

## REMARKS OF TREASURER DEBORAH B. GOLDBERG

*Consensus Revenue Hearing  
Gardner Auditorium  
State House, Boston, MA 02133  
Wednesday, December 16, 2015*

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*As prepared for delivery:*

Secretary Lepore, Chairwoman Spilka, Chairman Dempsey, and members of the Committee – thank you for the invitation to testify this morning relative to the Commonwealth’s revenue projections and broader fiscal outlook.

### **Budget and Stabilization Fund**

I believe that an important consideration for the FY17 budget is going to be how we address our stabilization fund. I want to begin today by acknowledging and applauding your recent \$120 million deposit into the fund. Doing so sent an important message to our investors and the rating agencies that we are serious about employing prudent and sound practices when it comes to managing the state’s finances.

I know that many of you have been wrestling, just as I have, with the recent analysis from Standard & Poor’s, which revised our outlook from “stable” to “negative.”

In their announcement, they said, “we base the outlook revision on a decline in financial reserves over the past several years despite a prolonged period of economic expansion and generally positive revenue trends.”<sup>1</sup>

That is feedback that each of us has taken seriously, and I am confident that we will work together to respond accordingly.

At last January’s Consensus Revenue Hearing I indicated that rating agencies and investors alike consistently pointed to our reserves as a source of fiscal strength. I also stated that building those reserves would be essential to maintaining our bond rating while working toward an even higher grade.

According to Pew estimates, our Rainy Day Fund balance of roughly \$1.25 billion ranks twelfth highest in the nation,<sup>2</sup> in actual dollars. But, as a percentage of general fund

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<sup>1</sup> Standard & Poor’s, “Massachusetts Outlook Revised To Negative On Projected Decline In Reserves; Ratings Affirmed; 2015D&E Bonds Rated ‘AA+’”, (November 2015)  
<http://www.massbondholder.com/sites/default/files/downloads/S%26P%20Report%20-%202015D%26E.pdf>

<sup>2</sup> Fiscal 50: State Trends and Analysis, (December 2015),  
<http://www.pewtrusts.org/en/multimedia/data-visualizations/2014/fiscal-50#ind5>

expenditures, it does rank 38<sup>th</sup>.<sup>3</sup> While the rating agencies consider balance when evaluating reserve funds, they also focus on the deposit rules we put in place as well as why and when withdrawals are made. They naturally grow concerned in the event of a draw down, especially during periods of economic expansion. Even if we do not withdraw from the fund, we raise red flags if we divert funds, which were meant to be deposited, as in the most recent diversion of capital gains tax revenue.

As to the question of what the appropriate amount should be, the research and analysis offers no consistent guidance. The National Conference of State Legislatures recommends or suggests an amount of 5 percent of annual spending.<sup>4</sup>

Standard & Poor's and Moody's award top scores in their rating methodologies to states with savings of around 8 or 10 percent of annual revenues, respectively.<sup>5 6</sup>

Additionally, the Government Finance Officers Association suggests that states maintain a stabilization fund balance of up to two months' worth of revenue.<sup>7</sup>

And, as you know, the Massachusetts Taxpayers Foundation recently endorsed and recommended that we reach an amount equal to 10 percent of tax revenue, over the next 5 years.<sup>8</sup> For FY16, that would require a balance of \$2.5 billion.

The fact is, there is no uniform recommendation or one-size-fits all approach to maintaining our stabilization fund. I know, however, that we will do what is right and appropriate for Massachusetts. We know we have to strengthen our Rainy Day Fund, and we share a commitment to do so.

## **Massachusetts State Lottery**

The first area of Treasury that I would like to discuss today is the Lottery. We all know our Lottery is the major source of unrestricted local aid for cities and towns. In FY15, the Lottery's net profit amounted to \$985.8 million.<sup>9</sup> This was another record profit for, and was an \$11 million increase over FY14.<sup>10</sup>

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<sup>3</sup> *Ibid.*

<sup>4</sup> National Conference of State Legislatures, "NCSL Fiscal Brief: State Balanced Budget Provisions" (October 2010), 7, <http://www.ncsl.org/documents/fiscal/statebalancedbudgetprovisions2010.pdf>.

<sup>5</sup> Standard & Poors, "Criteria | Governments | U.S. Public Finance: U.S. State Ratings Methodology," (January 2011), search "reserve," [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/type/HTML/id/1547849](https://www.standardandpoors.com/en_US/web/guest/article/-/view/type/HTML/id/1547849)

<sup>6</sup> Moody's, "US States Rating Methodology," (April 2013), [https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM\\_PBM129816](https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_PBM129816)

<sup>7</sup> Government Finance Officers Association, Best Practice: "Determining the Appropriate Level of Unrestricted Fund Balance in the General Fund" (2002 and 2009), <http://www.gfoa.org/determining-appropriate-level-unrestricted-fund-balance-general-fund>.

<sup>8</sup> Massachusetts Taxpayers Foundation, "Stabilization Fund Briefing" (November 2015), [http://www.masstaxpayers.org/sites/masstaxpayers.org/files/MTF\\_Stab\\_Fund.pdf](http://www.masstaxpayers.org/sites/masstaxpayers.org/files/MTF_Stab_Fund.pdf)

<sup>9</sup> Massachusetts State Lottery Commission FY15 Statement of Operations (June 2015), <http://www.masslottery.com/lib/downloads/about/June2015financialYTD.pdf>

<sup>10</sup> *Ibid.*

The Lottery also achieved record sales numbers, topping the \$5 billion mark for the first time ever with a total of \$5.014 billion. This represented our fourth consecutive year of record-setting sales. We also awarded a record amount of \$3.641 billion in prizes in FY15.<sup>11</sup>

What our consumers pay attention to and really care about is that 72.6 percent of all revenue<sup>12</sup>, more than any other state in the country, was returned to them in the form of winnings last year. Our most valuable partners, our retailers, many of whom are small business owners, earned \$286 million in commissions and bonuses. This is compared to \$277 million in FY14.

These results have been accomplished while spending \$100.5 million on administrative costs in FY15. This figure represents only 2 percent of our revenues, and continues to be the lowest ratio of any lottery in the country.

Our sales continue to be driven by our strongest performing games – instant tickets and Keno. These two games made up over 87 percent of our entire sales in FY15. Instant tickets contributed 70.2 percent and Keno added another 17 percent.<sup>13</sup> Instant ticket price points of \$10 and above are strong sales performers. They also carry a higher prize payout, averaging over 80 percent. As sales continue to shift toward these higher prize payout tickets, our net profit does weaken.

So, although I am pleased with our growth year over year, I am concerned that just two games make up such a significant portion of our overall sales. In fact, some of our draw games, such as Powerball and MegaMillions actually saw a decrease in sales last year.<sup>14</sup> Others, such as the Numbers Game or Mass Cash, remained relatively stagnant.

Consequently, in order for us to remain competitive in the future, we must find ways to innovate and be less dependent upon instant games and Keno. The emergence of daily fantasy sports and other mobile applications has clearly caught the attention of the millennial market. Lotteries across the country have been unable to successfully attract this audience to the traditional slate of products.

In order to better understand this rapidly growing and popular industry, the Lottery will be publishing an RFI that formally requests feedback from the private sector. The platforms these entities employ as well as the customers they attract are something we need to pay attention to. If we can attract these players it will grow our business.

I am hopeful that the feedback we receive as a result of our RFI will provide us with a glimpse into what technology exists in the market today, and whether or not we should consider embracing it here in Massachusetts. Ultimately, anything we do would have to

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<sup>11</sup> *Ibid.*

<sup>12</sup> *Ibid.*

<sup>13</sup> *Ibid.*

<sup>14</sup> In FY14, Powerball enjoyed \$113M in sales. In FY15, that amount dropped to \$101M, representing a 9.9 percent decrease. In FY14, MegaMillions enjoyed \$82M in sales. In FY15, that amount dropped to \$78M, representing a 5 percent decrease.

conform to our existing Lottery model which insists on game integrity, consumer protection, and fair payout structures.

And, of course, I would look forward to sharing what we learn along the way with each of you in order to inform your ongoing legislative conversations around this issue.

As for the remainder of FY16, we continue to be on track to deliver \$962 million of net profit. This figure includes a \$20 million impact in our payouts based on a second chance prize from a 2009 Instant Ticket game.<sup>15</sup>

Looking ahead to FY17, we anticipate that we can return \$980.7 million in net profit. This figure assumes a level funding of the Lottery's operations, including \$8 million in advertising.

Impacting this projection is the introduction of a new monitor game which replaces Jackpot Poker. You may recall that Jackpot Poker was launched in June 2013, and despite some modifications, has fallen short of expectations. We expect to replace the game with a more customer-friendly alternative at the beginning of FY17. We assume improved sales with its launch, but would hope to support it with sufficient advertising resources.

Our data has proven that our sales directly benefit from increased consumer awareness generated through integrated advertising promotions. As I sit here today, we are in the midst of our holiday advertising campaign, which in the past has generated \$4 in revenue for every \$1 that we have spent.

While our Lottery continues to be the most profitable and efficient in the country, that does not mean we can be complacent. The marketplace continues to change, whether it is the introduction of new brick and mortar destinations, or as I just discussed, the emergence and expansion of mobile offerings.

The Lottery should be prepared to evolve as well. That evolution should include both innovative offerings that attract new players, as well as worthy investments that maintain, improve, and promote our current games.

Naturally, I look forward to discussing this with each of you further as your budget deliberations continue into the New Year.

### ***Unclaimed Property***

Another area of Treasury that leads the nation is our Unclaimed Property Division. In Massachusetts, we return more property per capita than any other state in the country.

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<sup>15</sup> This prize is the official close of an Instant Ticket Mega Cash game that was released in October 2009 and officially sold out in August 2014. The Lottery has eliminated the practice of offering Instant Tickets such as this with large end of game second chance prizes that are designed to be awarded one year after game sales have ended.

In FY15, we were successful in returning \$114 million in cash, stock and mutual funds to its rightful owners. We have continued to evaluate and expand our outreach efforts in order to alert more people that we may have their property. You may have noticed advertisements in your local newspapers or met our customer service staff at local fairs or expos.

These efforts have us on track to break last fiscal year's record return of \$114 million.

Also with respect to FY16, I am pleased to report that we are now projecting a reversion to the state's General Fund of approximately \$100 million. As you will recall, our original estimate for this current fiscal year had been \$81 million in reversions. However, a recent stock liquidation and the associated gains realized by it will allow us to return more.

In FY17, we anticipate that we will again be able to revert \$81 million to the General Fund. We do not anticipate such a large stock liquidation, nor are we projecting any other settlements that would significantly increase our returns.

### ***Alcoholic Beverages Control Commission***

At the Alcoholic Beverages Control Commission (ABCC), they were able to generate \$4,583,000 in revenue for the Commonwealth in FY15.<sup>16</sup> This represented an increase of 8.4 percent over the previous fiscal year.<sup>17</sup>

The majority of their revenue stems from license applications, including the issuance of new licenses, new license types, as well as renewals. For example, in calendar year 2014, the Commission issued 23,186 licenses, certificates and permits for alcoholic beverages and processed 30,217 license transactions.<sup>18</sup> These both represent increases over the previous years.

It is important to note that the ABCC also works collaboratively with other state agencies in order to generate additional revenue for the Commonwealth. For instance, in FY15 they have worked with the Department of Unemployment Assistance, the Department of Industrial Accidents, the Lottery, and the Department of Revenue to collect \$13,100,000 in outstanding taxes, fines and other debt owed to Massachusetts.

The Commission anticipates that they will collect \$4.3 million in FY16, and is projecting the same figure for FY17.

This work is accomplished with a budget of \$2,266,976 after 9C cuts, twenty six employees, and the fifth lowest ratio of enforcement agents to licensees in the country. While it is obvious that the ABCC provides significant value to the Commonwealth,

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<sup>16</sup> SD2268/HD4232, Alcoholic Beverages Control Commission Annual Report (October 2015)  
<http://www.mass.gov/abcc/pdf/annualreports/2015AnnualReport.pdf>

<sup>17</sup> *Ibid.*

<sup>18</sup> *Ibid.*, p. 3

additional resources will be necessary to balance the volume of licenses and the need to prevent alcohol related injuries and incidents across the state.

### ***Pension Fund Assumed Rate of Return***

Before closing, I would like to comment on the current state of our pension fund as well as our anticipated rate of return. The balance of our pension fund, at the end of October, was \$60.7 billion. In the last fiscal year, the fund earned a return of 3.9 percent, which placed it within the top quartile. And, just this month, the pension fund was recognized by Asset International-CIO for “excellence in innovation.”<sup>19</sup>

You will also be hearing from the Public Employee Retirement Administration Committee (PERAC) about the assumed rate of return topic in just a few minutes. They will provide feedback on the trends around the country, particularly amongst comparable pension funds.

Just last year, we lowered our anticipated rate of return from 8 percent to 7.75 percent. However, this remains on the higher side.

Nearly 80 percent of local systems use a rate of return of lower than 7.9 percent today and they are trending downward. There has also been movement across the country - CalPERS is currently at 7.5 percent but recently announced that they could move to 6.5 percent over the next 20 years.<sup>20</sup>

New York’s comptroller, Thomas DiNapoli, announced in September that they were lowering their return assumption from 7.5 to 7 percent.<sup>21</sup> In doing so, the comptroller described their decision as “fiscally prudent” and “consistent with the tougher investment climate ahead.”<sup>22</sup>

I echo that sentiment and believe we should lower our assumed rate to 7.5 percent.

I fully realize and appreciate that this will change our unfunded liability. However, the investment community and the rating agencies prefer more realistic assumptions. Making such an adjustment would signal our shared commitment to disciplined fiscal management and prudent investment standards.

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<sup>19</sup> *The Bond Buyer*, “Mass. PRIM Named Best in Innovation,” (December 2015), <http://www.mass.gov/treasury/about/media-pubs/treas-news/bond-buyer-mass-prim-named-best-in-innovation.pdf>

<sup>20</sup> *Pensions & Investments*, “CalPERS approves plan to gradually reduce assumed rate of return to 6.5%” (November 2015), <http://www.pionline.com/article/20151118/ONLINE/151119854/calpers-approves-plan-to-gradually-reduce-assumed-rate-of-return-to-65>

<sup>21</sup> *Wall Street Journal*, “New York lowers return assumption for state retirement system,” (September 2015), <http://www.wsj.com/articles/new-york-lowers-return-assumption-for-state-retirement-system-1441383501>

<sup>22</sup> *Ibid.*

## *Conclusion*

Again, I want to thank you for your time this morning, as well as for the invitation to participate in today's hearing. I know this is the first of many conversations we will have in the coming weeks and months as you develop your respective budgets.

I am looking forward to working with each of you in that process.

My colleagues and I will be happy to answer any questions that you might have.