

CALIFORNIA STATE LOTTERY COMMISSION

Minutes – February 10, 2011

Sacramento, California

1. Call to Order

Chairperson John Mass called the public meeting of the California State Lottery Commission to order at 9:30 a.m. at the California State Lottery Headquarters, 600 North 10th Street, Sacramento, CA 95811

2. Pledge of Allegiance

John Mass led the Pledge of Allegiance.

3. Roll Call

Mass thanked Yuri Vanetik for his service as Lottery Commissioner and welcomed Alex Fortunati as the Lottery's newest Commissioner. Mass also congratulated Commissioner Menchaca on his appointment and approval by the Senate. Finally, he thanked Joan Borucki for four and a half years of leading the Lottery as Director.

Commission Members Present:

Commissioner John Menchaca

Commissioner Alex Fortunati

Chairman John Mass

CSL Staff and presenters:

Linh Nguyen, Acting Director

Lisa Hightower, Chief Legal Counsel

Michael Ota, Deputy Director of Finance

Roberto Zavala, Chief of Internal Audits

Jim Hasegawa, Deputy Director of Business Planning

Rudy DiMassa, Special Assistant to the Deputy Director of Sales/Marketing

Michele Tong, Deputy Director of Sales

Ed Fong, Chief of Product Development

Liz Furtado, Sr. Marketing Specialist

Leticia Saldivar, Chief of Consumer Marketing and Advertising

John Reilly, Sr. Marketing Specialist

Elisa Topete, Assistant to the Commission

Mary Montelongo, Recording Secretary

4. Consider Approval of the Agenda

Mass asked if any of the Commissioners wanted to make changes to the February 10, 2011 agenda as proposed. Menchaca moved to approve the agenda. Seconded by Fortunati. The motion passed unanimously (3-0).

5. Approval of Minutes

Mass asked if there were any additions or corrections to the December 9, 2010 minutes. Menchaca moved to approve the October 28, 2010 minutes. Seconded by Fortunati. The motion passed unanimously (3-0).

6. Commission Liaison Reports

Mass will discuss the liaison appointment with Fortunati and it will be announced at the next Commission Meeting.

Commissioner Menchaca:

Menchaca provided the Audit Liaison Report. Field work has been completed on the Fourth Quarter Transfer report, Fiscal Year (FY) 2010. One preliminary issue will be noted once a draft report is issued. Field work has been completed on the First Quarter Transfer report, FY 2011. There are no preliminary issues. Field work has been completed on the implementation of past State Controller's Office audit recommendations. Five preliminary issues will be noted once a draft report is issued. Field work has been completed on the 3Ball Production contract audit. Five preliminary issues will be noted once a draft report is issued. Field work is expected to last through the end of February 2011 on the Otto Construction contract. There are no preliminary issues. Field work has been completed and is under review of the LPA Sacramento, Inc., contract audit. There are no preliminary issues.

KPMG continues to observe and report on the Lottery's daily draws. No significant issues were noted. The Contract and Procurement Services internal audit is on hold with no preliminary issues. Field work began in August 2010 on the Camelot audit and is expected to last through the end of February 2011. There are no preliminary issues. Field work began in August 2010 on the Lottery's Asset Management and the audit scope expanded in November to include the inventory of Scratchers® tickets. Field work is expected to last through the end of February 2011, and there are no preliminary issues. Finally, the Audit Committee will have a formal meeting following today's Commission meeting.

Chairman Mass:

As Marketing Liaison, Mass was updated on the new MEGA Millions® television commercial. The California Lottery and its agency, Casanova Pendrill, produced and aired a brand new commercial for MEGA Millions titled, "Fun House." The ad aired during the recent MEGA Millions roll of \$360 million, and will air in rotation on other MEGA Millions branded commercials in the future. Jackpot alerts include MEGA Millions jackpot specific messages to support jackpots of \$50 million or more in Los Angeles and \$70 million in San Francisco.

The new "Set for Life" Scratchers advertising campaign will begin in February with a \$5 price point offering \$100,000 a year for 20 years. It will be featured in

an advertising campaign that will mark the first effort to put together a commercial with the Lottery's new general marketing advertising agency, David & Goliath of Los Angeles.

The Lottery entered into partnership on November 18, 2010 to jointly offer prize incentives to players in contiguous areas around the Viejas Casino which is located in San Diego during February 2011. The promotion represents the first time the Lottery has partnered with a tribal casino.

As Procurement Liaison, Mass was briefed by staff and requested approval of the following: A purchase order for Allied Network Solutions to replace existing annual maintenance contracts. The Lottery is migrating to Juniper for its networking equipment. The OPNET Solutions replaced the Cisco maintenance contract, which is up for renewal in April 2011.

There is a contract amendment with Honeywell International to continue providing 24-hour a day, seven days a week scheduled maintenance of the Lottery air-conditioning systems. There was a purchase order to Avantel for the procurement of Juniper network equipment for the district offices. There is a contract award to Infiniti Consulting Group to provide project management services and assist the Information Technology Department in implementing several technological infrastructure projects to support the Lottery's move to the new headquarters building.

The Lottery released an invitation to bid to provide on-call, as needed services for an independent firm to provide expert advice, analysis, and recommendations on current financial reporting issues, accounting treatments, and potential changes to business processes. The Lottery released a Request for Proposal to procure services for an advertising agency to provide Hispanic marketing services. There is a contract amendment with Mayer Brown, LLP, which provides the Lottery with legal counsel and services in connection with some specialized tax matters that the Lottery has. Lastly, there is a contract award to University Enterprises, Inc., to provide student assistant services to provide various divisions and offices within the Lottery with assistance.

7. Director's Report

a. Lottery Report Card

Linh Nguyen, Acting Director, stated the Report Card would be presented in parts; A sales update and the RENEW project update. Nguyen reported that sales have accelerated since December due to the passage of Assembly Bill (AB)142, which allowed the Lottery to increase prize payout percentages, and the three-year strategic plan initiatives, which is the RENEW project. Sales have been around \$3 billion for the past several years however the Lottery expects it to increase to over \$3.4 billion this Fiscal Year (FY) and reach over \$5 billion by

FY 2013-14. More importantly, profits to education which have been around a billion dollars for the last several years are also expected to increase to about \$1.4 billion by 2013-2014.

Scratchers are up 11 percent over this same period last year and MEGA Millions is up 16 percent. SuperLOTTO Plus® (SLP) is down 7 percent and the Daily Games are up 4 percent, with Hot Spot® being up 9 percent over that same period. Scratchers are projected to finish the year at 26 percent above the prior fiscal year, MEGA Millions up 2 percent, SLP down 9 percent, Daily Games up 2 percent and Hot Spot up 15 percent.

Based on the LaFleur's data, which is an industry publication that tracks sales for all state lotteries, the California Lottery is currently the fastest growing lottery in the United States. From October to December in the fourth quarter of 2010, the Lottery had a 20 percent year-over-year growth, which is compared to the next best states, which are West Virginia and Delaware, both at 16 percent. Lottery sales are projected to grow to over \$5 billion by FY 2013-14. Retailer commissions will grow significantly as well as the result of the RENEW Projects and the prize payout strategy. Because of the business plan and AB 142, players are happier with the product; players are winning more in prizes; education will receive more money; and it is good for business because retailers have more money that goes into local communities.

Nguyen introduced Rudy DiMassa who is the new project manager for the RENEW Project. DiMassa stated that the RENEW strategy commenced in August 2009 with the objective to develop a three-year business strategy for the Lottery. The strategy was signed off by the Commission in May 2010. The project subsequently moved into the implementation phase of five main streams of work: Retailer and Sales Support, Scratchers End to End, Draw and Jackpot Games, Marketing, and Digital Communications and Public Website. DiMassa introduced the team leads that have been heading each one of the work streams for an update.

Michele Tong, Deputy Director of Sales, provided accomplishments which have been achieved in the last six to nine months under the RENEW program. Retailer Segmentation is categorizing the Lottery's network by the different retailer segment's total combined sales, which is Scratchers and draw games, by district, Zip code, and trade style so that staff understands the business better. The Sales Advisory Committee is comprised of representatives from the field offices. The committee provides input and feedback on the variety of procedures, policies, and programs staff is currently work on. The headquarters staff field visits, is an opportunity for division managers and key decision-makers to get out in the field and obtain firsthand information by working with the Lottery's retailer and sales team. The Retailer Advisory Board allows the Lottery's retailers, both

independent chains and retail trade association members, to come in and assist staff in looking at developing more sales-building opportunities.

The first phase of the Retailer Incentive Program was the "Makeover of the Year" program. District Offices had the opportunity to select a middle-of-the-road retailer and using their sales expertise and hard work, staff was able to rebuild and educate the retailer in running a good Lottery business. The team included District Sales Representatives, district office staff, headquarters staff, retail marketing and also GTECH. South Grove Liquor was honored as being the Makeover of the Year retailer for 2010 and has raised their sales by an average of \$10,000 per week. (video shown).

The Field Pilot Program consisted of choosing one district office that represented the entire state and ran through seven components, ranging from visitation to modifying their sales call, focusing on merchandising, and a few other components. In three months, the San Francisco District Office raised incremental sales at each one of the 900 locations in the tests, from zero to \$66 a week for each one of those locations. The pilot for the seven components was extremely successful and staff is now focusing on Scratchers activations.

The Ex\$ell Program consists of four components; full facings, activations of the ideal mix, which is the Lottery's core games and new games; the multiple \$5 game facings; and lastly external visibility. The Key Account Sales Building Strategy is critical as the Lottery builds the business for the future. The strategy will run into an Ex\$ell format where staff will focus on six components in the top ten chains. Staff will initiate the plans with the chains already in a variety of areas as in placement, distribution, and full facings. The Retailer Network Optimization initiative will help staff determine why the Lottery needs to recruit, what it will recruit, where it will recruit, and how it will recruit. Staff will provide additional details on the project at a future meeting. The Retailer Communication initiative will help staff build a platform on how to communicate to the Lottery's retailers involving publications, the e-business site, and some other direct emails to the retailers to make sure they obtain the message as soon as possible.

The Ex\$ell program's performance includes higher sales, an increase in the activation numbers, and the increase in the number of \$5 facings. The activation figures are a total of 18 games, which was raised from 16 and these are the core games where there are specific themes and playstyles. The \$5 game is the target price point and it has helped sales grow incrementally because it takes the same effort to sell a \$1 ticket as it does a \$5 ticket, however the commission is much higher. Statistics have shown in player focus groups that players look for new games so the Lottery will continue to regularly keep them merchandised properly which will make a difference. The sales force is working hard on optimal placement of the Lottery's equipment and point of sale, educating the retailers on how to sell the Lottery successfully.

DiMassa introduced Liz Furtado, who is the leader of the Scratchers End-to-End team. Furtado is a Sr. Marketing Specialist in the Marketing department who is responsible for developing all the Lottery's Scratchers games. Furtado went over the initiatives which included the number of games that were being distributed by the Lottery's warehouses. When the review first began, there were over 50 games in active distribution and in prior months, there was over 70 games in distribution. Because the average games carried by Lottery retailers are about 18 to 20, it was not benefiting the Lottery because some of the games were not good-selling games. It was clogging the system and preventing the better-selling games from entering the marketplace. By removing half of the games, staff is able to provide players with preferred games, while providing retailers with games that move quickly and increase their profits.

Staff created the classification levels for the retailers based on sales, which specifically deals with inventory management. In the past, Lottery retailers were treated the same, whether they sold \$2,000 a week or \$200 a week. By creating the levels staff is able to provide the appropriate services and customize the ticket orders to better fit the retailers' needs. Staff quickly worked to revise the remaining 2009-10 product plan to make better use of the prize payouts and include core games that would provide for additional sales in that year. The Lottery was able to launch an additional \$5 game and on May 27, 2010, "Millions in Cash" was launched, which also had TV advertising support.

Staff developed the 2010-2011 game plan to include the many key learnings. Some highlights included launching games every three weeks versus the normal four-week intervals in order to get out the high payout games in the market quickly. Because of the strategy, the Lottery achieved over 90 percent of high payout games by the end of September. Staff improved the prize structures and created game profile templates which helped streamline the game development process. The Lottery was also able to include seven \$5 games. The Lottery launched its first \$5 Holiday game; and coming in May will launch the first \$5 crossword game. Staff revised the vending and in-counter display guides in order to ensure that the ideal mix of games was always being carried. There is a more proactive approach to Scratchers management by making sure everyone is receiving Scratchers sales information and by meeting frequently in order to make decisions to target specific areas that need improvement.

The initiatives that are still underway are the complete review of the distribution process which includes the ticket-ordering system and warehouse operations. The review is expected to be completed by June 2011. Staff is conducting additional research on Scratchers themes, attributes, and price points that will help predict the sales performance of games prior to their launch. Next year's product plan is at the beginning stages, taking into account the key learnings and also growing the player base and providing proven products in order to maximize sales, and increasing the contributions to education. The revenue and

performance indicators include weekly rate of sale, settlement, and validation reports, which are closely monitored each and every game.

DiMassa introduced Ed Fong, Chief of Product Development, who is the leader of the Draw and Jackpot Games team. Fong went over the three initiatives for the draw games category in terms of key findings and next steps. The first initiative was completing the situation analysis for Hot Spot, the California version of a Keno-type game. The game uses minimal marketing resources, and slight reinforcements that could translate into harder sales. Staff completed two Internet player research studies that updated the player demographic data which gained new insights into how players receive the Hot Spot game. The key elements from the player studies included, additional spots and higher payouts that generated more interest in the game. There was also very strong brand equity with the game name with core players. Bulls-eye was an important feature for all player segments, from the core players to the infrequent players. Nearly half of all players played the Bulls-eye feature which allows players to win higher prize amounts by wagering additional dollar per play per draw.

All player segments from the studies were interested in higher prize levels than the top prize of each spot and want to see new promotions and features. Retailer recruitment and servicing opportunities also surfaced from the studies. Some of the quick wins that were identified for Hot Spot included modifying the game to have all ten spots with the Bulls-eye feature for every single spot, and increasing the prize payouts. Staff will develop and launch a master-type program throughout the state to interact directly with the players and bring excitement back to the retail level, with the players as well as the Lottery. In terms of revenue and Key Performance Indicators (KPI) headlines for the Hot Spot game, staff tested various higher payout scenarios to gauge the sales response from players and higher payout promotions generated higher sales. The promotions helped staff in determining the optimum overall payout level which should fall between 62 to 64 percent. Should the prize payout increase to 62 percent in Hot Spot, the Lottery could potentially increase sales by 24 percent.

The second initiative was completing the situation analysis for SLP and MEGA Millions. Staff needs to understand the key issues that players express in terms of if a new game is desired, if more communication is needed with the current game or if it was something else. Some of the findings from the prior research studies indicate that SLP is in a long-term decline since MEGA Millions launched which is due to the reduction in player spending and frequency of play. SLP cannot compete with other multi-state games on a jackpot level because it takes several more rolls to reach large jackpots than before. SLP needs a clear, compelling proposition that will not be detrimental or negatively compared with other jackpot games. Staff needs to understand all player segments as well as the rationale and motivations to play SLP because players have expressed some confusion between SLP and MEGA Millions.

SLP is the most recognizable brand in California and there is also a very strong, positive attitude towards SLP with the existing players. It is still a viable game and the rate of decline has simmered to about \$4 million a draw. There are some player issues that need to be addressed and there are heavy marketing costs to launch any type of new game that might be cost prohibitive in terms of the return on investment. Staff needs to be careful with any type of game changes because other states that have been in a similar situation have tried to change their game and have failed miserably.

In terms of initiatives for progress in SLP, staff has identified some quick wins when examining repositioning and differentiating the game by leveraging the California theme and capitalizing on the affinity players have for SLP. The Lottery needs to regain the top-of-mind awareness, the saliency the game could bring through Lottery-owned devices. Staff needs to develop some value-added programs such as a second chance feature, some purchase incentives, and promoting winner awareness at the retailer. Staff wants to use advertising and promotional agencies to brainstorm some potential game ideas that can be developed into a possible game or promotion for SLP. The Lottery would like to investigate a subscription program and a loyalty program to keep core players interested in the game. If the Lottery does not help the game, staff estimates that SLP sales will continue to decline about 5 to 15 percent over a 12-18 month period.

The third initiative was addressing a change for Fantasy 5, which began in 1992 and is a 5 of 39 matrix. In 1995, a \$5 purchase incentive was added to the game so that players who purchased \$5 or more received a coupon that enabled them to appear on the Lottery's TV show for a chance to win \$150,000. In 2009, the TV show ended but staff developed a program to maintain the \$5 purchase incentive called "Bonus Bucks." Players enter codes at the Lottery website by purchasing \$5 or more of Fantasy 5 plays and had a chance to win prizes and weekly drawings. The Fantasy 5 Bonus Bucks program is a self-funded program that awards 15 weekly prizes that total \$42,000. Since the program launch, the Lottery has maintained sales levels at the lower rolls and actually increased sales at the higher rolls; up to a 29 percent increase in sales during the 1 to 5 roll periods.

DiMassa introduced Leticia Saldivar, Chief of Consumer Marketing and Advertising. Saldivar went over the completed initiatives beginning with the General Market Request for Proposal (RFP). Last year, staff researched industry agency review of best practices and worked with an agency review consultant to update the Lottery's procurement process. A key change was to include a semifinalist phase to the RFP process. The additional phase allowed the Lottery evaluation team more face-to-face meeting time with agencies to better assess their qualifications, philosophy, and staff experience. The key learnings led to

the successful award of the general market advertising services contract to David & Goliath, which the Commission approved October 2010.

The 2010-11 marketing plan was developed to support key business initiatives such as marketing MEGA Millions and Scratchers. In the past, staff supported the SLP brand and jackpots with advertising. The analysis found that due to limited ad budgets, the Lottery's dollars were best spent supporting the MEGA Millions game with its higher jackpots. The MEGA Millions marketing initiative re-launched the consumer-tested, "Imagine What a Buck Could Do" advertising campaign in support of jackpot alerts. The advertising support for MEGA Millions was focused in key markets with the greatest sales potential which was Los Angeles and San Francisco. Saldivar showed the latest consumer-tested TV ad that was launched January 3 to freshen the MEGA Millions "Imagine What a Buck Could Do" campaign. It was created by the Lottery's Hispanic advertising agency partner, Casanova Pendrill, and airs in both general and Hispanic markets. It is titled, "Fun House" (video played).

The next initiative was the marketing of Scratchers. On September 13, 2010, the Lottery kicked off the higher prize payout advertising campaign to announce the change and benefit to players. A second statewide Scratchers advertising effort ran in December to reinforce Scratchers higher prize payout messaging during the key holiday season. The objective of higher prize payout advertising was to increase sales and ultimately meet the Scratchers sales goal for the year. Saldivar showed the first TV spot created by the Lottery's new general market agency partner David & Goliath that will begin airing February 14 in Los Angeles, San Francisco, and Sacramento, in support of the \$5 "Set for Life" Scratchers (video played).

The first initiative in progress is the marketing Return on Investment (ROI), also known as media analytics and econometrics. This initiative will help staff refine the Lottery's media planning and spend allocations. The next item is the Marketing Communication Processes. The initiative will document marketing processes starting from the research phase, through the performance measures for the following areas: Consumer marketing, retail marketing, experiential marketing, and online marketing. By defining, documenting, and streamlining the marketing processes, future business activities such as decision-making and efficiencies would be enhanced.

Another initiative in progress is the Hispanic Market Advertising Services RFP. The marketing staff utilized the proven and successful general market procurement process that incorporated industry best practices into the recently released Hispanic Market Advertising Services RFP. For the 2011-12 advertising plan, staff is in the process of developing an advertising plan for the upcoming fiscal year that supports key business initiatives. Staff will begin using the media analytics or econometrics model that will identify campaign factors that can be

influenced. For example, where to advertise and which media vehicles to use to increase future sales and measure the effectiveness of marketing spend.

Under the key performance initiative headlines, sales for MEGA Millions are over \$61 million, or 23 percent higher than sales for prior draws at comparable jackpots, from the start of the fiscal year through the week ending February 5. For Scratchers, unaided game awareness was measured by the Lottery's Communication Effectiveness Tracking Study. It went from 29 percent prior to the September 13 advertising campaign, to 50 percent after the campaign. Prior to advertising on September 13, Scratchers past-year playership was around 20 percent. After the statewide higher prize payout advertising effort, past-year playership showed an increase of 7 percent.

DiMassa introduced John Reilly who is responsible for developing, implementing, and maintaining the Lottery's new online marketing program. Reilly stated that several years ago it was determined by staff that the existing public website's foundational structure or architecture could not sustain enhancements the Lottery wanted to employ to increase the overall activity on the site. It was concluded that the digital channel was underutilized and could be more than a source for winning numbers. Staff's strategic objective for the new website is to transform the existing website from a purely informational channel, to an entertainment destination site for use a key marketing tool to drive sales and ultimately increase the contribution to education.

The new public website project was initiated during the second quarter of Fiscal Year 2009-10. The project has four distinct phases. The first phase is the define phase, which is the process whereby the project team, in conjunction with Solution Set, identified business challenges, the various audiences, the current landscape or best practices, consumer insights, and general goals and objectives the Lottery wanted to achieve from a new website. The goals and objectives included increasing sales, improving brand image, and increasing visitor efficiency. The results of the phase provide the basis for Phase 2, which is the design phase. This phase is the process of developing a specific marketing plan for the new website, including a variety of solutions to achieve the stated goals and objectives. The result of Phase 2 was the approval of the new look and feel of the site, along with site attributes and navigation

Reilly provided samples of the new site that included the new homepage, which had a main navigational bar that offers visitors the information most seek in an intuitive and easy-to-understand presentation. It also features a games bar that presents the Lottery's entire game portfolio and important information for each game in a player-selected format. The homepage also includes a winner's scroll bar, reinforcing to visitors that there are many winners that play the Lottery. The homepage has an extensive amount of real estate, with the hero space above the game bar and flexible modules below it to promote, inform and entice visitors

to become aware of the Lottery's various value-added offers. The homepage footer provides more one-click links to specific information and allows secondary information that visitors want, to have the visibility by being on the home page.

The casual games page offers visitors an opportunity to play games just for fun. It will offer a variety of fun game styles, allowing players to compete against themselves or even play versus friends. The Lottery will also offer tournaments as an additional source of entertainment. It enables the Lottery to communicate with players on a regular basis with information that is important to them as they routinely play games. Integrating the existing second-chance program platform, such as Replay and Fantasy 5 Bonus Bucks with the new casual games platform creates a strong, initial push at offering visitors an entertainment destination.

The third phase of the project is the development phase, or the actual programming of the architecture for the site, along with its navigational structure, and the flexibility and scalability that will be available to sustain future enhancements. Once completed, the phase will include testing of the functionality or navigation of the site, its content and integration with information sources. Staff will utilize two testing methodologies, each being approximately 30 days in duration; the alpha testing and the beta testing.

The final phase is the deploy phase, or the launch of the new site. Based on a successful beta test, a soft launch is schedule for the summer of 2011. Once launched, there will be constant refining of the site using site analytics to ensure optimum performance. An additional element within the scope of the project is the creation of a digital marketing communications department that will be responsible for the online marketing program which will maintain the new site. It will also include an interfacing with other Lottery divisions regarding the governance process for content changes, managing new site initiatives, and organizing player casual game tournaments and player interactions.

With the availability of the new public website's architecture, future functionality that will be studied and implemented if research and business practices dictate, are check-a-ticket functionality. It will allow players to determine if they have won and how much they have won by entering tickets online. With the players' permission, that ticket number can also be automatically entered into the appropriate second-chance program, creating greater efficiency for the player and increasing redemption rates into the Second Chance Program. The Lottery will announce that the existing Scratchers Replay program has just registered its one-millionth player and surpassed 100 million tickets entered since inception of the program in late May 2009. Staff believes the additional functionality will help increase the redemption rate of non-winning tickets by integrating check-a-ticket with the second chance programs.

Another initiative to be studied is a rewards or loyalty program that will further create second chance entry efficiencies and provide the Lottery with player purchase history to offer regard points which the player can then use to enter bonus draws. Once the new site goes live, staff will be focused on several key performance indicators, including the number of visitors, the length of time visitors spend on the site, and the number of pages viewed. Additionally, staff will track the number of players that register in the second chance programs as well as Jackpot Captains. Staff will monitor all casual game play, the most popular games, and other metrics associated with the casual game platform.

b. Annual Investment Portfolio Restructuring Report

Michael Ota, Deputy Director of Finance, presented the Annual Investment Portfolio Restructuring Report. Ota thanked Joel Tokimitsu, who is the Lottery's investment officer, for his work on the Investment Restructuring Program. One of the requirements of the Lottery's investment policy is that a comprehensive report on the Lottery's Investment Restructuring Program be provided to the Commission no less than annually.

The program achieved \$61 million of net proceeds from investment restructuring, which were earned during a 14-month period beginning May 2001 and ending June 2010. The Investment Restructuring Program involved replacing a portion of the Lottery's \$1.5 billion of U.S. Treasury securities with higher-yielding U.S. Agency securities and Municipal securities. Of the \$61 million of net proceeds, 34 percent went directly to education. The remainder was utilized to increase prize payouts, fund marketing efforts, and also the RENEW initiatives. The proceeds from the investment restructuring enabled the Lottery to generate higher sales and greater contributions to public education in fiscal years 2008-09 and 2009-2010.

The Lottery is proud of the results and the manner in which it was accomplished. The Investment Restructuring Program took place using prudent investment standards that are the foundation of the Lottery's investment policy. Risk management was essential throughout the process. Sufficiency of cash flow and safety of capital were key components of the Lottery's risk management strategy. "Sufficiency of cash flow" means that the Lottery replaced U.S. Treasury securities with investments that maintained future cash flow to pay our annuity prize winners.

"Safety of capital" refers to the swapping of U.S. Treasuries for other investment securities which added a small element of risk to the Lottery's investment portfolio. The added risk is primarily with Municipal securities. The risk was addressed through two means: one, by requiring minimum credit ratings for those municipal bonds, and two, diversification of the Lottery's investment portfolio.

The Investment Restructuring Program was essentially completed in June 2010. Not only did staff achieve \$61 million, it built an investment portfolio of well-diversified safe and secure investments. At completion of the restructuring effort, the investment portfolio was comprised of 32 percent of U.S. Treasury Securities, 31 percent of U.S. Agency Securities and, 37 percent of Municipal Securities. Therefore 63 percent of the Lottery's investment portfolio is either backed by an explicit or implicit guarantee by the United States government. The remaining 37 percent of the portfolio is allocated to investment-grade municipal bonds, primarily general obligation bonds, which are backed by the taxing authority of the state or local issuer, and are considered to be among the safest municipal bonds.

The financial markets have changed considerably since the Lottery first introduced investment restructuring. Staff does not anticipate opportunities to further leverage the investment portfolio in the near future. The Lottery's investment activities will focus on the business as usual activity of purchasing securities for the Lottery's annuity prize winners and activities to manage investment risk. Staff will continue to monitor opportunities to utilize the Lottery's investment portfolio and take advantage of opportunities to advance the mission of maximizing contributions to public education and keeping the Lottery's investment safe and secure.

8. Consent Calendar

a. Microsoft Enterprise Licensing Agreement Purchase

Menchaca made the motion to approve Consent Calendar Item 8(a).
Seconded by Fortunati. The motion passed unanimously (3-0).

9. Action Items

a. Financial Services Contract

Roberto Zavala, Chief of Internal Audits, presented information on the contract award to KPMG for financial auditing-related services. Government Code section 8880.46.5 states, "The Lottery shall engage an independent firm of certified public accountants to conduct an audit of all accounts and transactions." The Lottery's past contract expired December 31, 2010. On October 1, 2010, a Request for Proposal (RFP) was publicly advertised, emailed, and mailed to 32 potential vendors. The RFP was also advertised in the Small Business Exchange, Disabled Veteran Voice, Bidsync, and the Lottery Interplay News. The Lottery received ten intent-to-bids and ultimately received five proposals.

Lottery staff evaluated the proposals according to its policies and procedures including the following four elements: Mandatory Submittals Evaluation, DVBE Evaluations, Rated Submittals Evaluations, and Price Proposal Assessment. All five proposals passed. The evaluation team rated and compared proposals in the four categories as, "superior,"

“significantly exceeds,” “exceeds,” “meets,” “meets with exceptions,” and “does not meet.” The bidders were evaluated on the following items: Background, experience, and capabilities; education and work experience; company and account-team organization charts; and their work plan. The final step of the evaluation process included a review of the price proposal assessment. Price proposals were revealed only after completing the first three steps of the evaluation process.

Pursuant to the Lottery Act and the terms of the RFP, the contract is to be awarded to the bidder with the best value to the Lottery. Three bidders received overall “significantly exceeds” for the overall rated submittals evaluation, including KPMG. KPMG was the only proposal to achieve a “superior” rating for the category of personnel, education, and work experience. KPMG also submitted the second-lowest price. Lottery staff believes the proposal submitted by KPMG provides the overall best value for the Lottery. Staff recommends the contract award go to KPMG to provide financial auditing and related services for three years, with the option to extend up to two, one-year periods. The total amount of the contract spending authority is \$700,000.

Mass asked if anyone from the audience had any questions on Action Item 9(a). Ken Macias, founder and Chair of Macias, Gini & O’Connell, expressed his concerns of the contract award. Mass proceeded to the motion of approval.

Menchaca made the motion to approve Action Item 9(a). Seconded by Fortunati. The motion passed unanimously (3-0). Menchaca ask the Commission and staff to take into consideration Mr. Macias recommendations of going out to bid for other audits that will be coming up for bid in the next two years. Zavala stated that staff will go out to bid for the draw service and the security audit.

- b. Contract Award for Communication Effectiveness Tracking Study
Jim Hasegawa, Deputy Director of Business Planning, presented the recommendation on the contract award for the Communication Effectiveness tracking study. Examples of measures from the tracking study include unaided awareness of the Lottery’s games, attitudes about the Lottery’s products as well as about the Lottery overall, the percentage of adults playing the Lottery’s games and who plays these games. Finally, staff also includes other questions from time to time such as usage of the Lottery’s website.

The tracking study is done amongst a random sample of California adults. The tracking allows staff to measure any changes as a result of new games, new marketing programs, and specific advertising campaigns.

The second reason for the tracking study is that it fulfills a requirement in the Lottery Act. The Lottery Act requires the Lottery to conduct studies, either on an ongoing basis or from time to time, to look at such things as the reactions of citizens of the state to our existing or proposed features in Lottery games, as well as special studies about the demographics of the players.

The Request for Proposal (RFP) process took a little longer because it was on hold prior to the evaluations being conducted to ensure that the scope of services in the contract would meet the Lottery's needs because of potential changes with the various RENEW initiatives. As the RENEW projects were formulated, research staff worked with project sponsors and project managers to understand what their research needs would be. Based on these discussions, staff felt the existing RFP would meet the needs of the Lottery and determined a new procurement was not required. Nine of the ten bidders agreed to extend their proposals.

The two key areas of the RFP process are a rated submittal area and a cost proposal. In the rated submittal area, the most important factor is called "managing the internet sample," because the contract would change the methodology of the tracking study. Traditionally, most market research studies in the past have been done typically either in person or phone; and the tracking study used a telephone methodology. The RFP specified the desire to change to incorporate internet collection of the interviews. The other important area of the rated submittals was the "survey strategies" to ensure that proper techniques and quality controls would be used. This way, the data collected would be representative of the state as a whole. This is critical since the data from this study are used to make decisions on advertising like whether a particular campaign was successful.

The Lottery is required to award the proposal to the overall best value therefore staff recommends Burke as the company. Burke had the highest ratings of "significantly exceeds" for the most critical areas, both in terms of managing the Internet sample, as well as for the survey strategies. Compared to the other vendor receiving a score of "significantly exceeds" in one of the two critical categories, Burke offered a substantially lower cost. While Burke is not the lowest cost, their proposal delivers substantially more through providing a sample of respondents with the highest quality. If the sample is not representative of all California adults, the result of the study would be of no value. The new contract with Burke would result in a cost savings of over 40 percent compared to the amount spent currently for this study.

Commissioner Fortunati asked who makes the determination of why only two languages are used for the surveys, English and Spanish. Hasegawa stated that there is not a large market research community that does in-language interviews outside of English and Spanish. With few firms having these capabilities, it would be very expensive to do interviews in other languages for the tracking study. From time to time, staff has conducted research in other languages, based on the needs of the Marketing Division.

The current study is an ongoing, every-week enterprise which is why it was elected to perform them in English and Spanish because it covers the predominant languages in California.

Mass asked if anyone from the audience had any questions on Action Item 9(b). No one came forward so he proceeded to the motion of approval.

Menchaca made the motion to approve Action Item 9(b). Seconded by Fortunati. The motion passed unanimously (3-0).

10. Commissioner General Discussion

11. Scheduling Next Meetings

The next Commission Meetings are tentatively scheduled for April 7, May 19, June 23, September 8, October 27, and December 8, 2011 in Sacramento.

12. Public Discussion

Mass asked if anyone from the public had anything to discuss. Mark Nichols from the California Peace Officer's Memorial Foundation spoke about future partnering opportunities with the Lottery. Joan Michel-Lahman, president of "Saving our School," spoke of her concern regarding the Lottery's contribution to schools. Ms. Michel-Lahman requested a copy of the Lottery's past two years budgets, including the current 2011 budget.

13. Closed Session

The Commission convened to a closed session at 11:32 a.m. to confer and receive advice from legal counsel regarding litigation (including adjudicatory proceedings, potential litigation exposure or initiation): California Attorneys, Administrative Law Judges and Hearing Officers, etc. v. Schwarzenegger et al.; SEIU Local 1000 v. Schwarzenegger et al.; International Union of Operating Engineers etc. v. Schwarzenegger et al.; Claim for Refund of Sales and Use Tax, State Board of Equalization; Seastrom v. California Lottery et al.

14. Adjournment

Meeting adjourned at 12:00 p.m.