Failures of English Language Schools: What Should be done?

The collapse at the start of February of yet another English language school (eight in fact, run by GEOS) highlights the question of whether existing arrangements for protecting foreign students from financial loss and disruption are adequate and well designed

This is an important export industry, both in terms of its own activities, but also as part of the supply chain in preparing foreign students for entry to Australian Universities. In 2008 there were over 162,000 international students enrolled with over 250 accredited providers delivered English language courses.

Given the trashing in the overseas press of Australia's reputation regarding the physical safety of foreign students, the last thing needed is concerns also about the financial safety of the investments they are making in their education.

The loss of large prepaid tuition (or other) fees borne by foreign students when a school fails are potentially significant, create major disruption to students living in a foreign land and subject to visa issues, and create reputational costs for the industry as a whole.

There is already a protection scheme in place, but judging from media hysteria about student losses it is not adequately publicized – or not working well. Nor has its effectiveness and financing been subject to much in the way of public scrutiny.

Under the ESOS Act of 2000 registered providers of education services to international students are required to be members of the ESOS Assurance Fund which is charged with arranging alternative courses or refunding students pre-paid fees, when a provider fails. This covers more than just English language schools, and in 2008 (the 2009 Annual Report is not yet public) provided refunds of around $3.5 mill in response to claims of around 1300 students with a similar value of claims outstanding.

For 2009, the fees levied by the Fund were set at $530 plus 0.09 per cent (9 basis points) of the registered provider's annual foreign student fee income. For 2010, the fees have been increased (to 0.189 per cent) and an additional special levy proposed, reflecting an "urgent need to support the solvency of the Fund"

Registered providers are also (generally) required to be members of a Tuition Assurance Scheme (TAS) – which are private, industry operated, operated schemes, whereby participants agree to take on (if possible) students whose providers have not delivered the course involved – or have failed. Those schemes charge participants a fee, but not one that is sufficient to cover the student fees lost through failure of a member. They are likely to work best in the situations where a solvent provider ceases to offer a particular course, and is able to transfer fee income already received to an alternative provider.

The Senate Standing Committee on Education, Employment & Workplace Relations reviewed the ESOS Act in 2009 and its Report in October made some recommendations for change, reflecting the perspective that a small number of unscrupulous operators had damaged the international reputation of the Australian Industry. Its main recommendations related to tightening up of registration provisions, and did not address the financial aspects of the financial protection schemes.

The Hon Bruce Baird is leading a further review of the ESOS Act. In his Issues Paper released in September 2009 he noted "the issue of whether the risk associated with any given provider has been adequately reflected in contributions to the TAS or the ESOS Assurance Fund. Although the TAS's are established under ESOS, they are independent and there are minimal legislative mechanisms to ensure their effectiveness."

In his Interim Report in December 2009, he noted that "Consultations to date have indicated that the current arrangements are too complex, do not support the student adequately at a stressful time, have not been able to place students and are leading to increasing claims on the ESOS Assurance Fund". The Review is considering the how TAS might be amended, perhaps including financial viability tests and risk assessment.

A number of possible changes warrant consideration. The first, and perhaps most contentious, would be to place students as the most senior creditors of a failed provider. This would facilitate the administrator of a failed provider in quickly organizing transfer of students to another provider – for the following reason. Absent such a transfer, students would be creditors for the full amount of fees paid, but the costs involved in a transfer would involve (approximately) the fees for the undelivered part of the course – thus reducing the losses to other creditors.

A second change would be to base ESOS levies on student numbers rather than aggregate fee income. Providers of cheap courses in a particular subject area may be operating on thin margins and more likely to fail, and the cost of their failure is related to the costs of getting other providers to take on the students. (It would probably be appropriate to have different fee rates for different industry sectors to reflect different cost levels and risks).

A third change would be to link ESOS levies to some objective measures of default risk. Various studies have found that variables such as a liquidity ratio, capital ratio, and profitability have some power in predicting failure, while rapid growth is also often seen as a "red flag" –particularly by banking regulators.

Finally, the question of whether the multi-layered structure involving insolvency administrators, industry TAS and government ESOS Assurance Fund is the most efficient in case of failures needs to be examined. The unique requirement to achieve both a smooth continuation of the education experience as well as financial protection, makes this a complicated area. There is no doubt that industry support in ensuring speedy transfer of students to alternative providers is essential – and the question which warrants attention is whether this is better achieved via continuance of the TAS schemes or incorporating them into the ESOS Assurance Fund.

Kevin Davis
Professor of Finance, University of Melbourne
Research Director, Melbourne Centre for Financial Studies
February 5, 2010