

**For discussion on
5 January 2006**

Legislative Council Panel on Financial Affairs

**Sale and Outsourcing of the
Funding and Administration of
Loans Made to Students**

PURPOSE

This paper informs Members of the Administration's plan to dispose of the Government's non-means tested student loan portfolio and outsource the funding and administration of these loan schemes to the private sector, and seeks Members' views on the proposed way forward.

BACKGROUND

2. At present, the Student Financial Assistance Agency (SFAA) administers four student financial assistance schemes providing loans to students of tertiary education institutions for meeting their tuition fee payments, academic expenses and/or living expenses. These schemes are the Local Student Finance Scheme (LSFS), the Financial Assistance Scheme for Post-secondary Students (FASP), the Non-means Tested Loan Scheme (NLS) and the Non-means Tested Loan Scheme for Post-secondary Students (NLSPS). All loans under these schemes are unsecured loans.

3. The sale and outsourcing of the funding and administration of loans made by Government to students form part of the Administration's asset disposal programme. While it was Government's original intention to

dispose of the whole student loan portfolio (i.e. both the means-tested schemes and the non-means tested schemes) amounting to some \$5 billion, after due consideration of market sentiments and administrative considerations, we have decided to exclude the means-tested schemes from the current exercise.

4. The NLS and NLSPS provide financial assistance in the form of non-means-tested loans to eligible students of publicly-funded institutions¹, and eligible students pursuing accredited post-secondary programmes, courses offered by the Hong Kong Shue Yan College and the Open University of Hong Kong, and continuing and professional education courses provided in Hong Kong by registered schools, non-local universities and recognised training bodies, as appropriate.

5. The NLS and the NLSPS operate on a full-cost recovery basis. Interest is payable on the outstanding balance of the loan at the “no-gain-no-loss” rate (5.275% prevailing on 1 December 2005), plus a 1.5% risk-adjusted factor which seeks to cover the Government’s risk in disbursing unsecured loans. An administrative fee is chargeable for each application and annually thereafter until the loan is fully repaid. Since the introduction of the NLS and NLSPS in 1998 and 2001 respectively, funding requirements of the scheme have seen a remarkable upward trend. In anticipation of the surging demand for loans under these schemes, we estimate that about \$1.1 billion are required under the Loan Fund to meet the net payment requirements (i.e. payments less receipts) in 2005-06. This level of funding roughly represents a 40% increase over the actual net payment of some \$800 million

¹ Publicly-funded institutions refer to the eight University Grants Committee-funded institutions, the Hong Kong Institute of Vocational Education of the Vocational Training Council, the Hong Kong Academy for Performing Arts and the Prince Philip Dental Hospital (as relating to the Dental Technology Course).

in 2003-04. The governing provisions of the terms and conditions of the schemes as approved by the Finance Committee of LegCo are summarised in the **Annex**.

JUSTIFICATIONS

6. Having regard to the nature and strong demand of the NLS/NLSPS loans from the students, we consider that there is a case to invite the private sector to participate in funding the student loan schemes to help ensure funding sustainability in the longer term. We consider that, subject to sufficient market interest, the existing student loan portfolio should be sold and the funding and administration of any future loans under the two schemes outsourced to the private sector in line with the “Small Government, Big Market” principle. The disposal/outsourcing will bring in long-established management skills in the private sector in respect of loan processing and administration, which will help improve service standards to borrowers.

7. To gauge the market’s interest, we have recently invited expression of interest on a non-committal basis from the financial institutions in Hong Kong. A number of these institutions have indicated interests in acquiring the existing loan portfolio and/or taking over the funding and/or administration of future loans subject to the terms and conditions to be determined in due course. In the light of the encouraging responses from the institutions, we consider that the disposal/outsourcing should be conducted through a competitive process. We are in the course of preparing the tendering documents with a view to completing the disposal/outsourcing exercise in the 2006-07 financial year.

RIGHTS AND OBLIGATIONS OF LOAN BORROWERS

8. It is the Government's policy to ensure that no student is deprived of education due to lack of means. In taking forward the disposal/outsourcing proposals, we are mindful that the proposal should not adversely affect the interest payable by, and other rights and obligations of, the borrowers, which are determined in accordance with the agreed terms of the respective loan schemes as approved by the Finance Committee. A review of the NLS and NLSPS is currently underway. Without pre-empting the review findings, changes, if any, to the existing terms of the schemes would require the Finance Committee's approval. To safeguard the interests of the students, the overriding requirement of preserving the terms and conditions of the schemes as approved by the Finance Committee and the administrative standards of the loans will be clearly set out in the tendering document, which will form part of a legally binding agreement with the successful tenderer.

9. We shall critically examine all the tenders received to ensure that they meet our specifications before the contract is awarded. A monitoring mechanism would be put in place to ensure full compliance by the successful tenderer with all requirements stipulated in the contract.

FINANCIAL IMPLICATIONS

10. As at 30 November 2005, the net outstanding loan balance of the non-means tested loan schemes amounted to some \$3.4 billion². On existing terms and conditions, the projected annual net payments (i.e.

² Not including loans which are in default or have been approved for deferral of repayments.

payments less receipts) of the schemes will increase from some \$1.1 billion in 2005-06 to some \$1.4 billion in 2009-10. It is estimated that there will be about \$7 million annual savings in SFAA, should the administration of the loans be outsourced.

WAY FORWARD

11. Subject to Members' comments, we intend to invite open tenders from the private sector to submit bids on the disposal of student loans and/or outsourcing of the NLS/NLSPS as set out in paragraph 7 above.

ADVICE SOUGHT

12. Members' views are sought on the proposed way forward.

Treasury Branch
Financial Services and the Treasury Bureau
December 2005

**Non-means Tested Loan Scheme (NLS) /
Non-means Tested Loan Scheme for Post-secondary Students (NLSPS) -
Rights and Obligations of Loan Borrowers**

Clientele	<p>NLS</p> <ul style="list-style-type: none"> • Registered full-time students of recognized courses run by the eight University Grants Committee-funded institutions, the Hong Kong Institute of Vocational Education of the Vocational Training Council, the Prince Philip Dental Hospital and the Hong Kong Academy for Performing Arts; • Students of the Open University of Hong Kong (OUHK), Hong Kong Shue Yan College, part-time publicly-funded programmes or self-financing, local award-bearing programmes offered by publicly-funded institutions (including their Schools of Professional and Continuing Education); students pursuing programmes offered under the “Project Yi Jin” and all other persons pursuing continuing or professional education courses provided in Hong Kong by registered schools, non-local universities and recognized training bodies. <p>NLSPS</p> <ul style="list-style-type: none"> • Registered full-time students aged 25 or below who have not obtained any sub-degree qualification or above and are pursuing full-time accredited, self-financing post-secondary education programmes leading to a qualification at or above the levels of higher diploma, associate degree and/or professional diploma. Accredited programmes refer to those included in the Register of Accredited Programmes approved by the Secretary for Education and Manpower. • Applicants for either scheme must have the right of abode in Hong Kong or have resided or have had their home in Hong Kong continuously for three complete years immediately prior to the commencement of the course.
Type of financial assistance	<ul style="list-style-type: none"> • Tuition fee loan; • Living expenses loan (applicable to NLSPS only).
Tuition fee loan	<ul style="list-style-type: none"> • Maximum amount – tuition fees payable • Minimum amount – HK\$1,000 • Lending restrictions – <ul style="list-style-type: none"> ➢ loan amount for students obtaining means-tested assistance under the Local Student Finance Scheme (LSFS) administered by the Student Financial Assistance Agency may not exceed the difference between the student’s maximum entitlement under the LSFS and the actual amount of means-tested assistance offered or the actual tuition fees payable, whichever is the less. ➢ loan amount for students obtaining means-tested assistance under the Financial Assistance Scheme for Post-secondary Students may not exceed the difference in the tuition fees payable and the amount of means-tested assistance offered. ➢ upon availability of result of means-test, any excess borrowing already paid is subject to immediate refund (by off-setting means-tested assistance) plus accrued interest. Any excess borrowing approved but not yet paid will be cancelled. ➢ loan amount for students of the OUHK is restricted to tuition fees stipulated in demand note. Any demand note for which tuition fees are endorsed as having been settled by OUHK’s own loan assistance scheme is not accepted for the NLS.
Living expenses loan (applicable to NLSPS only)	<ul style="list-style-type: none"> • Maximum amount pegged to means-tested living expenses loan provided under the LSFS. HK\$33,850 for 2005/06; • Minimum amount - HK\$1,000; • Only applicable to students aged 25 and below who have not obtained any sub-degree qualification or above and are pursuing full-time accredited, self-financing post-secondary education programmes offered in Hong Kong.

(cont'd)

Loan interest rate	<ul style="list-style-type: none">• Prevailing NLS/NLSPS interest rate = 6.775% per annum as at 1 December 2005;• Chargeable once the loan is drawn down.
Indemnifier	<ul style="list-style-type: none">• Normally required.
Payment arrangements	<ul style="list-style-type: none">• Normally paid to course provider by direct credit or by cheque if fees have yet to be settled. For payment by cheque, a maximum of 3 draw down dates permitted, i.e. when tuition fee instalments become due;• Paid to student by direct credit if –<ul style="list-style-type: none">(i) fees have already been settled; or(ii) student is pursuing accredited, self-financing post-secondary programme (applicable to NLSPS only).
Repayment	<ul style="list-style-type: none">• No repayment of loan principal or interest during study period;• Loan repayment commences upon completion / withdrawal of studies or lapse of 6 years, whichever is the earlier;• Loan repaid with interest in full in 40 equal quarterly instalments over 10 years;• Early repayment, partial repayment permitted without additional charges/penalty.
Interest charge during study period	<ul style="list-style-type: none">• Interest is charged on outstanding loan principal. Interest accrued is not capitalized (no interest on interest). On graduation, study interest accumulated is frozen and repaid in 40 equal quarterly instalments.
Interest charge on completion of studies	<ul style="list-style-type: none">• On reducing loan principal.
Deferment of loan repayment	<ul style="list-style-type: none">• Permitted with documentary proof –<ul style="list-style-type: none">- Continuing studies;- Serious illness; or- Financial hardship;• Interest accrued during deferment period is capitalized upon recommencement of repayment.
Late repayment	<ul style="list-style-type: none">• Overdue amount subject to additional interest charge at prime rate.
Defaulting loans	<ul style="list-style-type: none">• In default if overdue for 2 consecutive quarterly instalments. Indemnifier informed and if still in default after last deadline, indemnifier will be demanded to repay, failing which recovery action would commence.