

MEMORANDUM

To: The Chairman

From: Francis F. Lincoln

Re: The present position and activities of the Foreign Bondholders Protective Council, Inc.

This memo is largely, but not entirely, based on reports of the Council made public in 1940 and 1941 and statements issued at the announcement of debt adjustments setting forth the Council's attitude toward them.

The principal contact of the Commission and the Council is through the "Board of Visitors", whose principal function is the examination of the internal financial operations of the Council and does not include a review of its negotiations.¹

From its reports it is obvious that in the last two years the Council has done little effective work. The war and its effects on the internal financial position of many of the old world nations has caused the postponement of any adjustment of default by countries in that region. The financial disturbances, particularly in the early stages of the war, put heavy strain on the position of Latin American countries and made them feel the uncertainties of a warring world, and fearful of the future.

Of course the critical factor in the ability of a nation to service debt held abroad is its foreign exchange position, present and prospective. With increased buying by the United States, the current position has improved in several of the countries in this hemisphere, and along with the uncertainties there have been compensating factors, and some adjustment of default has been worked out in spite of wars.

In working out the more important adjustments made in the last two years the council has not taken a leading part. At present it is practically a skeleton organization. Its active personnel consists of Francis White, president, and a small staff. As its activities have decreased expenditures have been curtailed. It has carried on conversations concerning default and worked out some minor adjustments, but as stated has not been instrumental in the more important situations. Personal factors seem to be

¹ See joint release Department of State and S.E.C. July 22, 1937, which states that a Board of Visitors will be designated and outlines its functions.

partly responsible for this. There are such substantial financial transactions between various Latin American countries and the U.S., that they constitute an important element in our relations with them. The bondholders' spokesman should be working with the governmental agencies handling other financial matters with these countries. It is unfortunate that the Council has not been in this close cooperation with these agencies.

Its position may be judged from the handling of the more important adjustment plans announced in the last two years.

In April of 1940, Brazil offered a scheme by which it undertook to pay part of interest due on coupons in default, paying a sliding scale of the contractual percentage on surrender of two coupons each year for four years. The scheme in general called for payment of 13%-25% of the interest due on the bulk of the debt outstanding in the U.S.

The Council stated that it had not negotiated the proposal and limited its comment concerning it, "to the remark that pursuant to consultation with the Department of State negotiations at present would seem to hold no favorable prospect of obtaining any better offer. The Council must leave to bondholders to determine whether or not they will accept what is now offered."

The Republic Colombia announced an offer of default adjustment in 1940. Following a temporary arrangement by which 50% of interest was offered for 1940 coupons on two 6% dollar loans, on December 30, 1940 Colombia offered to resume interest payment also at 50% of the contractual 6%, and offered scrip convertible into 3% bonds for half of the past due interest.

Settlement of this debt had been discussed for several years, first generally, then in more definite terms. In early 1940 (a year before the announcement of the plan by the Colombian Government) the Council had indicated (not publicly) a willingness to recommend a reduction of the 6% interest rate on the bonds of the Colombian national government to 3% increasing to 4% after a few years, (and treatment of arrears that differed somewhat from that finally adopted). The Council took part in the negotiations, but before their final stages were reached it had withdrawn from them completely.

Although, as can be noted, the terms of the Colombian offer were not very far from terms which the Council had indicated a willingness to recommend, after the announcement of the offer by Colombia, the Council voiced its disapproval of the offer in a caustic statement that included the following: "The Council does not consider this a just, fair and equitable offer because:

"(a) A very substantial cut in interest is provided, entirely out of line with what Colombia can do and not in consonance with her position as a credit risk.

"(b) The offer discriminates against the bondholders in providing only 50% interest while serving internal bonds and short term credits in full."

It also commented that “the Council does not feel justified in expecting that the Colombian Government will make any more favorable proposal to the bondholders.”

The third adjustment effected in 1940-'41 was of debt of Panama. In working out terms, Panama employed, as advisors, two U.S. banking firms who also underwrote a new issue of bonds in connection with the adjustment plan. The Council had been consulted and recommended the plan as being “in the interest of the bondholders to accept.” It is obvious that the Council had not carried the burden of negotiation preceding the offer.

This is past history, but there is still work to be done. While agreements with Latin American countries involving advances by the U.S. Government to them are being negotiated there seems to be a chance for concurrent negotiations as to debt settlement; as far as is known, however, such negotiations are not taking place.¹

The willingness of these countries to resume interest payment is as unknown as terms on which a resumption, if any, could be worked out. However the present lack of cooperation between the Council and other agencies of the Government is most unfortunate. It makes easy avoidance of any payment of interest on outstanding obligations by countries in an exchange position to do so.

The difficulties inherent in the position of the Council (or any other negotiator in a similar position) have not been alluded to but should not be forgotten. The Council has no sanction to compel resumption of service. Adjustments compromise claims and generate clouds of resentment and bondholders are likely to be critical and to look for a whipping boy. The American spokesman is going to find himself, to a degree, the sponsor of the new offer. It would probably be unwise for an arm of the Government to assume such sponsorship, so the present arrangement by which a private agency is the bondholders' spokesman should be continued. Those problems of the Council that are inherent in its position would confront any other similar organization. To the extent that they flow from personal equations they could be met by a change in personnel.

The difficulties are common to situations and do not alter the present state of affairs, in which the claims of U.S. bondholders are not being championed though some of the debtor nations are profiting greatly from other relations with the U.S. and seem to

¹ There are no reports of progress toward settlement of the debts of Bolivia, Peru, and the Departmental and Municipal Debts of Colombia. Furthermore, Brazil's plan of adjustment was for but four years, of which two have gone by.

be in a position to pay at least part of their bond interest. To remedy this, the bondholders' spokesman must work in sympathetic cooperation with other agencies of the Government.

F. F. Lincoln

May 26, 1942