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Chairman Johnson, Ranking Member Crapo, and Members of the Committee, my name is Ken Bentsen and I am President of the Securities Industry and Financial Markets Association (SIFMA).[1] Thank you for the invitation to testify today regarding the risks associated with a default on the nation's public debt. SIFMA appreciates the opportunity to provide input on consequences to the financial markets and the overall economy should the United States fail to make timely payments on any of its outstanding debt obligations. Given the important role U.S. Treasury debt plays as a world currency and store of value, any such default would likely negatively impact the economy and certainly disrupt the operations of our financial markets. Indeed market observers have already noted the effects of the current uncertainty regarding the public debt limit, including fairly dramatic pricing effects on the short end of the Treasury market and re-purchase agreements or repos. While we firmly believe that the time is long overdue for the Administration and the Congress to come together and develop long-term solutions to our very real fiscal challenges, voluntarily defaulting on the nation's obligations should not be an option for policymakers to consider. Even a short-term failure to fulfill our obligations would seriously impair market operations and could have significant consequences to our fragile economic recovery.

Should Congress fail to raise the debt limit and the Treasury is unable to meet interest and principal payments coming due, it would in effect trigger a series of events which inevitably would lead to American

[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org

taxpayers paying more to finance our debt. We strongly urge the President and the Congress to come together and negotiate a workable solution to avoid these consequences.

Since the threat of default first arose in the summer of 2011, SIFMA has been engaged with its members in developing scenarios to better understand the consequences of a failure to pay on Treasury securities. I would stress that while market participants believe that the likelihood of a default remains low, the industry also believes that, given the potential negative consequences, it is prudent from an individual member perspective as well as a broad market and economic perspective, to develop plans to further cooperation, coordination, and information sharing. Based on our work, we believe market participants are operationally prepared to deal with the scenarios that a Treasury failure to pay would present. Market participants have worked to develop reasonable assumptions and to prepare accordingly so that this important market continues to function. However, as you know, a default by the U.S. government would be unprecedented and the consequences for the market and the economy would be dangerously unpredictable so no amount of planning can identify and mitigate all of the potential short and long term consequences of a default. But we are certain that one of the most significant consequences to the nation would be a rise in Treasury's cost of funding as investors demand a default premium that will result in higher rates at auction to compensate for the additional risk.

Working with SIFMA's broad membership from both the buy and sell side, as well as key operators of the settlement infrastructure of the Treasury market, SIFMA has developed scenarios based on a number of reasonable assumptions. Working through these scenarios, SIFMA developed possible approaches and noted questions and issues that could not be resolved. I would stress that over the course of the industry's consideration of the dangers of default, no scenario presents a clear cut answer. Indeed, the settlement arrangements for Treasury securities do not contemplate or recognize the possibility of a default and thus the ability to sell, finance, or post as collateral, defaulted Treasuries may be compromised. This ultimately could lead to a liquidity drain from the market. It is important to note that Treasury securities are a key factor in the daily financing of market operations with the U.S. Treasury repo market totaling between $1.2 and $1.9

trillion daily. Undermining that market would have a deleterious effect on every market participant. I outline additional consequences below based on discussions among our members.

October 17 and Beyond

The Secretary of the Treasury has stated that the Treasury will have exhausted all "extraordinary measures" by October 17, and that estimated cash on hand will be insufficient to meet current obligations. Significantly, Treasury has payments coming due of $120 billion on October 17 and $93 billion on October 24, followed by additional principal and interest payments due every week thereafter.

Settlement Timeline and Impact on Payments

Settlement and processing for daily transactions in Treasury securities takes place in the evening after the trading day in the U.S. Fedwire (the Federal Reserve service that provides transfer services for Treasury securities) normally runs its evening processing around 7:00pm eastern time, and other processes, including those of the clearing banks and DTCC's Fixed Income Clearing Corporation (FICC), run shortly after that. Should there be an announcement that Treasury will be postponing a payment due the following day because of an inability to pay, before these systems run, the systems should be able to adjust to reflect changed payments dates. Under this scenario, securities may be transferred and can be sold, financed and, if acceptable to a counterparty, used as collateral. However, we note that it is impossible to predict what overall impact on the market for these securities, on the price, on their acceptability as collateral in repo transactions or as to their acceptability as collateral throughout the global financial system since in effect Treasury would be acknowledging that it could not pay principal and/or interest when due.

If a Treasury determination and announcement were delayed beyond the time when systems normally run, some processes may be delayed for a short-period in the evening. It is not clear how late systems can be held and the potential consequences of any delay on the opening of the trading day in Asia. An announcement of an intent to extend a payment beyond the current expected maturity after systems have been run (with the assumption that payments will be made the following day) would not be reflected in the

evening's processing and would result in the inability to transfer further the security after the payment is missed on the following day. That is, certain Treasury securities may no longer be eligible collateral and may have limited ability to be pledged or sold.

In addition, Treasury securities are traded in a global market with the global trading day beginning in Asia at 8:00pm eastern time. Market participants normally run their own internal processes prior to the trading open in Asia in order to provide a clear cut-off to reflect positions in their books and records. Failure to provide early indications of intention could further confuse positions and could cause trading confusion in the Asian markets as it will be unclear whether certain securities will be paid in a timely manner. The disruption to pricing and trading behavior is impossible to predict.

Announcements from Treasury

The timing of Treasury's announcement of its intention not to make a payment timely remains the key variable under all the scenarios our members reviewed. Given what we understand to be the limitations of the transfer mechanism for Treasury securities, failure to provide sufficient notification for a payment failure prevents the security from being further transferred. Holders of such a security may have limited opportunity to sell it, finance it through repo or post it as collateral.

As noted above, as a result of a late notification, a Treasury security on which a payment is not made may not be further transferable. While we assume that the missed payments will eventually be made, while the payment remains unpaid the holder of the security that expected its payment may not be able to sell the security or to finance it in the repo market. Similarly, collateral and margin requirements at clearing houses and central counterparties may no longer be able to be met with these securities. Further, it is entirely possible that for purposes of any escrow, collateral or margin arrangement involving such securities could result in them being deemed non-eligible and subject to replacement. Essentially the holder would have a receivable from the Treasury that could not be further transferred and, overall we would expect some frictional decrease in liquidity in the market—liquidity that would be available for further investments, loans

and important business development. The impact could be widespread. Counterparties might begin to question whether other counterparties would be able to replace ineligible collateral.

Disruptions in the Treasury repo market would further impact price changes on Treasury securities. Treasuries are the world's safest asset and the most widely used collateral for both risk mitigation and financing. Shrinkage in the financing market would further pressure rates as haircuts on Treasuries would increase—thus reducing financing capability—and disrupt the collateral market because of margin calls throughout the financial system that would reflect the overall repricing of Treasury collateral.

Inability to Plan

Our understanding is that Treasury will determine payments/postponements on a day-by-day basis. Once Treasury fails to make a timely payment, markets will have to wait each day for Treasury's indications as to its intentions for payments due on the following days. If this were to continue for any length of time, market participants would need guidance on missed payments as well as future payments on additional securities. In addition, we understand that coupon payments that are not paid will ultimately be paid to the holder of record of the security on the day the payment should have been made. Uncertainty on that payment will continue until payment is finally made Clearly, securities that are coming due in the short-term would be less attractive to hold and may become harder to finance as doubts about the payment of interest and principal when due would be more prevalent. Even if the debt ceiling were raised at the last minute, experience from the 2011 event suggests that securities that may be the subject of a default in the near future will trade at a premium and will be more expensive to finance.

Municipal Funding Challenges

Some specific issues arise with regard to the municipal securities market. A key interaction between municipal securities—the principal means by which state and local governments finance investment in schools, highways, airports, water and sewer systems, hospitals and other key infrastructure—and Treasury securities involves municipal refunding transactions. A refunding typically occurs when interest rates have

fallen since a state or municipality issued long-term bonds, and a borrower is able to achieve interest cost savings by refinancing bonds at the current lower rates. When a refunding can be achieved before the old, higher-interest bonds can be redeemed early, the borrower invests the proceeds of the new, lower-interest bonds in Treasury securities, and the income earned from these investments is used to pay debt service on and eventually redeem the old bonds. When old, higher-interest bonds are fully backed by an escrow portfolio, they are said to be "defeased" or "escrowed" and treated as triple-A rated.

One issue involves a category of non-marketable Treasury securities, State and Local Government Series ("SLGS"), special, customized securities sold by Treasury specifically for the purpose of funding state and local government escrow portfolios. The Treasury Department stopped selling SLGS on May 15, 2013 as the government's debt outstanding approached the current debt ceiling, making it more difficult and costly for states and localities to refund outstanding bonds. An even bigger issue would arise if the Treasury defaulted on outstanding bonds which are backing defeased municipal bonds. Because defeased bonds are backed by the income from the escrow portfolio, a Treasury default would "pass through" to the municipal bond holders, calling into question the reliability of escrowed municipal securities in general.

Industry Playbook

Given the significant uncertainty of the timing of a default and the uncertain impacts, market participants and SIFMA have developed a playbook this is intended to provide key market participants and service providers a forum to share information about the latest developments including decisions from the Treasury, the Administration and Congress and the status of the infrastructure and settlement providers. Of particular concern to market participants is whether an early indication from Treasury that securities will be extended has been made and, if not, whether processes are being—or can be—delayed. Our current playbook calls for an initial call with market participants at 2:00pm eastern time to share the latest information and set in motion the later planned calls. The schedule suggests industry wide calls at 6:30pm, 8:00pm, 10:00pm and 8:00am eastern time the following morning in order to allow market participants to monitor in real time the impact on the settlement process. Without a resolution of the debt ceiling before the

Treasury's expected limit of extraordinary measure on October 17, we expect to initiate this call protocol on October 16 as a Treasury bill is scheduled to mature on October 17. Of course, we maintain the ability to call the industry together at any time should events dictate.

Conclusion

U.S. debt obligations are the currency of U.S. and global financial markets and the real economy and their soundness should not be questioned. No amount of planning can anticipate all the potential consequences of a default. Short and long term costs to the taxpayer can be anticipated but the further limits on the ability to transfer, sell, finance and post as collateral defaulted securities would only serve to undermine investor confidence and hurt our fragile economic recovery. SIFMA and its member firms have frequently called on Congress and the Administration to work together to put our fiscal house in order but unnecessarily triggering a historic default will result in dramatic, and possibly permanent, damage to our economy and markets in ways both anticipated and unanticipated, and must be avoided. Again, SIFMA appreciates the opportunity to testify today and I look forward to answering your questions.