

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 79-35
March 1, 1979

REVISION OF REGULATION V

TO ALL BANKS
AND OTHERS CONCERNED IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:

The Board of Governors of the Federal Reserve System has simplified its Regulation V, Loan Guarantees for Defense Production, consolidated rules into the Regulation, and revised the interest rate and guarantee fee structures applying to such loans.

Although the rules have been issued in final form, the Board of Governors has invited public comment, through April 30, 1979, on the question whether the V-loan program should be restructured or eliminated. The revised regulation was issued on the basis of the existing program, pending completion of consideration of this question.

Printed on the following pages is a copy of the Board's press release and the text of the revised Regulation V as it appeared in the *Federal Register*. Comments should be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, and should refer to Docket No. R-0201.

Sincerely yours,

Robert H. Boykin

First Vice President



FEDERAL RESERVE

press release

For immediate release

February 12, 1979

The Federal Reserve Board has simplified its Regulation V (defense production loan guarantees), consolidated related rules into the Regulation and revised the interest rate and guarantee fee structures applying to such loans.

The Board invited public comment, through April 30, 1979, on the question whether the V-loan program should be restructured or eliminated. The Board issued its revision of Regulation V on the basis of the existing program pending completion of consideration of this basic question.

Regulation V grew out of a program begun in World War II to facilitate production or other operations for national defense. The Federal Reserve acts as fiscal agent. It also sets the maximum rate of interest that a financing institution may charge and establishes the fees Government agencies may charge for making guarantees.

Before issuing its revised regulation the Board requested and received comment from the Government agencies guaranteeing loans. The regulation as revised takes account of comment received from guaranteeing agencies.

The Board revised Regulation V as part of a current review of all its regulations to determine whether a regulation, in whole or in part, is required by law, to assess the costs and benefits of each regulation, whether there are more desirable non-regulatory alternatives, whether the Board's regulations should be simplified and whether to make recommendations to the Congress for modernizing changes in the statutes underlying Federal Reserve regulations.

The principal elements of the revision of Regulation V are:

1. Simplification and streamlining of the Regulation's language.

2. Consolidation into the Regulation of administrative rules not previously available in published form.

3. A change in the maximum rate of interest that a financing institution may charge for a V-loan, from a fixed maximum rate (which has been 7 1/2 per cent) to the rate the institution currently charges its most creditworthy business customers for loans of comparable maturity (unless the governmental guarantor decides that a particular loan bearing a higher rate of interest is necessary for national defense purposes).

4. Modification of the scale used for calculating the fee that a guarantor may charge for guaranteeing a loan. The guarantee fee runs from 10 per cent of the base interest rate (the rate used for calculating guarantee fees) for the guaranteed portion of a loan of which 70 per cent or less is guaranteed, to 40-50 per cent of the base interest rate on a loan of which 95 per cent or more is guaranteed. The base interest rate is set by the guaranteeing agency and is to be 6 per cent or more. Previously, the base interest rate was a flat 6 per cent. The base rate may not be varied from borrower to borrower.

For example, for a V-loan that is 70 per cent guaranteed, and on which the base interest rate is 10 per cent, the guarantor could charge a fee of 1 per cent of the interest on the guaranteed part of the loan.

The use of V-loans has declined from a peak at the end of 1952 of \$979 million outstanding of loans of which a portion was guaranteed, to \$1 million outstanding at the end of 1978. Current authorization is for \$30 million. Only six new V-loans have been made since 1971.

In the light of this record, the Board said:

These facts suggest that the loan guarantee program may have outlived its usefulness. Moreover, there may be more efficient or economical means of performing both guaranteeing and fiscal agency functions. For these reasons, the Board might consider recommending legislative or other changes in the V-loan program.

The Board noted, also, that the Defense Production Act authorizing the program will expire on September 30, 1979 unless extended by Congress.

The text of the Board's revised Regulation V is attached.

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[6210-01-M]

**Title 32A—National Defense,
Appendix**

**Extract from
Federal Register
VOL. 44, NO. 35
Tuesday, February 20, 1979
pp. 10382 - 10385**

**CHAPTER XV—FEDERAL RESERVE
SYSTEM**

[Reg. V, Docket No. R-0201]

**PART 1505—LOAN GUARANTEES
FOR DEFENSE PRODUCTION**

Revision of Entire Regulation

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rules.

SUMMARY: The Federal Reserve System is engaged in a Regulatory Improvement Project involving a review of all of its regulations; and, as part of that Project, the Board has revised Regulation V, which relates to loan guarantees for defense production. This action is being taken, after consultation with the heads of the guaranteeing agencies, in order to simplify and consolidate the Board's rules concerning the V-loan program.

The Board's Regulatory Improvement Project also involves an analysis of the costs and benefits of each regulation. This analysis might lead to recommendations for legislative or other changes. Accordingly, the Board is soliciting comments from the public regarding the desirability of the loan guarantee program and the manner in which it is operated.

DATES: The revision of Regulation V is effective February 20, 1979, and public comment is not being solicited in this regard. However, comments regarding the desirability of the V-loan program that underlies the regulation should be submitted in writing and received by April 30, 1979.

ADDRESS: Comments should be sent to the Secretary of the Board, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. They should include the Docket No. R-0201. The comments will be made available for inspection and copying upon request, except as provided in § 261.6(a) of the Board's Rules Regarding Avail-

ability of Information (12 CFR 261.6(a)).

FOR FURTHER INFORMATION CONTACT:

Ralph C. Maurer, Credit Specialist, Division of Federal Reserve Bank Operations, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202-452-3174).

SUPPLEMENTARY INFORMATION: Regulation V ("Loan Guarantees for Defense Production") sets forth the procedures and standards to be observed by Federal Reserve Banks in fulfilling their responsibilities as fiscal agents for those Government departments and agencies authorized to guarantee loans for national defense purposes. The regulation also sets forth the maximum rate of interest, guarantee fees, and commitment fees that may be charged for a guaranteed loan.

The Board has reviewed Regulation V as part of the Federal Reserve System's Regulatory Improvement Project, involving all of its regulations. In considering what changes to make, the Board has consulted the federal guaranteeing departments or agencies; namely, the Defense Logistics Agency, Department of Agriculture, Department of the Air Force, Department of the Army, Department of Commerce, Department of Energy, Department of the Interior, Department of the Navy, General Services Administration, National Aeronautics and Space Administration, and Nuclear Regulatory Commission.

The Board has decided to simplify and streamline the language of Regulation V and to incorporate into the regulation previously unpublished rules or rulings relating to the following:

(1) The eligibility of financing institutions in United States Territories or possessions to participate in the loan guarantee program;

(2) The standard forms that the Board has prescribed for the program;

(3) The basis for calculating the loan commitment fee;

(4) The conditions under which penalties may be charged for prepayment of a guaranteed loan; and

(5) The interest charges to guaranteeing agencies made by Federal Reserve Banks in advancing funds to purchase a guaranteed portion of a loan.

Moreover, the Board has decided to eliminate a fixed maximum interest rate for such loans and to adopt instead a maximum rate equal to the rate charged to the particular financing institution's most creditworthy business customers for loans of comparable maturity, thereby permitting the maximum rate of interest to adjust to market conditions.

The Board has also decided to grant discretionary authority to the guaranteeing agencies to increase the ceiling rate of interest (now set at 6 percent) that serves as the basis for calculating loan guarantee fees. This change will assure that the federal agencies will be able to cover the costs of administering the program. If the agencies exercise this authority, they would not be permitted to discriminate among loan applicants in imposing the higher charge.

The revised rules, of course, will apply only to future applications for loan guarantees.

The Federal Reserve System's Regulatory Improvement Project also involves an analysis of the costs and benefits of each regulation. The Board has found that, although a loan guarantee program was important during World War II and later conflicts, the amount of loans involved in the present V-loan program has declined significantly in recent years. During the 1960's the volume of guaranteed loans remained very low as defense contractors received financial support by means such as advance payments or unusual progress payments. Only six new loans have been approved since 1971; and, at present, authorization for loan guarantees by all departments or agencies is limited to a total of \$30 million. Despite this low level of activity, the guaranteeing functions and the fiscal agency functions are divided between executive departments or agencies and the Federal Reserve System.

These facts suggest that the loan guarantee program may have outlived its usefulness. Moreover, there may be more efficient or economical means of performing both guaranteeing and fiscal agency functions. For these reasons, the Board might consider recommending legislative or other changes in the V-loan program; and it invites comments that might serve as the basis for making such recommendations. In this connection, it is noted that the Defense Production Act of 1950 has been extended by Congress periodically since 1950 and will expire on September 30, 1979, unless extended again.

The procedures of section 553(b) of title 5, United States Code, regarding notice, public participation, and deferred effective date were not followed in connection with revision of Regulation V. The maximum rate of interest specified in the earlier version of Regulation V (i.e., 7½ per cent per annum) was outdated. Permitting the maximum rate of interest to adjust to current market conditions should facilitate the financing of contracts or other operations deemed necessary to national defense production. Simplification and consolidation of the Board's V-loan rules should also result

in immediate public benefits. For these reasons, among others, the Board finds that pursuing further rulemaking procedures and delaying implementation of the revised rules are unnecessary and would be contrary to the public interest, and that consultation with industry representatives is impracticable. Furthermore, section 709 of the Defense Production Act of 1950 (50 App. U.S.C. 2159) exempts functions exercised under the Act from the rulemaking requirements of the Administrative Procedure Act. In the light of these considerations, the Board also has not followed the expanded rulemaking procedures set forth in its policy statement of January 15, 1979 (44 F.R. 3957).

32 CFR Part 1505 (Regulation V) is revised effective February 20, 1979, to read as follows:

PART 1505—LOAN GUARANTEES FOR DEFENSE PRODUCTION

Sec.

1505.1 Authority, purpose, and scope.

1505.2 Processing of loan guarantee applications.

1505.3 Federal Reserve Bank fees and charges.

1505.4 Maximum rate of interest, guarantee fees, commitment fees, and prepayment penalties.

AUTHORITY: Sec. 302(c), Executive Order No. 10480 (3 CFR 1949-53 Comp., p. 962), implementing sec. 301, Defense Production Act of 1950 (50 App. U.S.C. 2091).

§ 1505.1 Authority, purpose, and scope.

(a) **Authority.** This part comprises the regulations of the Board of Governors of the Federal Reserve System (referred to in this part as the "Board") issued pursuant to Executive Order No. 10480 (3 CFR 1949-53 Comp., p. 962; reprinted as amended following 50 App. U.S.C. 2153 (1970) (referred to in this part as the "Order"), implementing the Defense Production Act of 1950 (50 App. U.S.C. 2061 et seq. (1970)) (referred to in this part as the "Act").

(b) **Purpose and scope.** The purpose of the Act, the Order and this part is to facilitate the financing of contract or other operations deemed necessary to national defense production. This part applies to private financing institutions, located in the United States or in any of its Territories or possessions, that make loans for defense production that are guaranteed by the federal departments or agencies designated by the Act of Order* (Commonly referred to as "V-loans").

§ 1505.2 Processing of loan guarantee applications.

(a) **Submission of applications.** Any private financing institution may

*The names of the federal departments or agencies may be obtained from any Federal Reserve Bank.

submit to the Federal Reserve Bank of its District an application for a guarantee of a loan to a borrower determined to be eligible in accordance with the provisions of paragraph (b) of this section. The application form is available through the Federal Reserve Bank.

(b) *Determination of eligibility of borrower.* To be eligible for a V-loan, a borrower must be seeking financing for a contract, subcontract, or other operation deemed by the appropriate guaranteeing federal department or agency to be necessary to expedite production and deliveries or services under a Government contract for the procurement of materials or the performance of services for the national defense. A determination that the borrower is eligible shall be made by the guaranteeing department or agency on the basis of information contained in the loan guarantee application and any further information that it needs. No loan shall be guaranteed until that determination is made.

(c) *Lender's rates and fees.* No application for a loan guarantee shall be considered where the loan agreement is inconsistent with the rate of interest, guarantee fees, commitment fees, and prepayment penalties prescribed by the Board in § 1505.4 (the Supplement).

(d) *Consideration of applications.* Each application by a financing institution shall be subject to approval by the guaranteeing department or agency or, to the extent that the department or agency prescribes, by the Federal Reserve Bank to which the application is submitted.

(1) If a guaranteeing department or agency is to decide the application, the Federal Reserve Bank shall make a recommendation for action on the application before the department or agency acts. The Federal Reserve Bank shall transmit the application and its recommendation, together with all necessary supporting information, through the Board to that department or agency. If the department or agency approves the application and transmits its authorization through the Board on the Board's standard form, the Federal Reserve Bank, acting as fiscal agent of the United States on behalf of the department or agency, shall execute and deliver the guarantee (Board's standard "V-Loan Guarantee Agreement" form) to the applicant in accordance with the terms of the authorization.

(2) If a Federal Reserve Bank is to decide the application, it shall do so without submitting the application to the guaranteeing department or agency for prior approval; but the application shall be subject first to the department's or agency's determination of the borrower's eligibility. If the

Federal Reserve Bank approves the application, it shall execute and deliver the guarantee (Board's standard "V-Loan Guarantee Agreement" form) to the applicant and promptly notify the department or agency.

(e) *Basis of Federal Reserve Bank decision.* In making a recommendation or deciding an application as described in paragraph (d) of this section, a Federal Reserve Bank shall consider whether the financing arrangement affords the guaranteeing department or agency the best available protection against possible financial loss consistent with obtaining national defense production expeditiously.

(f) *Federal Reserve Bank liability.* In arranging for or making any guarantee on behalf of any guaranteeing department or agency, no Federal Reserve Bank shall have any responsibility or accountability except as fiscal agent.

(g) *Other forms and procedures.* From time to time the Board, after consulting guaranteeing departments or agencies, may prescribe other forms and procedures related to the V-loan program. These forms and procedural rules are to be made available through the Federal Reserve Banks.

§ 1505.3 Federal Reserve Bank fees and charges.

Each Federal Reserve Bank shall be reimbursed by each guaranteeing department or agency in the usual manner for all expenses and losses incurred by the Reserve Bank in acting as agent on behalf of the department or agency. Regardless of any other provision of law, such expenses shall include attorneys' fees and expenses of litigation. If a Federal Reserve Bank advances its own funds to purchase a guaranteed portion of a loan, when authorized to do so as fiscal agent by the guaranteeing department or agency, it shall charge interest on its advances at the current regular discount rate.

§ 1505.4 Maximum rate of interest, guarantee fees, commitment fees, and prepayment penalties.

The Board of Governors of the Federal Reserve System prescribes the following charges for loans guaranteed pursuant to the Defense Production Act of 1950 ("V-loans"):

(a) *Maximum rate of interest.* The maximum rate of interest rate of interest that a financing institution may charge a borrower for a V-loan is the rate that institution currently charges its most creditworthy business customers for loans of comparable maturity, unless the guaranteeing department or agency determines that the particular loan at a higher rate of interest is necessary for the purposes of the Defense Production Act of 1950.

(b) *Guarantee fees.* The schedule of fees for guaranteeing V-loans is as follows:

Percentage of loan guaranteed:	Guarantee fee ¹
70 or less.....	10
75	15
80	20
85	25
90	30
95	35
Over 95	40-50

¹ Percentage of interest payable by borrower on guaranteed portion of loan.

In any case in which the rate of interest on the loan exceeds 6 per cent, the guarantee fee shall be computed as though the interest rate were 6 per cent. However, at its discretion, a guaranteeing department or agency may increase the 6 per cent ceiling rate to a higher rate (not to exceed the actual rate of interest charged); but if it does so, the policy in this regard must be applied consistently with respect to all applications received while the policy is in effect.

(c) *Commitment fees.* Any commitment fee charged a borrower for a V-loan shall not exceed $\frac{1}{2}$ of 1 per cent per annum, based on the average daily unused balance of the maximum principal amount of the loan. That fee may not begin to accrue prior to the date on which the committed funds are first available to the borrower according to the terms of the loan agreement or other similar financing arrangement. In any such case, the financing institution shall pay to the guaranteeing department or agency, a percentage of the commitment fee (1) based on the guaranteed portion of the loan, and (2) equal to the percentage of the interest on the loan that is payable as a guarantee fee by the financing institution.

(d) *Prepayment penalties.* (1) In the case of a V-loan made primarily for working capital purposes, a financing institution may not charge a penalty for prepayment of the loan but may recover out-of-pocket expenses.

(2) In the case of a V-loan made for the purpose of financing facilities expansion, provision for a prepayment penalty may be made in the loan agreement if all of the following conditions are met:

(i) The loan has a maturity of 5 years or more;

(ii) The prepayment penalty shall not exceed the rate of interest to be paid by the borrower according to the terms of the loan;

(iii) Provision is made for a graduated decrease in the prepayment penalty as the loan approaches maturity; and

(iv) The loan agreement explicitly provides that the prepayment penalty shall not be applicable in the event the loan is refinanced by or consolidated with another loan that is made

or guaranteed by the federal government or any of its agencies.

Effective date. This revision is effective February 20, 1979.

Board of Governors of the Federal Reserve System, February 12, 1979.

THEODORE E. ALLISON,
Secretary of the Board

[FR Doc. 79-5212 Filed 2-16-79; 8:45 am]
