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TESTIMONY OF STATE TREASURER NANCY K. KOPP

Before the

House Public Safety and Administration Subcommittee

February 22, 2017

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 2018. As usual, my sincere thanks to the Department of Legislative Services, and particularly 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 achievements carried out by the talented and dedicated staff within the Office over this past year before addressing our FY 2018 budget.

Treasury Management Division – The Treasury Management Division 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.

The Department procures financial products and services statewide. The Child Support Enforcement Administration (CSEA) contract for banking services was awarded

and the kickoff meeting was held in December, 2016. The Statewide Lockbox Services RFP was released November 21, 2016 with proposals due January 11, 2017. We expect to award the contract by the end of February.

BSD continues to ensure 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. For FY 2016, total cash receipts and disbursements exceeded \$565 billion. BSD monitors over 1,800 agency bank accounts at 23 financial institutions.

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, 2017 was \$7,658,082,539.87 as compared to January 31, 2016 when it was \$7,062,039,787.01. This is an increase of \$596 million dollars.

On January 31, 2017, the portfolio was earning an average of 1.374%, compared to 0.953% for the same date in 2016. The General Fund gross interest earnings received year-to-date for FY 2017 are \$40,626,871 compared with \$35,107,013 received for the same time period in FY 2016. This is an increase of \$5,519,858.

The Maryland Local Government Investment Pool's (MLGIP) AAA rating was reaffirmed by S&P Global Ratings on September 26, 2016. The Pool consists of 303 participants with a balance at January 31, 2017 of \$5,068,072,126.55 compared with \$4,559,934,335.46 for the same date in 2016. This is an increase of over \$508 million dollars due to participants' higher available cash balances. The MLGIP is paying 0.56% as of January 31, 2017, compared to 0.10% last fiscal year.

Debt Management Division - Maryland continues to be one of now eleven 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.

A conference call with the rating agencies was held on February 15th prior to the March sale of the 2017 First Series General Obligation Bonds, and ratings are expected to be issued February 24th. Once ratings have been affirmed, copies of the ratings reports will be posted on our website.

2017 First Series General Obligation Bonds: The next general obligation financing is scheduled for March 8, 2017 and is expected to total \$575 million in tax-exempt bonds and \$100 million in taxable bonds. Depending on market conditions, the State may also offer tax-exempt refunding bonds in a competitive sale.

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 \$1,251,439.48 from parties responsible for damaging State-owned property in FY 2016. With four months remaining in FY 2017, the Unit has already recovered over \$1.2 million as of February 16th, 2017 and expects to recover \$1.5 million by the end of this year.

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:

- The Maryland Transit Administration's excess liability coverage renewed effective July 1, 2016 with ridership up 2.8% and a rate reduction of 6.5% overall, resulting in a premium **savings of \$326,867**.
- The Maryland Transit Administration's rail car floater coverage renewed effective July 1, 2016 with values up \$5,945,000 and a rate reduction of 3.3%, generating a **savings of \$17,034**.
- The Maryland Transit Administration's auto physical damage coverage for their bus fleet renewed July 1, 2016. The bus values were up by \$28,150,740, but our renewal premium only increased by \$27,600.
- The Allied Health professional liability coverage for student interns from various schools renewed effective September 1, 2016. There was a 4.3% drop in the number of student interns, and a rate reduction of 13.5%, resulting in a premium **savings of \$13,147**.

Proposed Budget – We appreciate the support we've received for our Financial Systems Modernization project to replace our core financial systems currently in use. These systems will no longer be supported after December 2018, and we have invested significant time over the past two years conducting requirements analysis and more recently hiring a project manager to lead us through this effort with the support of our internal information technology team.

With this new system we look forward to enhancing our current processes through automation of manual processes, improving cash flow management and bank reconciliation processes, and implementing a modernized insurance claims management solution that will provide enhanced web capabilities for our constituents and interface with our accounting system. Our goal is to develop a scalable platform that can meet the

needs of our office as well as the needs of other state agencies on many levels such as banking interface functionality, general ledger, check management, accounts payable and receivables, workflow management and customer relationship management.

Response to Legislative Analyst's Recommended Actions:

Recommended Actions

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

STO Response

Office concurs.

Audit Findings:

Finding 1: The State Treasurer's Office (STO) has still not resolved longstanding contract issues involving oversight of claims processing services for workers' compensation claims provided by the Injured Workers' Insurance Fund. For example, STO has not implemented certain recommendations made by the Maryland Insurance Administration that were intended to safeguard the State's financial interests.

STO Response:

In October 2016, our office hired a full time employee who is an expert in the area of Workers' Compensation to serve as the Workers' Compensation Program Manager responsible for managing our contract with the Injured Workers' Insurance Fund (IWIF). Since that time, we have been working closely with IWIF to gather information necessary to understand current processes and to make recommendations for changes in the new contract. We expect to have the new contract negotiated and in effect by July 1, 2017.

Finding 2: STO did not transfer excess funds totaling \$3.9 million from the State's Unpresented Check Fund to the General Fund at the end of fiscal 2015, as required by State law.

STO Response:

We consult with the Comptroller's Office Revenue Administration Division (RAD) annually regarding eligible income tax refund checks that are sitting in the Unpresented Check Fund to be reverted to the State's General Funds. During our annual closeout process for FY2016, RAD confirmed this large outstanding check was eligible for reversion and as such, these funds were included in our annual transfer out of the Unpresented Check Fund to the State's General Funds on July 21, 2016.

Finding 3: Sensitive personally identifiable information was not properly protected by STO.

STO Response:

The Office has several processes in place to protect personally identifiable information (PII), including encryption on all files transmitted between our Office and state agencies; usage of secure VPN tunnels and file encryption during transmission when connecting to banks and other external partners; and ongoing reviews of Firewall logs, Intrusion Prevention Systems and Intrusion Detection Systems.

Finding 4: STO did not have a comprehensive information technology disaster recovery plan for recovering its computer operations from a disaster scenario.

STO Response:

The Office has an information technology disaster recovery plan for recovering our computer operations and the physical infrastructure to execute these plans at our disaster recovery site in Hagerstown is in place.