B/F tomorrow 21/11. with Treasury

PRIME MINISTER NBPM 20 November 1985

TRAINING LOANS

In principle, training loans are an excellent idea. They will introduce the public gradually to the idea of loans instead of grants; and, unlike student loans, they are popular.

But the scheme now being offered by David Young looks poorly designed. The head offices of the banks may be far too lax in administering the scheme during the first 18 months, because they will know that they can afford to lose 40% of their total lendings without having to pay a penny: the Government will mop up the debt. And individual branch managers will not have any method of assessing risk: they may each make extremely risky loans, on the assumption that managers of other branches will be making safer bets, and in the knowledge that head office can look to the Government to cover all the bad debts that could be expected to accrue.

Couldn't David Young go back to the banks with a slightly tougher proposal - insisting that the bank itself should bear at least some small fraction (say 10%) of <u>each</u> bad debt? This way - although the Government would still be liable for 40% of the total amount lost during the first 18 months - both the individual branch manager and his head office would have an incentive to act responsibly right from the start.

When Department of Employment officials tried this on the banks before, they did not succeed - largely because they did not make any matching concession. If the Government offered to balance the new requirement by (for example) increasing the interest rate paid during the "repayment holiday", the banks might well accept the deal.

We recommend that you should:

- welcome David Young's plan in principle; but

- ask him to negotiate further, offering the banks a higher interest rate during the "repayment holiday" in exchange for their agreement to bear at least a small fraction of each bad debt.

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OLIVER LETWIN

EDUCATION: Student Loans I March 81.