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ADDITIONAL INTEREST EARNINGS OF OASDI TRUST FUNDS RESULTING FROM CHANGED INTEREST RATE PROVIDED IN 1960 AMENDMENTS

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This note is the third in an annual series of notes that analyze the interest earnings of the OASDI Trust Funds with regard to the effect of statutory changes in the basis of determining the interest rate for special issues. *In summary, the change made by the 1960 amendments has benefited the trust funds by about \$140 million in fiscal years 1961-66.*

The 1960 amendments provided that the rate for special issues would be based on the average market-yield rate, computed as of the end of the preceding month, for all marketable interest-bearing obligations not due or callable for at least 4 years. Comparison is made with the interest rate provided by the 1956 amendments, which was based on the average coupon rate of securities issued for at least 5 years, and with the interest rate provided by the 1939 amendments, which was based on the average coupon rate of all interest-bearing obligations. Table 1 shows the three interest rates, by months, from the effective date of the 1960 amendments to June 1966.

The special investments issued for the trust funds mature on June 30, and consist of one-year (or less) certificates, one- to five-year notes, and bonds with maturities up to 15 years. Generally, investments in notes and bonds are made only at the end of the fiscal year, on June 30. Special certificates are issued three times a month throughout the year. Investments are liquidated on the last day of the month to provide funds for benefit payments. Certificates are liquidated first, then notes and bonds, in order of maturity date with the lower interest rate issues redeemed first.

The pattern of investments in and redemptions of special issues has been studied during the

period October 1960 through June 1966. With respect to special certificates issued during a fiscal year and maturing on June 30 next, interest earnings are included in this study only for certificates held at least one full month; that is, interest on certificates issued in a month and liquidated on the last day of that month is excluded. Thus, the estimates of the added interest earnings on these certificates are understated, and the amount of gain shown represents a minimum. As to longer-term issues in notes and bonds, interest earnings are based on the actual period that the securities were held, with liquidation assumed to occur on the last day of the month.

Table 2 summarizes the holdings in special issues as of October 31, 1960, and at the end of each of the fiscal years 1961-66. Because both trust funds have been decreasing over much of this period, it has been necessary to liquidate notes and bonds during the year, and these liquidations have been largely in issues at 2½% and 2-5/8%. Receipts are high in the early part of the year, particularly in February and May, and thus funds are usually available for long-term investment on June 30.

Table 3 shows the effect of the 1960 change, by fiscal year and by type of special issue. In the first fiscal year, 1961, additional interest earnings were realized only on certificates. Investments on June 30, 1961, in notes and bonds at 3¾% that were held for the entire fiscal year 1962, resulted in substantial gains for that year. For the OASI Trust Fund, the entire investment was in bonds maturing in 1975 and 1976, while for the DI Trust Fund, a part of the investment was in 2-5 year notes, and the remainder was in bonds maturing annually from 1967 to 1976.

On June 30, 1962, most of the OASI funds available for investment were held in 1-year certificates, with a small amount in 2-year notes, which were liquidated during fiscal 1963. For the DI Trust Fund, the amount of 3¾% special issues maturing in each year from 1964 to 1976 was increased and bonds maturing in 1977 were added. During fiscal 1963, one-third of the 3¾% notes issued June 30, 1961 for the DI Trust Fund were liquidated.

On June 30, 1963, the only long-term investment that was made for both funds was in 3-7/8% bonds maturing June 30, 1977-78. During the succeeding fiscal year, liquidations in the OASI Trust Fund were in 2½% and 2-5/8% bonds with maturity dates to June 30, 1966, while for the DI Trust Fund substantially all of the remaining 3¾% notes issued on June 30, 1961-62, as well as 2½% and 2-5/8% bonds, were liquidated.

On June 30, 1964, 4-1/8% bonds maturing June 30, 1979 were issued for both funds. In addition, for the OASI Trust Fund, almost \$598 million in 2-year notes was issued on June 30, 1964, but was liquidated during the next month. Other liquidations in the OASI Trust Fund during fiscal 1965 were in 2½% and 2-5/8% bonds maturing on June 30, 1966-67. For the DI Trust Fund, liquidations consisted of the remaining 3¾% notes issued June 30, 1962; most of the 2½% and 2-5/8% bonds with maturity dates up to June 30, 1970; and a small portion of the 3¾% bonds issued on June 30, 1961-62.

On June 30, 1965, the long-term investment that was made for the OASI Trust Fund was in 4-1/8% bonds maturing June 30, 1980. In addition, over \$1 billion in 2-year notes at 4-1/8% was issued, but was liquidated by the end of October. Other

liquidations during fiscal year 1966 consisted of 2-5/8% bonds maturing June 30, 1967-70, and the remainder of the 2½% bonds. For the DI Trust Fund, the only investment made on June 30, 1965, was in 4-1/8% bonds maturing on June 30, 1979-80. Liquidations during fiscal year 1966 were 2-5/8% and 3¾% bonds maturing on June 30, 1970-74.

On June 30, 1966, the only long-term investment that was made for both funds was in 4-7/8% notes. For the OASI Trust Fund, almost \$2,820 million was invested in 2-5 year notes, and for the DI Trust Fund, \$158 million was invested in 5-year notes. This investment in notes is of particular interest, since usually the largest investment is in 15-year bonds. However, since the Second Liberty Bond Act limits the interest rate on bonds to a maximum of 4¼%, the Managing Trustee invested solely in 2-5 year notes at 4-7/8%. Most of these high-interest notes have earlier maturity dates than the bonds held and thus may be liquidated first. Besides the 4-7/8% notes, the OASI Trust Fund held \$5.6 billion in 3¾%, 3-7/8%, and 4-1/8% bonds maturing in 1975-80. The DI Trust Fund held \$782 million in 3¾% and 4-1/8% bonds maturing in 1974-80.

As shown in Table 3, the additional interest earnings during the 6 fiscal years since the change was made have aggregated \$140 million, with the increase during fiscal year 1966 being \$43 million.

Table 4 makes a similar comparison using the interest rates under the 1939 amendments. A slightly smaller gain is shown, due to the fact that the 1939 rate has equaled or exceeded the 1956 rate during all of the period except the 5 months April-August 1963.

Table 1

EFFECTIVE INTEREST RATES COMPARED WITH RATES UNDER PROVISIONS
OF 1956 AMENDMENTS AND 1939 AMENDMENTS

<u>Period</u>	<u>Effective Rate</u>	<u>1956 Rate</u>	<u>1939 Rate</u>
1960 October	3.625%	2.625%	3.125%
November	3.750	2.750	3.125
December	4.000	2.750	3.125
1961 January	3.625	2.750	3.125
February	3.750	2.750	3.000
March	3.625	2.750	3.000
April	3.750	2.875	3.000
May	3.625	2.875	3.000
June	3.750	2.875	3.000
July-August	3.875	2.875	3.000
September	4.000	2.875	3.000
October-November	3.875	2.875	3.000
December	4.000	3.000	3.000
1962 January-February	4.000	3.000	3.125
March	3.875	3.000	3.125
April	3.750	3.000	3.125
May-June	3.750	3.125	3.125
July	3.875	3.125	3.125
August	4.000	3.125	3.125
September	4.000	3.125	3.250
October	3.875	3.125	3.250
November	3.750	3.125	3.250
December	3.750	3.250	3.250
1963 January-February	3.750	3.250	3.250
March	3.875	3.250	3.250
April-August	3.875	3.375	3.250
September-October	4.000	3.375	3.375
November	4.125	3.375	3.375
December	4.000	3.375	3.375
1964 January	4.125	3.375	3.375
February-March	4.125	3.500	3.500
April	4.250	3.500	3.500
May-December	4.125	3.500	3.500
1965 January	4.125	3.500	3.500
February-August	4.125	3.625	3.625
September	4.250	3.625	3.625
October-December	4.375	3.625	3.625
1966 January	4.625	3.625	3.750
February	4.750	3.625	3.750
March	5.000	3.625	3.750
April-May	4.750	3.625	3.875
June	4.875	3.625	3.875

Table 2

INVESTMENTS IN SPECIAL ISSUES HELD ON VARIOUS DATES
(in millions)

Type of Investment	Oct. 31 1960	June 30					
		1961	1962	1963	1964	1965	1966
OASI Trust Fund							
Total	\$15,816	\$16,200	\$15,074	\$14,221	\$14,799	\$15,261	\$14,403
Certificates	167	441	1,080	—	—	141	—
Notes	1,934	1,387	257	—	598	1,032	2,820
Bonds	13,715	14,372	13,737	14,221	14,201	14,088	11,583
2-1/2%	4,825	4,560	3,925	2,671	1,324	412	—
2-5/8%	8,890	8,572	8,572	8,572	8,397	8,116	6,023
3-3/4%	—	1,240	1,240	1,240	1,240	1,240	1,240
3-7/8%	—	—	—	1,738	1,738	1,738	1,738
4-1/8%	—	—	—	—	1,502	2,582	2,582
DI Trust Fund							
Total	\$ 2,092	\$ 2,299	\$ 2,304	\$ 2,165	\$ 1,903	\$ 1,563	\$ 1,150
Certificates	232	34	1	6	—	—	—
Notes	386	464	336	84	1	—	158
Bonds	1,474	1,801	1,967	2,076	1,901	1,563	992
2-1/2%	188	188	188	142	30	—	—
2-5/8%	1,287	1,287	1,287	1,287	1,092	698	210
3-3/4%	—	327	493	493	493	432	349
3-7/8%	—	—	—	154	154	154	154
4-1/8%	—	—	—	—	133	279	279

Table 3

ADDITIONAL INTEREST EARNINGS, EFFECTIVE RATE OVER
RATE PROVIDED BY 1956 AMENDMENTS
(in thousands)

<u>Fiscal Year</u>	<u>Certificates</u>	<u>Notes</u>	<u>Bonds</u>	<u>Total</u>
OASI Trust Fund				
1961	\$1,227	-	-	\$ 1,227
1962	1,621	-	\$10,851	12,472
1963	1,148	\$ 324	10,851	12,323
1964	1,090	-	19,543	20,633
1965	939	311	28,928	30,178
1966	2,191	817	34,328	37,336
Total	8,216	1,452	104,501	114,169
DI Trust Fund				
1961	\$1,447	-	-	\$ 1,447
1962	585	\$ 679	\$ 2,859	4,123
1963	229	570	3,895	4,694
1964	51	193	4,663	4,907
1965	50	3	5,188	5,241
1966	148	-	5,255	5,403
Total	2,510	1,445	21,860	25,815

Table 4

ADDITIONAL INTEREST EARNINGS, EFFECTIVE RATE OVER
RATE PROVIDED BY 1939 AMENDMENTS
(in thousands)

<u>Fiscal Year</u>	<u>Certificates</u>	<u>Notes</u>	<u>Bonds</u>	<u>Total</u>
OASI Trust Fund				
1961	\$1,032	-	-	\$ 1,032
1962	1,502	-	\$ 9,301	10,803
1963	1,329	\$ 324	9,301	10,954
1964	1,090	-	20,166	21,256
1965	939	311	29,551	30,801
1966	1,704	817	34,951	37,472
Total	7,596	1,452	103,270	112,318
DI Trust Fund				
1961	\$1,016	-	-	\$ 1,016
1962	521	\$ 582	\$ 2,451	3,554
1963	240	494	3,487	4,221
1964	51	168	4,447	4,666
1965	50	3	5,016	5,069
1966	115	-	5,172	5,287
Total	1,993	1,247	20,573	23,813