty.

13. Inland Revenue, with other student loan agencies, is reviewing recent bankruptcies to see if there have been any changes in borrower behaviour driven by collection behaviour or increased awareness of bankruptcy as a means of avoiding debt.

14. We will advise Ministers of the findings of this, and our conclusions will be reflected in the next forecast valuation in April 2019.

Maintaining overseas compliance

15. The valuers note that overseas compliance is at an all-time high, and the valuation assumes this rate of compliance will continue. A deterioration in compliance would lower the value of the scheme.

16. The valuers recommend that the focus on overseas collections continue, and note that overseas borrower behaviour is “sticky”, in that borrowers are most likely to repeat their previous behaviour.

17. Evidence suggests that improvement in the compliance of overseas borrowers also affects those borrowers in New Zealand who are likely to travel overseas. That is, both the existing and future overseas borrowers are showing significantly improved compliance and repayment behaviour.

Outcomes for low earners

18. The valuers have assumed no future change in the current rate at which borrowers become low earners after study, and in the length of time that low earners remain so. Deterioration in post-study employment outcomes, particularly for those with lower-level qualifications, and/or for long-term low earners, is a risk to the scheme’s performance, and valuation.
19. We will shortly be completing further data analysis to better understand low earner behaviour and any policy implications.

Impact on Vote Revenue

20. Crown accounting requires changes in the value of the scheme to be classified as either a remeasurement (change in forecasts that affect the value) or an appropriation.

21. The final valuation as at 30 June 2018 includes a positive remeasurement of $777m due to macroeconomic factors. The remaining positive impairment of $297m will be reflected in Vote Revenue appropriations.

Upcoming changes to reporting

Moving to a fair value approach will increase the volatility of the scheme’s value

22. As we advised when we briefed you on the forecast 2018 valuation, a new standard applies to the student loan valuation from 1 July 2018 [METIS 1120886, Student Loan Scheme Forecast Valuation 2018, refers].

23. The key point of difference is that the valuation will be calculated based on the scheme’s fair value.

24. In a fair value approach instead of locking in a discount rate for each year’s tranche of lending, current discount rates will be applied to the entire loan book at each valuation. The discount rate is used in calculating the current value of expected repayments, and is based off market interest rates.

25. The value of the scheme will be more volatile due to rises and falls in the discount rate, driven by changes in market interest rates. As an illustration, the valuers found that a 1% change in the discount rate affects the fair value by around $557m.

What will this look like for future valuations?

26. The fair value of the scheme is $9,927m at 30 June 2018. This is an improvement of $292m.

27. The increase in the fair value is due to:

- Changes in cash flows ($114m improvement): this reflects the changes in the scheme’s value that were discussed in paragraph 7.
- Changes in expense assumptions ($11m improvement): this captures a slight increase in the expected cost of collecting repayments.
- Changes in the discount rate ($190m improvement): market interest rates have fallen and the risk premium has increased.

28. With the change in the adopted accounting standard from 1 July 2018, the fair value at 30 June 2018 will serve as the starting point for next year’s valuation.

How we will manage the change to fair value?

29. The move to fair value will result in a one-off improvement of $628m to the value of the scheme (as we apply current discount rates to the entire loan book for the first time).

30. This one-off increase will be reflected in the 2017/18 comparative numbers when the 2018/19 financial year’s result is published. The Treasury has advised that this one-off
change has no impact on OBEAGL or net core Crown debt, but it will affect the operating and capital allowances.

31. From 2018/19, the valuation will:
   - continue with the forecast and full revaluation once a year, including current scrutiny and governance processes
   - provide updated discount rates three times a year to align with the BEFU, Half Yearly Economic and Fiscal Update, and end of year reporting requirements
   - report separately on changes in value due to market discount rates and performance information on expected future repayments, including reporting any shift in value due to discount rates below OBEAGL.

32. The approach will ensure that the scheme is represented accurately and fairly on the Crown's balance sheet and meets compliance requirements, while still maintaining reliable, accurate, and transparent information about the performance and real cost of student loans.

Proactive Release

33. We recommend that this report is proactively released. Any information which may need to be withheld will be done so in line with the provisions of the Official Information Act 1982.