

Why GAO Did This Study

The U.S. Treasury market is the deepest and most liquid debt market in the world. Liquidity is important to a well-functioning Treasury market and for lowest cost borrowing over time. Exploring various debt management tools can assist Treasury in maintaining liquidity as budget and market conditions change.

To help maintain an efficient Treasury market, Treasury needs the ability and flexibility to actively manage the mix of outstanding securities and respond to market disruptions. Debt buybacks—the redemption of marketable securities prior to their maturity dates—were used to manage declining debt during a time of budget surpluses. However, other countries use buybacks and similar tools even during times of deficit. GAO assessed: (1) the budget and market conditions under which debt buybacks could help Treasury achieve its debt management goals, (2) the operational features of buyback programs that would support these goals, and (3) other debt management tools used by case study countries to achieve similar objectives. GAO examined both the U.S. program and those of Canada, France, Germany, and the United Kingdom and analyzed the costs and benefits.

What GAO Recommends

To have flexibility to respond to potential changes in market conditions, GAO recommends that Treasury build the capacity for buyback and switch auction programs as well as bilateral trades or debt exchanges.

Treasury concurred with the findings and said the report would be very useful in analyzing tools that increase their flexibility.

View [GAO-12-314](#). For more information, contact Susan J. Irving at (202) 512-6806 or irvings@gao.gov.

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DEBT MANAGEMENT

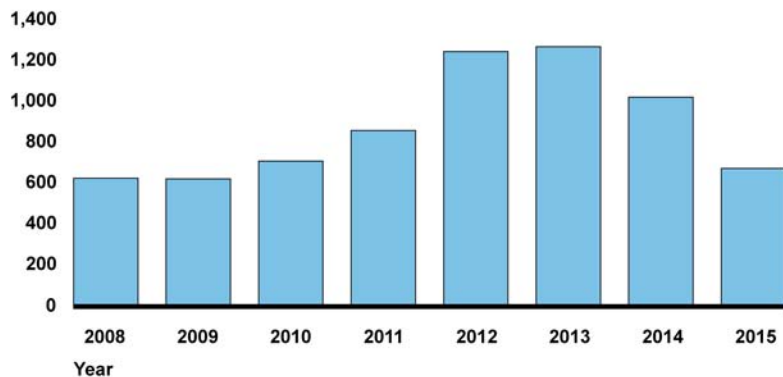
Buybacks Can Enhance Treasury's Capacity to Manage under Changing Market Conditions

What GAO Found

Debt buybacks can help advance Treasury's goals under a variety of budget and market conditions. For example, Treasury currently faces rollover peaks—large increases in the amounts of maturing debt that must be refinanced at a given time (see fig.)—which expose Treasury to the risk of refinancing large amounts of debt when interest rates are less favorable. All four of our case study countries use debt buybacks to mitigate rollover risk. Buybacks can also be used to enhance liquidity, which can be adversely affected when the growth in borrowing slows rapidly and issue sizes decline significantly. GAO's illustrative analysis of Treasury's past buyback program showed that, had Treasury refinanced the debt by simultaneously issuing new debt, it could have captured a liquidity premium—the additional price investors are willing to pay for securities that can be easily traded—which would reduce interest costs.

Treasury Notes and Bonds Maturing

Dollars (in billions)



Source: GAO analysis of data from www.treasurydirect.gov through Dec. 31, 2011.

Note: Does not include future debt issuance to refinance maturing debt or finance new borrowing needs.

Implementing a well-designed buyback program could help Treasury minimize borrowing costs over time. Other countries have used both reverse auctions—a process in which participants submit competitive offers to sell particular securities—and bilateral trades—transactions between the government and specific holders of a security. Of these, reverse auctions are most consistent with Treasury's principles. However, if certain features of bilateral trades were modified, they could be useful for responding to unforeseen market disruptions. Participation in a buyback program would be encouraged by a regularly scheduled program, with a clear purpose and timely announcement of operations. Also, because greater participation fosters competition, broadening the eligibility to participate beyond primary dealers should be explored.

Switches and debt exchanges—tools similar to buybacks that involve early redemption of securities in exchange for liquid benchmark securities—could also be used to manage rollover peaks and help maintain liquidity. They could also have the added advantage of broadening Treasury's investor base by appealing to investors that want to maintain the average maturity of their portfolios in ways that minimize market risk.