REGULATION V
WAR FINANCING

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

For your information we set forth below the answers of the War Department, the Navy Department and the United States Maritime Commission to certain inquiries which have thus far been made in connection with the broadened Regulation V program outlined in our Circular No. 2681 dated September 1, 1943, (the loans pursuant thereto being referred to as “VT” loans).

1. Q. Is a guarantee agreement in order where war production contractor has ample working capital and only desires commitment because of doubts as to his future cash position in the event of the cancellation of his war production contracts?
   A. Yes; but at least a portion of the funds to be provided under a “VT” loan agreement should be available to the contractor for financing war production as well as for financing termination settlements. This avoids any question as to the power to guarantee a loan to be made available solely after termination.

2. Q. What is maximum maturity of commitments which would be approved by the services?
   A. Three to three and one-half years, or term of settlement provided in guarantee agreement, whichever is shorter.

3. Q. Is it intended there should be a breakdown between amount committed for “borrowed working capital” and amount committed for freeing borrower’s “own working capital upon cancellations of his war production contracts” or is it intended there should be over-all credit and that the maximum amounts which may be borrowed for the two purposes should be limited by a loan formula?
   A. It is intended that there should be an over-all credit, and the maximum amounts which may be borrowed may be divided between the two purposes, depending on agreement between the borrower and the bank as to the loan formula. The War Department will in general permit the full credit to be used for war production as well as on termination, but the Navy and Maritime Commission may in approving the terms of the loan require a limitation on the amounts to be drawn down before cancellation to amounts needed for financing war production. As indicated in question (1) a portion of the credit must be so made available at the borrower’s election even though he may not choose to avail himself of the right to borrow until after termination.

4. Q. Is credit available upon cancellations of war production contracts to be limited by amount of inventories, work in process, and accounts receivable, etc., which are allocable to cancelled contracts?
   A. No. The credit may be predicated on total war production inventories and work-in-process, and accounts receivable attributable to both cancelled and un-cancelled contracts. In addition the credit may be predicated upon moneys which have been used or are to be used concurrently to pay sub-contractors’ claims on cancelled contracts without overlap, of course, with inventory or receivables.

5. Q. In determining borrower’s own “working capital” are bank loans, accounts payable, and other current liabilities to be deducted from current assets?
   A. Yes.

6. Q. Is amount of credit to be available upon cancellation of war production contracts to be limited by amount of borrower’s “own working capital”?
   A. No, since the formula might include payments to subcontractors in excess of then working capital or receivable representing a claim for facilities or expenditures expressly made reimbursable by the procurement agency, or the borrower may have a net minus working capital or just a heavily extended position.

(over)
I. Q. Is it desired that guarantee agreements to be limited by the proportion of borrower's "own working capital" which the borrower's investment in inventories, work in process, and accounts receivable which are allocable to cancelled contracts bear to his aggregate investment in inventories, work in process, and accounts receivable?
A. No, the credit to be available is to be a percentage of the investment in war production inventories and work in process and war production receivables and payments made or concurrently to be made to subcontractors.

8. Q. Is credit available on cancellation of war production contracts to be made available to subcontractors as well as prime contractors?
A. Yes.

9. Q. If borrower is prime contractor, may cancellation of war production contract upon which he is subcontractor be made a basis for credit?
A. Yes.

10. Q. Is it desired that guarantee agreements should be so drawn that financing institutions must assume burden of verifying inventories, goods in process and accounts receivable where loans are made based on cancellation of war production contracts or is it sufficient if loan agreement provides for certificates of borrower and provides that financing institution acting in good faith may rely thereon?
A. There is no change in policy in this respect from ordinary Regulation V loans. The financing institution may provide in the loan agreement for certification by borrower. Inasmuch as the financing institution in this type of loan will always have at least a 10% interest, it is believed that it will have sufficient incentive to exercise reasonable care to obtain additional verification in those cases where that appears to be necessary.

11. Q. Where borrower is presently being financed by Regulation V loan, can financing institution make commitment separate and apart from outstanding loan and guarantee and receive an independent guarantee therefor which does not require the financing institution to waive any protection afforded by section 5 of outstanding guarantee agreement?
A. In general it is believed that the existing V loan should be converted into a larger VT loan where the latter type of loan appears desirable. This will avoid serious problems of loans competing for collateral.

12. Q. Is the policy of the War Department changed with respect to making Regulation V loans to borrowers who can readily obtain needed credit accommodation without a guarantee?
A. No. It is the view of the War Department that any contractor engaged in war production who needs money for that production, including sufficient to cover his tax liabilities with tax notes, can have a Regulation V loan. If the amount of borrowing sought is however, obviously primarily for post-war protection, he will have to take a new type V loan or a "VT" loan. For instance, if a borrower needs $7,000,000 for present war production and $20,000,000 to cover his war production receivables and inventories on termination, to permit him to use his own working capital for re-conversion, if the loan comes in at $20,000,000 it will be classified as a VT loan. If it comes in at $7,000,000 it will be classified as an old form guaranteed loan. Moreover, in the case of a weak contractor, the tendency of the War Department as heretofore will be to approve as a Regulation V loan, a somewhat inflated credit on the theory that the financing institution needs additional protection in that type of case.

13. Q. Where a bank makes a loan, after cancellation, under a commitment theretofore given, does borrower pay interest on the loan, or does service involved pay interest? If a correct interpretation of section 6, in such a case, is that the guarantor, rather than the borrower, pays interest, does not this section need revision? This point is raised in view of fact that first part of section 6 refers to adjustment of interest, which implies that borrower has previously paid it.
A. Where a bank makes a loan after cancellation under a commitment theretofore given, interest is waived and guarantor pays interest on a portion of loan proportionate to amount of cancellations, all as provided in section 6 of guarantee agreement. Borrower must make request for adjustment, and waiver of interest is effective from adjustment notice date, as provided by section 6. Not considered necessary to revise section 6, inasmuch as its provisions are applicable in the same way under the broadened program as under the ordinary type of V loan. "Adjustment" referred to in section 6 is the waiver of interest and suspension of maturity on the portion of the loan affected.

Additional copies of this circular will be furnished upon request.

ALLAN SPROUL,
President.