CHAPTER-II

THEORETICAL BACKGROUND ON EDUCATION LOAN

2.1 INTRODUCTION

The evaluation and development of priority sector lending, contribution to priority sector developments by the commercial banks in India and its methodology have been discussed in the previous chapter. This chapter deals with the theoretical note on education loan, its importance, criteria, revisions in the eligibility and the new initiatives by the Reserve Bank of India towards education loan.

2.2 EDUCATION LOAN SEGMENT

Education in India is seen as one of the ways to upward social mobility. Good education is seen as a stepping stone to a high flying career. Education System in India currently represents a great paradox. On the one hand we have IIMs & IITs that rank among the best institutes in the world and on the other hand there are number of schools in the country that don't even have the basic infrastructure. Even after more than 50 years after independence we are far away from the goal of universal literacy. But on a positive note, Indian professionals are considered among the best in the world. Hence they are in great demand. This signifies the inherent strength of Indian education system.

The Educational structure in India which operates at all conceivable levels from pre-school to post doctoral is of monumental proportions. According to a World Bank report there are more than 7,40,000 formal schools; more than 3.6 million teachers are working on full time basis; there are more than 175 Universities offering under graduate and post graduate courses and about 6000 colleges affiliated to these universities.

The educational structure in India is generally referred to as the Ten + Two + Three (10+2+3) pattern. The first ten years provide undifferentiated general
education for all students. The +2 stage, also known as the higher secondary or senior secondary, provides for differentiation into academic and vocational streams and marks the end of school education. In +3 stages, which involve college education, the student goes for higher studies in his chosen field of subject. This is a comprehensive website on education in India. It gives detailed information on education and career options in India.

The rising cost of higher education has become a big cause of worry for students and parents alike. How will one be able to fund the huge expense required for professional courses is the prime concern for people seeking to increase their qualifications. If a student is seeking to go abroad for pursuing higher studies, the costs are far greater as compared to studying in India. A n education loan to pay for the high tuition fees and other associated costs is fast becoming a need for an ambitious student. Banks provide great financial help needed to cover almost all the expenses incurred for a successful completion of the desired course.

2.3 EDUCATION LOAN AND ITS COMPOSITION

Education loan is a special purpose loan given by banks and financial institutions to cover the cost of any higher degrees or specialized courses. The education loan provided by banks in India cover the fee Payable to the College, School or Hostel. It also covers the examination fee, library fee, lab fees, caution deposits, refundable deposit asked by the institution. Building fund supported by Institution bills or receipts, Purchase of Books, equipments, instruments, uniforms, Travel expenses/passage money for studies abroad, purchase of computers - essential for completion of the course and any other expense required to complete the course - like study tours, project work, thesis, etc are also covered.

2.4 CRITERIA OF EDUCATION LOAN

Banks provide great financial help needed to cover almost all the expenses incurred for a successful completion of the desired course. Banks in India now cover a wide spectrum of courses in their education loan schemes. Catering both to under
graduate and post graduate courses, banks readily provide education loans for management, engineering, medicine, MCA, fine arts, designing, architecture, hotel management, agriculture, pure sciences, arts and commerce courses. Banks do consider the reputation and affiliation of institute from where the course is being conducted, before giving any educational loan. Indian banks while providing education loans require that the applicant must be a resident Indian having secured admission in any of the bank's list of approved course or universities. Whether you get 100% of the cost of education as education loan or not, depends on individual banks.

2.5 OTHER QUALIFYING CRITERIA OF EDUCATION LOANS IN INDIA

Anyone between 16-30 years of age, who qualifies otherwise, can get an education loan from banks in India. The amount of loan provided by banks depends on many factors. Professional courses like management, engineering, medicine etc. will be give higher loan amounts as compared to B.A. or M.A. This could be due to the higher employability and cost of education in the former case. Secondly, if you are pursuing a course abroad you are likely to get a bigger educational loan as compared to courses with Indian universities. Bank readily provides loan up to 15 lakhs for studies abroad, while they can lend up to ₹7.5 lakhs for courses within India. The third factor that decides the quantum of loan is the collateral offered with education loans. Yes, every education loan of a higher denomination is a secured loan. This means that the person taking loan must provide some guarantee, usually provided by a guarantor who can be a parent or guardian of the student.

2.6 REPAYMENT OF EDUCATION LOAN

The good thing with education loans is that you don't have to start repaying them immediately like most other loans. The general criteria adopted by banks for repayment is that it starts 1 year after course completion or 6 months after obtaining employment (whichever is earlier). The education loans are available for decently long tenures of up to 7 years, and even more in some cases. This repayment tenure
includes the moratorium period. Good banks provide hassle free services and speedy loan approval process.

Depending on the fee schedule of your educational institute at the time of loan approval process, the banks can decide to disburse the loan directly to your educational institute.

2.7 DOCUMENTS REQUIRED FOR EDUCATION LOAN

To get an education loan from a bank one has to submit certain documents to the bank. These include, income proof of the co-applicant, proof of age which is usually the birth certificate, residence proof, latest mark sheet of the student, letter of admission from an institute, a document detailing the cost breakup of course. If a student wants to go abroad for studies, the banks will ask for recommendation letter from the related University's head of department, approved visa documents, travel documents, GRE/GMAT/SAT scores. In addition to all the documents mentioned above, the applicant will have to satisfy the bank with a declaration or affidavit that he isn't seeking a similar loan from other banks or financial institutions and will have to submit any other document required by the bank. Finding finances for your dream course has been made extremely simple by the educational loans.

2.8 EDUCATION LOAN AND MINISTRY OF FINANCE

Government takes an initiative to render financial assistance to meet the higher education expenses. Nowadays it is easy to get assistance with banks. Former finance minister Mr.P.Chidambaram made the statement during 2005, "Education has been democratized. The Government is paving the way to facilitate education for all. It would therefore be impossible to give scholarship to the entire community of students. In such a situation, financial assistance/support has become inevitable. Also stating that while appreciating the bankers for extending financial support to the needy students, the Finance Minister categorically stated that it would be the duty of the beneficiaries to repay the loan.
In India many students quit higher education, as they cannot afford it. This is an era of primary education available to remote villages and the slums in cities. This is possible only with a determined government. To tackle this problem, education loans offered by most banks and financial institutions are initiated.

With higher education becoming expensive with changing times, taking an education loan has become quite commonplace. The benefit of this loan is that you have the option of starting the repayment once you start working. This is a big relief as it does not burden the family under any circumstances. However there are few factors that can make your loan work much more effectively, which you need to check these factors while going for an education loan.

2.9 INTEREST RATE

The interest rate is most important factor for any loan and the same goes for an education loan as well. The interest rate determines the overall cost of the loan. Education loan rates are usually lower than the interest rate charged on a personal loan but slightly higher than the home loan rates. The rate charged differs from lender to lender and also depends on the loan amount. Higher the loan amount, higher is the interest charged and vice-versa.

Some banks offer a ‘fixed’ rate of interest while others offer ‘floating’ rate of interest. So if the difference between the two types of rate is only of around 1% then it better to go in for a fixed rate as these loans have shorter repayment period of 5 to 7 years. However some banks offer fixed interest rate with reset clause which means that the lender can alter interest rate whenever it feels the need. In such a situation it is better to opt for a floating rate. This rate is linked to the prime lending rate (PLR) of the bank. The interest is normally payable on a quarterly reducing basis but some banks also charge it on a monthly reducing basis which is better for consumers.
2.10 REPAYMENT PERIOD

Education loan like all other loans comprises of both principal amount and interest but it has an option to postpone the repayment of loan (principal + interest) until the completion of the course. However if you want, you can also start repaying the interest immediately after the month of availing the loan. Typically an education loan has three repayment options.

1. Normally banks allow the applicant to suspend their repayment. Most lenders insist on education loan repayment to start within 1 year of completing the course or six months of getting a job, whichever is earlier.

2. Interest amount can be paid during the course tenure and the actual EMI that includes both principal and interest starts after the course is completed.

3. The EMI starts immediately after the loan is availed. If you opt for this option then the interest rate charged is lower.

2.11 PROCESSING FEES

The processing fee on an education loan differs from bank to bank. In fact many banks do not charge any such fee but on the other hand there are some private banks that charge as much as 2.25% of the loan amount as processing fee. So make sure that if your lender is demanding for a processing fee then you are not caught in the trap.

2.12 MARGIN MONEY

Like for any other loan, you have to pay the margin money in education loan too. Margin money is the percentage of amount that the applicant needs to pay while availing the loan. Banks only lend some percentage of the loan amount and the remaining has to be brought by the applicant. The margin for most banks differs from 10% to 25% and this margin also varies according to the loan amount. Generally this margin is better known as a down payment.
2.13 PRE-PAYMENT PENALTY

Normally a pre-payment is charged if the borrower plans to prepay his loan but in case of education loan, most banks allow a pre-payment with no extra charges or penalty. However this is only applicable as long as the borrower is repaying the loan from his own resources and if the prepayment is sourced through a different medium such as loan from another bank then pre-payment is charged by the lender.

2.14 COLLATERAL

The Reserve Bank of India and the Indian Banker's Association have outlined the nation's Comprehensive Educational Loan Scheme whereby a loan amount up to ₹7.5 lakhs can be sought by students for pursuing their education in India and for those who are looking to study abroad a loan of ₹15 lakhs can be availed. Following this most banks are demanding collateral or a security of comparable value if the loan amount exceeds ₹7.5 lakhs. Banks also ask for a Co-obligation of parents/guardians/ a related third-party along with an assignment of the expected future income of the student in order to calculate the repayment period. For loans that range between ₹4 lakhs and ₹7.5 lakhs, security only in the form of satisfactory third party guarantee is required.

2.15 EXPENSES COVERED BY EDUCATION LOAN

An education loan generally covers most expenses incurred during the period of study. However these expenses again differ from bank to bank. Under most cases the expenses that are included in an education loan are:

1. Fees payable to college or school and Hostel including the tuition fee
2. Fees payable to College or School and Hostel including the tuition fee.
3. Examination, library and laboratory fees.
5. Caution deposit, building fund, refundable deposit supported by the institution's bills or receipts.

6. Any other expenses required to complete the course like study tours, project work, thesis, etc.

Today almost all the banks are ready to support your pursuit for excellence through the medium of education loans but an applicant should be alert while finalizing the deal.

2.16 REVISION IN ELIGIBILITY CRITERIA FOR EDUCATIONAL LOAN

The eligibility criteria for students seeking education loans have been modified. According to the revised norms, the students who could not clear the plus two exams in their first attempts can also avail these loans.

The maximum loan limit for studies within India is ₹10 lakhs and abroad is ₹20 lakhs. The students need not give any surety for amount up to ₹4 lakhs. A personal guarantee is needed for loan amounts above ₹4 lakhs and ₹7.5 lakhs.

Is pursuing a course of your choice abroad one of the priorities of your life? Do you want to be among the top notch professional with a reputed foreign university degree under your belt? Chances are good that to fulfill all these aspirations you will need an educational loan. Staying and living abroad along with the payment for your choice of course require a huge amount of money. With the recent spurt in global economy these costs are rising even further. However, leading banks in India are more than willing to be a part of your dream.

Indian Bank, State Bank of India (SBI), Indian Overseas Bank, Canara Bank, Central bank of India, Union Bank etc., and Lakshmi Vilas Bank, HDFC Bank, AXIS bank, Karur Vysys Bank, Federal Bank and other Public sector and private sector Banks, all are lined up to provide an education loan to the deserving aspirant. The innovative products offered by these banks have simple terms and provide the much needed financial assistance in a very short period of time. With all these banks...
competing to provide an educational loan for your choice of course, what all things should you keep in mind while applying for an education loan from banks in India?

Here are the 6 most important factors that you should compare before taking any education loan from banks;

1. **Interest rates:** The first and the foremost is the interest rates charged on the education loan. This interest rate is the primary factor that earns money for banks and so they want it to be higher, but the competition in the loan market makes the bank keep it to a level where the education loan seems affordable to the customer, while it earns money for the banks too. Whether the interest rate charged on your education loan is fixed or floating is also a matter of concern. Generally, the value of fixed interest rates is higher than the floating interest rates. Going for floating interest rates in this low interest regime is always a better option.

   The interest rates also depend on the amount of education loan one wants, keeping in mind all the realistic requirements, a judicious comparison of various offers from leading banks will certainly help the student find an education loan that pinches the least.

2. **How the interest is charged:** Though the banks defer repayments, but they start charging the interest immediately after the disbursal of the loan. How this interest is charged will determine the amount of interest you will pay. Enquire carefully whether it is charged on a daily reducing balance, or on a quarterly reducing balance. The interest rates charged on loans thus keep accumulating until you start the repayments. This can significantly increase the repayment burden. If the bank providing education loan gives an option to pay the interest portion of your education loan immediately, use it by all means.

3. **The waiver period:** The third most important thing to watch out is the waiver period. Banks providing education loans generally don't expect the student to pay until he gains employment after completion of the course. Check this out
carefully. Does your education loan provider give you such an option? The whole idea is to get comfortable financially before the bank asks you for a repayment.

4. **Fees and other costs:** The fees associated with the education loan such as processing fees, administrative fees, documentation costs etc. should be minimal.

5. **Collateral, guarantee or security:** There is a collateral clause with all the educational loans from banks in India provided the education loan exceeds a value of 4 lakhs. This figure can vary from bank to bank but it is generally a norm. Make sure to ask the bank about collateral requirements and have it ready before the disbursal of loan.

6. **The down payment:** A down payment also has to be made with every education loan, ranging between 5%-20% of the loan amount depending on banks. This money has to be paid upfront.

2.17 **UNION BUDGET AND EDUCATION LOAN**

Higher Educational Refinance Corporation, the government had proposed to provide education loans at a lower cost during the 2007-2008 budget. The scheme was proposed to be fulfilled by the UPA during the 11th Five-Year Plan. However, this budget seems to throw no further light on these aspects. A fund of Rs 2,500 crore was to have been provided to the corporation during the 11th Five-Year Plan.

2.18 **NEW INTEREST FREE EDUCATION LOANS ANNOUNCEMENT BY INDIAN GOVERNMENT**

The new scheme announced by center says Students from families with earnings less than ₹4.5 lakhs per annum will be eligible for this scheme. Only those enrolled in recognized professional courses can avail of this scheme. This would include education institutions established by Act of Parliament, institutes recognized by relevant statutory bodies, IIMs and other institutions set up by the central government. The actual interest will be paid by the government to the bankers. It is really good initiative by the government to help the poor students. This scheme will
be applicable from the academic year 2009-10. The implementation and monitoring of the scheme will be finalized in connection with Canara Bank. The Prime Minister Dr. Manmohan Singh had announced the scheme in his Independence Day address.

The full interest subsidy will be provided during the period of moratorium on loan for students. Here the moratorium means the time till the students completing the course and 6 month after completing the course. The proof of income is to be certified by authorities to be designated by the State governments.

**Top 5 points to consider for interest free Education loan**

1. This subsidy loans will available for all the technical and professional courses in India. If you are doing any course outside India will not be applicable.

2. Courses done after class XII in institutions established by Acts of Parliament recognized by statutory bodies, IIMs and other central government institutions.

3. The existing education loans will be linked to this scheme.

4. This scheme will be available only once for a student. For example if you have used this scheme for undergraduate studies, then you cannot apply again for the post graduate. But, it is applicable if you are doing the combined UG and PG courses.

5. This scheme won’t be available if you discontinue your course in the middle except if there is any medical problem.

### 2.19 CONCLUSION

The theoretical concepts on education loan, the development of priority to the loan scheme are presented in this chapter. The importance of education loan to the students’ community and the initiatives taken by the government to satisfy the financial requirements and increasing the economic welfare of the society are also presented elaborately. The following chapter presents various studies on the issues of priority sector credit & education loan schemes and the performance of commercial banks.