C O P Y

THE UNDER SECRETARY OF THE TREASURY

Washington

January 17, 1942

Dear Marriner:

We in the Treasury have been giving some thought to a question of a special security for the purpose of absorbing some of the idle balances that will be created by corporations and state and local governments as a result of the application of priorities, allocations, and other controls. I am enclosing herewith several copies of a memorandum discussing this proposed special security with a schedule of redemption values and yields for the first five years. Thereafter it would bear 1-3/4 per cent interest payable every six months.

I shall appreciate it if you will go over this with your people and let me have your suggestions and criticisms. You can either do this in writing or we can have a conference on it within the next week.

Sincerely yours,

(Signed) D. W. Bell

Under Secretary of the Treasury

Honorable Marriner S. Eccles,
Chairman,
Board of Governors of the
Federal Reserve System,
Washington, D. C.

Proposed Special Security for the Purpose of Absorbing Idle Business Balances

It is claimed in some quarters that funds saved by business enterprises because of deferred maintenance, reduced inventories, inability to reinvest depreciation and depletion reserves, and inability to make plant extensions will provide a major source for financing the war effort. The amount of these funds has probably been exaggerated. To the extent that such funds are saved, furthermore, they may be devoted to reducing bank loans, retiring other indebtedness, etc., and so will be available to the Treasury only through the sale of securities to banks or to persons or corporations other than the business enterprises making the savings. Nevertheless, it seems that idle business balances may prove a sufficiently important source of funds to justify offering a special type of security for their investment. Such a security would also be suitable for the investment of idle State and municipal, and, to some extent, personal balances.

In order to provide a suitable investment for funds of the character discussed, a special security should, from the standpoint of the investor, be liquid, free from market risk, and bear a satisfactory rate of return. From the standpoint of the Treasury, it should be readily callable, so that it may be retired or converted into more permanent forms of debt as soon as practicable after the conclusion of the war emergency.

The proposed security would mature in ten years. It would be issued at 93.96, and interest during the first five-year period would consist exclusively of a gradual increase in its value to 100 at the end of five years. This is equivalent to interest at the rate of 1-1/4 percent per annum compounded semiannually if held for the full five years. During the second five-year period current interest would be paid semiannually at the rate of 1-3/4 percent per annum. The average return, if held for the full ten-year period, would thus be 1-1/2 percent.*

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* This is, of course, merely the simple average of 1-1/4 percent per annum (received during the first five years) and 1-3/4 percent per annum (received during the second five years). Making full allowance for the compounding factor, however, the average return, if held for the full ten years, would still be 1.49 percent.

The security would be redeemable, at the option of the holder, on three months' notice at any time six months after date of issuance. During the first five-year period such redemption would be at prices corresponding to a scale of yields commencing at 1/4 of 1 percent per annum if the security is held for one year and rising by 1/8 of 1 percent per annum (for the entire period held) for each additional six months. These prices and yields are shown in the attached table. They are somewhat under those on Series G savings bonds, which commence at 0.30 percent per annum if held for one year and rise to 1.51 percent per annum if held for five years. They are also somewhat below the yields obtainable in the open market on taxable Treasury notes. This is considered desirable because the proposed securities, unlike Series G bonds, are purchasable in unlimited amount and, unlike open market securities, are redeemable on demand.

The proposed security would be callable at the option of the Government upon three months' notice at any time six months after date of issuance. During the first five-year period such callability would be at an ascending scale of redemption values corresponding to a flat yield of 1-1/4 percent for the period held. These redemption values are shown in the attached table. During the second five-year period the security would be callable at 100.

The proposed security would be non-negotiable and would be available for sale in unlimited amount to all persons and corporations other than banks and insurance companies. The minimum denomination would be $5,000.

Attachment

Intermediate Redemption Values and Yields of
Proposed Special Security to Absorb
Idle Business Balances

Period held	Yield for period held	Redemption value	Redemption value if called by Treasury *
1/2 year	0 %	93.96	94.55
1 "	1/4	94.20	95.14
1-1/2 "	3/8	94.49	95.73
2 "	1/2	94.90	96.33
2-1/2 "	5/8	95.44	96.93
3 "	3/4	96.09	97.54
3-1/2 "	7/8	96.88	98.15
4 "	1	97.78	98.76
4-1/2 "	1-1/8	98.83	99.38
5 "	1-1/4	100.00	100.00

* All values in this column correspond to a yield of 1-1/4 percent for period held.