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THE WORLD BANK  
Washington, D.C.


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The World Bank  
1818 H Street NW  
Washington DC 20433  
Telephone: 202-473-1000  
Internet: [www.worldbank.org](http://www.worldbank.org)


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L.B. Rist : Loan Policy

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Leonard B. Rist - Loan Policy - Correspondence - Volume 5

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INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

CONFIDENTIAL

R - 257

**DECLASSIFIED**

Date: 11/15/2010 STB

(To be submitted to the  
Executive Directors on  
October 25, 1949, for  
approval.)

October 20, 1949

FROM: The Secretary

AGREEMENTS TO REIMBURSE FOR PAYMENTS MADE  
UNDER LETTERS OF CREDIT

In accordance with Section 5 of Article III of the Articles of Agreement and as part of the Bank's procedure for the disbursement of loans, the Treasurer's Department has developed and has been using a procedure for depositing collateral to secure letters of credit opened through commercial banks for the purpose of purchasing goods to be financed out of the proceeds of loans made by the Bank. When this procedure is followed the amount of collateral so deposited is charged to the Borrower as a withdrawal from the Loan Account, thus requiring the Borrower to pay full interest and commission on that amount from the date of deposit.

Loan Agreements heretofore entered into permit the use of an alternative procedure to accomplish the same result. The Bank may agree with banking institutions through which letters of credit are opened to reimburse them for any payments made under such letters of credit. The use of this procedure rather than the procedure of depositing collateral would result in savings to the Borrower. No withdrawal would be made from the Loan Account until actual reimbursement by the Bank. Hence, for the period from the opening of the letter of credit to the



time of such reimbursement, the Borrower would pay only the commitment charge under the Loan Agreement instead of full interest and commission. A number of the Bank's Borrowers have expressed an interest in the establishment of such a procedure by the Bank.

During the past several months the Treasurer's Department, in cooperation with the Committee on Foreign Banking representing leading commercial banks in the United States, has worked out a mutually satisfactory procedure which, together with the forms of applications and agreements to be used in connection therewith, is set forth in the attached group of documents entitled Outline of Procedure to be Followed in Issuing Agreements to Reimburse for Payments Made under Letters of Credit.

It is anticipated that one or more Borrowers will soon wish to avail themselves of the new procedure and commercial banks in the United States are prepared to put it into effect. Before doing so, however, they have asked to be furnished with evidence, in the form of a certified copy of a resolution of the Executive Directors, of the authority of the officers of the Bank to sign the Agreements to Reimburse (Form G 6) contemplated by the Outline of Procedure. This request appears reasonable to the Staff and accordingly there is circulated herewith, for consideration of the Executive Directors, a draft resolution authorizing such signature by the President, the Vice President, the Treasurer or the Assistant Treasurer.

Distribution:

Executive Directors and Alternates  
President  
Vice President  
Department Heads



INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Treasurer's Department  
FOL- Disbursements

Outline of Procedure to be Followed in Issuing  
Agreements to Reimburse for Payments  
Made under Letters of Credit

1. The Commercial Bank in the United States receives instructions from its foreign correspondent to open a letter of credit which the International Bank for Reconstruction and Development is to be requested to agree to reimburse. The Commercial Bank will apply to the International Bank for the requisite forms.

2. The Commercial Bank sends to the Borrower's representative two copies of the proposed letter of credit with a request for an agreement by the International Bank to reimburse the Commercial Bank for payments to be made under said letter of credit (Form G.1 "Bank's Request for Agreement to Reimburse").

3. The Borrower's representative sends to the International Bank the Bank's Request for Agreement to Reimburse, with the two copies of the proposed letter of credit and an Application for an Agreement to Reimburse (Forms G.4 and G.4a). In the Application the Borrower will, among other things, authorize and request the International Bank to pay to the Commercial Bank from time to time, as withdrawals from the Loan Account, such amounts as shall be required to reimburse the Commercial Bank for payments made by it under the letter of credit.

4. The International Bank returns one copy of the proposed letter of credit to the Commercial Bank with an original and duplicate Agreement to Reimburse (Form G.6) for the Commercial Bank's acceptance. One copy of this Agreement to Reimburse is sent to the Borrower's representative.

5. Promptly after each payment under the letter of credit, the Commercial Bank notifies the International Bank by sending a "Bank's Report of Payment and Request for Reimbursement" (Form G.3) with supporting documents attached.

A copy of the Bank's Report of Payment and Request for Reimbursement is sent by the Commercial Bank to the Borrower's representative.

6. The International Bank makes payment directly to the Commercial Bank, at the same time notifying the Borrower's representative of the debit to the Loan Account.

7. If an amendment of the letter of credit is requested, (a) the Commercial Bank sends to the Borrower's representative two copies of the proposed amendment with a request for approval thereof by the International Bank (Form G.2 "Bank's Request for Approval of Amendment of Letter of Credit"); (b) the Borrower's representative sends such request to the International Bank with the two copies of the proposed amendment and a "Borrower's Application for Approval of Amendment of Letter of Credit" (Form G.5); and (c) the International Bank returns one copy of the proposed amendment to the Commercial Bank with one copy of "Approval of Amendment of Letter of Credit" (Form G.7) signed by the International Bank, sending a copy to the Borrower's representative.



FORM G.1

Serial No.....  
(Not to be filled out by Commercial  
Bank)

BANK'S REQUEST FOR AGREEMENT TO REIMBURSE

Date.....  
Our Letter of Credit No.....  
Loan Symbol.....

To:.....  
(Name of Borrower's Representative)  
.....  
.....(Address).....

This is to advise you that our correspondent.....  
has informed us that it has established a documentary Credit No.....  
for account of.....(Name and Address of Purchaser).....  
and has requested us to advise and confirm said Credit in the amount of\$.....  
in favor of .....(Name and Address of Supplier)  
relating to .....(Description of Merchandise)  
expiring on .....

Pursuant to arrangements made with said correspondent, we require an  
agreement by International Bank for Reconstruction and Development to reimburse  
us for payments which shall be made by us under said Credit. Upon receipt of  
such agreement in form satisfactory to us we will advise and irrevocably con-  
firm said Credit.

In the meantime, pending the receipt of the necessary agreement, we are  
enclosing herewith two copies of our proposed Letter of Credit for submission  
to the International Bank for Reconstruction and Development.

Very truly yours,

.....(Commercial Bank).....

By .....  
(Authorized Signature)



Serial No .....  
(Not to be filled out by Commercial Bank)

BANK'S REQUEST FOR APPROVAL OF AMMENDMENT OF  
LETTER OF CREDIT

Date.....  
Our Letter of Credit No.....  
Loan Symbol.....

To: .....  
(Name of Borrower's Representative)  
.....  
.....  
(Address)

This is to advise you that our correspondent.....  
..... has requested us to advise and confirm  
an amendment of the above specified letter of credit as follows:

.....  
..... (Date and General Description of the Amendment) .....

In accordance with the Agreement to Reimburse No.....  
of International Bank for Reconstruction and Development, we require the  
written approval by said Bank of such amendment before advising and confirming  
the same and therefore we enclose herewith two copies of the proposed amendment  
for submission to said Bank.

Yours very truly,

.....  
(Commercial Bank)

By .....  
(Authorized Representative)



Serial No.....  
 (Not to be filled in by Commercial  
 Bank)

BANK'S REPORT OF PAYMENT AND REQUEST FOR REIMBURSEMENT

Date.....  
 Our Letter of Credit No.....  
 Loan Symbol.....

To: International Bank for  
 Reconstruction and Development  
 Washington 25, D.C.

We have paid \$..... on ..... to or on the order of  
 .....  
 (Name and Address of Beneficiary)  
 under the above specified letter of credit advised and confirmed by us.

Such payment was made against delivery of documents specified in said letter of credit evidencing

- ☐ shipment of the merchandise specified below per R.R.....  
 from..... to.....; or  
☐ shipment of said merchandise per S.S.....  
 from..... to .....B/L #.....  
 dated.....; or  
☐ storage of said merchandise at .....; or  
☐ .....

Merchandise.....

Said documents have been disposed of as follows:

Copy of the supplier's invoice is attached.

Such payment was made in accordance with the terms of said letter of credit as set forth in the copy thereof enclosed with your Agreement to Reimburse No..... and amendments thereof, if any, approved in writing by you. We request reimbursement of the above amount pursuant to said Agreement to Reimburse.

Very truly yours,

.....  
 (Commercial Bank)

By .....  
 (Authorized Signature)



BORROWER'S APPLICATION FOR AGREEMENT(S) TO  
REIMBURSE AND FOR WITHDRAWALS PURSUANT  
THERE TO

(United States Dollars)

To: International Bank for  
 Reconstruction and Development  
 Washington 25, D.C.

Date .....

Loan No. ....

Application Serial No. ....

Pursuant to the Loan Agreement dated ..... between the  
 International Bank for Reconstruction and Development (hereinafter called the  
 Bank) and ..... (hereinafter called the Borrower) the  
 Borrower hereby certifies and agrees as follows:

1. In accordance with the request(s) by .....  
 (Commercial Bank)  
 (hereinafter called the Commercial Bank) annexed to the attached summary  
 sheet(s), the Borrower requests the Bank to issue an Agreement to Reimburse  
 to the Commercial Bank whereby the Bank shall agree, on such terms and  
 conditions as it shall deem appropriate, to reimburse the Commercial Bank  
 for payments which shall be made by the Commercial Bank under each letter  
 of credit specified in such summary sheet(s) as the same shall be amended  
 from time to time with the written approval of the Bank.
2. The Borrower hereby irrevocably authorizes and requests the Bank to pay  
 to the Commercial Bank from time to time, as withdrawals from the Loan  
 Account, such amounts as shall be requested by the Commercial Bank to  
 reimburse it for payments which shall be made by it under said letter (s)  
 of credit as the same shall be amended from time to time. The Bank may  
 conclusively rely on any written statement by the Commercial Bank that any  
 payment has been made by it under and in accordance with the terms of a  
 designated letter of credit and amendments, if any, thereto.
3. Said amounts are required to enable the Borrower to meet payments to be  
 made in said currency as set forth in such summary sheet (s).
4. The Borrower has not heretofore withdrawn from the Loan Account or  
 applied for the withdrawal from the Loan Account of any amount for the  
 purpose of reimbursing the Borrower for or meeting such payments and has  
 not obtained and will not obtain funds for such purposes out of the  
 proceeds of any other loan, credit or grant available to it.



5. Such payments will be made for the purposes specified in Article III of said Loan Agreement; the goods purchased or to be purchased by means of such payments are appropriate for such purposes; and the cost and terms of purchase thereof are reasonable.

6. At the date of this application there is no existing default in the performance of any of the obligations of the Borrower under said Loan Agreement or of the Guarantor under the Guarantee Agreement referred to therein.

7. For the purposes of Section 2(b) of Article II of said Loan Agreement, the obligation of the Bank under such Agreement(s) to Reimburse shall not be deemed to terminate

(a) with respect to any amount of any such letter of credit which shall be cancelled, until the date of receipt by the Bank of written notice from the Commercial Bank specifying the amount of such cancellation; or

(b) with respect to any unused balance under any such letter of credit upon final payment thereunder or upon the expiration thereof, until the date of receipt by the Bank of written notice from the Commercial Bank specifying the amount of such unused balance.

8. The Borrower agrees that no cancellation or suspension pursuant to Section 6, 7 or 8 of Article IV of such Loan Agreement shall, unless the Bank and the Borrower shall otherwise agree in writing, be effective with respect to any part of the Loan as to which the Bank shall have issued an Agreement to Reimburse pursuant to this application.

This application consists of this page and ..... signed and numbered summary sheet(s).

.....  
(Borrower)

By.....  
(Authorized Representative)







BORROWER'S APPLICATION FOR APPROVAL OF AMENDMENT  
OF LETTER OF CREDIT

Date .....

Letter of Credit No. ....

Application Serial No. ....

Loan Symbol .....

To: International Bank for Reconstruction  
and Development  
Washington 25, D.C.

There is forwarded herewith a request dated .....  
by ..... for your written approval of a  
(Commercial Bank)  
proposed amendment dated ..... of the above letter of credit,  
together with two copies of the proposed amendment.

The undersigned hereby requests that you confirm directly to the said  
Commercial Bank your approval of such proposed amendment.

.....  
(Borrower)

By .....  
(Authorized Representative)



## No. . . . .

Gentlemen:

At the request of ... (Borrower) .....

This agreement is subject to the following terms and conditions:

- Please confirm your acceptance of this agreement on the foregoing terms and conditions by signing the form of acceptance on the enclosed copy of this letter and returning it to us .

INTERNATIONAL BANK FOR RECONSTRUCTION  
AND DEVELOPMENT

### Form of Acceptance

(Commercial Bank)

Date.....



FORM G.7

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

APPROVAL OF AMENDMENT OF LETTER OF CREDIT

NO.....

Date.....

Your Letter of Credit No.....

Application Serial No.....

Loan Symbol.....

To: ..... (Commercial Bank) .....  
 .....  
 ..... (Address) .....

We hereby confirm our approval, for the purposes of our Agreement to Reimburse No....., of proposed amendment dated..... of the above letter of credit, in accordance with the copy of said amendment annexed hereto.

INTERNATIONAL BANK FOR RECONSTRUCTION  
AND DEVELOPMENT

By

(Treasurer



DRAFT RESOLUTION NO.

Authorization of President or Vice President or Treasurer or Assistant Treasurer to execute and deliver to banking institutions agreements to reimburse for payments made under Letters of Credit and other documents relating thereto.

RESOLVED:

THAT the President or the Vice President or the Treasurer or the Assistant Treasurer be, and each of them hereby is, authorized in the name and on behalf of the Bank at any time or from time to time (a) to execute and deliver to banking institutions agreements to reimburse such banking institutions for payments made under letters of credit substantially in the form of the form of Agreement to Reimburse which was presented to this meeting with such changes therein as they or any of them shall approve, the execution of any such Agreement to Reimburse by any such officer to be conclusive evidence of his approval of any such changes; and (b) to take any and all such other action and to execute and deliver any and all such other agreements and documents as they, or any of them, shall deem necessary or proper in order to carry fully into effect the purposes of this Resolution.



6. The term "Guarantor" means the member of the Bank which guarantees the Loan provided for in a Loan Agreement. If the only party to a Loan Agreement other than the Bank is a member of the Bank and the Loan provided for in the Loan Agreement is not guaranteed by any other party, references herein to a Guarantor shall be disregarded in so far as concerns such Loan Agreement.

7. The term "Bonds" means bonds or other securities of the Borrower issued to the Bank under a Loan Agreement for all or any part of the Loan provided for therein.

8. The term "member" means a member of the Bank.

9. The term "currency" means such coin or currency of the government referred to, whether or not such government is a member, as at the time referred to is legal tender for the payment of public and private debts in the territories of such government.

10. The term "18% currency" means currency of a member other than the United States of America which, if held by the Bank at the time referred to, would come within the provisions of Section 9(a) of the Articles.

11. The term "dollars" means dollars in such coin or currency of the United States of America as at the time referred to is legal tender for the payment of public and private debts in said United States.

12. The terms "advance" and "advanced" refer to the payment by the Bank of an amount to or on the order of the



Borrower as a withdrawal from the Loan Account pursuant to a Loan Agreement or the incurring by the Bank pursuant to a Loan Agreement of a firm obligation to a person or entity other than the Borrower to pay such amount, whichever shall first occur.

13. The term "book value" as applied to the currency of any member means the rate of exchange of such currency for dollars used by the Bank, as shown on its books, in computing the amount of the payment in such currency which such member last became obligated to make to the Bank under the provisions of Section 7 or Section 9(a) of Article II of the Articles or of the payment in such currency which the Bank last became obligated to make to such member pursuant to the provisions of Section 9(b) of Article II of the Articles, whichever is the latest. The term "book value" as applied to currency of a government which at the time is not a member means the foreign exchange value of such currency in terms of dollars as determined by the Bank.



## ARTICLE II

### INTRODUCTORY PROVISIONS

1. Section 9 of Article II of the Articles provides as follows:

(a) Whenever (i) the par value of a member's currency is reduced, or (ii) the foreign exchange value of a member's currency has, in the opinion of the Bank, depreciated to a significant extent within that member's territories, the member shall pay to the Bank within a reasonable time an additional amount of its own currency sufficient to maintain the value, as of the time of initial subscription, of the amount of the currency of such member which is held by the Bank and derived from currency originally paid in to the Bank by the member under Article II, Section 7(i), from currency referred to in Article IV, Section 2(b), or from any additional currency furnished under the provisions of the present paragraph, and which has not been repurchased by the member for gold or for the currency of any member which is acceptable to the Bank.

(b) Whenever the par value of a member's currency is increased, the Bank shall return to such member within a reasonable time an amount of that member's currency equal to the increase in the value of the amount of such currency described in (a) above.

(c) The provisions of the preceding paragraphs may be waived by the Bank when a uniform proportionate change in the par values of the currencies of all its members is made by the International Monetary Fund.

2. The question whether the obligation of a member under said Section to maintain the value of its 18% currency extends to any part of such currency during any period for which such part of such currency has been loaned by the Bank has not been decided by the Executive Directors of the Bank under Article IX of the Articles.



3. These Regulations are intended, pending a determination of that question in the affirmative, to provide for the protection of the Bank's capital against fluctuations in the value in terms of dollars of an 18% currency during any period for which any part of such currency has been loaned by the Bank. It is the intention of these Regulations that Borrowers of any 18% currency shall afford to the Bank protection against fluctuations in the value of such currency in terms of dollars coextensive with the protection which the member whose currency is involved would be required to afford if such currency had not been so loaned.

4. The Executive Directors on , 1948, made the following decision regarding the interpretation of Section 9(a) of Article II of the Articles:

QUESTION

- If (1) the Bank advances to a borrower pursuant to a loan agreement part of the 18% of the Bank's capital paid in by a member in its own currency pursuant to Article II, Section 7(i), of the Articles of Agreement; and
- (2) the foreign exchange value of the currency of such member depreciates to a significant extent within such member's territories after



- the date of advance and prior to the date on which repayment of such advance is made; and
- (3) such depreciation continues after the date on which such repayment is made; and
- (4) the Bank then determines for the first time that such value has so depreciated;

is such member obligated under Article II, Section 9(a), of the Articles of Agreement to pay to the Bank, in respect of the amount so repaid, an additional amount of such currency sufficient to maintain the value, as of the time of initial subscription, of the currency so repaid?

ANSWER

- (a) Yes. Under Article II, Section 9(a), of the Articles of Agreement, if the foreign exchange value of a member's currency has in the opinion of the Bank, depreciated to a significant extent within that member's territory, such member is obligated to pay to the Bank within a reasonable time an additional amount of its own currency sufficient to maintain the value, as of the time of initial subscription, of the amount of the currency of such member which is held by the Bank (within the meaning of said Section) at the time when the Bank makes a determination



that such depreciation has occurred, notwithstanding the fact that such depreciation or any part thereof occurred during any period prior to such determination in which part of such currency had been loaned by the Bank and had not been repaid.

- (b) For the purposes of said Section 9(a), the time when the Bank makes a determination that such a depreciation has occurred shall be deemed to be the time when the Bank notifies such member in writing that such determination has been made.
- (c) No delay or omission by the Bank fully to exercise any right accruing to it under said Section 9(a) shall impair such right or be construed to be a waiver of such right, in whole or in part, nor shall any action by the Bank under said Section in respect of any depreciation of the value of the currency of any member of the Bank affect or impair any right of the Bank in respect thereof or of any subsequent depreciation of the value of such currency.

5. When Loans are expressed in terms of "dollars or the equivalent thereof in currencies other than dollars," it is necessary, as parts of the Loan are advanced in currencies other than dollars, to determine the equivalent in dollars



of the amount of each currency so advanced, whether or not such currency is 18% currency or currency of a member. These Regulations are also intended to provide a basis on which such determinations shall be made in respect of parts of Loans which are repayable in currencies other than dollars.



ARTICLE III

APPLICATION TO LOAN AGREEMENTS

1. If and to the extent that any Loan Agreement shall so provide, these Regulations shall be applicable to the determination of the equivalent in dollars of parts of Loans repayable in currencies other than dollars and to the determination of the amounts to be paid on account of principal, interest and other charges in respect of parts of Loans advanced in 18% currencies.

2. These Regulations are subject to revocation or amendment by the Bank at any time without prior notice; provided, however, that no such revocation or amendment shall be effective in respect of any such Loan Agreement, unless the parties thereto shall so agree.

3. Any Loan Agreement may provide for modifications of or exceptions to these Regulations as they shall apply with respect to such Loan Agreement.



ARTICLE IV

DOLLAR EQUIVALENT OF PARTS OF LOANS  
REPAYABLE IN CURRENCIES OTHER THAN DOLLARS

The equivalent in dollars of any part of a Loan which shall be repayable in any currency other than dollars shall be computed on the basis of the book value of such currency at the date on which such currency is advanced.



ARTICLE V

PAYMENTS OF PRINCIPAL OF AND INTEREST  
AND OTHER CHARGES ON PARTS OF LOANS ADVANCED  
IN 18% CURRENCIES

1. The amount of any currency which the Borrower shall be required to pay on account of the principal of any part of a Loan which shall have been advanced in 18% currency shall be equal in value to the equivalent in dollars of such part of the Loan determined as provided in Article IV of these Regulations. For such purpose the value of such currency shall be computed on the basis of its book value on the date when payment is made.

2. The amount of any currency which the Borrower shall be required to pay on account of interest, commitment charge or commission on, or premium on redemption of, any part of a Loan that shall have been advanced in 18% currency shall be equal in value to interest, commitment charge, commission or redemption premium at the respective rates thereof specified in the particular Loan Agreement on the equivalent in dollars of such part of the Loan determined as provided in Article IV of these Regulations. For such purpose the value of such currency shall be computed on the basis of its book value at the date when payment is made.

3. If there shall be submitted to arbitration pursuant to the provisions of any Loan Agreement any controversy concerning the book value of any currency affecting any amount payable



in such currency by the Borrower under Sections 1 or 2 of this Article, the Borrower shall, pending the conclusion of such arbitration, make payment of the principal of, and interest, commitment charge and commission on, and the premium on redemption of, the Loan in accordance with the provisions of said Loan Agreement, and the amounts of such payments shall be computed on the basis of the book value of such currency as specified by the Bank. When and as a final award shall be made in such arbitration appropriate adjustment shall be made in accordance with the terms of such award.

4. The provisions of this Article shall apply notwithstanding the provisions of any Loan Agreement or any Bond specifying the principal amount of such Bond.

5. The provisions of this Article shall not be applicable to any payment required to be made under the provisions of any Bond at a time when the Bank is not the beneficial owner of such Bond.

6. This Article shall not apply to payments falling due after the date when it shall finally be decided in accordance with Article IX of the Articles that the provisions of Article II, Section 9, of the Articles are applicable to 18% currencies during any period for which such currencies have been loaned by the Bank.

Dated March , 1948.

INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

By

President



**OFFICE MEMORANDUM**

TO: Mr. C. A. McLain, Mr. C. C. Pineo and  
Mr. L. B. Rist  
FROM: D. Crena de Iongh  
SUBJECT: Procedure of Loan Disbursement

DATE: March 4, 1947

1. With my memorandum of February 13, 1947, on this subject, I submitted a confidential memorandum entitled THE PROCEDURE OF LOAN DISBURSEMENT, dated February 12, 1947.
2. The attached memorandum has been prepared by Mr. S. Aldewereld of my office after discussion of the problem of loan disbursement with the leading New York banks.
3. My office is now drafting forms which may be used by the Bank's borrowers if they finance their purchases through letters of credit. It is suggested that in the course of negotiations with our borrowers information be obtained as to the method by which they intend to carry out and finance their purchasing program, and that the completion of negotiations include an agreement that disbursement be made in accordance with the procedure outlined in the attached memorandum and that of February 12, 1947, in case borrowers finance their purchases by opening bank-credits.

Attachment



Mr. D. Crena de Iongh

March 3, 1947

S. Aldewereld

Discussion with New York Banks on Disbursement of Loans

Reference is made to the Treasurer's Memorandum of February 12, 1947, on the procedure of loan disbursements.

On February 25, 26 and 27 I discussed some technical aspects of this problem in New York with Mr. Thomas McKittrick of the Chase National Bank, Mr. Howard J. Rogers of the Bank of the Manhattan Company, Mr. Knight Woolley of Brown Brothers Harriman & Company, Mr. Clarence E. Hunter of the New York Trust Company, and Mr. Floyd G. Blair of the National City Bank.

The main object of the discussions was to verify whether the general principles laid down in the above memorandum would be workable on the basis of existing commercial bank practices. The discussions were, therefore, limited to those transactions in which the commercial banks will be called upon to perform certain functions, which normally will be the case when the International Bank's borrowers will open commercial letters of credit.

I informed the banks that the International Bank, according to its Articles of Agreement, may not advance the full amount of the loan after it has been committed but may only disburse to its borrowers when expenditures are actually incurred (Article III, Section 5 (c)). The Bank has, therefore, the obligation to check, at some time, whether these expenditures are in agreement with the program or project which the International Bank will finance. Furthermore, the International Bank will have to investigate whether the goods or equipment, etc., for which the expenditures are made, are actually delivered to the borrowers.

Whenever the borrower makes use of letters of credit, opened by the commercial banks, in its purchase transactions, these banks will check in their normal procedure whether the payment is in agreement with the letter of credit, whether the documents are in order, etc. This means that the banks are already following the procedure which the International Bank, according to its Articles of Agreement, must also follow. I, therefore, asked the banks whether it would be possible for them to issue a simple statement, signed by an authorized officer, to the effect that payments relating to a specified transaction have been made and that certain documents have been received by them. If this statement could be issued, the International Bank would avoid a considerable amount of detailed checking. All of the banks informed me that if the proper measures were taken beforehand, this statement could be issued by them, and they promised, with no exception, all possible cooperation.

This procedure will have distinct advantages because the International Bank will not only avoid duplication of the commercial banks' work but will also be in a position to save considerable expenses for specialized personnel which, under present conditions, is very hard to find.



I considered it inadvisable to discuss with the commercial banks further technical aspects of the procedure, for instance, the form and text of the different statements to be issued by the commercial banks, when, how and to whom these statements should be sent, etc., because it will be necessary first for the International Bank to decide whether in general or under special circumstances the policy outlined above will be adopted. After this decision has been made, we could draft the various forms in cooperation with the Legal Department.

In the course of the discussions practically all of the commercial banks consulted agreed that the procedure might be facilitated if all of the commercial banks would issue uniform statements. Furthermore, it was agreed that a great advantage would be gained if, in the description of the goods and equipment, in the letters of credit and, therefore, also in the statements, the same symbols would be used as those appearing in the loan agreements. Some commercial banks even suggested the introduction of a uniform commercial letter of credit to be used solely for those transactions which will be financed ultimately out of the proceeds of the Bank's loans. It was anticipated that this could not be achieved in practice because of the various requirements of the different commercial banks in relation to their letters of credit, but it was considered possible that certain special provisions of interest to the International Bank could be included in all the letters of credit. As a special device to recognize the letters of credit, the advisability of giving them a distinctive identification was mentioned.

After the consultations I have come to the conclusion that the general policy laid down in the Treasurer's memorandum of February 12th can be put into practice, that we can expect a great amount of cooperation from the New York banks and that this cooperation can be a factor to achieve a speedy and efficient handling of disbursements.

Because of their legal and policy limits as to the aggregate amount of commercial letters of credit which they can open for their clients, the banks may not be willing to extend these credits above a certain limit without additional security. It can be argued, of course, that inasmuch as the credit standing of their clients would improve because of the Bank's loans, the commercial bank might extend this limit without this additional security.

We have to realize that the International Bank may be called upon to supply this security in one way or another. This can be done either by placing at the borrower's disposal amounts to be used as collateral for the credits opened\* or by the International Bank's confirmation of these credits. The latter procedure

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\* The same result could, of course, be achieved if the International Bank would maintain balances with the commercial banks as collateral for credits opened by or on instructions of the borrower.



has the distinct advantage that it would allow the International Bank to earn interest on short-term investments during the period of confirmation.

My own personal observation is that the International Bank should only confirm letters of credit under special circumstances whenever this appears to be absolutely necessary, for instance, because of a low credit standing of the borrower, the opening of credits which are far beyond the borrower's normal business, etc. Great care should be exercised to avoid any unnecessary confirmation.

If the International Bank should decide to confirm letters of credit under these special circumstances, the question remains regarding the technical method of accomplishing confirmation without involving the International Bank in a detailed examination of every letter of credit and every amendment. It is believed that a satisfactory solution could be worked out.

Under certain circumstances borrowers may not use the medium of the letter of credit to finance the purchase of the required goods. In such an event the International Bank will be required to use a different procedure for disbursement on loans than that discussed above in this memorandum.

My final observation is that the Bank in its disbursements should not lay down rigid regulations but should follow a flexible procedure, appropriate to the circumstances. As mentioned before, the cooperation of the commercial bank will be of valuable assistance.

cc Mr. McLain  
cc Mr. Pineo  
cc Mr. Rist



SUPERVISION



## STAFF LOAN COMMITTEE

(This document is for the use of the President, Vice President and members of the Staff Loan Committee only. Its contents should not be communicated to other persons except in the course of duty.)

Minutes of Meeting of Staff Loan Committee held 11:30 a.m., Thursday,  
December 14, 1950

**DECLASSIFIED**

Date: 11/15/2010  
STB

1. There were present:

Mr. R. L. Garner  
Mr. W.A.B. Iliff  
Mr. A.S.C. Hoar  
Mr. D. Sommers  
Mr. B. Crenas de Iongh  
Mr. L.B. Rist  
Mr. M.L. Lejeune, Secretary

In attendance

Mr. O.A. Schmidt  
Mr. J. Adler  
Mr. M.M. Rosen

2. End-Use Covenants

The Committee considered SLC/O/274 (Revised), Memorandum from the Treasurer to the President on End-Use Covenants, and

AGREED:

- (a) That in omitting from loan agreements with development banks and banking consortia covenants giving the Bank the right to inspect projects and goods for purposes of end-use supervision the Bank is acting in conformity with the spirit of delegation of administrative responsibility implicit in such agreements and
- (b) That in omitting or including from "project" loan agreements covenants giving the Bank the right to inspect goods or projects or covenants requiring the completion of projects, the Bank should be guided by circumstances rather than by precedent or standard practice.

3. Charge for Firm Commitments

The Committee considered SLC/O/284, Loan Department Memorandum on Report and Recommendations of Special Working Party on Charge for Firm Commitments, and



CONCURRED:

In the recommendations of the Special Working Party contained in  
SLC/O/284.

Distribution

- |                          |                        |
|--------------------------|------------------------|
| 1. Mr. Eugene Black      | 9. Mr. A.S.G. Hoar     |
| 2. Mr. R. L. Garner      | 10. Mr. O. A. Schmidt  |
| 3. Mr. W.A.B. Iliff      | 11. Gen. R. A. Wheeler |
| 4. Mr. D. Somers         | 12. Mr. E. G. Burland  |
| 5. Mr. D. Cerna de Longh | 13. Mr. M. L. Lejeune  |
| 6. Mr. L. B. Rist        | 14. Files              |
| 7. Mr. L. B. Rist        | 15. Mr. Graves         |
| 8. Mr. R. H. Demuth      |                        |



INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

*Mr. Rist Loan Policy*  
*End Use*

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## STAFF LOAN COMMITTEE

(This document is for the use of the President, Vice President and members of the Staff Loan Committee only. Its contents should not be communicated to other persons except in the course of duty.)

**DECLASSIFIED**

Date: 11/15/2000 STB

November 22, 1950

### MEMORANDUM FOR MEMBERS OF THE STAFF LOAN COMMITTEE:

The attached SLC/O/274 (Revised), Memorandum to the President from the Treasurer on End-Use Covenants, is circulated for the information of the Committee at the request of the Treasurer's Department.

Michael L. Lejeune  
Secretary



Memorandum to: Mr. Eugene R. Black  
From: D. Crena de Iongh  
Subject: End-Use Covenants

**DECLASSIFIED**

Date:

I would like to bring together my comments (which have already been expressed in Staff Loan Committee Meetings on separate occasions), regarding the omission or modification of certain types of covenants in loan agreements recently signed and in draft agreements now being considered. The reason why I wish to do this is that, in my opinion, a useful purpose would be served by reconsidering the relevant aspects of the Bank's policy.

I have in mind in general two aspects of end-use supervision, viz:

- 1) the Bank's approach to loans granted to development banks or banking consortia, and
- 2) the omission of covenants providing for the supervision of the project from a loan agreement which includes a description of a specific project.

In the first place, the covenant which would give the Bank the right to inspect the goods and the projects was omitted on the initiative of the Bank from the Ethiopian Loan (Industrial Bank), the Turkish Loan (Industrial Bank) and the Mexican Loan (Consortium).

I am aware that in these cases the theory is that the Bank has not given up the right to end-use supervision, but only delegated this right to an intermediary organization. This argument was based on a situation where the Bank had the right to approve the management of such an organization, although even so it represents a departure from the principle that in supervising end-use, the Bank should not have to rely exclusively on statements submitted by the borrower. The argument has even less force if, as is the case in Mexico (a country where our supervision experience has not been entirely fortunate) the management of the intermediary organization is not subject to approval by the Bank. Even in the Ethiopian and Turkish cases, it would have been better, in my view, to include the normal provisions. If things went well, we might never have to make use of them; in any case, we should not have set a precedent.

In the second place, the draft of the proposed South African loan agreement (Transport Project) includes a description of the project and the text makes several references to the project. However, although the draft contains the usual end-use covenants concerning the goods, there are no provisions requiring the borrower to complete the project or to maintain books and records concerning the progress of the project or to furnish information concerning the project. Moreover, although the draft of the proposed South African loan agreement (Electricity Project) which is also drafted as a project loan agreement, includes the usual end-use covenants included in such project loans, the Bank's right of inspection extends only to the goods and not to the project.

There seems to be a fundamental inconsistency in the drafting of the transport loan. Either no reference should have been made to a project, in which



case the covenants would be suitable as drafted; or else the normal covenants concerning the project should be included. The policy so far adopted in this case is in marked contrast to the policy followed in connection with the loan recently signed for the rehabilitation of the Thai railways. In the latter case, not only does the loan agreement include the usual end-use covenants relating to a project, but in addition the Bank is to supervise the whole rehabilitation program of the railways, (even though the loan covers only 1/10 of the foreign currency required for the program).

The above considerations lead me to suggest that the Bank's policy in this connection should be reviewed, since there seems to be a risk that we may not only be inconsistent in the way we draft agreements for similar loans, but also that we may give the public impression of discriminating between different borrowers.

It is of course true that in developed countries we may assume a reasonably high standard of efficient management and control, whereas we cannot make this assumption in some cases of less developed countries. However, it places the Bank's negotiators on the defensive, and puts them in an invidious position if they have to argue along this line to support the inclusion of covenants which have been left out of agreements of loans of a similar character.

In interpreting existing loan agreements in practice, the Bank has always decided, in the light of the circumstances in each case, how far to use its rights under the loan agreements, thus recognizing that what is reasonable to ask in one case may not be reasonable in another. To give one example, although the Dutch development bank loan agreement contains the standard project clauses (which have now been omitted from the loan agreements with other development banks) we have in practice relied on the known efficiency of the Herstelbank to do the work for us. If they fail to carry it out well in future, we have the right to do it ourselves. Only experience will show whether, for instance, the Mexican banks can do an efficient job. If they fall down, we have no right to step in.

My first recommendation is that all project loan agreements should contain the standard supervision clauses and that we should continue in practice to use our discretion in deciding how far to go in each particular case. My second recommendation is that the Bank should avoid drafting loan agreements in the project form in cases where it is not truly applicable. I recognize, of course, that there will be some borderline cases. In such cases, my recommendation is that we should decide to treat each one consistently as a project loan, or alternatively to draft the loan agreement without any reference to a project.

I see two possible dangers into which we may run if we do not follow a consistent policy.

Prospective borrowers will always be inclined to start negotiations on the basis of asking from the Bank every concession granted in any existing loan agreement, which will weaken the Bank's negotiating position. This situation may lead to a progressive weakening of the protective arrangements which the Bank from the beginning of operations has considered necessary and, consequently, may make the task of efficient supervision more difficult.



The second danger lies in the possible effect on the market for the Bank's bonds. Investors will be quick to notice apparent weakening of our supervision policy, which has always impressed them so favorably, and the advantages of which have been so much stressed in the Bank's public relations.



*has been recalled*

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

*Mr. Rist*

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## STAFF LOAN COMMITTEE

(This document is for the use of the President, Vice President and members of the Staff Loan Committee only. Its contents should not be communicated to other persons except in the course of duty.)

**DECLASSIFIED**

Date: 11/15/2010 *SRB*

November 16, 1950

### MEMORANDUM FOR MEMBERS OF THE STAFF LOAN COMMITTEE:

The attached SLC/O/274, Memorandum to the President from the Treasurer on End-Use Covenants, is circulated for the information of the Committee at the request of the Treasurer's Department.

*PA*

Patrick Acheson  
Acting Secretary



November 14, 1950

**DECLASSIFIED**

Memorandum to: Mr. Eugene R. Black  
From: D. Crena de Iongh  
Subject: End-Use Covenants

Date:

I would like to submit to you my comments on some facts which have come to my attention in studying the text of loan agreements recently signed and of draft agreements now being considered.

When the Loan Regulations adopted on August 15, 1950, were under discussion, I pointed out that the end-use covenants in existing loan agreements form the basis on which we carry out the Bank's established policy, and advocated therefore their inclusion in the Loan Regulations. However, the Staff Loan Committee decided, against my advice, that they should be omitted, and should be drafted specially on each occasion for inclusion in the loan agreement. Loan agreements recently concluded, and draft agreements now under consideration, show a tendency to weaken the end-use supervision clauses. This has not been the result of objections to the text of the standard clauses raised by prospective borrowers during negotiations. The changes in question have been advocated within the Bank on the grounds that they are justified by special circumstances.

The following paragraphs give examples of the changes I have in mind.

(1) Australian Loan

This loan is a "general purpose" loan, and not a project loan. Consequently, in accordance with the Bank's normal policy, end-use supervision is restricted to the goods financed by the Bank. However, the usual covenant of the borrower to keep books and records concerning the goods and their end use was omitted from the loan agreement. Moreover, there is no provision concerning the insurance of the goods.

(2) Ethiopian Loan (Industrial Bank)

Although this loan agreement contains the covenant obliging the borrower to keep books and records concerning the goods and the projects, it does not contain any provision giving the Bank the right to inspect them. This omission was the result of an oversight, and the Bank has now asked the Ethiopian Government to agree that the Bank should have this right. Furthermore, the covenant which would give the Bank the right to inspect the goods and the projects (as opposed to the records) was omitted on the initiative of the Bank.

(3) Turkish Loan (Industrial Bank)

The covenant giving the Bank the right to inspect the goods and the projects was omitted from this loan agreement on the initiative of the Bank.



(4) Mexico (Consortium)

The covenant giving the Bank the right to inspect the goods and the projects was omitted from this loan agreement also on the initiative of the Bank.

(5) South Africa - Draft Loan Agreement (Transport Project)

The draft includes a description of the project and the text shows many references to the project. However, although the draft contains the usual end-use covenants concerning the goods, there are no provisions requiring the borrower to complete the project, or to maintain books and records concerning the progress of the project, or to furnish information concerning the project. In addition, there is no covenant regarding the insurance of goods. This would have been logical if the proposed South African loan had been treated as a "general purpose" loan, but in that case the South African draft should not have contained any reference to or description of a project. If the proposed South African loan is to be treated as a project loan, the text should include the supervision covenants which normally feature in project loans.

The way in which this draft loan agreement has been framed is in contrast to the text of the loan agreement just signed for the rehabilitation of the Thai railways. In the latter case, not only does the loan agreement include the usual end-use covenants inserted in the project loans, but in addition the Bank is to supervise the whole rehabilitation program of the railways (even though the loan amounts to only one-tenth of the foreign currency required for the program).

(6) South Africa - Draft Loan Agreement (Electricity Project)

Although in general this draft includes the usual end-use covenants included in project loans, the Bank's right of inspection extends only to the goods, and not to the projects.

I am aware that in the case of the loans to Ethiopia and Turkey for Industrial Banks, and the Mexican Consortium loan, the theory is that the Bank has not given up the right to end-use supervision but only delegated this right to an intermediary organization. This argument has considerable force where the Bank has the right to approve the management of such an organization, although even so it represents a departure from the principle that in supervising end use, the Bank should not rely exclusively on statements submitted by the borrower. The argument has much less force if, as is the case in Mexico (a country where our supervision experience has not been entirely fortunate) the management of the intermediary organization is not subject to approval by the Bank. Even in the Ethiopian and Turkish cases, it would have been better, in my view, to include the normal provisions. If things went well, we might never have to make use of them; in any case, we should not have set a precedent.

I am also aware that in developed countries such as South Africa and Australia, we may assume a reasonably high standard of efficient management



and control, whereas we cannot make this assumption in the case of a less developed country. But it places the Bank's negotiators on the defensive in negotiating loans to less developed countries, and puts them in an invidious position if they have to argue along this line to support the inclusion of covenants which have been left out of other loan agreements.

My point is that we seem to be running a risk of giving the public impression of discriminating between borrowers, whereas until recently there were no grounds for such an impression. In practice, of course, the Bank has decided in each case how far to use its rights under the loan agreements, thus recognizing that what is reasonable to ask in one case is not reasonable to ask in another. To give one example, though the Dutch Development Bank loan agreement contains the standard clauses (which have now been omitted from the loan agreements with the Turkish, Ethiopian and Mexican banks) we have in practice relied on the known efficiency of the Herstelbank to do the job for us. If they fall down on the job in future, we have the right to do it ourselves. Only experience will show whether, for instance, the Mexican banks can do an efficient job. If they fall down, we have no right to step in.

It is noteworthy that all the loan agreements or draft loan agreements enumerated above were, with the exception of the Australian loan agreement, negotiated away from headquarters. I can understand that in certain circumstances there may be arguments in favor of negotiating loan agreements in the prospective borrower's country, but I am inclined to think that the arguments against this procedure are stronger. In the first place, the Bank's negotiating position is psychologically weakened. In the second place, the benefits of the working party system, which has proved to be so valuable, are not available. Thirdly, changes which may be generally agreed in the Bank to be desirable may in practice be difficult even to suggest to the prospective borrower, if, as is the case in South Africa, the negotiators have brought back drafts which have been approved by the Cabinet.

To sum up, I see two dangers in this tendency to omit or modify certain types of covenants which until recently were always included in the loan agreements.

Prospective borrowers will always be inclined to start negotiations on the basis of asking from the Bank every concession granted in any existing loan agreement, which will weaken the Bank's negotiating position. This situation may lead to a progressive weakening of the protective arrangements which the Bank from the beginning of operations has considered necessary and, consequently, may make the task of efficient supervision more difficult.

The second danger lies in the possible effect on the market for the Bank's bonds. Investors will be quick to notice apparent weakening of our supervision policy, which has always impressed them so favorably, and the advantages of which have been so much stressed in the Bank's public relations.



*Supervision*

INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

FOR THE PRESS

FOR IMMEDIATE RELEASE

Press Release No. 91

April 13, 1948

The International Bank for Reconstruction and Development today announced details regarding the supervision over its loans which the Bank is carrying out in borrowing countries and the specific uses to which the goods financed out of these loans are being put. Before making any disbursement, the Bank's headquarters in Washington, D.C., determines that the funds disbursed are to be used for transactions which the Bank has agreed to finance in the loan agreement. Field representatives of the Bank, stationed in various borrowing countries, then ensure that the equipment, supplies and materials financed by Bank loans are used only for the productive purposes specified in the loan agreements.

At the present time the Bank has field representatives for this purpose in Paris, France; The Hague, The Netherlands; and Copenhagen, Denmark. These offices supervise the end use of goods financed by the loans to France, amounting to \$250 million; the Netherlands, to \$195 million; Denmark, to \$40 million; and Luxembourg, to \$12 million.

The evidence which the Bank has received indicates that the uses of the proceeds of these four loans are consistent with the provisions of the loan agreements. There have been a few instances in which investigation has shown that supplies had been inadvertently put to ineligible uses; in such cases, however, a refund and an adjustment has been made by agreement with the borrower. The following examples illustrate the results of the Bank's end use supervision:



Out of the proceeds of the loan to France, 7 million tons of coal were purchased in the United States and imported into France. This represents about 47% of the total French coal imports during 1947. Investigation by the Bank of the use to which this coal has been put has shown that it was allocated as follows: to the railroads, 29%; to gas works, 20%; steel industries, 10%; electric power, 4%; and various other industries, 37%. The Bank established that loan funds were also applied to the purchase of 30,000 tons of copper which were used mainly to manufacture copper wires used to rehabilitate the heavily damaged communication and power distribution systems of France, and for the import of some 175,000 bales of cotton (representing about 15% of the French consumption for 1947). Delivery of this cotton to spinners has been verified.

The loan, in agreement with the Bank, was also used by the French to finance nearly 50% of the purchase price of a steel mill which will be erected in France during 1949. The capacity of this new mill is expected to reach 1,000,000 tons a year. In addition, it has been ascertained that loan-financed steel products have been used in various government-sponsored reconstruction programs, such as that for the rebuilding of bridges.

A considerable amount of American machinery was purchased out of the proceeds of the French loan to help re-equip the Renault Works, heavily damaged during the war. Because of this machinery the Renault Works have been able to begin production of a new low-powered automobile.

The Bank also helped finance earth-moving equipment which is being used by two large French firms building hydro-electric power dams in the Rhone and Rhine valleys. When completed, these dams will enable France to



increase industrial production considerably in the regions concerned. Another type of equipment consists of oil well drilling equipment which is being employed in Southern France in prospecting for new petroleum resources.

Loan-financed tankers are making a sizeable contribution to the recovery of France by enabling France to transport more petroleum products from Venezuela. This is an operation which otherwise France could ill afford because of the high cost of trans-Atlantic freight which would have to be paid in dollars.

In order to rebuild the country's badly damaged transportation system, France has also used part of the proceeds of the loan to purchase numerous locomotives, airplanes, tugs, barges, etc. Bank investigation has shown that this equipment, only part of which has been delivered up to the present time, is being used for productive purposes. Approximately 100 new locomotives have already been received by the French National Railways. Parts for railway freight cars which have been financed out of the proceeds of the loan are expected to be delivered in France shortly. These will help France materially in rebuilding her war-damaged rolling stock. Supervision of the use of this material will begin as soon as it arrives in France.

In Luxembourg, the Bank's field representatives inspected progress made at the site of a new steel mill which is being partially financed out of the proceeds of the Bank's loan. The main equipment for this mill is being completed in Pittsburgh by the United Engineering and Foundry Company; auxiliary equipment is being manufactured by other United States firms. Locomotives, built in England and in France, also financed out of the proceeds of the loan, are in use on Luxembourg railways.



In Denmark, the Bank's field representatives visited the installations of the Northern Cable and Wire Works which produces, among other things, transoceanic and other communication cables out of copper and lead financed through the Bank's loan to that country. The same representatives are now supervising the use to which loan-financed agricultural and industrial machinery are being put.

In Holland, the use to which 60 loan-financed cargo vessels and tankers are put has been ascertained, and the distribution of fertilizers, machinery, building materials, rolling mill products, etc. to users for productive purposes is being supervised.



for some

Monday

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new draft expected



INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

# ROUTING SLIP

TO-	Name	Room No.
1	Mr. Rist	418
2		
3		
4		

FOR-	Action	Initialing
	Approval	Preparing Reply
	Comment	Previous Papers
	Filing	Noting and Returning
	Full Report	Recommendation
	Information	Signature

REMARKS

Mr. McLain voudrait  
tenir un meeting à ce  
sujet demain matin  
à 11 h. Rem 1122.  
11 h - to morrow Friday.

Date— 2/26	From— D. Sommers	Office Services 13-12
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Confidential Draft

**DECLASSIFIED**

February 26, 1947

Date: 11/15/2010 STB

Committee on Loan Policy

From: The Secretary

Attached for the consideration of the Committee on Loan Policy is a revised draft Report on Supervision of Loans (Committee on Loan Policy Document No. 2), which has been prepared at the Committee's request to reflect the discussions of the Committee in its consideration of this subject, including the memorandum dated February 20, 1947, (Committee on Loan Policy Document No. 4).

The attached draft supersedes Committee on Loan Policy Document No. 2. Committee on Loan Policy Document No. 3 has not been revised to conform to the revision of Document No. 2, because Document No. 3 was prepared only for the purpose of the discussion before the Committee. It is not contemplated that any document corresponding to Document No. 3 will be presented to the Executive Directors, because it is assumed that they will not wish to enter upon a discussion of the detailed provisions of the loan contract.

Distribution:

*key comments are in ink full.*

*This is a substantial improvement, though there is still no distinction between enforceable and unenforceable "rights".*



**Date:**

INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

February 26, 1947

COMMITTEE ON LOAN POLICY  
REPORT ON SUPERVISION OF LOANS

The Ad Hoc Committee on Pending Loan Applications requested the staff (R-35, approved October 22, 1946) to present its comments and recommendations in respect of the measures the Bank should take to supervise its loans. The President of the Bank thereafter appointed a Staff Committee on Loan Supervision, which filed with the Committee on Loan Policy a report on this matter dated January 14, 1947. (Committee on Loan Policy Document No. 1).

Upon consideration of the staff report and after discussion of the questions of policy raised thereby, the Committee on Loan Policy submits the following report to the Executive Directors.

A. THE FUNCTIONS OF THE BANK IN RESPECT OF THE ADMINISTRATION  
OF LOANS.

1. Subsections (b) and (c) of Section 5 of Article III of the Articles of Agreement of the Bank provide as follows:

- "(b) The Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations.



"(c) In the case of loans made by the Bank, it shall open an account in the name of the borrower and the amount of the loan shall be credited to this account in the currency or currencies in which the loan is made. The borrower shall be permitted by the Bank to draw on this account only to meet expenses in connection with the project as they are actually incurred."

2. Having regard to the general purposes of the Bank as set forth in its Articles of Agreement and to the fact that the greater part of the loans which the Bank will make will be made out of funds borrowed by the Bank from private investors, it must be recognized that the responsibilities of the Bank with regard to the administration of loans made by it go beyond the specific duty of making arrangements to ensure that the loans are used only for the purposes for which they are granted. Those responsibilities include the responsibility for making appropriate arrangements to ensure that the purposes for which the loans are granted will be accomplished and that the service of the loans will be maintained. *Article I*

3. In considering the methods which the Bank should adopt to carry out those responsibilities, two aspects of the problem should be carefully distinguished. The first concerns the rights which the provisions of the loan contract should give to the Bank. The second concerns the extent to which those rights should be exercised by the staff of the Bank in its administration and application of the provisions of the loan contract. *Distinguishing between responsibilities and exercise of rights*

The Bank's responsibilities require that the loan contract shall contain appropriate provisions setting forth <sup>the</sup> arrangements whereby the Bank shall be kept fully and currently informed of the progress of the project or program for which the loan was granted and of the development of any conditions which might prevent or interfere with the accomplishment of that project or program or the maintenance of the service of the loan. The loan



contract should also contain arrangements affording the Bank timely opportunity to consult with the borrower and the guarantor (if any) and to take timely and appropriate action in order to ensure in so far as it properly can do so that the purposes of the loan are not defeated and that the service of the loan is maintained.

In the nature of things, the provisions of the loan contract must be broad and general in character, more especially because it will be impossible to foresee when the loan contract is made what specific conditions may arise which will require the Bank to avail itself of such provisions. Since the extreme and exceptional contingencies will be those in which the Bank will have the greatest need to exercise its functions most firmly and effectively, it will be necessary that the provisions of the loan contract are such as to ensure that the Bank will have adequate opportunity and adequate power to deal with such contingencies in the best interests of all its members. While such provisions will necessarily vary as among different types of loans, it must be borne in mind that the Bank will probably not find it feasible to discriminate among borrowers with regard to the general scope of such provisions.

On the other hand, so far as concerns the exercise of the Bank's rights when the staff is called upon to administer and apply the provisions of the loan contract, the Bank should find it practicable to adapt the application of the provisions of the loan contract to the circumstances of the particular case. Only infrequently should the Bank find it necessary to take all of the measures which may be permitted under the loan contract.

4. The arrangements which shall be set forth in the loan contract and the administration of such arrangements by the Bank's staff must be such as not to offend the dignity of the government concerned or to involve interference



in the internal politics of the particular country. They must also be such as not to make the Bank actually or apparently responsible for the conduct of the particular project or program or of the affairs of the borrower or the guarantor.

5. The nature and purposes of the loans will be such in most cases as to require that the Bank exercise its administrative functions not only at its principal office in Washington but also through representatives in the country in which the loan is made and in some cases in the countries in which the proceeds of the loan are expended. As a matter of policy and economy, whenever practicable, such field representatives should operate out of regional offices of the Bank rather than be detailed specifically to a particular country.

6. In general the costs of loan administration should be borne by the Bank as part of its general operating expenses rather than be charged to the borrower as a specific part of the cost of the loan. In exceptional cases in which the borrower may request special services in connection with the administration of a loan, the borrower will undoubtedly be willing to pay the cost of such special services.



B. ARRANGEMENTS RELATING TO THE APPLICATION  
OF PROCEEDS OF THE LOAN.

7. In dealing with the problem of ensuring that the proceeds of the loan are used only for the purposes for which it was granted, two primary considerations must be taken into account. On the one hand, the Bank must make its internal procedures sufficiently flexible and expeditious to permit the borrower to withdraw funds when it needs them without undue delay. On the other hand, the Bank must obtain adequate assurance that the proceeds of the loan are used for the purposes for which the loan was granted. The Committee is of the opinion that the procedures outlined below give adequate recognition to both of these considerations.

8. From the standpoint of the Bank, the most practicable arrangement for supervising the expenditure of the proceeds of a loan would be for the borrower in the first instance, by use of its own funds or of a short-term banking credit obtained by it for the purpose, to make payment for the goods or services in question and then to request the Bank to advance the amount of such payment under the loan. If, however, as recommended in a report of the Financial Policy Committee (R-71, second revision) now before the Executive Directors, the Bank determines to charge interest from the date of the loan contract, the Bank should in so far as practicable make arrangements whereby the borrower can, if it desires, obtain <sup>in the hands of</sup> the proceeds of the loan <sup>as shall be necessary</sup> in-time to meet its expenditures currently without the necessity of using its own funds or borrowing funds elsewhere to meet such expenditures. To that end the Bank may, under



appropriate conditions, make advances to the borrower for the purpose of meeting expenses in connection with the project or program, including advance payments and deposits of collateral to secure grants of credit, as they are actually incurred. [In some cases such advances might take the form of a revolving credit, replenishment of which will depend upon the subsequent furnishing of adequate proof that expenses paid therefrom were consistent with the loan contract. In other cases, the advances might be made in anticipation of future expenditures that are known to be required under the terms of existing contracts, purchase orders and credit arrangements.] In all cases, the borrower would undertake promptly to furnish the proof required to show that the proceeds of the loan were expended for the purposes for which the loan was granted and <sup>confirmation</sup> that the equipment and supplies purchased with such proceeds were actually received and used for such purposes.

Still other arrangements may, of course, be made where they are more suitable to the particular case at hand; for example, it might be agreed that the borrower might draw a draft on the Bank in favor of the supplier to whom the expense is payable; or the Bank might in some cases open a documentary letter of credit with a commercial bank in favor of the particular supplier.

The particular procedures, or combinations of procedures, will necessarily vary from loan to loan.

9. Whatever procedures are followed, the loan contract should entitle the Bank to require the borrower to support a request for funds by furnishing adequate proof that expenditures have been or will be made



for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations. In general, the proof ultimately required to justify an advance under the loan should include a certification by the borrower to the effect that the amount of the advance has been paid to actual suppliers of goods or services required for the project or program for which the loan was granted; that the goods or services are of such character that they will fulfill the purposes for which required; that the amount paid and the terms of purchase are not unreasonable; and that the expenditures for which the advance is used have not otherwise been reimbursed to the borrower from the loan account and that they have not been and will not be used as a basis for advances under any other loan or credit which may be available to the borrower. When the advance is made for the purpose of meeting anticipated expenditures, the certification will be appropriately modified to meet the particular circumstances.

The loan contract should, of course contain appropriate provisions to enable the Bank to verify the accuracy of the certifications to the extent deemed necessary in the particular case by requiring the submission of supporting documents or otherwise.

The borrower should have the opportunity, if it so desires, of obtaining the approval of the Bank for proposed purchases prior to making commitment therefor.

10. The loan contract, through provisions for inspection, furnishing of information, etc., should entitle the Bank to ascertain that goods or services for which an advance is made are actually and properly used as



contemplated in the loan contract, and, in general, that the project or program for which the loan was granted is properly carried out. The administration of such provisions will normally be the duty of a field representative of the Bank. The type of representative and the extent and character of the staff and consulting services which he may need will depend on the type of loan.

C. ARRANGEMENTS RELATING TO THE MAINTENANCE  
OF THE SERVICE OF THE LOAN AND THE ACCOMPLISHMENT  
OF THE PURPOSES FOR WHICH THE LOAN WAS MADE

11. The loan contract should provide that the borrower and the guarantor (when a member of the Bank is not the borrower) will furnish the Bank currently with full information with regard to the operation of the project or program for which the loan has been made and with regard to any other matters which are relevant to the purpose of the loan and the maintenance of service of the loan. They should also undertake to make available to the Bank, as it may reasonably request, facilities for examining or obtaining the material contained in the sources from which such information is compiled. Arrangements should also be made whereby economic and financial information which a member of the Bank is required to furnish to the Fund and other public international organizations shall be made available to the Bank.

12. In view of the general purposes for which the Bank will make loans, arrangements should be made whereby the Bank will have adequate and timely opportunity for consultation with its borrowers on matters of mutual interest to the end that the Bank's loans may serve the purposes



set forth in its Articles of Agreement. The most important task of the Bank's field representatives will be to establish and maintain cordial and mutually helpful relations with borrowers with a view to averting the occurrence of conditions which might defeat the accomplishment of the purposes of the loan or imperil the service of the loan.

The loan contract should, therefore, contain suitable provisions providing for consultation <sup>from time to time between representatives of the Bank</sup> ~~in certain circumstances.~~  
<sup>and representatives of the borrower or the guarantor.</sup>

13. The scope of such provisions and the extent to which they may be availed of will necessarily vary according to circumstances. As to certain kinds of action by the borrower or the guarantor which may directly affect the purposes for which the loan was granted or the maintenance of the service of the loan, the Bank would be warranted in requiring that no such action should be taken without its prior consent. As to other kinds of action which <sup>may</sup> would not have such a direct effect, the loan contract might merely provide that no such action would be taken without affording to the Bank a reasonable opportunity to consult with and make recommendations to the guarantor and the borrower, who should agree to give any such recommendations serious consideration. The loan contract should also contain appropriate provisions whereby the borrower and the guarantor would agree that when conditions arise which threaten to imperil the maintenance of the service of the loan, they will in good time consult with the Bank as to possible measures to meet such conditions. [Furthermore, the loan contract should recognize the general right of the Bank to make recommendations to the borrower and the guarantor on economic matters affecting the loan and the purposes for which the loan was granted.]



14. The extent of the rights which the Bank should reserve in any particular situation must depend on the nature of the loan, on its relationship with other external debt, existing and contemplated, and on other economic circumstances of the borrower and the guarantor.

The comments of the Committee contained in the following paragraphs must therefore be considered as statements of general principle which are subject to modification in the light of particular circumstances.

15. <sup>First</sup> The creation of charges or other priorities on revenues or foreign exchange receipts to secure <sup>future, existing & future</sup> external debts incurred by the borrower or guarantor will generally have a direct effect on the prospects of repayment of the Bank's loan. The Bank's interest in this type of action is so immediate that the loan contract should normally contain provisions prohibiting the creation of such charges or priorities without the prior consent of the Bank.

16. The Bank has an equally direct interest in agreements, other <sup>First</sup> than loan and credit agreements, which may in form or in effect create <sup>other</sup> charges or priorities on foreign exchange receipts of such nature as to affect the prospects of repayment of the loan. Certain types of bilateral payments agreements, clearing agreements, commodity agreements and barter agreements may have the effect of creating charges of this kind. Since, however, the net effect of such <sup>agreements</sup> may not be adverse to the interests and purposes of the Bank, it <sup>may</sup> ~~should~~ generally be sufficient <sup>in many cases</sup> simply to require that the borrower or guarantor agree to consult with the Bank in advance of making such agreements.

*[I suggest solution]*



17. The Bank also has an interest in the amount of external debt which the borrower may incur. In most cases the principal reasons impelling the borrower to seek a loan from the Bank will be the need to import goods for purposes of economic reconstruction or development and the fact that the balance of payments situation and prospects of the borrower are such that it cannot finance such imports by other means than a long-term loan from the Bank. In such cases the prospects of repayment of the loan will depend primarily on the future availability to the borrower of the foreign exchange required for such repayment. The Bank is therefore vitally interested that the fundamental assumptions upon which the amortization provisions of the loan contract are based and upon which the prospects of repayment depend shall not be impaired by the creation of future needs for foreign exchange resulting from excessive and economically unsound external borrowings. Here again, however, as in the case of the agreements mentioned in the preceding paragraph, certain kinds of action may not be disadvantageous for the Bank. Some additional external debt may be beneficial from the Bank's viewpoint as well as the borrower's. This subject should, therefore, also be dealt with normally by provisions requiring prior consultation with the Bank. In general, such provisions should take the form of limitations on the aggregate amount of external loans, or of the annual service charges on external loans, which the borrower or guarantor may contract without consultation with the Bank, with appropriate exceptions to provide for refunding operations and certain types of short-term credits.



The amount of the limitations would depend on the estimated needs for additional external financing and on the estimated balance of payments prospects.

CONCLUSION

The Committee is of the opinion that no fixed policy can be framed that will cover all aspects of the problem of loan administration or fit each individual loan. It recommends that this report be approved by the Executive Directors as a general statement of principles to guide the staff in carrying out its responsibilities in the field of loan administration.

Committee on Loan Policy

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Chairman



Mr. C. C. Pineo.

27th February 1947.

Walter Hill

Note on Section D of Draft Report No. 2 on Loan Supervision prepared at the request of Mr. Pineo.

1. The draft reports on the administration of loans all prescribe a code of behaviour for borrowers designed to ensure the maintenance of the service of loans. The tacit assumption in the recommendations is that the maintenance of the loan service is mainly a matter of the goodwill of the borrower.
2. This assumption, surely, is a questionable, not to say unrealistic, one. Goodwill on the part of the borrower is only one of the factors in the maintenance of the service of loans. Goodwill on the part of the lender to accept capital and interest payments is another. Since, at any rate to begin with, the Bank will have to borrow the greater part of its funds in the United States, and since it will lend to countries that are short of dollars, it stands midway between creditor and debtor countries and not between creditors and debtors in the same country. Any realistic approach to the problem must therefore aim at a code of behaviour designed to ensure compliance by the lending countries as well as by the borrowing countries. Yet, there is not a word about possible transfer difficulties arising from the policy of the lending countries and of their avoidance.
3. The reasoning underlying the draft reports is that borrowing countries should undertake to budget at all costs for a surplus at least equivalent to the amount of the annual debt service in their external transactions with other countries which, during the next five years, means an export



surplus with the United States and the few countries whose currencies are convertible into dollars. They do not take into consideration the corresponding assumption, that is that there must emerge a corresponding import surplus in lending countries or, alternatively, that the amounts due in debt service must be re-lent to the borrower. If borrowing countries are asked to budget for an export surplus at least equivalent to the cost of the debt service without regard to the policy of the lending countries, the volume of their imports must be limited rigidly to the import and lending policy of the lending countries, irrespective of needs. (This, incidentally, may compel debtor countries to maintain quantitative import restrictions well beyond the period of 5 years envisaged by the Bretton Woods Act.) If the creditor countries choose to cut their imports or not to increase them sufficiently, and if they choose to reduce the volume of foreign lending, then the borrowing countries must suffer serious hardship. If, on the other hand, the creditor countries pursue an expansionist policy in their imports or lending or both, no difficulties will arise.

4. If this line of approach is accepted, then the borrowing countries should be given the right to consult with the Bank if they experience transfer difficulties arising from the unwillingness of the lending countries to absorb an appropriate volume of goods and services.
5. With reference to the French Loan contract ( the problem is the same with other countries) the Section on "Arrangements to ensure that the Service of the Loan can and will be maintained" (paragraphs 16-19 of the Draft dated February 19th) might be re-cast on some such lines.



- (a) It should be recognised that the maintenance of the service of the loan is not merely a matter of ability and willingness on the part of the borrowing countries but also of the lending countries. If the borrowing countries are asked to budget for an export surplus at least equivalent to the cost of their total debt service) with other countries, then the lending countries can be asked to budget for an import surplus large enough to enable the borrowing countries to discharge their liabilities. The Bank can legitimately ask to consult with borrowing countries about the evolution of their balance of payments; the borrowing countries can legitimately ask to consult with the Bank about the evolution of the balance of payments of lending countries.
- (b) Subject to the recognition of the transfer problem, the Bank is bound by the Articles of Agreement to ensure that the borrowing country is maintaining the service of a loan to the best of its ability. If the Bank is to live up to its responsibility, the contract should provide for the right to consult with the borrowing country about the evolution of its balance of payments, for the inclusion of certain safeguards, and for the provision by the borrowing country of adequate information and statistics.

Consultations. Arrangements should be made for continuous consultation, as distinct from consultation when difficulties/



when difficulties have arisen. This would enable both sides to discuss their problems periodically, informally, and without the publicity that is almost inseparable from "crisis" conferences.

Safeguards. The borrowing country would undertake to budget for an appropriate export surplus and to strive to achieve it to the best of its ability; the Bank in turn would adjust repayment terms to the magnitude of the export surplus that can reasonably be expected over a period of years, taking into account the existing obligations of the borrowing country. The borrowing country would undertake not to create any prior charges (by one means or another) on its export surplus in favour of other lenders without consultation with the Bank; similarly, it would undertake to inform the Bank about any intention to add substantially to its external debt.

Information. The borrowing country would agree to provide the Bank at regular intervals with information sufficient to a current appraisal of the evolution of its balance of payments, as well as with copies of any new commercial or financial agreements or arrangements made with other countries.



INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

February 20, 1947

COMMITTEE ON LOAN POLICY

UNITED STATES PROPOSAL WITH RESPECT TO TRADE  
AND OTHER POLICIES IN BORROWING COUNTRIES

In the course of discussion, at the meeting of the Committee on Loan Policy on Thursday, February 20, 1947, on Loan Supervision (Committee on Loan Policy, Documents Nos. 2 and 3), Mr. E.G. Collado, Executive Director for the U.S., referred to the proposal of the United States with respect to trade and other policies in borrowing countries.

Hereunder is the text of the proposal, the substance, rather than the wording of which, Mr. Collado stresses as of importance to the Committee discussion on Loan Supervision:

"Since the basic purposes of the Bank, among others, are to assist in the reconstruction and development of the territories of members, to promote the long range balanced growth of international trade and the maintenance of equilibrium in balances of payments, and to bring about a smooth transition from a wartime to a peacetime economy;

And since the commercial and financial policies of each borrower may have a direct effect upon (1) the success of projects financed by the Bank in any member country, (2) the total financing needs of the borrower or of other member countries, and (3) the ability of the borrower or of other member countries to discharge their obligations to the Bank;

The borrower shall refrain from commercial and financial arrangements which are inconsistent with the basic purposes as provided in Article I of the Bank's Articles of Agreement, and if the Bank should indicate at any time that in its opinion the commercial and financial policies of the borrower are such as to impede the success of the projects financed by the Bank



in any member country, or to increase unduly the total borrowing needs of member countries, or to jeopardize fulfillment of the borrower's or other member countries' obligations to the Bank, the borrower shall consult with the Bank concerning such policies with a view to taking any necessary corrective measures."

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INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

February 17, 1947

COMMITTEE ON LOAN POLICY

In accordance with the request of the Committee on Loan Policy, there are submitted herewith brief descriptions of provisions which might be included in loan contracts to carry out some of the principal recommendations in the report dated January 14, 1947, of the Staff Committee on Loan Supervision (Committee on Loan Policy, Document No. 1). The provisions described are intended only as examples. The wording of the actual provisions will necessarily vary as among the different loans and it is probable that different types of provisions would have to be included in some loan contracts to adapt the policies proposed in the Committee's report to the circumstances of particular cases.

Staff Committee on Loan Supervision

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C. A. McLain, Chairman

D. Crena de Iongh  
Richard H. Demuth  
A. S. G. Hoar

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INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

February 17, 1947

DESCRIPTION OF TYPES OF PROVISIONS FOR LOAN CONTRACT

I -- PROVISIONS REGARDING DISBURSEMENT OF THE LOAN.

Such provisions would include provisions to the following effect:

- (a) The Bank will open an account on its books in the name of the borrower and will credit the amount of the loan to such account. Withdrawals from that account will be permitted only in accordance with the provisions of the loan contract.
- (b) The contract will include a reasonable description of the goods and services to be purchased by the borrower with the proceeds of the loan.
- (c) Whenever the borrower desires to draw on the loan account, it shall deliver to the Bank an application in writing setting forth
  - (i) The amount to be withdrawn;
  - (ii) A reasonably itemized statement of the expenditures made by the borrower for goods or services for which reimbursement is requested, including the prices of the goods or services purchased, the dates of payment, the names and addresses of suppliers, the destination of such goods or services and the purposes for which they will be or have been used in connection with the project;
  - (iii) A statement that the amount to be withdrawn is required to



reimburse the borrower for expenditures made by the borrower for the purpose specified in the application;

- (iv) A statement that the borrower has not theretofore withdrawn or applied for withdrawal from the loan account, or from any other credit available to the borrower, of any amounts for the purpose of reimbursing the borrower for such expenditures;
  - (v) A statement that such expenditures were made for the purpose of carrying out the project and that the goods or services purchased by means of such expenditures are appropriate for such purpose and that the cost thereof is not unreasonable.
- (d) Each application shall be accompanied by original or duplicate receipted bills or invoices and other documents sufficient to show that the expenditures covered by the application have been made for the goods or services specified therein and that the amount to be withdrawn from the loan account is to be used only for the purposes for which the loan is granted.
- (e) In order to facilitate approval of such applications the borrower may request the Bank to approve any proposed expenditure prior to the time when the borrower shall place the orders for the goods or services involved.
- (f) The Bank will not be required to make any advance unless it is satisfied that the borrower is currently complying with all the terms and conditions of the loan contract.



II - COVENANTS OF THE BORROWER\* RELATING TO  
MAINTENANCE OF THE SERVICE OF THE LOAN.

Such covenants would include covenants to the following effect:

- (a) The borrower will use its best efforts to carry out the project.\*\*  
If any condition arises which shall make it necessary or advisable to make any material modification in the project, the borrower will consult with the Bank sufficiently in advance to enable the Bank to consider the proposed modification and to present to the borrower the comments of the Bank thereon, and the borrower will give due consideration to such comments.
- (b) The borrower will not, without the prior consent of the Bank, make any agreement which creates, or the effect of which is to create, any charge or other priority upon the borrower's foreign exchange receipts or other external revenues, except as security for short-term indebtedness of the borrower contracted in the ordinary course of its international trade to finance current, self-liquidating transactions.
- (c) The borrower will not, without the prior consent of the Bank, enter into any agreement which would interfere with the accomplishment of the purposes of the loan or the maintenance of the service of the loan.

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\* In cases in which the borrower is not a member of the Bank the member of the Bank (or its agency) which guarantees the loan will also make such covenants.

\*\* In this memorandum the term project also includes general programs of economic reconstruction.



- (d) If any conditions shall arise which shall interfere with, or threaten to interfere with, the accomplishment of the purposes of the loan or the maintenance of the service of the loan, the borrower will consult with the Bank promptly for the purpose of considering what action, if any, should be taken in order to meet such conditions; and the borrower will keep the Bank currently informed of any such conditions which arise or threaten.
- (e) The borrower will furnish the following information to the Bank:
  - (i) Periodic reports showing in reasonable detail the progress of the project, including the use made of the goods or services purchased with the proceeds of the loan;
  - (ii) Periodic reports showing the international balance of payments position of the borrower, setting forth by categories and by countries foreign exchange payments and receipts;
  - (iii) Periodic reports showing the amount and status of the external debt of the borrower, its political sub-divisions and its agencies;
  - (iv) Copies of external financial, loan, clearing, monetary, commercial and trade agreements entered into by the borrower, and all agreements providing for the guarantee by the borrower of external obligations;
  - (v) Copies of all legislation and decrees relating to or affecting the project or the service of the loan, including legislation and decrees with respect to foreign exchange controls, trade restrictions, the budget, price and wage controls, etc.;



- (vi) Such other information concerning the foreign exchange and economic position of the borrower as shall be relevant to the maintenance of the service of the loan.
- (f) There shall be made available to the Bank all information which the borrower shall furnish, or be required to furnish, to the International Monetary Fund and other public international organizations.
- (g) Facilities shall be made available to the Bank, as it may reasonably request; for examining or obtaining the material contained in sources from which the information furnished to the Bank is compiled.
- (h) External debt limitations.

Such provisions will necessarily vary according to the circumstances of the particular loan. In general they will take the form of limitations on the aggregate amount of external loans, or of annual service charges on external loans, which the borrower may contract without the consent of the Bank or without adequate consultation with the Bank. The aim of such provisions would be to limit the amount by which the borrower might increase its aggregate requirements of foreign exchange for the payment of service charges on its external debt. Certain exceptions to such limitations would, of course, have to be made in respect of such matters as refunding operations and short-term indebtedness contracted in the ordinary course of international trade to finance current, self-liquidating transactions. The degree of stringency of such limitations will to a large extent depend on the estimates which can be made at the time the loan is made with regard to the future



balance of payments prospects of the borrower and the degree of confidence which the Bank can place in such estimates. In cases in which such estimates leave a narrow margin of safety or where they are subject to a large margin of miscalculation the limitations with regard to the contracting of additional external debt will need to be more stringent than in cases in which the estimates as to the balance of payments prospects of the borrower are more optimistic and more certain. The amount of the limitation would also depend on the estimated needs of the borrower for additional external financing and the extent to which the estimated balance of payments prospects of the borrower leave room for such additional financing without imperilling the prospects of repayment of the Bank's loan.

NOTE: The above outlined provisions would, of course, have to be modified or supplemented according to the circumstances of the particular loan.



INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

February 17, 1947

COMMITTEE ON LOAN POLICY

FROM: The Secretary

DRAFT REPORT ON SUPERVISION OF LOANS

The attached draft Report on Supervision of Loans was prepared by the Staff Committee on Loan Supervision in compliance with the request made by the Committee on Loan Policy at its meeting on January 20, 1947.

The draft Report will be considered at an early meeting of the Committee on Loan Policy with a view to its submission to the Executive Directors.

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INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

February 17, 1947

COMMITTEE ON LOAN POLICY  
REPORT ON SUPERVISION OF LOANS

The Ad Hoc Committee on Pending Loan Applications requested the staff (R-35, approved October 22, 1946) to present its comments and recommendations in respect of the measures the Bank should take to supervise its loans. The President of the Bank thereafter appointed a Staff Committee on Loan Supervision, which filed with the Committee on Loan Policy a report on this matter dated January 14, 1947. (Committee on Loan Policy Document No. 1).

Upon consideration of the staff report and after discussion of the questions of policy raised thereby, the Committee on Loan Policy submits the following report to the Executive Directors.

A. THE FUNCTIONS OF THE BANK IN RESPECT OF THE ADMINISTRATION OF LOANS.

1. Subsections (b) and (c) of Section 5 of Article III of the Articles of Agreement of the Bank provide as follows:

"(b) The Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations.

"(c) In the case of loans made by the Bank, it shall open an account in the name of the borrower and the amount of the loan shall be credited to this account in the currency or currencies in which the loan is made. The borrower shall be permitted by the Bank to draw on this account only to meet expenses in connection with the project as they are actually incurred."

2. Having regard to the general purposes of the Bank as set forth in its Articles of Agreement and to the fact that the greater part of the loans which



the Bank will make will be made out of funds borrowed by the Bank from private investors, it must be recognized that the responsibilities of the Bank with regard to the administration of loans made by it go beyond the specific duty of making arrangements to ensure that the loans are used only for the purposes for which they are granted. Those responsibilities include the responsibility for making appropriate arrangements to ensure that the purposes for which the loans are granted will be accomplished and that the service of the loans will be maintained.

3. In considering the methods which the Bank should adopt to carry out those responsibilities, two aspects of the problem should be carefully distinguished. The first concerns the rights which the provisions of the loan contract should give to the Bank. The second concerns the extent to which those rights should be exercised by the staff of the Bank in its administration and application of the provisions of the loan contract.

4. The Bank's responsibilities require that the loan contract shall contain appropriate provisions setting forth the arrangements whereby the Bank shall be kept fully and currently informed of the progress of the project or program for which the loan was granted and of the development of any conditions which might prevent or interfere with the accomplishment of that project or program or the maintenance of the service of the loan. The loan contract should also contain arrangements affording the Bank timely opportunity to consult with the borrower and the guarantor (if any) and to take timely and appropriate action in order to ensure in so far as it properly can do so that the purposes of the loan are not defeated and that the service of the loan is maintained.

5. In the nature of things, the provisions of the loan contract must be broad and general in character, more especially because it will be impossible to foresee when the loan contract is made what specific conditions may arise which will require the Bank to avail itself of such provisions. Since the extreme and exceptional contingencies will be those in which the Bank will have the



greatest need to exercise its functions most firmly and effectively, it will be necessary that the provisions of the loan contract are such as to ensure that the Bank will have adequate opportunity and adequate power to deal with such contingencies in the best interests of all its members. While such provisions will necessarily vary as among different types of loans, it must be borne in mind that the Bank will probably not find it feasible to discriminate among borrowers with regard to the general scope of such provisions.

6. On the other hand, so far as concerns the exercise of the Bank's rights when the staff is called upon to administer and apply the provisions of the loan contract, the Bank should find it practicable to adapt the application of the provisions of the loan contract to the circumstances of the particular case. Only infrequently should the Bank find it necessary to take all of the measures which may be permitted under the loan contract.

7. The arrangements which shall be set forth in the loan contract and the administration of such arrangements by the Bank's staff must be such as not to offend the dignity of the government concerned or to involve interference in the internal politics of the particular country. They must also be such as not to make the Bank actually or apparently responsible for the conduct of the particular project or program or of the affairs of the borrower or the guarantor.

8. The nature and purposes of the loans will be such in most cases as to require that the Bank exercise its administrative functions not only at its principal office in Washington but also through representatives in the country in which the loan is made and in some cases in the countries in which the proceeds of the loan are expended. As a matter of policy and economy, whenever practicable, such field representatives should operate out of regional offices of the Bank rather than be detailed specifically to a particular country.

9. In general the costs of loan administration should be borne by the Bank as part of its general operating expenses rather than be charged to the



borrower as a specific part of the cost of the loan. In exceptional cases in which the borrower may request special services in connection with the administration of a loan, the borrower will undoubtedly be willing to pay the cost of such special services.

B. ARRANGEMENTS TO ENSURE THAT THE PROCEEDS OF THE LOAN ARE USED ONLY FOR THE PURPOSES FOR WHICH IT WAS GRANTED.

10. From the standpoint of the Bank the most practicable arrangement for supervising the expenditure of the proceeds of a loan will be for the borrower in the first instance, by use of its own funds or of a short-term banking credit obtained by it for the purpose, to make payment for the goods or services in question and then to request the Bank to advance the amount of such payment under the loan. Other arrangements may, of course, be made where they are more suitable to the particular case at hand; for example, it might be agreed that the borrower might draw on the Bank a draft in favor of the supplier to whom the expense is payable; or the Bank might in some cases open with a commercial bank a documentary letter of credit in favor of the particular supplier; or the Bank might agree, in special cases and under appropriate conditions, to advance funds out of which the borrower will pay the expenses in the first instance, replenishment of such funds to depend upon the furnishing of adequate proof that expenses paid therefrom were consistent with the contract.

11. The loan contract should entitle the Bank to require the borrower, in order to support an advance, to furnish adequate proof that the money is used for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations. It might, for example, be arranged that the borrower will furnish with each request for an advance an appropriate certificate to the effect that the amount to be advanced has been or will be paid to



actual suppliers of goods or services required for the project or program for which the loan was granted; that the goods or services are of such character that they will fulfill the purposes for which required; that the amount paid and the terms of purchase are not unreasonable; and that the expenditures for which the advance is requested have not theretofore been reimbursed to the borrower from the loan account and that they have not been and will not be used as a basis for advances under any other loan or credit which may be available to the borrower. The loan contract should, of course, put the Bank in a position to verify the accuracy of the certification, to the extent deemed appropriate in the particular case. In that connection, the loan contract should contain appropriate representations by the borrower with regard to all other loans and credit arrangements available to the borrower, in order that the Bank can be assured that the expenditures for which advances under the Bank's loan are requested have not been and will not be financed by other loans or credits.

12. The borrower should have opportunity, where appropriate, to secure the approval of the Bank to its purchases prior to making commitment therefor.

13. The loan contract should entitle the Bank to ascertain whether the goods or services for which an advance is made are actually and properly used as contemplated in the loan contract. The administration of such provisions will normally be the duty of a field representative of the Bank. The type of representative and the extent and character of the staff and consulting services which he may need will depend on the type of loan.

C. ARRANGEMENTS TO ENSURE THAT THE PROJECT FOR WHICH THE LOAN WAS GRANTED WILL ACCOMPLISH THE PURPOSES OF THE LOAN.

14. In the case of a loan for a specific project, the loan contract should contain provisions, such as those for inspection, the furnishing of information, and the making of representations by the Bank, sufficient to protect the interest



of the Bank in the efficient and economical operation of the project. Such provisions might also, to some extent, be applicable to loans granted for other than specific projects.

15. The type of arrangements contemplated by paragraph 14 should generally be administered primarily by the field representatives of the Bank, subject of course to direction from the principal office.

D. ARRANGEMENTS TO ENSURE THAT THE SERVICE OF THE LOAN CAN AND WILL BE MAINTAINED.

16. The loan contract should provide that the borrower and the guarantor (when a member of the Bank is not the borrower) will furnish the Bank currently with full information with regard to the conduct of the project or program for which the loan is made and with regard to any other matters which are relevant to the purpose of the loan and the maintenance of service on the loan. They should also undertake to make available to the Bank, as it may reasonably request, facilities for examining or obtaining the material contained in the sources from which such information is compiled. Arrangements should also be made whereby information which a member of the Bank is required to furnish to the Fund and other public international organizations shall be made available to the Bank.

17. The loan contract should contain provisions adequate to protect the Bank against action by the borrower or the guarantor which would imperil the maintenance of service on the Bank's loan, such as the making of agreements which formally or in effect create charges or other priorities on revenues or foreign exchange receipts of such nature as to endanger repayment prospects of the loan; the creation of additional external debt of such character and in such amount as would endanger repayment prospects of the loan; and other similar action.



18. The purpose of the suggested provisions relating to external debt should perhaps be explained in some detail. In most cases the principal reasons impelling a borrower to seek a loan from the Bank will be the need of the borrower to import goods for purposes of economic reconstruction or development and the fact that the balance of payments situation and prospects of the borrower are such that it cannot finance such imports by other means than a long-term loan from the Bank. In such cases the prospects of repayment of the loan will depend primarily on the future availability to the borrower of the foreign exchange required for such repayment. In fixing the terms of amortization of the loan, the Bank should take into account the balance of payment prospects of the borrower and its prospective needs for foreign exchange for all purposes, including the need for foreign exchange to meet its existing external debt. Thus, the Bank should arrange the terms of amortization of the Bank's loan so that the total annual service charges on all the borrower's external debt will not be excessive in any one year. In many cases, this may be accomplished by permitting the borrower to delay repayment of principal on the Bank's loan for a number of years or by establishing a schedule of annual amortization payments which takes into account any substantial variations from year to year in the aggregate service charges on the borrower's total existing external debt. The Bank should, therefore, see that the loan contract contains appropriate provisions to ensure that the fundamental assumptions upon which the prospects of repayment of the loan and the amortization provisions of the loan contract are based will not be impaired by the creation of future needs for foreign exchange resulting from excessive and economically unsound external borrowings. Unless the Bank is protected by provisions of that nature, it may be forced to provide less favorable terms of amortization in order to protect itself against the risk that subsequent creditors will take advantage of the relatively lenient amortization provisions



of the Bank's loan in order to obtain repayment of their loans in the earlier years when amortization payments on the Bank's loan are relatively small. In that connection the loan contract should also contain provisions whereby the Bank will be kept currently informed throughout the life of the loan of the status of the external debt of the borrower.

19. The Borrower should also agree that when conditions arise which threaten to imperil the maintenance of the service of the loan, it will in good time consult with the Bank as to possible measures to combat such conditions.

#### CONCLUSION

The Committee is of the opinion that no fixed policy can be framed that will cover all aspects of the problem of loan administration or fit each individual loan. It recommends that this report be approved by the Executive Directors as a general statement of principles to guide the staff in carrying out its responsibilities in the field of loan administration.

Committee on Loan Policy

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Chairman



CONFIDENTIAL DRAFT

DECLASSIFIED

Date: 11/15/2010  
STB

February 11, 1947

Committee on Loan Policy

In accordance with the request of the Committee on Loan Policy, there are submitted herewith brief descriptions of provisions which might be included in loan contracts to carry out some of the principal recommendations in the report dated January 14, 1947, of the Staff Committee on Loan Supervision. The provisions described are intended only as examples. The wording of the actual provisions will necessarily vary as among the different loans and it is probable that different types of provisions would have to be included in some loan contracts to adapt the policies proposed in the Committee's report to the circumstances of particular cases.

Staff Committee on Loan Supervision

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C. A. McLain, Chairman

D. Crena de Iongh  
Richard Demuth  
Arthur Hoar



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U.S. Res. 7

CONFIDENTIAL DRAFT

Date:

February 11, 1947

Report to the Executive Directors  
by the Committee on Loan Policy with respect  
to Supervision of Loans

- - - -

The Ad Hoc Committee on Pending Loan Applications requested the staff (R-35) to present its comments and recommendations in respect of the measures the Bank should take to supervise its loans. The President of the Bank thereafter appointed a Staff Committee on Loan Supervision, which filed with the Committee on Loan Policy a report on this matter dated January 14, 1947. (Committee on Loan Policy Document No. 1).

Upon consideration of the staff report and after discussion of the questions of policy raised thereby, the Committee on Loan Policy submits the following report to the Executive Directors.

A. The Functions of the Bank in Respect  
of the Administration of Loans.

1. Subsections (b) and (c) of Section 5 of Article III of the Articles of Agreement of the Bank provide as follows:

- "(b) The Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations.
- "(c) In the case of loans made by the Bank, it shall open an account in the name of the borrower and the amount of the loan shall be credited to this account in the currency or currencies in which



the loan is made. The borrower shall be permitted by the Bank to draw on this account only to meet expenses in connection with the project as they are actually incurred."

2. Having regard to the general purposes of the Bank as set forth in its Articles of Agreement and to the fact that the greater part of the loans which the Bank will make will be made out of funds borrowed by the Bank from private investors, it must be recognized that the responsibilities of the Bank with regard to the administration of loans made by it go beyond the specific duty of making arrangements to ensure that the loans are used only for the purposes for which they are granted. These responsibilities include the responsibility for making appropriate arrangements to ensure that the purposes for which the loans are granted will be accomplished and that the service of the loans will be maintained.

3. In considering the methods which the Bank should adopt to carry out those responsibilities, two aspects of the problem should be carefully distinguished. The first concerns the rights which the provisions of the loan contract should give to the Bank. The second concerns the extent to which those rights should be exercised by the staff of the Bank in its administration and application of the provisions of the loan contract.

4. The Bank's responsibilities require that the loan contract shall contain appropriate provisions setting forth the arrangements whereby the Bank shall be kept fully and currently informed of the progress of the project or program



for which the loan was granted and of the development of any conditions which might prevent, or interfere with the accomplishment of that project or program or the maintenance of the service of the loan and the arrangements whereby the Bank shall have a timely opportunity to consult with the borrower and the guarantor (if any) and to take timely and appropriate action in order to ensure in so far as it properly can do so that the purposes of the loan are not defeated and that the service of the loan is maintained.

5. In the nature of things, the provisions of the loan contract must be broad and general in character, more especially because it will be impossible to foresee when the loan contract is made what specific conditions may arise which will require the Bank to avail itself of such provisions. Since the extreme and exceptional contingencies will be those in which the Bank will have the greatest need to exercise its functions most firmly and effectively, it will be necessary that the provisions of the loan contract are such as to ensure that the Bank will have an adequate opportunity and adequate power to deal with such contingencies in the best interests of all its members. While such provisions will necessarily vary as among different types of loans, it must be borne in mind that the Bank will probably not find it feasible to discriminate among borrowers with regard to the general scope of such provisions.



6. On the other hand, so far as concerns the exercise of the Bank's rights when the staff is called upon to administer and apply the provisions of the loan contract, the Bank should find it practicable to adapt the application of the provisions of the loan contract to the circumstances of the particular case. Only infrequently should the Bank find it necessary to take all of the measures which may be permitted under the loan contract.

7. The arrangements which shall be set forth in the loan contract and the administration of such arrangements by the Bank's staff must be such as not to offend the dignity of the government concerned or to involve interference in the internal politics of the particular country. They must also be such as not to make the Bank actually or apparently responsible for the conduct of the particular project or program or of the affairs of the borrower or the guarantor.

8. The nature and purposes of the loans will be such in most cases as to require that the Bank exercise its administrative functions not only at its principal office in Washington but also through representatives in the country in which the loan is made and in some cases in the countries in which the proceeds of the loan are expended. As a matter of policy and economy, whenever practicable, such field representatives should operate out of regional offices of the Bank rather than be detailed specifically to a particular country.

Agree  
emphatically  
but  
interpretation?

Am against  
residuals  
in  
borrowing  
limits,  
subject to  
exceptions



9. In general the costs of loan administration should be borne by the Bank as part of its general operating expenses rather than be charged to the borrower as a specific part of the cost of the loan. In exceptional cases in which the borrower may request special services in connection with the administration of a loan, the borrower will undoubtedly be willing to pay the cost of such special services.

B. Arrangements to Ensure that the Proceeds of the Loan are Used only for the Purposes for which it was Granted.

10. From the standpoint of the Bank the most practicable arrangement for supervising the expenditure of the proceeds of a loan will be for the borrower in the first instance, by use of its own funds or of a short-term banking credit obtained by it for the purpose, to make payment for the goods or services in question and then to request the Bank to advance the amount of such payment under the loan. Other arrangements may, of course, be made where they are more suitable to the particular case at hand; for example, it might be agreed that the borrower might draw on the Bank a draft in favor of the supplier to whom the expense is payable; or the Bank might in some cases open with a commercial bank a documentary letter of credit in favor of the particular supplier; or the Bank might agree, in special cases and under appropriate conditions, to advance funds ~~to serve as a revolving fund~~ out of which the borrower will pay the



expenses in the first instance, replenishment of such fund to depend upon the furnishing of adequate proof that expenses paid therefrom were consistent with the contract.

11. The loan contract should entitle the Bank to require the borrower, in order to support an advance, to furnish adequate proof that the money ~~has been or will be~~ used for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations. It might, for example, be arranged that the borrower will furnish with each request for an advance an appropriate certificate to the effect that the amount to be advanced has been or will be paid to actual suppliers of goods or services required for the project or program for which the loan was granted; that the goods or services are of such character that they will fulfill the purposes for which <sup>they are</sup> required; that the amount paid and the terms of purchase are not unreasonable; and that the expenditures for which the advance is requested have not theretofore been reimbursed to the borrower from the loan account and that they have not been and will not be used as a basis for advances under any other loan or credit which may be available to the borrower. The loan contract should, of course, put the Bank in a position to verify the accuracy of the certification, to the extent deemed appropriate in the particular case. In that connection, the loan contract should contain appropriate representations by the borrower with regard to all other loans and credit arrangements available to the borrower, in order that the Bank can be assured that the expenditures for which advances under the Bank's loan are requested have not been and will not be financed by other loans or credits.

How can you  
get proof  
that some  
money  
will be  
used in  
the project?

I would  
agree to an  
undertaking.

undertaking

What does  
this mean?



12. The borrower should have opportunity, where appropriate, to secure the approval of the Bank to its purchases prior to making commitment therefor.

13. The loan contract should entitle the Bank to ascertain whether the goods or services for which an advance is made are actually and properly used as contemplated in the loan contract. The administration of such provisions will normally be the duty of a field representative of the Bank. The type of representative and the extent and character of the staff and consulting services which he may need will depend on the type of loan.

C. Arrangements to Ensure that the Project for which the Loan was Granted will Accomplish the Purposes of the Loan.

14. In the case of a loan for a specific project, the loan contract should contain provisions, such as those for inspection, the furnishing of information, and the making of representations by the Bank, sufficient to protect the interest of the Bank in the efficient and economical operation of the project. Such provisions might also, to some extent, be applicable to loans granted for other than specific projects.

15. The type of arrangements contemplated by paragraph 14 should generally be administered primarily by the field representatives of the Bank, subject of course to direction from the principal office.



D. Arrangements to Ensure that the Service of the Loan can and will be Maintained.

16. The loan contract should provide that the borrower and the guarantor (when a member of the Bank is not the borrower) will furnish the Bank currently with full information with regard to the conduct of the project or program for which the loan is made and with regard to any other matters which are relevant to the purpose of the loan and the maintenance of service on the loan. They should also undertake to make available to the Bank, as it may reasonably request, facilities for examining or obtaining the material contained in the sources from which such information is compiled. Arrangements should also be made whereby information which a member of the Bank is required to furnish to the Fund <sup>and other public international organizations</sup> shall be made available to the Bank.

17. The loan contract should contain provisions adequate to protect the Bank against action by the borrower or the guarantor which would imperil the maintenance of service on the Bank's loan, such as the making of agreements which formally or in effect create charges or <sup>other</sup> priorities on revenues or foreign exchange receipts of such nature as to endanger repayment prospects of the loan; the creation of additional external debt of such character and in such amount as would endanger repayment prospects of the loan; and other similar action.

18. The purpose of the suggested provisions relating to ~~long-term~~ external debt should perhaps be explained in some detail. In most cases the principal reasons impelling a borrower to seek a



loan from the Bank will be the need of the borrower to import goods for purposes of economic reconstruction or development and the fact that the balance of payments situation and prospects of the borrower are such that it cannot finance such imports by other means than a long-term loan from the Bank. In such cases the prospects of repayment of the loan will depend primarily on the future availability to the borrower of the foreign exchange required for such repayment. In fixing the terms of amortization of the loan, the Bank should take into account the balance of payment prospects of the borrower and its prospective needs for foreign exchange for all purposes, including the need for foreign exchange to meet its existing external debt. Thus, the Bank should arrange the terms of amortization of the Bank's loan so that the total annual service charges on all the borrower's external debt will not be excessive in any one year. In many cases, this may be accomplished by permitting the borrower to delay repayment of principal on the Bank's loan for a number of years or by establishing a schedule of annual amortization payments which takes into account any substantial variations from year to year in the aggregate service charges on the borrower's total existing external debt. The Bank should, therefore, see that the loan contract contains appropriate provisions to ensure that the fundamental assumptions upon which the prospects of repayment of the loan and the amortization provisions of the loan contract are based will not be impaired by the creation of future needs for foreign exchange resulting from excessive and economically unsound



external borrowings. Unless the Bank is protected by provisions of that nature, it may be forced to provide less favorable terms of amortization in order to protect itself against the risk that subsequent creditors will take advantage of the relatively lenient amortization provisions of the Bank's loan in order to obtain repayment of their loans in the earlier years when amortization payments on the Bank's loan are relatively small. In that connection the loan contract should also contain provisions whereby the Bank will be kept currently informed throughout the life of the loan of the status of the external debt of the borrower.

*among  
other  
things*

19. The Borrower should also agree that when conditions arise which threaten to imperil the maintenance of the service of the loan, it will in good time consult with the Bank as to possible measures to combat such conditions.

#### Conclusion

*Emphasize  
call* || The Committee is of the opinion that no fixed policy can be framed that will cover all aspects of the problem of loan administration or fit each individual loan. It recommends that this report be approved by the Executive Directors as a general statement of principles to guide the staff in carrying out its responsibilities in the field of loan administration.

Committee on Loan Policy

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Chairman



CONFIDENTIAL DRAFT

February 11, 1947

*types*  
DESCRIPTION OF PROVISIONS FOR LOAN CONTRACT

I - Provisions Regarding Disbursement of the Loan.

Such provisions would include provisions to the following effect:

- (a) The Bank will open an account on its books in the name of the borrower and will credit the amount of the loan to such account. Withdrawals from that account will be permitted only in accordance with the provisions of the loan contract.
- (b) The contract will include a *reasonable* description of the goods and services to be purchased by the borrower with the proceeds of the loan.
- (c) Whenever the borrower desires to draw on the loan account, it shall deliver to the Bank an application in writing setting forth
  - (1) The amount to be withdrawn;
  - (2) A reasonably itemized statement of the expenditures made by the borrower for goods or services for which reimbursement is requested, including the prices of the goods or services purchased, the dates of payment, the names and addresses of suppliers, the destination of such goods or services and the purposes for which they will be or have been used in connection with the project;



- (3) A statement that the amount to be withdrawn is required to reimburse the borrower for expenditures made by the borrower for the purposes specified in the application;
- (4) A statement that the borrower has not theretofore withdrawn or applied for withdrawal from the loan account, or from any other credit available to the borrower, of any amounts for the purpose of reimbursing the borrower for such expenditures;
- (5) A statement that such expenditures were made for the purpose of carrying out the project and that the goods or services purchased by means of such expenditures are appropriate for such purpose and that the cost thereof is not unreasonable.
- (d) Each application shall be accompanied by original or duplicate receipted bills or invoices and other documents sufficient to show that the expenditures covered by the application have been made for the goods or services specified therein and that the amount to be withdrawn from the loan account is to be used only for the purposes for which the loan is granted.
- (e) In order to facilitate approval of such applications the borrower may request the Bank to approve any proposed expenditure prior to the time when the borrower shall place the orders for the goods or services involved.



- (f) The Bank will not be required to make any advance unless it is satisfied that the borrower is currently complying with all the terms and conditions of the loan contract.



II - Covenants of the Borrower\* Relating to  
Maintenance of the Service of the Loan.

Such covenants would include covenants to the following effect:

- Yes, in  
merit*
- (a) The borrower will use its best efforts to carry out the project.\*\* If any condition arises which shall make it necessary or advisable to make any material modification in the project, the borrower will consult with the Bank sufficiently in advance to enable the Bank to consider the proposed modification and to present to the borrower the comments of the Bank thereon, and the borrower will give due consideration to such comments.
- Discretion*
- (b) The borrower will not, without the prior consent of the Bank, make any agreement which creates, or the effect of which is to create, any charge or other priority upon the borrower's foreign exchange receipts or other external revenues, except as security for short-term indebtedness of the borrower contracted in the ordinary course of its international trade to finance current, self-liquidating transactions.
- (c) The borrower will not, without the prior consent of the Bank, enter into any agreement which would interfere with the accomplishment of the purposes of the loan or the maintenance of the service of the loan.

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\* In cases in which the borrower is not a member of the Bank the member of the Bank (or its agency) which guarantees the loan will also make such covenants.

\*\* In this memorandum the term project also includes general programs of economic reconstruction.



- (d) If any conditions shall arise which shall interfere with, or threaten to interfere with, the accomplishment of the purposes of the loan or the maintenance of the service of the loan, the borrower will consult with the Bank promptly for the purpose of considering what action, if any, should be taken in order to meet such conditions; and the borrower will keep the Bank currently informed of any such conditions which arise or threaten.
- (e) The borrower will furnish the following information to the Bank:
- (1) Periodic reports showing in reasonable detail the progress of the project, including the use made of the goods or services purchased with the proceeds of the loan;
  - (2) Periodic reports showing the international balance of payments position of the borrower, setting forth by categories and by countries foreign exchange payments and receipts;
  - (3) Periodic reports showing the amount and status of the external debt of the borrower, its political sub-divisions and its agencies;
  - (4) Copies of external financial, loan, clearing, monetary, commercial and trade agreements entered into by the borrower, and all agreements providing for the guarantee by the borrower of external obligations.;



- (5) Copies of all legislation and decrees relating to or affecting the project or the service of the loan, including legislation and decrees with respect to foreign exchange controls, trade restrictions, the budget, price and wage controls, etc.;
- (6) Such other information concerning the foreign exchange and economic position of the borrower as shall be relevant to the maintenance of the service of the loan.
- (f) There shall be made available to the Bank all information which the borrower shall furnish, or be required to furnish, to the International Monetary Fund and other public international organizations.
- (g) Facilities shall be made available to the Bank, as it may reasonably request, for examining or obtaining the material contained in sources from which the information furnished to the Bank is compiled.
- (h) External debt limitations.

Such provisions will necessarily vary according to the circumstances of the particular loan. In general they will take the form of limitations on the aggregate amount of external loans, or of <sup>annual</sup> service charges on external loans, which the borrower may contract without the consent of the Bank or without adequate consultation with the Bank. The aim of such provisions would be to limit the amount by



which the borrower might increase its aggregate requirements of foreign exchange for the payment of service charges on its external debt. Certain exceptions to such limitations would, of course, have to be made in respect of such matters as refunding operations and short-term indebtedness contracted in the ordinary course of international trade to finance current, self-liquidating transactions. The degree of stringency of such limitations will to a large extent depend on the estimates which can be made at the time the loan is made with regard to the future balance of payments prospects of the borrower and the degree of confidence which the Bank can place in such estimates. In cases in which such estimates leave a narrow margin of safety or where they are subject to a large margin of miscalculation the limitations with regard to the contracting of additional external debt will need to be more stringent than in cases in which the estimates as to the balance of payments prospects of the borrower are more optimistic and more certain. The amount of the limitations would also depend on the estimated needs of the borrower for additional external financing and the extent to which the estimated balance of payments prospects of the borrower leave room for such additional financing without imperilling the prospects of repayment of the Bank's loan.

NOTE: The above outlined provisions would, of course, have to be modified or supplemented according to the circumstances of the particular loan.



The Members of the Committee on  
Loan Supervision  
The Treasurer

February 5, 1947

DECLASSIFIED

Date: 11/15/2010  
SJB

Attached please find a copy of a memorandum dated February 4, re "Relations of the Bank's Loans to Those of Others", which I would like to discuss at the next meeting of the Committee on Loan Supervision.

I am sending copies of the memorandum also to Messrs. Pinceo and Rist for their information.

Attachment

cc Mr. Demuth  
cc Mr. Hoar  
cc Mr. Pinceo  
cc Mr. Rist



CONFIDENTIAL

INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

**DECLASSIFIED**

Date:

February 4, 1947

MEMORANDUM FROM THE TREASURER

RE: RELATIONS OF THE BANK'S LOANS TO THOSE OF OTHERS

I. GENERAL REMARKS

1. Referring to the Report of the Staff Committee on Loan Supervision, I would like to make some remarks about a subject which is related to the matters discussed in that Report.
2. The Bank will begin its operations during a period in which financial and economic conditions are still unsettled in a great part of the world.
3. It cannot, therefore, be expected that during this period international private investments will be made on a large scale; however, a continuation of the existing trend of international credits extended by governments or government agencies can be expected.
4. At a later date it is to be anticipated that private international investments will be resumed. The Bank will welcome this as by its operations it intends "to promote private foreign investments" (sub-paragraph (ii) of Article I).
5. Because the Bank, according to its purposes, will never want to monopolize international financing, there can never be any objection from the side of the Bank against financing being done by governments or private investors, as long as such financial



transactions running alongside loans made by the Bank do not stand in the way of the Bank's purposes and the efficiency of the loans made by the Bank. As dangers exist in this field, attention should be given to problems confronting the Bank in this respect.

6. Loan applications until now received by the Bank show the extent to which governments have extended and are extending credits to the Bank's prospective borrowers. In the cases studied, the financing done by others runs into considerable amounts.
7. It was noted in connection with the French loan application that the United States, British and Canadian Governments and the Export-Import Bank of Washington have extended substantial credits to France and that the proceeds of these credits were spent or are intended to be spent in close relationship with the proceeds of a loan which France has requested from the Bank.
8. The research in connection with the Danish loan application shows that as a result of a short-term credit agreement between that country and the United Kingdom, Denmark owes considerable amounts on short term in sterling to the latter country. The repayment of these amounts will not be possible in the near future. As, however, a pending obligation on short term may endanger Denmark's obligation to the Bank, the Bank's loan cannot be made before a firm relation of the Bank's loan to Denmark's obligation to Great Britain is established.



9. The illustrations given above refer to credits given by members to applicants of loans from the Bank. In the case of the Chilean loan application, there is the additional complication of financial assistance to be given to an applicant by a non-member.
10. It is to be expected that in cases of other loan applications, either existing or to be made in the future, liabilities resulting from international financing by members and non-members will be an important element.
11. Part of these liabilities are a consequence of war-time financing; another part, however, is caused by post-war credits.
12. The problems confronting the Bank in these respects can be divided into two categories:
  - a. From the standpoint of supervision of disbursements:

Prevention of double financing of the same project out of loans from the Bank and loans from others.
  - b. From the standpoint of general supervision after disbursement:

Prevention of the borrower's commitment of international loans contrary to the Bank's purposes.

## II. PREVENTION OF DOUBLE FINANCING

1. In many cases external financial assistance to be obtained by borrowers from the Bank will only be a part of the external financing necessary for the execution of a country's reconstruction or development program.



2. The Bank should see to it that the proceeds of loans obtained or to be obtained from other sources are spent in harmony with the proceeds of the Bank's loans.
3. This implies that appropriate measures should be taken to prevent the proceeds of the Bank's loans being spent for purposes for which the borrower has been or will be paid by other sources.
4. Part of this task can be accomplished in the course of the Bank's general supervision as outlined in the Report of the Staff Committee on Loan Supervision. Especially in the case of general purpose loans, at the time a request for disbursement will be received by the Bank, the borrower will have to certify that the amount for which reimbursement is being requested has not been or will not be financed by other sources. The Bank will generally have to be satisfied with this certification at the time the disbursement to the borrower will be made. However, afterwards, in the course of the supervision in the territory of the borrower, special attention has to be given by the Bank's supervisor to the possibility of double financing. The results of this examination will, therefore, only be known after the proceeds of the loan have been spent.
5. It is also advisable, therefore, to examine the possibility of preventing double financing. Inasmuch as for the time being it is expected that the bulk of international financing will be borne by governments or government agencies, it is recommended that the Bank be in constant contact with the principal



governments which will be active in the international financial field.

III. PREVENTION OF THE BORROWER'S COMMITMENT OF INTERNATIONAL LOANS CONTRARY TO THE BANK'S PURPOSES

1. The measures to be taken by the Bank in this respect are partly connected with supervision and are partly a problem of coordination of the Bank's loans with those of others.
2. It is the duty of the Bank to prevent loan agreements of the borrower with others from interfering with the borrower's equilibrium in its balance of payments. This applies not only to the loan commitments which are beyond the borrower's capacity to repay but also to the assumption of commitments which are undesirable from the standpoint of the timing of repayments.
3. While during the time of negotiations with the borrowing member attention can be given to existing credit arrangements and funding of short-term debts can be studied and promoted before the loan is actually given, the Bank must be in a position to prevent the member from assuming such liabilities, after the loan contract is made and disbursements have taken place, in such cases where the financial position of the country and the safety of the Bank's loans would be endangered.
4. In respect to loan agreements entered into by borrowers after the time the latter have obtained loans from the Bank, it has the task to see that the projects or plans to be financed out of the proceeds of the new loans are in harmony with the



general economic and financial policy on which the Bank's loans were based.

5. The Bank should, therefore, always include in its loan agreements provisions to the effect that the borrower cannot contract foreign loans without the Bank's consent.
6. Apart from such a provision, coordination of the Bank's lending program with those of other lenders will be necessary as well as contact with the governments of the lender countries involved.
7. Especially when international loans are made by the Bank's members, this coordination will have the greatest chance of success. The most important will undoubtedly be:
  - a. United States
  - b. Canada
  - c. United Kingdom.
8. It will not be long before the Bank will have sufficient information at its disposal to ascertain approximately:
  - a. The extent to which its financial resources will be used in the first years to come.
  - b. The geographical distribution of the different loans.
  - c. The division between reconstruction and development loans.

The governments which can be expected to be the principal lenders will undoubtedly have comparable information at their disposal with respect to their own lending program.



9. It, therefore, would be possible to consult these governments in order to reach a coordination of the different lending programs.
10. The Bank, according to its Articles of Agreement, will not enter into short-term loan agreements whereas governments will undoubtedly also be active in this field. Therefore, the discussions should not only be limited to long-term credits but should also include short-term financial agreements. As mentioned before, the present financial relationship between Denmark and Great Britain shows that cooperation between the Bank and the United Kingdom is necessary.
11. If this coordination could be attained, this would not fully eliminate the danger of the borrower's commitment of international loans contrary to the Bank's purposes because it would not cover credits extended by either governments which are not members of the Bank or by private investors. The experience of the 'twenties shows that this danger is real, especially in respect to private investments. It happened in the case of League of Nations loans, for instance, that private investors, "free wheeling" on these loans, gave substantial credits to countries which previously had obtained loans under the auspices of the League. Though it would be questionable to state that this over-investment was the only cause of the failure of many international loans of the inter-war period, it is generally recognized that it was one of the major factors contributing to the defaults.



12. The problem of coordination is more difficult to solve in cases of international investment by governments, non-members, or private investors. It seems that no hard and fast rules can be given in this respect, but if the Bank remains alert to this problem it can certainly establish such contacts with institutions working in this field as would be necessary to be kept posted and ventilate the Bank's views and principles.
13. The success of the Bank's loans is not only dependent on good lending policy, supervision and coordination. Many factors over which the Bank has no control will determine whether the Bank will be able to accomplish its purposes. The Bank, by its actions, however, should attempt to achieve the position of leadership in the international financial field, thus performing its mission according to sub-paragraph (iii) of Article I:

"to promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investments for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labor in their territories."



Cell.

CONFIDENTIAL

**DECLASSIFIED**

December 30, 1946

Date: 11/15/2010 ~~STB~~

REPORT OF STAFF COMMITTEE ON  
LOAN SUPERVISION

*These distinctions should be made between "specific project" & general loans.*

This report is submitted in accordance with the request of the Ad Hoc Committee on Pending Loan Applications (R-35) that it be furnished with the comments and recommendations of the staff in respect of the measures the Bank should take to supervise its loans.

The report is confined to questions relating to loans made directly by the Bank. Guarantees and participations by the Bank in loans floated through regular market channels will present special problems which should be considered separately.

At the outset it should be noted that the term "supervision" is not used in any of the provisions of the Articles of Agreement which relate to the lending operations of the Bank. Furthermore "supervision" is not an appropriate term to describe the functions of the Bank which are here under consideration. These functions concern the general administration of the loan after the Bank has agreed to grant it and the Bank's interest in the borrower's capacity to repay. The details of carrying out those functions will differ somewhat as between loans for

1. distinction entire 3 components = 1) Spec projects (commercial)  
2) Salvage - Austria.  
3) 2/22. (reference Potark) *Is not there a substantial difference?*
- done page 3. erroneous*
2. *intitape UNRRA. = para 2.3. page 14 - reference to country*
3. *report on assumption of plan of finance in first three plus in plan (page 12)*
4. *VNO -*



specific projects and loans made "in special circumstances" under Section 4(vii) of Article III of the Articles of Agreement, but the underlying principles are the same,

Section 5(b) of Article III of the Articles of Agreement expressly requires that the "Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted." As has been indicated, however, in the discussions in the Ad Hoc Committee on Pending Loan Applications, that is only one phase of the Bank's responsibility in respect of any loan which it shall have agreed to grant.

In all its decisions the Bank must be guided by the purposes set forth in Article I of its Articles of Agreement. That means that the Bank should in every case take appropriate precautions to ensure, in so far as practicable, that any loan made by it will accomplish the purpose for which it was granted. Furthermore, Section 4(v) of Article III expressly enjoins the Bank "to act prudently in the interests both of the particular member in whose territories the project is located and of the members as a whole." That duty does not cease with the granting of the loan. It includes the duty of providing in the loan agreement prudent provisions to ensure that the purposes of the loan will be accomplished and that the service of the loan will be maintained, and of seeing that such



provisions are complied with during the life of the loan.

The functions of the Bank in respect of the administration of a loan may thus be considered under three headings:

- (1) Arrangements to ensure that the proceeds of the loan are used only for the purposes for which it was granted;
- (2) Arrangements to ensure that the project for which the loan was granted will accomplish the purposes of the loan; and
- (3) Arrangements to ensure that the service of the loan can and will be maintained.

A fourth heading relating to the arrangements covering the manner of paying the service of the loan concerns only administrative detail and does not raise questions of policy, at least in so far as direct loans by the Bank are concerned. Accordingly, it will not be dealt with in this memorandum.

Certain general comments are applicable to all three types of arrangements.

- (a) Under each type of arrangement the Bank will be required to exercise its functions not only in Washington, but also in the borrowing country and in some cases in the countries where the proceeds of the loan are expended.
- (b) The Bank cannot discriminate among its members with regard to any of the three types of arrangement, although the specific details will necessarily vary as among different kinds of loans, and



the extent to which the Bank may deem it necessary to exercise its rights under particular arrangements will vary according to its experience with the particular loan or loans.

- (c) The arrangements and the manner in which they are carried out should be such that they will not derogate from the responsibility of the borrower for the conduct of its affairs generally or of the particular project and will not impose any unnecessary burden on the borrower.
- (d) In general, the borrower should bear the costs of all three types of arrangements to the extent that such costs are specially incurred for the purposes of the particular loan and do not represent continuing costs of the Bank's permanent organization. Under this principle, the salary and expenses of a full-time representative in the borrowing country appointed solely in connection with the Bank's loan, and the charges of consultants retained by the Bank in connection with a particular loan, should normally be charged to the borrower. On the other hand, the costs of maintaining a permanent organization for loan administration at the Bank's principal office should be borne by the Bank. Between these relatively extreme examples, there will be room for exercise of judgment, and specific items of costs will have to be allocated, as between the Bank and the borrower, on the basis of the facts in each case.



(1) Arrangements to ensure that the proceeds of the loan are used only for the purposes for which it was granted.

Section 5(c) of Article III provides that the Bank shall credit the amount of the loan to an account in the name of the borrower in the currency or currencies in which the loan is made and shall permit the borrower to draw on the account "only to meet expenses in connection with the project as they are actually incurred." There are several ways in which a borrower might operate under that provision.

- (a) From the point of view of the Bank the simplest way would be for the borrower first to pay the particular expense (out of its own funds or out of a short term banking credit obtained by it for the purpose) and then request the Bank to advance the amount of the expense under the loan. The loan agreement would provide for the form of the request to be filed by the borrower and for the kind of proof which should accompany the request.
- (b) The borrower might draw on the Bank a draft in favor of the supplier to whom the expense is payable. In that case it would be necessary either that the borrower furnish to the Bank in advance of the presentation of the draft the proof requisite to support its request for the advance or that such proof accompany the draft.
- (c) The borrower might in some cases request the Bank to open with a commercial bank a documentary letter of credit in favor of a particular supplier, payment to be made against shipping documents for specified articles to be purchased out of the proceeds of the loan.



As is stated above, method (a) is the simplest method from the point of view of the Bank. Methods (b) and (c) would involve procedures and responsibilities which the Bank should undertake only in exceptional cases.

The manner in which the borrower may draw against its credit with the Bank would, of course, be specified in the loan agreement and would vary according to the circumstances of the particular loan.

The proof required to support an advance under the loan must be such as to satisfy the Bank that the amount of the advance has been or will be used for the purposes for which the loan was granted, "with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations."

That means that such proof must satisfy the Bank

- (a) that the amount to be advanced has been or is paid to actual suppliers of goods or services;
- (b) that such goods or services are required for the project or are consistent with the program for which the loan was granted;
- (c) that they are appropriate and adequate for the purpose for which they are required; and
- (d) that the prices and terms of purchase are not unreasonable.

*how is this verified*

*formula to be applied*

*to fund loans?*



Moreover, the Bank's duty does not stop there. It must also satisfy itself that such goods and services are actually and efficiently used in the project.

In order that the Bank may effectively exercise its functions in these respects without too large an administrative organization, the loan contract should be as specific as possible as to the purposes to which the proceeds of the loan are to be applied. When such information cannot be included in or furnished with the loan contract, provision should be made for furnishing the information to the Bank sufficiently in advance of the time when payments will be required to enable the Bank to check it. At least in the case of special project loans, such information should include schedules giving quantities and descriptions, with full specifications where practicable and actual or estimated prices of the respective goods and services to be purchased. Where engineering considerations are involved, detailed plans and specifications should also be furnished.

The loan contract should also provide that the Bank shall be furnished with all information and documents which it shall reasonably request in order to satisfy itself on the matters listed above, including, but not limited to, duplicate receipted invoices, bills of lading and purchase orders, and that representatives of the Bank shall



have access to all relevant records.

At its principal office the Bank should have an organization adequate to pass upon all requests for advances under the loan and the proof offered in support of such requests. For some projects such an organization may need to avail itself of expert engineering and accounting services on a consulting basis. The actual administrative practice will necessarily vary as between projects. In general the practice would be somewhat as follows: The Bank will require that all withdrawal requests be accompanied by a certification by the borrower and by duplicate receipted invoices and bills of lading, etc. These documents will be examined in order to determine whether they satisfy the requirements of the loan contract. Where special accounting or engineering questions are involved, certifications by accountants or engineers employed by the borrower should be submitted. There will need to be considerable flexibility in practice if the Bank's staff is not to be overburdened.

*invariably?*  
In addition to the organization at its principal office, the Bank will need a full or part-time representative in the borrowing country. The type of representative and the extent and character of the staff and consulting services which he may need will depend on the



type of loan. The Bank will require that requests for advances and the supporting documents be submitted in duplicate so that one set can be furnished to such representative. When an advance is made the representative will be so advised and it will be his duty to satisfy himself that the goods or services for which the advance was made are actually used as contemplated in the loan contract. He will also inquire into the efficiency with which such goods and services are used.

(2) Arrangements to ensure that the project for which the loan was granted will accomplish the purposes of the loan.

The type of arrangements discussed under this heading would apply primarily to loans granted for specific projects, although to some extent at least such arrangements might also be applicable to loans granted for other purposes. Such arrangements would include arrangements to ensure that the particular project is efficiently and economically carried out and operated.

Responsibility for carrying out such arrangements will generally rest with the representative of the Bank in the country where the project is located. For that purpose he should have access to all relevant operating, economic and statistical information relating to the project. He should also be furnished with periodic reports concerning the progress and status of the project.



In the case of some projects where it is not practicable to furnish a complete plan at the time the loan contract is made or where the loan contract contemplates modifications in the plan, the approval of the Bank may be required before certain parts of the project are undertaken or such modifications are made. In such cases the Bank's representative may be required to examine and report to the Bank with regard to the particular part of the project concerned.

In the case of some projects where adequate management may not be available in the country where the project is located, it may be necessary that the loan contract contain appropriate provisions to ensure that adequate management will be provided and maintained. The Bank should not, however, participate in or have the appearance of participating in the management of the project.

(3) Arrangements to ensure that the service of the loan can and will be maintained.

The Bank is an international institution which has been established as such by the members' acceptance of its Articles of Agreement. Among its objects are to "promote private foreign investment"; to "promote the long-range growth of international trade and the maintenance of equilibrium in balances of payments by encouraging inter-



national investment for the development of the productive resources of members"; and to "conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate postwar years, to assist in bringing about a smooth transition from a wartime to a peacetime economy."

The Bank cannot attain those objects merely by making arrangements to ensure that the funds loaned are expended for the purposes for which they were loaned. Its responsibilities under its Articles of Agreement do not cease when the monies loaned have been advanced.

The only way to revitalize the international investment markets is to re-establish the confidence of investors in the credit of the borrowers in these markets. The Bank's duty to take appropriate measures in order to protect the maintenance of the service of its loans, therefore, does not arise solely from the fact that in making these loans it risks the capital contributed by its members or funds borrowed from investors, but also from the fact that, if it is to accomplish its mission, it must by its operations demonstrate to the investors of the world that the risks of international investment when conducted on a sound basis are not excessive. While the Bank is expected to blaze the trail and, therefore, to assume risks



which would deter the private investor, it is none the less expected to conduct its operations on a sound economic basis and without regard to political susceptibilities or influences.

In applying for a loan, the borrowing country will normally support its application by setting forth the economic program and policies by means of which it expects to realize the long-range objectives of the loan and to assure repayment to the Bank. The very fact that such plans are submitted constitutes a recognition by the borrower of the legitimate interest of the Bank not only in the formulation but also in the execution of the program and policies. Since the Bank, as well as the borrower, must look to the program and policies as a means of achieving the objectives of the loan and of assuring repayment, the Bank should clearly put itself in a position to ascertain, during the entire life of the loan, whether the program and policies are being carried out and to protect itself from unwarranted deviations which might defeat the purpose or imperil the service of the loan.

In making any loan, therefore, the Bank has a clear duty to take appropriate measures in order to assure itself in so far as possible that the loan is within the



capacity of the borrower to repay; that the project or program for which the loan is made not only is adapted to improve the economic condition of the borrowing country but also will actually be so conducted as to accomplish that result; and further that the economy of such member will be so conducted as not to impair the prospects that the foreign exchange required for the service of the loan will be available to the borrower.

Under its Articles of Agreement the Bank is enjoined from interfering in the political affairs of any of its members. Nor is it any part of the duty of the Bank to assume responsibility for the conduct of any project or of the economy of the member in whose territories the project is located. At the same time, a realistic approach to the problem requires that all members of the Bank shall recognize the legitimate interest of the Bank not only in the conduct of the project for which it makes a loan but also in the economy of the borrowing member as it relates to the balance of international payments of such member.

Having recognized that fact, the practical problem is what measures can the Bank take in order to perform its duty in that regard. Some of those measures are self-evident.



First, the borrower should undertake to furnish to the Bank currently full information with regard to the conduct of the project or program for which the loan is made.

Second, the borrowing member should also agree to furnish the Bank currently with reports containing full information with regard to matters which are relevant to the purpose of the loan and the maintenance of the service of the loan. The borrowing member should also agree that the Bank's representative shall have access to such statistical and other records of the central bank, treasury, exchange control and other comparable agencies of such member as are relevant.

Third, the loan contract should contain provisions which would ensure <sup>with a facility</sup> that the borrowing member will not take any action that might imperil the maintenance of the service of the loan without the consent of the Bank. Such provisions would include provisions to limit the total amount of external debt which the borrowing member might ~~might~~ <sup>shall incur</sup> shall be within its capacity to pay



incur without the consent of the Bank,  
provisions against the creation of  
charges against revenues or foreign  
exchange receipts without the consent  
of the Bank, and other similar pro-  
visions.

Fourth, such member should also agree  
that, when any conditions arise which  
threaten to imperil the maintenance of  
the service of the loan, it will in good  
time consult with the Bank as to possible  
measures to combat such conditions. That  
would be a logical condition precedent to  
the right of any member to avail itself of  
the provisions of Section 4(c) of Article IV  
of the Articles of Agreement in order to  
obtain relief from the service requirements  
of a loan in case of an acute exchange  
stringency.

Provisions such as those outlined above would  
seem to be essential in any loan agreement. They are  
valuable not only for the protection they furnish in them-  
selves, but also for their effect in strengthening the hands  
of those in the borrowing country who support sound economic  
and financial policies. The actual details of the provisions

*Montez  
à la requête*

*to be inserted in good  
spirit of conditions of  
fulfilment of purpose*



would necessarily vary according to circumstances.

*See page 13*  
There remains the important question as to how the Bank can most effectively reinforce the above-mentioned provisions in order to have maximum assurance that they will remain effective in all the changing external and internal conditions of the borrowing country.

It is evident that the Bank's representative in that country can and should play a most important part to that end. His technical responsibilities will demand considerable technical qualifications. To these should be added personal qualities of the highest order which should enable him to command the confidence and respect of the responsible executive heads in the country of his assignment. It should be his steady purpose to establish his representation of the Bank in authority and prestige.

The Bank's representative should not only be able to assure that the Bank receives the documentary and statistical evidence of the economic and financial situation at the moment but should increasingly be able to keep the Bank informed of the intangible elements which are currently determining the trend of future policy in the borrowing country. Thus the Bank should be able at



an early stage to discern the evolution of circumstances or policies which might later jeopardise the service of the loan or the accomplishment of its purposes.

Clearly these responsibilities of the Bank's representative will grow with the progress of time and will become increasingly important after the whole of the loan proceeds have been expended. If adverse circumstances should then arise, the representative should already be established in a position in which his advice would be both sought and respected. If the need arose, he should be able to bring weighty counsels to bear. Such a system of advice and co-operation would ultimately rest upon the personal qualities of the representative and the reputation and authority of the Bank itself.

The provisions of Section 4(c) of Article IV may present occasions in which the Bank will be able to be of substantial assistance in promoting sound measures. If and when a member should "suffer from an acute exchange stringency" and should seek to avail itself of the provisions of that section by applying to the Bank "for a relaxation of the conditions of payment," the Bank should be in position to see to it that, if any such relaxation is granted, it shall be granted on terms that will ensure in so far as possible that proper measures are taken to correct the



*where / if they are within the  
province of the debtors influence*

conditions which gave rise to the exchange stringency.

If in the end the Bank and its representative should meet with unreasonable obduracy, it would be for the Bank to decide what other steps were open to it in an endeavor to persuade the government concerned to fulfill its obligations. The facts of the situation could, at an appropriate moment, be published and their communication to the United Nations might lead to support for the Bank's representations through the United Nations Organization or through diplomatic channels.

The further question whether or not the Bank should endeavor to obtain security in the form of an assignment of all or part of the foreign exchange received by the borrowing country from specific sources for the purpose of providing a possible deterrent to the evasion of obligations under the loan contract was also discussed by the committee. However, since the subject of security presents special problems not strictly within the province of the committee, it was decided not to present any recommendations on that subject at this time.

Staff Committee on Loan Supervision  
C. A. McLain, Chairman  
D. Crena de Iongh  
R. H. Demuth  
A. S. G. Hoar



INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

January 14, 1947

COMMITTEE ON LOAN POLICY

FROM: The Secretary

Report of the Staff Committee on Loan Supervision

Attached for the information of the Committee on Loan Policy is the report of the staff on supervision of loans made in compliance with the request of the Ad Hoc Committee on Pending Loan Applications (R-35 Final, dated October 22, 1946).

Distribution:

Members of the Committee on Loan Policy  
President  
Vice President  
Treasurer  
General Counsel  
Loan Director  
Research Director  
Chief of Communications  
Secretary

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Sec-274



INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

January 14, 1947.

REPORT OF STAFF COMMITTEE ON  
LOAN SUPERVISION

This report is submitted in accordance with the request of the Ad Hoc Committee on Pending Loan Applications (R-35) that it be furnished with the comments and recommendations of the staff in respect of the measures the Bank should take to supervise its loans.

The report is confined to questions relating to loans made directly by the Bank. Guarantees and participations by the Bank in loans floated through regular market channels will present special problems which should be considered separately.

At the outset it should be noted that the term "supervision" is not used in any of the provisions of the Articles of Agreement which relate to the lending operations of the Bank. Furthermore, "supervision" is not an appropriate term to describe the functions of the Bank which are here under consideration. These functions concern the general administration of the loan after the Bank has agreed to grant it and the Bank's interest in the borrower's capacity to repay. The details of carrying out those functions will differ as between loans for specific projects and loans made "in special circumstances" under Section 4 (vii) of Article III of the Articles of Agreement, but the underlying principles are the same.



Section 5 (b) of Article III of the Articles of Agreement expressly requires that the "Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted." As has been indicated, however, in the discussions in the Ad Hoc Committee on Pending Loan Applications, that is only one phase of the Bank's responsibility in respect of any loan which it shall have agreed to grant.

In all its decisions the Bank must be guided by the purposes set forth in Article I of its Articles of Agreement. That means that the Bank should in every case take appropriate precautions to ensure, insofar as practicable, that any loan made by it will accomplish the purpose for which it was granted. Furthermore, Section 4 (v) of Article III expressly enjoins the Bank "to act prudently in the interests both of the particular member in whose territories the project is located and of the members as a whole." That duty does not cease with the granting of the loan. It includes the duty of providing in the loan agreement prudent provisions to ensure that the purposes of the loan will be accomplished and that the service of the loan will be maintained, and of seeing that such provisions are complied with during the life of the loan.

The functions of the Bank in respect of the administration of a loan may thus be considered under three headings:

- (1) Arrangements to ensure that the proceeds of the loan are used only for the purposes for which it was granted;



- (2) Arrangements to ensure that the project for which the loan was granted will accomplish the purposes of the loan; and
- (3) Arrangements to ensure that the service of the loan can and will be maintained.

A fourth heading relating to the arrangements covering the manner of paying the service of the loan concerns only administrative detail and does not raise questions of policy, at least insofar as direct loans by the Bank are concerned. Accordingly, it will not be dealt with in this memorandum.

Certain general comments are applicable to all three types of arrangements.

- (a) Under each type of arrangement the Bank will be required to exercise its functions not only in Washington, but also in the borrowing country and in some cases in the countries where the proceeds of the loan are expended.
- (b) Although the specific provisions will necessarily vary as among different kinds of loans, and the extent to which the Bank may deem it necessary to exercise its rights under particular arrangements will vary according to its experience with the particular loan or loans, as a matter of policy the Bank should not discriminate among its members with regard to any of the three types of arrangements.
- (c) The arrangements and the manner in which they are carried out should be such that they will not derogate from the responsibility of the borrower for the conduct of its affairs generally or of the particular project and will not impose any unnecessary burden on the borrower.
- (d) In general, the borrower should bear the costs of all three types of arrangements to the extent that such costs are specially



incurred for the purposes of the particular loan and do not represent continuing costs of the Bank's permanent organization. Under this principle, the salary and expenses of a full time representative in the borrowing country appointed solely in connection with the Bank's loan, and the charges of consultants retained by the Bank in connection with a particular loan, should normally be charged to the borrower. On the other hand, the costs of maintaining a permanent organization for loan administration at the Bank's principal office should be borne by the Bank. Between these relatively extreme examples, there will be room for exercise of judgment, and specific items of costs will have to be allocated, as between the Bank and the borrower, on the basis of the facts in each case.

(1) ARRANGEMENTS TO ENSURE THAT THE PROCEEDS OF THE LOAN ARE USED ONLY FOR THE PURPOSES FOR WHICH IT WAS GRANTED.

Section 5(c) of Article III provides that the Bank shall credit the amount of the loan to an account in the name of the borrower in the currency or currencies in which the loan is made and shall permit the borrower to draw on the account "only to meet expenses in connection with the project as they are actually incurred." There are several ways in which a borrower might operate under that provision.

- (a) From the point of view of the Bank the simplest way would be for the borrower first to pay the particular expense (out of its own funds or out of a short term banking credit obtained by it for the purpose) and then request the Bank to advance the amount of the expense under the loan. The loan agreement would provide for the form of the request to be filed by the borrower and for the kind of proof which should accompany the request.



- (b) The borrower might draw on the Bank a draft in favor of the supplier to whom the expense is payable. In that case it would be necessary either that the borrower furnish to the Bank in advance of the presentation of the draft the proof requisite to support its request for the advance or that such proof accompany the draft.
- (c) The borrower might in some cases request the Bank to open with a commercial bank a documentary letter of credit in favor of a particular supplier, payment to be made against shipping documents for specified articles to be purchased out of the proceeds of the loan.

As is stated above, method (a) is the simplest method from the point of view of the Bank. Methods (b) and (c) would involve procedures and responsibilities which the Bank should undertake only in exceptional cases.

The manner in which the borrower may draw against its credit with the Bank would, of course, be specified in the loan agreement and would vary according to the circumstances of the particular loan.

The proof required to support an advance under the loan must be such as to satisfy the Bank that the amount of the advance has been or will be used for the purposes for which the loan was granted, "with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations."

That means that such proof must satisfy the Bank

- (a) that the amount to be advanced has been or is paid to actual suppliers of goods or services;



- (b) that such goods or services are required for the project or are consistent with the program for which the loan was granted;
- (c) that they are appropriate and adequate for the purpose for which they are required; and
- (d) that the prices and terms of purchase are not unreasonable.

(e) Moreover, the Bank's duty does not stop there. It must also satisfy itself that such goods and services are actually and efficiently used in the project.

In order that the Bank may effectively exercise its functions in these respects without too large an administrative organization, the loan contract should be as specific as possible as to the purposes to which the proceeds of the loan are to be applied. When such information cannot be included in or furnished with the loan contract, provision should be made for furnishing the information to the Bank sufficiently in advance of the time when payments will be required to enable the Bank to check it. At least in the case of special project loans, such information should include schedules giving quantities and descriptions, with full specifications where practicable and actual or estimated prices of the respective goods and services to be purchased. Where engineering considerations are involved, detailed plans and specifications should also be furnished.

The loan contract should also provide that the Bank shall be furnished with all information and documents which it shall reasonably request in order to satisfy itself on the matters listed above, including, but not limited to, duplicate



receipted invoices, bills of lading and purchase orders, and that representatives of the Bank shall have access to all relevant records.

At its principal office the Bank should have an organization adequate to pass upon all requests for advances under the loan and the proof offered in support of such requests. For some projects such an organization may need to avail itself of expert engineering and accounting services on a consulting basis. The actual administrative practice will necessarily vary as between projects and there will need to be considerable flexibility in practice if the Bank's staff is not to be overburdened.

In addition to the organization at its principal office, the Bank will probably need a full or part-time representative in the borrowing country. The type of representative and the extent and character of the staff and consulting services which he may need will depend on the type of loan. The Bank will require that requests for advances and the supporting documents be submitted in duplicate so that one set can be furnished to such representative. When an advance is made the representative will be so advised and it will be his duty to satisfy himself that the goods or services for which the advance was made are actually used as contemplated in the loan contract. He will also inquire into the efficiency with which such goods and services are used.



(2) ARRANGEMENTS TO ENSURE THAT THE PROJECT FOR WHICH THE LOAN WAS GRANTED WILL ACCOMPLISH THE PURPOSES OF THE LOAN.

The type of arrangements discussed under this heading would apply primarily to loans granted for specific projects, although to some extent at least such arrangements might also be applicable to loans granted for other purposes. Such arrangements would include arrangements to ensure that the particular project is efficiently and economically carried out and operated.

Responsibility for carrying out such arrangements will generally rest with the representative of the Bank in the country where the project is located. For that purpose he should have access to all relevant operating, economic and statistical information relating to the project. He should also be furnished with periodic reports concerning the progress and status of the project.

In the case of some projects where it is not practicable to furnish a complete plan at the time the loan contract is made or where the loan contract contemplates modifications in the plan, the approval of the Bank may be required before certain parts of the project are undertaken or such modifications are made. In such cases the Bank's representative may be required to examine and report to the Bank with regard to the particular part of the project concerned.

In the case of some projects where adequate



management may not be available in the country where the project is located, it may be necessary that the loan contract contain appropriate provisions to ensure that adequate management will be provided and maintained. The Bank should not, however, participate in or have the appearance of participating in the management of the project.

(3) ARRANGEMENTS TO ENSURE THAT THE SERVICE OF THE LOAN CAN AND WILL BE MAINTAINED.

The Bank is an international institution which has been established as such by the members' acceptance of its Articles of Agreement. Among its objects are to "promote private foreign investment"; to "promote the long-range growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members"; and to "conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate postwar years, to assist in bringing about a smooth transition from a wartime to a peacetime economy."

The Bank cannot attain those objects merely by making arrangements to ensure that the funds loaned are expended for the purposes for which they were loaned. Its responsibilities under its Articles of Agreement do not cease when



the monies loaned have been advanced.

The only way to revitalize the international investment markets is to re-establish the confidence of investors in the credit of the borrowers in these markets. The Bank's duty to take appropriate measures in order to protect the maintenance of the service of its loans, therefore, does not arise solely from the fact that in making these loans it risks the capital contributed by its members or funds borrowed from investors, but also from the fact that, if it is to accomplish its mission, it must by its operations demonstrate to the investors of the world that the risks of international investment when conducted on a sound basis are not excessive. While the Bank is expected to blaze the trail and, therefore, to assume risks which would deter the private investor, it is none the less expected to conduct its operations on a sound economic basis and without regard to political susceptibilities or influences.

In applying for a loan, the borrowing country will normally support its application by setting forth the economic program and policies by means of which it expects to realize the long-range objectives of the loan and to assure repayment to the Bank. The very fact that such plans are submitted constitutes a recognition by the borrower of the legitimate interest of the Bank not only in the formulation but also in the execution of the program and policies. Since the Bank, as well



as the borrower, must look to the program and policies as a means of achieving the objectives of the loan and of assuring repayment, the Bank should clearly put itself in a position to ascertain whether the program and policies are being carried out and to protect itself from unwarranted deviations which might defeat the purpose or imperil the service of the loan.

In making any loan, therefore, the Bank has a clear duty to take appropriate measures in order to assure itself insofar as possible that the loan is within the capacity of the borrower to repay; that the project or program for which the loan is made not only is adapted to improve the economic condition of the borrowing country but also will actually be so conducted as to accomplish that result; and further that the economy of such member will be so conducted as not to impair the prospects that the foreign exchange required for the service of the loan will be available to the borrower.

Under its Articles of Agreement the Bank is enjoined from interfering in the political affairs of any of its members. Nor is it any part of the duty of the Bank to assume responsibility for the conduct of any project or of the economy of the member in whose territories the project is located. At the same time, a realistic approach to the problem requires that all members of the Bank shall recognize the legitimate interest of the Bank not only in the conduct of the project for which it makes a loan but also in the economy of the borrowing member as



it relates to the balance of international payments of such member.

Having recognized that fact, the practical problem is what measures can the Bank take in order to perform its duty in that regard. Some of those measures are self-evident.

First, the borrower should undertake to furnish to the Bank currently full information with regard to the conduct of the project or program for which the loan is made.

Second, the borrowing member should also agree to furnish the Bank currently with reports containing full information with regard to matters which are relevant to the purpose of the loan and the maintenance of the service of the loan. The borrowing member should also agree that the Bank's representative shall have access to such statistical and other records of the central bank, treasury, exchange control and other comparable agencies of such member as are relevant.

Third, the loan contract should contain provisions which would ensure that the borrowing member will not take any action that might imperil the maintenance of the service of the loan without the consent of the Bank. Such



provisions would include appropriate provisions to ensure that the total amount of external debt which the borrowing member shall incur will be within its capacity to repay, provisions against the creation of charges against revenues or foreign exchange receipts without the consent of the Bank, and other similar provisions.

Fourth, such member should also agree that, when any conditions arise which threaten to imperil the maintenance of the service of the loan, it will in good time consult with the Bank as to possible measures to combat such conditions. That would be a logical condition precedent to the right of any member to avail itself of the provisions of Section 4(c) of Article IV of the Articles of Agreement in order to obtain relief from the service requirements of a loan in case of an acute exchange stringency.

Provisions such as those outlined above would seem to be essential in any loan agreement. They are valuable not only for the protection they furnish in themselves, but also for their effect in strengthening the hands of those in the borrowing country who support sound economic and financial policies. The actual details of the provisions would



necessarily vary according to circumstances.

There remains the important question as to how the Bank can most effectively reinforce the above-mentioned provisions in order to have maximum assurance that they will remain effective in all the changing external and internal conditions of the borrowing country.

It is evident that the Bank's representative in that country can and should play a most important part to that end. His technical responsibilities will demand considerable technical qualifications. To these should be added personal qualities of the highest order which should enable him to command the confidence and respect of the responsible executive heads in the country of his assignment. It should be his steady purpose to establish his representation of the Bank in authority and prestige.

The Bank's representative should not only be able to assure that the Bank receives the documentary and statistical evidence of the economic and financial situation at the moment but should increasingly be able to keep the Bank informed of the intangible elements which are currently determining the trend of future policy in the borrowing country. Thus the Bank should be able at an early stage to discern the evolution of circumstances or policies which might later jeopardize the service of the loan or the accomplishment of its purposes.

Clearly these responsibilities of the Bank's



representative will grow with the progress of time and will become increasingly important after the whole of the loan proceeds have been expended. If adverse circumstances should then arise, the representative should already be established in a position in which his advice would be both sought and respected. If the need arose, he should be able to bring weighty counsels to bear. Such a system of advice and cooperation would ultimately rest upon the personal qualities of the representative and the reputation and authority of the Bank itself.

The provisions of Section 4(c) of Article IV may present occasions in which the Bank will be able to be of substantial assistance in promoting sound measures. If and when a member should "suffer from an acute exchange stringency" and should seek to avail itself of the provisions of that section by applying to the Bank "for a relaxation of the conditions of payment," the Bank should be in position to see to it that, if any such relaxation is granted, it shall be granted on terms that will ensure insofar as possible that proper measures are taken to correct the conditions which gave rise to the exchange stringency.

If in the end the Bank and its representative should meet with unreasonable obduracy, it would be for the Bank to decide what other steps were open to it in an endeavor to persuade the government concerned to fulfill its obligations. The facts of the situation could, at an appropriate moment, be



published and their communication to the United Nations might lead to support for the Bank's representations through the United Nations Organization or through diplomatic channels.

The further question whether or not the Bank should endeavor to obtain security in the form of an assignment of all or part of the foreign exchange received by the borrowing country from specific sources for the purpose of providing a possible deterrent to the evasion of obligations under the loan contract was also discussed by the committee. However, since the subject of security presents special problems not strictly within the province of the committee, it was decided not to present any recommendations on that subject at this time.

In conclusion we reiterate that the principles which are herein set forth should be regarded as general principles, the application of which will necessarily vary according to the circumstances of the particular loan and the extent to which the Bank may deem it necessary to exercise its rights under any particular arrangements will also vary as among different loans.

Staff Committee on Loan Supervision  
C. A. McLain, Chairman  
D. Crena de Iough  
R. H. Demuth  
A. S. G. Hoar