Federal Register

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Part V

Department of the Treasury

31 CFR Part 25

Prepayment of Foreign Military Sales Loans; Final Rule

DEPARTMENT OF THE TREASURY

31 CFR Part 25

Prepayment of Foreign Military Sales Loans Made by the Defense Security Assistance Agency and Foreign Military Sales Loans Made by the Federal Financing Bank and Guaranteed by the Defense Security Assistance Agency

AGENCY: Department of the Treasury.

ACTION: Final rule.

SUMMARY: Pursuant to its March 21, 1988, issue of an interim rule with a request for comments, the Department of the Treasury is now issuing its final rule. This final rule is being issued pursuant to the requirement contained in Title III, Pub. L. 100–202, 31 U.S.C. 321, Foreign Military Sales Debt Reform (the refinancing legislation). This final rule concerns the prepayment and refinancing of Foreign Military Sales loans made by the Federal Financing Bank and guaranteed by the Defense Security Assistance Agency (DSAA) as well as Foreign Military Sales loans made directly by DSAA. The purpose of the rule is to establish procedures which will allow countries to which Foreign Military Sales loans have been made (Borrowers) to refinance certain existing Foreign Military Sales loans in a manner consistent with the refinancing legislation so as to achieve total lower debt service costs. The interim rule appeared in the **Federal Register** on March 24, 1988, in Volume 53, Number 57, page 9728.

EFFECTIVE DATE: July 6, 1988.

FOR FURTHER INFORMATION CONTACT: Gene Holland, Department of the Treasury, Room 3054, Main Treasury Building, Washington, DC 20220, (202) 566–2468.

SUPPLEMENTARY INFORMATION:

I. Comments

In the interim rule published in the **Federal Register** on March 24, 1988, in Volume 53, Number 57, page 9728, the Treasury Department stated that it would consider comments received from the public during the 30-day comment period defined in the preamble to the rule. This comment period ended April 25. Some comments, while dated April 25, were not delivered to the Treasury Department until after that date. However, the Treasury Department has reviewed and considered all of the comments received, including those that arrived after April 25.

During the comment period, the Treasury Department received fifteen letters of comments on the interim rule from the following commenters:

(1) The firm of Brown & Wood;

(2) The Republic of Honduras, through its embassy in Washington, DC;

(3) The Republic of Turkey, through its Undersecretariat of Treasury and Foreign Trade, General Directorate of Foreign Economic Relations;

(4) The Government of Pakistan, through its embassy in Washington, DC;

(5) J.P. Morgan Securities Inc.;

(6) The firm of Skadden, Arps, Slate, Meagher & Flom on behalf of The First Boston Corporation;

(7) MNC International Bank;

(8) Manufacturers Hanover Trust Company;

(9) Goldman, Sachs & Co.;

(10) The firm of Brown & Wood, on behalf of Citicorp Investment Bank;

(11) The firm of Sidley & Austin, on behalf of Shearson Lehman Hutton Inc.;

(12) The firm of Arnold & Porter, on behalf of the State of Israel;

(13) The firm of Vinson & Elkins on behalf of Salomon Brothers Inc.;

(14) Shearson Lehman Hutton Inc. on behalf of the Arab Republic of Egypt; and

(15) Shearson Lehman Hutton Inc. on behalf of the Kingdom of Morocco.

In addition, after the closing of the comment period, the Treasury Department received letters of comment from the following commenters:

(1) Senators Daniel K. Inouye and Robert W. Kasten, Chairman and Ranking Minority Member, respectively, Subcommittee on Foreign Operations, Senate Committee on Appropriations;

(2) The Riggs National Bank;

(3) The firm of Brown & Wood;

(4) Congressman David R. Obey, Chairman, Subcommittee on Foreign Operations, Export Financing, and Related Programs, House Committee on Appropriations;

(5) Shearson Lehman Hutton, Inc. and Salomon Brothers Inc. on behalf of the Government of Israel; and

(6) Bear, Stearns & Co. Inc., Drexel Burnham Lambert Inc., The First Boston Corporation, Merrill Lynch Capital Markets and Smith Barney, Harris Upham & Co. Inc. on behalf of the Government of Israel.

Many commenters focused on three provisions of the interim rule: The prohibition against separating the guaranteed amount of the refinancing loan from the unguaranteed amount; the prohibition against collateralizing the unguaranteed amount of the refinancing loan with securities backed by the full faith and credit of the United States; and the prepayment application processing period. Beyond these three provisions, there were a number of provisions that received isolated comments.

Some commenters argued that the provision in the refinancing legislation which states that the Treasury Department regulations shall "impose no restriction that increases the cost to borrowers of obtaining private financing for prepayment hereunder or that inhibits the ability of the borrower to enter into prepayment arrangements hereunder" requires the Treasury Department to resolve any statutory ambiguities in favor of the lowest cost result. The Treasury Department believes that, within the constraints imposed by the legislative authority, the interim rule and the following final rule achieve this goal.

Comments and the Treasury Department's response thereto are discussed in the following section-by-section analysis.

II. Section-by-Section Analysis of Comments on the Interim Rule

1. Section 25.100—Definitions

Some comments objected to the lack of a definition for the term "derivative". In response to these comments, the Treasury Department has added a new defined term and definition, titled "Derivative" (§ 25.100(e)). This term is principally used in the section pertaining to registration (§ 25.403) and the revised section pertaining to non-separability (§ 25.404).

One comment objected to the definition of "Eligible FMS Advance" (§ 25.100(f) in the interim rule, renumbered § 25.100(g) in the final rule). Specifically, this commenter believed that this definition precluded the refinancing of any advance bearing interest at a rate of 10 percent or greater that is part of an FFB loan bearing interest at a consolidated rate of less than 10 percent. The commenter stated that it was unclear that separate interest rates continue to exist on FMS advances after a consolidated rate has been established.

Paragraph two of the standard FFB promissory note provides that a consolidated interest rate is established for billing purposes after all funds available under the respective FMS loan agreement have been drawn. However, the respective interest rates continue to apply to individual advances, thus determining their eligibility under the definition. Therefore, the Treasury Department has not altered this definition.

Four comments reflected concern with the definition of "Private Lender" (§ 25.100(p) in the interim rule). This

definition has been renumbered § 25.100(i) and retitled "Eligible Private Lender" in the final rule. One commenter requested that clause (1)(i) should be expanded to include "or any subsidiary or affiliate thereof." The commenter asserted that this addition would allow institutions more flexibility and therefore lower financing costs to the borrower.

While the commenter did not offer any substantive support for this assertion, the Treasury Department has no objection to the comment and has incorporated this comment into the final rule.

Another commenter indicated that the definition described in clause (1)(i) should be expanded to specifically include "investment banking companies."

While the Treasury Department believes that the definition of "Private Lender," as written in the interim rule, effectively covered investment banking companies, the Treasury Department has no objection to modifying this definition to specifically incorporate the comment. Therefore, the definition has been so modified in the final rule.

Another comment on this section concerned the concept of "wholly owned initially" and the relationship of this concept to trusts and partnerships, which are not owned but are created.

The Treasury Department believes that this commenter misunderstood the intent of the phrase "wholly owned initially," and so has modified the phrase to clarify its purpose. The Treasury Department is of the opinion that if trusts or other special purpose financing entities are going to be used in making the Private Loan, then the criteria for "Eligible Private Lender" should be applied to the parties that initially "fund" the trust or other special purpose financing entities, since these parties are in reality making the Private Loan.

In addition to the newly created term "Derivative," the Treasury Department has added two new definitions to the final rule, "Guaranteed-Amount Debt Derivative" and "Guaranteed-Amount Equity Derivative" (§ 25.100 (n) and (o), respectively). These new defined terms are used in the revised section pertaining to non-separability (§ 25.404).

One comment requested that the final rule define the "Guaranty Coverage" of the Guaranty.

The Treasury Department did not accept this comment because it concluded that such a definition in the rule might create an ambiguity or a conflict with the terms of the Guaranty itself. Instead, the Treasury Department has included new defined terms in the final rule, "Guaranteed Loan Amount" (§ 25.100(q)), "Guaranteed Loan Portion Amount" (§ 25.100(r)), and "Guaranteed Amount Equivalent" (§ 25.100(p)). The term "Guaranteed Loan Amount" refers to the amount of a Private Loan which is guaranteed under the Guaranty. The term "Guaranteed Loan Portion Amount" refers to the amount of a portion of the Private Loan which is guaranteed under the Guaranty. The term "Guaranteed Amount Equivalent" is added to ensure that the prohibition against separating the guaranteed amount of the Private Loan from the unguaranteed amount is not circumvented through the establishment of successive trusts or special purpose financing entities issuing Derivatives of Derivatives. The terms "Guaranteed Loan Amount," "Guaranteed Loan Portion Amount," and "Guaranteed Amount Equivalent" are used in the revised section pertaining to non-separability (§ 25.404).

One comment asked for clarification of a perceived ambiguity between the definition of "Private Lender" in the interim rule and the definition of "Beneficiary" in the form of Guaranty (§ 25.406). Specifically, this commenter indicated that the definition of Private Lender states that the "Private Lender" must be chartered or otherwise organized under the laws of a state, the District of Columbia, the United States or any territory or possession of the United States and lawfully doing business in the United States, while the Guaranty indicates that the Lender may assign its rights under the Guaranty to any entity merely doing business in the United States.

The Treasury Department responds that the class of entities that are authorized to make the refinancing loans under the FMS refinancing legislation is a more narrow class than the class of entities that are permitted to hold guaranties under the Arms Export Control Act. Therefore, the Treasury Department has altered the Guaranty form in the final rule to clarify this point. Moreover, the final rule has added a new defined term, "Permitted Guaranty Holder" (§ 25.100(w)).

Some comments objected to the definition of "Permitted P&I Prepayment Amount" (§ 25.100(x) in the interim rule, renumbered § 25.100(v) in the final rule). Specifically, there was objection to clause (1) of this section which allows only principal amounts that become due and payable after September 30, 1989 to be included in "Eligible FMS Advances" or "Eligible FMS Loans" for refinancing.

The Treasury Department believes that the eligibility criteria established in this definition are mandated by the terms of the refinancing legislation, which provides authority only "to finance the prepayment at par of the principal amounts maturing after September 30, 1989." Therefore, this definition remains unchanged in the final rule.

A comment on the definition of "Private Loan" (§ 25.100(q) in the interim rule, renumbered § 25.100(y) in the final rule) reflected a concern that these definitions did not specifically address a public sale or private placement of debt obligations secured by the refinancing loan. The comment admitted that such sale or placement was implicit in the interim rule.

The Treasury Department agrees that such sale or placement is implicit in the interim rule. The final rule remains unchanged on this point.

Another comment on this section requested clarification that the "Private Loan" evidences an obligation of a sovereign nation. This commenter asserted that this clarification would reduce the Borrower's costs in obtaining a Private Loan.

The commenter offered no evidence to substantiate this assertion of reduced costs. Further, the Treasury Department did not believe that, for the purposes of this rule, it was either necessary or proper to define what does or does not constitute the sovereign debt of a country. Therefore, the Treasury Department has not changed this section of the rule.

As complements to the newly created definitions of the "Guaranteed Loan Amount" (§ 25.100(q)), the "Guaranteed Loan Portion Amount" (§ 25.100(r)), and the "Guaranteed-Amount Equivalent" (§ 25.100(p)), the Treasury Department has added new definitions for the "Unguaranteed Loan Amount" (§ 25.100(ee)), the "Unguaranteed Loan Portion Amount" (§ 25.100(ff)), and the "Unguaranteed-Amount Equivalent" (§ 25.100(dd)).

2. Section 25.200—General Rule

One commenter on paragraph (c) stated that while § 25.200 generally provided the necessary level of flexibility to a Borrower seeking to refinance existing loans, paragraph (c) did not provide the flexibility to split FMS loans so that early and late maturities could be separated and refinanced separately.

The interim rule allowed for Eligible FMS Loans to be refinanced on a advance-by-advance basis, thus allowing Borrowers and their Eligible Private Lenders great flexibility to structure Private Loans. However, the Treasury Department decided that the

administrative expense that would be incurred in accounting for partially refinanced advances did not warrant including this ultimate degree of flexibility. Moreover, the refinancing legislation does not contemplate the partial pepayment of advances.

Another commenter on this section was of the opinion that the interim rule provided that only whole Eligible FMS Loans could be refinanced.

This is incorrect. As stated above, Eligible FMS Loans can be refinanced on an advance-by-advance basis, but Eligible FMS Advances cannot be partially refinanced. Therefore, this section remains unchanged.

There were a few comments on subsection (b), the requirement that all prepayments must have a Closing Date not later than September 30, 1991. These commenters stated that Borrowers should be given the flexibility to seek approval of a prepayment application through that date and be allowed to close the approved prepayment at any time after that date.

The refinancing legislation authorizes the refinancing program for the period of Fiscal Year 1988 through 1991. The Treasury Department, in consultation with DSAA, the guarantor of the Private Loans, has concluded that authority does not exist to extend the program beyond Fiscal Year 1991. Therefore, this section remains unchanged in the final rule.

In response to a comment on Eligible FMS Advance, the Treasury Department has added § 25.200(d) which describes how principal payments that have already been made on FMS Loans which have already been consolidated will be applied under the terms of the respective promissory note for purposes of determining the outstanding principal balances of Eligible FMS Advances.

3. Section 25.300—Application Procedure

Two commenters stated that the requirement contained in § 25.300(a)(4) for the inclusion of all material transaction documents in substantially final form with a prepayment application was burdensome. One commenter stated that, as an alternative, the prepayment application should contain a detailed description of the proposed financial structure addressing terms of critical interest necessary to properly evaluate the Private Loan.

The Treasury Department has modified the section to allow a Borrower the choice of (1) the application procedure outlined in the interim rule, or (2) an optional additional procedure outlined in a new subsection (c) in the final rule, which allows the Borrower to obtain a preliminary, nonbinding review by DSAA of a proposed Private Loan. We believe that this optional procedure allows all of the parties concerned the necessary flexibility to place expeditiously a Private Loan.

4. Section 25.301—Approval Procedure

Many commenters objected to the provisions in this section that provide for unlimited review periods of the prepayment application by DSAA and the State Department.

The Treasury Department agrees that the total review and processing time by the DSAA, the State Department, and the Treasury Department should be limited to 30 days. In the final rule, these review periods have been defined and the section modified.

5. Section 25.302—Application Withdrawal

One commenter requested that the final rule provide that an approved refinancing application be permitted to be withdrawn at the option of the Borrower.

The final rule has added a new section to this effect.

6. Section 25.302—Closing Procedure (Renumbered § 25.303 in the Final Rule)

One commenter objected to the provisions contained in this section that would establish a Closing Date at the time that a prepayment application was approved. Further, this commenter urged that the rule be modified to allow the Closing Date to be established solely at the discretion of the Borrower.

The definition of "Closing Date", as written in the interim rule, provides that the Closing Date is to be established after the prepayment application has been approved. The interim rule also provides that the Closing Date is to be established by the mutual agreement of the Borrower, DSAA, and, in the case of FMS Loans which had been made by FFB, FFB. The Treasury Department believes that the reasonable administrative concerns of the respective governmental agencies need to be taken into account when scheduling Closing Dates. The Treasury Department has modified § 25.302 to reiterate that the Closing Date would be established on a date mutually agreeable to the parties involved in the closing. In addition, the Treasury Department has added a new paragraph (c) to this section clarifying that a Borrower may change an agreed upon Closing Date. However if the Borrower chooses to change the Closing Date, the new Closing Date must be mutually agreeable to the parties involved in the closing and the prepayment must be made in accordance with the approved prepayment application, adjusted for changes in accrued interest.

One commenter requested that prepayments be allowed to be made using "next day funds."

The institutional practice of the Federal Financing Bank is to require that any prepayments be made in "immediately available funds." Therefore, this provision has not been changed in the final rule.

7. Section 25.400—Loan Provisions

Many commenters objected to the requirement that the principal and interest payment schedule and maturity be similar to the Eligible FMS Loans or Eligible FMS Advances that are being refinanced. Many commenters stated that flexibility in payment structures would be of benefit to the Borrowers. Specifically, two commenters asserted that a savings of 5–10 basis points could be achieved if a payment structure of semi-annual payments of interest with annual payments of principal were allowable.

Another commenter indicated that the interim rule did not adequately define the first principal payment date for the Private Loan.

Another commenter on this section stated that the requirement that the principal and interest payment schedules of the proposed Private Loan be substantially the same as that of the eligible debt being refinanced conflicted with the structure that would result from the blending of payment schedules permitted by the interim rule. This commenter then went on to offer an example of how this conflict would lead to Private Loan repayment schedules that would be substantially different from the individual pieces of underlying debt.

The Treasury Department agrees that allowing for additional flexibility would facilitate refinancings. The Treasury Department also agrees that the blending of payment schedules permitted by the interim rule could result in substantial differences between payment schedules in the Private Loan and the Eligible FMS Loans or Eligible FMS Advances being refinanced. In an effort to address these issues in the final rule, the Treasury Department has modified this section to allow Borrowers and their Eligible Private Lenders two options for structuring the Private Loan and for fixing the first principal payment date.

The first option would permit the differing payment structures of Eligible

FMS Loans or Eligible FMS Advances to be consolidated into a single Private Loan payment structure that provides for semi-annual payments of principal and interest, with the amounts of principal of the Private Loan to be paid each year being the same as the principal that would have been paid in such year under the payment structure of the Eligible FMS Loans or Eligible FMS Advances.

The second option would allow for the differing payment structures of the Eligible FMS Loans or Eligible FMS Advances to be consolidated into a single payment structure of equal principal payments, subject to specific criteria relating to final maturity, first principal payment date and subsequent payment dates.

8. Section 25.401—Fees

One commenter indicated that the interim rule be modified to allow for the inclusion of "reasonable fees and expenses" in the amount refinanced. This commenter indicated further that the interim rule did not appear to contemplate the payment of fees and expenses on the Closing Date.

The interim rule states: "The interest rate on the Private Loan may include compensation for costs at prevailing market rates with the agreement of the Borrower and the Private Lender selected by the Borrower." This language is derived from the refinancing legislation, which provides that "the private lender may include, *in the interest rate charged,* a standard fee to cover costs, such fee which shall be set at prevailing market rates" (emphasis added). The Treasury Department believes that this language prohibits the Private Lender from including fees or expenses in the principal of the Private Loan. Therefore, this section remains unchanged in the final rule.

9. Section 25.403—Registration

One commenter objected to the provision that the Guaranty would cease to be effective if the guaranteed obligation were to provide significant support for a non-registered obligation.

This provision is derived directly from the refinancing legislation, which provides that "any guaranty transferred or extended shall cease to be effective if the private loan or any derivative thereof is to be used to provide significant support for any non-registered obligation."

Another commenter stated that it was unclear whether the Guaranty, as written in the interim rule, would continue to exist at all for any holders of any portion of a Private Loan Note if one holder of a portion of the Private Loan Note violated this section.

The Treasury Department responds that the Guaranty ceases to be effective only to the extent of, and only with respect to, the violation of this section. Therefore, this section has been modified to clarify this point in the final rule.

10. Section 25.404—Non-Separability

Many commenters objected to this section of the interim rule. In particular, many commenters stated that the Treasury Department was interfering with an Eligible Private Lender's "sources of funds" by applying the concept of non-separability to "derivatives" of the Private Loan.

While some commenters conceded that the prohibition against separating the guaranteed amount of the Private Loan from the unguaranteed amount could be interpreted as being applicable to participation shares of, or undivided ownership interests in, the Private Loan ("equity derivatives"), these same commenters asserted that the prohibition should not be interpreted as being applicable to debt instruments issued by the Eligible Private Lender that are secured by the Private Loan ("debt derivatives").

Many of the commenters also objected to this section having provided that the Guaranty would cease to be effective if the section were violated.

The refinancing legislation provides that the United States Government guaranty of a Private Loan "shall cover no more and no less than ninety percent of the private loan or any portion *or derivative thereof.* (emphasis added). The refinancing legislation also prohibits separating the guaranteed amount of the Private Loan from the unguaranteed amount. While this second provision is not made explicitly applicable to "derivatives" of the Private Loan, the Treasury Department interpreted the refinancing legislation by reading these two provisions together. Based on such a reading, the Treasury Department concluded in the interim rule that the prohibition against separating the guaranteed amount from unguaranteed amount applied to "derivatives" of the Private Loan.

As some commenters on this section conceded, the interpretation of the prohibition as being applicable to "equity derivatives" of the Private Loan, that is, participation shares of, or undivided ownership interests in, the Private Loan, is well supported by reading the two provisions of the refinancing legislation together. Therefore, the non-separability provision of the interim rule as it applies to such "equity derivatives" remains unchanged in the final rule.

The greatest objection to the non-separability provision of the interim rule was with respect to how it applied to "debt derivatives" of the Private Loan, that is, debt instruments of the Eligible Private Lender collateralized by the Private Loan. The commenters asserted this provision interfered with a lender's relationships with its investors.

The Treasury Department responds that this provision should have no effect on a lender's sources of funds so long as the lender does not separate the guaranteed amount of the Private Loan from the unguaranteed amount and use the guaranteed amount alone as a means of obtaining funds. The provision does not restrict an Eligible Private Lender from using the entire, unseparated Private Loan as collateral for obtaining funds.

Nevertheless, the Treasury Department recognizes that there is some ambiguity in the refinancing legislation as to the extent to which the non-separability provision of the refinancing legislation should be applied to the Eligible Private Lender's means of obtaining funds. Moreover, some commenters have asserted that some lenders will charge some Borrowers a higher cost of borrowing as a result of the non-separability provision being applied to the lenders' fund-raising activities. Accordingly, the Treasury Department has modified this section in the final rule to create a limited exception to the prohibition against separating the guaranteed amount from the unguaranteed amount of the Private Loan. This section now permits debt derivatives of the guaranteed amount of the Private Loan to be issued if both of two circumstances occur.

First, the Borrower must submit proof, satisfactory to the Treasury Department, that, as a result of the non-separability provision of the final rule, the Borrower will incur a substantial increase in the borrowing cost of the Private Loan, expressed in terms of the true rate of interest of the Private Loan. This increase in costs must be directly attributable to the prohibition against issuing derivatives of the guaranteed portion of the Private Loan. Second, the Treasury Department must determine that allowing a particular Borrower to refinance its loans using derivatives of the guaranteed amount of the Private Loan is necessary to achieve the international economic policy interests of the United States.

11. Section 25.405—Collateralization of Unguaranteed Amount

Many commenters objected to this section of the interim rule, asserting that the prohibition against collateralization with securities of the United States Government or any of its agencies had no foundation in the refinancing legislation.

As in the comments on § 25.403, many commenters objected to the section having provided that the Guaranty would cease to be effective if this section were violated.

The refinancing legislation provides that the United States Government guaranty of the Private Loan shall cover no more than 90 percent of the Private Loan. The Treasury Department interpreted this provision as prohibiting Borrowers from enhancing the credit of the 10 percent unguaranteed amount of the Private Loan to the point that the Private Loan became, in effect, 100 percent guaranteed. To give effect to this interpretation, the Treasury Department included in the interim rule a prohibition against Borrowers collateralizing the unguaranteed amount of their Private Loans with securities backed by the full faith and credit of the United States.

Upon reconsideration of its interpretation, however, the Treasury Department found no explicit direction in the refinancing legislation to prohibit such collateralization. Finding no such requirement, the Treasury Department has eliminated the prohibition in its entirety. The section containing the prohibition has been deleted from the final rule.

12. Section 25.406—Form of Guaranty (Renumbered § 25.405 in the Final Rule)

Some commenters indicated that the form of Guaranty is unattractive to the market and that the Guaranty should be altered to conform to market practice. These commenters asserted that failure to use a more conventional form of Guaranty would lead to more costly financings. In addition, some commenters submitted a form of Guaranty which they proposed to the Department of the Treasury for consideration as a substitute for the form of Guaranty contained in this section.

Debate about whether the use of a more conventional form of Guaranty would result in less expensive refinancings is irrelevant. The refinancing legislation specifically requires that "the terms of guarantees transferred or issued under this paragraph shall be exactly the same as the existing * * * guarantees, except as modified by this paragraph." Thus, the refinancing legislation allows no flexibility with regards to the Guaranty form. The Guaranty form included in this section follows the form of the existing guarantees attached to the existing FMS Loans, except to the extent that it has been modified to incorporate specific conditions required by the refinancing legislation. Therefore, the form of Guaranty contained in the final rule remains unchanged except as discussed above under the comments on the definition of Private Lender, non-separability and collateralization.

One commenter indicated that the prohibition against acceleration contained in the Guaranty would raise the cost of financing to the Borrower.

DSAA, the guarantor of the Private Loan, has advised us that it is necessary that this part of the Guaranty, which is derived from the existing guaranty on the FMS loans being refinanced, remain as provided for in the interim rule. Therefore, this section of the final rule remains unchanged.

Again, many commenters reiterated the argument that the Guaranty should not become ineffective if its terms are violated as discussed in the analysis of §§ 25.403, 25.404 and 25.405 above. The form of Guaranty has been revised in the final rule to clarify that it ceases to be effective only to the extent of, and only with respect to, the violation of the terms of the Guaranty, as in the analysis of these sections cited above. Moreover, the conditional nature of the Guaranty is required by the refinancing legislation.

13. Section 25.407—Savings Clause (Renumbered § 25.406 in the Final Rule)

One commenter objected to the inclusion of this section, arguing that it would be used by "persons or organizations" in an attempt to mislead or confuse Borrowers for narrow personal reasons.

The Treasury Department included this section to make it clear that neither the law nor the rules were intended to change the interpretation or application of existing statutes, including, but not limited to, tax, securities and banking statutes. The Treasury Department continues to believe that this clarification is useful.

As a final point on the interim rule, some commenters requested that the rule allow for refinancings of Private Loans, should such refinancings become financially attractive at some future date prior to the end of the program.

The Treasury Department responds that, inasmuch as a Private Loan made to refinance an Eligible FMS Loan or an Eligible FMS Advance would not have been an existing FMS loan on December 22, 1987, it would not be eligible for refinancing under the authority of the refinancing legislation.

III. Procedural Requirements

Because this rule involves foreign and military affairs functions of the United States, it is not subject to Executive Order 12291 or the public notice and delayed effective date requirements of the Administrative Procedure Act (5 U.S.C. 553).

As no notice of proposed rulemaking is required, this final rule is not subject to the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*).

IV. Paperwork Reduction Act

The requirements to collect information contained in the rule have been reviewed and approved by the Office of Management and Budget pursuant to section 3507 of the Paperwork Reduction Act of 1980 (44 U.S.C. 3507).

List of Subjects in 31 CFR Part 25

Banks and banking, Loan programs—national defense, Reporting and recordkeeping requirements.

V. Authority

Title III, Pub. L. 100–202, 31 U.S.C. 321, Foreign Military Sales Department Reform.

Subtitle A of Title 31, Code of Federal Rules, is amended by revising Part 25 to read as follows:

PART 25—PREPAYMENT OF FOREIGN MILITARY SALES LOANS MADE BY THE DEFENSE SECURITY ASSISTANCE AGENCY AND FOREIGN MILITARY SALES LOANS MADE BY THE FEDERAL FINANCING BANK AND GUARANTEED BY THE DEFENSE SECURITY ASSISTANCE AGENCY

Subpart A—General

Sec.

Subart B—Qualifications for Prepayment

Subpart C—Procedures

Subpart D—Form of Private Loan

Authority: Title III, Pub. L. 100–202; 31 U.S.C. 321.

Subpart A—General

§ 25.100 Definitions.

In this part, unless the context indicates otherwise:

(a) "Act" means the provisions entitled "Foreign Military Sales Debt Reform," of Title III, entitled "Military Assistance," of an act entitled "Foreign Operations, Export Financing and Related Programs Appropriations Act, 1988" (Pub. L. No. 100–202), enacted December 22, 1987.

(b) "AECA" means the Arms Export Control Act, as amended (22 U.S.C. 2751 *et seq.*).

(c) "Borrower" means the obligor on an FMS Advance.

(d) "Closing Date" means:

(1) With respect to the prepayment of the amounts permitted by this part to be prepaid of FMS Loans held by DSAA, the date designated by the mutual agreement of both the Borrower and DSAA on which the Guaranty will be attached to the Private Loan Note or the Private Loan Portion Notes, as the case may be, the Private Loan will be funded, and the Total Permitted Prepayment Amount, or the portion thereof which the Borrower has selected to prepay, will be prepaid; and

(2) With respect to the prepayment of the amounts permitted by this part to be prepaid of FMS Loans held by the FFB and guaranteed by DSAA, the date designated by the mutual agreement of the Borrower, the FFB, and DSAA on which the Guaranty will be attached to the Private Loan Note or the Private Loan Portion Notes, as the case may be, the Private Loan will be funded, and the Total Permitted Prepayment Amount, or Portion thereof which the Borrower has selected to prepay, will be prepaid.

(e) "Derivative" means any right, interest, instrument or security issued or traded on the credit of the Private Loan or any Private Loan Portion, including but not limited to:

(1) Any participation share of, or undivided ownership or other equity interest in, the Private Loan or any Private Loan Portion;

(2) Any note, bond or other debt instrument or obligation which is collateralized or otherwise secured by a pledge of, or secruity interest in, the Private Loan or any Private Loan Portion; or

(3) Any such interest in such an interest or any such instrument secured by such an instrument.

(f) "DSAA" means the Defense Security Assistance Agency, an agency within the Department of Defense.

(g) "Eligible FMS Advance" means any FMS Advance which:

(1) Was outstanding on December 22, 1987;

(2) Has principal amounts becoming due and payable after September 30, 1989; and

(3) Bears interest at a rate equal to or greater than 10 percentum per annum.

"Eligible FMS Advance" may include FMS Advances meeting the criteria of Eligible FMS Advance which are made on account of FMS Loans even when such FMS Loans do not, in themselves, meet the criteria of Eligible FMS Loan.

(h) "Eligible FMS Loan" means any FMS Loan which:

(1) Was outstanding on December 22, 1987;

(2) Has principal amounts becoming due and payable after September 30, 1989; and

(3) Bears interest pursuant to the terms of the loan agreement relating thereto at a consolidated rate equal to or greater than 10 percentum per annum.

"Eligible FMS Loans" may include FMS Advances which are made on account of FMS Loans meeting the criteria of Eligible FMS Loan even when such FMS Advances do not, in themselves, meet the criteria of Eligible FMS Advance.

(i) "Eligible Private Lender" means either:

(1) Any of the following entities:

(i) Any banking, savings, or lending institution, or any subsidiary or affiliate thereof, chartered or otherwise lawfully organized under the laws of any State, the District of Columbia, the United States or any territory or possession of the United States, including, but not limited to, any bank, trust company, industrial bank, investment banking company, savings association, savings and loan association, building and loan association, savings bank, credit union, or finance company, which is doing business in the United States;

(ii) Any broker or dealer registered with the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934;

(iii) Any company lawfully organized as an insurance company, and which is subject to supervision by the insurance commissioner or a similar official or agency of a State; or

(iv) Any United States pension fund; or

(2) Any trust or other special purpose financing entity which is funded initially by an entity or entities of the type described in paragraph (i)(1) of this section.

(j) "FFB" means the Federal Financing Bank, and instrumentality and wholly-owned corporation of the United States.

(k) "FMS" means Foreign Military Sales.

(l) "FMA Advance" means:

(1) A disbursement of funds made pursuant to a loan agreement between the Borrower and DSAA, which loan agreement provides for making of an FMS Loan; or

(2) A disbursement of funds made pursuant to a loan agreement between the Borrower and the FFB, which loan agreement provides for the making of an FMS Loan.

(m) "FMS Loan" means either:

(1) A loan made directly by the Secretary of Defense pursuant to section 23 of AECA; or

(2) A loan made by the FFB and guaranteed by the Secretary of Defense pursuant to section 24 of AECA; and "FMS Loans" mean the aggregate of such loans made to or for the account of a Borrower.

(n) "Guaranteed-Amount Debt Derivative" means any note, bond or other debt instrument or obligation which is collateralized or otherwise secured by a pledge of, or security interest in, the Private Loan Note or any Private Loan Portion Note or any Derivative, as the case may be, which has an exclusive or preferred claim to the Guaranteed Loan Amount or the respective Guaranteed Loan Portion Amount or the respective Guaranteed-Amount Equivalent, as the case may be.

(o) "Guaranteed-Amount Equity Derivative" means any participation share of, or undivided ownership or other equity interest in, the Private Loan or any Private Loan Portion or any Derivative, as the case may be, which has an exclusive or preferred claim to the Guaranteed Loan Amount or the respective Guaranteed Loan Portion Amount or the respective Guaranteed-Amount Equivalent, as the case may be.

(p) "Guaranteed-Amount Equivalent" means:

(1) With respect to any Derivative which is equal in principal amount to the Private Loan or any Private Loan Portion, that amount of payment on account of such Derivative which is equal to the Guaranteed Loan Amount or the respective Guaranteed Loan Portion Amount, as the case may be; or

(2) With respect to any Derivatives which in the aggregate are equal in principal amount to the Private Loan or any Private Loan Portion, that amount of payment on account of such derivatives which is equal to the Guaranteed Loan Amount or the respective Guaranteed Loan Portion Amount, as the case may be.

(q) "Guaranteed Loan Amount" means that amount of payment on account of

the Private Loan which is guaranteed under the terms of the Guaranty.

(r) "Guaranteed Loan Portion Amount" means that amount of payment on account of any Private Loan Portion which is guaranteed under the terms of the Guaranty.

(s) "Guaranty" means either a new guaranty of the United States issued by DSAA or an existing guaranty of the United States transferred by DSAA, in the form of guaranty set forth in § 25.405, which guaranty will be attached to a Private Loan Note or Private Loan Portion Note.

(t) "Interest Rate Difference" means the difference between:

(1) The cost of funds to the Borrower for the Private Loan (expressed in terms of the true rate of interest applicable to the Private Loan) if paragraph (a) of § 25.404 applies to the Private Loan; and

(2) The cost of funds to the Borrower for the Private Loan (expressed in terms of the true rate of interest applicable to the Private Loan) if paragraph (a) of § 25.404 does not apply to the Private Loan.

(u) "Non-Registered Obligation" means a bearer obligation which does not comply with all of the registration requirements of the Internal Revenue Code.

(v) "Permitted Arrears Prepayment Amount" means the sum of all arrears, if any, on all FMS Loans, which arrears are outstanding on the Closing Date.

(w) "Permitted Guaranty Holder" means:

(1) An individual domiciled in the United States;

(2) A corporation incorporated, chartered or otherwise organized in the United States; or

(3) A partnership or other juridical entity doing business in the United States.

(x) "Permitted P&I Prepayment Amount" means, with respect to each Eligible FMS Loan or Eligible FMS Advance, as the case may be, the sum of:

(1) All principal amounts which become due and payable after September 30, 1989, on the respective Eligible FMS Loan or Eligible FMS Advance; and

(2) All unpaid interest, if any, on the respective Eligible FMS Loan or Eligible FMS Advance accrued as of the Closing Date.

(y) "Private Loan" means, collectively, the loan or loans that is or are obtained by the Borrower from an Eligible Private Lender to prepay the Total Permitted Prepayment Amount, or the portion thereof which the Borrower has selected to prepay.

(z) "Private Loan Note" means, collectively, the note or notes executed and delivered by the Borrower to evidence the Private Loan.

(aa) "Private Loan Portion" means any portion of the Private Loan.

(bb) "Private Loan Portion Note" means any note executed and delivered by the Borrower to evidence a Private Loan Portion.

(cc) "Total Permitted Prepayment Amount" means the sum of:

(1) The aggregate of the respective Permitted P&I Prepayment amount for all Eligible FMS Loans and all Eligible FMS Advances on account of FMS Loans which FMS Loans do not, in themselves, meet the criteria of Eligible FMS Loans; and

(2) The Permitted Arrears Prepayment Amount.

(dd) "Unguaranteed-Amount Equivalent" means all amounts of payment on account of any Derivative other than the respective Guaranteed-Amount Equivalent.

(ee) "Unguaranteed Loan Amount" means all amounts of payment on account of the Private Loan other than the Guaranteed Amount.

(ff) "Unguaranteed Loan Portion Amount" means all amounts of payment on account of any Private Loan Portion other than the respective Guaranteed Loan Portion Amount.

§ 25.101 OMB control number.

The reporting requirements in this part have been approved under the Office of Management and Budget Control Number 1505–0109.

Subpart B—Qualifications for Prepayment

§ 25.200 General rules.

(a) To qualify for a loan prepayment at par pursuant to subsection (a) of the Act, a Borrower must have an Eligible FMS Loan or an Eligible FMS Advance.

(b) A Borrower may prepay the Total Permitted Prepayment Amount in portions using more than one closing; however, all prepayments of the Total Permitted Prepayment Amount must have a Closing Date that is not later than September 30, 1991.

(c) A Borrower may prepay all or a portion of the Total Permitted Prepayment Amount; however, if a Borrower selects to prepay any Permitted P&I Prepayment Amount of an FMS Advance, the Borrower must prepay the entire Permitted P&I Prepayment Amount of such FMS Advance.

(d) If the payment billings of an FMS Loan have been consolidated in accordance with the terms of the respective loan agreement, and if any principal payments have been made on account of the FMS Loan, then the outstanding principal balances of any Eligible FMS Advances shall be determined in accordance with the principal of "first disbursed, first repaid," that is, advances on account of the FMS Loan shall be deemed to have been repaid in the chronological order in which they were disbursed.

Subpart C—Procedures

§ 25.300 Application procedure.

(a) Each Borrower that wishes to prepay at par the Total Permitted Prepayment Amount, or any portion thereof, must submit a written prepayment application. To be considered complete, a prepayment application must contain the following information and materials:

(1) Part I of the prepayment application shall be the identification of each Eligible FMS Loan or Eligible FMS Advance, as the case may be, with respect to which the Borrower has selected to prepay the amount thereof permitted by this part to be prepaid, setting forth with respect to each such Eligible FMS Loan or Eligible FMS Advance:

(i) The date on which the Eligible FMS Advance was made or the date on which the Eligible FMS Loan was signed;

(ii) The original amount of the Eligible FMS Loan or Eligible FMS Advance;

(iii) The principal and interest payment schedule of the Eligible FMS Loan or Eligible FMS Advance; and

(iv) The maturity of the Eligible FMS Loan or Eligible FMS Advance.

(2) Part II of the prepayment application shall be the Borrower's estimate of the Permitted Arrears Prepayment Amount calculated as of the date of the application;

(3) Part III of the prepayment application shall be a description of each Private Loan, 90 percent of which the Borrower seeks to have guaranteed, setting forth with respect to each Private Loan:

(i) The total amount of the Private Loan,

(ii) The proposed principal and interest payment schedule of the Private Loan,

(iii) The proposed maturity of the Private Loan, and

(iv) The identity of each Eligible FMS Loan or Eligible FMS Advance with respect to which amount thereof permitted by this part to be prepaid is to be prepaid with the proceeds of the Private Loan;

(4) Part IV of the prepayment application shall be all material transaction documents, in substantially final form, relating to the prepayment of the Total Permitted Prepayment Amount, or the portion thereof which the Borrower has selected to prepay, with the proceeds of the Private Loan; and

(5) Part V of the prepayment application shall be the name, address, and telephone number of the Borrower's contact person with whom the FFB or DSAA will communicate to arrange for prepayment and closing.

(b) Each prepayment application shall be submitted in triplicate to DSAA at the following address: Defense Security Assistance Agency, The Pentagon, Washington, DC 20301–2800, Attention: Deputy Comptroller.

(c) A Borrower wishing to obtain preliminary, nonbinding review of a plan to prepay at par the Total Permitted Prepayment Amount, or any portion thereof, may, at the Borrower's option, prior to submitting a prepayment application in accordance with paragraph (a) of this section, submit to DSAA, at the address set forth in paragraph (b) of this section, a written plan of prepayment. To qualify for review, a plan of prepayment must include a detailed description of the proposed financing structure clearly addressing the terms and conditions of the proposed Private Loan. DSAA will review each plan of prepayment submitted by Borrowers and may engage in informal, non-binding discussions with each Borrower that submitted a plan of prepayment to assist such Borrower in preparing a prepayment application.

§ 25.301 Approval procedure.

(a) *Distribution, Review, and Processing by DSAA.* (1) Upon receipt of three copies of a completed prepayment application from a Borrower, DSAA will promptly deliver one copy of Parts I and II of the prepayment application to the State Department and one copy of Parts I, II, and V of the prepayment application to the Treasury Department.

(2) DSAA will review each completed prepayment application to ensure that the Private Loan complies with the requirements of this part, including without limitation the requirements of § 25.400. DSAA will also review each completed prepayment application to ensure that the provisions of subsection (d) of the Act (Purposes and Reports) are considered. DSAA will process each completed prepayment application within 16 days after receipt by DSAA of the respective completed application from a Borrower.

(3) After DSAA has processed a completed prepayment application, DSAA will either:

(i) Return the application to the Borrower; or

(ii) Deliver to the State Department written evidence of the approval of the prepayment application by DSAA.

(b) *Review and Processing by the State Department.* (1) The State Department will review Parts I and II of each prepayment application received by the State Department from DSAA to ensure that the provisions of subsection (d) of the Act (Purposes and Reports) are considered. The State Department will process Parts I and II of each prepayment application within 7 days after receipt by the State Department of written evidence of the approval of the prepayment application by DSAA.

(2) After the State Department has processed Parts I and II of a prepayment application, the State Department will either:

(i) Return the parts of the application to DSAA for return to the Borrower; or

(ii) Deliver to the Treasury Department written evidence of the approvals of the prepayment application by DSAA and the State Department.

(c) *Processing by the Treasury Department*—(1) *FMS Loans held by DSAA.* (i) The Treasury Department will process Parts I and II of each prepayment application regarding an Eligible FMS Loan made by DSAA or an Eligible FMS Advance on account of an FMS Loan made by DSAA, as the case may be, within 7 days after receipt by the Treasury Department of written evidence of the approvals of the prepayment application by DSAA and the State Department;

(ii) After the Treasury Department has processed Parts I and II of a prepayment application, the Treasury Department will return the parts of the application to DSAA, and thereupon DSAA will commence the Closing Procedures described in § 25.303(a) with respect to the application.

(2) *FMS Loans held by the FFB.* (i) The Treasury Department will process Parts I and II of each prepayment application regarding an Eligible FMS Loan made by the FFB and guaranteed by DSAA or an Eligible FMS Advance on account of an FMS Loan made by the FFB and guaranteed by DSAA, as the case may be, within 7 days after receipt by the Treasury Department from the State Department of written evidence of the approvals of the prepayment application by DSAA and the State Department; and

(ii) After the Treasury Department has processed Parts I and II of a prepayment application, the Treasury Department will commence the Closing Procedures described in § 25.303(b) with respect to the application.

§ 25.302 Application withdrawal; effect of approval.

A Borrower that submits a prepayment application may withdraw the prepayment application at any time prior to its approval. Even after a Borrower's prepayment application has been approved, the Borrower is not obligated to prepay its Eligible FMS Loans or Eligible FMS Advances.

§ 25.303 Closing procedure.

(a) *FMS Loans held by DSAA.* (1) After the Treasury has processed Parts I and II of a prepayment application regarding an Eligible FMS Loan made by DSAA or an Eligible FMS Advance on account of an FMS Loan made by DSAA, as the case may be, DSAA will communicate with the Borrower's contact person identified in Part V of the prepayment application to establish a Closing Date mutually agreeable to the Borrower and DSAA. DSAA will inform the Borrower of the final amount of the Total Permitted Prepayment Amount, or the portion thereof which the Borrower has selected to prepay, as of the Closing Date established. The determination by DSAA of the final amount of the Total Permitted Prepayment Amount, or the portion thereof which the Borrower has selected to prepay, shall be conclusive.

(2) On the Closing Date, the Guaranty will be attached to the Private Loan Note or the Private Loan Portion Notes, as the case may be, the Private Loan shall be funded, and the Total Permitted Prepayment Amount, or the portion thereof which the Borrower has selected to prepay, will be prepaid.

(3) The attachment of the Guaranty to the Private Loan Note or the Private Loan Portion Notes, as the case may be, will take place at such location as may be designated by the mutual agreement of the Borrower and DSAA.

(4) Prior to 1:00 p.m. prevailing local time in New York, New York, on the Closing Date, immediately available funds in amounts sufficient to prepay the Total Permitted Prepayment Amount, or the portion thereof which the Borrower has selected to prepay, shall be transferred by electronic funds transfer to DSAA at the Treasury Department account at the Federal Reserve Bank of New York. The funds transfer message must include the following credit information:

United States Treasury, New York, New York, 021030004, TREAS NYC/ (5037).

For credit to the Defense Security Assistance Agency, The Pentagon, Washington, DC 20301–2800.

This information must be *exactly* in this form (including spacing between words and numbers) to insure timely receipt by the DSAA. Checks, drafts, and other orders for payment will not be accepted.

(b) *FMS Loans held by the FFB.* (1) After the Treasury Department has processed Parts I and II of a prepayment application regarding an Eligible FMS Loan made by the FFB and guaranteed by DSAA or an Eligible FMS Advance on account of an FMS Loan made by the FFB and guaranteed by DSAA, as the case may be, the FFB will communicate with the Borrower's contact person identified in Part V of the prepayment application to establish a Closing Date mutually agreeable to the Borrower, the FFB, and DSAA. The FFB will inform the Borrower of the final amount of the Total Permitted Prepayment Amount, or the portion thereof which the Borrower has selected to prepay, as of the Closing Date established. The determination by the FFB of the final amount of the Total Permitted Prepayment Amount, or the portion thereof which the Borrower has selected to prepay, shall be conclusive.

(2) On the Closing Date, the Guaranty will be attached to the Private Loan Note or the Private Loan Portion Notes, as the case may be, the Private Loan will be funded, and the Total Permitted Prepayment Amount, or the portion thereof which the Borrower has selected to prepay, will be prepaid.

(3) The attachment of the Guaranty to the Private Loan Note or the Private Loan Portion Notes, as the case may be, will take place at such location as may be designated by the mutual agreement of the Borrower and DSAA.

(4) Prior to 1:00 p.m. prevailing local time in New York, New York, on the Closing Date, immediately available funds in amounts sufficient to prepay at par the Permitted Prepayment Amount, or the portion thereof which the Borrower has selected to prepay, shall be transferred by electronic funds transfer to the Treasury Department account at the Federal Reserve Bank of New York. The funds transfer message must include the following credit information:

United States Treasury, New York, New York, 021030004, TREAS NYC/ (20180006).

For credit to the Federal Financing Bank, Room 143, Liberty Center Building, 401 14th Street SW., Washington, DC 20227.

This information must be *exactly* in this form (including spacing between words and numbers) to insure timely receipt by the FFB. Checks, drafts, and others for payment will not be accepted.

(c) *Changes in the Closing Date.* If a Borrower does not prepay the Total Permitted Prepayment Amount or the portion thereof which the Borrower has selected to prepay, on the mutually agreed upon Closing Date, the Borrower may prepay the Total Permitted Prepayment Amount, or the portion thereof which the Borrower has selected to prepay, on a new Closing Date, *provided* that the new Closing Date is mutually agreeable to all interested parties, and *provided, further,* that the Borrower prepays such amount in accordance with the approved prepayment application, adjusted for changes in accrued interest.

Subpart D—Form of Private Loan

§ 25.400 Loan provisions.

(a) Subject to the provisions of paragraph (b) of this section, the principal and interest payment schedule and maturity of the Private Loan must be the same as the payment schedules and maturities of the Eligible FMS Loans or Eligible FMS Advances, as the case may be, which the Borrower has selected to prepay with the proceeds of the Private Loan.

(b) Notwithstanding the preceding paragraph, an Eligible Private Lender that proposes to make a Private Loan, the proceeds of which will be used to prepay Eligible FMS Loans or Eligible FMS Advances, as the case may be, having differing payment structures and maturities, may:

(1) Consolidate the differing payment structures of the Eligible FMS Loans or the Eligible FMS Advances, as the case may be, into a single payment structure which complies with the following criteria:

(i) The Private Loan shall have one set of semi-annual payment dates;

(ii) Interest on and principal of the Private Loan shall be payable semi-annually; and

(iii) The amount of principal to be paid each year on account of the Private Loan shall be equal (rounded to the nearest $1,000.00 if desired, except for the final payment) to the aggregate amount of principal that is scheduled to be paid in such year on account of the respective Eligible FMS Loans or Eligible FMS Advances; or

(2) Consolidate the differing payment structures and maturities of the Eligible FMS Loans or the Eligible FMS Advances, as the case may be, into a single payment structure and maturity complying with the following criteria:

(i) The final maturity date of the Private Loan shall be the approximate weighted average of the final maturity dates of the Eligible FMS Loans or the Eligible FMS Advances with respect to which the Borrower has selected to prepay amounts thereof permitted by this part to be prepaid;

(ii) The initial principal payment date of the Private Loan shall occur no later than the earliest scheduled principal payment date of the Eligible FMS Loans or the Eligible FMS Advances with respect to which the Borrower has selected to prepay amounts thereof permitted by this part to be prepaid;

(iii) The Private Loan shall have one set of semi-annual payment dates;

(iv) Interest on the Private Loan shall be payable semi-annually; and

(v) The principal of the Private Loan shall be payable in equal installments (rounded to the nearest $1,000.00 if desired, except for the final payment) and shall be payable either semi-annually or annually.

§ 25.401 Fees.

The interest rate on the Private Loan may include compensation for costs at prevailing market rates with the agreement of the Borrower and the Eligible Private Lender selected by the Borrower.

§ 25.402 Transferability.

Each Private Loan Note, with the Guaranty attached, shall be fully and freely transferable to any Permitted Guaranty Holder.

§ 25.403 Registration.

The Guaranty shall cease to be effective with respect to the Private Loan or any Private Loan Portion or any Derivative to the extent that the Private Loan or the respective Private Loan Portion or the respective Derivative, as the case may be, is used to provide significant support for a Non-Registered Obligation.

§ 25.404 Non-Separability.

(a) The Guaranty shall cease to be effective with respect to any Guaranteed Loan Amount or any Guaranteed Loan Portion Amount or any Guaranteed-Amount Equivalent to the extent that:

(1) The Guaranteed Amount or the respective Guaranteed Loan Portion Amount or the respective Guaranteed-Amount Equivalent, as the case may be, is separated at any time from the Unguaranteed Loan Amount or the respective Unguaranteed Loan Portion Amount or the respective Unguaranteed-Amount Equivalent, as the case may be, in any way, directly or through the issuance of any Guaranteed-Amount

Equity Derivative or any Guaranteed-Amount Debt Derivative; or

(2) Any holder of the Private Loan Note or any Private Loan Portion Note or any Derivative, as the case may be, having a claim to payments on the Private Loan receives more than 90 percent of any payment due to such holder from payments made under the Guaranty at any time during the term of the Private Loan.

(b) Notwithstanding the preceding paragraph, if any Guaranteed-Amount Debt Derivative is issued, the Guaranty shall not cease to be effective with respect to any Guaranteed Loan Amount or any Guaranteed Loan Portion Amount or any Guaranteed-Amount Equivalent, as the case may be, if both of the circumstances described in paragraphs (b)(1) and (b)(2) of this section.

(1) A Borrower shall have delivered to the Secretary of the treasury evidence, in form and substance satisfactory to the Secretary of the Treasury, that the Interest Rate Difference will be substantial.

(i) To be considered, the evidence must meet the following requirements:

(A) The Borrower must show that the Interest Rate Difference is directly attributable to paragraph (a) of this section being applied to the Private Loan, that is, that the Interest Rate Difference will exist even when all other financing terms of the Private Loan, including any collateralization of the Unguaranteed Loan Amount or the respective Unguaranteed Loan Portion Amount or the respective Unguaranteed-Amount Equivalent, as the case may be, are identical;

(B) When calculating the Interest Rate Difference, the Borrower must assume that the Unguaranteed Loan Amount or the respective Unguaranteed Loan Portion Amount or the respective Unguaranteed-Amount Equivalent, as the case may be, will be collateralized by securities backed by the full faith and credit of the United States, unless the Borrower is legally prohibited from so collateralizing the Unguaranteed Loan Amount or the respective Unguaranteed Loan Portion Amount or the respective Unguaranteed-Amount Equivalent, as the case may be, or the Borrower has demonstrated to the satisfaction of the Secretary of the Treasury that the Borrower is unable to so collateralize the Unguaranteed Loan Amount or the respective Unguaranteed Loan Portion Amount or the respective Unguaranteed-Amount Equivalent;

(C) If the Borrower is legally prohibited from collateralizing the Unguaranteed Loan Amount or the respective Loan Guaranteed Portion Amount or the respective Unguaranteed-Amount Equivalent, as the case may be, with securities backed by the full faith and credit of the United States or has demonstrated to the satisfaction of the Secretary of the Treasury that the Borrower is unable to so collateralize the Unguaranteed Loan Amount or the respective Unguaranteed Loan Portion Amount or the respective Unguaranteed-Amount Equivalent, as the case may be, then the Borrower may calculate the Interest Rate Difference using whatever collateralization assumptions the Borrower elects;

(D) If the Borrower delivers evidence to the Secretary of the Treasury respecting the Interest Rate Difference, which evidence assumes either that the Unguaranteed Loan Amount or the respective Unguaranteed Loan Portion Amount or the respective Unguaranteed-Amount Equivalent, as the case may be, will not be collateralized at all or that the Unguaranteed Loan Amount or the respective Unguaranteed Loan Portion Amount or the respective Unguaranteed-Amount Equivalent, as the case may be, will be collateralized, but not by securities backed by the full faith and credit of the United States, then the Borrower must also deliver to the Secretary of the Treasury the written agreement of the Borrower, which agreement shall be in form and substance satisfactory to the Secretary of the Treasury, that the Borrower will not collateralize the Unguaranteed Loan Amount or the respective Unguaranteed Loan Portion Amount or the respective Unguaranteed-Amount Equivalent, as the case may be, at any time during the term of the Private Loan in any way different from the assumptions used in calculating the Interest Rate Difference; and

(E) The Borrower must deliver to the Secretary of the Treasury the evidence pertaining to the Interest Rate Difference at the time that the Borrower submits to DSAA its plan for prepayment, if any, if no plan of prepayment is submitted, then no later than 10 days prior to the time that the Borrower submits to DSAA its prepayment application.

(ii) If the Secretary of the Treasury determines that the evidence submitted by the Borrower pertaining to the Interest Rate Difference is satisfactory in form and in substance, and that the Interest Rate Difference is substantial, a modified version of the Guaranty (deleting therefrom the provision that the Guaranty shall cease to be effective if any Guaranteed-Amount Debt Derivative is issued) will be attached to the Private Loan Note or the Private Loan Portion Notes, as the case may be.

(2) The Secretary of the Treasury shall have determined, in the sole discretion of the Secretary of the Treasury, that the respective Borrower's loan prepayment at par pursuant to subsection (a) of the Act through the issuance of any Guaranteed-Amount Debt Derivative is necessary to achieve the international economic policy interests of the United States.

§ 25.405 Form of guaranty.

(a) The Guaranty that will be attached to the Private Loan Note on the Closing Date shall be in the following form (except that the bracketed words shall be deleted if the conditions specified in § 25.404(b) shall have occurred):

For Value Received, the Defense Security Assistance Agency of the Department of Defense ("DSAA"), hereby guarantees to (Name of Lender) ("Lender"), incorporated under the laws of (U.S. State or other U.S. jurisdiction) or if not so incorporated or organized, then the principal place of doing business is (U.S. location, address, and zip code), under the authority of Section 24 of the Arms Export Control Act, as amended ("Act"), the due and punctual payment of ninety percent (90%) of amounts due: (1) on the promissory note ("Note") in the principal amount of up to $——— dated ——— issued to the Lender by the Government of (Name of Borrower) ("Borrower") pursuant to the Loan Agreement between the Lender and the Borrower dated the ——th day of ——— ("Agreement"); and (2) the Lender from the Borrower pursuant to the Agreement.

This Guaranty is a guaranty of payment covering all political and credit risks of nonpayment, including any nonpayment arising out of any claim which the Borrower may now or hereafter have against any person, corporation, or other entity (including without limitation, the United States, the Lender, and any supplier of defense items) in connection with any transaction, for any reason whatsoever. This Guaranty shall inure to the benefit of and shall be enforceable by the Lender and any Permitted Guaranty Holder (as hereinafter defined). This Guaranty shall not be impaired by any law, regulation or decree of the Borrower now or hereafter in effect which might in any manner change any of the terms of the Note or Agreement. The obligation of DSAA hereunder shall be binding irrespective of the irregularity, invalidity or unenforceability under any laws, regulations or decrees of the Borrower of the Note, the Agreement or other instruments related thereto.

DSAA hereby waives diligence, demand, protest, presentment and any requirement that the Lender exhaust any right or power to take any action against the Borrower and any notice of any kind whatsoever other than the demand for payment required to be given to DSAA hereunder in the event of default on a payment due under the Note.

In the event of failure of the Borrower to make payment, when and as due, of any installment of principal or interest under the Note, the DSAA shall make payment

Immediately to the Lender upon demand to the DSAA after the Borrower's failure to pay has continued for 10 calendar days. The amount payable under this Guaranty shall be ninety percent (90%) of the amount of the overdue installment of principal and interest, plus ninety percent (90%) of any and all late charges and interest thereon as provided in the Agreement. Upon payment by DSAA to the Lender, the Lender will assign to DSAA, without recourse or warranty, ninety percent (90%) of all of its rights in the Note and the Agreement with respect to such payment.

In the event of a default under the Agreement or the Note by the Borrower and so long as this Guaranty is in effect and the DSAA is not in default hereunder:

(i) The Lender or other Permitted Guaranty Holder shall not accelerate or reschedule payment of the principal or interest on the Note or any other note of the Borrower guaranteed by DSAA except with the written approval of DSAA; and

(ii) The Lender or other Permitted Guaranty Holder shall, if so directed by DSAA, invoke the default provisions of the Agreement.

Subject to the limitations set forth below, the Lender's rights under this Guaranty may be assigned to any "Permitted Guaranty Holder," that is: (1) An individual domiciled in the United States; (2) a corporation incorporated, chartered or otherwise organized in the United States; or (3) a partnership or other juridical entity doing business in the United States. In the event of such assignment DSAA shall be promptly notified. The Lender will not agree to any material amendment of the Agreement or Note or consent to any material deviation from the provisions thereof without the prior written consent of DSAA.

Permitted Guaranty Holders shall be severally bound by, and shall be severally entitled to, the rights and obligations of the Lender under the Note, the Agreement, and this Guaranty. The Lender shall maintain a current, accurate written record of the names, addresses, amount of financial interest in the Note and Agreement, and date of acquisition of such interest of each Permitted Guaranty Holder and shall furnish DSAA a copy of such record on its demand without charge. No assignment by the Lender or by any Permitted Guaranty Holder shall be effective for purposes of this Guaranty unless and until so recorded by the Lender.

The total amount of this Guaranty shall not at any time exceed ninety percent (90%) of the outstanding principal, unpaid accrued interest and arrearages, if any, under the Agreement and the Note, including any portion of the Note, or any derivative of the Note or any portion of the Note.

This Guaranty shall cease to be effective with respect to the guaranteed amount of the total amount of the Note (the "Guaranteed Loan Amount") or with respect to the guaranteed amount of any portion of the Note (the "Guaranteed Loan Portion Amount") [or with respect to the amount of any derivative or derivatives of the Note or any portion of the Note equal, or in the eggregate equal, in principal amount to the total amount of the Note or such portion of the Note, as the case may be, which amount of such derivative or derivatives is equal to the respective Guaranteed Loan Amount or Guaranteed Loan Portion Amount, as the case may be (the "Guaranteed-Amount Equivalent")] to the extent that (1) the Guaranteed Loan Amount or the respective Guaranteed Loan Portion Amount [or the respective Guaranteed-Amount Equivalent], as the case may be, is at any time separated from the unguaranteed amount of the total amount of the Note or the unguaranteed amount of the respective portion of the Note [or the amount of such derivative or derivatives of the Note which is not the amount which is equal to the Guaranteed Loan Amount or Guaranteed Loan Portion Amount, as the case may be], in any way, (a) directly, or (b) through the issuance of participation shares of, or undivided ownership or other equity interests in, the Note, or any portion of the Note, or any derivative of the Note or any portion of the Note, which have an exclusive or preferred claim to the Guaranteed Loan Amount or the respective Guaranteed Loan Portion Amount [or the respective Guaranteed-Amount Equivalent], as the case may be [or (c) through the issuance of notes, bonds or other debt instruments or obligations which are collateralized or otherwise secured by a pledge of, or security interest in, the Note, or any portion of the Note or any derivative of the Note or any portion of the Note, which has an exclusive or preferred claim to the Guaranteed Loan Amount or the respective Guaranteed Loan Portion Amount or the respective Guaranteed-Amount Equivalent, as the case may be]; or (2) any holder of the Note, or any portion of the Note, or any derivative of the Note or any portion of the Note, as the case may be, having claim to payment made on the Note, receives more than ninety percent of any payment due to such holder from payments made under this Guaranty at any time during the term of the Note or the Agreement.

This Guaranty is fully and freely transferable to any Permitted Guaranty Holder, except that it shall cease to be effective with respect to the Agreement or the Note, or any portion of the Note, or any derivative of the Note or any portion of the Note, to the extent that the Agreement or the Note, or the respective portion of the Note, or the respective derivative of the Note or any portion of the Note, as the case may be, is used to provide significant support for any non-registered obligation.

The full faith and credit of the United States is pledged to the performance of this Guaranty. No claim which the United States may now or hereafter have against the Lender or any Permitted Guaranty Holder for any reason whatsoever shall affect in any way the right of the Lender or any Permitted Guaranty Holder to receive full and prompt payment of any amount otherwise due under this Guaranty. The United States represents and warrants that (a) it has full power, authority and legal right to execute, deliver and perform this Guaranty, (b) this Guaranty has been executed in accordance with and pursuant to the terms and provisions of section 24 of the Act, the provisions of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1988, under the hearing "Foreign Military Sales Debt Reform," and Title 31, Part 25, of the Code of Federal Regulations, (c) this Guaranty has been duly executed and delivered by a duly authorized representative of DSAA, and (d) this Guaranty constitutes the valid and legally binding obligations of the United States, enforceable in accordance with the terms hereof.

Any notice, demand, or other communication hereunder shall be deemed to have been given if in writing and actually delivered to the Comptroller, DSAA, the Pentagon, Washington, DC 20301-2800, or the successor, or such other place as may be designated in writing by the Comptroller, DSAA or the successor thereof.

By acceptance of the Note, the Lender agrees to the terms and conditions of this Guaranty.

Dated:_____

By: _____

Director, DSAA.

(b) The obligations of DSAA under the Guaranty are expressly limited to those obligations contained in the form of Guaranty set forth in paragraph (a) of this section. Any provisions of any agreement relating to the Private Loan purporting to create obligations on the part of DSAA which are inconsistent with the terms of the Guaranty or any other provision of this part be unenforceable against DSAA.

§ 25.406 Savings clause.

Nothing in this rule is intended to authorize any person or entity to engage in any activity not otherwise authorized or permitted for such person or entity under any applicable laws of the United States, any territory or possession of the United States, any State, or the District of Columbia.

Date: June 29, 1988.

M. Peter McPherson,

Deputy Secretary.

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