

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

S-572

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

October 22, 1942.



Dear Sir:

The Board has received from the War Department a memorandum dated October 19, 1942, signed by Lieutenant Colonel Paul Cleveland, relating to the inclusion in loan agreements of provisions relating to the acceptance of advance payments and Government loans by borrowers whose loans have been guaranteed; and a copy of the War Department's memorandum is enclosed herewith. It will be noted that this memorandum supplements and modifies the War Department's memorandum of September 7, 1942, a copy of which was enclosed with the Board's letter of September 12, 1942.

Very truly yours,

L. P. Bethea,
Assistant Secretary.



Enclosure

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS

C O P Y

S-572-a

WAR DEPARTMENT
HEADQUARTERS, SERVICES OF SUPPLY
WASHINGTON, D. C.

SPEEJ

October 19, 1942

MEMORANDUM: From the War Department to the Board of Governors of the Federal Reserve System.

SUBJECT: Review of guarantee and loan agreements; provisions prohibiting the borrower from undertaking additional war contracts, from consenting to the modification of war contracts, and from accepting advance payments.

1. Reference is made to the War Department's memorandum of September 7, 1942 on the above subject.

2. Paragraph 4 of the above mentioned memorandum is hereby changed to read as follows:

"4. As to advance payments, the following requirements are prescribed by the War Department, and the Federal Reserve Banks are requested to see that all loan agreements and other similar instruments hereafter submitted to the War Department are in conformity with these requirements:

"a. Restrictions against the acceptance of advance payments or government loans in respect of War production contracts will be acceptable to the War Department only if they are worded substantially as follows:

"1. The borrower will not, without the prior written consent of the financing institution, accept any advance payments or government loans; provided, however, that without such consent the borrower may accept advance payments from the government or government loans in respect of war production contracts if (1) the entire credit provided for hereunder is at the time being used and the financing institution has not, after reasonable opportunity to do so, supplied additional necessary credit to the borrower on substantially the same terms and conditions as are provided in this Agreement (other than changes made necessary by the adjustment of the percentage of guarantee as provided in Section 13 () of the guarantee agreement),

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and if, in addition, (2) such advance payments or loans have been approved by a Financial Contracting Officer assigned to the Services of Supply, Washington, D.C., as being necessary under all the circumstances.'

"b. When the above clause is used in loan agreements the Federal Reserve Banks shall, if requested by the Financing Institution, insert a special condition in the Guarantee Agreement reading substantially as follows:

" If at any time the entire aggregate principal amount of the borrower's indebtedness incurred for moneys borrowed (including funded debt but excluding moneys advanced on Defense Plant Corporation leases or borrowed upon Emergency Plant Facilities Contracts), plus advance payments and loans, if any, from the United States, shall exceed \$ _____, then upon written request of the Financing Institution from time to time, the percentage of loan specified in Section 1 will be adjusted to such percentage as the Guarantor and the Financing Institution mutually consider fair and equitable under the circumstances, and if the Guarantor and the Financing Institution cannot agree upon such percentage within thirty (30) days after each such request, and such aggregate amount of indebtedness and advance payments and loans shall exceed \$ _____, then such percentage of guarantee shall be _____%, and, if such aggregate amount shall exceed \$ _____, such percentage of guarantee shall be _____%, and if such aggregate amount shall exceed \$ _____, such percentage of guarantee shall be 100%. Any such higher percentage of guarantee shall continue in effect notwithstanding any subsequent reduction in the aggregate amount of such indebtedness and advance payments and loans; and in the event of a prior adjustment, pursuant to section 5, of the percentage of loan specified in section 1, the above percentages shall be increased proportionately to reflect such adjustment.

"Unless otherwise agreed by the Guarantor and the Financing Institution, the percentage of guarantee fee to be paid by the Financing Institution in case of an adjustment under this subsection shall be 30% of the loan interest rate on the portion of the loan which the War Department is obligated to purchase if the percentage of the guarantee is in excess of 90% and less than 95%; 35% of the loan interest rate on the portion of the loan which the War Department is obligated to purchase if the percentage of the guarantee is 95% and less than 100%, and 40% of the loan interest rate if the guarantee is increased to 100%.

"For the purpose of increasing the protection of the financing institution under this subsection the proceeds of any security or of any right or priority (from whatever source realized) accruing in respect of any advance payments or loans by the United States shall be shared by the United States ratably with the loan guaranteed hereunder; except that the foregoing shall not apply to any pledge, purchase money mortgage, or lien taken by the United States upon the balance of such advance payments or loan, and upon specific materials, work in process, finished goods or facilities upon which such advance payments or loans have been expended."

"c. Restrictions against incurring additional indebtedness should always contain an appropriate exception in favor of advance payments or government loans in respect of war production contracts.

"d. Restrictions against encumbrances of the borrower's assets should always contain an appropriate exception in favor of liens or encumbrances arising in connection with advance payments or government loans in respect of war production contracts.

"e. The War Department has no objection to a loan agreement provision restricting the acceptance by the borrower of advance payments on subcontracts."

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3. For the information of the Federal Reserve Banks and financing institutions, it may be pointed out that at the present time there are only four Financial Contracting Officers, one of whom is the Director of the Fiscal Division, Services of Supply, Washington, D.C., and the other three of whom are assigned to the Advance Payment and Loan Branch, Fiscal Division, Services of Supply, Washington, D. C.

4. Kindly transmit the foregoing to all of the Federal Reserve Banks.

War Department of the United States

By: (Signed) Paul Cleveland

Paul Cleveland
Lt. Colonel, A. U. S.
Chief, Loan Section
Advance Payment and Loan Branch