

(5) Investments and Prizes Payable in Installments

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Department will not be able to recover the value of its investments that are in the possession of an outside party. Investments are held by the custodial bank's trust department in the name of the State Treasurer.

Interest rate risk is the risk that an investment's fair value decreases as market interest rates increase. Typically, this risk is higher in debt securities with longer maturities. The Department purchases investments with maturities scheduled to coincide with cash requirements. Interest rate risk is managed according to the purpose of the investments and the projected time frame for the use of these assets.

The risk that the Department will actually realize material losses from its investments in government securities resulting from changes in market interest rates is mitigated by the low probability that these securities will have to be sold prior to maturity.

The fair value of the securities is reflected in the accompanying financial statements of the Deferred Prize Winners Trust Fund as assets and as reserved fund equity. The original cost of the securities plus accrued interest is \$42,528,680 less than fair value as of October 31, 2020. These securities were purchased at discount rates ranging from 1.806% to 7.741% and mature in annual installments up to a 30 year period.

Investments in prize securities are in the form of United States Treasury zero-coupon bonds. Investments are held by a custody bank in the name of the State Treasurer. Credit ratings are not required for U.S. Government and agency securities that are explicitly guaranteed by the U.S. government. The fair value and investment maturities of the investments at October 31, 2020 are as follows:

Investment Maturities (In Years)	Fair Value Amount
Less than 1 year	\$ 24,496,030
1 to 5 years	97,442,753
6 to 10 years	85,792,753
More than 10 years	<u>79,353,246</u>
Total	<u>\$287,084,782</u>

The Department has an unconditional obligation to pay all grand prizewinners the future value of the prize. The fair value of the future prize payments, which is reported in the Deferred Prize Winners Trust Fund, follows:

	<u>Current</u>	<u>Long-Term</u>	<u>Total</u>
<u>For the Fiscal Year:</u>			
2020-2021	\$ 26,524,667	\$ -	\$ 26,524,667
2021-2022		23,841,667	23,841,667
2022-2023		24,995,667	24,995,667
2023-2024		23,648,667	23,648,667
2024-2025		23,977,000	23,977,000
2025-2030		90,880,000	90,880,000
2030-2035		70,158,000	70,158,000
2035-2040		20,424,000	20,424,000
2040-2045		2,878,000	2,878,000
2045-2050		139,000	139,000
Total Future Prize Payments	<u>26,524,667</u>	<u>280,942,001</u>	<u>307,466,668</u>
Less Present Value Adjustments	<u>3,706,284</u>	<u>59,204,283</u>	<u>62,910,567</u>
Present Value of Future Prize Payments	22,818,383	221,737,718	244,556,101
Add Adjustment to Reflect Fair Value	<u>1,677,647</u>	<u>40,851,034</u>	<u>42,528,681</u>
Fair Value of Future Prize Payments as of October 31, 2020	<u>\$ 24,496,030</u>	<u>\$ 262,588,752</u>	<u>\$ 287,084,782</u>

LOTTERY INVESTMENTS

Certain Lottery prizes awarded are payable to the winners in annual installments ranging from 19 years to life of the prize winners, with the first payment being made at the time of the drawing. Effective July 30, 1985, the law provides that the State Treasurer may, with consent of the Director; contract to invest in securities which provide payments corresponding to the Department's obligations to these winners.

Money may be invested only in bonds, notes, certificates of indebtedness, treasury bills, or other securities constituting direct obligations of the United States of America and all securities or obligations the prompt payment of principal and interest of which is guaranteed by a pledge of the full faith and credit of the United States of America.

October 31, 2020	Fair Value
PNC	<u>\$ 287,084,782</u>
Total	\$ 287,084,782

Interest Rate Percentages:

Minimum interest rate	1.806%
Maximum interest rate	7.741%

Investment Income and Average Yield Rate:

Investment Income	\$ 727,549
Average Yield Rate	3.575%

Monthly investment income and the average yield rate is an "effective" income amount and yield rate. There is no cash realization of interest income by the Lottery Department. The yield rate is computed by dividing the effective investment income for the month by the average present value of the investments for the month.

Broker-Dealers:

UBS Financial Services, Inc.
HSBC Securities, Inc.
Multi-Bank Securities, Inc.
RBC Capital Markets
U.S. Bancorp

Security Holders:

PNC

8. Investments and Prizes Payable in Installments

Prior to July 30, 1985, certain prizes awarded were payable to the winners in annual installments ranging from 10 years to life of the prize winners, with the first payment being made at the time of the drawing. The Department entered into agreements with insurance companies under which the Department purchased annuities under group contracts that provide payments corresponding to the Department's obligation to these winners.

Interest rate risk is the risk that an investment's fair value decreases as market interest rates increase. Typically, this risk is higher in debt securities with longer maturities. The Department purchases investments with maturities scheduled to coincide with cash requirements. Interest rate risk is managed according to the purpose of the investments and the projected time frame for the use of these assets.

The investment in prize annuities are subject to fluctuations in fair value due to interest rate risk, but these annuities are held to maturity to satisfy the annual installment obligations to prize winners. The fair value at maturity is the face value of the annuity, regardless of the fluctuations in value during the time period that the investments are outstanding.

As required by generally accepted governmental accounting principles, the present value of the annuities and the present value of the related liabilities have been reported in the financial statements for those annuities which were purchased in the name of the Department and which the Department has retained the rights of ownership. The Department would be liable for future payments if the insurance companies were to default on their payments. The investments in annuities have a weighted average maturity of 1.49 years. The present value of future prize payments, which is reported in the State Lottery Fund, follows:

	<u>Current</u>	<u>Long-Term</u>	<u>Total</u>
<u>For the Fiscal Year</u>			
2020-2021	\$50,000	\$ -	\$50,000
2021-2022		50,000	50,000
Total Future Prize Payments	50,000	50,000	100,000
Less: Present Value Adjustments	1,257	2,483	3,740
Present Value of Future Prize Payments as of October 31, 2020	<u>\$48,743</u>	<u>\$47,517</u>	<u>\$96,260</u>