



**Reservation in Private Sector
Educational Institutions –
Financing Framework for
Students**

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Executive Summary

- The Indian Parliament has passed the 104th Constitution Amendment Bill, which provides reservations for the socially and educationally backward classes, besides the Scheduled Classes and Scheduled Tribes, in all private aided and unaided educational institutions.
- **FICCI believes that without an adequate financial support structure for the education of backward classes and SC/STs, reservation in private educational institutions would not help the government achieve the objective of greater integration of the SC/ST students in the higher education network.**
- While in the United States and in most of the European countries funding of higher education comes from both the government and the commercial banks, the financing of educational needs of students in India has been left solely to the banking sector.
- The Comprehensive Educational Loan Scheme framed by the Reserve Bank of India in consultation with the Indian Bankers' Association, which constitutes the prime means for the Indian students to meet their financial requirements, turns out to be the weakest against the benchmarks on all relevant parameters (rate of interest, borrowing limit, payback period, security, margin) for the US and select EU countries.
- To make the reservation of seats in private educational institutions an effective mechanism to ensure an increased participation rate of students from disadvantaged groups in higher education, **FICCI suggests the following measures for consideration by the government -**

- The government should introduce centrally funded educational loan programmes for the students from the underrepresented communities who gain admission in higher educational institutions.
- Following the successful practices in US and select EU countries, these schemes should allow for soft loans with student friendly terms and conditions.
- Grants should be made available to all students from these classes who are admitted to the reserved seats with a family income below a relevant threshold level.



Reservation in Private Sector Educational Institutions - Financing Framework for Students

1. Reservation in Education: A Hollow Promise?

Recently, the Indian Parliament has passed the 104th Constitution Amendment Bill, which provides reservations for the socially and educationally backward classes, besides the Scheduled Classes and Scheduled Tribes, in all private aided and unaided educational institutions. The passing of this Bill signifies a big change, as it is the first time that unaided private institutions (excluding minority institutions), which do not receive government funding, are under the purview of the State. By passing the amendment, states are allowed to enact quota laws for socially and educationally backward classes or for SC/STs in unaided private educational institutions.

The move by the GoI to allocate a fixed number of seats to backward classes and SC/STs in private sector institutes, is however not accompanied with an adequate plan to back up these reservations financially. As course fees and additional costs of studying, especially in private institutions, can be substantial, the lack of financial support to backward classes and SC/STs severely impedes their ability to actually take up the seats reserved to them.

For reservation in education not to become a hollow promise, an adequate financial support structure for education of backward classes and SC/STs is of crucial importance. So far, the financing of educational needs of students in India has been left to the banking sector, with public sector banks increasingly offering student loans to allow poorer students to realize their educational capacities and ambitions. The terms and conditions of these loans however make this system highly ineffective for truly supporting meritorious students from backward classes and SC/STs in taking up the seats reserved for them.

2. Financing of Higher Education: The Indian Case

The Government of India, in consultation with the Reserve Bank of India and the Indian Banker's Association, has framed a Comprehensive Educational Loan Scheme, aiming to ensure that no deserving student in India is deprived of higher education for the want of finances. The scheme covers most graduate, post-graduate and professional courses in schools and colleges (engineering, medical, veterinary, law, dental, management etc.) both within and outside India. Since the scheme was introduced in 2001, popularity of education loans has risen sharply. During 2004-2005, the 27 PSU banks together had sanctioned 1,69,768 fresh loans for a cumulative amount of Rs. 3,525.91 crore, against 1,07,929 fresh loans amounting to Rs. 2,032.94 crore in the year before.

The most important features of the scheme are as follows:

➤ The scheme envisages loans up to Rs. 7.5 lakh for studies in India and up to Rs. 15 lakh for those studying abroad. (However, based on the nature of the course and the needs of the student, individual banks offer a higher amount on a case-to-case basis. State Bank of India, for example, has a cap of Rs. 10 lakh on educational loans for inland studies and Rs 20 lakh for studies abroad);

➤ For loans up to Rs. 4 lakh, no collateral or margin is required and the interest rate is not to exceed the Prime Lending Rates (PLR), which stood at 10.5% at the end of 2005. For loans above Rs. 4 lakh, collateral security is needed and the interest rate is not to exceed PLR + 1;



➤ The loans are to be repaid over a period of 5-7 years, with provision of a grace period of one year after completion of studies or six months after securing a job, whichever happens earlier;

➤ Education loans allow the borrower to reduce tax liability, although the 2005-2006 budget has reduced the extent. Where students were earlier allowed to deduct up to Rs. 40,000 from their total income for the years towards servicing of the principal and interest of the loan for eight years from the time of the first deduction, under the changed (2005) tax laws, deduction is only allowed on the interest portion of the loan. Under the changed tax regime, the deduction is not subject to any limits, but the repayment of the principal amount will not be taken into account for the tax benefit;

➤ Margin: Up to Rs. 4 lakh	Nil
Above Rs. 4 lakh, studies in India	5%
Studies abroad	15%

➤ Security: Upto Rs. 4 lakh: No security

Above Rs. 4 lakh and upto Rs. 7.5 lakh: Collateral in the form of third party guarantee. (The bank may waive the third party guarantee if satisfied with the net-worth/ means of parent who would be executing the document as 'joint borrower'.)

Above Rs. 7.5 lakh: Collateral security of suitable value or suitable third party guarantee along with the assignment of future income of the student for payment of installments;

➤ Expenses that can be considered in relation to the loan include: fee payable to college/ school/ hostel, examination/ library/ laboratory fee,



purchase of books/ equipments/ instruments/ uniforms, caution deposit/ building fund/ refundable deposit supported by institution bills/ receipts, travel expenses/ passage money for studies abroad, purchase of computers if essential for completion of the course, other expenses required for completion of the course.

Although the educational loans scheme is especially designed in order to 'ensure that no deserving student in India is deprived of higher education for the want of finances', there exist several pitfalls in the scheme that make it inadequate to ensure participation of backward classes and SC/STs in higher education through the means of reservation. The main drawbacks of the scheme are in the fields of margin / collateral and interest rates / payback period.

Margin / Collateral

The margin and collateral which are required for taking up an education loan above Rs. 4 lakh, are likely to pose heavy constraints on the ability to do so by students from backward classes and SC/STs. The purpose of reservation in higher education is to help meritorious, usually poor, students from backward groups of society getting a seat in higher education. Paradoxically, the requirements for even acquiring financial support to take up that seat, in the form of education loans, are not aligned with the social and economic background of these students.

For borrowing over Rs. 4 lakh, a *minimum* of Rs. 20,000 (5%) has to be coughed up as own contribution to the finances. Also, the likelihood for students from backward classes and SC/STs of finding a third party willing to guarantee their education loan, seriously has to be questioned.

Interest rates / payback period

The scheme for education loans in its current form creates a very heavy burden to pay off the loan, which might well be *too* heavy for graduates from backward classes and SC/STs, for whom additional financial means are usually very limited.

The high numbers of defaulting students in the past have made education loans a relatively risky undertaking for banks, resulting in high interest rates. The current 10.5% PLR that is charged on loans for domestic studies (even higher interest rates apply on loans for studying abroad) stand in no relation to the housing loans and car loans that are available at 8-8.5%. The repayment that starts 1 year after ending the course or 6 months after getting a job (whichever is earlier), and lasts for 5-7 years after the first repayment, is likely to become a very heavy burden in comparison with the average salary during the initial years after graduation. Although a graduate from a high-quality private educational institution can most likely look forward to a good salary in the long term, this is by far not necessarily the case in the shorter term with graduate salaries starting from Rs. 15,000-20,000. Especially medical students, who earn only very little money until completion of their MDs, are unlikely to carry the heavy financial burden of education loan paybacks independently. As financial help from outside (parents, family, third parties) is especially scarce in the case of backward classes and SC/STs, these groups can not be expected to be able to take up costly education loans in fear of excessive financial burdens in the future.

As a result, the educational loan scheme that constitutes the prime means for Indian students in need of financial support for completing their higher education, is not in line with the GoI's policy of reservation of seats in private sector higher education institutes for students from backward classes and

SC/STs, as it does not accommodate for the specific social and economic background of these students. By not offering the adequate financial support, the benefits of reservation in education are therefore likely to remain merely a hollow promise.

3. Financing of educational needs: the US/ European case

A detailed overview of the different forms of funding of higher education and terms and conditions can be found in Appendix 1. A short summary is given below.

➤ Financial Support Schemes for post secondary education in the US

Federal Student Aid is an integral part of America's post secondary education system. With the objective to benefit all eligible American students, the financial assistance programmes administered by the US Department of Education comprise the nation's largest source of student aid. During the year 2004-05 school year they provided approximately \$ 74 billion in new aid to nearly 10 million post secondary students and their families (1).

The three most common types of financial support schemes offered by the US Department of Education are grants, loans and work-study. For most students who receive a financial aid award from their college, part of their aid package includes either the subsidized or unsubsidized loan. Virtually all students enrolled at least half-time may borrow either through William D. Ford Federal Direct Loan Programme, which is funded by the federal government or through Federal Family Education Loan (FFEL) Programme, wherein private lenders provide federally guaranteed funds. Parents may also borrow to pay education expenses for dependent undergraduate students through either of these programmes.

¹ Source: US Department of Education website, <http://www.studentaid.ed.gov>

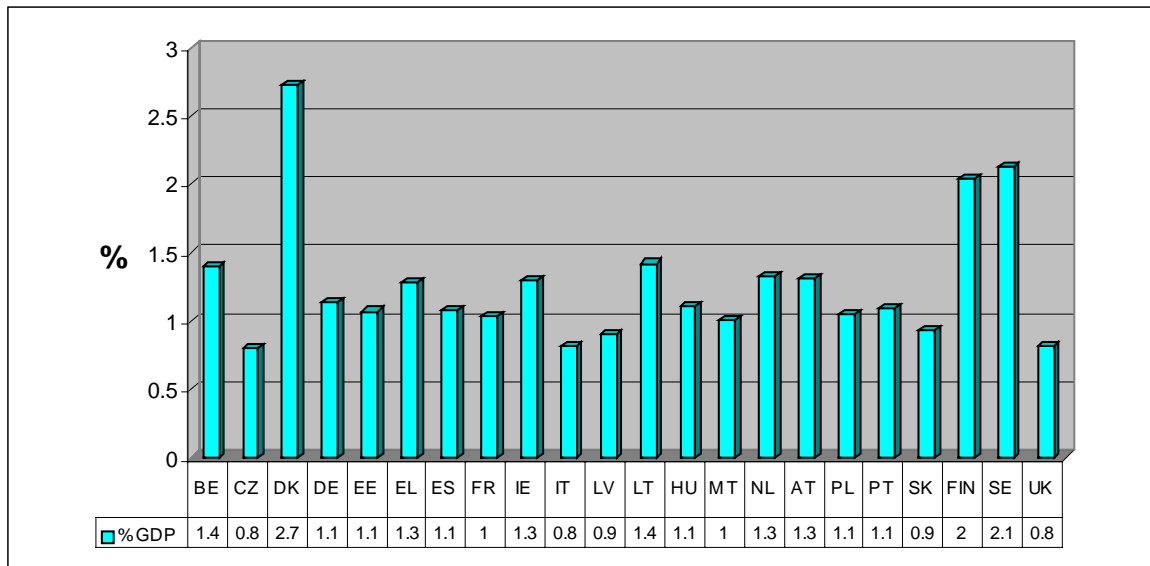
Subsidized loans are awarded by the U.S. Department of Education on the basis of financial need of the applicants. If a student is eligible for a subsidized loan, the government pays the interest on her loan while in school and for the first six months after she leaves school. Depending on the financial need, the student may borrow subsidized money for an amount up to the annual borrowing limit for her level of study.

Grants are awarded only to students having exceptional financial need. The amount of grants primarily depends on the cost associated with the programme under consideration and the enrollment status of the student.

➤ Financial Support Schemes for Higher Education in selected EU countries

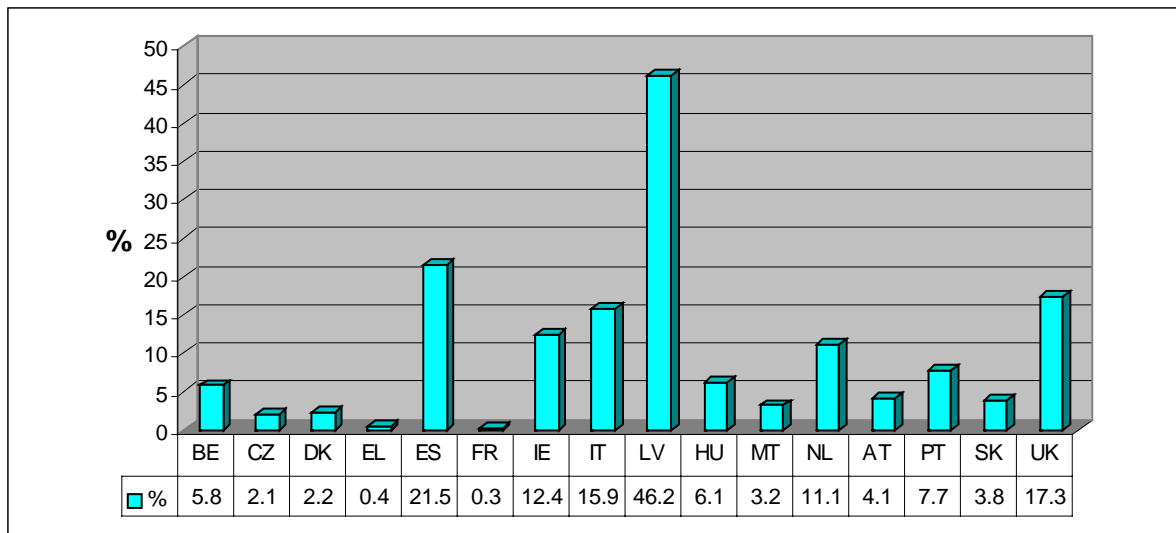
Sources of funding of higher education in the European Union can be broadly grouped into two: public and private sources. Public sources come from central, regional and local authorities while private sources refer to funding by students (and their respective households) and non-governmental bodies such as foundations and charities. The relative importance of each of the sources (public and private) varies from one Member State to another. There is a policy of free higher education in some Member States (e.g. Denmark, Finland, Germany and Sweden), while in most other Member States students have to pay tuition fees. Public expenditure on higher education varies between approximately 0.8% and 3% of GDP (figure 1), and the percentage family income spent on higher education however remains relatively low (figure 2).

Figure 1
Public expenditure on higher education as % of GDP



Source: EUROSTAT UOE Data Collection, taken from European Research Associates (2004), “The Financing of Higher Education in Europe”, available at www.europa.int/comm/education/policies/2010/studies/financing1_en.pdf

Figure 2
Payments by households to higher education institutions as a % of total income received in 2001



Source: EUROSTAT UOE Data Collection, taken from European Research Associates (2004), “The Financing of Higher Education in Europe”, available at www.europa.int/comm/education/policies/2010/studies/financing1_en.pdf

Financial assistance programmes offered to post secondary students in most EU countries include grants and soft loans. While EU countries typically offer a relatively high amount of grants funded by the government of the respective country, which are usually allocated to students based on family income, a typical financial aid package received by a European student also includes an educational loan, either provided by the government or by a commercial lender. These loans are offered at interest rates lower than the market rate of interest.

While all eligible students can apply for the grants and soft loans, the maximum amount of allocation typically depends on (a selection of) the following factors:

- ✓ The living situation and the household income of the student
- ✓ Dependency status of the student
- ✓ Total cost of education
- ✓ Type of education
- ✓ Level of performance

A majority share of financial support offered in European countries comes from central Governments, as opposed to Regional and Local authorities (table 1).

Table 1
Breakdown of public expenditure on scholarships and grant as % of total expenditure on student aid in 2001

Member State	Central	Regional	Local
Austria	99.5	0.5	0
Belgium	89.7	10.3	0
Czech Republic	85	0	15

Germany	32.1	58.9	9.0
Denmark	78.6	0.1	21.3
Estonia	100	0	0
Greece	100	0	0
Spain	95.6	4.4	0
Finland	100	0	0
France	100	0	0
Hungary	100	0	0
Ireland	22.1	0	77.9
Italy	64	36	0
Latvia	100	0	0
Lithuania	100	0	0
Malta	100	0	0
The Netherlands	100	0	0
Poland	98.7	0.6	0.7
Portugal	100	0	0
Sweden	100	0	0
Slovak Republic	100	0	0
United Kingdom	0	0	100

Source: EUROSTAT UOE Data Collection, taken from European Research Associates (2004), “The Financing of Higher Education in Europe”, available from www.europa.int/comm/education/policies/2010/studies/financing1_en.pdf

4. Lessons to be learnt

When summarizing the information gathered in Appendix 1 and described in section 3, table 2 instantly shows the shortcomings of the Indian scheme for the financing of higher education. On all relevant parameters, the current Indian scheme clearly turns out to be the weakest in the benchmark. If SC/STs are truly to be given a fair chance in higher education through the

means of reservation, an improved system with more financial space and flexibility is called for.

Table 2
Overview
Key variables for financing students in higher education for select countries

Country Parameter	U.S.	England	Netherlands	Germany	India
Interest Rate	5-9%	3.2%	2.74%	3.22%	10.25-11.75%
Borrowing Limit	For graduates: USD 138500 For undergraduates: USD 46000	For loans to cover fees: USD 21,250 (approx.) For loans to cover living costs: USD 31,200 (approx.)	USD 50,320 (approx.)	USD 35,000 (approx.)	For studies in India: USD 17,000 (approx.) For studies abroad: USD 34,000 (approx.)
Payback Period	From 10 to 30 years, depending on the amount of debt and the repayment option chosen	25 years	15 years	20 years	5 to 7 years
Security	Nil	Nil	Nil	Nil	Collateral in the form of a third party guarantee for loans above USD 9000 (approx.)
Margin	Nil	Nil	Nil	Nil	Above USD 9000 (approx.)

						for studies in India: 5% Studies abroad: 15%
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Source: FICCI Compilation

5. Suggestions

FICCI suggests:

➤ To make the reservation of seats in private educational institutions a valuable promise and effective mechanism for better integration of students from SC/STs and backward classes, the Government of India should provide an adequate scheme to these students to finance the substantial (opportunity) costs that are related to studying. This scheme has to take into account the specific social and economic background of these students.

➤ As commercial banks by nature operate from a profit-angle and handle specific terms and conditions when it comes to –high risk- student loans, which negatively impact the effectiveness of the current scheme, the provision of student loans cannot be solely left to this sector and has to be funded by the Government.

➤ As the current student loan scheme does not meet the specific social and economic background of students from SC/STs, the new Government- scheme should –following successful practices in US and selected EU countries- allow for soft loans with student friendly terms and conditions. Moreover, grants should be provided to meritorious students with weak financial means.

➤ Following practices in US/ EU, all students should be able to borrow money up to an amount that is needed for expenses on fees, housing, living

costs and additional study costs against a subsidized interest rate, to be paid back over a period of 20 years starting 3 years after graduation. Collateral and margin have to be done away with. For students from backward classes and SC/STs, grants should be made available to all students from these classes who are admitted to the reserved seats and a family income below a relevant threshold level.

✎ The grant scheme benefiting students from low-income families should not be restricted to only students from SC/STs, but should be extended to benefit all students from low-income families for whom the (opportunity) cost of studying is too high in relation to the finances needed for study.

Appendix 1: Overview financing of students in higher education England, Netherlands, Germany & US

Country	Type of finance (grant/ soft loan/ commercial loan)	Name program	Amount/ interest rate	Eligibility criteria	Calculation based on:	Funded by:
England	Grant	Tuition Fee Grant (no longer valid for students enrolling from 2006 onwards)	Up to maximum tuition fee (per year): 04/05: £1150 05/06: £1175 06/07: £1200	All English students can apply, allocation based on household income. EU students living in England 3 years prior to the start of their course can apply.	If household income (05/06): • <£22,010: grant covers full cost fees • between £22,010 and £32,744: partly contribution to fees, on a sliding scale. • >£32,745: no grant For independent students: Full grant if income <£10,250. If more, fees to pay: £45 plus £1 in every £9.50 that your income is over £10,250	Central government
	Grant	Higher Education Grant (for students enrolled from 2006 onwards: Maintenance Grant)	Students currently enrolled, up to (Per year): 04/07: £1000 Students to enroll from 2006 onwards, up to:	All English students can apply, allocation based on household income. EU students living in England 3	Dependent on household income (05/06): • <£15,580, entitled to full grant, • £15,580-£21,565, receive part of the grant	Central government

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			06/09: £2700	years prior to the start of their course can apply.	• >£21,565, no grant Extra grant available for students with disabilities, children, dependent on additional costs incurred and, except for disabled students, on household income.	
	Soft Loan	Student loan for fees (available from 06/07 onwards)	Students currently enrolled, up to (per year): 04/06: £ nil 06/07: £1000 Students to enroll from 2006, up to: 06/09: £3000 Interest rate is linked to rate of inflation and stand currently (05/06) at 3.2%.	All English students can apply, allocation based on household income. EU students living in England 3 years prior to the start of their course can apply.	Dependent on fee charged by university.	Central Government
	Soft Loan	Student loan for living costs	Up to (per year): 04/05: £4095 05/06: £4195 06/07: £4405 07/08: £4405 08/09: £4405 Interest rate is linked to rate of inflation and stand currently (05/06) at 3.2%.	All English students can apply, allocation based on household income. EU students living in England 3 years prior to the start of their course can apply.	Dependent on living situation and household income: • £4,195 for students living away from home • £5,175 for students in London and living away from home • £3,320 for students living at home. 75% of the max loan is available to all	Central Government

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					eligible students regardless of any other income they have. Whether you can get any or all of the remaining 25% depends on your income and that of your household.	
	Commercial Loans	e.g. Barclays Career Development Loan	£3000-£8000 Interest rate: Interest-free for up to 1 month after end of course (paid by Government for that period), at end of interest holiday of 13 month rate is 12.9%.	- 18 years or over - resident in Great Britain - Have unlimited right to remain in UK and intend to work in EEA once finished	Based on amount required, with maximum £8000.	Bank, Government
Netherlands	Grant	Student grant	Basic grant (max. 4 years, per month): Living without parents: €248.48 Living with parents: €89.24 Additional grant (max. 4 years, per month): Living without parents: €227.77 Living with parents: €209.17	All Dutch students between 18 and 34 years old, or EU citizens registered in Netherlands for more than 5 years, studying at accredited Dutch higher educational institute. Additional grant provided	Basic grant: based on living situation (with/without parents) and type of higher education followed. Additional grant dependent on income parents and type of education followed.	Central Government

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			Grant has to be repaid at 2.74% interest if studies are not completed within 10 years.	depending on parents' income.		
	Soft Loan	Student Loan	Maximum amount per month: €266 while receiving grant. After 4 years, when grant is no longer received, borrowing up to €796.31 per month for 3 years. Interest rate: 2.74%, repayable in 15 years after completing course with minimum of €15.41 per month.	All Dutch students, or EU citizens registered in Netherlands for more than 5 years, studying at accredited Dutch higher educational institute. Security not required.	Maximum to be borrowed dependent on living situation student, health insurance costs and type of education followed.	Central Government
	Commercial Loan	e.g. ABN AMRO Master Student Loan, Postbank Student Loan	E.g. ABN AMRO Master Student Loan: €5000-50.000 at 9% interest rate. Bachelor-loan up to €5000 at 7.3%-9.2% interest rate.	Any student in accredited higher education aged 18-33, Master Loan also applied to studies abroad and a BA degree is required there. Security not required.	Maximum amount calculated based on type of education followed. Master Loan dependent on fees/ living costs institution.	Banks
Germany	Grant/ loan (note: university fees in Germany)	Federal Training Assistance Act (Bundesausbildungsförderungsgesetz, 'Bafög')	Monthly stipend of max. €377 for students living with parents, and €466 for students not living	Every German student studying in Germany can apply. Allocation however depends	Dependent on personal income, parents' income and income husband/ wife and considering	Federal Government

	are zero. Although this is likely to change soon, they will remain relatively low, around EUR 500-1000 per semester)		with parents. Half of the stipend is an interest-free loan (maximum payback: €10.000), whereas the other half is a grant.	on income-criteria and good progress in your studies. Bafoeg is available for a wide range of studies, ranging from a young age to university level.	students with children. Payback sum reduced for participants with income under €960 per month (adapted rates for participants with children), for excellent students finishing early and for politically convicted people of the former DDR.	
	Soft Loan	Bildungskredit	Amount to be borrowed up to €7200, paid in 24 monthly installments of €300. Interest is based on 6-month EURIBOR rate plus 1% administration costs, and currently stands at 3.22%.	German citizens pursuing a degree in higher education or doing a study-related internship. Also available to foreign students/trainees who have German spouse/parent, or EU citizens registered in Germany. Security not required.	Fixed payment of €300 a month for 24 months.	Federal government
	Commercial Loan	e.g. Citibank Student Kredit	€1500-€50,000 at an interest rate of 5.5% onwards			

US	Grant	1. Federal Pell Grants (For undergraduate students)	USD 400 to USD 4,050 per student per academic year	To receive the grant a student has to be <ul style="list-style-type: none"> • US citizen or eligible non citizen • Enrolled at least half-time in a degree or certificate programme • Enrolled in a college or university that participates in the Federal Student Aid Programs • Not defaulted on previous student loans • Agrees to verify income information, if requested • Does not owe a repayment on a federal grant 	The maximum amount depends on <ul style="list-style-type: none"> • Financial needs • Costs of attendance • Enrollment status • The programme under consideration 	US Department of Education
	Grant	2. Federal Supplemental Educational Opportunity Grant (For undergraduate	USD 100 to USD 4000 per student per academic year	Same as above	Same as above	US Department of Education

	Soft Loan	<p>students)</p> <p>3. William D. Ford Federal Direct Loan Programme</p> <p>3.1. Subsidized Direct Stafford Loan (For graduate and under graduate students)</p>	<p>Maximum amount that can be borrowed:</p> <p>1st year: \$2,625</p> <p>2nd year: additional \$3,500</p> <p>Graduate & Professional students: \$ 8500 per year</p> <p>Interest rate is variable with a cap of 8.25%</p> <p>Up to \$ 4000 for each year of undergraduate study</p> <p>Interest rate is fixed at 5%</p>	Same as above	<ul style="list-style-type: none"> • Financial needs • Grade level 	US Department of Education
	Soft loan	<p>3.2. Federal Perkins Loan (For graduate and undergraduate students)</p>	<p>Cumulative limit:</p> <p>Dependent undergraduates: \$ 23000</p> <p>Independent undergraduates: \$46000</p> <p>Graduate:\$138500</p> <p>Interest rate is variable with a cap of 8.25%</p>	Same as above	Financial needs	US Department of Education
	Soft loan	<p>3.3. Unsubsidized Direct Stafford Loans (For undergraduate and</p>	<p>The yearly limit on a</p>	Same as above	Dependency status of the student and the programme of study under consideration	

	graduate students)					
	Soft Loan	3.4 Direct PLUS Loan (For parents of undergraduate students)	PLUS loan varies with the cost of attendance and any other financial aid received Interest rate is less than 9%	Same as above	<ul style="list-style-type: none"> Costs of attendance Total amount of other financial aids received by the student 	US Department of Education
	Commercial loan	4. Federal Family Education Loan (FFEL) Programme	Cumulative limit: Dependent undergraduates: \$ 23000 Independent undergraduates: \$46000 Graduate: \$138500 Interest rate is variable with a cap of 8.25%	Same as above	<ul style="list-style-type: none"> Financial needs Grade level Dependency status of the student 	US Department of Education
	Commercial loan	4.1. FFEL Stafford Loan (For graduate and undergraduate students)	Less than 9%	Same as above	<ul style="list-style-type: none"> Costs of attendance Other financial aids 	Banks
		4.2. FFEL PLUS Loan (For parents of undergraduate students)				Banks

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