FEDERAL RESERVE BANK
OF NEW YORK

Fiscal Agent of the United States

[Circular No. 5877
September 29, 1966]

Maximum Rate of Interest on Regulation V–Loans Increased from 6 to 7½%

*To All Banks, Other Financing Institutions, and Others Concerned,
in the Second Federal Reserve District:*

Following is the text of a statement issued today by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System, after consultation with the Department of Defense and other Government agencies that guarantee loans made by private financing institutions for the financing of defense contracts, has acted to raise the maximum rate of interest that may be charged for these special guaranteed loans (V–loans) authorized under the Defense Production Act.

No change was made in the existing schedule of guarantee fees. The Board's action also provided that in those cases where the interest rate on a loan is in excess of 6 per cent, the guarantee fee must continue to be computed as though the interest rate were 6 per cent.

The new maximum rate on V–loans is 7½ per cent, but the net return to a lending institution is governed by the proportion of the loan that is guaranteed by the Government agency whose defense contract is being financed. For example, if a loan is 100 per cent guaranteed, the maximum net return to the lending institution will be 4.5 per cent after deducting the guarantee fee payable to the Government agency. A 90 per cent guaranteed loan will yield 5.9 per cent, and a 75 per cent guaranteed loan will yield 6.8 per cent, to the lending institution after guarantee fees have been deducted. Before this change, the maximum interest rate was 6 per cent, but after deducting the guarantee fee payable to the Government agency, a 100 per cent guaranteed loan netted a lending bank only a maximum of 3 per cent; a 90 per cent guaranteed loan, 4.4 per cent; and a 75 per cent guaranteed loan yielded 5.3 per cent.

The action of the Board is designed to bring the net return to financing institutions on V–loans under this program more in line with current lending and money market rates and thus help to assure financing from commercial sources for contractors and subcontractors engaged in defense work.

Information received by the Board from the Federal Reserve Banks showed that the former ceiling rate, which had been in effect since 1957, provided a net return to financing institutions that had become increasingly noncompetitive with alternative loan and investment opportunities. As a result, the amounts disbursed under authorized V–loans dropped from $152 million in fiscal year 1964 to $119 million in fiscal year 1965, and $78 million in the year ended June 30, 1966, notwithstanding a substantial increase in military procurement. Although originally a World War II measure, the V–loan program was revived by the Defense Production Act of 1950. From September 1950 through June 1966 a total of 1,633 loans had been authorized, amounting to $3.5 billion. Most of these loans were made during the Korean war period. The loans average approximately $2 million, and are primarily used by small and medium-sized defense contractors having fewer than 500 employees. The income to the Government from the guarantee fees on authorized loans, after deduction of established and foreseeable losses, is in excess of $37 million.

Under provisions of the Defense Production Act of 1950, and implementing Executive Orders, designated procurement agencies of the Government[1] are authorized to guarantee loans made by commercial banks and other private financial institutions to finance and expedite production for national defense and to finance contractors and subcontractors in connection with, or in contemplation of, the termination of their defense contracts. The Federal Reserve Banks act as fiscal agents of the guaranteeing agencies in receiving applications for such credits and in the making of guarantee contracts.

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[1] The authorized guaranteeing agencies are the Departments of the Army, Navy, and Air Force, the Defense Supply Agency, the Departments of Commerce, Interior, and Agriculture, General Services Administration, the Atomic Energy Commission, and the National Aeronautics and Space Administration.

Additional copies of this circular will be furnished upon request.

Alfred Hayes,
President.