Issue Briefs
2010-7 Family Financial Education
UW Extension Cooperative Extension

Asset Building through Savings Bonds

What are Savings Bonds?

U.S. Savings Bonds are issued by the federal government. When you buy a bond you are loaning money to the Treasury in exchange for a risk-free rate of return. Savings bonds (which are different from Treasury bills or bonds) are designed for consumers to purchase and provide a low-cost way to save money.

Savings Bonds as a Savings Product

Some financial counselors may dismiss bonds as being too small and offering returns that are too low. But for many savers bonds have features that are hard to beat:

1. Risk Free: U.S. Savings Bonds are backed by the government and are among the least likely investments to default that exist today.
2. No Fees: Unlike some savings or investment products there are no management fees, sales fees or commissions. Every penny you invest is actually invested.
3. No Experience Necessary: Savings bonds are available no matter your savings level, credit history or status with ChexSystems.
4. Liquid but Some Constraints: Many people want to know they can tap their savings when they need it; savings bonds can be cashed for no charge at any regulated financial institution. But some people also want their savings not be so easy to spend; savings bonds create at least some barriers to cashing out on a whim.
5. Flexible: Bonds can be used to save for anything including education, retirement and even gifts.

You can buy a savings bond if you have a Social Security Number and are a resident or citizen of the United States. Minors may own U.S. Savings Bonds in their own name.

Bonds are also safe from theft or loss. A savings bond is a registered security and ownership is non-transferable. The United States Treasury has a contractual relationship with the owner/co-owners named on the bond regardless of who may possess a paper bond.

For more background on bonds see: http://www.d2dfund.org/research_publications/reinventing_savings_bonds

S Types of Bonds: EE & I

There are two types of EE Bonds, those sold as “paper” bonds and those sold electronically. Electronic bonds are sold at face value (you pay $100 for a $100 bond). There is a minimum of $25 and bonds can be of any amount (not just round numbers). Like other bonds, you can buy up to $5,000 per calendar year.

Paper EE bonds are sold at half their face value ($50 for a $100 bond--its worth its face value when it matures). Bonds are only available in denominations of $50, $75, $100, $200, $500, $1,000, and $5,000, and $10,000. Buyers are mailed paper bond certificates.

If you redeem EE Bonds in the first 5 years, you will forfeit the 3 most-recent months' interest; after 5 years there is no penalty.

Rates for EE Bonds depend on the issue date and are either a fixed rate of return or a variable rate based on 90% of 6-month averages of 5-year Treasury Securities yields. Series EE Bonds purchased on or after May 1, 2005, earn a fixed rate of return, which makes valuing the bonds easy. EE Bonds purchased between May 1997 and April 30, 2005, are based on 5-year Treasury security yields and earn a variable market-based rate of return—for these a visit to www.treasurydirect.gov will provide a current value. EE bonds pay interest for 30 years after which they should be cashed in.

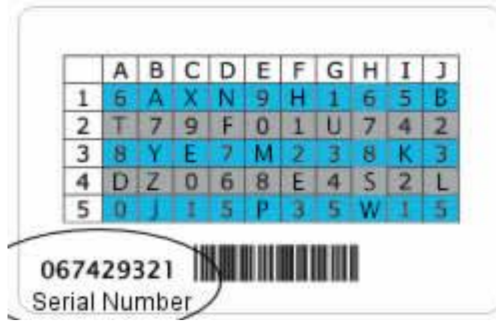
I Bonds earn interest that is indexed for inflation. The rate combines a fixed rate of return, which remains the same throughout the life of the I Bond and a variable semiannual (twice per year-- May and November) inflation rate based on changes in the Consumer Price Index for all Urban Consumers (CPI-U). Like EE Bonds, I Series bonds can be electronic or paper. Paper I bonds are sold at face value in amounts of $25 or more up to $5,000 maximum per year. Paper I series bonds are also sold at face value but only in denominations of $50, $75, $100, $200, $500, $1,000, and $5,000 (also the maximum purchase per year). These bonds grow with inflation-indexed earnings for up to 30 years. After 30 years the bonds are matured and should be cashed in.

Like EE series bonds, within the first 5 years, the 3 most recent months' interest are charged for cashing in a bond; after 5 years no penalty.

HH Bonds are no longer issued (as of September 1, 2004). These bonds still are in use and are pay interest every 6 months until maturity or redemption, whichever comes first.
For more background see:
http://www.mymoneyblog.com/archives/category/savings-bonds

Using Treasury Direct

Savings bonds are available from most banks and credit unions. But Savings Bonds are online too. TreasuryDirect.gov is a website where you can purchase and redeem bonds operated by the U.S. Department of Treasury. Only electronic bonds available but the site operates 24 hours a day using a secure Internet connection. You can open an online account with an email address; Social Security or tax identification number, driver's license number and bank routing transit number and savings or checking account number. Treasury has issued security code cards to raise the level of security on the site, the code card (an example is below) requires you to match keyboard letters to the card.



Savings Bonds and Payroll Deduction

Savings Bonds can be purchased via automatic payroll deductions at TreasuryDirect. Any employer with direct deposit can allow employees to opt to have a portion of their pay transferred to their TreasuryDirect accounts.

Tax Refunds as a Bond

IRS Form 8888 to tell the IRS you want to use part (or all) of your refund to purchase paper I Bonds. Purchase amounts must be in $50 multiples and any remaining funds will be delivered to you by direct deposit. Using Form 8888 a taxpayers must designate Routing Number: 043736881 and then Account Number: "BONDS". Another option is to use TreasuryDirect account numbers, allowing you to deposit any amount as a bond (not just $50 increments).

A pilot by D2D showed that bonds are tax time proved a valuable savings product for low-income taxpayers at selected tax sites. Most used savings bonds as their only savings vehicle and many bought bonds for kids or grandkids at tax time. See: http://www.d2dfund.org/our_work/building_savings/savings_bonds/pilot_testing_savings_bonds

Taxes

Savings bond interest is exempt from state income taxes, and all taxes can be deferred until the time of bond redemption. The Education Bond Program makes the interest on certain savings bonds tax free when the bonds are redeemed to pay for education expenses. For more on education uses of bonds see: http://www.finaid.org/savings/bonds.phtml

Summary

U.S. Savings Bonds are a useful savings vehicle for many people, including:

- minors and as gifts
- unbanked and under-banked
- tax filers at VITA sites
- people seeking risk free returns with low or no expenses

Returns on bonds are modest, but recent times have highlighted the risks of higher returns in investing. The key to savings is not high return—but rather continuous contributions. Savings Bonds offer one low-cost and easy way to do so.

Resources

Many Cooperative Extension educational materials and websites cover the topic of Savings Bonds.

For example, see eXtension at: http://www.extension.org/pages/Investing_Unit_5:_Series_EE_and_I_U.S._Savings_Bonds

Also Penn State Extension at: http://pubs.cas.psu.edu/freepubs/pdfs/UI375.pdf

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The University of Wisconsin-Extension (UWEX) Cooperative Extension's mission extends the knowledge and resources of the University of Wisconsin to people where they live and work. Issue Briefs are an ongoing series of the Family Financial Education Team. This brief was drafted by J. Michael Collins, Assistant Professor in Consumer Finance and Extension State Specialist.