Australian Journal of Basic and Applied Sciences, 9(7) April 2015, Pages: 125-128

ISSN:1991-8178

Australian Journal of Basic and Applied Sciences

Journal home page: www.ajbasweb.com

Student Loan-Backed Securitization for Higher Education Loans in Malaysia

[1]Bakri,M.H., [2]Ismail, S., [3]Ali,R. and [4]Azman M.N.

[1]*Faculty of Technology Management And Technopreneurship, Universiti Teknikal Malaysia, Melaka 76100, Malaysia*
[2]*Faculty of Business and Management,Universiti Teknologi MARA, Bandaraya Melaka 75300, Malaysia*
[3]*Arshad Ayub Graduate Business School,Universiti Teknologi MARA, Shah Alam 40450, Malaysia*
[4]*Kulliyah of Economy,Universiti Islam Antarabangsa, Kuala Lumpur 50728, Malaysia*

ARTICLE INFO

Article history:
Received 12 October 2014
Received in revised form 26 December 2014
Accepted 17 January 2015
Available online 28 February 2015

Keywords:
Student loan-backed securitization Debt financing Default rate Islamic financing

ABSTRACT

Expanding access to higher education has been a vital task to most countries. Access to higher education has been essential not only for national development, but also for individual advancement. However, governments in many countries have been under financial constraints to adequately support their higher education institutions (HEIs). Many researchers have tried to address this issue, usually by analyzing the repayment collections to reduce the default rate. The introduction of asset-backed securitization (ABS) in Malaysia has benefited the economy. This study particularly focuses on the student loan problem, which has not yet been implemented as a securitization process in Malaysia. The main purpose of this research is to investigate the use of Student Loan-Backed Securitization that meets shariah-compliance and can be implemented in Malaysia. This framework is proposed to create its structure and issue a highly graded and marketable sukuk that complies to global shariah principles, and hence, help the Malaysian government to produce high income nation with high labour skill and qualification.

To Cite This Article: Bakri, M.H., Ismail, S., Ali,R. and Azman M.N., Student Loan-Backed Securitization for Higher Education Loans in Malaysia. ***Aust. J. Basic & Appl. Sci.,*** *9(7): 125-128, 2015*

INTRODUCTION

As of May 2012, National Higher Education Fund Corporation (NHEFC) has approved loans for some 1.98 million students amounting to RM 44.18 billion, with the actual dispersed stood at RM30.44 billion (NHEFC) . While the total sum owed to NHEFC is RM 6.83 billion from 1.09 million borrowers, the corporation has so far only managed to collect RM 3.31 billion. Further statistics by the Corporation indicated that although many NHEFC borrowers are showing their interest to pay, the actual sum collected still remains low.

In a particular country, government and private parties have their own system to finance their higher education students (Chapman, B. and A. Harding, 1993; Barr, N., 2003) and each country adopts different way to handle it. Many goverments set up an institution or a corporation to manage student loans (Chapman, B., 2006) to offer to univerity students who qualify for the loans. According to (Khan, A., 2008) main reasons for non-repayment of student loans are their unemployment and desire to continue for higher degree.

Various loans schemes have been in operation in around 75 countries, with the largest loans schemes found in advanced economies such as the United States and Australia (Shen, H., and A. Ziderman, 2009). Two basic forms of student loans exist, with variations of each or hybrid versions of the two (Johnstone, D.B., 2004a) and the type of repayment schedule being the major difference among them (Salmi, J., and A. Hauptman, 2006). The conventional mortgage-type loan is characterized by fixed interest rate and repayment period, with the burden of repayment being the varying element; while the progressive loan type — income-contingent loans (ICL) — requires an obligation to commit a fixed proportion of the borrower’s future earnings until the loan is repaid. ICL was introduced in Australia in 1989 and the U.K. in 1997, and more recently in transition and developing economies (Albrecht, D., and A. Ziderman, 1991; Johnstone, D.B., 2007).

The value of the equity—from which new loans can be made—depends on the value of the notes as assets, which in turn depends on the repayment flows (a function of the interest rates on the notes) and on the aggregate likelihood of default (a function of collection capabilities and the presence or absence of guarantors or co-signers). In this method, the private capital market estimates the likely losses on the

Corresponding Author: Bakri,M.H., Faculty of Technology Management And Technopreneurship, Universiti Teknikal Malaysia, Melaka 76100, Malaysia
E-mail: hariribakri@gmail.com

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student loan notes to calculate the value of the equity; this estimation is similar to that used to calculate the appropriate discount for a direct purchase of the notes. The advantage of securitization is that the risk is essentially managed by the large numbers of revenue-producing notes and by the ability of the market to impose discipline in collection and servicing (Kendall, Leon T., and Michael J. Fishman, eds. 1996).

Description of the proposal framework Islamic Student Loan Backed Securities (i-SLBS) in Malaysia:

The new i-SLBS system contemplates the participation of six key agents throughout the process: students, higher education institutions (HEI), government, capital market, financial system and the Managing Commission for the whole system, see Figure 1.

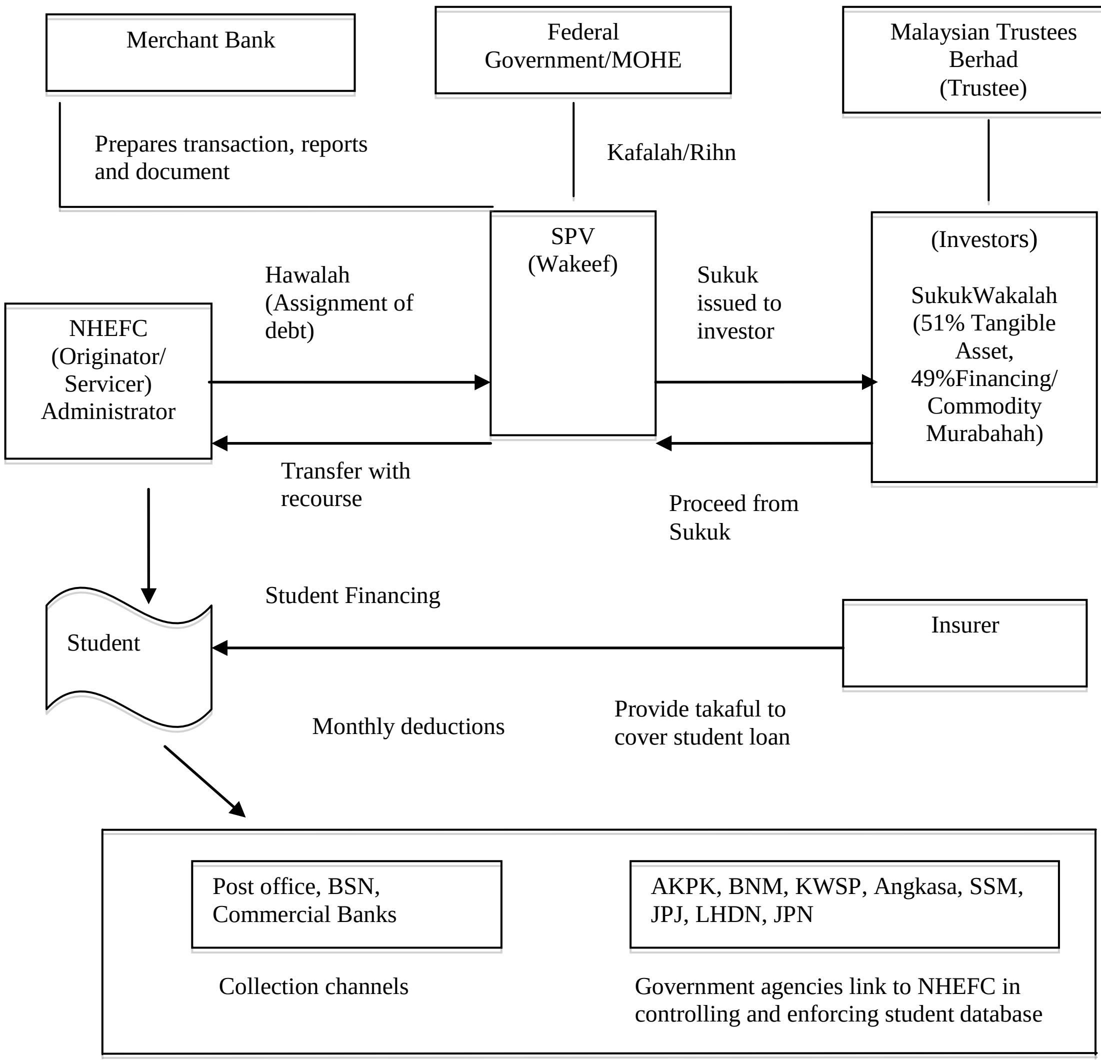

Fig. 1: Proposed Conceptual Framework of i-SLBS

MOHE - Ministry of Higher Education
BNM – Central Bank
Angkasa–National Cooperative Society in Malaysia
JPJ –National Road Transport Department
JPN – National Registration Office
AKPK – Counselling Credit
KWSP – Employees Provident Fund
SSM –Registrar of Malaysian Companies
LHDN – Inland Revenue Board

Table 1: Explanation of agents functions.

Agents	Functions
Students	Students will apply to the system through the Internet, and they have to provide a proof of their socioeconomic status. Once they obtained approval, they must go to the bank to sign the legal documentation. After graduated, the salary of graduates will be deducted 6 month after the graduates start working.
Federal Government / Ministry of Higher Education (MOHE)	The federal government that will represent by MOHE provides guarantees during the study period. They will select students who they will support by means of those guarantees and they submit them to the Originator. In the annual budget law, the Government determines the amount of resources available for guarantees and the amount

	of cash resources available to repurchase loans from the NHEFC. The Government will assume the cost of the unemployment contingency and therefore contributes to financing the NHEFC for the first 3 years.
Originator	The NHEFC centralizes all applications in a single system and orders them from poorest to richest. NHEFC will setup Special Purpose Vehicle that determines the maximum number of students that can receive the benefit based on the resources assigned in the fiscal budget law. It organizes the bank tender process. It acquires the loans that the NHEFC are not willing to maintain in their portfolio (those loans continue to be administer by the NHEFC that originated them). It securitizes the loan portfolio acquired from the NHEFC and receives and maintains custody of MOHE loan guarantees.
Trustee	The trustee's primary duty is to protect the interests of the investors who purchase the securities issued pursuant to the securitization and administer the duties of the SPV under the requisite agreements. The natures of the trustee's duties are specifically set forth in the trust agreement, and frequently require more intensive involvement by the trustee if covenants made by the Originator as part of the transaction are breached.
Merchant Bank / Financial system	Merchant banks will receive the tender and prepare documents; as well as to evaluate and presenting the offers to students. They will grant loans to students with direct disbursements and select the loans to be sold to the NHEFC. They also manage the loans in the adjudicated portfolio (including the loans they sell back to the NHEFC).
Investors / Capitals market	Long-term investors such as pension funds, Takaful companies, and mutual funds acquire the securitized portfolios, both those owned by the National Higher Education Fund and the banks that decide to securitize them.
Takaful (Islamic insurance)	Takaful (Islamic insurance) will cover the student loan if anything happen to the borrower (student).
Collection Agency	NHEFC will tie up with many collection agencies to improve collection from student such as the financial institutions, government agencies which is linked to the student database.

Conclusion and Recommendations:

Overall, the Malaysia case shows the complex dynamics between reforms in the loans system and expansion of higher education in Malaysia. The interaction among the various factors, the relationship between the funding structure of higher education and private HEIs, the regulation on university establishment and deregulation of student quota, education fever, and economic conditions such as introducing Ministry Education Blueprint 2013 has influenced the role of student loans policy on expansion of higher education.

Malaysia experience has several policy implications for developing countries looking to increase higher education opportunity in the midst of financial austerity to build the human capital needed for a knowledge economy. First, it is important to link the expansion of student loans with an economic development of the nation. When a nation needs unskilled labor for the rapid industrialization of the economy, it should invest more in basic and vocational education than in higher education as Malaysia did when the government changes Vocational school to Vocational College. As the nation progresses towards a knowledge-based economy, however, it should increase investment in higher education to produce high-skilled human resources by means of student loans system. By effectively linking strategies for economic development and student loans policies, both the financial efficiency of student loans and higher education accessibilities can be improved. Second, it is necessary to expand loans based on the supply and demand of higher education graduates. With the tertiary enrollment rate increasing every year in Malaysia, the growth in loans funds has led to an over-supply of college graduates, producing a rise in the number of unemployed graduates. Therefore, while the loans system has contributed to a surge in the number of beneficiaries, its efficiency has gradually been declining. In conclusion, the Malaysia case demonstrates that the government need new source to funding student loan so the introduction of i-SLBS right on track.

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