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SUBMITTED TO THE FINANCE, REVENUE AND BONDING COMMITTEE
FEBRUARY 23, 2009

Senator Daily, Representative Staples, and members of the Finance, Revenue and Bonding Committee, thank you for the opportunity to offer testimony in support of three bills submitted by the Treasurer for your consideration.

The first bill for which the Treasury urges passage is ***Raised Bill No. 905, An Act Concerning Technical Changes to the Calculation of Cost of Living Allowances for Members of the Teachers' Retirement System.*** This proposal would address a typographical error in the public act authorizing the issuance of pension obligation bonds. Specifically, the phrase "based upon one percent of voluntary contributions" should have read "based upon one percent or voluntary contributions." A review of earlier drafts of the amendment shows that this is truly a "typo" in the final version of the bill.

Passage of this proposal would clarify that "one percent contributions" are distinct from "voluntary contributions," and would make consistent various subsections of the statutes related to the calculation of COLAs. There is no fiscal impact associated with this bill.

The second bill before this Committee is ***Raised Bill No. 6432, An Act Concerning the Use of Transportation-Related General Obligation Bond Funds for Debt Service.*** As a threshold matter, we respectfully offer substitute language which we believe better reflects our intent in offering this proposal -- which is to allow for the use of transportation-related general obligation bond funds for payment of debt service for both general obligation bonds and transportation-related general obligation bonds. A copy of the proposed language is attached.

By way of background, existing statute limits the use of unexpended transportation-related general obligation bond funds to payment of debt service on such bonds. Currently, unexpended proceeds exceed the interest due on transportation-related general obligation bonds (both original and refunding) because the State no longer issues G.O. bonds for transportation, and debt service is declining.

Passage of the substitute language we offer today would allow approximately $4.9 million of unused bond proceeds to be used for debt service for both G.O. bonds and transportation-related general obligation bonds, and would allow for transfer to the general fund without preconditions -- except for the general rule that no transfer could be made if it would adversely affect the tax exemption of the bonds.

By contrast, the raised bill as currently drafted imposes an additional precondition that excess funds cannot be transferred unless the debt service on the bonds would have been payable from monies in the Special Transportation Fund. This precondition should not apply to transfers to the general fund. It might limit the ability to transfer these unspent proceeds to the general fund.

And lastly, I urge your favorable consideration of ***Raised Bill No. 6499, An Act Concerning Collateral for Securities Lending.*** By way of background, securities lending today plays a major role in the efficient functioning of the securities markets worldwide. Securities lending is the market practice whereby securities are temporarily transferred by one party (the lender) to another (the borrower). The borrower is obliged to return the securities to the lender, either on demand or at the end of any agreed term. For the period of the loan, the lender is secured by acceptable assets such as cash or securities delivered by the borrower to the lender as

collateral. This proposed legislation concerns the acceptable assets that could be delivered by the borrower to the State's pension and trust funds (known collectively as the CRPTF) as collateral.
Securities lending can be managed on behalf of large institutional investors, such as the CRPTF, through various specialist intermediaries. These intermediaries -- typically custodian banks, asset managers or brokers -- separate the underlying owners of securities (CRPTF) from the eventual borrowers of the securities. Entities borrow securities for a variety of reasons, which are not required to be disclosed, but include covering short positions, borrowing as part of a financing transaction and borrowing to temporarily transfer ownership.

In the case of the CRPTF we utilize our custodian, State Street Bank as the securities lending agent, who performs the administrative functions of the securities lending activities; they also provide borrower default indemnities to the CRPTF against any losses associated with the lending of securities. This last point is an important part of the risk assessment of entering into a securities lending arrangement. For example, when Lehman Brothers went bankrupt, our lending agent managed the collateral issues associated with lending to Lehman Brothers and was responsible for indemnifying the CRPTF for any potential losses associated with the replacement of securities out on loan with Lehman Brothers.

Why do we engage in securities lending? All told, we earn two sources of incremental income from engaging in securities lending activities. First, we earn fees from lending our securities; and secondly, we earn investment income solely when we receive cash as collateral. The receipt of both sources of this incremental securities lending income is used to enhance return and/or offset the costs of safekeeping our complex and global assets.

With regard to the second source of income – investment income on cash collateral – State Street Bank's global collateral management group, State Street Global Advisors (SSgA) manages and reinvests the cash collateral to earn an incremental spread. The investment in short-term securities is the risk borne by the institutional investor, such as the CRPTF, and many of the headlines regarding securities lending within the past year have been associated with the reinvestment of cash collateral. The CRPTF manages our cash collateral in a separate account and with guidelines approved by us that outline the acceptable amount of reinvestment risk we are willing to take. And while the fixed income short term markets have been impaired by the credit crisis, the CRPTF's securities lending program has not suffered any losses.

In conclusion, the purpose of Raised Bill No. 6499 is to expand the universe of permissible securities. Presently, we execute repurchase agreements for the cash collateral reinvestment account and allow the lending agent to lend securities from each fund. In both cases, our credit risk is that associated with the counterparty. Further, the statutes state that we may accept cash or securities guaranteed by the U.S. Government or its agencies as permissible collateral.

If this proposal were to be enacted, the types of collateral that would be permissible would be those that are typically considered common practice within the securities lending and repurchase markets, and could include: 1) securities equally-rated as those guaranteed by the U.S. government; (2) securities equally-rated as those guaranteed by any agency of the U.S. government; and/or (3) securities equally-rated as those guaranteed by other sovereign countries, such as G10 countries and their bonds (denominated in local currency).

If permitted to accept these additional securities, the CRPTF will benefit from additional lending income of as much as $3 million annually. Additionally, the cash collateral account will benefit from higher yields created by the expansion of acceptable repurchase collateral.

Thank you for the opportunity to offer testimony in support of these proposals.

PROPOSED SUBSTITUTE LANGUAGE FOR RAISED BILL NO. 6432:

AAC THE USE OF TRANSPORTATION-RELATED GENERAL OBLIGATION BOND FUNDS FOR DEBT SERVICE

SUBMITTED BY THE OFFICE OF THE STATE TREASURER

Section 1. (*Effective upon passage.*) Section 3-21c of the general statutes is hereby repealed and the following is substituted in lieu thereof: Notwithstanding any general statute, public act or special act, upon a determination by the Treasurer and approval by the State Bond Commission that unexpended proceeds of transportation related general obligation bonds of the state issued pursuant to section 3-20 and accounted for in a general obligation bond fund of the state established by the Treasurer are no longer required for any of the purposes or projects funded or remaining to be funded from amounts in such bond fund, the Treasurer is authorized to transfer all or any portion of said unexpended bond proceeds from such bond fund for further credit to the Special Transportation Fund of the state established pursuant to section 13b-68, provided the debt service on the bonds from which such unexpended proceeds were derived is otherwise payable from the Special Transportation Fund as permitted by section 13b-69<u>, or to the General Fund,</u> and provided further the Treasurer shall determine that such transfer shall not adversely affect the exclusion from gross income of the interest on the bonds from which such unexpended proceeds are derived, pursuant to Section 103 of the Internal Revenue Code of 1986 or any corresponding internal revenue code of the United States, as from time to time amended.