Regulatory Impact Statement

Legislative changes to assist in the recovery of student loan debt

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Inland Revenue. It provides analysis of proposed legislative support for the Commissioner of Inland Revenue to recall student loans when loan repayments are in arrears.

The problem is that although all student loan contracts have a clause that allows for recall of debt, the contracts differ in respect of which agency may recall the amount and whether it is only the amount in default or whether the whole loan (including amounts not currently in default) may be recalled.

Our recommended approach to this problem is a legislative change to provide the Commissioner of Inland Revenue with the ability to recall an entire student loan that could be exercised in cases of serious non-compliance. This is intended to encourage compliance, both from those borrowers in relation to whom the recall power is exercised, and from the wider borrower population who would become aware of the recall power. Initially, this power is intended to be used in respect of the recovery of debt from borrowers based in Australia.

We have consulted with the Treasury, the Ministry of Education, the Ministry of Education Lead Official, the Offices of the Privacy Commissioner in New Zealand and Australia and the Ministry of Consumer Affairs who agree with this approach. We also contacted the New Zealand Embassy in Australia, via the Ministry of Foreign Affairs and Trade, to create awareness of Inland Revenue's planned activities in Australia.

The legislative change proposed in this statement would not impose additional costs on businesses, impair private property rights, restrict market competition, or reduce the incentives on businesses to innovate and invest or override fundamental common law principles.

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BACKGROUND

Previous Intermediate Regulatory Impact Statement

1. As set out in our last Intermediate Regulatory Impact Statement, *Collection of overdue student loan repayments from overseas-based borrowers* (11 August 2010), the Student Loans Scheme is subject to much higher levels of potential loan default than would be accepted by a commercial lender. Despite the introduction of an amnesty and the three-year repayment holiday, overseas-based borrower debt is still growing.

2. The problem arises due to the unsecured nature of the loans, which are provided to a population of relatively mobile borrowers without regard to their ability to repay their loan. The lack of security becomes a particular problem with borrowers who move overseas.

3. In focusing debt-collection activities to maximise revenue for the Crown, the Commissioner makes trade-offs regarding the level and nature of debt pursued as a result of the finite resources available. Given the resource cost of pursuing offshore debt, the ability to collect overdue student loan repayments from borrowers based overseas is thereby impeded.

4. Further, the Student Loans Scheme is not well suited to simple or cost effective recovery of overseas-based borrower debt (including from those borrowers who are based in Australia). Issues arise in relation to integration with the tax system, the lack of legislative authority for the lender to recall and assign loans, payment costs and locating borrowers.

5. Therefore, the objective of our previous Intermediate Regulatory Impact Statement was to investigate ways to improve overdue student loan repayment collection, including by:

(i) legally pursuing overseas-based borrowers with significant overdue debt;
(ii) using private-sector firms to collect debt; and
(iii) preventing non-compliant student loan borrowers from travelling overseas.

6. Approaches (i) and (ii) are consistent with commercial debt recovery practices and have been progressed by Inland Revenue. However, approach (iii) gives rise to human rights issues and requires further work to gauge its viability. It will be reported on to the Minister of Revenue and Minister for Tertiary Education in December this year.

7. A more commercial approach to student loan debt recovery may be achieved through changes in the policy framework and the administrative approach to loan collection. Inland Revenue plans to operate a risk-based debt recovery model applied by a specialist debt recovery team focusing on borrowers with overdue student loan repayments who are based in Australia. If the initiative is successful it could be extended to collect student loan debt from borrowers in other jurisdictions.

This Regulatory Impact Statement

8. To assist Inland Revenue in its debt collection efforts, a legislative change is sought to provide the Commissioner with the ability to recall an entire student loan transferred to him (including amounts not yet in arrears) that may be exercised in cases of serious non-

compliance.[1] This is intended to encourage compliance from both the borrowers in relation to whom the recall power is exercised and the wider borrower population through awareness of collection activity.

STATUS QUO AND PROBLEM DEFINITION

9. As already noted, there are a number of difficulties in the current system that impair Inland Revenue's ability to collect student loans. This Regulatory Impact Statement focuses on whether legislation should be introduced so that student loans can be recalled.

10. The problem is that although all student loan contracts have a clause that allows for recall of debt, the contracts differ in respect of which agency may recall the amount and whether it is only the amount in default or whether the whole loan (including amounts not currently in default) may be recalled.

11. In circumstances where recall is limited to arrear amounts, a successful enforcement action may mean that debt is paid at the time of the enforcement, but the borrower defaults on future repayment obligations.

OBJECTIVE

12. The overall objective is to reduce the growth of student loan debt and support the Government's approach to reducing the permanent loss of skills to New Zealand by removing an incentive for individuals to leave New Zealand to obtain a student loan advantage.

13. This Statement assesses potential changes to the legislative framework needed to support the recovery of overdue repayments from student loan borrowers, in particular the recalling of student loans that may be exercised in cases of serious non-compliance.

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[1] The Ministry of Social Development annually transfers loans to the Commissioner of Inland Revenue in order that repayments can be made by borrowers when due.

POTENTIAL LEGISLATIVE OPTIONS

14. Potential legislative options in respect of the recall of student loans are set out below.

Options	Description	Disadvantages	Benefits	Implementation risks
No legislative authority providing the lender with the ability to recall student loan (status quo) Not preferred	The current student loan contracts are unclear as to whether student loans can be recalled in cases of serious non-compliance. This is because from year to year the lenders differ so it is unclear who can recall the loan and how much they can recall. The lack of clarity means that it is unclear whether the Commissioner can recall student loans.	The ability to recall the entire student loan is unclear. This means that this method is not available to the Commissioner to assist in the recovery of student loan debt and improve compliance. Less efficient and effective methods would continue to be used. If the legislation is not changed to allow for the recall of student loans then the expected cost is a continued high level of non-compliance.	Nil.	None since no legislative change would occur.
Legislative ability for Inland Revenue to recall outstanding amount of student loan Not preferred	Legislative authority for the Commissioner of Inland Revenue to recall only the outstanding amount of a student loan.	Recalling only overdue amounts is unlikely to improve compliance. There may still be a cost of subsequent legal action in respect of arrear amounts. Legal costs of enforcing the recall of the arrear amounts in cases of serious non-compliance are expected to be between \$5,000-\$10,000 per case for personnel and court costs. These are estimated costs as the Commissioner has not enforced a recall of a student loan before. The cost associated with communications on recalling student loan arrears and the expected compliance gained from this cannot be determined at this stage.	Recovery of the debt. Legislative ability to recall may encourage compliance even if ability not exercised.	Where successful action for enforcement of an arrear amount is taken against the overseas-based debtor, they may still default on their future loan repayment obligations (almost immediately). Further work will need to be undertaken on administrative processes.

Legislative ability for Inland Revenue to recall the entire student loan Preferred	Legislative authority for Commissioner of Inland Revenue to recall the entire student loan.	Cost of legal action in loan being recalled. personnel and court costs are expected to be between \$5,000-\$10,000 per case. These are estimated costs only as the Commissioner has not recalled a student loan. The cost associated with communications on recalling a student loan and the expected compliance gained from this cannot be determined at this early stage.	Encourages compliance in respect of the recall and impact on other borrowers. Consistent with commercial debt collection practices. Provides certainty in respect of which agency can recall student loans (some loans are currently unclear on this point)	Further work will need to be undertaken on administrative processes.

CONSULTATION

15. We have consulted with the Treasury, the Ministry of Education, the Ministry of Education Lead Official, the Offices of the Privacy Commissioner in New Zealand and Australia and the Ministry of Consumer Affairs. These agencies agree with the approach that we are proposing initially for application in Australia. The Ministry of Consumer Affairs also made the point that the legislation in relation to recalling student loans needs to be consistent with the substance of the contract.

16. We also contacted the New Zealand Embassy in Australia, via the Ministry of Foreign Affairs and Trade, to create awareness of Inland Revenue's planned activities in Australia.

RECOMMENDATION

17. For certainty and clarification of the student loan contracts, we recommend an amendment to the Student Loan Scheme Act allowing the Commissioner of Inland Revenue to recall the entire loan balance of loans that have been transferred to him. The recall of a loan is intended to be undertaken in cases of serious non-compliance and after other recovery actions have been attempted.

MONITORING, EVALUATION AND REVIEW

18. The Student Loan Scheme Act, which would contain the Commissioner's ability to recall a student loan, is subject to regular review. If issues are raised by borrowers in respect of the recall provision then officials would consider whether procedures are required to determine whether there are substantive grounds for review.

19. Integration of further elements into the Student Loans Scheme to improve the management of overseas-based borrower debt (including the assignment of student loans and the restriction on foreign travel) will be reported on to Ministers in December this year.