BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

S-254
Sec. 5136 R.S.-17

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

March 12, 1941

Dear Sir:

For your information there are enclosed herewith copies of certain correspondence between the President of the Federal Reserve Bank of Cleveland, the Board of Governors, and the Comptroller of the Currency with reference to certain questions regarding the applicability of section 5136 and section 5200, United States Revised Statutes, to the acquisition by member banks of assignments of claims arising under Emergency Plant Facilities Contracts. The following are the letters copies of which are enclosed:

Letter from the President of the Federal Reserve Bank of Cleveland dated November 29, 1940, with a copy of its enclosure;

Letter from the Board to the President of the Federal Reserve Bank of Cleveland dated December 9, 1940;

Letter from the Comptroller of the Currency to the Board dated February 24, 1941; and

Letter from the Board to the President of the Federal Reserve Bank of Cleveland dated February 26, 1941.

There were certain other letters of intermediate dates which were exchanged with regard to this matter, but they do not affect the conclusions expressed in the letters enclosed, and you will note that the enclosed letter from the Comptroller of the Currency expressly states that it supersedes certain earlier letters from his office on this subject.

Very truly yours,

L. P. Bethea,
Assistant Secretary.

Enclosures

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS

S-254-a
Sec. 5136 R.S.-17

FEDERAL RESERVE BANK OF CLEVELAND

November 29, 1940

Board of Governors of the
Federal Reserve System
Washington, D. C.

Gentlemen:

Enclosed you will find copy of a letter addressed to me by _____, Vice President of The _____ National Bank and Trust Company, _____, _____, on November 27, 1940.

In reading Mr. _____'s letter, I am impressed with the fact that if it is possible to accomplish the result desired by him, it cannot be achieved through any construction of R. S. Section 5200, for the reason that the provisions of this section, paragraph 8, clearly specify that the security of the notes mentioned therein must be bonds, notes, certificates of indebtedness or treasury bills of the United States, or obligations fully guaranteed both as to principal and interest by the United States. Clearly, the contract which Mr. _____ mentions is a direct obligation of the United States and not an obligation fully guaranteed by it both as to principal and interest.

In this connection, I invite your attention to the portion of the 7th paragraph of R. S. Section 5136, reading as follows:

> "The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply to obligations of the United States or general obligations of any state or of any political subdivision thereof ..."

As the amendments to this portion of this paragraph of Section 5136 were all made prior to the passage of the Assignment of Claims Act of 1940, it is arguable that the reference to obligations of the United States was intended to cover only obligations of the United States having the characteristics of investment securities. However, the literal terms of this portion of the section seem to me to include direct obligations of the United States of the type to which Mr. _____ refers. Therefore, I wish in considering Mr. _____'s letter that you would advise me whether the proceeds of contracts of the type mentioned by him may be assigned to member

banks by the contractor and considered as investments by the member banks on a parity with obligations of the United States having the quality of investment securities as mentioned in the 7th paragraph of said section 5136 and in the Regulations of the Comptroller of the Currency of June 28, 1938.

It is my opinion with respect to Defense Plant Contracts, after completion of the plant and acceptance thereof by the Government, that member banks may be willing to acquire the assignment of the right to receive payments from the United States under such contracts and hold such rights as investments in amounts far in excess of the limitations imposed by Section 5200 if obligations of the United States of this type can be given the same status as other obligations of the United States having the characteristics of investment securities.

In discussing this matter verbally, Mr. _____ has contended that obligations of the United States to pay stated installments under a contract should have the same status for investment by member banks as other obligations of the United States having the quality of investment securities, and that to make this distinction between the two types of obligations constitutes a discrimination against member banks in their efforts to aid in the Defense Program and to employ their excess reserves at a profit. His argument has impressed me as having merit.

Very truly yours,

(Signed) M. J. Fleming

President.

S-254-b
Sec. 5136 R.S.-17

THE _____ NATIONAL BANK AND TRUST COMPANY

November 27, 1940

Mr. M. J. Fleming, President
Federal Reserve Bank
Cleveland, Ohio

Dear Mr. Fleming:

For the past six weeks we have been working with one of our clients - namely, the _____ Corporation - to negotiate a contract with the United States Government for new plant facilities under the defense program, the estimated cost of which is $910,000.00.

During the closing days of negotiations between the company, the banks and the Government, it was stated by the Government representatives that the contract in its final form was a direct obligation of the Government for not less than 80% of the total cost of the new facilities. Therefore, the interest rate to be charged on this obligation by the banks would have to be closely in line with that of Government obligations, and they set a ceiling of 2% for this particular contract, and apparently the only reason for not making the rate lower than 2% was due to the fact that 20% of the obligation is to be repaid by the contractor - namely, the _____ Corporation.

_____ Corporation is a small but excellently operated corporation whose total resources will not exceed $250,000.00; therefore, it would be rather foolhardy for us to consider a loan of $910,000.00 to a company of this size unless the Government's obligation for 80% of the amount would be definitely irrevocable. It is our opinion that the present contract is an irrevocable obligation of the Government up to at least 80% of the total amount involved, and therefore we have not considered that the _____ Corporation will at any time be called upon to pay more than 20% of the total contract, plus the interest on the obligation during its existence.

If our assumption is correct in this matter, we feel that definite action should be taken by the Federal Reserve Board and the Comptroller of the Currency, to classify the contract up to 80% of the total figures involved, as a direct Government obligation, the same as a Government bond, thereby releasing the banks from the legal limitations as provided in Section 5200, and also providing them with an "A" classification from the Federal Reserve Bank on the contract

in case of emergency, for that portion which is the Government's obligation.

I believe that ___A___, from the _____ City Bank at _____, furnished your attorneys with his copy of this contract, and that Mr. ___B___ is thoroughly conversant with its contents.

I might state, for your information, that irrespective of the ruling which may be handed down in this case, we are proceeding with a loan to the company under the contract, in order that the National Defense Program will not be further held up, but would like to be in a position in the near future of releasing at least a portion of our legal credit limit to the _____ Corporation for working capital requirements which will be necessary after completion of the new facilities.

If there are any questions which you have in regard to the contract or any other phase of this situation, I will be more than glad to give you the desired information.

Thanking you for your consideration, and with kindest personal regards, I am

Sincerely yours,

(Signed) _____

Vice President

S-254-c
Sec. 5136 R.S.-17

December 9, 1940

Mr. M. J. Fleming, President,
Federal Reserve Bank of Cleveland,
Cleveland, Ohio.

Dear Mr. Fleming:

This refers to your letter of November 29, 1940, enclosing a letter from Mr. _____, Vice President of The _____ National Bank and Trust Company, _____, _____, raising certain questions with respect to the proper construction of section 5136 and section 5200 of the Revised Statutes in relation to obligations of the United States arising out of Emergency Plant Facilities Contracts. The questions you raised will be taken up with the office of the Comptroller of the Currency, since they involve limitations applicable to national banks as well as to State member banks, and you will be advised as soon as possible of the conclusions reached.

Very truly yours,

(Signed) Chester Morrill

Chester Morrill
Secretary.

S-254-d
Sec. 5136 R.S.-17

TREASURY DEPARTMENT

Comptroller of the Currency

Washington

February 24, 1941

Board of Governors of the
Federal Reserve System
Washington, D. C.

Gentlemen:

This is with further reference to your letters of December 10, 1940 and January 14, 1941, relating to the acquisition by national banks of claims against the Federal Government arising out of Emergency Plant Facilities Contracts assigned under the provisions of the Assignment of Claims Act of 1940. It is believed that this letter clarifies the opinions expressed in our letters of January 6th and February 8th, which are hereby superseded.

By virtue of the Assignment of Claims Act, claims arising under such contracts may be assigned to banks as security for loans. In such cases the loan is made to the contractor, and the claim against the Government is assigned to the bank as collateral security. Such loans are subject to the ordinary 10% limitation prescribed by section 5200 of Rev. Stat. of 1873, as amended (U.S.C. title 12, sec. 84), since none of the exceptions to that limitation specified in section 5200 is applicable to this situation.

The question has been raised whether assignments of such claims may be purchased by national banks outright, rather than being taken as security for loans to the contractor. Section 5136 of Rev. Stat. of 1873, as amended (U.S.C. title 12, sec. 24) authorizes national banks to acquire "promissory notes, drafts, bills of exchange, and other evidences of debt". In order to constitute an "evidence of debt" within this statutory provision, an obligation must involve an admission of liability or a promise to pay a specified or determinable amount. Until the completion of the plant facilities called for by these contracts, the Government does not appear to undertake any such absolute obligation, although it does bind itself to assume an obligation not to exceed a specified amount upon the completion of the facilities and the filing of a Final Cost Certificate. Accordingly, until the facilities have been completed and the Final Cost Certificate filed, the contractor's potential claim against the Government does not constitute an evidence of debt which may be purchased by a national bank.

After the facilities have been completed and the Final Cost Certificate filed, the contractor's claim against the United States becomes an evidence of debt within the meaning of section 5136 and may be acquired as such by a national bank.

The question then arises whether the acquisition of such claims is subject to any of the limits as to amount which are prescribed in the National Bank Act. Inasmuch as these assigned claims do not constitute "investment securities" as defined in section 5136, the applicable limitations and exceptions are those of section 5200, relating to loans and similar extensions of credit, rather than those of section 5136, relating to investment securities. However, it is the position of this office that the limitations of section 5200 do not apply to obligations of the United States, since the Federal Government is not deemed to be a "person, copartnership, or corporation" within the purview of that section. It is therefore concluded that after the plant facilities have been completed in accordance with the contract and the Final Cost Certificate filed, the claim of the contractor against the Government may be acquired by a national bank without any limitation other than those imposed by the applicable principles of safe and sound banking practice. In purchasing such claims, the bank should take into consideration whatever possibility exists of the assigned claim thereafter becoming subject to valid defenses, set-offs, or counterclaims.

If you deem it advisable, it is agreeable that this letter be published in the Federal Reserve Bulletin.

Yours very truly,

(Signed) Preston Delano

Comptroller of the Currency

S-254-e
Sec. 5136 R.S.-17

February 26, 1941

Mr. M. J. Fleming, President,
Federal Reserve Bank of Cleveland,
Cleveland, Ohio.

Dear Mr. Fleming:

This is in further reference to your letter of February 10, 1941, and previous correspondence regarding certain questions arising under section 5136 and section 5200, United States Revised Statutes, which were submitted by you and were by us referred to the Comptroller of the Currency. We enclose herewith a copy of a letter from the Comptroller of the Currency dated February 24, 1941, with reference to this matter.

You will note that the Comptroller's letter concludes that, after the plant facilities have been completed in accordance with the contract and the Final Cost Certificate filed, the claim of the contractor against the Government may be acquired by a national bank without any limitation other than those imposed by the applicable principles of safe and sound banking practice. In view of this ruling of the Comptroller of the Currency and the fact that State member banks under the law are subject to the same conditions with respect to the purchasing and holding of investment securities as are national banks, the Board will consider that State member banks, in acquiring claims against the Government of the kind described after the plant facilities have been completed in accordance with the contract and the Final Cost Certificate filed, are likewise not subject to the limitations imposed by section 5136, United States Revised Statutes.

Very truly yours,

(Signed) L. P. Bethea

L. P. Bethea,
Assistant Secretary.