

**The Lottery Enterprise Contribution Act – Why It Is Important**  
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Governor Christie and the State Legislature enacted the bipartisan Lottery Enterprise Contribution Act (the “Act”) on July 4<sup>th</sup> which marks the turning point in the State’s long-term credit rating slide. Some analysts and reporters have mistakenly written about this complex transaction absent full information. So, let me set the record straight by providing an overview.

**The Lottery Enterprise**

In November 1969, New Jersey voters overwhelmingly approved the establishment of the State Lottery. Since its inception, the Lottery Enterprise has been a business-focused entity. The Division of the State Lottery is constantly evolving the Lottery Enterprise brand and regularly revising and enhancing game offerings to retain existing players and attracting new ones. The Lottery Enterprise is recognized as one of the most profitable and well-operated lotteries in the United States and the world, generating approximately \$1 billion annually in net proceeds and is the fourth largest revenue source in the State’s budget. Lottery revenue is constitutionally dedicated toward State aid to education and State institutions.

**Asset Transfers in General**

Asset Transfers typically involve a contribution of an investment such as company stock and/or real estate in lieu of cash, transferred by a plan sponsor to a pension fund. Asset Transfers have been used for corporate pension funding for many years. For example, Diageo PLC, which is one of the world’s largest producers of spirits, including Johnnie Walker and Seagram’s, agreed in July 2010 to transfer 2.5 million barrels of whiskey to its defined benefit plan. The maturing whiskey became a valuable asset of the pension fund.

**The Contribution**

The Lottery Enterprise is an effective and efficient candidate due in part to its well-established financial history and status as a State-run monopoly with low capital needs. The Lottery Enterprise has been a consistent revenue-producing asset for 47 years. Absent federal and State restrictions on ownership, it would have substantial value to a third-party investor. Looking forward, the Lottery Enterprise is also a good candidate because the Northstar contract (in place through FY 2029) contains incentives to maximize net proceeds while protecting downside risk through minimum payment requirements imposed on the vendor.

The State’s pension plans faced an Unfunded Actuarial Accrued Liability of \$49 billion as of July 1, 2016. The Lottery Enterprise Contribution is expected to generate an estimated \$37 billion for the pension plans over the next 30 years. Using Actuarial Standard of Practice No. 44, a discounted cash flow model was used by an independent third party Valuation Service Provider, Acacia Financial Group, which determined the fair market value for the Lottery Enterprise at \$13.535 billion. The Contribution immediately improved the statutory funded ratio for the pension plans to 59 percent from its current 45 percent.

The projected statutory funded ratios after the Contribution and for the next 30 years are even higher than those projected to be achieved if the State started making 100 percent of the Actuarially Required Contribution every year beginning in FY 2018. At the end of the 30-year Contribution term, the State pension plans are expected to be **90 percent funded**, some 10 percent higher than if the Contribution had not occurred.

### **Irrevocable Transaction**

Under the Act, the State made an irrevocable Contribution of the Lottery Enterprise to a newly established Common Pension Fund L for the benefit of the Teachers' Pension and Annuity Fund (the "TPAF"), the Public Employees' Retirement Systems (the "PERS") and the Police and Firemen's Retirement System (the "PFRS") for a 30-year term. The Lottery Enterprise consists of all the assets, properties, interests and rights, existing or acquired in the future, useful or necessary to operate the State Lottery. The Act does not contain any termination provisions. Any decision by a future State Legislature or Governor to reverse the Contribution would trigger extremely harsh penalties on the pension plans and its 760,000 members by violating IRS regulations.

The New Jersey Supreme Court in Burgos has concluded that multi-year budget commitments such as a schedule of pension contributions are not enforceable under the State Constitution. In previous years, pension payments were either skipped because of budget issues or made at levels insufficient to overcome shortfalls. Therefore, the Contribution provides the strongest long-term pension funding commitment the State is able to make without voters passing a constitutional amendment.

The Act requires a revaluation of the Lottery Enterprise at least every five years or earlier if directed by the State Treasurer. If the Lottery Enterprise underperforms, its value will be lowered and the State must make up the difference. If the Lottery Enterprise outperforms, its value will increase, but the State must continue to make the same payment. In this scenario, the pension plans reap the benefit of the upside. As an additional enhancement, the Act contains an automatic trigger. If, for any reason and at any time, the funding level in the pension plans falls below 50 percent, the State must make up the difference by increasing funding.

What happens in year 31? There are no surprises. The Lottery Enterprise reverts back to the State. There is no impact on the pension plans since the Lottery Enterprise value will be depreciated to zero during the 30-year Contribution period.

### **Conclusion:**

- The Contribution provides the strongest long-term funding commitment to the pension system;
- The Contribution imposes a fiscal safety net. The Lottery is recession resistant, and the funding it provides to the pension plans is guaranteed rather than subject to appropriation;
- Adding this contribution to the record-high annual State pension payments made by the Christie Administration (\$8.8 billion since 2010 and two-and-a-half times the combined total contributions of all New Jersey governors since 1995) will immediately improve New Jersey's fiscal outlook;
- The fiscal impact on the State's General Fund throughout the term of the Contribution is neutral for the first five years and manageable thereafter. Those individuals that are most in need will be protected; and

- Along with the State's quarterly appropriated payments, the Contribution improves liquidity for the pension plans, which should result in higher rates of return.