



## M E M O R A N D U M

**Date:** September 24, 2020

**To:** California State Lottery Commission

**From:** Alva V. Johnson, Director *AVJ*

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**Subject:** Item 8(a) - Lottery Investment Strategy and Investment Policy

### **ISSUE**

Pursuant to the California State Lottery's (Lottery) Investment Policy (attached), the Lottery is required to annually present its Investment Strategy and Investment Policy to the California State Lottery Commission (Commission) for approval.

### **BACKGROUND**

As part of the Lottery's on-going investment activity in support of SuperLotto Plus<sup>®</sup>, Mega Millions<sup>®</sup>, Powerball<sup>®</sup>, and various Scratchers<sup>®</sup> games, the Lottery purchases U.S. Treasury securities to fund future payments to jackpot and top prize winners electing the annuity prize option. The U.S. Treasury securities are owned and managed by the Lottery within a single annuity prize portfolio (Investment Portfolio) held with the State Treasurer's Office. The attached report provides more information on the Investment Portfolio, including detailed breakouts of the Lottery's investments for the 2018-19 fiscal year.

The Lottery's Investment Policy requires that the Commission review and adopt, by vote, its Investment Strategy and Investment Policy not less than annually, including the approval of any changes to the Investment Policy.

### **DISCUSSION**

The Lottery's current Investment Strategy and Investment Policy focus on 1) the management of on-going investment activity in support of draw games and Scratchers games that offer an annuity option to winners and 2) maintenance of the Lottery's Investment Portfolio to monitor and mitigate potential investment risk. This ensures that scheduled payments to annuity prize winners are fully funded.

The Lottery purchases U.S. Treasury securities, facilitated by the State Treasurer's Office, to fund future prize payments for annuity prizes. The Lottery's investment in U.S. Treasury securities is a standard business practice for SuperLotto Plus, Mega

Millions, Powerball, and certain Scratchers games and represents the Lottery's on-going investment activity.

The Lottery ensures that investment transactions related to maintenance of its Investment Portfolio are consistent with industry practices and are limited to ad hoc transactions required for risk management purposes. Investment transactions required to manage risk include discretionary reinvestment of existing securities resulting from credit related events or mandatory calls, rebalancing of investments for purposes of maintaining diversification, and managing the Lottery's prize liability reserve.

The Lottery proposes several minor changes to the Investment Policy to result in greater transparency. In addition to some minor technical cleanup, the proposed changes would require the Lottery to notify the Commission within 15 days of a rating change bringing a particular security in the Lottery's investment portfolio below the minimum credit ratings defined in the policy. Similarly, the changes would require the Lottery to notify the Commission within 15 days of the fair market value of a Municipal Security investment exceeding the allocation limits specified in the policy. Other changes would help clarify that the Lottery's primary purpose of investing is to ensure timely payment to Lottery winners who elect the annuity payout option and would provide clarity on the process of restructuring the Lottery's investment portfolio to generate more funding for education. In such an instance, the policy would require the Lottery to competitively procure a financial consultant to assist with the restructuring and would add the financial consultant to the "Responsibilities" section. Lastly, the proposed changes would require the Lottery to report any restructuring effort to the Commission, including the intent to procure the required financial consultant.

### **RECOMMENDATION**

Lottery staff recommends that the Commission approve continuance of the Lottery's existing Investment Strategy and adopt the proposed changes to the Investment Policy for 2020. Both the Investment Strategy and Investment Policy continue to focus on 1) ongoing investment activity in support of SuperLotto Plus, Mega Millions, Powerball, and various Scratchers games and 2) maintenance of the Lottery's Investment Portfolio that includes monitoring and mitigating potential investment risk.

Attachments