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Type: Banking Circular

Subject: Exception to Lending Limits for
OPIC Insured Standby Letters of
Credit Issued by National Banks

To: All Presidents of National Banks, Regional Administrators, and Examining Personnel

Subject: Exception to Lending Limits for OPIC Insured Standby Letters of Credit Issued by
National Banks

There is attached for your information a copy of our letter dated September 24, 1976 to Mr. Hilliard A. Zola, Vice President for Insurance, Overseas Private Investment Corporation, and other related correspondence, regarding the conditions under which OPIC insured standby letters of credit are exempted from the legal lending limit pursuant to Interpretive Ruling 7.1160 (c)(3) [12 CFR 7.1160 (c)(3)].

Robert Bloom
Acting Comptroller of the Currency

Attachment



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

September 24, 1976

Mr. Hilliard Zola
Vice President for Insurance
Overseas Private Investment Corp.
1129 20th Street, N.W.
Washington, D.C. 20527

Dear Mr. Zola:

This is in response to your inquiries and those of your staff concerning the Overseas Private Investment Corporation (OPIC) proposal to provide, under certain carefully structured circumstances, political risk insurance for standby letters of credit issued by American banks on behalf of United States construction firms doing business in the Middle East. You have inquired whether the structure of the OPIC proposal would exempt National bank standby letters from the lending limit restrictions normally applicable pursuant to 12 U.S.C. 84 and 12 C.F.R. 7.1160.

I. Background

The huge increase in oil revenues of certain Middle Eastern countries since 1973 has enabled them to commence large internal development programs, including new roads, hospitals, factories, and other components of a modern industrial infrastructure. U. S. construction firms and suppliers have entered the new markets along with their European and Japanese competitors. These contractors are frequently required by the host country to post bid, performance, and advance payment guarantees for each venture or project. The guarantees are a form of insurance for the host country and are similar, in a contractual sense, to "liquidated" damages. Traditionally, Middle East countries have required that such guarantees be issued in the form of bank standby letters of credit or similar instruments. The countries have usually declined to accept surety bonds in lieu of such bank guarantees. Typically, the bank letters of credit vary in amount from 2 percent to 20 percent of the gross contract, provide for guarantee of performance by the contractor, and are treated as loans by the issuing bank.

On July 7, 1976, OPIC announced a proposal to offer political risk insurance for the standby letters of credit in order to "strengthen the position of U. S. contractors in competitive bidding for construction contracts abroad." Under the OPIC proposal, OPIC would insure 90 percent of the letter of credit against arbitrary drawing, thereby removing "the political risk inherent in these transactions and....permit[ing] more U. S. firms to participate in the development of the Middle East. The OPIC announcement also explained that, as a result of OPIC's action, "a number of surety companies have agreed to provide on-demand bonds to collateralize the commercial risk under the letters of credit, thus minimizing the issuing banks' risk and facilitating the issuance of the letters of credit." The July 7 announcement continued:

[T]hese additional services will place U. S. contractors on a more competitive footing with construction firms from other nations which provide a wide variety of incentives for their construction industries, often at concessional terms. Because the U. S. industry had no comparable service available, the U. S. has lost considerable economic advantage; but with this significant reduction of risk, contractors will be able to compete more effectively. With increased U. S. participation in overseas construction projects, the U. S. will benefit from increased exports, the creation of additional U. S. jobs, and will realize other positive contributions to this country's economy.

II. Statutes and Regulations Involved

The letter of credit obligations which national banks may issue under the OPIC proposal are presently curtailed by statute and regulation. 12 U.S.C. 84 generally limits (with exceptions not here pertinent) the total obligations which any "person, co-partner, association, or corporation" may have to a national bank to 10 percent of the bank's capital and unimpaired surplus. Standby letters of credit are treated as loans subject to this legal lending limit and must, therefore, be combined with any other nonexcepted loans to the account party by the issuing bank when applying 12 U.S.C.84. See generally 12 C.F.R. 7.1160. Pursuant to 12 C.F.R. 7.1160(b), however, the lending limit restriction will not be applicable where the "Comptroller of the Currency has found that a particular standby letter of credit or a class of standby letters of credit will not expose the issuer to the similar risk of loss as would a loan to the account party." The applicability of this exception in the circumstances of the OPIC proposal, therefore, depends upon an assessment of the risk to the national bank participant.

III. Details of OPIC Plan

Under the OPIC guarantee/surety proposal, standby letters of credit issued for the account of a U. S. contractor by a bank and payable to the country-beneficiary would be insured against both political and commercial risk. OPIC would cover 90 percent of the political risk while the private surety company would cover 100 percent of the commercial risk. The plan would work as follows:

Bank "A" would issue a standby letter of credit for the account of a contractor ("B") and to beneficiary ("C") (the government of Saudi Arabia, or another country). If "B" should default on its contract (a particular construction or a supply contract) "C" could demand that "A" meet its commitment under the letter of credit. After the bank honors the letter of credit, it would be entitled to reimbursement from the surety, or OPIC, depending upon whether default was caused by the contractor's nonperformance (commercial risk) or was based on political factors such as expropriation, arbitrary national action, war, insurrection, etc.

The question of whether default was political or commercial would be submitted to an impartial arbitrator for decision. OPIC has initially estimated that the determination of default could take up to two years. During the period of the arbitrator's deliberation, the bank would be expected to extend "bridge financing" to the contractor. The contractor would be required to pay interest on this loan.

If the arbitrator has not made a decision as to liability within one year, OPIC would intervene and make a "good faith" determination as to who is liable. If OPIC decided that default was based on political factors, it would reimburse the bank for 90 percent of the letter of credit. If OPIC determined that the default was caused by the nonperformance of the contractor, it would instruct the surety to pay. In such a situation the surety would be required to reimburse the bank for 100 percent of the letter of credit.

The arbitrator's final decision may be contrary to OPIC's "good faith" determination. Under such circumstances, if the arbitrator determined that political risk is the reason for default and OPIC had previously decided that the contractor's nonperformance was the cause, the bank would be required to reimburse the surety 100 percent of the original payment. If the situation were reverse the bank would be entitled to full reimbursement from the surety.

The only surety companies eligible for participation in the OPIC plan are those selected from a Treasury Department list of firms carefully screened for their underwriting capability. Treasury Circular 570. This list is public information which is disclosed on a semi-annual basis in the Federal Register. The current list is found at 41 Federal Register No. 132 (July 8, 1976).

IV. Conditional Availability of Exception to Lending Limits Pursuant to 12 C.F.R. 7.1160 (c) (3).

Based upon the information outlined above and additional information furnished during discussions among our respective staffs, I have concluded pursuant to 12 C.F.R. 7.1160(c)(3) that standby letters of credit issued by national bank participants in the OPIC Plan will not be subject to the lending limit restrictions of 12 U.S.C. ss84 provided that the following conditions are met:

1. Bridge loan financing by a participant national bank may not exceed 12 months.
2. The account party must agree that in the event of a drawing under a standby letter of credit, i.e., the creation of a "bridge loan," the account party will reduce its non-expected

obligations to the financing bank to the extent necessary to permit funding of the bridge loan within the bank's legal lending limit.

The granting of this exemption is based on our considered judgment that the OPIC Plan gives bank standby letters of credit issued under it certain unique aspects which make it clear that such letters will not expose the issuer to the same risk of loss as a loan. Particularly significant in that regard are the guarantee by a United States Government agency and the backing of surety companies specifically approved by the United States Treasury Department. Notwithstanding the impact of these government and private guarantees upon the risk factor, however, we have concluded that the additional conditions stated above are necessary in order to insure that all national banks as well as contractor-account parties who may participate in a number of these OPIC-guaranteed arrangements remain fully conscious of the lending limit problem which could be created if a bank were called upon to fund several standby letters of credit simultaneously. In effect, we shall expect national banks and participating contractors alike to provide adequate in-house margins to insure that such circumstances do not occur.

I trust that this has been responsive to your inquiries. If you have further questions, please feel free to discuss them with my staff.

Very truly yours,

Robert Bloom
Acting Comptroller of the Currency

OVERSEAS
PRIVATE
INVESTMENT
CORPORATION

[OPIC Logo
not available
electronically]

September 29, 1976

Mr. Robert Bloom
Acting Comptroller of the Currency
490 L'Enfant Plaza East, SW
Washington, DC 20219

Dear Mr. Bloom:

Thank you very much for your prompt cooperation and that of your staff in replying to OPIC's inquiry concerning its plan to offer political risk insurance for standby letters of credit issued by American banks on behalf of United States construction firms doing business abroad.

Your letter of September 24, 1976, describes the circumstances under which such letters of credit, backed by OPIC insurance as to political risk and a commercial surety's bond as to the contractor's nonperformance, will, pursuant to 12 CFR 7.1160 (b), not be treated as loans to the contractor that are subject to the legal lending limit.

Because OPIC will want to show your letter to United States banks that may issue such letters of credit on behalf of contractors, we thought it might be desirable to clarify our mutual understanding concerning the details of OPIC's plan, as described on page 3 of your letter. Accordingly, OPIC would greatly appreciate your confirmation that your advice was predicated on your understanding of the following details:

1. OPIC's insurance would cover 90% of the amount of any drawing of the letter of credit that was not based on the contractor's non-performance of its obligations under the construction contract, i. e., that was due to "political risk". The surety's bond would cover 100% of any drawing based on the contractor's non-performance, including insolvency.
2. If there should be a question as to whether a drawing of the letter of credit was based on non-performance or was a "political risk" covered by the OPIC insurance, the resolution would be based on the dispute-resolving mechanism specified in the underlying construction contract or in the letter of credit, if the letter contained such a provision.
3. If, due to a delay in the dispute-resolving mechanism,

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mination as to whether a drawing was "political" or due to contractor's non-performance, OPIC would make such determination based on its knowledge and understanding of the circumstances and would not become a party to, or participate in any way in, the adjudicatory proceeding required by the contractual dispute-resolving mechanism. OPIC (as to 90%) and the contractor (as to 10%) or the surety (as to 100%) would reimburse the bank in accordance with OPIC's determination. Of course, if the subsequent decision under the dispute-resolving mechanism should be inconsistent with that determination, OPIC, the contractor and the surety would adjust matters so that the ultimate payment burden was consistent with the adjudicatory decision.

Thank you again for your helpful and prompt response.

Sincerely yours,

Hilliard A. Zola
Vice President for Insurance

cc: Mr. John Shockey
Deputy General Counsel
Office of the Comptroller of the Currency



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

October 4, 1976

Mr. Hilliard A. Zola
Vice President for Insurance
Overseas Private Investment Corp.
1129 - 20th Street, N.W.
Washington, D.C. 20527

Dear Mr. Zola:

This is to acknowledge your letter dated September 29, 1976, to Mr. Robert Bloom, Acting Comptroller of the Currency. Your letter acknowledges receipt of a ruling dated September 24, 1976, copy enclosed, by the Comptroller of the Currency granting, pursuant to 12 C.F.R. 7.1160(c) (3) an exception to the lending limits for certain types of standby letters of credit issued by American banks on behalf of United States construction firms doing business abroad.

Your letter sets forth your understanding of certain details of the Comptroller's description of the approved arrangements. Specifically, you ask that we confirm that the ruling was predicted, inter alia, on our understanding of the following details:

1. OPIC's insurance would cover 90% of the amount of any drawing of the letter of credit that was not based on the contractor's non-performance of its obligations under the construction contract, i.e., that was due to "political risk." The surety's bond would cover 100% of any drawing based on the contractor's non-performance, including insolvency.
2. If there should be a question as to whether a drawing of the letter of credit was based on non-performance or was a "political risk" covered by the OPIC insurance, the resolution would be based on the dispute-resolving mechanism specified in the underlying construction contract or in the letter of credit, if the letter contained such a provision.
3. If, due to delay in the dispute-resolving mechanism, OPIC had to make an interim "good faith" determination as to whether a drawing was "political" or due to the contractor's nonperformance, OPIC would make such determination based on its knowledge and

understanding of the circumstances and would not become a party to, or participate in any way in, the adjudicatory proceeding required by the contractual dispute-resolving mechanism. OPIC (as to 90%) and the contractor (as to 10%) or the surety (as to 100%) would reimburse the bank in accordance with OPIC's determination. Of course, if the subsequent decision under the dispute-resolving mechanism should be inconsistent with that determination, OPIC, the contractor and the surety would adjust matters so that the ultimate payment burden was consistent with the adjudicatory decision.

The above description of certain details of the approved arrangement is in accord with our understanding and is fully within the ambit of the approval stated in the Acting Comptroller's letter of September 24.

Sincerely,

John E. Shockey
Acting Chief Counsel

Enclosure



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

September 24, 1976

Mr. Hilliard Zola
Vice President for Insurance
Overseas Private Investment Corp.
1129 20th Street, N.W.
Washington, D.C. 20527

Dear Mr. Zola:

This is in response to your inquiries and those of your staff concerning the Overseas Private Investment Corporation (OPIC) proposal to provide, under certain carefully structured circumstances, political risk insurance for standby letters of credit issued by American banks on behalf of United States construction firms doing business in the Middle East. You have inquired whether the structure of the OPIC proposal would exempt National bank standby letters from the lending limit restrictions normally applicable pursuant to 12 U.S.C. 84 and 12 C.F.R. 7.1160.

I. Background

The huge increase in oil revenues of certain Middle Eastern countries since 1973 has enabled them to commence large internal development programs, including new roads, hospitals, factories, and other components of a modern industrial infrastructure. U. S. construction firms and suppliers have entered the new markets along with their European and Japanese competitors. These contractors are frequently required by the host country to post bid, performance, and advance payment guarantees for each venture or project. The guarantees are a form of insurance for the host country and are similar, in a contractual sense, to "liquidated" damages. Traditionally, Middle East countries have required that such guarantees be issued in the form of bank standby letters of credit or similar instruments. The countries have usually declined to accept surety bonds in lieu of such bank guarantees. Typically, the bank letters of credit vary in amount from 2 percent to 20 percent of the gross contract, provide for guarantee of performance by the contractor, and are treated as loans by the issuing bank.

On July 7, 1976, OPIC announced a proposal to offer political risk insurance for the standby letters of credit in order to "strengthen the position of U. S. contractors in competitive bidding for construction contracts abroad." Under the OPIC proposal, OPIC would insure 90 percent of the letter of credit against arbitrary drawing, thereby removing "the political risk inherent in these transactions and....permit[ing] more U. S. firms to participate in the development of the Middle East. The OPIC announcement also explained that, as a result of OPIC's action, "a number of surety companies have agreed to provide on-demand bonds to collateralize the commercial risk under the letters of credit, thus minimizing the issuing banks' risk and facilitating the issuance of the letters of credit." The July 7 announcement continued:

[T]hese additional services will place U. S. contractors on a more competitive footing with construction firms from other nations which provide a wide variety of incentives for their construction industries, often at concessional terms. Because the U. S. industry had no comparable service available, the U. S. has lost considerable economic advantage; but with this significant reduction of risk, contractors will be able to compete more effectively. With increased U. S. participation in overseas construction projects, the U. S. will benefit from increased exports, the creation of additional U. S. jobs, and will realize other positive contributions to this country's economy.

II. Statutes and Regulations Involved

The letter of credit obligations which national banks may issue under the OPIC proposal are presently curtailed by statute and regulation. 12 U.S.C. 84 generally limits (with exceptions not here pertinent) the total obligations which any "person, co-partner, association, or corporation" may have to a national bank to 10 percent of the bank's capital and unimpaired surplus. Standby letters of credit are treated as loans subject to this legal lending limit and must, therefore, be combined with any other nonexcepted loans to the account party by the issuing bank when applying 12 U.S.C.84. See generally 12 C.F.R. 7.1160. Pursuant to 12 C.F.R. 7.1160(b), however, the lending limit restriction will not be applicable where the "Comptroller of the Currency has found that a particular standby letter of credit or a class of standby letters of credit will not expose the issuer to the similar risk of loss as would a loan to the account party." The applicability of this exception in the circumstances of the OPIC proposal, therefore, depends upon an assessment of the risk to the national bank participant.

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Bank "A" would issue a standby letter of credit for the account of a contractor ("B") and to beneficiary ("C") (the government of Saudi Arabia, or another country). If "B" should default on its contract (a particular construction or a supply contract) "C" could demand that "A" meet its commitment under the letter of credit. After the bank honors the letter of credit, it would be entitled to reimbursement from the surety, or OPIC, depending upon whether default was caused by the contractor's nonperformance (commercial risk) or was based on political factors such as expropriation, arbitrary national action, war, insurrection, etc.

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If the arbitrator has not made a decision as to liability within one year, OPIC would intervene and make a "good faith" determination as to who is liable. If OPIC decided that default was based on political factors, it would reimburse the bank for 90 percent of the letter of credit. If OPIC determined that the default was caused by the nonperformance of the contractor, it would instruct the surety to pay. In such a situation the surety would be required to reimburse the bank for 100 percent of the letter of credit.

The arbitrator's final decision may be contrary to OPIC's "good faith" determination. Under such circumstances, if the arbitrator determined that political risk is the reason for default and OPIC had previously decided that the contractor's nonperformance was the cause, the bank would be required to reimburse the surety 100 percent of the original payment. If the situation were reverse the bank would be entitled to full reimbursement from the surety.

The only surety companies eligible for participation in the OPIC plan are those selected from a Treasury Department list of firms carefully screened for their underwriting capability. Treasury Circular 570. This list is public information which is disclosed on a semi-annual basis in the Federal Register. The current list is found at 41 Federal Register No. 132 (July 8, 1976).

IV. Conditional Availability of Exception to Lending Limits Pursuant to 12 C.F.R. 7.1160 (c) (3).

Based upon the information outlined above and additional information furnished during discussions among our respective staffs, I have concluded pursuant to 12 C.F.R. 7.1160(c)(3) that standby letters of credit issued by national bank participants in the OPIC Plan will not be subject to the lending limit restrictions of 12 U.S.C. ss84 provided that the following conditions are met:

1. Bridge loan financing by a participant national bank may not exceed 12 months.
2. The account party must agree that in the event of a drawing under a standby letter of credit, i.e., the creation of a "bridge loan," the account party will reduce its non-expected obligations to the financing bank to the extent necessary to permit funding of the bridge loan within the bank's legal lending limit.

The granting of this exemption is based on our considered judgment that the OPIC Plan gives bank standby letters of credit issued under it certain unique aspects which make it clear that such

letters will not expose the issuer to the same risk of loss as a loan. Particularly significant in that regard are the guarantee by a United States Government agency and the backing of surety companies specifically approved by the United States Treasury Department. Notwithstanding the impact of these government and private guarantees upon the risk factor, however, we have concluded that the additional conditions stated above are necessary in order to insure that all national banks as well as contractor-account parties who may participate in a number of these OPIC-guaranteed arrangements remain fully conscious of the lending limit problem which could be created if a bank were called upon to fund several standby letters of credit simultaneously. In effect, we shall expect national banks and participating contractors alike to provide adequate in-house margins to insure that such circumstances do not occur.

I trust that this has been responsive to your inquiries. If you have further questions, please feel free to discuss them with my staff.

Very truly yours,

Robert Bloom
Acting Comptroller of the Currency

OVERSEAS
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[OPIC Logo
not available
electronically]

September 29, 1976

Mr. Robert Bloom
Acting Comptroller of the Currency
490 L'Enfant Plaza East, SW
Washington, DC 20219

Dear Mr. Bloom:

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Because OPIC will want to show your letter to United States banks that may issue such letters of credit on behalf of contractors, we thought it might be desirable to clarify our mutual understanding concerning the details of OPIC's plan, as described on page 3 of your letter. Accordingly, OPIC would greatly appreciate your confirmation that your advice was predicated on your understanding of the following details:

1. OPIC's insurance would cover 90% of the amount of any drawing of the letter of credit that was not based on the contractor's non-performance of its obligations under the construction contract, i. e., that was due to "political risk". The surety's bond would cover 100% of any drawing based on the contractor's non-performance, including insolvency.

2. If there should be a question as to whether a drawing of the letter of credit was based on non-performance or was a "political risk" covered by the OPIC insurance, the resolution would be based on the dispute-resolving mechanism specified in the underlying construction contract or in the letter of credit, if the letter contained such a provision.

3. If, due to a delay in the dispute-resolving mechanism,

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Thank you again for your helpful and prompt response.

Sincerely yours,

Hilliard A. Zola
Vice President for Insurance

cc: Mr. John Shockey
Deputy General Counsel
Office