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BY THE COMPTROLLER GENERAL
**Report To The Chairman, Committee On
Banking, Finance And Urban Affairs
House Of Representatives**
OF THE UNITED STATES

**Unauthorized Disclosure Of The Federal
Reserve's Monetary Policy Decision**

GAO reviewed several issues centering on the unauthorized disclosure of the Federal Reserve System's July 20, 1983, long-range monetary growth targets.
GAO

- was unable to determine exactly how and when the leak occurred,
- found that at least 239 persons in the Federal Reserve System or the Congress knew of the decision or handled documents containing the decision,
- found no indication that financial entities traded with knowledge of the leaked information prior to its publication in the press, and
- determined that safeguard procedures in both the Federal Reserve System and the House Banking Committee could be strengthened.

Reducing both the period of time the data must be safeguarded and the number of individuals who are authorized access to the sensitive material are ways to reduce the likelihood of a leak.



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COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON D.C. 20548

B-214109

The Honorable Fernand J. St Germain
Chairman, Committee on Banking, Finance
and Urban Affairs
House of Representatives

Dear Mr. Chairman:

On August 22, 1983, you asked that we review several issues centering on the unauthorized disclosure of the Federal Reserve System's (FRS) July 20, 1983, Midyear Monetary Policy Report to the Congress (known as the Humphrey-Hawkins report). The report is required by Section 108 of the Full Employment and Balanced Growth Act of 1978 (12 U.S.C. 225a) and contains the Federal Open Market Committee (FOMC) decision of the long-range (12 months or longer) monetary growth targets. These growth targets represent the FRS's plans for expansion of the Nation's money supply, which in turn, affect the cost of money as determined by interest rates. Participants in the financial markets are alert for information about FOMC actions and consider this and additional information in trading financial instruments. If individuals or organizations had advance knowledge of an FOMC decision and were able to predict the market reaction to this information, they could initiate trading to capitalize on the expected price changes.

Before the formal testimony by the FRS Chairman, which as a matter of practice is also the general public release of the data, key elements of the report fell into the hands of persons outside of the FRS and the House Committee on Banking, Finance and Urban Affairs (HBC). Concerned that advance knowledge of these targets could benefit groups or individuals, you specifically asked us to determine from where and to whom the material was transmitted in advance, how the leak occurred, and to suggest procedures that might avoid a recurrence.

We were unsuccessful in our attempt to determine exactly how the leak occurred, but we did determine the general sequence of events on July 19, 1983--the day evidence first surfaced that a leak had occurred (see p. 6 and app. II). We also identified at least 239 individuals who had access to or possession of the FOMC decision before its public release (see p. 4 and app. I).

We determined that safeguard procedures in both the FRS and the HBC could be strengthened and that some staff members at each entity were not cognizant and/or observant of existing procedures. We noted several incidents of noncompliance with safeguard procedures and saw a need for uniform policies for handling press communications.

On December 14, 1983, we briefed you and the FRS Chairman on our major findings and suggested actions that might be taken to improve and strengthen the safeguarding of the monetary policy decision prior to its public release. For security reasons we are not repeating in this report the specific safeguard procedures which need strengthening or our suggestions. It should be recognized that although revised or additional procedures and stricter adherence to them might reduce the likelihood of future unintentional leaks, such measures will do little to deter an individual who is authorized access to sensitive data and desires to divulge it to unauthorized persons. Reducing the period of time the data must be safeguarded and the number of individuals who are authorized access to the sensitive material are two ways to reduce the likelihood of a leak.

OBJECTIVES, SCOPE, AND METHODOLOGY

The scope and approach of our investigation were outlined in an agreement between you and the Chairman of the FRS. The objectives of our review were to:

- identify all persons in the FRS, in the Congress and on congressional staffs, in the news media, in the securities industry, and elsewhere with advance knowledge (before July 20, 1983) of the FOMC's decision;
- determine how the leak occurred and who released the information; and
- determine and assess internal controls and safeguards at the FRS and the HBC over the FOMC decision.

We conducted our review at the offices of the House Committee on Banking, Finance and Urban Affairs; the Senate Committee on Banking, Housing and Urban Affairs; the FRS headquarters in Washington, D.C.; and the 12 Federal Reserve banks. We conducted interviews of 273 FRS headquarters and bank employees--including the 7 FRS Governors--and 22 Senate and House Banking Committee staff members who had access to or knowledge of the July 13, 1983, FOMC decision or documents used to formulate that decision before its July 20, 1983, release to the public. We questioned each interviewee concerning three potential sources of information: (1) actual FOMC or FRS documents, (2) verbal communication about the FOMC decision, and

(3) exchanges of information about which the interviewee was knowledgeable but not a participant.

For the purpose of our review, we defined access to include knowledge of the FOMC decision (regardless of how obtained) or possession of any document containing the FOMC decision (including administrative purposes such as typing, filing, and copying). The structured interview assisted us in documenting who had access, how and when they obtained access, whether they were authorized access in accordance with existing procedures, and whether there was unauthorized disclosure. The instrument also contained questions to determine interviewee familiarity with existing safeguard procedures over FOMC material.

In your August 22, 1983, letter you expressed concern that individuals or organizations may have profited from advance knowledge of the July 1983 FOMC decision. In addition to discussions with FRS officials concerning the government securities market, we conducted interviews with officials at the Securities and Exchange Commission, Commodity Futures Trading Commission, self-regulatory organizations (such as stock and commodity futures exchanges), and financial houses. The interviews were held to determine (1) when individuals learned of the FOMC decision, (2) their views on the significance of the leak, and (3) whether there were any indications of unusual market activity that could be related to the leak. As leads on dissemination of the FOMC decision developed or allegations of trading with advance knowledge were noted, we pursued these with a number of sources, including the financial market regulators, "Fed watchers" (individuals who closely follow the FRS's monetary policy actions) and former FRS employees, and academicians. Although we performed some limited trading analyses of our own, due to time constraints we relied primarily on the results of analyses performed by the cognizant financial market regulators.

During the review we contacted officials at the Departments of Agriculture, Commerce, and Labor to review their safeguard procedures over sensitive economic data. Our objective was to determine whether they had procedures that could be applied at either the FRS or the HBC.

Our investigation was limited somewhat by circumstances that we were unable to overcome. In our pursuit of all potential leads to determine the source of the leak, we contacted reporters for Bondweek, The Wall Street Journal, The Washington Post, American Banker, Reuters, Associated Press (AP), and AP-Dow Jones Telerate. Bondweek, which received the FOMC information and provided it to AP-Dow Jones Telerate, leading to the

release by the other news services, refused to answer any questions related to the investigation. The reporter and a representative of the law firm retained by Bondweek stated that responding to any of our questions could lead to the identification of the reporter's source of information.

Because of limitations on our access to records contained in the Federal Banking Agency Audit Act (31 U.S.C. 714), we did not have access to restricted monetary policy documents as we conducted this investigation. For example, we were not permitted access to the FRS's policy options papers known as the "Blue Book" to determine whether the eventual FOMC decision was one of the options identified prior to the FOMC meeting.

Finally, our investigation was hampered because of the time lag between the leak and the start of our investigation. The leak could have occurred between July 13 and July 19, 1983. We were requested to investigate this matter on August 22, 1983, and after a series of discussions with the FRS and HBC to reach agreement on the scope of the investigation, we began our investigation in late September. Because of this delay, the memories of interviewees had faded and their recollections of events sometimes conflicted.

THE BROAD DISSEMINATION OF THE
DECISION HAMPERED EFFORTS TO
DETERMINE THE SOURCE OF THE LEAK

There is broad access to the long-range monetary growth target decision before its public dissemination at the time the FRS chairman testifies before the Congress. This situation results from the consultative nature of the FOMC decision-making process, and because of congressional committee requirements for advance copies of the FRS chairman's testimony. We identified at least 239¹ persons in Federal Reserve headquarters, the reserve banks, and the Congress that either knew of the decision or handled sensitive documents containing the decision between the July 13, 1983, FOMC decision-making meeting and the morning of July 20, 1983, when Chairman Volcker testified. Appendix I contains a detailed account of how these individuals obtained access and what documents they possessed.

Knowledge of the decision was gained or transmitted in several ways: attendance at the July 13 FOMC meeting, oral

¹This figure does not include all HBC members' personal staff who may have had access after the first indication of a leak.

communication of the decision, or receipt of one of the documents that contained the decision. The following chart shows the number of persons who had advance knowledge or possession of the FOMC decision and how they obtained access.

Knowledge or Possession of the FOMC Decision Before
Chairman Volcker's Testimony on July 20, 1983^a

<u>Organization</u>	<u>Attended FOMC meeting</u>	<u>Orally informed^b</u>	<u>Had access to FOMC directive</u>	<u>Had access to Humphrey- Hawkins report</u>	<u>Had access to FRS Testimony</u>
<u>FRS headquarters</u>					
Professional staff	14	23	21	34	18
Support staff	<u>0</u>	<u>1</u>	<u>9</u>	<u>29</u>	<u>19</u>
Total	<u>14</u>	<u>24</u>	<u>30</u>	<u>63</u>	<u>37</u>
<u>Federal Reserve banks</u>					
Professional staff	15	54	35	0	0
Support staff	<u>0</u>	<u>0</u>	<u>29</u>	<u>0</u>	<u>0</u>
Total	<u>15</u>	<u>54</u>	<u>64</u>	<u>0</u>	<u>0</u>
FRS total	<u>29</u>	<u>78</u>	<u>94</u>	<u>63</u>	<u>37</u>
<u>Congressional committees</u>					
Members ^c	NA	NA	NA	47	47
Professional staff	NA	NA	NA	17	12
Support staff	NA	NA	NA	<u>5</u>	<u>4</u>
Congressional total				<u>69</u>	<u>63</u>

^aSome individuals obtained access from more than one source.

^bIncludes individuals who first learned of the decision through their attendance at the FOMC meeting.

^cPackets containing copies of the Humphrey-Hawkins report and Chairman Volcker's testimony were delivered to the members' offices.

The first time that anyone could have obtained access to the decision was through participation at the FOMC meeting. Because the FRS Chairman was concerned over alleged leaks of FOMC information, attendance at the July 13, 1983, meeting was limited to 29 persons. However, most bank presidents and headquarters officials followed their normal pattern of informing key subordinates of the decision. By July 19, 1983, 49 FRS employees (78 orally informed minus 29 who attended the FOMC meeting) had been briefed on the decision.

The July 13 decision was also communicated in three documents. The first of these was the FOMC directive to the Federal Reserve Bank of New York. Before July 20, 94 FRS employees had access to the draft or final FOMC directive.

The Humphrey-Hawkins report was the second source. The Humphrey-Hawkins report conveys key FOMC decisions regarding estimates of economic growth and the conduct of open market operations which, in turn, affect the growth of the U.S. money supply and the cost and availability of money and credit in the economy. Before July 20, 63 Federal Reserve headquarters employees had access to the report. No copies were available in the reserve banks before July 20. About 150 copies of this report were delivered to the HBC at approximately 10:00 a.m. on July 19. Distribution to committee staff began immediately. By the time the Chairman testified on July 20, 1983, copies of the report were delivered to the offices of the 47 committee members and at least 22 congressional staff had access to a copy of the report.

The third document that contained the FOMC decision was the FRS Chairman's testimony prepared for delivery at 10:00 a.m. on July 20, 1983. Before July 20, 37 headquarters Federal Reserve professional and support staff had access to the testimony. The first copies of the testimony were delivered to the HBC at approximately 3:30 p.m. on July 19, after the first indications of the leak. By the time the Chairman testified on July 20, 1983, copies of the testimony were delivered to the offices of the 47 committee members and at least 16 congressional staff had access to the testimony.

THE SOURCE OF THE LEAK
REMAINS UNKNOWN

The source of the leak of the FOMC targets remains unknown. The broad dissemination of the decision, its availability from a variety of sources, and the unwillingness of Bondweek to respond to any of our questions prevented us from fixing responsibility within either the FRS or the HBC.

Our investigation failed to develop conclusive evidence as to who was the original recipient of the leaked information. We found no firm evidence of trading in the financial markets related to advance knowledge of the FOMC decision. Analysis we performed showed that some trading entities had notable position shifts in this period, but the direction of the shifts varied, and none of the more significant changes could be directly attributed to advance knowledge of the FOMC decision. We recognize that we cannot report with certainty that trading with advance knowledge did not occur. A detailed discussion of the events surrounding the leak and the results of our analysis of trading during this period is in appendix II.

ASSESSMENT OF SAFEGUARDS OVER THE
FOMC DECISION AT THE FEDERAL RESERVE
AND THE HOUSE BANKING COMMITTEE

Although we were unsuccessful in determining the original source of the leak, we did find instances where procedures could be strengthened at both the FRS and the HBC. Although the FRS has reasonable security arrangements in place, we found numerous instances of noncompliance with written procedures. The FRS could provide the semi-annual monetary target decisions to the Congress with better security by placing renewed emphasis on complying with written procedures, giving attention to some weaknesses in existing procedures, and conducting periodic systemwide reviews of FOMC and FRS Board security procedures to ensure continued compliance.

At the HBC, no formal safeguard procedures exist and we found instances where the handling of documents needs improvement. As we suggested to you on December 14, 1983, greater security would result if you (1) formally adopt a written position on the sensitivity of the FOMC material and expectations for safeguarding, and (2) institute accountability procedures over report and testimony distribution and safeguarding.

Given the extent of press and public interest in the target decisions and the extent of contact with the press and public by the HBC staff as well as key FRS officials, we believe the recording of such contacts could be improved at both organizations. At the FRS there is no requirement to report or record the nature and extent of press contacts, although some professional staff and all Governors have existing relationships with members of the press. At the HBC, the press office maintains a policy of no release of testimony prior to a

hearing. However, some HBC staff not connected with the press office make their own contacts with the press leading to an inconsistent handling of press inquiries.

Although adoption of our suggestions regarding safeguard procedures should offer improved security over the target decision, we believe that a change in the current practice of releasing the long-range targets offers valuable further insurance against a future leak. At the briefing, we provided for discussion a number of options for releasing the target decision. Some of the options reduce the time the information is at risk, thus reducing the opportunities for willful misuse of the information. We believe any one of the options could reduce the likelihood of and help fix accountability for a future leak.

CONCLUSIONS

We were unable to determine exactly how and when the leak occurred. Because the FOMC makes monetary target decisions through consultation and the Humphrey-Hawkins legislation requires the FRS to report long-range targets to the Congress, there was broad access to the target decision before its public dissemination on July 20, 1983. We found that at least 239 persons in the FRS or the Congress knew of the decision or handled documents containing the decision. Knowledge may have come from one of the documents containing the decision or have been orally transmitted. Although Bondweek possessed the leaked information on July 19, 1983, we could not establish that Bondweek was the original recipient of the leaked information or when the leak occurred. Our analysis of trading in the financial markets did not disclose any activity that would indicate advance knowledge of the FOMC decision.

Safeguard procedures at both the FRS and HBC could be improved and on December 14, 1983, we suggested some actions that might be taken to help prevent another leak in the future. It should be recognized, however, that revised procedures and stricter compliance with those procedures will do little to deter an individual who has access to and is intent on divulging sensitive data to unauthorized persons.

We understand that within the past 2 weeks HBC and FRS staff have held discussions on options for releasing the FOMC decision. We encourage these discussions and hope the parties can reach a mutually beneficial agreement.

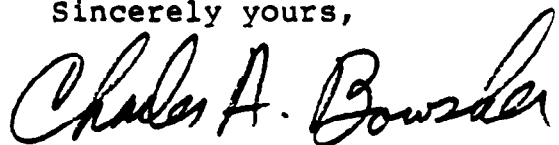
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A draft of this report was submitted to both you and the FRS chairman for comment. Changes have been made throughout the report, as appropriate, to reflect the oral comments we received.

We have made no other distribution of the report at this time. On February 6, 1984, we will transmit copies of this report to the FRS chairman, as well as make the report available to the media and general public.

We appreciate the cooperation which you and your staff displayed during this investigation. Without such cooperation the investigation would not have progressed as rapidly as it did.

Sincerely yours,



Comptroller General
of the United States

OVER 200 INDIVIDUALS HAD ACCESS TO THE
FEDERAL OPEN MARKET COMMITTEE DECISION

Before 10:00 a.m., July 20, 1983, when Federal Reserve System (FRS) Chairman Paul Volcker testified before the House Committee on Banking, Finance and Urban Affairs (HBC), at least 239 persons had access to documents used in formulating or containing the monetary policy decision made by the Federal Open Market Committee (FOMC). These individuals were mostly headquarters and bank employees of the FRS, members of the HBC, and staff members of congressional committees. They all had access to or knowledge about the FOMC decision sometime between July 13 and July 19, 1983. Most of these people had a recognized right or were otherwise authorized access to the information.

FRS PERSONNEL HAD ACCESS TO THE FOMC
DECISION THROUGH SEVERAL SOURCES

Before July 20, 1983, 170 FRS personnel had access to or knowledge about the FOMC monetary policy decision. These persons participated in the FOMC meeting; learned of the decision from others; and/or drafted, processed, or handled key documents that contained the information. These documents included the policy options papers (known as the "Blue Book") used to help formulate the decision, the FOMC directive to the Federal Reserve Bank of New York, the Midyear Monetary Policy Report to the Congress (Humphrey-Hawkins report), and the FRS Chairman's testimony prepared for presentation to the HBC.

Policy options papers
known as the Blue Book

Before each regular meeting of the FOMC, a package containing proposed options for long-range monetary objectives and supporting analysis, known as the Blue Book, is sent to each FOMC member¹ and to nonmember Federal Reserve bank presidents. The FRS considers the Blue Book to be among the most sensitive of FOMC documents; and, as such, it is given the highest FRS

¹The FOMC is composed of the seven members of the Board of Governors and five reserve bank presidents. The president of the New York bank serves on a continuous basis while other reserve bank presidents serve 1 year terms on a rotating basis.

security classification--Class I. Although FRS officials told us that one of the alternatives in the Blue Book can be similar to the eventual decision made at the FOMC meeting, they also told us that the July decision to select a different base for monitoring growth in the money supply was not a Blue Book alternative. Thus, according to FRS officials, it seems unlikely the Blue Book could have been the source of the leak.²

FOMC meeting held in July 1983

The FOMC met on July 12 and 13, 1983, to decide on midyear long-and short-range monetary growth targets. At these midyear meetings, the FOMC considers, among other things, the outlook for the U.S. economy over the next 6 to 18 months, and the economy's performance with respect to interest rates, employment, labor costs, inflation, and various spending patterns. The FOMC then decides on appropriate monetary policy and target objectives for the growth or reduction of the Nation's money supply.

The July FOMC meeting was notable because the attendance at the July 13th session, when the actual monetary policy decision was made, was restricted. Normally, attendance at the FOMC meetings includes the FRS Board of Governors, two key officials (usually the president and a senior vice president) of each of the 12 Federal Reserve banks, and key FRS headquarters personnel. Concerned about a series of alleged leaks of monetary policy information, most notably one occurring in October 1982 and another before the May 1983 FOMC meeting, Chairman Volcker restricted attendance at the July 13th session by excluding the second official from each of the banks and certain FRS headquarters staff who normally attend. Chairman Volcker had also restricted attendance at the November and December 1982 FOMC meetings. The number of individuals at the July 12, 1983, FOMC meeting was 53, while attendance at the July 13th decision-making session of the meeting was limited to 29.

Although the FRS Chairman decided to restrict attendance at the meeting on July 13th, many of the individuals normally in attendance soon learned of the decision from the others. For example, some of the reserve bank presidents informed their senior vice presidents of the decision upon returning to the regional banks. Others, however, adopted the Chairman's more

²Because of limitations on our access to records contained in the Federal Banking Agency Audit Act (31 U.S.C. 714), we did not have access to the Blue Book.

restrictive position and did not inform other bank officers of the decision.

FOMC directive to the
Federal Reserve Bank of New York

At the end of each FOMC meeting, a consensus for an appropriate policy course to be pursued is developed. This policy is embraced in the form of a written directive to the Federal Reserve Bank of New York. Thus, on July 13, 1983, staff members of the FRS's Office of Staff Director for Monetary and Fiscal Policy finalized an FOMC directive that contained both the long- and short-range target decisions of the FOMC.

The directive was approved by the Chairman and then sent to the reserve bank presidents. Although the bank presidents had attended the July 13th FOMC meeting, the distribution of the directive to the banks significantly increased the number of individuals with access to this information. For example, at some of the reserve banks the directive was shared with other high level bank officers. Additionally, support staff, i.e., secretaries and file clerks, gained access to the FOMC decision through the normal course of handling and processing paperwork within the banks.

A total of 94 people throughout the FRS had access to the draft or final FOMC directive before July 20, 1983. The 94 employees include 30 from headquarters (21 professional and 9 support staff members) and 64 from the banks (35 professional and 29 support staff members).

Humphrey-Hawkins report

The draft Humphrey-Hawkins report originates in the Division of Research and Statistics (R&S) where senior economists provide input to the narrative chapters of the report and also direct the formulation of charts to be included in the report. The senior associate director was responsible for assembling and processing the final report. After the FOMC meeting on July 13, the draft report was typed and distributed to other offices and divisions for comments. Final charts for the report were produced on July 15 after the Board meeting at which the draft report had been discussed. The final report was assembled by the senior associate director of R&S and a senior economist. On July 18, 1983, the report was delivered to graphics for final touches and from there was sent to the duplicating section.

On the morning of July 19, 1983, several R&S staff members inserted "flysheets" into 150 copies of the report. This flysheet contained a chart with the key elements of the July 13th FOMC decision and of projected Gross National Product (GNP) figures. The 150 copies (including the flysheets) were taken to the HBC by the Special Assistant to the Board for Congressional Liaison at about 10:00 a.m. the same day. An additional 250 copies of the Humphrey-Hawkins report were taken to the FRS Congressional Liaison Office between 2:00 and 3:00 p.m. on July 19, 1983, to be distributed the next day after Chairman Volcker testified. The report was not available at the reserve banks until July 20, 1983.

A total of 63 staff members at FRS headquarters (34 professional and 29 support staff) had access to the Humphrey-Hawkins report between July 13 and July 20, 1983.

Chairman Volcker's testimony

Following the July 13th meeting, Chairman Volcker and staff members from his office and R&S drafted the testimony. The testimony discussed the FRS monetary policy in the context of current and prospective economic conditions and highlighted some aspects of the Humphrey-Hawkins report. A small group of FRS executives, all of whom already knew the decision, met with the Chairman on July 18 for a final review of the testimony. Minor changes continued to be made to the testimony through the late afternoon of July 19. A total of 37 staff members at FRS headquarters (18 professional and 19 support staff) had access to Chairman Volcker's testimony before July 20, 1983.

FRS officials told us that at 3:30 p.m. three advance copies of the testimony were sent to the HBC by courier. Additional copies, approximately 150 in two large boxes, were later sent to the HBC at about 6:00 p.m., also by courier according to FRS officials. In contrast, HBC staff told us that only one advance copy of the testimony was received from the FRS and an unknown quantity of additional copies arrived in one box later on July 19.

MANY CONGRESSIONAL STAFF MEMBERS HAD KNOWLEDGE OF THE FOMC DECISION ONCE THE REPORT AND TESTIMONY WERE DELIVERED

Many congressional staff members learned of the FOMC decision soon after the FRS submitted copies of the Humphrey-Hawkins

report and Chairman Volcker's testimony. In addition to the 47 members of the HBC, at least 17 professional and 5 support staff personnel of the HBC, its subcommittees, the Senate Committee on Banking, Housing and Urban Affairs, and the Joint Economic Committee obtained a copy of or had access to these key documents prior to Chairman Volcker's testimony. The majority of the professional and support staff who had a copy of or access to these documents obtained them before the distribution of these documents to the HBC members, which occurred between 4:30 and 5:00 p.m. on July 19, 1983.

Committee rules require advance
delivery of testimony and accompanying
reports

Committee rules and procedures require that witnesses planning to testify before the HBC provide 175 copies³ of proposed testimony at least 24 hours in advance. The purpose of the 24-hour rule is to permit advance copies of key documents to be distributed and reviewed by members of the committees and subcommittees, and their staffs, thereby enabling participants to more thoroughly discuss the issues involved. The Senate Banking Committee has a similar 24-hour rule. Usually, the FRS chairman alternates testifying first before the House and the Senate. In July 1983, he testified before the House first.

The FRS delivered an estimated 150 copies of the Humphrey-Hawkins report to the HBC at about 10:00 a.m. on July 19, 1983, the day before Chairman Volcker was scheduled to testify. Consequently, it was necessary for committee staff members to safeguard the Humphrey-Hawkins report for a full day before the public release of its contents. Although advance copies of the Humphrey-Hawkins report were received 24 hours before the hearings, advance copies of Chairman Volcker's proposed testimony were not delivered until after 3:30 p.m. that same day. Even then, only a few advance copies were delivered, which required committee staff members to reproduce sufficient copies for all the members.

³By letter to the FRS Chairman dated July 11, 1983, the HBC Chairman waived the 175-copy requirement and requested 150 copies of the testimony and report.

Humphrey-Hawkins report

Distribution of the Humphrey-Hawkins report began immediately after the reports were delivered by the FRS. An estimated 150 copies of the report were delivered to the HBC at approximately 10:00 a.m. on July 19, 1983. These reports were received in and controlled through the Staff Director's office. Within about 15 minutes after the reports were delivered, four professional staff members of the committee each had possession of at least one copy. The remaining copies of the Humphrey-Hawkins report were in the custody of a fifth HBC professional staff member.

The dissemination of the Humphrey-Hawkins reports continued throughout the afternoon of July 19, 1983. For example, the hearings being conducted that day adjourned at 12:40 p.m., and immediately thereafter a subcommittee staff member picked up a copy of the report before returning to his office. Before the Humphrey-Hawkins reports were distributed to the HBC members, which occurred between 4:30 and 5:00 p.m., 12 additional congressional staff obtained a copy of or had access to the reports. Additionally, four Senate Banking Committee staff members obtained copies of the Humphrey-Hawkins report from HBC or FRS staff before Chairman Volcker's testimony.

Enclosed with each Humphrey-Hawkins report was the flysheet that contained the key elements of the FOMC monetary policy decision. This loose page was not in the format that had been requested by the HBC staff economist. The HBC staff prepared a reconfigured page and reproduced and stapled it into the reports during the afternoon of July 19, 1983. The older version of the flysheet prepared by the FRS was discarded.

Chairman Volcker's testimony

Basically, the same individuals within the HBC and its subcommittees who had access to the Humphrey-Hawkins report also had access to or obtained copies of Chairman Volcker's testimony. This access occurred later on July 19, 1983, however, because copies of Chairman Volcker's testimony were not delivered by the FRS until after 3:30 p.m. Even then, only a few advance copies were sent to the HBC. Committee staff members duplicated sufficient copies of Chairman Volcker's testimony to be delivered to the HBC members. Additional copies were made for key HBC staff members and for distribution to the press the next day.

The required quantity of Chairman Volcker's testimony was not delivered by the FRS until about 6:30 p.m. on July 19, 1983. These copies remained overnight in a cardboard box just inside the locked HBC staff members' office area.

DISCUSSION OF EVENTS SURROUNDING THE LEAK

The leak could have occurred any time after the FOMC made its decision on July 13, 1983. The first indications that a leak had occurred did not surface until the afternoon of July 19, 1983. If the leak had occurred before this date, it clearly could have only originated from the FRS. On July 19, 1983, the FRS delivered to the HBC 150 copies of the Humphrey-Hawkins report at 10:00 a.m. According to conflicting statements of HBC and FRS interviewees, either one or three copies of Chairman Volcker's testimony were delivered in mid-afternoon and the remainder about 6:30 p.m. Since the Humphrey-Hawkins report containing the monetary target information was delivered to the HBC at 10:00 a.m., the source of the leak could have been either the FRS or the HBC.

BONDWEEK FIGURES IN ALL ACCOUNTS
OF HOW THE LEAK OCCURRED

Between the hours of approximately 2:00 and 4:00 p.m. on July 19, 1983, a Bondweek reporter requested two congressional staff members not connected with the HBC press office to confirm information the reporter had about the FOMC decision. Although we were unable to determine with certainty in which order the two congressional staff members were called, we were able to obtain from them some details about their conversations. Bondweek made no attempt to confirm the information through the HBC press office.

An HBC staff member the Bondweek reporter called seeking confirmation told the reporter he had not examined the report and would not comment on unreleased data. The staff member told us that upon checking the Humphrey-Hawkins report after the telephone call, he ascertained that the Bondweek reporter's information was accurate. This staff member subsequently called the FRS's Congressional Liaison Office to inform the liaison that a leak had occurred. This was the first indication the FRS had of the leak.

The second person who received a call seeking confirmation of the information was an HBC subcommittee staff member. This staff member stated he neither confirmed nor denied that the reporter's information was accurate. However, he told us that he did pull out his copy of the report to check the accuracy of

the reporter's numbers. He also said he may have discussed the significance of the reporter's information during the course of the conversation. The staff member recognizes that the Bondweek reporter may have believed this conversation confirmed the information.

Both staff members stated they were informed by the Bondweek reporter that the reporter had gotten the information from the reporter's editor in New York. According to the HBC staff member, the reporter stated that the Bondweek editor had received the information from someone in a New York securities firm. Two other individuals we questioned, however, stated that the Bondweek reporter had told them that the reporter had originally obtained the information and then sent the information to the editor in New York. Because we were unable to interview Bondweek representatives, we were unable to determine the correct version.

Bondweek released the story to the AP-Dow Jones Telerate between 4:00 and 5:00 p.m. on July 19, and AP-Dow Jones Telerate sent the FOMC decision out on its service at about 6:00 p.m. AP-Dow Jones Telerate then provided the story to an AP reporter in New York. The AP reporter who wrote the story that went out on the AP business wire at about 6:25 p.m. told us that the AP-Dow Jones Telerate press account was not very long and that he modified and expanded on it in writing his story. At approximately 6:40 p.m. the story appeared on the general news wire. Neither representatives of Bondweek nor the Chief Executive Officer of AP-Dow Jones Telerate would discuss the source of the information. They also would not provide us with a copy of the Bondweek release that was provided to AP-Dow Jones Telerate or state whether the information was disclosed to Bondweek orally or in writing.

The AP business wire report stated, in part, "Bondweek said that it has learned from senior Washington sources familiar with the testimony that Volcker is to give before the House Banking Committee" This implies more than one source for the information. The report also implies that the information was provided to a "Fed watcher" for his reaction. Because we were unable to obtain the Bondweek report that was passed to AP-Dow Jones Telerate, we could not tie the wording in that report to any of the potential sources of information discussed in appendix I. Likewise, our review of the wire service reports could not tie the wording to any of the potential source documents. The relevant information was brief enough that it could have been transmitted orally.

After the story appeared on the wire services, other financial market reporters began contacting FRS and congressional sources for confirmation and/or additional details on the FOMC decision in the 6:00-7:45 p.m. timeframe. A reporter for The Wall Street Journal telephoned the HBC Chairman who refused to comment on the story. Later in the evening a reporter for The Washington Post telephoned a congressional staff member. At the FRS, the Assistant to the Board for Public Affairs received calls from reporters at The Washington Post, The Wall Street Journal, AP, and ABC News. By 8:00 p.m. e.s.t., information about the FOMC's monetary policy decision began circulating in foreign financial markets.

INDICATIONS OF TRADING BASED ON
ADVANCE KNOWLEDGE WERE NOT FOUND

Our work indicates that market sensitivity to the semi-annual targets is somewhat in question, with market participants and FRS officials expressing different views. The financial markets all initially reacted favorably after the July 1983 decision, however, pushing prices higher. We studied these price movements and trading activity in the government securities and futures markets. We did not find any organizations which took trading positions during this time period that could be directly attributed to advance knowledge of the FOMC decision.

Opinions vary on the sensitivity
of semi-annual FOMC targets

Opinions on the sensitivity of the July FOMC decision were mixed. Regulatory agency officials, especially those at the Federal Reserve and the Commodity Futures Trading Commission, tended to discount the importance of advance knowledge of the July FOMC decision. These officials, many of whom are economists, believed that the July decision made for a particularly difficult projection of market reaction. In fact, although a number of these officials suggested that their projection would have been for a positive market reaction, some would have projected negative market reactions, and others would have been unwilling to make any projection at all.

Four of the Governors of the FRS informed us that the semi-annual targets are not as market sensitive as other information the FRS releases. For example, one Governor told us that the weekly release of money supply figures is the most sensitive information as viewed by financial market watchers and

participants, the short-term targets are the next most sensitive figures, and the semi-annual target decisions are the least sensitive.

Market-oriented contacts, including officials at financial houses, "Fed watchers," and financial instrument traders, told us the information was important. Participants in the financial markets are alert for any information about FOMC actions or monetary policy. Rumors are always abundant, and the markets react to rumors, even though they might turn out to be false. While concurring with Federal Reserve officials that the short-term FOMC targets are generally of greater interest to the markets than the semi-annual target decisions, our market contacts believe that any information out of the Federal Reserve can be important.

Initial market reaction after the
FOMC decision was favorable

The value of inside information is dependent upon the ability of the possessor to predict market movements in response to the information. Before July 19, 1983, rumors in the financial markets centered on a more stringent Federal Reserve monetary policy. The decision to select a different base for monitoring growth in the money supply was viewed by the markets as positive news, and major financial markets reacted favorably and moved up on July 20, 1983. FRS officials were skeptical that this market reaction would have been predictable, but our market contacts believe differently. We quizzed traders of financial futures and a major government securities dealer, and all stated they had correctly predicted the initial market responses to the July decision.

Financial markets reacted positively after learning of the FOMC decision, with gains in government securities, financial futures, currency exchange rates, and stocks. The price movements were first noted in foreign markets about 8:00 p.m. e.s.t. on July 19, 1983. The next day government securities opened significantly above the previous day's close on domestic markets and continued a short rally before closing lower. Chicago futures exchanges showed price increases in Treasury bond, Treasury note, Government National Mortgage Association, and currency contracts. The Dow Jones index of industrial stocks was up 30 points at closing.

Market analysis identified no
unusual trading patterns

Through our own analysis and that of the major domestic market regulators, we were unable to identify any instances of trading that indicated advance knowledge before the FOMC decision appeared in the financial press. We looked specifically for such trading in the government securities, financial and currency futures, and equity markets. Market sources and FRS officials suggested government securities and financial futures were the instruments most affected by FOMC decisions. Therefore, in these markets the analysis was directed not only at general market movements but also in greater depths at financial houses alleged to have had advance knowledge.

The FRS oversees dealers in government securities. Officials at the Federal Reserve Bank of New York reviewed changes in dealer positions for significant shifts in holdings consistent with advance knowledge of the FOMC decision; first informally in late July, and then on a more detailed basis in response to a request we made as part of our investigation. The reviews consisted of analyzing the daily position reports that dealers submit and a report that is used on an ongoing basis to study movements in dealer positions. The analysis did not identify any large position shifts that could be attributed only to advance knowledge of the FOMC decision.

An analysis of trading in financial futures was also performed with similar results. We reviewed changes in price and volume for a number of interest rate sensitive and currency futures contracts for the period of July 11-29, 1983. We discussed our approach and the results of our analysis with and obtained other information from contacts at the Commodity Futures Trading Commission, the major Chicago commodity futures exchanges, the National Futures Association (the commodity futures industry self-regulatory organization), consultants, and traders. The analysis showed that some trading entities had notable position shifts in this period. However, the direction of the shifts varied, and none of the more significant position changes could be directly attributed to advance knowledge of the FOMC decision.

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