For Information

LegCo Panel on Education

Local Student Finance Scheme
Review of Fixed Interest Rate

Purpose

This paper reports the findings of a review of the fixed interest rate charged on loans provided to needy students under the Local Student Finance Scheme (LSFS).

Introduction

2. On 28 November 2001, the Hon CHEUNG Man-kwong raised a question at the Legislative Council, urging the Government to review the adjustment mechanism of the interest rate of loans provided under various student financial assistance schemes with a view to lowering the interest rates to alleviate the burden of borrowers.

3. The Secretary for Education and Manpower explained at the meeting that the interest rate charged under the Non-means Tested Loan Scheme (NLS) is linked to the Best Lending Rate (BLR) of the note issuing banks, with a difference of 0.5 percentage point[1]. The adjustment to the NLS interest rate takes effect at the beginning of the month following the adjustment to the BLR. The current adjustment mechanism already enables borrowers to benefit from lower interest rate in tandem with the downward movement in the market. The present exercise reviews the fixed interest rate charged for loans under the LSFS.

Background

4. Under the LSFS, we provide means-tested grants (to cover tuition fees, academic expenses and compulsory student union fees) and/or loans (to cover living expenses) to eligible full-time students pursuing

---

[1] The interest rate charged under NLS is the Government No-Gain-No-Loss rate which is 2% below the BLR, plus a risk adjustment factor of 1.5%. The risk adjustment factor is being reviewed separately.

publicly-funded degree or sub-degree programmes of the eight University Grants Committee-funded institutions, the Hong Kong Academy for Performing Arts, the Hong Kong Institute of Vocational Education and the Prince Philip Dental Hospital. Prior to 1987-88, the loans were interest-free.

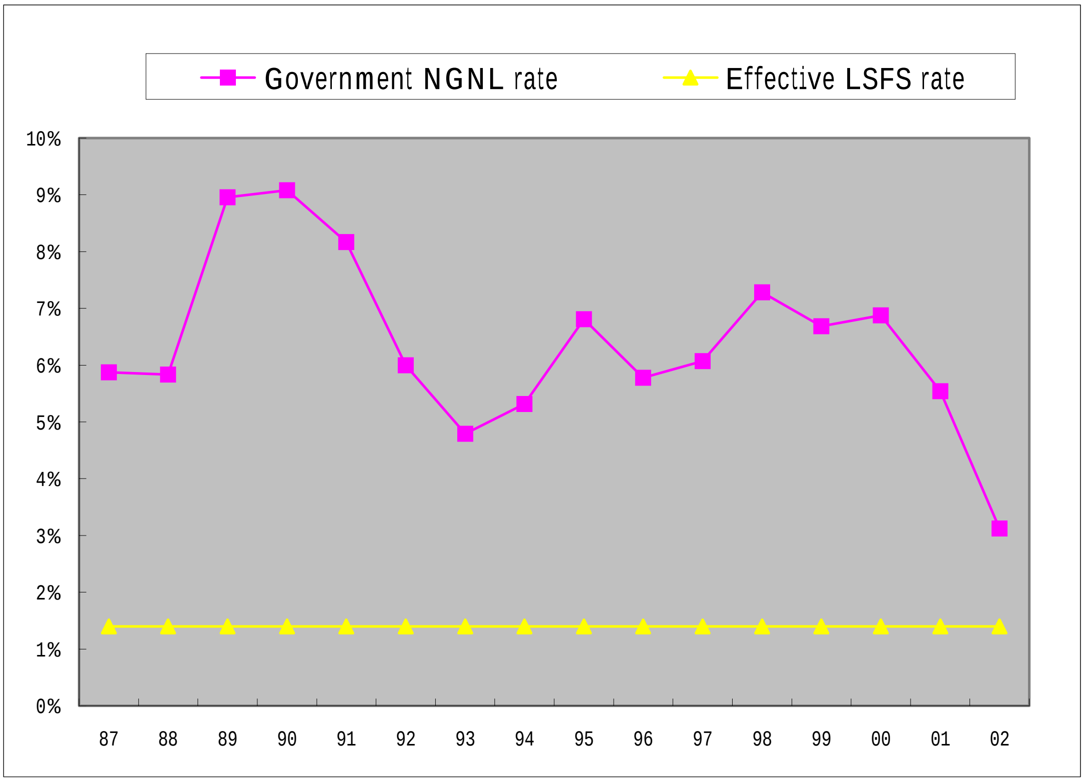
5. Based on observations made by the Director of Audit on the operation of the LSFS, the Public Accounts Committee recommended in 1986 that the Administration consider charging interest on loans. The Administration had subsequently conducted a study on the effects on students of various rates and repayment periods. Eventually, we decided to introduce in 1987-88 a fixed interest rate of 2.5% p.a. with a repayment period of five years after graduation. This subsidised rate was thus set without reference to the market interest rate. At that time, the estimated monthly repayment for an average student was about $453. The charging of interest at 2.5% p.a. would increase the monthly repayment amount by about $30 to $482, which was then affordable by students.

The Review

Effective Interest Rate

6. Under the LSFS, interest is not charged during the study period. Thus, the fixed interest rate of 2.5% p.a. is nominal only. The effective interest rate over the entire loan period depends on the length of the study period as well as the period of repayment.

7. A substantial number of borrowers under the LSFS pursue a 3-year programme. Assuming they take out a loan of the same amount annually and repay over a 5-year period**,** the effective interest rate is 1.4% p.a. This is much lower than the Government’s current no-gain-no-loss (NGNL) rate of 3.125% p.a. The following graph illustrates how the low fixed interest rate has insulated borrowers from the vagaries of interest rates over the years -



Repayment of Loan and Interest

8. The average size of loans (i.e. the amount drawn down) under repayment status is $63,000. At the existing nominal interest rate of 2.5% p.a., the total interest payable over a 5-year repayment period is $4,216 or an average of $70 p.m. The monthly repayment of loan and interest comes to $1,120.

9. The loan ceiling under the LSFS is $33,690 in 2002-03. Assuming that a student obtains the same maximum loan over a 3-year programme, his total loan would be $101,070 on graduation. In this case, the total interest payable over a 5-year period would be $6,764 or $113 p.m., bringing the total monthly repayment amount to $1,797.

10. There are existing arrangements for deferment of LSFS loan repayments on grounds of further studies, serious illness and financial hardship. Borrowers may apply for deferring repayment or re-scheduling their loans, within a maximum repayment period of 10 years after graduation. They would however need to produce documentary evidence of their difficulties, such as student identity cards, medical certificates, financial statements, copies of job applications, etc.

11. The "deferment" arrangements provide effective assistance to borrowers who have difficulty in making repayment. In the first half of the 2002-03 financial year, the Student Financial Assistance Agency had approved 913 applications for deferment, comprising 512 cases on grounds of financial hardship, 388 for further studies and 13 due to serious illness. As at 30 September 2002, there were 3 158 borrowers, with outstanding loan principals totalling $171.4 million, deferring their loan repayment.

Scope for Reducing Interest Rate

12. As illustrated in paragraphs 8 and 9, interest is but a small element in the monthly repayment amount. A 1% reduction of the nominal interest rate to 1.5% p.a.[2] would, for example, bring down the monthly repayment amount for an average student borrower taking a loan of $63,000 by a mere $28, from $1,120 to $1,092. In the case of a student drawing the maximum amount of loan totaling $101,070 over a 3-year programme, his monthly repayment would come down by just $45, from $1,797 to $1,752.

13. A general reduction of the fixed interest rate of 2.5% would have little impact for borrowers in financial hardship. But the financial implication for the Government is substantial. With some $1,700 m loans under repayment, a 1% reduction of the fixed interest rate would result in interest forgone of about $17 million a year for the Government. It is difficult to justify such a use of public funds at the expense of other services or activities in the current economic climate.

14. On the other hand, we have explained in paragraphs 10-11 that the deferment / re-scheduling of loan repayment is an effective measure to assist borrowers in financial hardship. Furthermore, we would point out that no interest is charged on loans during the period of deferment. The effective interest rate in such cases would therefore be even lower than the average of 1.4% mentioned in paragraph 7 above. We consider that this "reduction" of effective interest rate for the group of borrowers most in need, rather than an across the board reduction for all, appropriate.

---

[2] The effective interest rate calculated on the same basis as that explained in paragraph 7 is 0.84% p.a.

Conclusion

15. Members are invited to note that for the reasons set out in paragraphs 12-14, we do not propose to change the existing fixed interest rate of 2.5% p.a. under the LSFS. We will inform the Joint Committee on Student Finance of the result of this review at its next meeting in November 2002.

Education and Manpower Bureau
October 2002