FEDERAL RESERVE BANK OF DALLAS

FISCAL AGENT OF THE UNITED STATES

DALLAS, TEXAS 75222

Circular No. 69-173
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To All Issuing Agents and Others Concerned
in the Eleventh Federal Reserve District:

The enclosed press statement and related material concerning a proposed rate increase on savings bonds was released on July 11. Additional copies will be furnished upon request.

FEDERAL RESERVE BANK OF DALLAS
Fiscal Agent of the United States

Enclosures

TREASURY DEPARTMENT

WASHINGTON, D.C.

July 11, 1969

FOR IMMEDIATE RELEASE

TREASURY SECRETARY KENNEDY PROPOSES
5 PERCENT RATE ON SAVINGS BONDS

Secretary of the Treasury David M. Kennedy today disclosed details of the Nixon Administration's request to Congress for legislation to permit the payment of a 5 percent rate of interest to investors in United States Savings Bonds. He said that in the same proposal the Administration would seek removal of the 4-1/4 percent interest ceiling on all Treasury bonds.

The maximum rate that may be paid on any Treasury bond, including Savings Bonds, is now 4-1/4 percent, a statutory limitation which has been unchanged since 1918.

Mr. Kennedy disclosed the intention to ask for this legislation during his testimony earlier this week before the Senate Finance Committee.

In submitting the proposal, the Secretary emphasized his hope that the House Ways and Means Committee consideration of the legislation would await the completion of work on tax reform. He said that Committee enactment of a meaningful tax reform proposal on the earliest practicable date is a matter of highest priority.

About $52 billion of Series E and H Savings Bonds are outstanding. Approximately 11 million people are now buying bonds through a payroll savings plan. The proposed 5 percent rate would apply to Savings Bonds purchased after June 1, 1969 and held to maturity. Holders of outstanding Savings Bonds would also receive a 5 percent rate for the remaining period to maturity after June 1, 1969.

Treasury is recommending the increase in rate because the current 4-1/4 percent return is not competitive with other investment and savings opportunities. Redemptions have been running ahead of sales for seven successive months. In June, redemptions were $483 million and sales were $383 million. The last time savings bond rates were raised was in June, 1968 when they went to the permitted ceiling of 4-1/4 percent from 4.15 percent.

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The 4-1/4 percent interest rate ceiling applies to all Treasury bonds, including longer term marketable securities with maturities of more than 7 years. In the past, such bonds played an important role in providing the flexibility for orderly management of the Federal debt.

Treasury has been unable to sell any marketable bonds since May of 1965 because longer term interest rates have been above the 4-1/4 percent ceiling. Instead it has had to rely on short term instruments -- bills and notes -- on which there is no interest rate ceiling. As a result, the average maturity of the privately held marketable debt has dropped about 30 percent since mid-1965.

Treasury is seeking the removal of the ceiling in order to permit the orderly restructuring of the public debt in accordance with national objectives.

Subject to enabling legislation, the proposals effect Series E and H bonds and the Freedom Share as follows:

E and H Bonds: The new rate of 5 percent to maturity will apply to all bonds sold on or after June 1, 1969. As in the past, bonds redeemed prior to maturity will earn a lesser yield but these interim rates have been improved over the current schedule. For example, in the case of E Bonds at 6 months the new rate will be 3.20 compared to the current 2.24. At 1 year the new rate will be 4.01 compared to the current 3.02 and at 3 years 4.44 compared to 3.75 percent. The lower rate of return for short term holdings reflects the desire of the Treasury not to compete unduly with private saving institutions and to retain an incentive for purchasers to hold their bonds to maturity.

Beginning with the first semi-annual interest period starting on or after June 1, 1969, rates on outstanding E and H Bonds will be increased to yield 5 percent when held to maturity or extended maturity. These outstanding bonds will also benefit by an improved interim schedule in the case of earlier redemptions. Holders are assured there will be no advantage in redeeming currently outstanding bonds to purchase new bonds.

The dollar limit on annual purchases of E Bonds by an individual will be reduced to $5,000 purchase price from the $20,000 face amount limit currently in force. The annual limit on H Bonds will be reduced to $5,000 face amount from the current $30,000 (on H Bonds the issue price is the same as the face amount). Nontaxable exchanges of Series E Bonds for Series H Bonds will not be counted against these new annual purchase limits.

The original maturity of the Series E Bond will be shortened to 5 years 10 months from the current 7 years. The maturity of the Series H Bonds will continue to 10 years. Both bonds will be extendible at the discretion of the Secretary of the Treasury.

Freedom Share: The Freedom Share will continue on sale for 6 months following Congressional approval of the proposed legislation. This continuation period will provide a reasonable time for subscribers to convert to the purchase of savings bonds and will also facilitate payroll and accounting changes. Legislation is being requested to provide authority for an extension of Freedom Shares similar to those available on savings bonds.

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FACT SHEET

REMOVAL OF 4-1/4% INTEREST RATE CEILING

I. The Present Situation

1. Congress placed a 4-1/4% ceiling on U.S. Government bonds in 1918, and the ceiling has been unchanged since that date.

2. Throughout most of the intervening fifty years, the ceiling posed no serious problems for effective debt management because

   1) long-term interest rates generally held below the ceiling level; and

   2) during brief periods of higher rates, the Treasury could issue shorter-term securities, such as Treasury bills or notes, to which the ceiling does not apply.

3. Since 1965, interest rates on longer term Government securities have continuously been above 4-1/4%. As a result the Treasury has been unable to sell any longer-term securities for the last four years. Instead, it has been forced to confine its issues to maturities of seven years or less.*

4. Because the interest ceiling precluded longer-term issues, the average maturity of the Government's marketable debt in private hands has dropped from 5-3/4 years in mid-1965 to about 4 years today.

5. In operational terms, this shortening of the debt meant that the Treasury had to refinance some $21 billion of maturing notes and bonds in fiscal 1969, compared with less than $14 billion in fiscal 1966, a jump of more than 50%.

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* Five years or less prior to June 30, 1967.

II. Adverse Effects of the 4-1/4% Ceiling

1. Since the 4-1/4% ceiling applies to Savings Bonds as well as to marketable Government bonds, the Treasury has been prevented from paying an equitable and fully competitive rate of return to holders of Savings Bonds.

2. By forcing the Government to do all its financing in the short- and medium-term areas, the ceiling has put upward pressure on shorter term rates, thus complicating the problems of thrift institutions in competing for savings.

3. The pile-up of maturing notes and bonds added to the difficulties of orderly financing the Government's needs for new funds during periods of deficit.

4. The shortening of the Government's debt contributes to the inflationary potential of the economy by

   1) complicating the task of the monetary authorities in pursuing a policy of credit restraint; and

   2) providing investors with liquid assets that increasingly resembled cash-in-hand.

5. During the past four years, a period of generally rising interest rates, the ceiling has probably added to the costs of carrying the public debt by

   1) concentrating Treasury financings in the shorter end of the market where rates have generally been higher than on longer-term securities; and

   2) preventing issues of longer-term securities during temporary periods of lower interest rates.

III. Advantages from Removal of Ceiling

1. Removal of the ceiling would mitigate each of the adverse effects cited above.

2. Specifically, the Treasury would

   1) be free to pay a 5% rate of return to holders of Savings Bonds, as proposed by the Administration;

   2) be able to plan for orderly restructuring of the Government's debt when conditions permitted.

3. In general, removal of the ceiling will enable the Treasury to conduct the nation's financial housekeeping in a way that supports national economic objectives rather than conflicting with them.

IV. Use of Longer-term Borrowing

1. Removal of the 4-1/4% ceiling would not cause the Treasury automatically to push large amounts of debt out to the long-term area. Rather, it would permit the Treasury to take advantage of market opportunities gradually to extend the maturity of the debt through longer-term issues in amounts that would not disrupt either the Government securities market or other segments of the capital market.

2. The experience of the first half of the 1960's is illustrative of what can be accomplished through flexible debt management. Mainly through the use of so-called advance refundings -- offering of longer-term securities to holders of issues in advance of their maturity -- the Treasury was able to increase the average maturity of the debt by more than 25% without adverse effects on the financing of local governments, house construction, or other activities.

3. Given the anticipated demands on capital markets to finance the high employment economy of the 1970's, there is little likelihood that longer-term interest rates will fall below the 4-1/4% level in the foreseeable future. There is no reason, therefore, to delay the removal of a ceiling that serves no purpose, but only stands in the way of the orderly planning of debt management.

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	Series E	Series H
Redeemability prior to maturity:		
By Treasury	Not callable	Not callable
By Owner	At any time not less than 2 months from issue date at any qualified paying agent.	At any time not less than 6 months from issue date at any Federal Reserve Bank or branch, or at the U.S. Treasury except during the month preceding an interest payment date.
Negotiability	None	None
Eligibility as collateral for loans	None	None
Eligible subscribers	Natural persons and public and private organizations, but not commercial banks.	Natural persons and public and private organizations, but not commercial banks.
Annual limit on new purchases	Annual limit of $5,000, issue price ($2,000 face amount per participant in employee savings plans).	Annual limit of $5,000, issue price ($200,000 for certain organizations when received as gifts).
Denominations	$25, $50, $75, $100, $200, $500, and $1,000 (maturity value). Also $10,000 and $100,000 for certain employee savings plans.	$500, $1,000, and $5,000 ($10,000 for use in certain exchanges).
Bearer or registered	Registered only, natural persons may have co-owner or beneficiary registration.	Registered only, natural persons may have co-owner or beneficiary registration.
Extension privilege	Extendable for 10 years at rate in effect at time of extension.	Extendable for 10 years at rate in effect at time of extension.

7-11-69

Summary of Terms and Conditions of Savings Bonds
(Subject to enabling legislation)

	Series E	Series H
Effective date	All bonds sold on or after June 1, 1969.	All bonds sold on or after June 1, 1969.
Issue price	75% of face amount.	100% of face amount.
Issue date	First day of month in which payment is received by an authorized issuing agent.	First day of month in which payment is received by a Federal Reserve Bank or branch, or by U.S. Treasury.
Maturity	5 years 10 months from issue date.	10 years from issue date.
Interest:		
New bonds	Accrues to approximately face amount to provide an investment yield of approximately 5% if held to maturity, lesser yields if redeemed earlier.	Paid semi-annually by check. Provides investment yield of approximately 5% if held to maturity, lesser yields if redeemed earlier.
Outstanding bonds	Increased to provide 5% for remaining time to maturity or extended maturity.	Increased to provide 5% for remaining time to maturity or extended maturity.

QUESTIONS AND ANSWERS ABOUT UNITED STATES SAVINGS BONDS

Q: What is the Treasury proposing regarding the statutory interest ceiling on United States Savings Bonds?

A: Treasury is asking Congress to lift the ceiling and provide legislation whereby the rate on Savings Bonds could be set by Treasury at a rate consistent with marketing conditions, fairness to the investors and not unduly competitive with thrift institutions.

Q: What rate does Treasury propose to set currently on savings bonds?

A: Treasury proposes that the rate on new bonds be set at 5 percent, effective from June 1, 1969, and that the rate paid on existing bonds be adjusted, so that they will also earn at the rate of 5 percent to maturity for interest periods beginning after June 1.

Q: What is the current rate?

A: Savings bonds now receive the statutory limit of 4-1/4 percent per annum.

Q: When was this rate set?

A: The general statutory ceiling for bonds was set in 1918. The current rate on savings bonds was raised to the legal limit of 4.25% in June 1968 from 4.15%.

Q: Why raise the rate on savings bonds?

A: Rates paid by many savings institutions are higher, and have been higher for several years. Market rates have also risen substantially. The 4-1/4 percent rate paid on savings bonds has failed to attract new savers and new purchasers. As a matter of fact, redemptions of savings bonds have exceeded sales for the last seven months. In June, redemptions of $483 million exceeded sales by $100 million.

Q: To what savings bonds would the new rate apply?

A: All savings bonds, both Series E and Series H, new issues and outstanding issues.

Q: What are the characteristics of these bonds?

A: Series E bonds are sold at 75% of face value. Interest is paid by the gradual increase in redemption value, reaching approximately face amount at the end of their stated original maturity. The currently proposed bond will reach original maturity in 5 years 10 months. Older bonds had various original maturity lengths up to 10 years. They are non-negotiable and may only be redeemed by the Treasury or an authorized redemption agency. In practice, most banks and other financial institutions redeem Series E bonds. Series H bonds are 10 year bonds sold at par on which interest is paid by semiannual checks issued by the Treasury. They are also non-negotiable.

Q: Will there be any change in denominations in which bonds are sold?

A: Yes. Series E bonds will be sold in denominations of $25, $50, $75, $100, $200, $500, $1,000 maturity value. They will no longer be sold in denominations of $10,000 except for employees savings plans. Series H bonds will be sold in denominations of $500, $1,000, and $5,000. They will no longer be sold in denominations of $10,000. The $10,000 denominations will also be available for exchanges.

Q: Is there any limit on the amount of savings bonds one may buy?

A: Yes. The annual limit on Series E bonds will be set at $5,000 issue price -- a reduction from $20,000 face amount; and the yearly limit on Series H bonds will be set at $5,000 issue price -- a reduction from $30,000 (issue price and face amount are the same for Series H bonds).

Q: Why the smaller annual limit?

A: This is largely a technical matter involving other savings and thrift institutions, such as savings and loan associations which finance much of the nation's housing. Treasury has no desire to cause a shift from these institutions into savings bonds. Its primary objective is to promote new savings.

Q: Will present holders of savings bonds benefit from the new rates?

A: Yes. The new rates will apply to all savings bonds effective the first interest crediting period beginning on or after June 1. The rate on bonds currently outstanding will be adjusted so that they will receive 5 percent to maturity or extended maturity.

Q: What will happen to Freedom Shares?

A: Freedom Shares, first offered in 1967, will continue on sale for six months after the proposed legislation is passed.

Q: Is there any reason for present holders of savings bonds to cash them in for the new issues?

A: No. Rates of return on all outstanding issues are being improved so that there is no incentive for such conversions.

Q: If savings bonds are redeemed prior to maturity does the holder receive a lower rate of interest?

A: Yes, but the interim yields have been substantially improved. For example holders of both E and H Bonds will receive 4 percent or more after the first year.

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7-11-69