<u>M E M O R A N D U M</u>

February 27, 1946

TO: NAC Working Group

FROM: Securities and Exchange Commission
(Walter C. Louchheim, Adviser on Foreign Investments)

SUBJECT: Loan Application of the Italian Government

In the few hours between notification by the Export-Import Bank of the urgency of this application and the meeting of the Working Group it is not possible to set down with precision and in detail the facts relative to the present debt status of Italy and other matters with respect to the private capital markets which might well have an important bearing upon consideration of this application. A few of the factors, however, are mentioned herein and will be elaborated in a subsequent memorandum and supported by more precise factual data.

1. There are outstanding in the United States over $100,000,000 of Italian bonds representing the obligations of the national government, of municipalities and of corporations with government guarantees. The annual contractual interest on these obligations is approximately $7,000,000. In addition there are outstanding approximately $50,000,000 of Italian corporate bonds with an annual contractual interest of over $3,000,000. These bonds have been widely distributed in the United States and are now held by many small investors. The service on these bonds, therefore, and any adjustment or refunding that may be made would clearly seem to be a matter involving the public interest and the protection of investors.

In response to action initiated by the Foreign Bondholders Protective Council in 1940 the State Department through the American Embassy in Rome took up the matter of defaults on the outstanding dollar bonds with the Italian Minister of Foreign Trade and Exchange and was advised that service charges were being paid regularly in lire, that the sums so deposited "would be transferred to the last cent as soon as the war was over, and that transfers would be made at an early date if radical changes in the situation should make it possible to do so." However, up to the present time it does not appear that the Italian government has taken any steps either to transfer these past due service payments, to renew payments, or to arrange for an exchange or refunding of the outstanding obligations. Some months ago in connection with the negotiation of the Italian Treaty advice was received from the Department of State that a plan for refunding these Italian bonds would shortly be submitted by emissaries of that government then in the United States. In fact, the Department had arranged for a representative of the Italian government to call upon the Securities and Exchange Commission for the purpose of discussing such a program. This appointment, however, was canceled and no other discussion has been arranged either by the Department of State or by Italian representatives. The Supporting Statements for Application of the Italian Government for Export-Import Bank Credit on page 74 states that "preliminary approaches have already taken place between Italian representatives and American banking agencies with the view of arriving at a settlement of the outstanding Italian obligations - - - The Italian government has repeatedly affirmed its desire to face its obligations." In view of the above described situation there is some doubt as to the accuracy of these statements and as to the sincerity of the Italian attitude expressed therein. It is felt that the National Advisory Council should give serious consideration to the question as to whether to entertain any application from Italy for an interim or other credit before steps have been taken to reinstate private bondholders of outstanding dollar obligations.

2. With respect to Italy as well as other Axis countries there is a special situation which deserves careful consideration. This situation arises from the fact that the bonds of Italy together with those of German and Japanese issue have been suspended from all dealings on national securities exchanges and over the counter markets since the outbreak of the war. This action was taken by the Securities and Exchange Commission upon consultation with the Secretary of the Treasury. It consisted of a request to the securities exchanges to continue the suspension of dealings which they authorized on their own motion following the attack on Pearl Harbor. At the same time the Commission requested over-the-counter brokers and dealers through their national organizations to refrain from making any public market in these bonds. The Commission has consistently refused to relax this action and has consulted on many occasions with the Treasury Department and State Department as to the advisability of this action. These Departments have confirmed the Commission’s position.

In 1942 or 1943 the Commissioner of Internal Revenue ruled that in view of there not being any market value of the bonds of German, Italian or Japanese issue holders would be permitted to treat them as valueless in establishing claims for capital losses in their income tax reports.

Among the reasons for continuing to withhold public purchases and sales of outstanding Italian dollar bonds was the anticipation of an exchange or refunding program expected to be filed. It has seemed inadvisable to this Commission as well as to the State and Treasury Department to permit trading in these bonds prior to public announcement of the terms of such an exchange or refunding. In view of this situation and of the public interest involved there would seem to be considerable question as to this government authorizing a loan to Italy prior to the announcement of a reasonable adjustment on the outstanding bonds and the resumption of public markets in these issues.

3. Without a settlement of the outstanding dollar obligations of Italy it may be predicted that its credit would not permit the borrowing of any substantial funds in the private capital markets without the guarantee of the Export-Import Bank or the International Bank. With such guarantee, however, a successful offering would be well taken for a number of reasons. A reasonable estimate of the amounts which might be offered and the terms upon which they could be sold would, of course, require a more careful appraisal than the present opportunity permits. However, there seems to be an obstacle to any offering of Italian bonds in view of the continuing provisions of the Johnson Act. In this instance it appears that this Act in its present form and limited application

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