For discussion
on 26 January 2006

LC Paper No. CB(2)955/05-06(02)

Legislative Council Panel on Education

Sale and Outsourcing of the Funding and Administration of Loans made to Students

PURPOSE

This paper provides additional information on the Administration's proposal to dispose of the Government's non-means-tested student loan portfolio and outsource the funding and administration of these loan schemes to financial institutions in the non-government sector, and seeks Members' views on the proposal.

BACKGROUND

2. At present, the Student Financial Assistance Agency (SFAA) administers four student financial assistance schemes providing unsecured loans to, inter alia, students of tertiary education institutions for meeting their tuition fee payment, academic expenses and/or living expenses. Two of these schemes are non-means-tested, namely, the Non-means-Tested Loan Scheme (NLS) and the Non-means-Tested Loan Scheme for Post-secondary Students (NLSPS).

3. The NLS and NLSPS are applicable to eligible students of publicly-funded institutions[1], 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. The two schemes operate on a full-cost recovery basis. Interest is payable on the outstanding balance of the loan at the "no-gain-no-loss" rate[2], plus a 1.5% risk-adjusted factor which seeks to cover the Government's risk in disbursing

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[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).

[2] The no-gain-no-loss interest rate is set at a fixed percentage below the average of the best lending rates of the note-issuing banks (BLR), with that percentage being the average differential between the BLR and the Hong Kong Dollar Inter-bank Offered Rates (HIBOR) in the preceding 120-month period at the time of review.

unsecured loans. An administrative fee is chargeable for each application and annually thereafter until the loan is fully repaid.

PROPOSAL

4. The Administration proposes, on the condition that students' and public interests are safeguarded –

(a) all existing loan portfolios under the NLS/NLSPS exclusive of loans in default or granted approval for deferred repayment (amounting to some $3.4 billion at book value as at November 2005) be disposed of to financial institutions in the non-government sector; and

(b) the funding and administration of future loan applications under the NLS/NLSPS be outsourced to financial institutions in the non-government sector for a specified period of time.

JUSTIFICATION

5. Since the introduction of the NLS and NLSPS in 1998 and 2001 respectively, funding requirements of the schemes have seen a remarkable upward trend. In anticipation of the surging demand for loans under these schemes, we estimate that about $1.1 billion would be 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 in 2003-04. In anticipation of the strongly-growing demand for the NLS/NLSPS loans, we consider that there is a case to invite financial institutions in the non-government sector to participate in funding these student loan schemes to help ensure funding sustainability in the longer term.

6. The proposal is also in line with the "Big Market, Small Government" principle. In addition, it will bring in the long-established management skills of financial institutions in respect of loan processing and administration, which will help improve service standards to borrowers.

RECENT DEVELOPMENTS

7. The Administration briefed the Panel on Financial Affairs (FA Panel) on the proposal to dispose of and outsource the NLS/NLSPS loans on 5 January 2006. That Panel meeting was open to all other Members of the Legislative Council and a copy of the paper is attached in the **Enclosure** for easy reference.

8. As reported at the above meeting, the Administration has recently invited, on a non-committal basis, expressions of interest from financial institutions in Hong Kong in acquiring the existing loan portfolio and/or taking over the funding and/or administration of future loans. A number of these institutions have indicated interest subject to terms and conditions to be determined in due course. In the light of the positive response, we consider that the disposal/outsourcing may proceed through a competitive process. We are preparing the tender documents and aim to complete the disposal/outsourcing exercise in the 2006-07 financial year.

FURTHER INFORMATION

9. To address concerns raised by Members at the FA Panel meeting, we provide in the ensuing paragraphs further information to facilitate consideration of the proposal.

Rights and Obligations of Loan Borrowers

10. It has been the Government's policy to ensure that no student is deprived of education due to lack of means. In taking forward the proposal, it remains the Government's primary concern to safeguard students' interest. We are mindful that the proposal should not adversely affect existing rights and obligations of the borrowers. The overriding requirement of preserving the terms and conditions of the schemes as approved by the Finance Committee (please refer to the attachment to the FA Panel paper in the Enclosure) and the service standards for administering the student loans will be clearly set out in the tender document, which will form part of a legally binding agreement with the successful service provider.

Interest Payable

11. The Administration appreciates loan borrowers' concern about possible impacts on interest payable and administrative fees under the loan schemes should we proceed with the proposal. To address their concern over the interest payable, we would stipulate in the contract the existing mechanism for determining interest rate charged on loans under the NLS and the NLSPS, as well as the repayment period, should we decide to proceed with the disposal and outsourcing proposal. The service provider would not be allowed to raise, of its own accord, the interest rate above the level as determined by the existing mechanism approved by the Finance Committee.

12. On administrative fees, the Administration would set out clearly in the tender documents/contract that the service provider could not charge administrative fees higher than the existing levels, save for price adjustments in accordance with

Consumer Price Index (A), noting that the current level of charge is in fact not able to recover the full costs being incurred in administering the schemes.

Collection of Outstanding Debts

13. Some Members have expressed concern as to how the service provider would collect outstanding debts should the administration of the loan schemes be outsourced to financial institutions in the non-government sector. At present, SFAA has put in place a set of procedures for collecting outstanding loans. For instance, SFAA would issue reminders to defaulters to demand repayment and failing that, take action to recover outstanding loans to protect public money. These procedures would continue to apply and be stipulated in the tender documents/contract. Moreover, the proposal is targeted at reputable financial institutions in Hong Kong. Their operations, including the collection of overdue loans, are regulated by relevant authorities. Authorized banking institutions, for instance, are required to comply with the Code of Banking Practice jointly issued by the Hong Kong Association of Banks and the DTC Association. The Code of Banking Practice stipulates that these institutions should prohibit their debt collection agencies from collecting debts by harassment or other improper means. The Hong Kong Monetary Authority (HKMA) monitors compliance with the Code as part of its supervision of authorized banking institutions. The HKMA has not received any complaints concerning credit services provided by authorized banking institutions to students in the past three years.

Loan Deferment

14. Members were also concerned with the procedures for handling applications for loan deferment. We would ensure that the service provider follows SFAA's existing procedures for processing applications for deferment of loan repayment. Specifically, loan borrowers who have difficulties in repaying loans on grounds of further studies, financial hardship or serious illness would, subject to documentary proof, continue to be allowed to restructure their repayment schedule or defer their loan repayment.

15. The Administration would request the service provider to submit reports on the collection of loans and handling of applications for deferred repayment. The Administration would keep a close watch on the service provider through periodic reports and random inspections to ensure that it fully complies with the requirements stipulated in the contract.

16. If the tenderers' proposals cannot meet the Administration's specifications and requirements, no contract would be awarded.

FINANCIAL IMPLICATIONS

17. As at 30 November 2005, the net outstanding loan balance of the non-means tested loan schemes amounted to some $3.4 billion, exclusive of loans in default or approved for deferred repayment. On existing terms and conditions, the projected annual net payments (i.e. payments less receipts) of the schemes under the Loan Fund will increase from some $1.1 billion in 2005-06 to some $1.4 billion in 2009-10.

18. It is estimated that there will be about $7 million annual savings in SFAA, should the administration of the loans be outsourced, which includes realizable savings of staff cost of $5 million (for about 40 staff) and other departmental expenses of $2 million. This is, however, not a primary consideration of the Administration in making the proposal and the savings will be ploughed back entirely to SFAA to improve services.

PUBLIC CONSULTATION

19. The Administration has been keeping students informed of the proposal and the progress through reports at the regular meetings of the Joint Committee on Student Finance (JCSF). The Committee comprises prominent members of the community, staff and student representatives from the University Grants Committee-funded institutions and other relevant tertiary education institutions, and advises the Administration on the operation of the student grant and loan schemes.

20. Specifically, we submitted a paper to the JCSF in April 2005 to report on developments and seek Members' views on the way forward. Members generally raised no objection to the proposal to dispose of and outsource student loans to financial institutions in the non-government sector, but asked the Administration to ensure that the interests of students were safeguarded, particularly in respect of interest payable and the repayment period.

21. In September 2005, we advised the JSCF that the Government had invited, on a non-committal basis, interested financial institutions to submit initial proposals on the disposal/outsourcing initiative, and that a number of financial institutions had indicated interest in the exercise. Some JCSF Members reiterated the importance of safeguarding students' interest in the disposal/outsourcing exercise. In response, we reassured Members that the Government would seek to upkeep the existing service quality. In particular, we advised Members that the terms and conditions as stipulated by the Finance Committee would continue to apply. The Government would stipulate the existing mechanism for determining the interest rate in the

contract to be awarded to the successful service provider. The service provider would not be allowed to raise the interest rate on its own.

22. We consulted the JCSF again at its regular meeting on 17 January 2006. Some members questioned whether the risk-adjusted factor would go up and whether the service provider will engage in improper means in collecting overdue debts. Members were briefed on measures we will take to safeguard students' interest, including the stipulation of a tender requirement not to allow the service provider to raise the RAF above the existing level approved by the Finance Committee. The meeting noted that the Administration was preparing the tender documents and would further discuss the issue at this Panel. The meeting came to a view that the disposal/outsourcing exercise is contingent upon putting in place all necessary measures to safeguard the interests of taxpayers and students, to which the Administration agreed. The existing rights and obligations of loan borrowers under the NLS and the NLSPS should remain intact. We would bear these comments in mind in finalizing the tender documents/contract.

23. Separately, we briefed representatives of the Hong Kong Federation of Students (HKFS) on our proposal on 17 January 2006. HKFS representatives expressed concerns as to how the Administration could safeguard students' rights and obligations, and preserve the existing terms and conditions under the NLS/NLSPS. The Administration reassured them that the existing rights and obligations of borrowers, and terms and conditions, under the NLS/NLSPS, including the interest payable, as approved by the Finance Committee, as well as the existing loan administration procedures, will be set out clearly in the tender documents and contract. They noted that a monitoring mechanism would be set up by the Administration to oversee the performance of the service provider and that if the tenderers' proposals could not meet the Administration's specifications and requirements, no contract would be awarded.

Advice sought

24. Members' views on the proposal are most welcome.

Education and Manpower Bureau
Financial Services and the Treasury Bureau
January 2006

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 institutions[1], 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

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[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 billion[2]. On existing terms and conditions, the projected annual net payments (i.e.

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[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

Annex

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

Clientele	**NLS** • 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. **NLSPS** • 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	• Tuition fee loan; • Living expenses loan (applicable to NLSPS only).
Tuition fee loan	• Maximum amount – tuition fees payable • Minimum amount – HK$1,000 • Lending restrictions – ➢ 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)	• 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	• Prevailing NLS/NLSPS interest rate = 6.775% per annum as at 1 December 2005; • Chargeable once the loan is drawn down.
Indemnifier	• Normally required.
Payment arrangements	• 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 – (i) fees have already been settled; or (ii) student is pursuing accredited, self-financing post-secondary programme (applicable to NLSPS only).
Repayment	• 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	• 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	• On reducing loan principal.
Deferment of loan repayment	• Permitted with documentary proof – - Continuing studies; - Serious illness; or - Financial hardship; • Interest accrued during deferment period is capitalized upon recommencement of repayment.
Late repayment	• Overdue amount subject to additional interest charge at prime rate.
Defaulting loans	• 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.