Our Generation, Inc.

Minutes of

Default Clock Review Committee Meeting

October 8, 2020

The meeting was called to order at 9:12am on October 8, 2020 and was held by Zoom.

Present were Baker Spring, Jim Claire, Alan P. Dye, Dan Perrin, Dean Clancy, Chip DeMoss and Kevin Miller.

Mr. Spring commenced the meeting by indicating that, by his calculation, the clock is still three minutes from midnight, as it was in February, but for different reasons.

Factors 4, 6 and 9 relating to gross federal interest payments, the ratio of public to intra-governmental debt, and federal revenues exceeding 17.5% of GDP each buy one minute from midnight. Thus, it is these three factors that buy the three minutes from midnight on the Clock. Seven of the remaining nine factors buy zero minutes from midnight. Several of the factors that already bought zero minutes from midnight, however, are dramatically worse than at the time of the last review in February 2020. In Mr. Spring's view, it will be practically impossible to recover from the negative trends in Factors 1 (on federal outlays), 3 (on debt as a share of GDP), 8 (on the structure of the debt) and 12 (on the projected increases in mandatory spending) in the foreseeable future. Finally, Mr. Spring recommended that the Review Committee use the permitted option under the Clock to discount two factors. These are Factors 5 (on the gross interest costs relative to the issuance of new debt) and 7 (on foreign-held federal debt).

Mr. Spring then went on to point out that, the Federal Reserve, by keeping interest rates near zero and increasing its holdings of Treasury securities, has so far offset the increasingly negative factors. This is why the Clock can remain at three minutes from midnight despite very large increases in both the deficit and the debt during fiscal year 2020. The Fed is bailing out the Treasury; otherwise the Clock would be on the cusp of midnight.

Mr. Spring opened the floor to discussion. There was no further discussion.

Mr. Spring asked if anyone had modifications. Mr. Perrin moved adoption of Mr. Spring's recommendations for updating the Debt Default Clock and his motion was unanimously approved.

The next item taken up on the agenda was Mr. Spring's progress on the issue of creating credit default swaps based upon the Clock. Mr. Spring has drafted and will circulate draft agreements with modified appendices, without a recommendation, for initial review by the Review Committee. Under the drafts,the credit event that would activate the swap would be reaching midnight on the Clock. In Spring's view these swaps could serve the policy purpose of strengthening investor confidence in Treasury securities under the circumstance where the overall size of the debt could otherwise undermine that confidence. He also pointed out this kind of swap could provide a market-based tool for detecting emerging stress.

Mr. Spring also told the other Review Committee members that he has talked to a lawyer who thinks this is possible. He will keep in contact with this lawyer regarding legally drafting the model swap. Mr. Spring will also be looking for someone to help assess the current conditions of the market for credit default swaps on Treasury securities.

Mr. Claire indicated that swaps of this type already exist and are often bespoke instruments. This may make Mr. Spring's proposal redundant. There is already a large and efficient market and there may not be a place for this type of derivative.

Mr. Spring responded by acknowledging there is an existing market for the swaps on Treasury securities and the questions becomes: "What are we trying to accomplish?" He reiterated his earlier observation that the exercise would provide Congress with a market-based warning of default and that at the margin, it could provide comfort to market actors if things become dicey. In addition, if the project takes off, it would substantially raise the profile of the Clock and the committee.

Mr. Perrin interjected that (1) what Mr. Spring is proposing is important and that interest rate derivates are of limited utility; and (2) he agrees that it would increase the credibility of the committee.

The question arose as to what is the nature of the credit event that would trigger the swap. Mr. Spring indicated that this would be spelled out in the derivatives contract. Like any insurance policy, the event would be the equivalent of a car wreck. The contract would be specific to each event.

Mr. Claire indicated that there would be few triggering events for such CDS's. Almost all payouts on derivates are arbitrated. Such arbitration has taken place a good bit with Argentine debt. With Treasuries, there is very little chance of an actual declaration of default.

Mr. Perrin raised two other comments/questions:

1. The triggering event would be the Clock moving to zero minutes to midnight. The event could also be non-payment on a Treasury security. Finally, he pointed out that it would be necessary to build a wall between the clock and the swaps.
2. In the event of default, do we automatically take the Clock to zero?

Spring observed that one way for the government to get out of its problem would be to instruct the Federal Reserve by law to buy all of the federal debt, which then becomes intra-governmental debt.

Mr. Claire suggested that by taking such a step the government will be consuming its own debt, not financing it, and if you ever established this requirement, the US would become Zimbabwe and print worthless money.

Mr. Spring suggested that such an extraordinary event would be unprecedented and the Committee would have to declare midnight because the government by taking this action would effectively be acknowledging it no longer has the means to finance the debt.

A question was raised by several Review Committee members as to how the committee would present itself as the credible arbiter of midnight. Credibility is an issue. Mr. Spring responded that this is a critical question, which requires considerable additional discussion.

The committee approved the posting of the minutes.

There being no further business, the meeting was adjourned at 9:40 AM.

Respectfully submitted,

Alan P. Dye

Attachments: