

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON



S-590

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

November 23, 1942.

Dear Sir:

For your information, there is enclosed a copy of a letter received by the Board from Mr. C. B. Upham, Deputy Comptroller of the Currency, dated November 19, 1942, enclosing a copy of a letter from Mr. L. H. Sedlacek, Deputy Comptroller, to Mr. Gibbs Lyons, District Chief Bank Examiner, New York City, dated November 12, 1942, regarding the applicability of Exception 10 to Section 5200 of the Revised Statutes to participations in loans covered by guarantees or take-over commitments pursuant to Executive Order No. 9112.

Very truly yours,

A handwritten signature in dark ink, appearing to read "L. P. Bethea".

L. P. Bethea,
Assistant Secretary.

Enclosures 2



TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS.

S-590-a

TREASURY DEPARTMENT
COMPTROLLER OF THE CURRENCY

Washington

Address Reply to
"Comptroller of the Currency"

November 19, 1942

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

Attention: Mr. George Vest

Dear Sirs:

Pursuant to the conversation between you and our
Mr. Robertson with respect to loans covered by governmental
guaranties or take-over commitments, there is attached hereto
for your information a copy of a letter directed to Mr. Gibbs
Lyons, District Chief National Bank Examiner, New York City.

Yours very truly,

(Signed) C. B. Upham

Deputy Comptroller

Enclosure

COPY

S-590-b

November 12, 1942.

Mr. Gibbs Lyons,
District Chief National Bank Examiner,
525 Federal Reserve Bank Building,
New York, New York.

Dear Mr. Lyons:

This is in reply to your letter dated October 22, relating to participations in loans covered by governmental guaranties or take-over commitments. In the situation you present, "the participating bank would not be managing the loan and would not be the bank to whom the guarantee was issued", but would merely receive from the managing bank a letter certifying that it has a specified participation in the loan.

Exception 10 to section 5200 of Rev. Stat. of 1873, as amended (U. S. C. title 12, sec. 84), is based upon the principle that to the extent that a loan is covered by a take-over commitment which cannot be nullified by any contingency not within the control of the lending bank, the loan is freed from the usual risk element, and therefore need not be subjected to the ordinary 10% limitation. As stated in paragraph (b) of the definition of the term "unconditional", the bank "must be in a position, at any time during the life of the loan, to demand performance of the agreement and to receive payment in cash, in full, within sixty days." Consequently, it is essential that the participating bank have the independent power to require take-over of the guaranteed part of its portion of the loan, at any time. In the absence of this power, the guaranty would not meet the requirements of exception 10, as far as the participating bank is concerned.

In our opinion, the guaranty would also be defective, from the point of view of exception 10, if its continuance in effect were to depend upon action or inaction by the managing bank, beyond the control of the participating bank. For example, where there is no participation problem, the inclusion of a provision that the guaranty will terminate if the bank sues the borrower without prior consent of the guarantor, would not prevent the guaranty from being unconditional. (See example (5) in definition of "unconditional".) On the other hand, if a participating bank's protection through the guaranty would be wholly or partially lost in the event the managing bank, solely of its own volition, were to sue the borrower without having obtained the required prior consent of the guarantor, the protection to the participating bank would be subject to defeasance by a contingency not within its control, and consequently the guaranty would not be unconditional as to that bank.

It is believed that problems of this sort can be worked out in most cases through comparatively simple modifications in procedure. Under

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the General Motors Corporation Credit Agreement and Guarantee Agreement, for example, the borrower's obligations are to be evidenced by notes in varying amounts running to the participating banks individually, and the guaranty also runs to the individual banks and consequently may be exercised by each, independently of any action by others. Furthermore, the Committee which was set up in that case to expedite operations was given no powers which could result in loss of guaranty protection to any participating bank through acts or occurrences beyond its own control.

Yours very truly,

(Signed) L. H. Sedlacek

Deputy Comptroller