

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

S-560

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 30, 1942.



Dear Sir:

The War Department, the Navy Department, and the United States Maritime Commission have adopted instructions in substantially similar form for the guidance of the Federal Reserve Banks in arranging guarantees and in servicing guaranteed loans pursuant to Executive Order No. 9112. The instructions are contained in the following letters to all Federal Reserve Banks, copies of which are transmitted herewith:

- (1) Letter from the Navy Department to all Federal Reserve Banks, dated September 17, 1942, signed by Mr. S. A. Mitchell, Chief of Finance Section;
- (2) Letter from the War Department to all Federal Reserve Banks, dated September 21, 1942, signed by the Honorable Robert P. Patterson, Under Secretary of War; and
- (3) Letter from the United States Maritime Commission to all Federal Reserve Banks, dated September 23, 1942, signed by Mr. R. E. Anderson, Director of Finance.

Very truly yours

S. R. Carpenter,
Assistant Secretary.

Enclosure 3

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS



S-560-a

NAVY DEPARTMENT

WASHINGTON

September 17, 1942

TO ALL FEDERAL RESERVE BANKS:

The Federal Reserve Banks are requested to observe the following instructions in arranging and closing guarantees pursuant to Executive Order No. 9112 on behalf of the Navy Department and in following the progress of loans which have been guaranteed. The Navy Department does not deem it practicable to prescribe rigid instructions governing the question whether a Federal Reserve Bank should ascertain the information or take the actions herein indicated through its own efforts or should rely upon the financing institution to do so, as this matter is one which should be governed by the circumstances of particular cases. While the Navy Department does however expect the Federal Reserve Banks to use their best banking judgment in these matters, it will not hold a Federal Reserve Bank responsible if it exercises a discretion in good faith in accordance with the instructions herein given.

Arranging Guarantees

In arranging, executing and completing guarantees a Federal Reserve Bank should exercise its discretion as to the steps to be taken to see that the conditions of the authorization for the guarantee and the instructions of the Navy Department are observed. The Reserve Bank should, of course, carefully prepare the guarantee agreement in accordance with the standard form and such special provisions as may be approved or required in the particular case by the Navy Department. The Reserve Bank may make minor changes in the terms and conditions of the loan prescribed by the Navy Department in authorizing the guarantee without obtaining the prior approval of the Navy Department provided such changes in the terms are considered by the Reserve Bank in its discretion not to make any important or substantial alteration. All the terms and conditions prescribed by the Navy Department either in the identical form prescribed or as modified by such minor changes, should be included in summary form in the guarantee agreement. When the Reserve Bank has received the authorization from the Navy Department, it should transmit to the financing institution the guarantee agreement with such written advice of the conditions which are required in connection with the guarantee and such other information as it may deem appropriate. The Reserve Bank should ascertain, or, if it deems it safe to do so, rely upon the financing institution to see, that the conditions prescribed by the Navy Department in authorizing the loan are fulfilled and that the loan agreement, if any, assignments of contracts or other collateral,

and any standby or subordination agreements or other similar documents unless such documents have been previously passed upon by the Navy Department do not contain provisions which conflict with any provision of the guarantee agreement or with any condition prescribed by the Navy Department in authorizing the guarantee in question. For example, if among the terms of the authorization is a provision that the proceeds of the loan be used only for expenditures in connection with contracts assigned as security for the loan, the Federal Reserve Bank should satisfy itself that mechanics reasonably calculated to assure this result have been set up. Where feasible, copies of loan agreements and the form of the notes should be obtained from the financing institution and one copy forwarded to the Navy Department through the Board of Governors.

The Federal Reserve Bank should exercise its discretion as to whether to examine into the legal sufficiency of mortgages, deeds of trust and other similar collateral. In some cases it may find it desirable to do this before the guarantee agreement is executed, but in many cases, that may be impracticable, and reliance may then be placed upon a statement of the financing institution. In the latter event the Federal Reserve Bank may deem it to be in the interests of the Navy Department that these matters be looked into after the execution of the guarantee agreement. The Federal Reserve Bank will not be expected to examine into questions of legal incorporation of the borrower or other party, or of the authority of the signing officers of the borrower or other party, unless there are special circumstances which make the Federal Reserve Bank feel that this is necessary in the particular case.

The Federal Reserve Bank must satisfy itself that the various matters mentioned above have been properly examined into. It may accomplish this result by making the examination itself, or, in the exercise of its discretion, may rely upon the financing institution to do so. However, it should not rely upon the financing institution if by reason of the size or character of the financing institution, or the quality of its management, the percentage of guarantee, or other considerations, it has reason to believe that the financing institution will not check all the appropriate matters or that the information obtained from the financing institution on this subject may not be entirely adequate. The question as to the circumstances in which the Federal Reserve Bank is justified in relying on the financing institution is left to the determination of the Reserve Bank in its discretion, in the absence of specific instructions in the particular case from the Navy Department.

Servicing Guaranteed Loans

In connection with each loan guaranteed pursuant to Executive Order No. 9112, the Federal Reserve Bank should, in the absence of special circumstances, require reports from the financing institution

showing the daily net outstanding amounts of each guaranteed loan and such other pertinent information as the Reserve Bank may deem necessary. Such reports should be required at such times and in such form as the Reserve Bank deems appropriate. The Reserve Bank may require such other reports, explanations and information from the financing institution or the borrower, make such visits to the financing institution or the borrower, and take such other steps as in its judgment may be desirable in this connection or as are requested by the Navy Department. The Reserve Bank will be expected to furnish the information requested in the letter addressed to you by the Board of Governors of the Federal Reserve System under date of June 30, 1942 (S-520).

The question as to the extent to which the Federal Reserve Bank should follow the progress of guaranteed loans or rely upon the financing institution to do so is left to the determination of the Reserve Bank in its discretion, in the absence of specific instructions in the particular case from the Navy Department. In this connection, consideration should be given the circumstances of the particular case, including the amount and nature of the loan and of the collateral, the size and character of the financing institution and the quality of its management, the percentage of guarantee, information received with respect to the progress of the loan, and other considerations.

In the usual cases the Federal Reserve Bank will not be expected to make or undertake to enforce any requirement with respect to the obtaining or maintenance of insurance by the borrower. In the absence of special instructions from the Navy Department, this may be left to the financing institution. There is no objection, however, to the Reserve Bank's taking such steps as it deems necessary with respect to the maintenance of insurance if for any reason it feels that it is desirable to do so in any particular case.

In the absence of specific instructions from the Navy Department, the Reserve Bank may, in cases where it deems it appropriate in order to enforce compliance with conditions of the loan agreement, suggest to the financing institution such action as appears necessary in any particular case regarding salaries of executive officers of the borrower, payment of dividends by the borrower, incurring of indebtedness by the borrower, the making of capital expenditures by the borrower, or other similar matters, and in the event that the Reserve Bank and the financing institution cannot agree on a basis which the Reserve Bank believes to be in the best interests of the Government, the matter should be reported to the Navy Department.

It is possible that the Navy Department may find it necessary at a later date, in the light of experience with guaranteed loans, to issue additional or supplementary instructions with regard to the responsibilities of the Federal Reserve Banks with respect to the matters discussed above.

NAVY DEPARTMENT OF THE UNITED STATES

By (Signed) S. A. Mitchell

S. A. Mitchell

Chief of Finance Section

September 21, 1942

TO ALL FEDERAL RESERVE BANKS:

The Federal Reserve Banks are requested to observe the following instructions in arranging and closing guarantees pursuant to Executive Order No. 9112 on behalf of the War Department and in following the progress of loans which have been guaranteed. The War Department does not deem it practicable to prescribe rigid instructions governing the question whether a Federal Reserve Bank should ascertain the information or take the actions herein indicated through its own efforts or should rely upon the financing institution to do so, as this matter is one which should be governed by the circumstances of particular cases. While the War Department does however expect the Federal Reserve Banks to use their best banking judgment in these matters, it will not hold a Federal Reserve Bank responsible if it exercises a discretion in good faith in accordance with the instructions herein given.

Arranging Guarantees

In arranging, executing and completing guarantees a Federal Reserve Bank should exercise its discretion as to the steps to be taken to see that the conditions of the authorization for the guarantee and the instructions of the War Department are observed. The Reserve Bank should, of course, carefully prepare the guarantee agreement in accordance with the standard form and such special provisions as may be approved or required in the particular case by the War Department. The Reserve Bank may make minor changes in the terms and conditions of the loan prescribed by the War Department in authorizing the guarantee without obtaining the prior approval of the War Department provided such changes are considered by the Reserve Bank in its discretion not to make any important or substantial alteration (in the terms or conditions prescribed). All the terms and conditions prescribed by the War Department either in the identical form prescribed or as modified by such minor changes, should be included in summary form in the guarantee agreement. When the Reserve Bank has received the authorization from the War Department (or is prepared to execute the guarantee if the case is one in which no advance approval from the War Department is necessary), it should transmit to the financing institution the guarantee agreement with such written advice of the conditions which are required in connection with the guarantee and such other information as it may deem appropriate. The Reserve Bank should ascertain, or if it deems it safe to do so, rely upon the financing institution to see, that the conditions prescribed by the War Department in authorizing the loan are fulfilled and that the loan agreement, if any, assignments of contracts or other collateral, and any standby or subordination agreements or other similar documents unless such documents have been previously passed

upon by the War Department do not contain provisions which conflict with any provision of the guarantee agreement or with any condition prescribed by the War Department in authorizing the guarantee in question. For example if among the terms of the authorization is a provision that the proceeds of the loan be used only for expenditures in connection with contracts assigned as security for the loan, the Federal Reserve Bank should satisfy itself that mechanics reasonably calculated to assure this result have been set up. Where feasible, copies of loan agreements and the form of the notes should be obtained from the financing institution and one copy forwarded to the War Department through the Board of Governors.

The Federal Reserve Bank should exercise its discretion as to whether to examine into the legal sufficiency of mortgages, deeds of trust and other similar collateral. In some cases it may find it desirable to do this before the guarantee agreement is executed, but in many cases, that may be impracticable, and reliance may then be placed upon a statement of the financing institution. In the latter event the Federal Reserve Bank may deem it to be in the interests of the War Department in some cases that these matters be looked into after the execution of the guarantee agreement. The Federal Reserve Bank will not be expected to examine into questions of legal incorporation of the borrower or other party, or of the authority of the signing officers of the borrower or other party, unless there are special circumstances which make the Federal Reserve Bank feel that this is necessary in the particular case.

The Federal Reserve Bank must satisfy itself that the various matters mentioned above have been properly examined into. It may accomplish this result by making the examination itself, or, in the exercise of its discretion, may rely upon the financing institution to do so. However, it should not rely upon the financing institution if by reason of the size or character of the financing institution or the quality of its management, the percentage of guarantee, or other considerations, it has reason to believe that the financing institution will not check all the appropriate matters or that the information obtained from the financing institution on this subject may not be entirely adequate. The question as to the circumstances in which the Federal Reserve Bank is justified in relying on the financing institution is left to the determination of the Reserve Bank in its discretion, in the absence of specific instructions in the particular case from the War Department.

Servicing Guaranteed Loans

In connection with each loan guaranteed pursuant to Executive Order No. 9112, the Federal Reserve Bank should, in the absence of special circumstances, require reports from the financing institution showing the daily net outstanding amounts of each guaranteed loan and

such other pertinent information as the Reserve Bank may deem necessary. Such reports should be required at such times and in such form as the Reserve Bank deems appropriate. The Reserve Bank may require such other reports, explanations and information from the financing institution or the borrower, make such visits to the financing institution or the borrower, and take such other steps as in its judgment may be desirable in this connection or as are requested by the War Department. The Reserve Bank will be expected to furnish the information requested in the letter addressed to you by the Board of Governors of the Federal Reserve System under date of June 30, 1942 (S-520).

The question as to the extent to which the Federal Reserve Bank should follow the progress of guaranteed loans or rely upon the financing institution to do so is left to the determination of the Reserve Bank in its discretion, in the absence of specific instructions in the particular case from the War Department. In this connection, consideration should be given the circumstances of the particular case, including the amount and nature of the loan and of the collateral, the size and character of the financing institution and the quality of its management, the percentage of guarantee, information received with respect to the progress of the loan, and other considerations.

In the usual cases the Federal Reserve Bank will not be expected to make or undertake to enforce any requirement with respect to the obtaining or maintenance of insurance by the borrower. In the absence of special instructions from the War Department, this may be left to the financing institution. There is no objection, however, to the Reserve Bank's taking such steps as it deems necessary with respect to the maintenance of insurance if for any reason it feels that it is desirable to do so in any particular case.

In the absence of specific instructions from the War Department, the Reserve Bank may, in cases where it deems it appropriate in order to enforce compliance with conditions of the loan agreement, suggest to the financing institution such action as appears necessary in any particular case regarding salaries of executive officers of the borrower, payment of dividends by the borrower, incurring of indebtedness by the borrower, the making of capital expenditures by the borrower, or other similar matters, and in the event that the Reserve Bank and the financing institution cannot agree on a basis which the Reserve Bank believes to be in the best interests of the Government, the matter should be reported to the War Department.

It is possible that the War Department may find it necessary at a later date, in the light of experience with guaranteed loans, to issue additional or supplementary instructions with regard to the responsibilities of the Federal Reserve Banks with respect to the matters discussed above.

Sincerely yours,

(Signed) Robert P. Patterson

Under Secretary of War

September 23, 1942

TO ALL FEDERAL RESERVE BANKS:

The Federal Reserve Banks are requested to observe the following instructions in arranging and closing guarantees pursuant to Executive Order No. 9112 on behalf of the Maritime Commission and in following the progress of loans which have been guaranteed. The Maritime Commission does not desire to prescribe rigid instructions governing the question whether a Federal Reserve Bank should ascertain the information or take the actions herein indicated through its own efforts or should rely upon the financing institution to do so, as this matter is one which may well be treated differently at the different Federal Reserve Banks and will be governed by the circumstances of particular cases. A Federal Reserve Bank, however, will not be held responsible by the Maritime Commission if it exercises a discretion in good faith in accordance with the instructions herein given.

Arranging Guarantees

In arranging, executing and completing guarantees, a Federal Reserve Bank should exercise its discretion as to the steps to be taken to see that the conditions of the authorization for the guarantee and the instructions of the Maritime Commission are observed. The Reserve Bank should, of course, carefully prepare the guarantee agreement in accordance with the standard form and such special provisions as may be approved or required in the particular case by the Maritime Commission. All the terms and conditions prescribed by the Maritime Commission either in the identical form prescribed or as modified by the Commission, should be included in summary form in the guarantee agreement. When the Reserve Bank has received the authorization from the Maritime Commission (or is prepared to execute the guarantee, if the case is one in which no advance approval from the Maritime Commission is necessary), it should transmit to the financing institution the guarantee agreement with such written advice of the conditions which are required in connection with the guarantee and such other information as it may deem appropriate. The Reserve Bank should ascertain, or rely upon the financing institution to see, that the conditions prescribed by the Maritime Commission in authorizing the loan are fulfilled and that the loan agreement, if any, assignments of contracts or other collateral, and any standby or subordination agreements or other similar documents unless such documents have been previously passed upon by the Maritime Commission do not contain provisions which conflict with any provision of the guarantee agreement or with any condition prescribed by the Maritime Commission in authorizing the guarantee in question. However, where

feasible, copies of loan agreements and notes should be obtained from the financing institution and one copy forwarded to the Maritime Commission through the Board of Governors.

The Federal Reserve Bank should exercise its discretion as to whether to examine into the legal sufficiency of mortgages, deeds of trust and other similar collateral. In some cases it may find it desirable to do this before the guarantee agreement is executed, but in many cases, perhaps usually, that may be impracticable, and reliance may then be placed upon a statement of the financing institution. In the latter event the Federal Reserve Bank may deem it to be in the interests of the Maritime Commission in some cases that these matters be looked into after the execution of the guarantee agreement. The Federal Reserve Bank will not be expected to examine into questions of legal incorporation of the borrower or other party, or of the authority of the signing officers of the borrower or other party, unless there are special circumstances which make the Federal Reserve Bank feel that this is necessary in the particular case.

The Federal Reserve Bank may itself ascertain the various matters mentioned above, or, in the exercise of its discretion, may rely upon the financing institution to ascertain them. However, it should not rely entirely upon the financing institution if by reason of the size or character of the financing institution or the quality of its management, the percentage of guarantee, or other considerations, it has reason to believe that the financing institution will not check all the appropriate matters or that the information obtained from the financing institution on this subject may not be entirely adequate. The question as to the circumstances in which the Federal Reserve Bank is justified in relying on the financing institution is left to the determination of the Reserve Bank in its discretion, in the absence of specific instructions in the particular case from the Maritime Commission.

Servicing Guaranteed Loans

In connection with each loan guaranteed pursuant to Executive Order No. 9112, the Federal Reserve Bank should, in the absence of special circumstances, require reports from the financing institution showing the daily net outstanding amounts of each guaranteed loan and such other pertinent information as the Reserve Bank may deem necessary. Such reports should be required at such times and in such form as the Reserve Bank deems appropriate. The Reserve Bank may require such other reports, explanations and information from the financing institution or the borrower, make such visits to the financing institution or the borrower, and take such other steps as in its judgment may be desirable in this connection. The Reserve Bank will be expected

to furnish the information requested in the letter addressed to you by the Board of Governors of the Federal Reserve System under date of June 30, 1942 (S-520).

The question as to the extent to which the Federal Reserve Bank should follow the progress of guaranteed loans or rely upon the financing institution to do so is left to the determination of the Reserve Bank in its discretion, in the absence of specific instructions in the particular case from the Maritime Commission. In this connection, consideration should be given the circumstances of the particular case, including the amount and nature of the loan and of the collateral, the size and character of the financing institution and the quality of its management, the percentage of guarantee, information received with respect to the progress of the loan, and other considerations.

In the usual cases the Federal Reserve Bank will not be expected to make or undertake to enforce any requirement with respect to the obtaining or maintenance of insurance by the borrower. In the absence of special instructions from the Maritime Commission, this may be left to the financing institution. There is no objection, however, to the Reserve Bank's taking such steps as it deems necessary with respect to the maintenance of insurance if for any reason it feels that it is desirable to do so in any particular case. In the absence of specific instructions from the Maritime Commission, the Reserve Bank may, in cases where it deems it appropriate in order to enforce compliance with conditions of the loan agreement, suggest to the financing institution such action as appears necessary in any particular case regarding salaries of executive officers of the borrower, payment of dividends by the borrower, incurring of indebtedness by the borrower, the making of capital expenditures by the borrower, or other similar matters, and in the event that the Reserve Bank and the financing institution cannot agree on a basis which the Reserve Bank believes to be in the best interests of the Government, the matter should be reported to the Maritime Commission.

It is possible that the Maritime Commission may find it necessary at a later date, in the light of experience with guaranteed loans, to issue additional or supplementary instructions with regard to the responsibilities of the Federal Reserve Banks with respect to the matters discussed above.

Very truly yours,

(Signed) R. E. Anderson

R. E. Anderson
Director of Finance