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Treasury Market Operations and the Debt Ceiling

Treasury expects to reach the limit of its current "extraordinary measures" for funding by October 17. If the debt ceiling were not raised and Treasury reaches it limit for "extraordinary measures", Treasury will only be able to fund government operations through: 1. Cash on hand (Treasury estimates that it will have $30 billion on hand as of October 17); and 2. Revenues (tax receipts etc.). A Treasury bill ($120 billion) is scheduled to mature on October 17 with another bill ($93 billion) to mature on October 24. On October 31 Treasury is scheduled to make principal and interest payments on a number of bills and notes. In addition to the significant market concerns, while we believe that market participants are operationally prepared to deal with the scenarios that a Treasury failure to pay would present, it is also clear that the operational arrangements for clearing and settling transactions in Treasury securities, in certain circumstances would be challenging.

Timing/Treasury's Intentions: The timing of Treasury's announcement of its intention not to make a payment timely remains important for the smooth and normal functioning of the settlement infrastructure.. Early notice to the market of Treasury intent to extend a payment date would be helpful to allow firms to finish their settlement processes and prepare for the beginning of trading in the Asian markets.

Evening Processing: Settlement and processing for daily transactions in Treasury securities takes place in the evening after the trading day. Fedwire (the Federal Reserve service that provides transfer services for Treasury securities) normally runs its evening processing around 7:00pm, and other processes, including those of the clearing banks and DTCC, run shortly after that. Should there be an announcement that Treasury will be postponing a payment due the following day before these systems run, the systems should be able to adjust to reflect changed payments dates. While the processes may be delayed for a short-period in the evening, we believe, in any event, many market participants will need to run by around 10:00pm. Any announcement about a failure to pay after that would not be reflected in the evenings processing and could result in the inability to transfer the security after the payment is missed on the following day.

Consequences: Treasury securities that drop off the clearing systems are generally not transferable.. However, market participants continue to pursue additional solutions to reduce any operational risks and understand that the triparty repo market operational arrangements will be able to continue to support securities with extended payments regardless of the timing of notice. In addition, our understanding is that, with respect to an extended coupon payment, Treasury will pay, when it does, the holder of record on the date of the original failure to pay and, in the interim, the holder of that defaulted security (or the holder of the security on the date for a coupon payment) will hold a receivable that cannot be transferred as a Treasury security.

Inability to Plan: Our understanding is that Treasury will determine payments/postponements on a day by day basis. Securities that are coming due in the short-term may be be less attractive to hold and may become harder to finance.

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