

Title: Ex-Ante Assessment of Financial instrument in Operational Programme II 2014-2020 financed through ESF

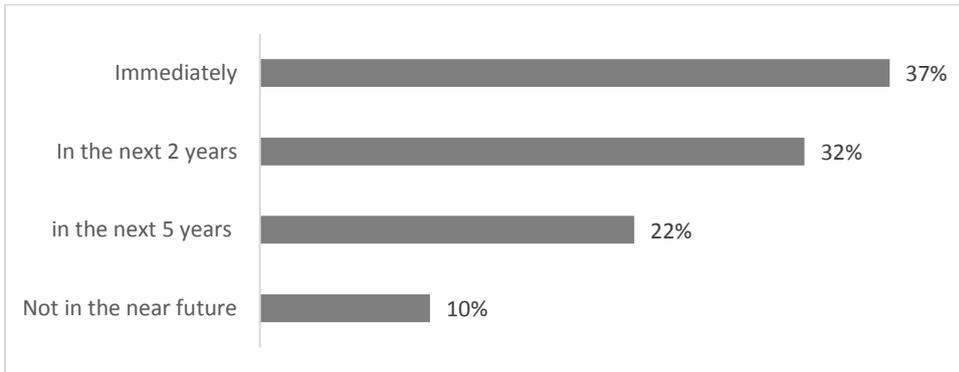
Contractor: Ernst and Young – Malta

Summary of Final Draft Report:

1. **Terms of Reference:** The Managing Authority (MA) assessed the potential use of Financial Instruments (FIs) under Priority Axis 3 of Operational Programme II 2014-2020. The objective of the contract was to identify the main causes and extent of the market failure in vocational and professional areas, to calculate the current financing gap between the existent scholarships/financial support at tertiary and equivalent level, as well as to highlight the increased demand of financial support to continue their studies in different areas (at undergraduate, graduate and postgraduate level as well as at vocational level), according to the market's needs. The report also sought to identify potential FI/s and provide the evidence of such adequacy against the identified market failure or suboptimal investment situation, and ensure that the FI could contribute to the achievement of the Programme and ESIF objectives.
2. **Methodology:** This study includes both qualitative data, which is used in the theoretical analysis, as well as quantitative data, which is integrated in a number of computations carried out to quantify the market gap. The qualitative data was collected through desktop research and consultation with major stakeholders (both demand and supply side providers, as well as policy makers) in Malta. The quantitative data was collected through a demand-side questionnaire and studies and statistics published by EUROSTAT, and the European Commission (EC), as well as the MEDE, the National Commission for Higher Education (NCFHE), and the National Statistics Office (NSO) as well as through specific requests to stakeholders, mostly in the educational and banking sectors.
3. **Stylised Facts:** In order to identify the existence, extent and main causes of market failure, the study elaborated on eleven (11) stylized facts in order to look closely at the: (i) Maltese educational market; (ii) labour market, and the (iii) financial aspects of education. The gist of these stylised facts was that the Maltese economy is characterised by limited resources, with human capital being the only natural resource. Even though Malta is a knowledge-based and increasingly specialised economy, it still has high early school leaving rates and the labour and employment markets face various skills mismatches. Education up to MQF level 6 is provided mostly free of charge. There are various funding assistance options for further education, which are mostly nationally and/or EU funded.
4. **Market Failure:** The education sector can witness various forms of market failure, resulting in the inefficient allocation of resources as well as the under provision of finance. Market failure in this sector has been observed in the following ways:
 - Information asymmetry: From the borrowers' side: (i) students might not be fully informed of the different financial products available through financial intermediaries as well as other schemes, grants and scholarships available; (ii) terms and conditions might be presented in a manner which discourages potential applicants. The online survey showed that a total of 43% of discouraged respondents (due to financial reasons) and 33% of those intending to study further, indicated being unaware of available funding as a reason for not seeking financial help;
 - Non-rational behaviour;
 - Underdeveloped market: Risk and repayment maturity mismatch for loans as well as incomplete markets;
 - Externalities and Regulatory failure;
 - Market power was not observed to be present.
5. **Estimating demand:** The results of an online survey specifically conducted for this study (EY Student Questionnaire) and the NSO's currently enrolled student figures per MQF level were used as the basis to estimate projected demand for continuing education over the next five years, whilst students not needing finance because courses are free or are able to pay were removed. Respondents that indicated being discouraged from furthering their studies due to financial reasons have also been included in the estimate. The resultant estimated demand for

continuing education ranged between 4,905 (for 1 enrolment cycle) and 13,071 individuals (over 5 enrolment cycles), spread across MQF levels 5 - 8.

As for timeframes, the respondents of the online survey indicated the following:



Moreover, the demand for financing was calculated as follows:

Total Estimated Enrolled Student Demand (A+B)		Average Student Expenditure (E) ¹
<i>Enrolled Student demand over the next 5 years (A)</i>	<i>Discouraged Enrolled Student Population (B)</i>	
% based on current level of education	% based on current level of education	Course fees (€)
+ % interested in continuing to study in the future		
+ % <5 years' timeframe for further studies		
+ % currently studying full/part-time	% who would not continue study due to financial reasons	+ Accommodation (€)
+ % future level of education		
+ % mode of study		
+ % type of study		+ Other ² (€)

6. **Estimating student expenditure:** The potential students' expenditure requirements over the next five years was calculated by multiplying this estimated enrolled demand by indicative study related expenditures. These expenses have been sourced from the EY Student Questionnaire, the ERASMUS programme guides as well as publicly available documents. These estimated study related expenditure requirements ranged between €100mIn and €275mIn over five years.

¹ Average Student Expenditure was calculated through a combination of the Student Questionnaire, desk research and consultations with the relevant authorities. The education costs/expenses included in this scenario were agreed with the CA.

² 'Other' costs relates to flights for foreign and blended courses..

7. **Financing Gap:** This was calculated by removing the projected estimated supply of financial assistance for 2014 - 2020 (€30.2 mln³) from the estimated demand for finance. The resultant gap ranges between €70mln (using the currently enrolled student population as a low limit) and €245mln (using the projected 5 year enrolment populations as the upper limit). This shows that a market gap exists as the current (and projected) supply of financing assistance in Malta for education is failing to satisfy local demand. Such a gap will also increase if the current grant (and tax credit) schemes are discontinued.

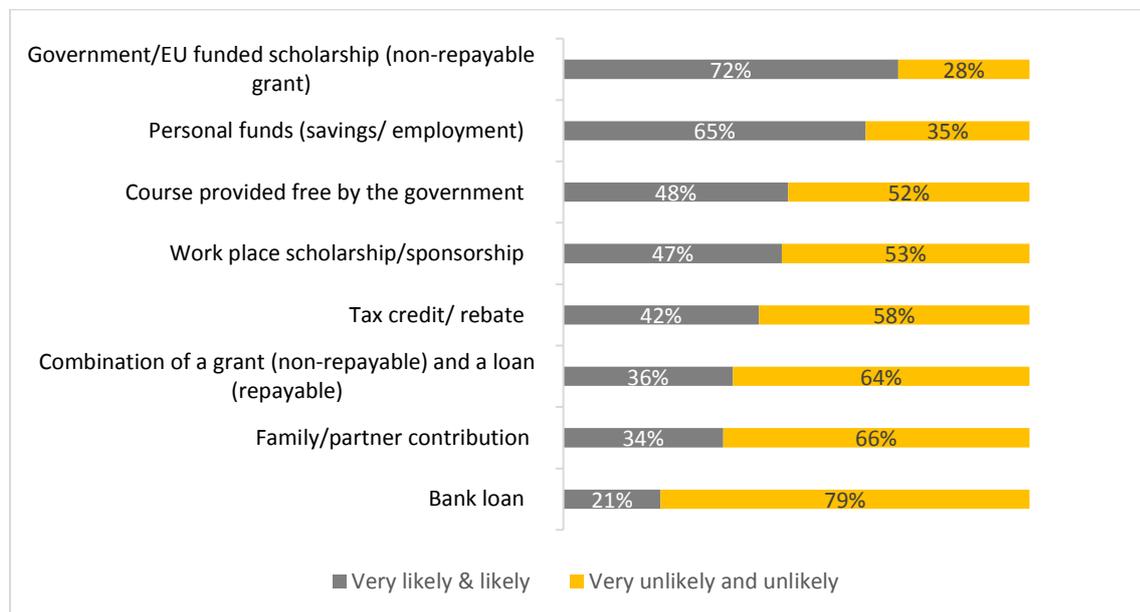
In short:

Financing Gap =

(Total Estimated Enrolled Demand X Average Education Expenses Fees) - Total Supply of Financial Assistance

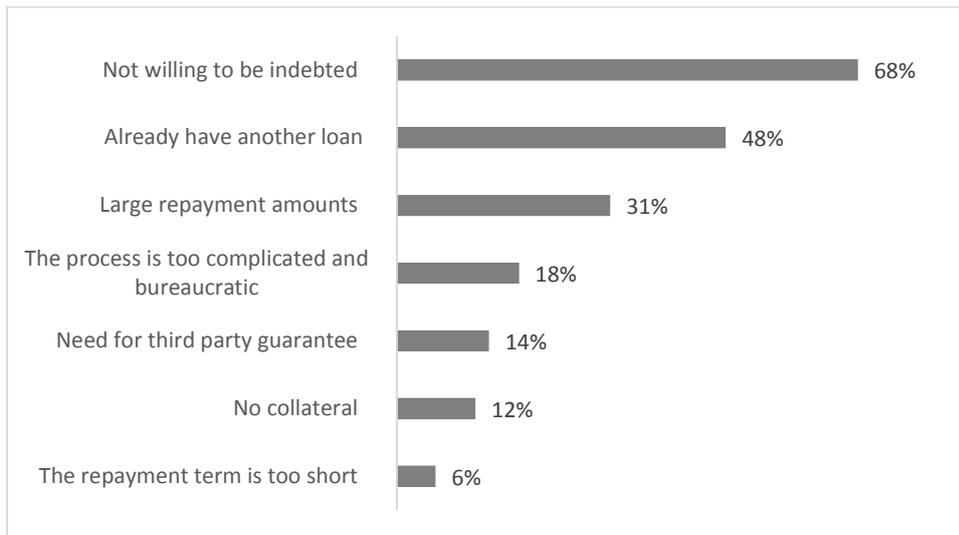
8. **Different financial instruments:** The research conducted, data collected and consultation meetings held, led to the identification of different types of measures and FIs which could target the identified market gap; (i) Select courses being provided free of charge, (ii) Grants and scholarships, (iii) Tax credits, (iv) Loans (including Loan guarantees, loans with lower interest rates ("Soft loans"), a loan with a moratorium, and an income- contingent loan), (v) Hybrid instrument: part grant-part loan, (vi) Job guarantees.
9. **Student preference:** The research has reinforced popular perceptions that students in Malta remain greatly dependent on non-repayable assistance. Students indicated direct grants and scholarships as their most preferred financing options, followed by tax credits, with finance (solely) through bank loans being the least popular. It is evident that Maltese residents are generally more cautious with regards to student loan take-up, notwithstanding the existence of various products offered through commercial banks.

Preferred means to fund future studies

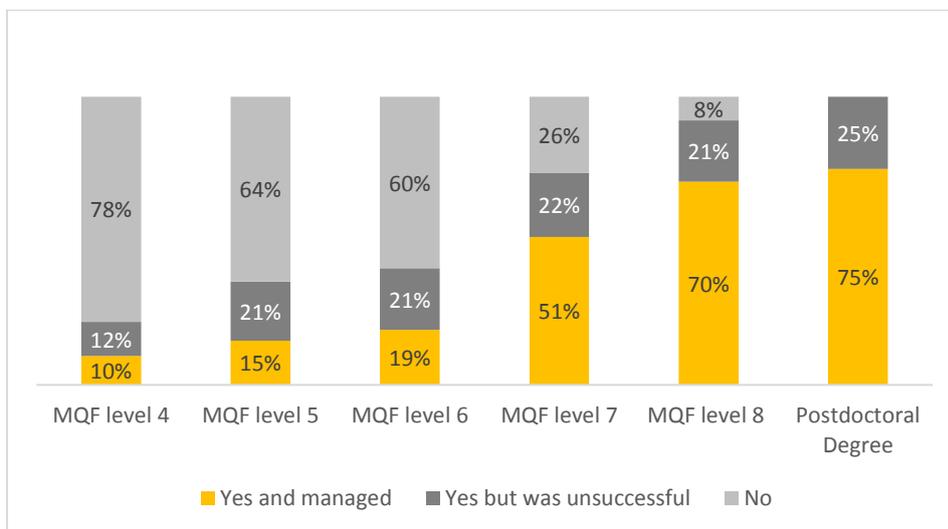


³ The estimates used to quantify the projected supply of assistance over the next five years emanate from allocated to 2014-2020 OPII Programming period ESF allocations, as well as data gathered from the commercial banks in Malta, Malta Enterprise and MEDE, amongst others.

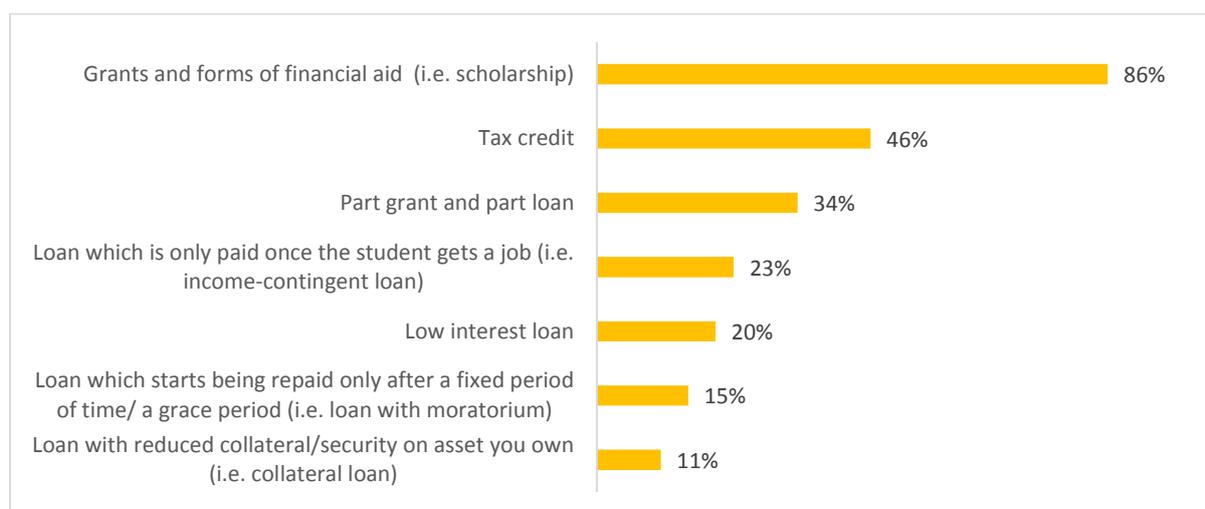
Reasons for not considering loans



Attempts to obtain financial assistance to continue studying (by education level)



Financial instruments to encourage discouraged students to study further



10. **Variant loan options:** From the loan options analysed, a mixture of a grant and loan is considered the most favourable option followed by lower interest rate loans. Students that are discouraged to continue studying due to financial reasons are more in favour of income-contingent loans than lower-interest rate loans. A loan with a moratorium and a low collateral loan are considered the least attractive options to continue studying, for both those that are interested in further studies, and those that are currently discouraged to do so due to financial reasons. (Figures provided above.)
11. **Previous FIs' in education:** No particular experience in the EU exists regarding the utilisation of FI's that are financed by the ESF and applied to (financially) assist students to continue to study, with the very limited possible exception of the ERASMUS Master Loan programme. Through this programme students (from a few European countries) are being offered (loan) assistance to students following MQF level 7 courses. Malta is currently not participating in this Programme.
12. **Shortfall in supply of assistance:** Analysis of supply and demand in Malta for scholarships and assistance over the past decade sees a consistent shortfall between demand for assistance and available assistance. Certain subjects and levels have also not been covered by available assistance. Some students also claim that the assistance granted does not adequately cover study related expenditure, especially for certain types of courses. It is also clear that lack of adequate funding is just one of the reasons for failure to continue studying. Other factors, such as work and family commitments, are also possible.
13. **Potential FI budget:** Malta's OPII PA3 currently has an indicative budget of around €38 million and projects to the tune of €11 million have already been committed. Hence even if no other projects are approved under this PA (which is practically impossible) the maximum budget (or ceiling), for an FI coming from an ESIF contribution currently amounts to €27mIn for the rest of the programming period.
14. **Take up with status quo:** It is expected that students in Malta will continue to prefer non-repayable grants over repayable loan products. Hence new 'standalone' and separate study loan products in Malta may not generate significant demand from students, especially if the currently envisaged (non-repayable) scholarship grants and the tax credits scheme/s continue at the same time. Interest in a new FI would be stimulated through the conditions it offers, such as the possibility for advance payments and the repayment terms being offered (which need to be long term or subsidized further in the case of specific disadvantaged cohorts). The most appropriate financial product to address the identified 'student' market needs is a combined part loan part grant financial instrument.

Investment Strategy

15. **Target market:** Targets for a newly developed FI in Malta include (i) previous (future) applicants for grants whose application was not accepted as demand outstripped supply, (ii) those who indicate that they are not finding adequate financial support on the market, (iii) those who are discouraged from studying due to financial reasons, (iv) those who study areas or levels are currently not eligible for the assistance they require and (v) those who cannot meet the requirements of any assistance being offered to them (guarantees/payment schedules/reimbursement process).
16. **Options for implementation:** If the decision is taken to proceed, the MA has four FI implementation options:
- **Contributing with ESIF resources to EU-level FIs:** The EU's 'Erasmus for All' can be considered to be similar in scope to the Malta-based FI which is being currently considered. This programme offers a combination of grants for students to spend part of their study periods abroad as well as repayable loans for students willing to follow their Master's Degree (MQF level 7) in other countries. It has already been documented that to date Maltese students have very low interest in and take up of study loan products, especially when concurrently grants and tax credit options are available. Moreover, directly joining this Programme does not seem to be a preferred option for the Maltese authorities.
 - **Investing in the capital of an existing or newly created legal entity:** With regards to investing in existing or a newly created legal entity, this is considered as the second best option for the implementation of any new FI in Malta.
 - **Entrusting implementation tasks to another entity:** The MA also has the option of appointing a financial institution for public interest under public control (such as for instance possibly the planned Malta national development bank) or potentially other bodies subject to private law such as commercial banks to implement any new FI. In view of previous experience in Malta, the involvement of commercial banks seems to be the most realistic way forward. Besides, this will ensure the utilisation of the banks' specific know-how on the local financial and legal environment, including various types of student products and in some instances also access to other EU co-financed FIs
 - **Undertaking implementation tasks directly:** Undertaking implementation tasks directly by the MA is considered to be a challenge in view of the administrative and technical capacity required to do so directly.

The two types of FI include specifically developed tailor-made instruments or the adoption of one of the off-the-shelf instruments developed by the European Commission. In view of previous experiences for Malta, entrusting implementation tasks directly through the involvement of commercial banks seems to be the most realistic way forward. This will ensure utilisation of the banks' specific know-how in the local financial and legal environment, including various types of student products. Investing in existing or a newly created legal entity is considered as the second best option for the implementation of the new FI. A tailor made FI is required as no Commission off-the-shelf instrument was found to fit the MA's existing requirements and objectives.

17. **Involving intermediaries:** A funding agreement with an intermediary (similar for instance to the involvement of EIB in JEREMIE/JAIME) will probably be required. Financial intermediaries in Malta have expressed their interest in providing a new FI aimed at students but further in-depth consultation is required. A public procurement process will be required to give an equal chance to all through a transparent process.
18. **Size of market and take up:** Ultimately, average demand for continuing education, especially at higher levels, is still lower in Malta than its European counterparts, and in a country the size of Malta, this makes absolute demand (headcount numbers) even smaller. With this in mind, the reality of potential lack of sufficient take-up of any new FI remains a distinct possibility which will need to be considered in any discussions on the way forward. A pilot project could also potentially be considered which builds on previous and ongoing instances of cooperation between the commercial banks and government-linked entities.