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LEGISLATION AND STUDENTS' LOANS RECOVERY IN KENYA

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Abstract

The history of financing higher education in Kenya can be traced back to colonial period when the then colonial government financed studies of Kenyans pursuing education in universities outside East Africa. In 1974, the government of Kenya introduced University Students Loans Scheme (USLS) which was managed by the Ministry of Education. Legislation on cost sharing in public universities was introduced in 1991 while in 1995, the HELB Act (CAP 213A) was enacted in parliament. In this paper, the effectiveness of various legislation changes in students' loans recovery in Kenya has been examined. A comparison of the quality of debt portfolio before and after 1995 was done. The comparison of sample means of Portfolio at Risk (PAR) before and after HELB Act indicated that legislation led to a significant change in the quality of loan portfolio as explained by the reduced Portfolio at Risk. The study recommends for a continuous review of the existing legislation in line with the dynamic Socio-economic environment and enhance sustainability is students' financing.

Keywords: Loans Recovery, Legislation, Portfolio at Risk, Higher Education, Students Loan Schemes

INTRODUCTION

Students' Loans Recovery is the collection of amounts due on loans disbursed to students to finance their education. In the recent years, students' loans default rates have risen notably leading to concern about the public financial risks associated with loan defaults and financial challenges faced by many students (Darolia, 2013). These trends have come along with a sizeable and increasing public investment in postsecondary education. Students' loans help reduce the economic burden of students as well as the governments. However, according to

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Kenayathulla and Tengyue, (2016) the default in loan repayment has become an important phenomenon in recent years. Because of the unemployment rates, personal family background, debt burden, and personal attitudes, the default rates in students' loans have increased recently.

Globally, higher education in most countries was majorly state funded. However, when the demand for higher education grew without a corresponding increase in the budgets of many countries, several national governments sought for alternative funding mechanisms, including the student loans schemes. According to Shen and Ziderman (2008), government sponsored student loans schemes are in place in over seventy countries and regions round the world. These student loans schemes are usually concerned with tertiary education and are of interest to governments because they are able to contribute to the solution of a range of pressing policy problems those governments face.

The challenge of funding higher education today is a worldwide phenomenon. However, the situations are dire in African countries where universal primary education (UPE) and universal secondary education (USE) programmes have been launched resulting into an upsurge in the number of students qualifying for higher education (Onen et al., 2015). These developments have not only caused financial constraints, but have also driven many national governments in Africa which for decades had played a major role in funding higher education, to seek for alternative funding mechanisms in order to be able to meet the rising demand for higher education in their respective countries.

In light of this challenge, the use of student loan schemes as an alternative means of funding higher education has become popular in different African countries including Kenya, Ghana, Tanzania, Namibia, South Africa, Nigeria and recently, Rwanda and Uganda (Onen et al, 2015). Student loans have been widely advocated as a way of financing the private costs of investing in higher education and more than seventy countries now have loans schemes which enable students to borrow from governments' agencies or commercial banks in order to finance their tuition fees or leaving expenses and to repay the loans after graduation. However, according to Warue and Ngali (2016), the rates of loan repayment and recovery have been low in Kenya with over 32% of the student's loans forming the portfolio at risk of not being recovered.

In Kenya, the Higher Education Loans Board (HELB) is the state corporation mandated to disburse loans to students and to recover the same upon maturity so as to create a revolving fund from which funds can be drawn to finance higher education for needy students. The history of financing higher education in Kenya dates back to 1952 when the then colonial government financed university education under the then Higher Education Loans Fund (HELF) to Kenyans

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pursuing education in universities outside East Africa notably Britain, the USA, the former USSR, India and South Africa. In 1974, the government of Kenya introduced University Students Loans Scheme (USLS) which was managed by the then Ministry of Education. Through the scheme, the then Ministry of Education issued loans to Kenyan students who were in Makerere University (Uganda), University of Nairobi (Kenya) and Dar es Salaam University (Tanzania) to cover their tuition, personal needs and repay the loans after completion of studies. The University Students Loans Scheme faced several challenges, including legal challenges in the recovery of matured loans from the beneficiaries. Additionally, there was a misinformation and a wrong perception from the general public and university students that the loan was a grant from the government that was meant to be repaid. From this background, the Higher Education Loans Board was formed with its key tasks being to source for funds, allocate and disburse to needy Kenyan students pursuing Higher Education in recognized institutions of higher learning. Its other mandate includes the collection of loan amounts due for all mature disbursed since 1974. However, the revolving fund is yet to become sustainable owing to the low levels of loans recoveries and high default rates despite the various measures undertaken by the government.

Legal frameworks have helped in the efficient operation of students' loans schemes around the globe. According to Mussa (2015), the legislation governing the Higher Education Students Loans Board (HELSB) of Tanzania was amended in 2004 to facilitate efficiency in the collection of amounts due on student's loans. Initially, the existing law was not supportive on recovery of students' loans in Tanzania and for this reason; the legal framework was reviewed to facilitate collection. Further, Mussa (2015) concluded that for enforcement of effective recovery, the law should give mandate to the students lending body and ensure that their loan collection procedures are legally protected to enhance recovery of the students' loans.

Legal systems have played a major role in enforcing loans repayment in Microfinance institutions and in the commercial banking sector. In instances where the systems have shortcomings, debt management is slowed down. According to Mamun *et al.*, (2011), Microfinance institutions in Peninsular Malaysia faced legal shortcomings to enforce repayments and most of them adopted the group lending model. This is because in the group lending the levels of default were lower than individual borrowing since the group members appraise and co-guarantee one another. However, the existing legislation was not clear on the action that could be taken in case of default by a member. Through the group co-guarantee, a joint liability is taken by the group members to facilitate repayment before disbursing a loan to any other group member.

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This concurs with the findings of Ogeisia *et al.*, (2014) who cited the weakness in legal systems that led to delay in contract enforcements. The operations of the Board are regulated by the HELB Act Cap 213A; and to an extent influenced by decisions made by other regulations which include but not limited to the Universities Act 2012, the TVET Act 2013, the requirements of Vision 2030 as well as the recommendations of the Sessional paper No. 14 of 2012 in Education and Training. The HELB Act (1995) is the major legislation regulating the operations of the Board. It came into existence on the 21st day of July 1995 through Kenya Gazette supplement (CAP 213A). The act deliberately clarified on loans repayment by former beneficiaries some of whom were not sure whether the funds disbursed to cater for their university education were to be repaid. It required all former beneficiaries of the higher education funds to repay their loans to facilitate the creation of revolving fund and finance future generation in their studies. Further, the legal framework clarified on the consequences of default and stated various penalties applicable to individual loanees and employers. The charges have been like deterrence measures to default on student loans borrowers.

The legislation created a critical intervention in students' loans recovery and enhancement of sustainable students' finance in the country. It created an enabling environment by intensifying the loan collection from past matured loans in numerous ways. One of the ways is employer disclosure requirement whereby employers of graduates are required to inform HELB that they have employed the beneficiaries of students' loan. The Act requires all employers to notify the lending agency when they employ students' loan beneficiary within three months of employment. After this activity, a computation of amortization schedule to determine the amount to be deducted from the beneficiary is done. The act requires that all the amounts deducted be remitted by the employer on behalf of the employee every month until completion. This legislative requirement to employers is a major boost to the recovery of students' loans.

According to Engede (2015), loans recovery through check-off system is very convenient to both loanee and the board as the deduction is made at source and stipulated dates of remittance just like the other statutory deductions. The system has facilitated recovery of most debts and enabled other key players to cooperate in students' loans recovery. This has led to relatively higher recoveries and reduced rates of the loans portfolio that is at the risk of being irrecoverable. Employers of graduates are required to make monthly deductions commonly referred as 'deduction at source' (DAS) from the salaries of loanees and remit the same in a timely manner. According to the HELB Act (1995), non-disclosure of loanees and delayed remittance of amounts deducted attracts penalty charges to both the employer and the loan beneficiary.

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The Act can be said to have facilitated recoveries, promoted productivity and convenience in loan repayment through authorization of employer inspection countrywide and assigning various mandates to inspectors. Inspectors have a legal mandate to enforce employer compliance. This is done to ensure full disclosure of loanees by employers as well as employer awareness on their role in ensuring that the student loans beneficiaries who are in their payroll are repaying their loans at the recommended rates hence the relevance of legislation in recovery of loans from former students.

According to the HELB act (1995), loanees who are not servicing their loans are supposed to be penalized on monthly basis. The act prescribes a minimum charge of at least five thousand Kenya shillings per month for every month that a loan instalment is not paid. This punitive prescription has had mixed reactions to loanees with some opting to pay their loans in lump sum to avoid pitfall of penalties. Other loanees who have accumulated big amounts of penalties because of defaulting for long end up being demotivated when they get high amounts of the loans due to penalties. On the other hand, the penalties have deterred some loanees from defaulting since they do not want to bear the consequences associated with default.

Nevertheless, the same law has allowed the lending agency to give penalty waivers to loanees who defaulted but may want to clear their loan in one or few installments. This comes as a relief to loanees. Some loanees may take up the waiver, take advantage of the penalties and pay in lumpsum to clear their loans. Others begin repayment with a promise of penalty waiver on the loans. As a result of accelerated installments, there is growth in the amount collected from matured loans and reduction in the portfolio at risk. This incentive-based loan collection approaches buoyed by enabling legislation forms a win- win situation because of the mutual benefit accruing to both the loanees and the Board.

The constitution of Kenya promulgated in 2010 brought hope to the recovery of students' loans as it required people to be cleared by various agencies to qualify for election into leadership positions. People seeking appointment in various government positions are also required to clear with these agencies. The prospective candidates who were beneficiaries of student loans are required to prove that they have either cleared their loans or were repaying their loans. This requirement prompted many loanees who were in default to repay their loans to partially meet the requirements of the chapter 6 of the constitution. The Board used the opportunity to encourage loanees to start paying their loans and reduce default levels in the students' debt portfolio. This study sought to ascertain the relationship between legislation and students' loan recovery. Students' loan recovery was measured by the proportion of non-performing loans in the portfolio that was referred to as the portfolio at risk.

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Research Objective

To examine the effectiveness of legislation in students' loans recovery in Kenya, before and after 1995

Hypothesis

$\mathbf{H_{0:}}$ There is no statistically significant relationship between Legislation and Students' Loans Recovery before and after 1995

$\mathbf{H_{1:}}$ There is a statistically significant relationship between Legislation and Students' Loans Recovery before and after 1995

Justification of the Study

This study is useful to the government of the Republic of Kenya. In particular, the Ministry of Education and HELB as it provides more information on the effectiveness of legislative changes in debt recovery and the education revolving fund. This is important in management decision making and in formulation of policies related to administration of student's revolving fund. It provides insightful information applicable in projecting the supply of funds from recovery activities.

It is in line with the aspirations of Africa Agenda 2063, Kenya's Vision 2030, and the Sustainable Development Goals (SDGs) of education. According to the sixth aspiration of the Africa agenda (2063), we aspire for a prosperous Africa where development is people driven, unleashing the potential of women and youth. In the social pillar of Kenya's vision 2030, we envision an increased transition rates to technical institutions and universities, and globally competitive quality education. The provision of affordable education loans to scholars from disadvantaged backgrounds promotes access to higher education.

Additionally, this lays a firm foundation for further enquiry by researchers and scholars in both public and private sector on matters related to recovery of University and College education loans and overall management of debt.

RESEARCH METHODOLOGY

Data Collection

Secondary data was collected from the Higher Education Loans Board from back in 1974 to the year 2016. The choice of this period is because in 1974 is when the government of Kenya introduced University Students Loans Scheme which was administered by the then Ministry of Education and started issuing loans to Kenyan students who were studying in various

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universities outside the Country. The loans issued to students after 2016 are not yet mature for repayment hence the rationale for the choice of under series under the period.

Annual reports were reviewed and provided data on debt portfolio at risk, recovery rates and annual amounts collected. Higher Education Loans Board being a public institution, it is subject to both internal and external audit annually and thus the annual financial statements released by the entity were taken to represent a true and fair view of its operations for the period under study.

Data Analysis

The effect of legislation on student loan recovery was tested by comparing means of two samples of data for the period before and after the major legislation on student's loans. A dummy was introduced for the year 1995 and the model was run in STATA to establish the influence of legislation on student loan recovery.

Model Specification

To test the effectiveness of legislation on students Loans recovery: A dummy model specification was done as follows:

Students' Loan Recovery (SL) = $\beta_0 + \beta_2 Đ_2 + \varepsilon$

Where,

$Đ_2$ = is a dummy in testing the effectiveness of legislation on loans recovery

$\boldsymbol{\beta_0}$ is the constant variable and explains the level of loans recovery before HELB Act (1995) when the dummy is zero.

$\boldsymbol{\beta_2}$ is the coefficient of determination of the variable

$\boldsymbol{\varepsilon}$ is the error term

The mean of Students Loan Recovery before 1996 was taken as the base category while $Đ_2$ is the period after 1996 i.e.

$$Đ_2 = \begin{cases} 0 \text{ for } < 1996 \\ 1 \text{ for } \geq 1996 \end{cases}$$

RESULTS

In order to test the effect of legislation on Students' Loan Recovery, paired samples *t*-test was used to compare the means of Portfolio at Risk (PAR) before enactment of the HELB Act in 1995 and after. The purpose was to test the null hypothesis that the difference between the two related means is **Zero (0)** with a view of establishing whether legislation significantly contributed to improved student loan recoveries. The results are presented in Table 1.

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Table 1: Paired Samples Statistics

		Mean	N	Std. Deviation	Std. Error Mean
Pair 1	Before	99.7180	20	.80389	.17976
	After	53.5460	20	10.00425	2.23702

The results presented in *Table 1* indicated that on average the Portfolio at Risk after enactment of the HELB Act in 1995 reduced significantly from an average of **99.71** to an average of **53.54**. This means that there is an effect on Students' Loans Recovery that came as a result of the introduction of the major legislation in 1995.

According to Chacha (2004), the HELB act was enacted to increase efficiency in disbursements pf funds to students, promote efficacy in Students' Loans Recovery and create a revolving fund that is self-sustainable from where funds may be drawn and lent to needy Kenyan students. The results of this study concur with Njenga (2014) on the influence of legislation on loans recovery. The forming of the Board with a mandate to recover all loans disbursed since 1974 triggered a response from the past graduates some of whom repaid their loans immediately in order to be on the safe side of the law. However, others maintained that the funds disbursed to them were a grant that was not meant to be paid back. This calls for the government to institute other recovery measures. *Table 2* shows the results of Paired Sample Test.

Table 2: Paired Sample Test

		Paired Differences							
					95% Confidence Interval of the Difference				
		Mean	Std. Deviation	Std. Error Mean	Lower	Upper	T	df	Sig. (2-tailed)
Pair 1	Before - After	46.172	9.50653	2.12572	41.7228	50.6211	21.721	19	.000

The results in Table 2 show that enactment of the legislation in 1995 significantly contributed to greater Students' Loan Recovery by the Higher Education Loans Board. This is explained by high *t - values of 19* and *p values < 0.05*. This means the act significantly contributed to the recovery of past students' loans. The Act was enacted with a view of establishing a legal framework to guide and enhance the student loan recovery from beneficiaries. The rates of portfolio at risk before 1995 and after 1995 were analyzed using regression analysis with the Portfolio at Risk for the year 1995 held as dummy.

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Table 3: Estimated effect of Legislation on Student Loan Recovery

First Difference of Student Loan Recovery	**Coefficient**	**Robust Std. Err.**	**T**	**P>t**	**[95% Confidence Interval]**	
Legislation	-41.496	39.546	-1.049	0.003	4.9304	1.0686
Constant	95.042	92.693	1.025	0.008	1.4513	1.3776
Linear Regression						
Number of Observations = 41						
F(1, 39) = 66.129						
Prob > F = 0.0032						
R-squared = 0.622						
Adjusted R-squared = 0.608						
Root MSE = 0789						

Table 4: Model Summary

Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**
1	.789	.622	.608	16.68986

The study findings shown in *Table 4* indicates that there exists a strong relationship between legislation and student loan recovery (r = 0.789). The findings further indicate that 62.2% of the student loan recovery in Kenya could not be achieved if there was not supporting legal framework on student loan repayment.

The regression results indicate that student loan recovery in Kenya before the major legislative changes and other factors held constant had a PAR of 95.042%. The results further show that implementation of legislation led to a 41.496 (β_1) increase in Student Loan Recovery. The relationship is significant as the P-value (0.000) was less than the significance level (0.05). This means that the introduction of legislation on Students' Loan Recovery led to an estimated 41.496% reduction in the rate of the portfolio at risk. The predicted Model for the effectiveness of legislation on loans recovery became:

Students' Loan Recovery (SLR) = $\beta_1 + \beta_2 Đ_2 + \varepsilon$

Students' Loan Recovery (SLR) = 95.042- 41.496 Đ2

From the predictive model, PAR on students' loans is highly dependent on legislation and the law supporting loan recovery. Enhancement of legislation led to a 41.496 decrease in the portfolio at risk indicating that there was an increased recovery as a result of the supporting

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legislation. This led to increased loans recovery and reduced portfolio at risk comparing mean rates of recovery before and after the legislation was enacted. After the enactment of HELB Act (1995), the Higher Education Loans Board recorded a steep drop in Portfolio at Risk. The rate dropped from a high of 91.6% in 1995/1996 financial year to 76% in the following financial year, 1996/1997. Further, the rates of portfolio at risk continued to drop steeply to 38% in 2016 financial year.

The results of this study concur with the findings of the findings of Mussa (2015) on legislation and sustainability of higher education fund in Tanzania. The study indicated that legislation plays a pivotal role in loans recovery as it sets out the responsibilities of various parties in the student loan repayment. The study highlighted on the role played by legislation in student loans repayment. In addition legislation enables the lending institution to determine the scope of their clientele through the eligibility criteria. The beneficiaries of these student loans are required by the law to repay back the loans upon completion of the studies. The study found that the enactment of the HELSB Act in 2004 to govern the students lending program in Tanzania increased efficiency in lending and collection of loans due on students' debt.

Test of Hypothesis

The hypothesis was stated that there is no statistically significant relationship between Legislation and students' Loan Recovery in Kenya. The finding as presented in Table 5 below indicates that high statistic values were reported after enactment of the HELB Act. The findings show that low *p values* are also reported before and after enactment of the HELB Act in 1995. This therefore implies that enactment of the HELB Act led to improved student loan recovery.

Table 5: Test of Hypothesis Five

Type of Analysis	Value
ANOVA	
F-Ratio	9.87
Sig. *(p)*	0.003
R Square (R^2)	0.2020
Unstandardized Beta Coefficient	-2.9995

The results presented in *Table 5* show that legislation produces a statistically significant effect on student loan recovery thus the null hypothesis was rejected as stated.

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CONCLUSION

The rates portfolio at risk reduced to a great extent after the enactment of the HELB act. The results of comparison of the means before and after 1995 indicated that the portfolio at risk reduced from a high of 91.6% in 1996 to 76% in the following financial year and further the rates went down to a portfolio at risk of 32.5% in 2015/16. The findings further reveal that implementation of legislation led to a 41.496 (β_1) increase in student loan recovery. The relationship is significant as the P-value (0.000) was less than the significance level (0.05). The results of this study leads to a conclusion that legislation has a significant effect on students' loans recovery at the higher education loans Board of Kenya.

This study tested the effectiveness of legislation in students' loans recovery using independent t-tests and clarified on the role played by legislation in students' loans recovery. The enactment of HELB act (1995) led to greater recovery of students' loans comparing the rates of recovery before and after the law came in to being. The HELB act (1995) was effective in promoting loans recovery from ex- university students. Therefore, legislation has a significant effect on students' loans recovery at the Higher Education Loans Board of Kenya.

RECOMMENDATIONS

The policy makers can utilize the new knowledge in addressing various policy formulation issues surrounding the sustainability of students' revolving fund especially on the recovery function. There is great need to review the HELB Act which was enacted in 1995 with a view of accommodating the dynamics in the industry. The policy makers may propose to the Kenya's National Assembly for a review of the existing laws to respond to changing environment where more focus may be given on the role and responsibilities of the borrower and their guarantors in loans recovery.

Further, a policy to guide the recovery of loans from the informal sector is highly required in Kenya. In the wake of increasing rates of unemployment most loanees are not formally engaged in the formal sector. Some of the individuals in the informal sector may be earning higher income amounts compared to their colleagues in the formal sector but fail to service their loans citing their being unemployed in the formal sector. Therefore, there is a need to develop a policy framework to net defaulters and recover loans from the informal sector which has been contributing significantly to recoveries in the recent past and still has a potential that is not fully exploited.

In the wake of devolution, the constitution of Kenya (2010) created devolved units which became County governments. Currently, Kenya has forty-Seven county governments and consequently, forty-Seven county assemblies. Some county assemblies have already passed

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motions to create students revolving funds to finance education for students who come from these counties. However, they are faced with the challenge of a weak legal framework which can only regulate within those counties. This study recommends to the devolved governments seeking establishing revolving funds to put into consideration the loan collection approaches, legal backing and economic dynamics among other factors to increase the chances of sustaining the revolving funds.

This report recommends further studies on the influence of borrower attitudes and even family backgrounds on the rate of repayment of higher education loans. Other recommended areas for follow up studies may include the effect of factors in the microenvironment (outside the control of the lending institution) on education loans repayment including but not limited to GDP, Political forces, Socio Cultural, Technological advancements. Further enquiry may also be done find out how pandemics like COVID -19 impact on students' loans recovery in various loan schemes across the globe.

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