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House Bill 4715 (as passed by the House)  
Sponsor: Representative Bert Johnson  
House Committee: Regulatory Reform  
Senate Committee: Appropriations

Date Completed: 5-6-09

## **CONTENT**

House Bill 4715 would amend the McCauley-Traxler-Law-Bowman-McNeely Lottery Act to allow the State Treasurer to invest State Lottery Prize Fund revenue in Michigan State government general obligation (G.O.) bonds. Expanding the investment options to include State G.O. bonds would help maximize the rate of return earned by the Lottery Prize Fund and ensure that Lottery Prize Fund revenue continues to be invested in very safe financial assets. Given current prices and interest rates on U.S. Treasury bonds and State G.O. bonds, this proposed change would allow the State to sell some U.S. Treasury notes and bonds that the lottery fund is currently invested in and replace them with State G.O. bonds in order to realize a capital gain while still fully funding the Lottery Prize Fund. Some of the key components of this proposed change, along with some background information, are summarized below:

- Currently, the State Treasurer's options for investing Lottery Prize Fund revenue are limited to U.S. Treasury securities. U.S. Treasury notes and bonds are a very safe financial investment and the investment amounts and the timing of their maturities can be structured to coincide with the known timing of future installment prize payouts.
- Bond prices vary inversely with bond rates. Given the current financial situation in the U.S., the demand for U.S. Treasury notes and bonds is very high, so their prices are relatively high and their rates of return are relatively low.
- Some of the U.S. Treasury notes and bonds currently held by the lottery fund were purchased at a time when bond prices were lower and the rates of return were higher compared with their current levels. As a result, these existing U.S. Treasury notes and bonds are worth more at the present time than they were when they were originally purchased.
- State of Michigan G.O. bonds are also a very safe financial investment, but in today's financial market, the demand for them is much less than the demand for U.S. Treasury notes and bonds. As a result, Michigan G.O. bonds are less expensive than U.S. Treasury bonds and pay a higher rate of return.
- Giving the State Treasurer the additional option of investing in Michigan G.O. bonds, as proposed in this bill, would allow the Treasurer to sell some U.S. Treasury notes and bonds, replace them with Michigan G.O. bonds, and realize a net capital gain on the transaction.
- As long as U.S. financial market conditions generate higher prices and lower rates of return on new U.S. Treasury bonds compared with previously purchased U.S. Treasury bonds and new State G.O. bonds, a net gain would be realized by moving from U.S. Treasury bonds to State G.O. bonds. However, if market conditions change in such a way as to narrow the current gap in these bond prices and rates, the potential capital gain would become smaller or possibly disappear.

## **FISCAL IMPACT**

Under the bill, the State Treasurer would have the added option of investing Lottery Prize Fund revenue in Michigan G.O. bonds. Given current financial conditions, it would be prudent for the Treasurer to sell some U.S. Treasury bonds held by the Lottery Prize Fund and purchase some Michigan G.O. bonds. These State bonds would be purchased in such a way as to replicate the same cash flow maturity amounts and timing that would be realized from the U.S. Treasury bonds. This transaction would generate a net financial gain of an estimated \$25.0 million to \$30.0 million, given current market conditions, while still fully funding the Lottery Prize Fund.

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