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UNITED STATES GENERAL ACCOUNTING OFFICE

REPORT TO COMMITTEE ON BANKING AND CURRENCY HOUSE OF REPRESENTATIVES

Review Of Procedures For Offering Marketable Obligations Of The Treasury Department

B-164556

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

AUG. 1, 1969

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-164556

Dear Mr. Chairman:

This is our report on the review of policies, methods, and procedures followed by the U.S. Treasury Department in connection with the public offering of U.S. debt obligations subsequent to the occurrence of a breach of confidentiality concerning the terms of an August 1967 Treasury financing operation. The review was made pursuant to your request of June 10, 1968.

This report points out that, although procedural changes by the Treasury Department have significantly reduced the possibility of a breach of confidentiality, the Treasury should, in our opinion, consider certain additional procedural changes to further reduce such a possibility.

In accordance with the request of your Staff Director, we did not submit this report for advance review by agency officials.

We plan to make no further distribution of this report unless copies are specifically requested, and then we shall make such distribution only after your agreement has been obtained or public announcement has been made by you concerning the contents of this report.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

The Honorable Wright Patman, Chairman
Committee on Banking and Currency
House of Representatives

Contents

ABBREVIATIONS

ABA	American Bankers Association
BPD	Bureau of Public Debt
GAO	General Accounting Office
IBA	Investment Bankers Association
SEC	Securities and Exchange Commission

COMPTROLLER GENERAL'S REPORT TO COMMITTEE ON BANKING AND CURRENCY, HOUSE OR REPRESENTATIVES

REVIEW OF PROCEDURES FOR OFFERING MARKETABLE OBLIGATIONS OF THE TREASURY DEPARTMENT
B-164556

D I G E S T

WHY THE REVIEW WAS MADE

At the request of the Chairman of the Committee on Banking and Currency, House of Representatives, the General Accounting Office (GAO) has reviewed the policies, methods, and procedures followed by the Treasury Department in connection with an offering of marketable Treasury obligations in February 1969.

The Chairman's request pertained to reports that the quantity and maturities of debt obligations to be offered in a Treasury debt refinancing operation in August 1967 were the subject of widespread rumors, apparently based on fact, among dealers and brokers in Government obligations.

FINDINGS AND CONCLUSIONS

The Treasury made changes in its marketing procedures as a result of its special investigation of the unauthorized disclosure of advance information on the August 1967 note offering. GAO believes that the changes made have significantly reduced the possiblity of such unauthorized disclosure of information regarding the terms of an offering of marketable obligations.

GAO's review of the procedures followed in the February 1969 note refinancing operation showed that the new procedures:

--Reduced substantially the number of people who had early access to the financing terms by delaying transmittal of the terms of the financing to the Federal Reserve banks and the Bureau of Engraving and Printing until after the official public announcement.

--Limited advance information of the financing terms to the President, the Secretary of the Treasury, eight members of the Treasury Finance Group, the Commissioner of the Public Debt and three of his assistants, and the Chairman of the Board of Governors of the Federal Reserve System.

--Delayed notification of the terms of the financing to five of the eight members of the Treasury Finance Group until about 40 minutes before the official public announcement. (See pp. 5 and 6.)

RECOMMENDATIONS OR SUGGESTIONS

GAO believes that, to further reduce the possibility of unauthorized disclosures of advance information on financing terms of an offering of marketable obligations, the Treasury should consider the possibility of (1) further reducing the number of people having early access to financing terms by restricting the information to an absolute "need to know" basis and (2) putting official restrictions on the actions of certain people who have early access until the official public release time. (See pp. 20 and 21.)

GAO believes also that the Treasury should consider whether formalized meetings with committees representing the financial community on quarterly refinancing operations are needed, because the meetings are held during the decisionmaking process and there is, in GAO's opinion, a possibility of the market anticipating the final decision. (See p. 21.)

In addition, GAO believes that the Treasury should establish formal written marketing procedures to (1) provide for better internal control of a financing operation and furnish a basis for supervisory reviews and (2) facilitate the standardization of marketing procedures for its obligations and provide for continuity of such procedures in the event of a substantial change in key personnel. (See pp. 21 through 23.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

GAO did not submit this report for advance review by agency officials.

INTRODUCTION

The General Accounting Office has reviewed the policies, methods, and procedures followed by the Treasury Department in connection with the offering of marketable Treasury obligations, at the request of Congressman Wright Patman, Chairman of the Committee on Banking and Currency, House of Representatives.

The Chairman's request pertained to reports that a Treasury debt refinancing operation in August 1967 was the subject of widespread rumors among dealers and brokers in Government obligations. The Chairman stated that the rumors detailed the quantity and maturities of debt obligations which were to be offered to the public through the Federal Reserve System, that the rumors were apparently based on fact, and that the source of the accurate advance information was reportedly traced to an employee of a Federal Reserve bank.

The Treasury's investigation into the refinancing, which was started in August 1967, resulted in (1) suspension of a Federal Reserve bank employee, since deceased, who was alleged to be the source of the advance information, (2) turning over information on the activities of those persons who received advance knowledge of the Treasury offering to the Securities and Exchange Commission (SEC) to determine whether there were possible violations of Federal securities law, and (3) certain changes in Treasury financing procedures.

SEC's investigation into the breach of confidentially, undertaken in February 1968, resulted in SEC's taking disciplinary action in January 1969 against an investment company and a former officer of the company because they allegedly violated the antifraud provisions of Federal securities law and failed to supervise properly certain bond department employees.

In February 1969, pursuant to SEC's request, a Federal district court issued an injunction blocking 14 individuals, four brokerage houses, and a bank from violating Federal securities law by participating in alleged trading schemes, which involved the use of secret trading accounts by Government-securities traders, to profit at the expense of their employers. Some of the defendants immediately agreed to the injunction without admitting the charges.

We were informed by an SEC official that the latter SEC action grew out of the Treasury's investigation of the unauthorized disclosure of advance information on the August 1967 note offering, although it was not directly related.

OFFERINGS OF MARKETABLE TREASURY OBLIGATIONS

We believe that the Treasury, as a result of changes in its marketing procedures resulting from the Treasury's special investigation of the unauthorized disclosure of advance information on the August 1967 note offering, has significantly reduced the possibility of such unauthorized disclosure of information regarding the terms of an offering of marketable obligations.

The Treasury's report on its special investigation of the procedures used in the August 1967 refinancing stated that the terms of the financing were transmitted to the Federal Reserve banks, the Treasury's Public Information Office, and the Bureau of Engraving and Printing, before the official public announcement, and consequently there was widespread exposure to the terms of the offering. Our review of the procedures followed in a February 1969 note refinancing operation showed that the new procedures substantially reduced the number of people who had early access to the financing terms by:

--Delaying transmittal of the terms of the financing to the Federal Reserve banks until after the Treasury's official public announcement. This delay resulted in eliminating the largest group of non-Treasury employees--Federal Reserve bank personnel--who previously had advance knowledge of the financing terms.

--Delaying notification of the terms of the financing to the Bureau of Engraving and Printing and the Treasury's Public Information Office until the time of the official public announcement. This delay resulted in reducing the number of Treasury employees receiving advance information of the financing terms.

For the February 1969 note refinancing, the Treasury limited advance information of the financing terms to the President, the Secretary of the Treasury, eight members of the Treasury Finance Group, the Commissioner of the Public Debt and three of his assistants, and the Chairman of the Board of Governors of the Federal Reserve System. Also, the Treasury delayed notifying the Treasury Finance Group--except for the Under Secretary of the Treasury, the Under Secretary for Monetary Affairs, and the Fiscal Assistant Secretary--of the financing terms until about 40 minutes before the official public announcement.

We believe that, to further reduce the possibility of unauthorized disclosures of advance information on financing terms of an offering of marketable obligations, the Treasury should consider the possibility of (1) further reducing the number of people having early access to the financing terms by restricting the information to an absolute "need to know" basis and (2) putting official restrictions on the actions of certain people who have early access until the official public release time. Also, we believe that the Treasury should establish formal written marketing procedures.

Following are specific details on the Treasury's procedures for marketing of its obligations.

MARKETING TREASURY OBLIGATIONS

The marketable obligations that the Treasury Department is authorized to issue comprise bonds (31 U.S.C. 752), notes (31 U.S.C. 753), and certificates of indebtedness and Treasury bills (31 U.S.C. 754).

Treasury bonds, notes, certificates of indebtedness, and bills are offered to the public for cash or in exchange for outstanding or maturing issues. Bonds, notes, and certificates of indebtedness are offered at a price and stated interest rate which, based upon Treasury analyses of the money market, will produce a yield that will result in their market acceptability. Treasury bills are sold at auction on a discount basis, their face value being payable at maturity.

During fiscal year 1968, the Treasury issued marketable obligations in the total amount of about $203.5 billion, comprising about $159.1 billion in Treasury bills with maturities ranging from 3 to 12 months and about $44.4 billion in Treasury notes with maturities ranging from 15 to 84 months. The Treasury has not offered any marketable bonds because of the 4.25-percent statutory interest limitation. Also, the Treasury has not issued any certificates of indebtedness since 1966.

The offering of a marketable Treasury obligation involves (1) arriving at a decision as to the amount; type; offering date; issue date; maturity date; period during which tenders or subscriptions will be received; and, with the exception of Treasury bills which are sold at auction on a discount basis, the stated interest rate and sales price to produce a certain yield on the obligation to be offered; (2) making public announcement of the offering; (3) printing the obligations; (4) accepting bids or subscriptions; and (5) distributing the obligations to the purchasers.

The Secretary of the Treasury is responsible for making the decisions concerning the obligations to be offered, and the Secretary must obtain the approval of the

President for all obligations having a maturity of more than 1 year.

A Treasury official advised us that an informally designated Treasury Finance Group--composed of various officials from the Office of the Secretary--assists the Secretary in arriving at his decisions. He advised us also that the Finance Group assembles and reviews data necessary to arrive at its recommendations to the Secretary concerning the amount; type; maturity date; and, except for Treasury bills, the interest rate and sales price of the obligations to be offered to the public. In arriving at its recommendations, Treasury records show that the Finance Group obtains information on market conditions from the Federal Open Market Committee of the Board of Governors of the Federal Reserve System and from representatives of the financial community.

The records show also that, after the Secretary makes his decision and Presidential approval has been obtained for note or bond offerings, public announcement is made concerning the terms of the offering; the Federal Reserve banks are notified to arrange for the printing of an offering circular for distribution to news media and potential subscribers; and the Bureau of Engraving and Printing is directed to print the necessary obligations.

The Federal Reserve System, as fiscal agent for the Treasury, receives the competitive bids and subscriptions to purchase Treasury bills and notes, respectively; allocates, in accordance with the Treasury's instructions, the amount of the obligations that may be purchased by each bidder or subscriber; delivers the obligations to the purchasers; accepts payment for the obligations and credits the funds to the Treasury's account; pays interest; makes exchanges of denominations or kinds; and redeems the obligations as they mature. These services are provided on a cost-reimbursable basis.

Treasury notes

Treasury notes may be issued with a maturity of not less than 1 year or more than 7 years. Notes are offered at a price and stated interest rate which will produce a yield that will result in their market acceptability. Treasury notes generally mature on one of four dates during the year: February 15, May 15, August 15, or November 15.

The Treasury classifies its note financings into four categories, as follows.

--Exchange refunding: notes offered only to holders of maturing Treasury obligations, who have the option of redeeming them for cash and/or exchanging them for the new notes.

--Cash refinancing: notes offered to raise money to pay off maturing obligations.

--New cash financing: notes offered to raise new cash.

--Advance refunding: notes offered in exchange for outstanding obligations that have not reached maturity.

Exchange refunding and cash refinancing

The Treasury has four regularly scheduled refinancings a year involving maturing notes and/or bonds--February, May, August, and November. To provide funds for redeeming maturing obligations, Treasury generally markets notes in an exchange refunding or in a cash refinancing or some combination thereof.

The Treasury's quarterly refinancing operations generally conform to the previously stated procedures (pp. 7 and 8), except that the Treasury has a series of formal meetings with representatives of the investment market. The purpose of these meetings, according to a Treasury official, is to obtain information on market conditions relating to the method of financing and the maturity dates of the new notes. We were informed that these meetings are in addition to normal contacts with market representatives, which are maintained by Treasury officials on a year-round basis.

We reviewed the procedures followed by the Treasury for the February 1969 quarterly refinancing--official public announcement of the terms of the refinancing operation was made at 3:25 p.m. on January 29, 1969. This was an exchange refunding; the new obligations were 15-month notes, with a coupon rate of 6-3/8 percent, discounted to a price of 99.95 to yield 6.42 percent, and 7-year notes, with a coupon rate of 6-1/4 percent, discounted to a price of 99.75 to yield about 6.29 percent.

The maturing obligations, totaling $14,466 million, matured on February 15, 1969, and consisted of $10,738 million of Treasury notes and $3,728 million of Treasury bonds. About $9.1 billion of the maturing obligations were held by the Federal Government Investment Accounts--accounts of Government agencies or trust and other custodial funds administered by the Government, such as the Federal Old Age and Survivors Insurance Trust Fund--and about $5.4 billion were held by private interests.

The documentation supplied by the Treasury and discussions with Treasury officials indicated the following chronology of events concerning the February 15, 1969, refinancing operation.

> December 30, 1968--By letter, the Assistant to the Secretary (Debt Management) notified the Chairmen of the Government Borrowing Committee, American Bankers Association (ABA), and the Governmental Securities Committee, Investment Bankers Association (IBA), that Treasury's next regular quarterly meetings with the committees would be (1) held in Washington on January 28 and 29, 1969, (2) primarily concerned with refinancing the obligations maturing on February 15, and (3) concerned also with the committees' views regarding the Treasury's "additional financing needs through the next few months."

January 24, 1969--The Under Secretary for Monetary Affairs held a series of separate meetings in New York with representatives from 10 firms and banks that deal in Government obligations, to obtain their views as to how the February refinancing should be handled. A representative of the Federal Reserve Bank of New York also attended these meetings. A Treasury official informed us that the purpose of these meetings was to get the opinions of market people other than those attending the regularly scheduled meetings with the IBA and ABA committees.

The Secretary of the Treasury sent a memorandum to the President informing him that the Treasury was planning to announce, at 3:30 p.m. on January 29, the terms of an offering to refinance maturing obligations, that the new obligations would be coupon issues having maturities of more than 1 year, and that it was probable that the new obligations would have to carry the highest interest coupon rate on any Treasury obligation issued since the Civil War.

January 28, 1969--Members of the Treasury Finance Group met with the IBA and ABA committees for background briefings--IBA committee at 9 a.m. and ABA committee at 10 a.m. Treasury records showed that the IBA and ABA committees were briefed on the current economic and financial conditions of the country, the public debt situation, and the Treasury's current and future cash balances and needs. We were informed by a Treasury official that the background material presented to the committees--which was prepared by personnel from the Office of Debt Analysis, Office of the Secretary--was generally of a public nature and contained no restricted information.

The records showed also that, for the February 1969 refinancing, the Finance Group consisted of the Under Secretary of the Treasury, the Under Secretary and the Deputy Under Secretary for Monetary Affairs, the Fiscal Assistant Secretary, the Deputy

Fiscal Assistant Secretary, the Assistant to the Secretary (Debt Management), and the Director and the Assistant Director of the Office of Debt Analysis.

A Treasury official informed us that the Manager, System Open Market Account, Federal Reserve System, and his assistant, assisted the Finance Group during the 2-day period the IBA and ABA committees were in Washington.

In addition, Treasury records showed that the following "observers" attended some or all of the meetings of the Finance Group relating to the February 1969 refinancing: the Special Assistant to the Fiscal Assistant Secretary; a Fiscal Economist from the Office of Debt Analysis; representatives from the Executive Secretariat; and an Advisor to the Board of Governors of the Federal Reserve System.

Following the background briefings for the IBA and ABA committees, separate discussion sessions were held with the committees--IBA at 10 a.m. and ABA at 11 a.m.--that, a Treasury official stated, consisted of questions and answers of a general nature. Treasury records showed that the committees were asked to consider various alternatives for handling the February refinancing, including type of offering, coupon rate, and feasibility of issuing longer term obligations.

An official of the Treasury informed us that the IBA and ABA committees are dealt with separately so that the committees will not be influenced by each other. He also told us that the Treasury maintains contact with the Trading Desk of the Federal Reserve Bank of New York on a continual basis, especially during the time of decisionmaking for a financing operation.

After the IBA and ABA meetings, the Finance Group met, at 12 noon and again at 2:30 p.m., to discuss the alternatives for handling the February refinancing. The minutes of the Finance Group's meetings indicated that most of its members favored an exchange refunding consisting of a dual offering of 15-month and 4-year or 7-year coupon obligations.

January 29, 1969--At 10 a.m., the Secretary of the Treasury and the Finance Group met with the IBA committee to hear its recommendations concerning the refinancing. Documentation in Treasury's files indicated that the majority of the IBA committee members favored an exchange refunding, consisting of an 18-month note, with a 6-3/8-percent coupon rate, priced to yield between 6.40 percent and 6.45 percent, and a 4-year 3-month note, with a 6-1/4-percent coupon rate, priced at par. The records showed that a "respectable minority of the committee preferred a more aggressive package of 2 year and 7 year notes which would provide more extension."

At 10:45 a.m., the ABA committee presented its recommendations concerning the refinancing to the Secretary and the Finance Group. In its report, the committee recommended an exchange refunding, consisting of 15-month and 4-year or 4-1/4-year notes, both with a coupon rate of 6-1/4 percent and offered at discounts from par consistent with general market conditions at the time of the announcement.

At 11:15 a.m., the Finance Group met to formulate its recommendations for presentation to the Secretary. The minutes of this meeting indicated that the members favored short- and long-term exchange refunding issues, the shorter term issue to be a 15-month note, with a 6-3/8-percent coupon rate, discounted to a price of 99.95. For the longer term issue, some members favored a 4-year note and other members favored a 7-year note--both alternatives to have a 6-1/4-percent coupon rate and to be sold at a discount.

At 12:30 p.m., the Treasury Finance Group met with the Secretary. The minutes of this meeting stated that:

"The previous findings of the group were briefly discussed and the Secretary asked the individual members to state their views on the long option. It was indicated that the Secretary would privately make a decision as to the terms of the financing which will be announced later today."

At approximately 12:45 p.m., the Secretary, the Under Secretary, and the Under Secretary for Monetary Affairs, met to make the final decision--an exchange refunding. The new obligations were 15-month notes, with a coupon rate of 6-3/8 percent, discounted to a price of 99.95 to yield 6.42 percent, and 7-year notes, with a coupon rate of 6-1/4 percent, discounted to a price of 99.75 to yield about 6.29 percent.

At approximately 12:55 p.m., the Fiscal Assistant Secretary--who has overall responsibility for preparing the letter to the President requesting his approval of the refinancing, the official press release, and the circular fill-in wire (notice to the Federal Reserve banks of the terms of the offering)--was informed of the Secretary's decision.

The letter to the President, the press release, and the fill-in wire were prepared by three individuals from the Bureau of the Public Debt (BPD)--all of whom are assistants to the Commissioner of the Public Debt. The Fiscal Assistant Secretary informed us that he notified the Commissioner of the Public Debt of the terms of the financing at the same time he supplied the information to the three individuals in BPD.

The duties of the three individuals from BPD included (1) drafting, typing, and reproducing the above three documents, (2) maintaining control of all copies of the documents and related work material, and (3) delivering the documents to their respective destinations.

--The letter to the President was given to the Fiscal Assistant Secretary for delivery.

--The press releases were hand-carried to the room where the press conference was to be held approximately 5 minutes before the official announcement; the individual delivering the press releases was not allowed to leave the press room until after the announcement.

--The circular fill-in wire was delivered to the Telecommunications Department at about 3:15 p.m.; the individual delivering the fill-in wire remained in the room to make sure that the information was not transmitted to any Federal Reserve bank before 3:30 p.m.

We were advised by the Commissioner and one of his assistants that, in light of the amount and type of work that has to be performed, it would not be possible, in their opinion, to compress BPD's operations into a shorter time period.

At approximately 1 p.m., a luncheon was held in the Secretary's dining room, attended by the Secretary of the Treasury; the Finance Group; the Manager, System Open Market Account, Federal Reserve System, and his assistant; and the Chairman of the Board of Governors of the Federal Reserve System. A Treasury official informed us that the Secretary's final decision was not disclosed at the luncheon.

At approximately 1:30 p.m., the letter to the President, setting forth the Secretary's recommendation and requesting the President's approval, was sent to the White House by special messenger. Notification of approval by the President was received prior to the official announcement.

Subsequent to the luncheon, at approximately 1:45 p.m., the Secretary informed the Chairman of the Board of Governors of the Federal Reserve System of his decision. Also, about that time, members of the press were notified that Treasury would hold a press briefing at 3:25 p.m.

At 2:45 p.m., members of the Finance Group met with the Under Secretary for Monetary Affairs to prepare for the press briefing. We were informed by a Treasury official that it was at this time that the members of the Finance Group--except for the Under Secretary of the Treasury, the Under Secretary for Monetary Affairs, and the Fiscal Assistant Secretary--first learned of the Secretary's decision.

The official informed us also that, for many previous financings, the Finance Group members--including the two representatives from the System Open Market Account--either had participated in the making of the final decision or had learned about it during the luncheon.

At 3:25 p.m., the Under Secretary for Monetary Affairs held a press briefing--also attended by other members of the Finance Group--to announce the refinancing terms. The reporters were allowed to leave at 3:25 p.m. We were advised by a Treasury official that the Treasury's Public Information Office was first informed of the decision at the press briefing.

The official informed us also that, after the press briefing, notification of the terms of the financing was sent to the Federal Reserve banks. Also, at that time, the Bureau of Engraving and Printing was notified to produce the necessary certificates.

We were informed by a Treasury official that, to his knowledge, there are no official restrictions on the actions of any of the Treasury personnel who learn of a decision prior to the press announcement.

New cash financing

The last new cash financing involving the issuance of notes was the August 17, 1967, financing--the one involving the unauthorized disclosure of advance information. We were informed by a Treasury official that the procedures involved in a new cash note financing would be similar to those for an exchange refunding or a cash refinancing except that there would be no formal consultations with the market; no participation by the Manager, System Open Market Account, or his assistant, in the meetings and decisions of the Finance Group; and, generally, no formal press conference.

New cash note financings--like new cash financings involving bills--are not regularly scheduled but are marketed on an "as needed" basis. A Treasury official informed us that the uncertainty in announcing new cash note financings does not allow sufficient time to schedule formal meetings with representatives of the investment market. The official added that there are no technical reasons for not formally calling in the market on new cash note financings. Rather, he stated that it is a logistics problem--advance notice to the IBA and ABA committees, setting up travel plans hotel reservations, etc.--that prevents the Treasury from having formal consultations with the committees on new cash note financings.

We were informed by a Treasury official that, although there are no formal consultations with the market, the Treasury would have the benefit of routine informal contacts with the market when considering such a financing. In addition, he stated that contact would be maintained with the Trading Desk of the Federal Reserve Bank of New York.

Advance refunding

We were advised by a Treasury official that the primary purpose of advance refundings is to even out the schedule of maturing Treasury obligations and that, by refunding outstanding obligations before they mature, the Treasury can control the amount of obligations coming due on any given date.

The official informed us also that, to make an advance refunding offer attractive to the holders of the affected outstanding obligations, the Treasury sets the yield of the new obligations slightly above the market yield for comparable outstanding Treasury obligations, which places an added value on ownership of the affected outstanding Treasury obligations. He informed us further that the Treasury tries to prevent any information concerning its plans for advance refundings from being released prematurely because interested individuals could purchase the affected outstanding obligations to take advantage of the added yield of the new obligations.

The official advised us that there had been no advance refundings for the past 2 years. However, he stated that the procedures would be similar to those for quarterly refinancings except that there would be no contact with the market--either formally or informally--and the Manager, System Open Market Account, and his assistant would not participate in the meetings of the Finance Group.

Treasury bills

Treasury bills are sold at auction on a discount basis and are paid at face amount without interest at maturity. They have maturities of 1 year or less. The Treasury's bill offerings consist of regular weekly offerings of 3-month and 6-month bills and regular monthly offerings of 9-month and 1-year bills.

The Fiscal Assistant Secretary is responsible to the Secretary for handling the regular weekly and monthly auctions of Treasury bills. Unless otherwise designated by the Secretary, a regular bill offering is essentially a turnover operation with the amounts and terms of the new bills being offered generally the same as the maturing bills.

A Treasury official informed us that action by the Finance Group is needed only when new cash is needed. He added that, if the Treasury decides to raise the new cash through issuance of Treasury bills, it can increase the amount of the regular bill offerings or it can issue Tax Anticipation Bills. Tax Anticipation Bills have maturity dates about a week after payment dates for Federal income taxes. They may be used at face value to pay taxes on the specified tax date or they may be turned in for cash at maturity date.

The official advised us also that, because bills are sold at auction rather than at a fixed price, the procedures for bill offerings are not as involved as those for notes. As an example, he stated that there are no formal meetings with representatives of the market; no participation by the Manager, System Open Market Account, in the meetings and decisions of the Finance Group; and usually no formal press conference to make the announcement.

CONCLUSIONS

On the basis of our review, we believe that the changes made by the Treasury in its marketing procedures as a result of the special investigation of the August 1967 financing have reduced the possibility of unauthorized disclosure of advance information regarding the terms of an offering of marketable securities by substantially reducing the number of people who have early access to financing terms.

Although we have no reason to question the integrity of the people who have early access to financing terms, we believe that the Treasury should consider the possibility of (1) further reducing the number of people having early access by restricting the information to an absolute "need to know" basis and (2) putting official restrictions on the actions of certain people who have early access until the official release time.

For example, it is questionable whether the Commissioner of the Public Debt would have an absolute "need to know" since a Treasury official informed us that the Commissioner is advised of the financing terms principally because three of his staff members prepare certain correspondence and the press release on the financings.

We were informed by the Commissioner of the Public Debt that there are no official restrictions on the actions of the three individuals from BPD once they learn the terms of the financing. He stated, however, that all their work, other than reproducing the press release, confines them to their immediate offices; time restrictions prevent them from engaging in any other activities except the financing operation, or accepting incoming telephone calls from other than Treasury officials concerned with the financing operation; and, if they leave their offices, all pertinent data is put away.

We believe that official restrictions on the actions of the BPD personnel until the official release time--such as officially restricting their use of the telephone to necessary calls pertaining to the financing and requiring that they not be alone at any time during the subject period--may be desirable.

In addition, we believe that the Treasury should consider whether formalized meetings with the IBA and ABA committees on quarterly refinancings are needed because the meetings are held during the decisionmaking process and there is, in our opinion, a possibility of the market anticipating the final decision. In this connection, we noted that the Treasury does not hold formalized meetings with the IBA and ABA committees for either new cash financings or advance refundings.

In our opinion, the Treasury should establish formal written marketing procedures. In this connection, the Treasury's report on the investigation of the unauthorized disclosure of financing terms of the obligations marketed in August 1967 noted that there were no formal written procedures or guidelines covering Treasury financing operations. The report suggested that, to provide a means for better internal control of a financing and to furnish a basis for supervisory review, consideration be given to the preparation of written guidelines which would set forth procedures for each type of financing.

The Department established guidelines and two check-lists for the financing operations performed by the Office of the Secretary.

The guidelines, in their entirety, are as follows:

> "On each Treasury financing, other than regular Treasury bill auctions, the attached general and technical check lists are to be completed and made a part of the official files. The Bureau of the Public Debt check list will also be made a part of the official files on each financing.
>
> "Knowledge of the financing, prior to the time of announcement, is to be restricted to members of the Financing Group and a few officials in the Bureau of the Public Debt. These persons are to be named on each completed check list.

Other than the above, only the Secretary, Under Secretary, and the Chairman or Vice Chairman of the Federal Reserve Board of Governors are to be informed of the financing terms prior to the release time.

"Routine inquiries on current Treasury financing operations or planning, including inquiries relating to financing announcements, are to be referred to the Public Information Office. All other questions (going beyond the details spelled out in financing press releases) are to be referred to the Assistant to the Secretary (Debt Management) or to the Deputy Under Secretary for Monetary Affairs. If both these officials are unavailable, another member of the Financing Group may be designated by the Under Secretary for Monetary Affairs to answer such inquiries.

"The Assistant to the Secretary (Debt Management) is to be responsible for completing and filing the attached check lists."

The general checklist is a two-page document on which to list specific facts on the obligations issued; the names of the individuals who participated in the meetings of the Finance Group; the dates on which various letters, memorandums, and charts were prepared; and the dates and times the Finance Group met.

The technical checklists are two- or three-page documents for listing the specifics relating to the maturing obligations, if applicable; the terms of the new obligations; and the administrative details regarding the new obligations, such as announcement date and issue date.

Although the checklists for the operations performed by the Office of the Secretary will enable the Treasury to maintain an official record of what occurred in regard to particular financings, the checklists are filled out after the fact and do not set forth the procedures to be followed in a financing operation.

We believe that the Treasury should establish formalized written marketing procedures which would provide for better internal control of a financing operation and furnish a basis for supervisory reviews. Formalized written procedures would, in our opinion, facilitate the standardization of marketing procedures for offerings of Treasury obligations and provide for continuity of such procedures in the event of a substantial change in key personnel. In establishing such procedures, the Treasury should, in our opinion, try to maintain a tight compression between the time the advance knowledge is disclosed and the time of the official release of the information.

SCOPE OF REVIEW

We reviewed the policies, methods, and procedures followed by the Treasury Department in connection with the February 1969 offering of marketable Treasury obligations. Our review consisted of an examination of Treasury files maintained by the Office of the Secretary and the Bureau of the Public Debt. We reviewed selected documentation prepared by the Internal Revenue Service and the Securities and Exchange Commission in the course of their investigations of the unauthorized disclosure of advance information on the August 1967 note offering.

In addition, discussions were held with appropriate officials from the Treasury Department--Office of the Secretary, Bureau of the Public Debt, and Internal Revenue Service--and the Securities and Exchange Commission.

We did not review the procedures followed by the Federal Reserve System because, under the new Treasury Department procedures, members of the System, except for the Chairman or Vice Chairman of the Board of Governors, are excluded from receiving advance knowledge of the terms of a financing.

APPENDIX

HOUSE OF REPRESENTATIVES

COMMITTEE ON BANKING AND CURRENCY

NINETIETH CONGRESS

2129 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, D.C. 20515

June 10, 1968

Honorable Elmer B. Staats
Comptroller General of the United States
General Accounting Office
General Accounting Office Building
441 G Street
Washington, D. C. 20548

Dear General Staats:

It is requested that the General Accounting Office inquire into and report on the policies, methods, and procedures followed by the United States Treasury Department and the Federal Reserve System in connection with the public offering of United States debt obligations.

This request is specifically related to reports that last year a Treasury Department debt refinancing operation was the subject of widespread rumors among dealers and brokers in United States Government securities. The rumors detailed the quantity and maturities of debt obligations that were to be offered to the public through the Federal Reserve System. The rumors were apparently based on fact and the source of the accurate advance information was reportedly traced to an employee of the Philadelphia Federal Reserve Bank, since deceased.

The Treasury Department and the Federal Reserve System have indicated that a reoccurrence of such a breach of confidentiality is impossible because the method and timing of related news releases have been changed. They also take the position that any profits or losses resulting from such a breach would be minor and entirely in the public sector; i.e., the Government is not directly affected in any event.

Honorable Elmer B. Staats June 10, 1968

We suggest that the investigation should be made, at least, for the present, here in Washington, at the United States Treasury Department and the Board of Governors of the Federal Reserve System.

We have asked the Secretary of the Treasury and the Chairman of the Board of Governors to give you their cooperation in carrying out this assignment for the Committee.

Sincerely,

Wright Patman
Chairman

U.S. GAO, Wash., D.C.