

## Summary:

# The State's credit losses on study loans

The Swedish National Audit Office has audited central government management of the risk of credit losses on study loans. The audit shows that expected losses on study loans are not calculated using established methods and that the efforts made by the Swedish Board for Study Support (CSN) to increase repayments of unpaid study loan debts have not had the intended effect.

## Background

The total stock of study loans from the Swedish Board for Study Support amounts to SEK 207 billion. The Swedish Board for Study Support regards about SEK 28 billion of these receivables as doubtful due to the formulation of loan terms and lack of willingness to pay. Borrowers outside Sweden are greatly overrepresented among those who default on repayments of study loans.

From the point of view of central government finances, the study loan portfolio is a considerable financial asset that the Government is tasked by the Riksdag to manage. Study loans are also part of the study support system the aims of which include a recruiting effect, thus contributing to high participation in education. Therefore the interest rate on study loans does not reflect the State's credit risk, but is instead subsidised by taxpayers.

In January 2014 the Government adjusted the credit model for new study loan lending to the provisions of the Budget Act (2011:203) on central government lending with credit risk. This was done in order to make visible the costs of study loans to central government. The adjustment means that expected losses on new loans are to be calculated and financed via appropriations when the loans are issued. Losses on loans paid out before 2014 are charged instead to appropriations when they are realised. In 2015 expected losses were estimated to be SEK 1.2 billion, or 7.3 per cent of the SEK 17 billion plus in loans during the year. Receivables of more than SEK 0.5 billion referring to lending before 2014 were written off.

It is important that the Swedish Board for Study Support recovers as much as possible of outstanding receivables. It is also important that the valuation of expected losses is based on the best possible assessment of credit risk in the loans issued. The Swedish National Audit Office has noted that current valuation principles mean that credit risk is set at zero for most of the Swedish Board for Study Support's lending. This is not consistent with what is normally meant by expected loss. In order to control costs, and ensure that the study loans' inbuilt subsidies are used for the purpose intended, it is important that the Government's reporting of credit losses on study loans to the Riksdag is transparent.

The purpose of the audit was to investigate whether the State's risk management for credit losses on study loans is appropriate and effective. The audit includes the Government's reporting of expected losses in the central government budget and the Swedish Board for Study Support's measures to secure repayment of loans.

## Audit conclusions

The Swedish NAO's audit shows that expected losses on new study loans are not calculated using established methods. Using established methods would enable loss provision to better reflect the probability of payment defaults by new borrowers. In this report the Swedish NAO presents its own estimates that show that this is possible.

The approach used today to calculate expected losses is based on the Swedish Board for Study Support's write-downs for doubtful receivables. The calculation model is appropriate for that task, but it is not appropriate for analysis of future payment behaviour of borrowers. Nor does it provide any information on accuracy of the various loan terms that are to compensate for borrowers' deficient ability to pay – in other words if the study loans' subsidies are being used for the purpose intended.

The Swedish NAO also considers that the total central government costs for study loans can be reported more clearly in the central government budget and to the Riksdag. Of the write-downs for doubtful receivables of SEK 27.9 billion in the annual report of the Swedish Board for Study Support, two thirds can be attributed to the formulation of the loan terms (SEK 19.6 billion) and the remaining third (SEK 8.3 billion) to borrowers who default on their payments. In the current situation the Government does not inform the Riksdag of the cost allocation of study loans between formulation of the loan terms and payment defaults.

Borrowers living abroad account for 8 per cent of outstanding receivables, but at the same time account for half of the more than SEK 8 billion that the Swedish Board for Study Support regards as doubtful due to default. The efforts of the Swedish Board for

Study Support to get these borrowers to pay have not had any visible effect on the key indicators the agency uses for follow-up. Instead, payments from borrowers abroad have decreased as a share of annual amounts debited, and in 2015 amounted to about 70 per cent. As a comparison, the repayment rate for borrowers living in Sweden was almost 94 per cent. There is no satisfactory explanation for the negative trend, apart from the hope that improved working methods and adjustments made to the regulatory framework will bring results in the long term.

The Swedish NAO considers that the Swedish Board for Study Support could to a greater extent use existing statistics on its approximately 1.5 borrowers to analyse their future payment behaviour to enable the agency to apply preventive measures to relevant groups. To reverse the trend of unpaid debt by borrowers abroad the Swedish NAO also considers that international collaboration should be tried more than is the case at present.

There are good reasons for being clear with regard to the costs of study loans. The costs of deficient ability to pay and willingness to pay should be possible to report separately. There should also be information available concerning the accuracy of the rules that are to compensate for deficient ability to pay. In that way the Riksdag can obtain a better basis for determining the design of the regulatory framework and how great a risk taxpayers and borrowers respectively should bear.

## The Swedish National Audit Office's recommendations

### *Recommendations to the Swedish Board for Study Support*

In the course of the audit the Swedish Board for Study Support announced that it wants to investigate the possibility of introducing predictive analytics. This is to enable the agency to take accurate measures in relation to borrowers with a high default risk. The Swedish Board for Study Support also intends to investigate why payments are falling in relation to the amount debited from borrowers living abroad. The Swedish NAO recommends that the Swedish Board for Study Support completes the work on these important questions.

The Swedish Board for Study Support should also increase collaboration with study support agencies in other countries regarding exchange of addresses and other information that can improve the prospects to collect unpaid debts from borrowers abroad.

### *Recommendations to the Government*

The Swedish National Audit Office recommends that the Government should base its calculations of the appropriation for expected losses on study loans issued from 2014 on the assessed risk for new borrowers rather than on the average risk in the entire stock of annuity loans. The Government should also clarify the breakdown into appropriation items so that the central government budget shows the proportion of credit loss provisions that is estimated to be due to the formulation of loan terms and payment defaults respectively.

The Government should review the accuracy of the study loans' various rules that are to compensate for borrowers' deficient ability to pay.

The Government should work to bring about international agreements making it possible to collect study loans in other countries under the provisions of decisions or judgments from Sweden.