

# State of Connecticut

DENISE L. NAPPIER  
TREASURER



Hartford

July 17, 2008

Dear STIF Investors:

As we have written to you on several occasions over the past 10 months, the Short-Term Investment Fund ("STIF") owns two \$50 million Cheyne Finance notes that went into receivership last summer. In April, we received a cash distribution of \$18.7 million, reducing our total exposure to \$81.3 million, or 1.6 percent of STIF's approximately \$5 billion in assets. The receivers have been pursuing a restructuring of these notes, which is now available to us. I am writing to update you on this situation and to inform you of the decision we have made to best protect the financial interests of all STIF investors – state and local.

We chose to convert our Cheyne position into pass-through notes that, in effect, give us ownership with other senior creditors of the portfolio of securities underlying the Cheyne notes, of which roughly three-quarters was rated Aaa/AAA or Aa/AA by Moody's or S&P earlier this month. Our analysis indicates that the pass-through notes, which were organized by Goldman Sachs in the name of Gryphon Funding, offer the greatest value for our investors by affording the best opportunity for the upside recovery of asset values as markets stabilize.

Yesterday, an auction price for the existing portfolio of securities underlying the Cheyne notes was announced that would result in the total recovery of approximately \$60 million of our original \$100 million investment after factoring in other receivership distributions. We rejected the cash-out option, because in our view, and in the views of investment managers and advisors with whom we have consulted, the auction price in the current dislocated and distressed markets represents a level below the true value of the portfolio of securities. For example, earlier this week, Moody's issued a report indicating that the auction represents a "fire sale" and that the securities are worth significantly more than the auction price of forty-four percent of the security portfolio.

In order to hold the pass-through notes, however, we must amend our STIF Investment Policy because they would be unrated and their legal final maturity based on the longest security in the portfolio would be in excess of STIF's maturity guidelines. The notes would have a monthly put feature that would enable STIF to receive an in-kind portion of the portfolio, which could then be sold. Accordingly, we have revised the policy, effective July 16, 2008, to include the following section:

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Section H.1.1 (New) Notwithstanding the approved investments enumerated above, STIF may hold securities or other assets received as a result of a restructuring of securities that were, when originally purchased, among the list of approved investments as set forth herein, following consultation with an outside investment advisor. The Treasurer will notify investors of such situations within two (2) business days of the receipt of such securities or assets.

This action will result in mark-to-market adjustments in the value of our overall portfolio, as we assign a market value to the new Gryphon holdings. STIF's \$53.4 million in reserves, however, will allow us to cover the market value adjustments without affecting STIF's \$1 per share net asset value. Importantly, the Cheyne restructuring, as well as any other security held in the STIF portfolio, will not result in any loss of principal to any of our investors.

The unprecedented risks inherent in today's financial markets require stepped-up vigilance by all of us who are entrusted with the care of public funds. Here at the Connecticut Treasury, we remain strongly committed to managing STIF prudently and cautiously.

Should you have any questions regarding this matter, please feel free to contact STIF managers Larry Wilson (860-702-3126 or [lawrence.wilson@ct.gov](mailto:lawrence.wilson@ct.gov)) or Lee Ann Palladino (860-702-3229 or [leann.palladino@ct.gov](mailto:leann.palladino@ct.gov)).

Sincerely,



Denise L. Nappier  
State Treasurer