

# Subpart 32.3 - Loan Guarantees for Defense Production

**Parent topic:** [Part 32 - Contract Financing](#)

## 32.300 Scope of subpart.

This subpart prescribes policies and procedures for designated agencies' guarantees of loans made by private financial institutions to *borrowers* performing contracts related to *national defense* (see [30.102](#)).

## 32.301 Definitions.

As used in this subpart-

*Borrower* means a contractor, subcontractor (at any tier), or other supplier who receives a *guaranteed loan*.

*Federal Reserve Board* means the Board of Governors of the Federal Reserve System.

*Guaranteed loan* or "V loan" means a loan, revolving credit fund, or other financial arrangement made pursuant to Regulation V of the *Federal Reserve Board*, under which the *guaranteeing agency* is obligated, on demand of the lender, to purchase a stated percentage of the loan and to share any losses in the amount of the guaranteed percentage.

*Guaranteeing agency* means any agency that the President has authorized to guarantee loans, through Federal Reserve Banks, for expediting *national defense* production.

## 32.302 Authority.

Congress has authorized Federal Reserve Banks to act, on behalf of *guaranteeing agencies*, as fiscal agents of the *United States* in the making of loan guarantees for defense production (Section 301, Defense Production Act of 1950 (50 U.S.C. App. 2091)). By Executive Order 10480, August 14, 1953 (3 CFR 1949-53), as amended, the President has designated the following agencies as *guaranteeing agencies*:

- (a) Department of Defense.
- (b) Department of Energy.
- (c) Department of Commerce.
- (d) Department of the Interior.
- (e) Department of Agriculture.

(f) General Services Administration.

(g) National Aeronautics and Space Administration.

## 32.303 General.

(a) Section 301 of the Defense Production Act authorizes loan guarantees for contract performance or other operations related to *national defense*, subject to amounts annually authorized by Congress on the maximum obligation of any *guaranteeing agency* under any loan, discount, advance, or commitment in connection therewith, entered into under section 301. (See 50 U.S.C. App.2091 for statutory limitations and exceptions concerning the authorization of loan guarantee amounts and the use of loan guarantees for the prevention of insolvency or bankruptcy.)

(b) The guarantee *shall* be for less than 100 percent of the loan unless the agency determines that-

(1) The circumstances are exceptional;

(2) The operations of the contractor are vital to the *national defense*; and

(3) No other suitable means of financing are available.

(c) Loan guarantees are not issued to other agencies of the Government.

(d) *Guaranteed loans* are essentially the same as conventional loans made by private financial institutions, except that the *guaranteeing agency* is obligated, on demand of the lender, to purchase a stated percentage of the loan and to share any losses in the amount of guaranteed percentage. It is the responsibility of the private financial institution to disburse and collect funds and to administer the loan. Under Regulation V of the *Federal Reserve Board* (12 CFR245), any private financing institution *may* submit an application to the Federal Reserve Bank of its district for guarantee of a loan or credit.

(e) Federal Reserve Banks will make the loan guarantee agreements on behalf of the *guaranteeing agencies*.

(f) Under Section 302(c) of Executive Order 10480, August 14,1953 (3 CFR1949-53), as amended, all actions and operations of Federal Reserve Banks, as fiscal agents, are subject to the supervision of the *Federal Reserve Board*. The *Federal Reserve Board* is authorized to prescribe the following, after consultation with the heads of *guaranteeing agencies*:

(1) Regulations governing the actions and operations of fiscal agents.

(2) Rates of interest, guarantee and commitment fees, and other charges that *may* be made for loans, discounts, advances, or commitments guaranteed by the *guaranteeing agencies* through the Federal Reserve Banks. These prescriptions *may* be in the form of specific rates or limits, or in other forms.

(3) Uniform forms and procedures to be used in connection with the guarantees.

(g) The *guaranteeing agency* is responsible for certifying eligibility for the guarantee and fixing the maximum dollar amount and maturity date of the *guaranteed loan* to meet the contractor's requirement for financing performance of the defense production contract on hand at the time the

guarantee application is submitted.

## **32.304 Procedures.**

### **32.304-1 Application for guarantee.**

(a) A contractor, subcontractor, or supplier that needs operating funds to perform a contract related to *national defense* may apply to a financing institution for a loan. If the financing institution is willing to extend credit, but considers a Government guarantee necessary, the institution *may* apply to the Federal Reserve Bank of its district for the guarantee. Application forms and guidance are available at all Federal Reserve Banks.

(b) The Federal Reserve Bank will promptly send a copy of the application, including a list of the relevant defense contracts held by the contractor, to the *Federal Reserve Board*. The Board will transmit the application and the list of contracts to the interested *guaranteeing agency*, so that the agency can determine the eligibility of the contractor.

(c) To expedite the process, the Federal Reserve Bank *may*, pursuant to instructions of a *guaranteeing agency*, submit lists of the defense contracts to the interested *contracting officers*.

(d) While eligibility is being determined, the Federal Reserve Bank will make any necessary credit investigations to supplement the information furnished by the applicant financing institution in order to-

(1) Expedite necessary defense financing; and

(2) Protect the Government against monetary loss.

(e) The Federal Reserve Bank will send its report and recommendation to the *Federal Reserve Board*. The Board will transmit them to the interested *guaranteeing agency*.

### **32.304-2 Certificate of eligibility.**

(a) The *contracting officer* shall prepare the certificate of eligibility for a contract that the *contracting officer* deems to be of material consequence, when-

(1) The contract financing office requests it;

(2) Another interested agency requests it; or

(3) The application for a loan guarantee relates to a contract or subcontract within the cognizance of the *contracting officer*.

(b) The agency *shall* evaluate the relevant data, including the certificate of eligibility, the accompanying data, and any other relevant information on the contractor's financial status and performance, to determine whether authorization of a loan guarantee would be in the Government's interest.

(c) If the contractor has several major *national defense* contracts, it is normally not necessary to

evaluate the eligibility of relatively minor contracts. The determination of eligibility *should* be processed, without delay, based on the preponderance of the amount of the contracts.

(d) The certificate of eligibility *shall* include the following determinations:

(1) The *supplies* or services to be acquired are essential to the *national defense*.

(2) The contractor has the facilities and the technical and management ability required for contract performance.

(3) There is no practicable *alternate* source for the *acquisition* without prejudice to the *national defense*. (This statement *shall* not be included if the contractor is a small business concern.)

(e) The *contracting officer* *shall* consider the following factors in determining if a practicable *alternate* source exists:

(1) Prejudice to the *national defense*, because reletting of a contract with another source would conflict with a major policy on defense *acquisition*; *e.g.*, policies relating to the mobilization base.

(2) The urgency of contract performance schedules.

(3) The technical ability and facilities of other potential sources.

(4) The extent to which other sources would need contract financing to perform.

(5) The willingness of other sources to enter into contracts.

(6) The time and expense involved in repurchasing for contracts or parts of contracts. This *may* include potential *claims* under a *termination for convenience* or delays incident to default at a later date.

(7) The comparative prices available from other sources.

(8) The disruption of established subcontracting arrangements.

(9) Other pertinent factors.

(f) The *contracting officer* *shall* attach sufficient data to the certificate of eligibility to support the determinations made. Available pertinent information *shall* be included on-

(1) The contractor's *past performance*;

(2) The relationship of the contractor's operations to performance schedules; and

(3) Other factors listed in paragraph (e) of this section, if relevant to the case under consideration.

(g) If the *contracting officer* determines that a certificate of eligibility is not justified, the facts and reasons supporting that conclusion *shall* be documented and furnished to the agency contract finance office.

(h) The *guaranteeing agency* *shall* review the proposed guarantee terms and conditions. If they are considered appropriate, the *guaranteeing agency* *shall* complete a standard form of authorization as prescribed by the *Federal Reserve Board*. The agency *shall* transmit the authorization through the *Federal Reserve Board* to the Federal Reserve Bank. The Bank is authorized to execute and deliver

to the financing institution a standard form of guarantee agreement, with the terms and conditions approved for the particular case. The financing institution will then make the loan.

(i) Substantially the same procedure *may* be followed for the application of an *offeror* who is actively negotiating or bidding for a defense contract, except that the guarantee *shall* not be authorized until the contract has been executed.

(j) The *contracting officer* shall report to the agency contract finance office any information about the contractor that would have a potentially adverse impact on a pending guarantee application. The *contracting officer* is not required, however, to initiate any special investigation for this purpose.

(k) With regard to existing contracts, the agency *shall* not consider the percentage of guarantee requested by the financing institution in determining the contractor's eligibility.

### **32.304-3 Asset formula.**

(a) Under *guaranteed loans* made primarily for working capital purposes, the agency *shall* normally limit the guarantee, by use of an asset formula, to an amount that does not exceed a specified percentage (90 percent or less) of the contractor's investment (*e.g.*, payrolls and inventories) in defense production contracts. The asset formula *may* include all items under defense contracts for which the contractor would be entitled to payment on performance or termination. The formula *shall* exclude-

- (1) Amounts for which the contractor has not done any work or made any expenditure;
- (2) Amounts that would become due as the result of later performance under the contracts; and
- (3) Cash collateral or bank deposit balances.

(b) Progress payments are deducted from the asset formula.

(c) The agency *may* relax the asset formula to an appropriate extent for the time actually necessary for contract performance, if the contractor's working capital and credit are inadequate.

### **32.304-4 Guarantee amount and maturity.**

The agency *may* change the guarantee amount or maturity date, within the limitations at [32.304-3](#), as follows:

(a) If the contractor enters into additional defense production contracts after the application for, but before authorization of, a guarantee, the agency *may* adjust the loan guarantee amount or maturity date to meet any significant increase in financing need.

(b) If the contractor enters into defense production contracts during the term of the *guaranteed loan*, the parties *may* adjust the existing guarantee agreement to provide for financing the new contracts. Pertinent information and the Federal Reserve Bank reports will be submitted to the *guaranteeing agency* under the procedures for the original guarantee application, described in [32.304-1](#). Normally, a new certificate of eligibility is required.

### **32.304-5 Assignment of claims under contracts.**

(a) The agency *shall* generally require a contractor that is provided a *guaranteed loan* to execute an *assignment of claims* under defense production contracts (including any contracts entered into during the term of the *guaranteed loan* that are eligible for financing under the loan); however, the agency need not require assignment if any of the following conditions are present:

(1) The contractor's financial condition is so strong that the protection to the Government provided by an *assignment of claims* is unnecessary.

(2) In connection with the *assignment of claims* under a major contract, the increased protection of the loan that would be provided by the assignments under additional, relatively smaller contracts is not considered necessary by the agency.

(3) The *assignment of claims* would create an administrative burden disproportionate to the protection required; *e.g.*, if the contractor has a large number of contracts with individually small dollar amounts.

(b) The contractor *shall* also execute an *assignment of claims* if requested to do so by the guarantor or the financing institution.

(c) A subcontract or *purchase order* issued to a subcontractor *shall* not be considered eligible for financing under *guaranteed loans* when the issuer of the subcontract or *purchase order* reserves-

(1) The privilege of making payments directly to the assignor or to the assignor and assignee jointly, after notice of the assignment, or

(2) The right to reduce or set off assigned proceeds under defense production contracts by reason of *claims* against the *borrower* arising after notice of assignment and independently of defense production contracts under which the *borrower* is the seller.

### **32.304-6 Other collateral security.**

The following are examples of other forms of security that, although seldom invoked under *guaranteed loans*, may be required when considered necessary for protection of the Government interest:

(a) Mortgages on fixed assets.

(b) Liens against inventories.

(c) Endorsements.

(d) Guarantees.

(e) Subordinations or standbys of other indebtedness.

### **32.304-7 Contract surety bonds and loan guarantees.**

(a) Contract *surety* bonds are incompatible with the Government's interests under *guaranteed loans*, unless the interests of the *surety* are subordinated to the *guaranteed loan*.

(b) If a substantial share of the contractor's defense contracts are covered by *surety* bonds, or the amount of the bond is substantial in relation to the contractor's net worth, the agency *shall* not authorize the guarantee of a loan on a bonded contract unless the *surety* enters into an agreement with the financing institution to subordinate the *surety's* rights and *claims* in favor of the *guaranteed loan*.

(c) The agency approval of a guarantee for a loan involving relatively substantial subcontracts covered by *surety* bonds *shall* also depend on the establishment of a reasonable allocation agreement between the *sureties* and the financing institution. The agreement *should* give the financing institution the benefit, with regard to payments to be made on the contract, of the portion of its loans fairly attributable to expenditures made under the bonded subcontracts before notice of default.

### **32.304-8 Other borrowing.**

(a) Because of the limitations under *guaranteed loans*, some contractors seek to supplement the loan by other borrowing (outside the guarantee) from the financing institution or other sources. It has been recognized in practice that, while prohibition of borrowings outside the *guaranteed loan* is preferable when practicable in a given V-loan case, such other borrowings *should* be permitted when necessary.

(b) If the agency consents to the contractor obtaining other borrowing during the *guaranteed loan* period, the agency *shall* apply the following restrictions:

(1) A reasonable limit on the amount of other borrowing.

(2) If guaranteed and unguaranteed loans are made by the same financing institution, a requirement that any collateral security requested by the institution under the unguaranteed loan is also to be secondary collateral for the *guaranteed loan*.

(3) A requirement that the contractor provide appropriate documentation to the *guaranteeing agency*, at intervals not longer than 30 days, to disclose outstanding unguaranteed borrowings.

### **32.305 Loan guarantees for terminated contracts.**

(a) The purpose of *guaranteed loans*; *i.e.*, to provide for financing based on the *borrower's* recoverable investment in defense production contracts, *may* also apply to contracts that have been terminated (partially or totally) for the convenience of the Government. *Guaranteed loans* also *may* be made before such termination if it is known that termination of particular contracts for the convenience of the Government is about to occur. These loans are expected to provide necessary financing pending termination settlements and payments. They *may* also finance continuing performance of defense production contracts that are eligible for *guaranteed loans*.

(b) The procedure for such guarantees is substantially the same as that outlined in [32.304](#), except that certificates of eligibility are not required for (1) contracts that have been totally terminated or (2) the terminated portion of contracts that have been partially terminated. The agency *shall* take

precautions necessary to avoid Government losses and to ensure the loans will be self-liquidating from the proceeds of defense production contracts.

(c) Loan guarantees for contract termination financing *shall* not be provided before specific contract terminations are certain.

### **32.306 Loan guarantees for subcontracts.**

If the request for a loan guarantee concerns a subcontractor that is financially weak in comparison with its contractor, the Government's interests *may* be fostered by the contractor making progress payments to the subcontractor. If so, the agency *shall* try to arrange for the contractor to provide the progress payments. As a result, the need for the loan guarantee *may* be reduced or eliminated and the contractor would bear part or all of the risk of loss arising from the selection of the subcontractor.