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U.S. SAVINGS BONDS 5 PERCENT INTEREST RATE

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Mr. Williams of Delaware, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 14020]

The Committee on Finance, to which was referred the bill (H.R. 14020) to amend the Second Liberty Bond Act to increase the maximum interest rate permitted on U.S. savings bonds, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

I. SUMMARY

This bill (H.R. 14020) raises the maximum allowable interest rate ceiling on U.S. savings bonds to 5 percent from its present level of 4¼ percent and makes other technical changes. The new 5-percent ceiling applies to all savings bonds issued on or after June 1, 1969, and also to outstanding savings bonds for interest periods beginning on or after June 1, 1969. This bill is endorsed by the Treasury Department.

II. GENERAL STATEMENT

The Treasury Department has indicated that as soon as this legislation is adopted it will raise the interest rate paid on series E and H bonds to the new 5-percent ceiling rate. The present 4.25 percent interest rate on savings bonds has been in effect since June 1968 when the rate was moved up to the maximum permitted by the present ceiling limitation for savings bonds which has been applicable since September of 1959. At that time, authority was provided to increase the interest rate on savings bonds to 4.25 percent (the ceiling rate applicable to other bonds since 1918) on a finding by the President that the national interest required this.

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This change is needed primarily for two reasons. First, the increase in the ceiling rate on savings bonds provided by H.R. 14020 is needed because the rates of interest on other competitive forms of savings substantially exceed 4¼ percent. Interest rates have risen rapidly in recent years, primarily as a consequence of the inflationary pressures generated by an overactive economy. As a result, the yields on Government savings bonds are now significantly lower than those on alternative forms of savings. For example, although the maximum permissible rate for passbook savings is now 4 percent for commercial banks and 4¾ percent for savings and loan institutions, banks may pay 5 percent on time deposits under $100,000, and savings and loan institutions may pay 5¼ percent on certificates required to be held 6 months or more. In this settings, the present 4¼-percent ceiling for savings bonds prevents payment of a fully competitive rate of return to their holders. The new 5-percent ceiling on interest rates provided by the bill is needed to bring savings bond yields into line with those paid on other forms of comparable savings.

Second, this increase in the ceiling rate for savings bonds is also required for the sound management of the Nation's debt. This is because it is essential for purposes of managing the public debt to keep the savings bond program operative. About 11 million people are now buying savings bonds through payroll savings plans, and there are about $52 billion of series E and H savings bonds outstanding. In fact, the dollar amount of savings bonds outstanding is almost one-third the size of the total outstanding privately held marketable debt.

An effective savings bond program helps to reduce the problem of refunding the national debt. The average maturity of the outstanding privately held marketable Treasury debt is now only 3 years and 11 months. In contrast, the $52 billion of outstanding savings bonds will remain outstanding for 7 years if past experience continues into the future.

The Treasury has indicated that in the next 12 months it will need to refund more than $76 billion of the $160 billion of outstanding privately held marketable debt, or close to 50 percent of the total. However, the redemptions of savings bonds in the same period of time are expected to amount to about $6 billion or 11 percent of the total, oustanding savings bonds.

The 4¼-percent ceiling on interests rates for savings bonds now impairs the effectiveness of the savings bond program. Because this rate is significantly below the present interest rates paid on alternative forms of savings, it has reduced the incentive for individuals to buy savings bonds and redemptions of these bonds have substantially exceeded sales in recent months. As a result, the outstanding volume of series E and H bonds has declined in every month in this year except February and May. Even taking into account interest accruals which run at an annual rate of approximately $1.8 billion, the total amount of savings bonds outstanding has declined by more than $300 million from the level outstanding at the end of December 1968. The cash drain—the excess of redemptions over sales—has amounted to $1,516 million in the first 8 months of 1969 compared with $1,219 million in the whole of calendar 1968.

The 5-percent-ceiling rate on savings bonds authorized by H.R. 14020 will help make savings bonds more attractive to savers and thereby increase bond sales and reduce redemptions.

While recognizing the need for an increase in the maximum interest rate on savings bonds, the committee agrees with the Committee on Ways and Means of the House that any ceiling rate for savings bonds must necessarily be considered with regard to its impact on private savings institutions, such as savings and loan institutions and banks. Accordingly, it is important not to set the interest rate on savings bonds so high that these private savings institutions find it difficult to attract savings and thus are hampered in performing the functions of channeling funds into the housing and other markets.

In other words, the ceiling rate for savings bonds must achieve a balance between providing a fair return for the holders of such bonds and maintaining adequate incentives to invest in comparable forms of private saving. We believe that the 5-percent-ceiling rate under the pending legislation achieves such a balance.

It is understood that the Treasury Department has consulted with the various private financial institutions and that these institutions understand the need for increasing the interest rate on savings bonds to 5 percent and have voiced no objection. In considering the impact of this change on financial institutions, it also should be noted that under the customary type of repayment schedule, the 5-percent yield will apply only to savings bonds held to maturity and that bonds redeemed prior to maturity will yield below 5 percent. Moreover, the 5-percent-ceiling rate for savings bonds will provide substantially less of a competitive problem to private financial institutions than the alternative method of financing the Government debt that would be necessary if, in the absence of the new higher ceiling, savings bonds could not be sold to investors. In this event, the Federal Government would be forced to borrow funds in the open market at substantially higher interest rates. For example, to secure the funds needed to refund $8.9 billion of notes and bonds maturing October 1, and December 15, 1969, the Treasury recently had to pay interest rates as high as 8 percent. Increased reliance on such financing in the open market and less reliance on savings bonds as a source of funds would not only increase the cost of servicing the national debt but would also increase the direct purchase of securities by individual savers without channeling their funds through a financial institution.

III. GENERAL EXPLANATION

This bill increases the interest rate ceiling on Government savings bonds from 3.26 to 5 percent (by amending sec. 22(b)(1) of the Second Liberty Bond Act). It also repeals the section of the Second Liberty Bond Act (sec. 25) which gives the President the power to raise the interest rate on savings bonds above 3.26 percent up to 4¼ percent if the national interest so requires.

The new 5 percent interest ceiling is available for U.S. savings bonds issued on or after June 1, 1969. The new ceiling rate also is available for existing savings bonds for interest periods beginning on or after June 1, 1969.

The bill further provides that the treatment of U.S. notes known as Freedom Shares, issued not later than 1 year after the date of enactment of this legislation, is to be conformed with that accorded series E bonds in two respects:

(a) The Secretary of the Treasury is authorized to provide by regulations that owners of Freedom Shares (like owners of series E and H savings bonds), may, at their option, retain the Shares after maturity and continue to earn interest on them at the prescribed rates consistent with the maximum rate ceiling; and

(b) An individual not on the accrual basis of accounting, who exchanges a Freedom Share (like one who exchanges a series E bond) for another nontransferable U.S. obligation in an exchange on which gain or loss is not recognized, is to be taxed on the accumulated interest in the year the share is finally redeemed or matures, whichever is earlier (rather than at the time of the exchange).

In approving this new interest rate ceiling, the committee is aware that the mechanics of the issue in redemption of the series "E" bonds may make it impossible to achieve an exact yield of 5 percent. This is due to small discrepancies, before rounding, which result from the administrative necessities of using maturities stated in monthly intervals, and maintaining established issue and redemption prices.

The committee contemplates that the Treasury Department, in setting the precise terms of new issues in accord with established procedures, should remain within the new ceiling when rates are stated with the degree of precision that accords with common practice in the securities market. Accordingly, this ceiling is not intended to prohibit sales of bonds at a rate of 5 percent rounded to two decimal places.

This situation can be illustrated as follows: The proposed new "E" bond would have a term of 5 years and 10 months with a redemption value of $25.01. The rate of return on this bond would be 5.000027 percent (six decimal places). A redemption value of $25 would provide a return of 4.993000 percent (again rounded to six decimal places). The proposed bond, rounded to two decimal places, thus is a 5-percent bond.

Changes in Existing Law

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italic; existing law in which no change is proposed is shown in roman):

SECOND LIBERTY BOND ACT

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SEC. 22. (a) The Secretary of the Treasury, with the approval of the President, is authorized to issue, from time to time, through the Postal Service or otherwise, United States savings bonds and United States Treasury savings certificates, the proceeds of which shall be available to meet any public expenditures authorized by law, and to retire any outstanding obligations of the United States bearing interest or issued on a discount basis. The various issues and series of the savings bonds

and the savings certificates shall be in such forms, shall be offered in such amounts, subject to the limitation imposed by section 21 of this Act, as amended, and shall be issued in such manner and subject to such terms and conditions consistent with subsections (b), (c), and (d) hereof, and including any restrictions on their transfer, as the Secretary of the Treasury may from time to time prescribe.

(b) (1) Savings bonds and savings certificates may be issued on an interest-bearing basis, on a discount basis, or on a combination interest-bearing and discount basis and shall mature, in the case of bonds, not more than twenty years, and in the case of certificates, not more than ten years, from the date as of which issued. Such bonds and certificates may be sold at such price or prices, and redeemed before maturity upon such terms and conditions as the Secretary of the Treasury may prescribe: *Provided*, That the interest rate on, and the issue price of, savings bonds and savings certificates and the terms upon which they may be redeemed shall be such as to afford an investment yield not in excess of [3.26 per centum] *5 per centum* per annum, compounded semiannually. The denominations of savings bonds and of savings certificates shall be such as the Secretary of the Treasury may from time to time determine and shall be expressed in terms of their maturity value. The Secretary of the Treasury is authorized by regulation to fix the amount of savings bonds and savings certificates issued in any one year that may be held by any person at any one time.

(2) The Secretary of the Treasury, with the approval of the President, is authorized to provide by regulations:

(A) That owners of series E and H savings bonds may, at their option, retain the bonds after maturity, or after any period beyond maturity during which such bonds have earned interest, and continue to earn interest upon them at rates which [(subject to section 25)] are consistent with the provisions of paragraph (1).

(B) That series E and H savings bonds on which the rates of interest have been fixed prior to such regulations will earn interest at higher rates which [(subject to section 25)] are consistent with the provisions of paragraph (1).

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[SEC. 25. In the case of any offering of United States savings bonds issued or to be issued under section 22 of this Act, the maximum limits on the interest rate or the investment yield or both may be exceeded upon a finding by the President with respect to such offering that the national interest requires that such maximum limits be exceeded: *Provided, however*, That in no event may the interest rate or the invesment yield exceed 4¼ per centum per annum.]

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