The Honorable Jacob Lew  
Secretary  
U.S. Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, D.C. 20500  

Dear Secretary Lew:  

In testimony before the Senate Committee on Finance on October 10, 2013, when asked whether the Treasury Department ("Department") could prioritize payments on Treasury bonds in the event the debt ceiling was not lifted — thereby ensuring that a default on Treasury bonds could be averted and market panic could be forestalled — you testified:

We [the Department] write roughly 80 million checks a month. The systems are automated to pay because for 224 years, the policy of Congress and every president has been we pay our bills. You cannot go into those systems and easily make them pay some things and not other things. They weren’t designed that way because it was never the policy of this government to be in the position that we would have to be in if we couldn’t pay all our bills.

In a May 7, 2014 letter to the Committee on Financial Services ("Committee"), you painted a somewhat different picture of the technological feasibility of prioritization:

If the debt limit were not raised, and assuming Treasury had sufficient cash on hand, the New York Fed’s systems would be technologically capable of continuing to make principal and interest payments while Treasury was not making other kinds of payments, although this approach would be entirely experimental and create unacceptable risk to both domestic and global financial markets.

(Emphasis added.)

Departmental and Federal Reserve System documents reviewed by the Committee staff demonstrate that, as early as March 2013, Department and Federal Reserve Bank of New York staff had documented in writing and in painstaking detail the steps the Department would take to successfully carry out any directive to prioritize payments on Treasury bonds if the debt ceiling were not raised. These plans raise the question whether you knew or should have known that it was possible to prioritize such payments when you testified before the Senate Finance Committee in October 2013. The plans additionally raise the question whether there was an adequate factual basis for your assertion that “[y]ou cannot go into those [payment] systems and easily make them pay some things and not others.”

Documents and e-mails reviewed by the Committee staff relating to planning in the event the Department chose not to fully prioritize debt payments — despite its apparent ability to
fully make such payments — also call into question the basis for your testimony; such planning suggests that the government could pay certain bonds while rolling forward the dates on other bonds.

I. Documents indicating that the Department and/or the Federal Reserve System could fully prioritize Treasury bond payments and thereby prevent default on Treasury bonds

The following documents reviewed by the Committee staff suggest that the Department could instruct the Federal Reserve Bank of New York to process principal and interest payments on Treasury obligations if the debt ceiling were not raised, and that the Bank’s payment systems could carry out those instructions:

- “WPO Treasury Debt Ceiling Internal Securities Procedures (March 2013) [See Document from Bates Stamp # 224-244]
- “Fedwire Securities Delayed Payment Support” (September 2013); and
- “Fedwire Securities Delayed Payments Wholesale Internal Walkthrough (October 2013) [See Document beginning at Bates Stamp # 308]"

The documents, which were prepared by the Federal Reserve Bank of New York prior to your Senate Finance Committee testimony, exhaustively detail how the Department and the Bank would implement any plan to prioritize payments on Treasury bonds. For example, they describe how, during any “suspension period,” the Department could determine whether sufficient funds existed to make payments scheduled for settlement the next day and that, if the Department “determine[d] to make principal and interest payments (or only the interest payments), the payment wires [would] need to be released no later than 4 p.m. Eastern.” The documents include sample e-mails for use by the Department and/or the Federal Reserve to communicate the Department’s actions to third parties and to communicate the Department’s instructions to the NY Fed; they further describe how status messages could be posted to an Internet-based portal accessible to such third parties. The documents also include a dial-in number and passcode for Treasury and Federal Reserve staff to communicate with each other about debt ceiling prioritization efforts.

Simply put, the documents do not appear to support your October 2013 testimony that “[y]ou cannot go into those [payment] systems and easily make them pay some things and not other things.” In fact, the Committee’s preliminary review suggests that the Department failed to share with the American public, and with holders of U.S. Treasury debt, material information that could have prevented needless market volatility in the Treasury bond market in the period leading up to the congressional debate over the debt ceiling. A similar misleading representation by an issuer of publicly traded corporate bonds could result in exposure to liability for securities fraud.

1 The documents the Department made available for the Committee’s review do not provide an adequate basis to fully assess the Department’s unsubstantiated claim that it might not be able to raise sufficient funds in auctions to continue making principal payments if the debt ceiling were not raised. Documents in the Department’s possession that have not yet been produced may contain information probative of this question.
II. Documents and e-mails reflecting additional planning by the Federal Reserve Bank of New York to minimize market disruptions if the Department decided to partially delay Treasury bond payments

Nothing in the documents indicates that the Department would be unable to prioritize payments on Treasury obligations. Yet the documents also indicate that out of an abundance of caution the Federal Reserve further engaged in extensive planning to prepare for the contingency that the Department would choose not to prioritize Treasury bond payments, and choose to default on those obligations, in order that the Department might cause a brief market panic and thereby induce a quick resolution of the debt ceiling vote.

Those documents, as well as various emails to which James Naron (the official then in charge of the Federal Reserve Bank of New York's Fedwire Securities System) is a party, demonstrate that the Federal Reserve had extensive operational plans in place to roll forward maturity dates on outstanding securities (including choosing to roll forward only some batches of securities on a particular maturity date); to track any maturity dates rolled forward and make future payments on deferred payments; and to continue "business as usual" with respect to discount window acceptance of Treasury obligations as collateral and to continue to value that collateral. The Federal Reserve Bank of New York also determined during previous planning efforts in 2011 that even if the debt ceiling were not lifted "[d]uring the summer of 2011, most large clearing banks indicated they would likely still be able to clear trades and perform other services for their clients including custody services, tri-party repurchase agreements, and securities lending, albeit with substantial manual intervention."

In the event that the Department chose to default on principal and interest payments, despite its clear ability to prevent that from occurring, the Federal Reserve was also prepared to conduct open market operation repo transactions directly with dealers to further forestall market disruption caused by an unfortunate decision by the Department to default. In a scenario in which the Department chose to default, the Federal Reserve further determined that legislation may be required to compensate "holders of securities affected by delayed payment on Treasury debt for the delay in these payments" but that "market prices of Treasury securities would take into account the possibility of such compensatory payments[.]." Accordingly, the Federal Reserve proposed policies and procedures to accommodate such compensatory payments in planning documentation which would have been of considerable material value to potentially affected debt holders in 2013.

It is clear that these documents and emails would provide financial markets with substantial comfort the next time that the Congress and the President contemplate a vote.

---

2 See e.g., Bates Stamp #578, 747, 759, 899.
3 See Bates Stamp #882.
4 See Bates Stamp # 1064-1065.
5 See Bates Stamp # 884.
6 Id.
to increase the debt ceiling. It is clear that the substantial benefit of this information to the American public outweighs any political calculation that has led you to keep these materials secret.

III. Conclusion

We note that the Department has thus far failed to cooperate fully and completely with the Committee’s legitimate oversight and that the Department’s failure may have inhibited the Committee’s assessment of the Administration’s debt ceiling contingency planning. First, the Department has permitted the Committee to review the above-described documents, together with certain other documents, on an in camera basis only, notwithstanding that the documents — marked merely as “sensitive but not classified” — are not subject to a legal privilege that might qualify the Committee’s right to obtain custody and control of them. Second, despite the Committee’s previous requests, the Department has failed to provide assurances that it produced all known responsive documents for the Committee’s in camera review. As a result, the Committee cannot rule out that the Department has withheld responsive documents in its possession.

It may have been in the Department’s strategic political interest to keep its extensive debt ceiling contingency plans secret during 2013. This Committee nevertheless has an obligation to insist that those secret debt ceiling plans be shared with the American people without further delay. We trust that the American people and holders of U.S. Treasury debt will then be in a position to reach their own informed conclusion about the veracity of your statements concerning the debt ceiling. Accordingly, by July 1, 2014, please produce all documents and other records that are responsive to the Committee’s previous requests on this matter. In addition to producing the documents previously reviewed by the Committee on an in camera basis, please produce any other known responsive documents and records.

Please contact J.W. Verret or Joseph Clark of Committee staff at (202) 225-7502 with any questions regarding this matter.

Sincerely,

[Signatures]

cc: The Honorable Maxine Waters
    The Honorable Al Green
    The Honorable William Dudley