FEDERAL RESERVE BANK
OF NEW YORK

Fiscal Agent of the United States

[Circular No. **5082**
September 7, 1961]

TREASURY FINANCING

*To All Banking Institutions, and Others Concerned,
in the Second Federal Reserve District:*

The Treasury Department has announced cash borrowing plans and an advance refunding offer to holders of the 2½ percent Treasury Bonds of March 1965-70 and March 1966-71. The texts of two Treasury statements on the offerings, both made public today, appear below.

The subscription books for the exchange will be open from September 11 through September 15 for receipt of subscriptions from subscribers other than individuals, and through September 20 for receipt of subscriptions from individuals. The official offering circulars and subscription forms will be mailed to arrive by Monday, September 11.

Alfred Hayes,
President.

TREASURY ANNOUNCES ADVANCE REFUNDING AND CASH BORROWING PLANS

The Treasury announced today its first Public Debt offering designed especially to enlist long-term investors in the Government's current financing program. At the same time, it outlined plans to borrow $5 billion in new cash later in September and during October. Holders of $7.6 billion of two issues of World War II Treasury bonds will be given an opportunity to exchange them for additional amounts of other outstanding bonds, all bearing coupons of 3½ percent, which mature in 1980, 1990, and 1998.

This advance refunding offer is available to all holders of the 2½ percent bonds of March 1965–70 and March 1966–71. Holdings of these particular bonds are concentrated largely in insurance companies, savings banks, and private individuals (many of them original World War II subscribers).

The Treasury is making it possible for investors to gain additional income by extending the maturity of their holdings, as they choose, for additional periods of roughly 10 to 29 years. In order to equal the terms of this offering, holders of the 1965–70 and 1966–71 bonds would otherwise have to reinvest the proceeds of their bonds on maturity in comparable securities at interest rates ranging from 4.28 percent to 4.36 percent.

To the extent that investors choose to extend the maturity of their existing holdings, the Treasury will have accomplished some needed restructuring of its outstanding debt, without diverting from productive purposes in other sectors of the economy the new savings currently flowing into the long-term capital markets. Books will be open for subscriptions beginning Monday, September 11, and will remain open through September 15. In addition, individuals will be allowed to subscribe for a further period through September 20.

The Treasury will meet its estimated cash needs of roughly $5 billion over the next two months in three steps. On September 20, it will offer at auction $2½ billion of tax anticipation bills due June 22, 1962, for payment on September 27. Commercial banks may pay for such bills through their Tax and Loan Accounts. Near the end of September, the Treasury plans to announce the terms for an early October offering of approximately $2 billion in a Treasury note maturing in the spring of 1963. On October 10, the Treasury will auction, without Tax and Loan account credit, $2 billion of one-year Treasury bills, to replace $1½ billion of outstanding one-year bills which mature on October 16.

Recent increases in projected defense programs have not necessitated any revision in the Treasury's cash requirements for the months immediately ahead. Added expenditures will affect the seasonal cash surplus that normally occurs toward the end of the fiscal year. For that reason, the Treasury has reduced the extent of its reliance on a June tax anticipation bill, in comparison with the uses made of similar instruments in recent years. The Treasury is scheduling the maturity of part of its borrowings for the spring of 1963, when the return to a balanced budget for the fiscal year will again assure a seasonal cash surplus of substantial size.

ADVANCE REFUNDING OFFER

The Treasury is offering holders of $4.7 billion 2½% Bonds of March 15, 1965–1970, and $2.9 billion 2½% Bonds of March 15, 1966–71, which were issued during the war-loan drives in 1944, the right to exchange them for any of the following outstanding bonds:

3½% Bonds due November 15, 1980;
3½% Bonds due February 15, 1990;
3½% Bonds due November 15, 1998.

The exchanges will be made on the basis of par for par, as of September 15, 1961, with payments by the holders to the Treasury (or by the Treasury to the holders) and with accrued interest to September 15, 1961, on the 3½% Bonds, to be paid by the investors, as indicated in paragraph No. 3, hereunder.

The offering provides an immediate increase in interest to investors who accept a security of longer maturity. By making this conversion, holders will obtain somewhat higher yields than could be obtained by purchasing any of the affected issues in the market at current prices. Holders of the 1965–70 and 1966–71 bonds would otherwise have to reinvest their proceeds on maturity in Treasury Bonds of equal maturity at rates of 4.28 to 4.36 percent, to equal the terms of this offering. The exchange of old for new securities will not be treated as a sale and purchase for tax purposes, thereby avoiding immediate recording of book gains or losses on the securities being accepted by the Treasury in exchange for the new issues.

Terms and Conditions of the Advance Refunding Offer

1. To all holders owning $500, or more, of the following outstanding Treasury bonds:

Description of bonds	*Issue date*	*Final maturity date*	*Remaining term to final maturity (Yrs.–Mos.)*	*Amount outstanding (in billions)*
2½% bonds 1965–70	Feb. 1, 1944	March 15, 1970	8 — 6	$4.7
2½% bonds 1966–71	Dec. 1, 1944	March 15, 1971	9 — 6	2.9

2. New bonds to be issued: (additional amounts of outstanding issues)

Description of bonds	*Issue date*	*Amount outstanding (in billions)*	*Interest starts*[1]	*Interest payable*
3½% bonds of Nov. 15, 1980	Oct. 3, 1960	$ .6	Sept. 15, 1961	May 15 & Nov. 15
3½% bonds of Feb. 15, 1990	Feb. 14, 1958	2.7	Sept. 15, 1961	Feb. 15 & Aug. 15
3½% bonds of Nov. 15, 1998	Oct. 3, 1960	2.3	Sept. 15, 1961	May 15 & Nov. 15

1 Interest on the bonds surrendered stops on September 15, 1961.

3. Terms of the exchange:

Exchanges will be made on the basis of par for par, with payments by and to the Treasury, and with adjustments of accrued interest to September 15, 1961, on the 3½% bonds to be issued, (per $100 face amount) as indicated below:

		Amount of purchase price of 3½% bonds			*Net amount*		
Bonds to be exchanged	*Bonds to be issued*	*To be paid to subscriber*	*To be collected from subscriber*	*Accrued interest to be paid by subscriber*	*To be paid to subscriber*	*To be collected from subscriber*	*Extension of maturity Yrs.–Mos.*
2½% 1965–70	3½% 1980	—	$2.25	$1.170	—	$3.420	10 — 8
	3½% 1990	$1.00	—	0.295	$0.705	—	19 — 11
	3½% 1998	2.00	—	1.170	0.830	—	28 — 8
2½% 1966–71	3½% 1980	—	3.50	1.170	—	4.670	9 — 8
	3½% 1990	—	.25	0.295	—	0.545	18 — 11
	3½% 1998	1.00	—	1.170	—	0.170	27 — 8

Coupons dated September 15, 1961, on the $2\frac{1}{2}\%$ bonds in bearer form should be *detached* by holders and cashed when due. Interest on the bonds in registered form will be paid by check on September 15, 1961, by the Treasury in regular course to holders of record on August 15, 1961.

4. Limitation on amount of bonds to be issued:

   The amount of the $3\frac{1}{2}\%$ bonds to be issued under this offering will be limited to the amount of the eligible $2\frac{1}{2}\%$ bonds tendered in exchange and accepted.

5. Books open for subscriptions for the $3\frac{1}{2}\%$ bonds:

   The books will be open for the receipt of subscriptions from *ALL* classes of subscribers from Monday, September 11, through Friday, September 15. In addition, the books will also be open for the receipt of subscriptions from *individuals* through Wednesday, September 20. For this purpose, individuals are defined as natural persons in their own right. Subscriptions placed in the mail by midnight of the respective closing dates, addressed to the Treasurer, U. S., Washington 25, D. C., or any Federal Reserve Bank or Branch, will be considered as timely. The use of registered mail is recommended for bondholders' protection in submitting bonds to be exchanged. The new bonds will be delivered to subscribers on September 29, 1961.

6. Requirements applicable to subscriptions:

   Subscriptions will be received at Federal Reserve Banks and Branches and at the Office of the Treasurer of the United States, Washington 25, D. C. Banking institutions generally may submit subscriptions for account of customers, provided the names of the customers are set forth in such subscriptions.

7. Denominations and other characteristics of the $3\frac{1}{2}\%$ bonds:

   $500, $1,000, $5,000, $10,000, $100,000, and $1,000,000 in coupon and registered forms. They will be acceptable to secure deposits of public moneys.

8. Nonrecognition of gain or loss for Federal income tax purposes:

   (a) *Where the exchange is solely of the $2\frac{1}{2}\%$ Bonds for the $3\frac{1}{2}\%$ Bonds* — the Secretary of the Treasury has declared pursuant to section 1037(a) of the Internal Revenue Code that no gain or loss shall be recognized for Federal income tax purposes; *however,* section 1031(b) of the Code requires recognition of any gain realized on the exchange to the extent that money (other than interest) is received by the bondholder in connection with the exchange as indicated in (b).

   (b) *Where the $3\frac{1}{2}\%$ Bonds are offered by the Treasury with a payment to the investor* — if the fair market value[1] of the $3\frac{1}{2}\%$ Bonds plus the amount paid to the investor (discount) exceeds the cost basis of the $2\frac{1}{2}\%$ Bonds to the investor, such gain (but not to exceed the amount of the payment) must be recognized and accounted for as gain for the taxable year of exchange. He will carry the $3\frac{1}{2}\%$ Bonds on his books at the same amount as he is now carrying the $2\frac{1}{2}\%$ Bonds except that he will reduce the cost basis by the amount of the payment and increase it by the amount of the gain recognized. If the fair market value of the $3\frac{1}{2}\%$ Bonds plus the amount of the payment does not exceed the cost basis of the $2\frac{1}{2}\%$ Bonds, the basis in the $3\frac{1}{2}\%$ Bonds will be the cost basis in the $2\frac{1}{2}\%$ Bonds reduced by the amount of the payment.

   (c) *Where premium is paid by the subscriber* — if a premium is paid by the subscriber no gain or loss will be recognized; but his tax basis in the $3\frac{1}{2}\%$ Bonds will be his cost basis in the $2\frac{1}{2}\%$ Bonds *increased* by the amount of the premium.

   (d) Gain to the extent not recognized under (b) (or loss), if any, upon the $2\frac{1}{2}\%$ Bonds surrendered in exchange will be taken into account upon the disposition or redemption of the $3\frac{1}{2}\%$ Bonds.

9. Federal estate tax option on the $3\frac{1}{2}\%$ Bonds:

   The $3\frac{1}{2}\%$ Treasury Bonds of 1980, 1990, and 1998 will be redeemable at par and accrued interest prior to maturity for the purpose of using the proceeds in payment of Federal estate taxes *but only if they are owned by the decedent at the time of his death and thereupon constitute part of his estate.* Accordingly, estates of decedents to which the similar option in the $2\frac{1}{2}\%$ Treasury Bonds of 1965-70 and 1966-71 has accrued at the date of exchange cannot make the exchange,

[1] The mean of the bid and asked quotations on date subscriptions are submitted.

with the expectation of using the proceeds of redemption of the 3½% Bonds prior to maturity in payment of estate taxes because such 3½% Bonds were not owned by the decedent at the time of his death.

10. Book value of new bonds to banking institutions:

The Comptroller of the Currency, Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation have indicated to the Treasury that banks under their supervision may place the new bonds received in exchange on their books

(a) at an amount not greater than the amount at which the eligible bonds surrendered by them are carried on their books plus the amount of premium, if any, paid on the new bonds; or

(b) at the amount at which the eligible bonds surrendered are carried on their books, reduced by the amount of discount, if any, received by the subscriber and increased by the amount of gain, if any, which will be recognized as indicated in paragraph 8 (b).

They will so advise their examiners.

11. Computation of reinvestment rate for the extension of maturity:

A holder of the outstanding eligible 2½% Bonds has the option of accepting the Treasury's exchange offer or of holding the bonds to maturity. Consequently, he can compare the interest he will receive resulting from exchanging now with the interest he might obtain by reinvesting the proceeds of the 2½% Bonds at maturity.

The interest income before tax for making the extension now through exchange will be the coupon rate on the new issue. If a holder of the eligible 2½% Bonds does *not* make the exchange, he would receive only the 2½% rate to their maturity and would have to reinvest at that time at a rate equal to that indicated in section 12 below for the remaining term of the issue now offered, in order to equal the interest he would receive by accepting the exchange offer. For example, if the 2½% Bonds of 1965–70 are exchanged for the 3½% Bonds of 1990, the rate for the entire twenty-eight years and five months will be 3½%. If the exchange is not made, a 2½% rate will be received until March 15, 1970, requiring reinvestment of the proceeds of the 2½'s at that time at a rate of at least 4.36% for the remaining nineteen years and eleven months, all at compound interest, to average out to a 3½% rate for twenty-eight years and five months. This minimum reinvestment rate for the extension period is shown in the table under section 12. The minimum reinvestment rates for the other issues included in the exchange are also shown in the table under section 12.

12. Investment rates on the 3½% bonds offered in exchange, to holders of the eligible 2½% bonds:

Eligible bonds	2½% March 15, 1965–70			2½% March 15, 1966–71		
Bonds offered in exchange	3½% Nov. 15, 1980	3½% Feb. 15, 1990	3½% Nov. 15, 1998	3½% Nov. 15, 1980	3½% Feb. 15, 1990	3½% Nov. 15, 1998
Payments on account of $100 issue price:						
By subscriber	$2.25			$3.50	$0.25	
To subscriber		$1.00	$2.00			$1.00
Approximate investment yield from exchange date (9/15/61) to maturity of 3½% bonds based on price of eligible 2½% bond[1]	4.16%	4.23%	4.19%	4.15%	4.21%	4.19%
Approximate minimum reinvestment rate for the extension period[2]	4.31%	4.36%	4.28%	4.30%	4.36%	4.30%

[1] Yield to nontaxable holder or before tax. Based on mean of bid and ask prices (adjusted for payments on account of issue price) at noon September 6, 1961.

[2] Rate for nontaxable holder or before tax. For explanation see paragraph 11 above.