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REPORT TO LEGAL AND MONETARY AFFAIRS SUBCOMMITTEE, COMMITTEE ON GOVERNMENT OPERATIONS HOUSE OF REPRESENTATIVES

Raise In Minimum Denomination Of Treasury Bills B-169231

Department Of The Treasury

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

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

B- 169231

Dear Mr. Chairman:

This is our report on examination into certain aspects of the Department of the Treasury's decision to raise the minimum denomination of Treasury bills from $1,000 to $10,000. The examination was made pursuant to your request of February 27, 1970.

This report presents our belief that the Treasury should consider the desirability of changing its method of pricing noncompetitive sales of Treasury bills from the average to the high price of the competitive sales even though the minimum bill denomination remains at $10,000. Had this method of pricing been followed by the Treasury for the bills issued during the first 8 months of fiscal year 1970, we estimate that the Government would have reduced its interest costs by about $4.5 million.

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

Enclosure

The Honorable Dante B. Fascell, Chairman
Legal and Monetary Affairs Subcommittee
Committee on Government Operations
House of Representatives

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D I G E S T

WHY THE REVIEW WAS MADE

On February 25, 1970, the Department of the Treasury announced that the minimum denomination of Treasury bills would be raised from $1,000 to $10,000.

At the request of the Chairman of the Legal and Monetary Affairs Subcommittee, Committee on Government Operations, House of Representatives, the General Accounting Office (GAO) examined into (1) the stated cost of processing sales of small denomination Treasury bills, which was cited by the Treasury as a justification for the Department of the Treasury's decision for discontinuing such bills, (2) whether the elimination of small denomination bills could have an adverse effect on the overall interest costs for Treasury bills, and (3) whether other means of marketing Treasury bills were available to offset the costs of marketing small denomination bills.

FINDINGS AND CONCLUSIONS

GAO was advised that the approximately $15 to $20 stated cost for processing each direct sale of small denomination Treasury bills to individuals, cited as a justification for the Department of the Treasury's decision, was based on a cost study by the Federal Reserve Bank of New York and on general discussions with officials of other Federal Reserve banks and various dealers in Treasury bills.

From its review of the cost study, GAO believes that the study was not, of itself, an adequate basis for the cost cited by the Treasury. Because adequate data was not available, GAO did not attempt to estimate such cost. (See pp. 6 to 10.)

Because the amount of noncompetitive bids under $10,000 was not available, GAO could not determine the effect of raising the minimum denomination of Treasury bills on Treasury's interest costs. (See pp. 11 and 12.)

GAO believes that a means of marketing Treasury bills which may decrease the Government's interest costs would be to change the method of pricing noncompetitive sales from the average price of the accepted competitive bids to the high price of the accepted competitive bids. (See pp. 13 and 14.)

In contrast to a competitive bidder, a noncompetitive bidder is assured of acquiring 100 percent of the amount of Treasury bills ordered and he does not have to formulate a bid price. The noncompetitive bidder also obtains a more favorable price than one who bids competitively at prices higher than the average.

GAO believes that the difference between the high and average competitive prices would be considered minor to most noncompetitive bidders for Treasury bills and that pricing such bills at the high prices may not appreciably affect the amount of Treasury bills sold noncompetitively.

For the bills issued during the first 8 months of fiscal year 1970, the average differences in prices between the high and average competitive prices for each $1,000 of Treasury bills were 17 cents for the 3-month bills and 19 cents for the 6-month bills.

For the bills issued during the first 8 months of fiscal year 1970, GAO estimated that such a change in pricing method might have reduced the Government's interest cost by about $4.5 million. (See pp. 13 and 14.)

RECOMMENDATIONS OR SUGGESTIONS

In view of the magnitude of the possible savings in interest costs to the Government, GAO is recommending that the Secretary of the Treasury consider the desirability of changing the policy of pricing noncompetitive tenders for Treasury bills from the average to the high price of the accepted competitive bids even though the minimum bill denomination remains at $10,000. (See p. 15.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

GAO did not submit this report for advance review by agency officials but it did notify the appropriate Treasury official that this report was to be issued.

CHAPTER 1

INTRODUCTION

At the request of Congressman Dante B. Fascell, Chairman of the Legal and Monetary Affairs Subcommittee of the Committee on Government Operations, House of Representatives (see app. I), the General Accounting Office has examined into certain aspects of the Department of the Treasury's decision to increase the minimum denomination of Treasury bills from $1,000 to $10,000. The scope of our review is described on page 16 of this report.

TREASURY BILLS

Treasury bills are bearer form obligations, sold at a discount and paid at face value without interest at maturity.

Treasury bills are sold at auction on competitive bid and noncompetitive bid bases. Noncompetitive bids are accepted in full and awarded at the average price of the accepted competitive bids. Generally, each noncompetitive bidder is limited to $200,000 or less for each bill issue. In calendar year 1969, the Department issued about $181 billion of Treasury bills, of which about $31 billion or 17 percent, were issued on a noncompetitive bid basis.

Treasury bill offerings consist of regular weekly offerings of 3-month and 6-month bills, regular monthly offerings of 9-month and 1-year bills, and periodic offerings of tax anticipation bills--a vehicle to provide corporations a means for investing funds set aside for the payment of income taxes--of maturities up to about 9 months. Tenders--bids to purchase bills--are invited by the Secretary of the Treasury through the Federal Reserve banks. Banking institutions may submit tenders for the accounts of their customers, provided the names of the customers are set forth in the tenders, but others may submit tenders only for their own accounts.

The Federal Reserve System, as fiscal agent for the Department of the Treasury, receives the tenders to purchase Treasury bills and the subscriptions to purchase other Treasury issues; allocates, in accordance with the Department's instructions, the amount of the obligations to be purchased under each tender or subscription; accepts payment for the issues, and credits the funds to the Department's account; makes requested exchanges of denominations; and redeems the issues as they mature. These services are provided on a cost-reimbursable basis.

ELIMINATION OF SMALL DENOMINATION BILLS

On February 25, 1970, the Treasury announced (see app. II) that, effective with the bill auction scheduled for March 2, 1970, Treasury bills would be provided in minimum denominations of $10,000. The announcement stated that Treasury notes and bonds would continue to be made available in denominations as small as $1,000.

The Treasury cited the following five specific factors that had been considered in arriving at the above decisions.

1. The basic function of the Treasury bill market is to afford the Treasury access to the large volume of funds available from institutional investors, and the extraordinary volume of small individual transactions was beginning to overtax existing market facilities.

2. The costs to the Government for issuing small denominations are excessive in relation to the volume of funds attracted.

3. Service charges--imposed by dealers, banks, and brokers--and security risks--bills are in bearer form--could make Treasury bills unattractive for small investors.

4. Such risks and costs are substantially reduced in the case of Treasury notes and bonds, since these obligations afford investment for longer periods of time and are available in registered form. The transactions costs are spread over a longer period of time, so their impact on interest returns or Government costs is substantially reduced.

5. Diversion of savings into Treasury bills was contributing to the interruption of the orderly flow of funds into the housing mortgage market.

CHAPTER 2

COST TO PROCESS TENDERS FOR TREASURY BILLS

The February 25, 1970, announcement of the Treasury stated that:

> "The direct costs to the Government of issuing very small denominations are excessive in relationship to the volume of funds attracted. Analysis of these costs indicates that the processing cost for subscriptions submitted by individuals to the Federal Reserve Banks amounts to approximately $15 to $20 per item. This is equivalent to an additional interest cost of 1.2 to 1.6 percent for a typical $5,000 sale of a three month bill and to more than 1/2 percent for six month bills. These costs are proportionately more for smaller transactions, at the extreme, equivalent to 6 or 8 percent for a $1,000 sale of three month bills. Such costs are obviously far out of proportion with going rates of interest." (Underscoring supplied.)

An official of the Department of the Treasury advised us that the $15 to $20 cost for processing each tender--subscription--submitted by an individual for bills was based on (1) a cost study by the Federal Reserve Bank of New York and (2) general discussions with officials of other Federal Reserve banks and various dealers in Treasury bills.

We did not discuss these matters with dealers in Treasury bills or with officials of the other Federal Reserve banks. We reviewed the cost study by the New York Federal Reserve Bank and discussed our views with the officials of that bank.

From our review of the cost study by the Federal Reserve Bank of New York, we believe that the study was not, of itself, an adequate basis for Treasury's announced cost of $15 to $20 to process each tender submitted by individuals. Because adequate data was not available, we did not attempt to estimate such cost.

COST STUDY OF FEDERAL RESERVE BANK OF NEW YORK

Officials of the Federal Reserve Bank of New York informed us that the Bank's marketing operation was designed to handle sales of Treasury bills to large institutional investors and that, as such, its operation was not geared to handle sales to the public. The officials stated that by late 1969 and early 1970 the public's demand for Treasury bills became so great that the Bank was being inundated with inquiries from individuals concerning these bills.

By January 1970, it became apparent to the officials that the public's demand for Treasury bills and the Bank's associated costs were increasing. Therefore, the Bank made a study, for internal purposes, to determine a rough approximation of its costs to handle noncompetitive tenders for Treasury bills that were submitted directly to the Bank by individuals for the bill auction of January 5, 1970.

The study showed that the estimated cost for the Bank to process the 666 noncompetitive tenders--377 tenders were for less than $10,000 each--submitted directly by individuals was $9,846, or $14.78 for each tender. The study was qualified, however, by the statement that it was "not in any sense a formal projection," that it pertained only to the one offering, and that substantial changes in the volume of tenders or the operating conditions would require a reevaluation of the cost.

In summary, the Bank's cost elements, methods, and estimated costs to process the noncompetitive tenders submitted by individuals were:

	Estimated costs
Direct salary cost for the estimated direct time employees spent in connection with such noncompetitive tenders. To provide comparability to staffing conditions that would prevail in a long-term environment, (1) direct salary costs were calculated at regular pay rates, although the direct hours actually used included substantial overtime and (2) a provision for leave was included	$2,867
Salaries of supporting staff functions, allocated on the basis of the historical cost relationship to direct salary costs.	1,367
Salaries of officers, allocated on the basis of the historical cost relationship to the total salary costs above.	290
Provision for retirement and other employee benefits based on historical cost relationship to total salary costs above.	842
Direct cost for postage and registry fees for mailing the Treasury bills, and handling cost for the mailing activity.	2,400
Other expenses, such as telephone and telegraph, utilities, depreciation, and real estate taxes, allocated on the basis of their historical cost relationship to total salary and related personnel expenses or to certain other expenses.	2,080
Total estimated costs	$9,846

The cost study may have been useful for the Bank's purposes. We believe, however, that the method for determining the costs did not result in an adequate basis for the Treasury's announced $15 to $20 cost to process noncompetitive tenders submitted by individuals to the Federal Reserve banks, because it is questionable whether some of the direct salary costs were applicable to only the processing of the 666 noncompetitive tenders submitted by individuals.

Direct salary costs included $1,216 for the time spent by employees of the Bank's Public Information Department in answering public inquiries regarding Treasury bills. Officials of the Bank informed us that they assumed that the inquiry workload would be reflected in the number of noncompetitive tenders received from individuals.

It is questionable, in our opinion, whether the Public Information Department's entire cost of answering inquiries should have been allocated to the 666 noncompetitive tenders submitted by individuals, since Treasury bills may also be purchased by individuals through commercial banks, dealers, and brokers and many of those individuals who inquired may have purchased bills from such other sources. In this connection, commercial banks' tenders included 11,061 noncompetitive bids for account of their customers for the bill auction of January 5, 1970.

The Bank did not compile the Public Information Department's workload data relating to the bill auction on January 5, 1970. Subsequent workload data for the 4-week period--January 26 through February 20, 1970--prior to the change in the minimum denomination of bills shows that, of the approximately 20,200 inquiries regarding Treasury bills, 57 percent were handled by telephone, 16 percent by letter, and 27 percent in person. Based on the Bank's assumption, this workload would have been attributable to the 3,336 noncompetitive tenders which were submitted by individuals for the four weekly offerings, although commercial banks' tenders during this period included 33,023 noncompetitive bids for account of their customers.

For each dollar of direct salary cost that was assigned to the 666 noncompetitive tenders submitted by individuals, an additional $1.67 for other elements was allocated on the basis of the direct salary costs. Therefore, for each dollar of direct salary costs that was assigned to the 666 noncompetitive tenders but should not have been, the cost to process these tenders was overstated by $2.67.

We do not question the method of determining the amount of the other cost elements. It should be noted, however, that assuming noncompetitive tenders from individuals were not accepted, certain of these costs would continue or would not be decreased proportionately and would, for the most part, be allocated to other operations of the Bank; for example, salaries for legal staff--included in the supporting staff function--salaries for officers, and costs of real estate taxes and utilities.

EFFECT ON INTEREST COSTS OF RAISING MINIMUM DENOMINATION OF TREASURY BILLS

Under Treasury's practice, all noncompetitive bids for Treasury bills are accepted in full and are awarded at the average price of the accepted competitive bids. Then, starting with the highest priced competitive bid and working down, all competitive bids are accepted until the cumulative total amount of noncompetitive and competitive bids equals the total amount of the bill offering.

To the extent that the increase in the minimum bill denomination eliminates small noncompetitive bidders, the Treasury must accept a larger amount of competitive bids in order to sell the entire bill offering. Thus, the Treasury's interest cost would be increased because:

--The additional competitive bids accepted would be at lower prices.

--The acceptance of an increased number of competitive bids at lower prices, if substantial, would also lower the average price at which the noncompetitive bids would be awarded.

Because the amount of noncompetitive bids under $10,000 was not available, we could not determine the effect of raising the minimum denomination of Treasury bills on the interest costs. However, the increase in the minimum denomination might have resulted in a rather small increase in such costs, as explained below.

The 666 noncompetitive tenders for about $7.4 million of Treasury bills submitted by individuals to the Federal Reserve Bank of New York in the bill auction of January 5, 1970, included 377 tenders, each for less than $10,000, for about $1.4 million in bills--about 19 percent of the total amount. Data was not available on the number and amount of bids under $10,000 included in the 11,061 noncompetitive bids, for about $227 million of bills, submitted to the Bank through banking institutions. We have no knowledge whether the percentage of tenders for bills in amounts less than $10,000--19 percent--submitted to the Bank by individuals would be representative of the percentage of the noncompetitive bids in amounts less than $10,000 that were submitted to the Bank through banking institutions or of the amounts of noncompetitive bids submitted to other Federal Reserve banks.

Assuming that the relationship was representative, for discussion purposes, and assuming that the $10,000 minimum bill denomination was applicable to the January 5, 1970, auction, we estimate that the Treasury's interest costs would have been increased, from the elimination of the small noncompetitive bidders, by about $9,500 (in comparison, the actual interest cost was about $83.8 million) for the total amount of bills sold by all Federal Reserve banks at the January 5, 1970, auction.

CHAPTER 3

ALTERNATIVE METHOD OF PRICING NONCOMPETITIVE SALES

A means of marketing Treasury bills, which may decrease the Government's interest costs, would be to change the method of pricing noncompetitive sales from the average price of the accepted competitive bids to the high price of the accepted competitive bids.

We estimate that, had the noncompetitive sales been priced at the high price of the accepted competitive bids for the Treasury bill auction of January 5, 1970, the Government's interest costs would have been decreased by about $43,300 for the bills sold by the Federal Reserve Bank of New York and by about $153,600 for the total amount of bills sold by all Federal Reserve banks.

The high and average prices for each $1,000 and the resulting effective rates of interest for the January 5, 1970, auction were as follows.

	3-month bills		6-month bills	
	Price	Interest rate	Price	Interest rate
High	$980.12	8.13%	$959.66	8.43%
Average	979.88	8.24	959.60	8.44
Difference	$ .24	0.11%	$ .06	0.01%

The above schedule shows that the differences in prices and interest rates were relatively insignificant.

We discussed with the Special Assistant to the Secretary of the Treasury (Debt Management) the possibility of pricing the noncompetitive sales at the high price of the competitive bids. He informed us of the Treasury's belief that the average price is the most equitable to those who purchase bills noncompetitively.

In our opinion, however, it would be more equitable to all concerned if the noncompetitive sales of Treasury bills were made at the high competitive bid price because the noncompetitive bidders are assured of receiving 100 percent of the amount of bills ordered and they receive a more favorable price than those who purchase bills competitively at prices higher than the average. Also, the noncompetitive bidders do not have to go to the trouble of forming an opinion on a reasonable bid.

Regarding whether the pricing of noncompetitive sales at the high price of the competitive sales would affect the amount of noncompetitive tenders submitted for Treasury bills, officials of the New York Federal Reserve Bank informed us that it may or may not drive some of the noncompetitive bidders out of the Treasury bill market or it may drive them into submitting competitive tenders.

We believe that the difference between the high and average competitive prices would be considered as rather minor to most noncompetitive bidders for Treasury bills and that pricing such bills at the high prices may not appreciably affect the amount of Treasury bills sold noncompetitively. In this connection, during the first 8 months of fiscal year 1970, the high and average competitive prices for each $1,000 and the effective rates of interest for the regular weekly bill offerings were as follows.

	3-month bills		6-month bills	
	Price	Interest rate	Price	Interest rate
High	$981.75	7.46%	$962.58	7.79%
Average	981.58	7.53	962.39	7.83
Difference	$ .17	.07%	$ .19	.04%

Also, the average amount of bills purchased by the noncompetitive bidders was about $29,000 for the 13-week bills and about $24,000 for the 26-week bills. The difference in cost for the average noncompetitive purchase, therefore, would have been about $4.93 for the 13-week bills and $4.56 for the 26-week bills.

RECOMMENDATION

In view of the possible savings in interest costs to the Government--about \$4.5 million for about \$24 billion of the bills issued on a noncompetitive basis during the first 8 months of fiscal year 1970--and the relatively insignificant difference in amount of interest to a noncompetitive bidder, we recommend that the Secretary of the Treasury consider the desirability of changing the policy of pricing noncompetitive tenders for Treasury bills from the average to the high price of the accepted competitive bids even though the minimum bill denomination remains at \$10,000.

CHAPTER 4

SCOPE OF REVIEW

We reviewed the policies, method, and procedures followed by the Department of the Treasury in the offering of Treasury bills. Our review included an examination of files maintained by the Office of the Secretary and the Bureau of the Public Debt. We also reviewed the procedures for issuing Treasury bills at the Federal Reserve Bank of New York and the costing method used by the bank in its study of the cost of handling the noncompetitive tenders for Treasury bills submitted by individuals for the auction of January 5, 1970.

In addition, discussions were held with officials of the Department of the Treasury in Washington, D.C.--Office of the Secretary and Bureau of the Public Debt--and the Federal Reserve Bank of New York.

APPENDIXES

TREASURY DEPARTMENT

WASHINGTON, D.C.
February 25, 1970

FOR IMMEDIATE RELEASE

TREASURY RAISES MINIMUM BILL DENOMINATION IN MOVE BOOSTING HOUSING MORTGAGE FUND SUPPLY

The U. S. Treasury today announced that:

(1) New issues of Treasury bills, beginning with the auction scheduled on March 2, will be provided in minimum denominations of $10,000.

(2) Treasury notes and bonds will continue to be made available in denominations as small as $1,000.

These decisions are based upon an evaluation of Treasury costs, trading activity and market needs in recent months. These decisions recognize the desirability of maintaining access by small investors to marketable U.S. Government securities. At the same time, the deterioration in the market's ability to handle normal activity and the increase in costs that have arisen from the extraordinarily large volume of small transactions in short-term Treasury bills will be ameliorated.

Specific Factors in Decisions

(1) The basic function of the Treasury bill market is to afford the Treasury regular and economical access to the large volume of funds available from institutional investors for short-term employment in the money market. Typically, such funds are available in large blocks. The extraordinary volume of small individual transactions, which provide neither an important nor a dependable source of funds to the Treasury,is beginning to overtax existing market facilities to the point where the effectiveness of this basic source of Treasury finance could be impaired.

K-354

DANTE B. FASCELL, FLA., CHAIRMAN
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225-4407

NINETY-FIRST CONGRESS

Congress of the United States
House of Representatives
LEGAL AND MONETARY AFFAIRS SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
RAYBURN HOUSE OFFICE BUILDING, ROOM B349-A
WASHINGTON, D.C. 20515

February 27, 1970

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

Dear Mr. Staats:

The Treasury Department recently raised the minimum denomination of Treasury bills from $1,000 to $10,000. One justification for such action was stated to be the high costs of handling small denominations, estimated between $15 and $20 on a $1,000 three-month bill.

I would appreciate your conducting an inquiry for the Subcommittee to evaluate the stated costs of the sales of small denomination Treasury bills, whether any other means of marketing of such bills are available to offset the costs, and whether the elimination of the small denomination bills could have an adverse effect on the overall interest costs to the Treasury of marketing its short term obligations.

The staff of the Subcommittee stands ready to confer with and assist members of your staff that you may assign to the matter.

Sincerely yours,

Dante B. Fascell

Dante B. Fascell
Chairman

(2) The direct costs to the Government of issuing very small denominations are excessive in relation to the volume of funds attracted. Analysis of these costs indicates that the processing cost for subscriptions submitted by individuals to the Federal Reserve Banks amounts to approximately $15 to $20 per item. This is equivalent to an additional interest cost of 1.2 to 1.6 percent for a typical $5,000 sale of a three month bill and to more than 1/2 percent for six month bills. These costs are proportionately more for smaller transactions, at the extreme, equivalent to 6 or 8 percent for a $1,000 sale of three month bills. Such costs are obviously far out of proportion with going rates of interest.

(3) Sizeable charges increasingly placed by dealers, banks, and brokers on small transactions to cover their costs often reduce the net return to these investors well below the quoted yield on the bill. A $10 charge, for instance, would reduce the effective yield on purchases of three month bills from 7 to 3 percent for a $1,000 purchase or to 6.2 percent for a $5,000 transaction. Moreover, there are significant dangers of loss or additional costs to small investors without adequate and convenient means of safeguarding holdings of these bearer securities, which must be handled by the investor like cash.

(4) These risks and costs are substantially reduced in the case of notes and bonds. These readily available securities, which afford investment for periods of one year or more, are available in registered form more suitable for individuals. The transactions costs are spread over a longer period of time, so their impact on interest returns or Government costs is substantially reduced.

(5) Action at this time is particularly timely. The diversion of savings into Treasury bills, while relatively small in terms of Treasury finance, has contributed to the interruption of the orderly flow of funds into the housing mortgage market. This has aggravated the problems of homebuyers and the already depressed housing industry. This action thus supports national policy designed to maintain an adequate flow of funds into mortgages at this critical juncture.

George Romney, Secretary of the Department of Housing and Urban Development issued the following statement:

> "The outflow of savings from savings and loan associations, mutual savings banks, and other thrift institutions has aggravated the shortage of mortgage funds and contributed to a serious decline in housing production. To avoid a serious, growing housing shortage it is essential that we discourage the outflow of funds from mortgage lending institutions. This Treasury action should substantially improve our housing outlook."

oOo

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