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GAO
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Highlights

Highlights of GAO-06-1007, a report to the Chairman, Committee on Ways and Means, House of Representatives

DEBT MANAGEMENT

Backup Funding Options Would Enhance Treasury's Resilience to a Financial Market Disruption

Why GAO Did This Study

The September 11, 2001, attacks significantly affected the financial markets that the U.S. Treasury (Treasury) relies on. To understand how Treasury could obtain funds during a future potential wide-scale financial market disruption GAO examined (1) steps Treasury and others took during the September 11 attacks and after to assure required debt obligations and payments were made on time and ensure liquidity in the markets, (2) major actions Treasury and others have taken since the attacks to increase the resiliency of the auction process, and (3) the opinions of relevant parties on the main design features of any backup funding options. We conducted interviews with Treasury officials and others and reviewed appropriate documents.

What GAO Recommends

We recommend that the Secretary of the Treasury examine the requirements for establishing a line of credit and a private placement of a CM bill and select the most appropriate option(s) as a first tier. As a second tier, Congress should consider allowing the Federal Reserve to lend directly to the Treasury during a wide-scale disruption using a carefully crafted last resort funding option. Both Treasury and the Federal Reserve agreed that Treasury should examine the first-tier options. Neither took a position on the second tier, but both emphasized the importance of maintaining the independence of the central bank.

www.gao.gov/cgi-bin/getrpt?GAO-06-1007.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Susan J. Irving at (202) 512-9142 or irvings@gao.gov.

What GAO Found

In response to the effects of the September 11 attacks on the financial markets, Treasury canceled a scheduled 4-week bill auction after communicating with the Federal Reserve Bank of New York (FRBNY). Treasury then used compensating balances from banks across the country to help meet its obligations on time. Compensating balances were replaced by direct payments in 2004. Also, in response to the attacks' financial effects, the Federal Reserve lent billions of dollars to both domestic and foreign financial institutions through a combination of methods to help markets recover. Federal Reserve actions and market behavior in the aftermath of the September 11 attacks are informative when considering potential alternative funding sources for Treasury during a future wide-scale financial market disruption.

Treasury, the Federal Reserve, and primary dealers have added contingency sites and systems intended to increase the resilience of the auction process. Regardless of resiliency efforts, the nature and impact of a potential future wide-scale disruption are unknown. In addition, Treasury has at least one less source of cash since the compensating balances Treasury relied upon during the September 11 attacks are no longer used. Finally, Treasury's cash management policy of minimal cash balances to lower borrowing costs further limits Treasury's access to cash during a wide-scale disruption. All these factors make it prudent for Treasury to explore other funding alternatives to use during a wide-scale disruption. Relevant parties with whom we spoke, including primary dealers, agreed. They also generally agreed on a list of main design features including source of funds, situations for use, approvals, and costs, among others, that should be considered when weighing alternative funding options.

Discussions with Treasury, the Federal Reserve, and other relevant parties have led GAO to conclude that a two-tiered approach is promising. The first tier consists of two funding options involving a range of appropriate financial institutions, namely a credit line and a private placement of a flexible security known as a cash management (CM) bill. The second tier involves a direct draw from the Federal Reserve that would provide Treasury a last resort source of funds when other options are not viable. A credit line with several financial institutions would involve a prior transparent commitment or understanding by certain financial institutions to provide funds to Treasury. A private placement of a CM bill would involve a prior arrangement to issue a CM bill after communicating with certain senior executives at financial institutions who would have the ability and authority to meet Treasury's immediate funding needs. Finally, a direct draw from the Federal Reserve would require a change in the law to allow the Federal Reserve to directly lend to Treasury. Appropriate limitations, adequate flexibility, and accountability would have to be included in the design.