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## **TESTIMONY OF STATE TREASURER NANCY K. KOPP**

**Before the**

**House Public Safety and Administration Subcommittee**

**March 2, 2016**

Good afternoon, Mr. Chairman and members of the committee. I am pleased to appear before you today to present the State Treasurer's Office (STO) proposed budget for 2017. As usual, my sincere thanks to the Department of Legislative Services, and particularly thank Sierra Boney for her excellent work and analysis of this budget. We appreciate the critique and agree with the recommendation.

The State Treasurer's Office is tasked with carrying out several constitutional and statutory responsibilities on behalf of the State, including:

- Safeguarding and investment of excess cash balances;
- Timely recordation and reconciliation of State funds;
- Issuance of statewide debt to finance capital projects;
- Procurement of all banking and financial services, insurance and insurance services; and
- Statewide insurance management to provide risk assessment and mitigation through loss protection, loss control and loss restoration.

I would like to take the opportunity to highlight some of the unique achievements carried out by the talented and dedicated staff within the Office over this past year before addressing the analyst's recommendation regarding our FY 2017 budget.

**Treasury Management Division** – The Treasury Management Division, created in FY 2013, includes the Banking Services Department and the Investment Department together under one division.

***Banking Services Department (BSD)*** - BSD is directly responsible for managing the banking needs for all agencies of the State. This includes the procurement of all financial products and services statewide, and the related contract management and oversight. During the fiscal year, BSD continued the implementation process for the Agency Depository Contracts for statewide banking depository services. Almost 400

agency bank accounts have been moved to the newly-designated depositories. Reminder notices have been sent to all Agencies with deposits at ineligible depositories. BSD conducted procurements on behalf of the College Savings Plans of Maryland (CSPM) to provide services for the accounts and assets under the control of the CSPM Board, including depository, disbursements, lockbox and custodial services. BSD also procured E-WIC processing for WIC for Maryland and U.S. Virgin Islands, and is assisting the Child Support Enforcement Administration (CSEA) in drafting an RFP for general banking services.

As noted by the analyst, BSD ensures the accurate and timely recordation of State funds and the reconciliation of the State's bank accounts to the State's R\*STARS accounting system. The average number of days to reconcile accounts has remained under 4 days since FY 2008 and dropped to less than 3 days in FY 2015. For fiscal year 2015, total cash receipts and disbursements each exceeded \$216 billion and the State's General Fund bank accounts continued to be reconciled to the penny on a daily basis to the State's general ledger.

Another responsibility of the Department is to ensure protection of all State funds on deposit with financial institutions through monitoring of bank account and collateral balances. Utilizing the Treasurer's Bank Account Information System (TBAIS), BSD monitors over 1,800 agency bank accounts at 23 financial institutions. Total posted collateral as of January 31, 2016 was in excess of \$578 million (unaudited). The annual Bank Account Survey, a verification tool used to ensure all accounts are collateralized appropriately and monitored monthly has been completed. The results of the survey were updated in TBAIS, and we utilize this information to ensure collection of all interest owed to the General Fund.

***Investment Department*** – The State's conservative investment policy and practices have protected the investment portfolio through these volatile and unprecedented economic times and has resulted in a modest but continuous return on the portfolio. The par value of the General Fund investment portfolio for January 31, 2016 was \$7,062,039,787.01 as compared to January 31, 2015 when it was \$6,324,111,099.80. This is an increase of \$737 million dollars.

On January 31, 2016, the portfolio was earning an average of 0.953%, compared to 1.021% for the same date in 2015. The return reflects the diligence of the investment staff despite the impact of the Federal Open Market Committee maintaining the Fed Funds Target rate at .25% or less since December 16, 2008. For comparison, the three month constant maturity Treasury Bill averaged 0.106% from July 2015 until the end of January 2016 as compared with 0.024% for the same time period in the previous fiscal year. The low rate environment, combined with the highly conservative portfolio strategy focused on liquidity to offset unpredictable and volatile cash flows, has resulted in continued minimal but positive interest earned.

The General Fund gross interest earnings received year-to-date for FY 2016 are \$35,107,013 compared with \$34,588,860 received for the same time period in FY 2015. This is an increase of \$518,153.

The Office continues to promote MBE participation in the investment of State funds. Twenty-six MBE broker/dealers are on the Office's approved list for FY 2016 compared with twenty-four in FY 2015.

The Maryland Local Government Investment Pool's (MLGIP) AAAM rating was reaffirmed by Standard and Poor's on September 28, 2015. The Pool consists of 302 participants with a balance at January 31, 2016 of \$4,559,934,335.46 compared with \$3,619,649,254.88 for the same date in 2015. This is an increase of over \$940 million dollars due to participants' higher available cash balances. The MLGIP is paying 0.10% as of January 31, 2016, compared to 0.05% last fiscal year. The participants continue to use the Pool due to the lack of safe short-term investment alternatives for Investment Pool members at a comparable yield.

**Debt Management Division** –Maryland continues to be one of now ten states with AAA ratings from all three rating agencies. S&P has rated the bonds AAA since 1961, Moody's has assigned the bonds a rating of Aaa since 1973, and Fitch Ratings has rated the bonds AAA since 1993. In awarding Maryland this coveted recognition, the rating agencies repeatedly cite the economic and fiscal strength of the State and the State's fiscal management, including our model Capital Debt Affordability process.

The next conference call with the rating agencies is expected prior to the sale of the 2016 First Series General Obligation Bonds in May, 2016. Once ratings have been affirmed, copies of the ratings reports will be posted on our website.

### ***2016 First Series General Obligation Bonds***

The new general obligation financing is scheduled for May 11, 2016 and is expected to total \$518 million in tax-exempt bonds.

### ***Calendar Year 2015 Bond Sales***

***The 2015 First Series*** was sold on March 4, 2015 and totaled \$883,360,000. The proceeds were used to finance new projects and refund existing bonds. The sale closed on March 17, 2015 and had two series:

- Series A: \$518.0 million in Tax-Exempt Bonds sold in a competitive sale primarily to institutions; and
- Series B: \$365.4 million of Tax-Exempt Refunding Bonds.

The Series A bonds provided \$518.0 million, at a TIC (True Interest Cost) of 2.65%, to finance investments in capital projects critical to our State. Series B refunding bonds saved taxpayers \$21.8 million in debt service costs. In addition, the State received a premium of \$74,682,961 to offset FY 2016 debt service costs and provide \$48.4 million to fund capital projects on a paygo basis.

*The 2015 Second Series* was sold on July 16, 2015 and totaled \$500,000,000. The proceeds were used to finance new projects. The sale closed on August 3, 2015 and had two series:

- Series A: \$450 million in Tax-Exempt Bonds sold on a competitive basis primarily to institutions; and
- Series B: \$50 million in Taxable Bonds.

The Series A bonds provided \$450.0 million, at a TIC of 2.83%, to finance investments in capital projects critical to our State. Series B provided \$50 million, at a TIC of 1.36% (maturing August 1, 2018 and 2019) to finance loan programs and other capital projects with the potential to benefit non-governmental entities. In addition, the State received a premium of \$45,918,725 to offset FY2016 debt service costs.

*Qualified Zone Academy Bonds (QZAB) of 2015* were sold on December 9, 2015, closed on December 17, 2015 and totaled \$4,625,000. These were tax credit bonds bearing no interest. QZAB proceeds are used to fund capital improvements and repairs at existing schools in which at least 35% of the students are eligible for free or reduced-price lunch.

***Closed Financing – Leases***

The Capital Lease-Finance Program allows State agencies to acquire equipment and pay for those items over a three or five year timeframe. Between July 1, 2015 and February 26, 2016, capital equipment was leased by State agencies through the State Treasurer’s Office as follows:

<b>Date</b>	<b>Lease Value</b>	<b>3 Yr Lease Interest Rate</b>	<b>5 Yr Lease Interest Rate</b>
October 2015	\$1,206,387.17	1.0720%	1.3260%
January 2016	\$1,629,237.57	1.3400%	1.5500%

The Treasurer’s Office also finances Energy Performance Leases in cooperation with the Department of General Services, providing funding for energy conservation at State facilities. The program finances significant up-front investments in conservation projects; the lease is paid using the savings in operating costs. The State closed on a \$5,282,358 energy lease on November 13, 2015 to finance improvements at six Department of Juvenile Services’ facilities.

## **Insurance Division**

***Claims Unit*** - The Claims Unit continued to proactively pursue debts owed to the State from the negligence of others. The Office recovered over \$950,000 from parties responsible for damaging State-owned property in FY 2015. With four months remaining in FY 2016, the Unit expects to recover \$1 million by the end of the year, having recovered over \$906,942.03 as of February 26<sup>th</sup>, 2016.

***Underwriting Unit*** - The Insurance Division procures broker services for the purchase of commercial insurance to protect the State Insurance Trust Fund from catastrophic loss, to meet statutory or regulatory requirements, and for compliance with agencies' contractual agreements. The Underwriting Unit has been very successful in improving coverage and in achieving competitive premiums for some of the State's largest risks:

- **State of Maryland's blanket terrorism coverage** for property exposures renewed effective 10/13/2015 with property values up 15.7%, a rate reduction of 36.8%, resulting in a premium savings of \$91,437.
- **Maryland Transportation Authority's terrorism** coverage for property exposures renewed effective 10/13/2015 with property values up 2%, and a rate reduction of 49%, generated a premium savings of \$70,115.
- **Maryland Port Administration's crane insurance** renewed effective 11/25/2015. Crane values were down 5.7% and there was no rate change, thereby resulting in a premium savings of \$10,289.
- **Maryland Port Administration's auto coverage** renewed effective 1/1/2016 with three fewer autos, and an approximate 2% rate reduction, resulting in a premium savings of \$2,856.
- **Maryland Port Administration's** liability and terrorism coverages renewed effective 1/31/2016 with shipments of dry goods up 83% and cruise passengers up 42%. Even though there have been losses, in addition to the exposure increases, the broker negotiated a renewal that generated a premium savings of \$7,124.

**STO Budget** – The Treasurer's Office recognizes the shared goals of the Governor and Legislature in controlling statewide spending growth, and our FY 2017 allowance maintains level General Fund spending in line with cost containment initiatives implemented for FY 2016. With an appropriation comprised of more than 95% in non-discretionary spending, consisting primarily of Salaries, Benefits and Bank Fees, we continue to examine ways to increase efficiencies in daily operations through greater automation of manual processes and conducting routine reviews of existing contracts for increased savings opportunities.

The Office acquired a new position during FY 2016 via transfer of an existing tort attorney from the Attorney Generals' Office, which resulted in an increase in personnel

costs for FY 2017. However we have absorbed these costs in our current year budget to prevent the need for a budget amendment. In addition, the Office has procured a new high-speed check printer that has lease costs included in our FY 2017 allowance, and is expected to be installed before the end of this fiscal year. This new printer will provide for self sealing of checks, which should reduce costs incurred for envelopes and processing costs related to preparing and sealing the envelopes for mailing. Our current check printer is over 14 years old and, as of December 2015, the manufacturer has ceased making replacement parts. This new printer allows us greater flexibility in preparing and processing checks and remittance advices printed on behalf of the Comptroller's General Accounting Division, the Department of Human Resources and the State Retirement and Pension Systems.

We continue to operate within a very lean appropriation and are consistently looking for ways to streamline and automate processes wherever feasible while continuing to provide a high level of service to State agencies and the citizens of Maryland.

**Response to Legislative Analyst's Recommended Actions:**

**Recommended Actions**

- 1) *Concur with Governor's allowance.*

**STO Response**

Office concurs.