

Series I Bonds

United States Treasury Department

What Are Series I Bonds?

Series I bonds (as in “eye” and not the Roman numeral) are a new series of United States Savings Bond offered by the Department of the Treasury. These bonds are backed by the full faith and credit of the United States.

A bond earns interest through application of a composite rate. The composite rate consists of a fixed rate that remains the same for the life of the bond and an inflation rate that changes twice a year. Interest earned from the composite rate accrues monthly and is compounded semiannually.

A bond will earn interest for up to 30 years and interest earnings are payable upon redemption. Interest earnings on a bond are exempt from state and local income taxes, but are subject to other state and local taxes as well as Federal taxes.

What’s This Information Statement All About?

This information statement explains selected features of Series I bonds, as well as some investment considerations relating to these bonds. You can use this document to help you determine whether to buy a bond. This document is explanatory only. The offering, terms, and conditions of bonds are located in the Code of Federal Regulations. This information, along with informal guidance on bonds, can be found on the Internet at www.savingsbonds.gov.

What Are Some Investment Considerations Relating to Series I Bonds?

Although these investment considerations are summarized below, you are urged to read more on the pages listed.

- **Deflation.** Because the composite rate for a bond is determined in part by a measurement of costs and prices, the value of a bond may increase slowly or not increase at all because of deflation. However, we will not allow a bond’s value to decrease. See **page 6**.
- **Redemption.** You cannot redeem a bond until six months after its issue date. See **page 9**.
- **Interest Penalty.** If you redeem a bond before it turns five years old, you’ll forfeit the three most recent months’ worth of interest on that bond. See **page 9**.
- **Time Lag.** There can be a delay of several months between the end of the six-month period over which inflation is measured for incorporation into the composite rate and the dates that this measurement affects a bond’s value. See **page 9**.
- **CPI-U Contingencies.** We use the CPI-U to measure inflation. Its use poses some uncertainties. See **page 12**.
- **Portfolio.** As with any investment product, you should consider whether these bonds are the right choice for your investment portfolio. See **page 3**.

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Introduction

Overview of Bonds. Series I bonds (as in “eye” and not the Roman numeral) are a new series of United States Savings Bond offered by the Department of the Treasury. These bonds are backed by the full faith and credit of the United States.

A bond earns interest through application of a composite rate. The composite rate consists of a fixed rate that remains the same for the life of the bond and an inflation rate that changes twice a year. Interest earned from the composite rate accrues monthly and is compounded semiannually.

A bond will earn interest for up to 30 years and interest earnings are payable upon redemption. However, you cannot redeem a bond until six months after its issue date. Furthermore, if you redeem a bond before it turns five years old, you’ll forfeit the three most recent months’ worth of interest on that bond. Interest earnings on a bond are exempt from state and local income taxes, but are subject to state and local estate, inheritance, gift, and other excise taxes. Interest earnings also are subject to Federal taxes.

The Big Picture--Bonds and Your Portfolio. As with any investment, you should reflect on whether Series I bonds meet your investment goals.

Series I bonds are designed to be low-risk investments for the general public. Generally, the longer your investment horizon, the more risk you may be willing to accept. The greater the risk you assume, the larger the return you may earn. However, greater risk also exposes you to an increased possibility of loss.

In addition, you also should consider how your portfolio should be diversified. By placing your investment eggs in different baskets, you can reduce your potential loss if some of your investments do not perform well. On the other hand, diversification means that some of your investments will not perform as well as others.

Keeping your investment goals in mind, you can use this information statement to help you evaluate the extent to which Series I bonds should be a part of your portfolio.

What Are Inflation and Deflation?

Series I bonds earn interest based on a composite rate that is indexed to inflation. Because these bonds are indexed to inflation, a little background on inflation and how it is measured may be useful to you.

Inflation is an economy-wide increase in costs and prices over the nation's entire cost and price structure. In contrast, deflation is a decrease in these costs and prices. Generally speaking, inflation can hurt the relative value of a fixed-value investment while deflation can improve its relative value. Series I bonds are designed to prevent the uncertainty that cost and price changes can have on fixed-price investments.

Example: Suppose that you invest \$100 for one year at a simple interest rate of 6% and that inflation for the year is 2%. Ignoring any tax consequences, at the end of the year your investment would be worth \$106. However, the value of your investment would be somewhat offset by inflation that has caused items that cost \$100 the year before to cost \$102.

On the other hand, if there was deflation of 2% during the year, it would cost only \$98 to buy what \$100 would have purchased the year before. Deflation would increase the relative value of your investment.

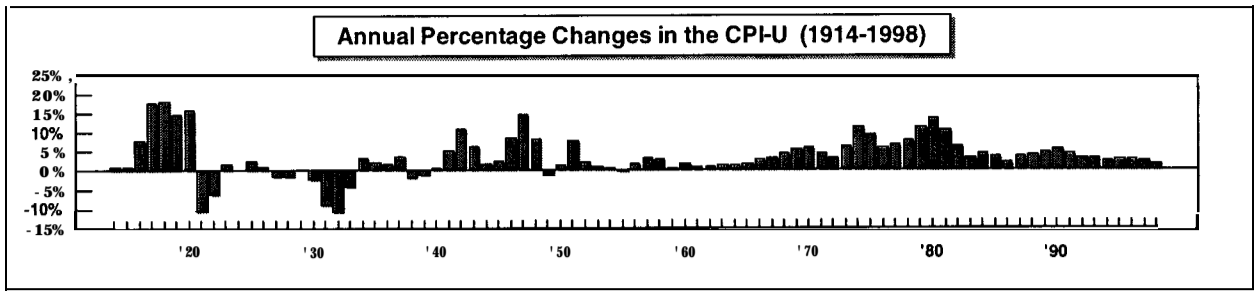
Inflation and deflation are difficult to measure, leading to the creation of several

measurement techniques. Perhaps the best known of these measurements is the Consumer Price Index (CPI). The CPI is calculated by the Bureau of Labor Statistics, which is part of the Department of Labor. The CPI is a measure of the average change over time in prices paid by consumers for a fixed market basket of consumer goods and services. It is based upon the prices of about 90,000 items. The broadest, most comprehensive CPI is the Consumer Price Index for All Urban Consumers: U.S. City Average for All Items (CPI-U). We index the interest rate for Series I bonds to the CPI-u.

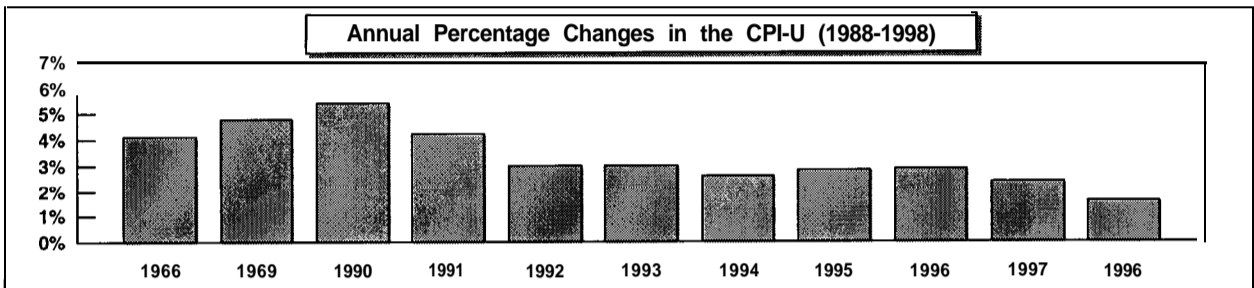
The CPI-U that is frequently reported in the press is the seasonally adjusted CPI-U. As the name implies, the seasonally adjusted CPI-U attempts to account for seasonal influences upon cost figures. However, the CPI-U we use for Series I bonds is not seasonally adjusted. The seasonally adjusted CPI-U is subject to revision for a period of up to five years, which makes problematic its use in calculating interest earnings for bonds. The non-seasonally adjusted CPI-U is generally not subject to revision. Furthermore, bonds are designed to be long-term investments, making seasonal adjustments unnecessary.

On the next page, we've provided examples of CPI-U figures since its inception, over a ten-year period, and over a one-year period.

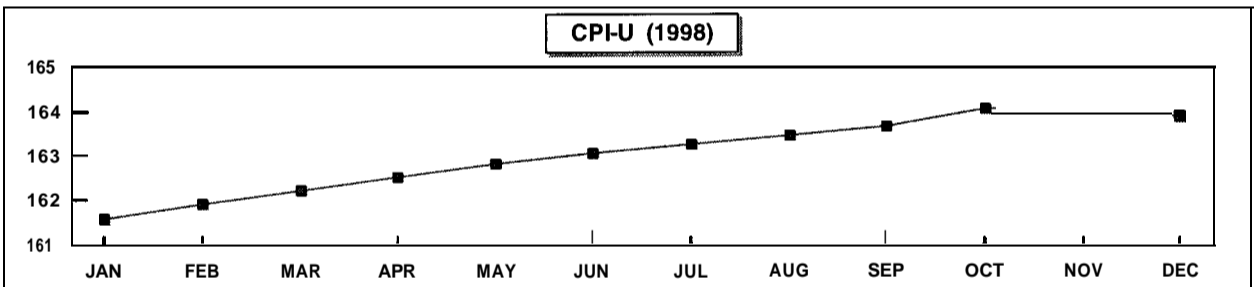
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This graph shows, on a year-by-year basis, annual percentage changes in the CPI-U since its inception. For instance, the average of costs and prices as measured by the CPI-U for 1993 was 3.0% greater than the average of costs and prices for 1992. The average of costs and prices as measured by the CPI-U for 1954 was 0.4% less than the average of costs and prices for 1953. However, keep in mind that occasional technical changes in the CPI-U complicate exact comparisons between years.



This graph shows, on a year-by-year basis, annual percentage changes in the CPI-U between 1988 and 1998. (These percentage changes are also shown on the first graph, but are shown here in closer detail.) For instance, the average of costs and prices as measured by the CPI-U for 1998 was 1.6% greater than the average of costs and prices for 1997.



This graph shows, on a month-by-month basis, the CPI-U during 1997. In calculating the CPI-U, the Bureau of Labor Statistics currently uses the average cost of goods and services between 1982-1984 as a reference base of 100. For instance, if the average cost of goods and services during 1982-1984 is set at \$100, then the average cost of goods and services during January 1997 was \$159.10, and \$161.20 during October 1997. Please note that these figures have not been adjusted to account for month-to-month price variations that may be due only to seasonal changes.

How Does a Bond Increase In Value?

It is important to understand how we use inflation and deflation (as measured by the CPI-U) in calculating the value of a Series I bond.

Composite Rate. A bond accrues earnings based on both a *fixed rate* of return and a *semiannual inflation rate*. A single, annual rate called the composite rate reflects the combined effects of the fixed rate and the semiannual inflation rate. The composite rate is designed to protect the relative value of your investment from the effects of inflation. We'll spare you the details, but you should know that the formula used to calculate the composite rate is more complicated than simply adding together the fixed rate and the semiannual inflation rate.

If the semiannual inflation rate reflects any inflation, a bond's composite rate will be higher than its fixed rate. In other words, inflation will cause a bond to earn additional interest. If the semiannual inflation rate reflects any deflation, a bond's composite rate will be lower than its fixed rate. Deflation will cause a bond to increase in value slowly, or not increase in value at all. However, even if deflation becomes so great that it would reduce the composite rate to below zero, we will not allow the value of a bond to decrease.

The announcement dates for these rates typically are each May 1 and November 1. If we are not open for business on the first of the month, the announcements will be made on the next business day. However, in all cases the effective date of a rate announcement will be the first day of the month.

Fixed Rate. The fixed rate is a rate selected by us. The fixed rate that is in effect when a bond is issued applies until the bond stops increasing in value upon reaching the end of its maturity period, 30 years after its issue date. (The issue date always is listed on a bond as the first day of the month in which the bond was purchased.) Thus, even though a new fixed rate is announced at the beginning of every May and November, the most recently announced fixed rate applies only to bonds purchased during the six months following its announcement.

Semiannual Inflation Rate. The semiannual inflation rate reflects the percentage change in the CPI-U over a preceding six-month period. There is a delay between the last of the months covered in this period and the date of the inflation rate announcement.

Examples: As stated above, we announce a new semiannual inflation rate at the beginning of every May and November. The semiannual inflation rate we announce at the beginning of May reflects the percentage change between the CPI-U figures from the preceding September and March. Similarly, the semiannual inflation rate we announce at the beginning of November reflects the percentage change between the CPI-U figures from the preceding March and September.

Please note that the composite rate is not equivalent to an annual percentage yield (APY), which financial institutions must disclose when detailing terms of certificates of deposit and other financial offerings. You cannot make direct comparisons between the composite rate and the APY.

Semiannual Rate Periods. A bond's semiannual rate periods are consecutive six-month periods, the first of which begins with the bond's issue date.

Why are semiannual rate periods important? It is not until a bond enters a new semiannual rate period that the most recently announced composite rate begins to apply. This means that there can be delay of several months from the time of a composite rate announcement to the time that the composite rate begins to apply to determine interest earnings for a bond.

Examples: If you purchased a bond in April, its semiannual rate periods begin every April and October. In April, the most recently announced composite rate will have been that which was

announced the previous November. This rate will apply to determine interest earnings for your bond for the next six months, through the end of September. In October, the most recently announced composite rate would have been that from the previous May. This rate will apply to determine interest earnings for your bond until the following April.

In contrast, if you purchased a bond in May, its semiannual rate periods begin in May and November. Accordingly, the composite rates announced in May or November will apply immediately to this bond.

The chart on the next page may help you understand when a composite rate applies to a bond, depending on the bond's issue date.

How Semiannual Rate Periods Determine When an Announced Composite Rate Begins to Apply to a Bond

Your Bond's Issue Date	Your Bond's First Semiannual Rate Period Begins	Announcement Date of Composite Rate That Applies During First Rate Period	Your Bond's Second Semiannual Rate Period Begins	Announcement Date of Composite Rate That Applies During Second Rate Period
January 1	January 1	November 1 (announced 2 months prior to start of first semiannual rate period)	July 1	May 1 (announced 2 months prior to start of second semiannual rate period)
February 1	February 1	November 1 (announced 3 months prior to start of first semiannual rate period)	August 1	May 1 (announced 3 months prior to start of second semiannual rate period)
March 1	March 1	November 1 (announced 4 months prior to start of first semiannual rate period)	September 1	May 1 (announced 4 months prior to start of second semiannual rate period)
April 1	April 1	November 1 (announced 5 months prior to start of first semiannual rate period)	October 1	May 1 (announced 5 months prior to start of second semiannual rate period)
May 1	May 1	May 1	November 1	November 1
June 1	June 1	May 1 (announced 1 month prior to start of first semiannual rate period)	December 1	November 1 (announced 1 month prior to start of second semiannual rate period)
July 1	July 1	May 1 (announced 2 months prior to start of first semiannual rate period)	January 1	November 1 (announced 2 months prior to start of second semiannual rate period)
August 1	August 1	May 1 (announced 3 months prior to start of first semiannual rate period)	February 1	November 1 (announced 3 months prior to start of second semiannual rate period)
September 1	September 1	May 1 (announced 4 months prior to start of first semiannual rate period)	March 1	November 1 (announced 4 months prior to start of second semiannual rate period)
October 1	October 1	May 1 (announced 5 months prior to start of first semiannual rate period)	April 1	November 1 (announced 5 months prior to start of second semiannual rate period)
November 1	November 1	November 1	May 1	May 1
December 1	December 1	November 1 (announced 1 month prior to start of first semiannual rate period)	June 1	May 1 (announced 1 month prior to start of second semiannual rate period)

Notes:

- (1) If we are not open on the regularly scheduled date for a rate announcement, the announcement will be made on the next business day. In all cases, the effective date of the rates announced will be the first day of the month of the announcement.
- (2) Interest earned during each month of a rate period is added to a bond's value on the first day of the following month. However, a three-month interest penalty is assessed against a bond that is redeemed before it turns five years old.

Accrual of Interest. Interest on a bond accrues on the first day of each month. In other words, interest earned on a bond during any given month is added to its value at the beginning of the next month.

Example: If you redeem a bond on January 31, none of the interest earned in January will be included in its value. If you wait one more day and redeem the bond on February 1, the value of the bond will reflect interest earned during January.

Accrued interest is payable upon redemption, though a three-month interest penalty applies if you redeem a bond before it turns five years old (see below).

Compounding. For the purpose of determining future interest accruals, the accrued interest on a bond is compounded semiannually, at the beginning of each semiannual rate period.

Purchase Limitation. YOU can purchase **no more than \$30,000** in bonds during any calendar year.

Base Denomination for Calculations of Interest. We base all calculations of interest on a hypothetical bond with a denomination of \$25. (We do so even though the lowest actual denomination for a bond is \$50). All bonds are purchased at face value, which means that the purchase price of a bond is the same as its denomination. This differs from Series EE savings bonds, which are sold at 50% off face value. The value of this hypothetical bond is used to determine the value of bonds in higher denominations purchased at the same time. The effect of rounding off the value of the \$25 bond is magnified at higher denominations. This

can work to your slight advantage or disadvantage, depending on whether the value is rounded up or down.

Example: A composite rate of 5.07% will result in a newly purchased hypothetical \$25 bond increasing in value after six months to \$25.63, when rounded to the nearest cent. Thus, a \$5,000 bond purchased at the same time as the hypothetical \$25 bond will be worth \$5,126 ($[\$5,000 \div \$25] \times \$25.63$) after six months. In contrast, if it applied directly to a \$5,000 bond, the rate would render a value of \$5,126.75 after six months, a difference of 75 cents. (Please note that this example does not include any discussion of the interest penalty imposed if a bond is redeemed less than five years after its issue date.)

Redemption. You may not redeem a bond until six months after its issue date.

Interest Penalty for Early

Redemption. If you redeem a bond that is less than five years old, you'll forfeit the three most recent months' worth of interest on that bond. However, the bond's redemption value will never be less than what you paid for it.

Example: Suppose that you purchase a bond with an issue date of January 1, 1999 and decide to redeem it nine months later, in October 1999. The redemption value of the bond will be calculated as if you had redeemed it three months earlier, in July 1999.

A Few Words About Time Lag. As mentioned earlier, there is a delay between the last month used in measuring the six-month percentage change in the CPI-U and the announcement date of the semiannual inflation and composite rates that reflect this

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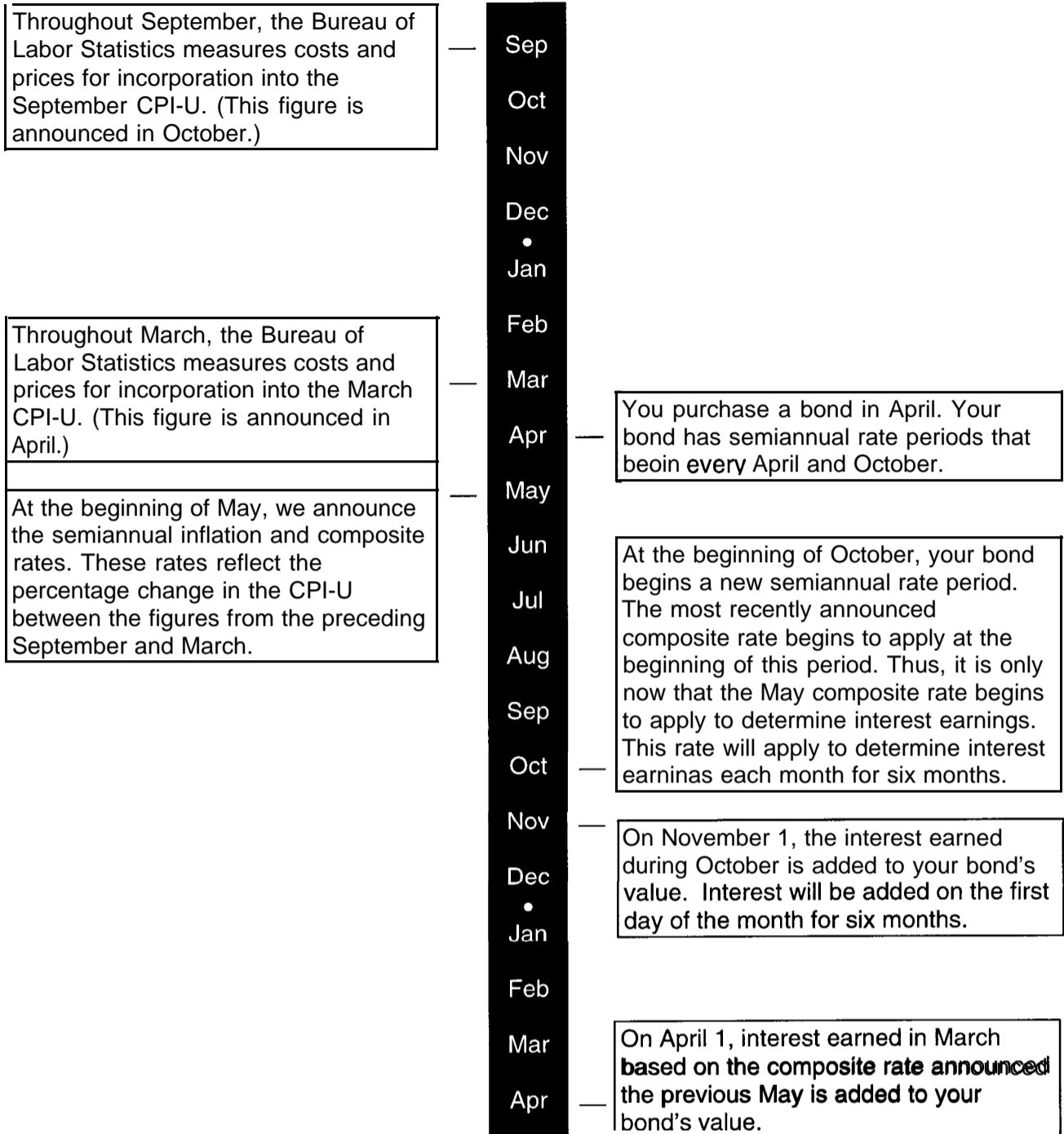
change. Depending on the issue month of a bond, there may also be an additional delay between the date of a composite rate announcement and the date that the composite rate begins to apply to determine interest earnings for the bond. Once the rate begins to apply, it will continue to do so for the next six months. Finally, interest earned from application of the composite rate during any month is not added to the bond's value until the beginning of the following month. These delays can result in significant time lag between the end of the six-month period used to measure the percentage change in the CPI-U and the dates when the bond's value finally is affected by the measurement of this change.

Example: The percentage change in the CPI-U between the figures from September 1999 and March 2000 will be reflected in the semiannual inflation and composite rates announced at the

beginning of May, 2000. If you purchase a bond in April, the composite rate announced in May will not begin to apply to your bond until the beginning of October, 2000, when your bond enters a new semiannual rate period. This composite rate will apply to determine interest for the next six months, through the following March, 2001. Interest earned from application of the composite rate each month accrues on the first day of the following month. Thus, the first interest earned in this example does not get added your bond until November 1, 2000, with the last accrual date occurring six months later on April 1, 2001. (Please note that this example does not include any discussion of the interest penalty imposed on a bond that is redeemed less than five years after its issue date.)

The **timeline** on the following page may help you better understand the above example.

How Time Lag Impacts the Value of a Bond



Note: This timeline example does not reflect the three-month interest penalty applied to a bond that is redeemed prior to turning five years old.

Contingencies Relating to the CPI-U. Inflation and deflation are difficult to

measure and there are measures of inflation other than the CPI-U. The CPI-U is subject

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to changes that could affect your bond. The CPI-U could even be discontinued. You should be aware of circumstances that may cause us to alter or discontinue its reliance upon the CPI-U.

Revised **CPI-U**. If a previously reported CPI-U is revised, we will continue to use the previously reported CPI-U in calculating the semiannual inflation and composite rates.

Rebased CPI-U. If the CPI-U is rebased to a different year, we will continue to use the CPI-U based on the base reference period in effect when the bond was first issued, as long as that CPI-U continues to be published.

Unreported **CPI-U**. If the CPI for a particular month is not reported by the last day of the following month, we will announce an index number based on the last available 12-month change in the CPI. Any calculations of our payment obligations on a bond that rely on that month's CPI will be based on the index number that we have announced.

Discontinued or Fundamentally Altered CPI-U. If the CPI-U is discontinued or (in our judgment) fundamentally altered in a manner materially adverse to your interests, we will substitute an appropriate alternative index.

Technical changes to the CPI-U by the Bureau of Labor Statistics to improve its accuracy will not be considered

fundamental. Technical changes include, but are not limited to:

- (1) the way specific items (such as apples or major appliances) are priced for the index;
- (2) the way individual price quotations are used to construct component price indices for these items;
- (3) the method for combining these component price indices to obtain the comprehensive, all-items CPI; and
- (4) the procedures for incorporating new goods into the index and making adjustments for quality changes in existing goods.

One technical change to the CPI previously made by Bureau of Labor Statistics was to introduce probability sampling to select the precise items for which prices are collected and the stores in which collection takes place. Other technical changes have involved how the price movements of major components are measured, such as shelter costs for homeowners in the early 1980's and medical care costs beginning in 1997. Also, changes in the CPI-U to account for the fact that consumers often respond to rising prices by shifting to lower-cost substitutes qualify as technical changes. In contrast, a decision by the Bureau of Labor Statistics to replace the monthly CPI-U with an annual measure of consumer prices would qualify as a fundamental change.

How is Interest Treated for Tax Purposes?

Taxable Interest. A Series I bond is sold at its face amount, which is equal to its denomination. Any increase above this amount is interest, regardless of whether the interest is due to the application of the fixed rate or the semiannual inflation rate. This interest may be subject to taxation.

State and Local Taxes. Interest earnings on bonds are exempt from state and local income taxes. However, interest earnings are subject to state and local estate, inheritance, gift, and other excise taxes.

Federal Taxes. Interest earnings on bonds are subject to all Federal taxes imposed under the Internal Revenue Code of 1986, as amended.

Reporting Basis. You may use either the *cash basis* or *accrual basis* method for reporting interest for Federal income tax purposes. Under the cash basis method, Federal tax is deferred until the year the bond ceases to earn interest or is redeemed or otherwise disposed of, whichever occurs first. Under the accrual basis, you report interest each year as it accrues.

In deciding which method to use, you should consider two additional factors. First, if you use the cash basis method, you must use this method for all Series I bonds you own or may later purchase. If you use this method, you must also use it for any Treasury obligations purchased on a discount from face value, such as Series E or EE savings

bonds or Treasury bills. Second, if you elect the accrual basis method, you may only switch to the cash basis method with the permission of the Internal Revenue Service (IRS). However, if you use the cash basis method, you may switch to the accrual basis without the permission of the IRS. Unless you choose otherwise, you'll be treated as if you had chosen the cash basis method.

Reissuance. A reissuance (re-registration) of a bond that affects the rights of any of the persons named on the bond may have a tax consequence. More information on this subject is available in IRS publication 550, "Investment Income and Expenses." This IRS publication may be found at the Internet site of the IRS, www.irs.treas.gov.

Education Bond Program. Subject to certain income limitations, you may be able to exclude all or a portion of the interest received upon redemption of a bond from your gross income for Federal tax purposes if you use the interest to pay for qualified educational expenses. Additional details regarding the education bond program are found in IRS Publication 17, "Your Federal Income Tax," and Publication 550, "Investment Income and Expenses." These IRS publications may be found at the Internet site of the IRS, www.irs.treas.gov.

Where Can I Find Additional Information?

Comprehensive details on the offering, terms, and conditions of Series I bonds can be found in parts 359 and 360 of title 31 of the Code of Federal Regulations. The regulations deal with a variety of topics not covered in this information statement, including procedures for purchasing, redeeming, replacing, and reissuing (re-registering) bonds. This information is

available at the Internet site of the Treasury Department's Bureau of the Public Debt, www.savingsbonds.gov. Informal guidance on savings bonds also is available from this site, as is a downloadable program called the "Savings Bond Wizard" that allows you to keep track of the current redemption value of all savings bonds you may have purchased since 1941.

Note: This document is explanatory only. It is not an offer of bonds and does not have the force of law. The Code of Federal Regulation provides the offering, terms, and conditions of Series I savings bonds. This document does not supplement or modify the official texts.

Last revised: 212211999

SB-2297