calottery

MEMORANDUM

Date: September 24, 2013

To: California State Lottery Commission

From: Paula LaBrie, Acting Director

Prepared By: Nicholas Buchen, Deputy Director
Finance

Subject: Item 9 (c) - California State Lottery Insurable Risk Policy

ISSUE

Should the California State Lottery Commission (Commission) approve the proposed insurable risk policy?

RECOMMENDATION

We recommend that the Commission approve the California State Lottery (Lottery) Insurable Risk Policy.

BACKGROUND

The Lottery has conducted a comprehensive enterprise wide analysis (Analysis) of the organization's risk exposures to determine the most appropriate management solution of its insurable risks. The Analysis identified eight insurable risk categories that represented the most significant risk exposures of the Lottery: property losses, general liability, automobile liability and physical damages, crime, errors and omissions, professional liability, cyber crime, and advertising injury. In its Analysis, the Lottery also acknowledged its capital risk tolerances, or its ability to absorb insurance related expenses without exceeding its statutory limit for administrative expenses. Finally, a key recommendation from the Analysis is implementing a comprehensive risk management policy that protects the Lottery's beneficiary by ensuring insurable risks are effectively administered.

This policy applies to all enterprise wide insurable risks and determines the appropriate management solution for each risk. Further, the policy provides for a periodic review and analysis of insurable risk to optimize the organization's approach to managing that risk while continuing to maximize supplemental funding for public schools and colleges.

DISCUSSION

The Lottery has a history of managing most of its probable fiscal exposures through self-insurance. With the completion of the Lottery's new headquarter office building in 2011, it was determined that the time was appropriate to take a fresh look at insurable risk and the Lottery's historic approach to managing that risk.

Over the last 18 months, the Lottery conducted an enterprise wide assessment of the organization's insurable risk exposures along with a comprehensive analysis to determine the most appropriate approach to the management of these risks. The work on the Analysis yielded several recommendations for the organization. Based on the recommendations, the Lottery has created a $5 million reserve within its Fiscal Year 2013-14 Administrative Expense budget for the insurable risks it has elected to self-insure. Further the Analysis established a $15 million guideline by which to determine the appropriate self-insurance or insurance approach to mitigating each insurable risk. Any of these risks that are identified to be above the self-insurance threshold will be transferred to an insurance provider unless an exception is identified in the Analysis and approved by the Director.

The policy presented today culminates the recommendations from the Analysis and, by requiring a similar Analysis to be conducted every five years, sets a foundation for the Lottery's continued management of insurable risk.

Attachment

California State Lottery
Insurable Risk Policy

I. STATUTORY AUTHORITY

Pursuant to Government Code Section 8880.24, the Lottery Commission will exercise all powers necessary to effectuate the purposes of the California State Lottery Act. In all decisions, the Commission shall act to promote and ensure integrity, security, honesty, and fairness in the operation and administration of the California State Lottery (Lottery). The Lottery must be operated so as to produce the maximum amount of net revenues to supplement the total amount of money allocated for public education in California.

II. SCOPE

The scope of the insurable risk policy applies to enterprise wide insurable risks of the Lottery. The goal of this policy is to identify all insurable risk and to determine the appropriate management solution for that insurable risk. This policy will also provide for a periodic review and analysis of insurable risk to further ensure that the organization is operating with the most efficient and effective approach in managing insurable risk.

III. INSURABLE RISK

Insurable risk is a type of risk that an insurance provider would be able to charge a large enough fee to cover expected risk expense and also cover the expenses of the insurance provider. This risk must be definable and be financially measurable. The risk cannot be so great that the associated insurance fees are so high that they make insuring unfeasible. Finally, to be insurable, the risk must be actualized from chance. If any of these conditions are not met, the risk is considered uninsurable.

INSURANCE

With insurance, the Lottery would pay a fee to transfer specific risk to an insurance provider. The provider of the insurance charges a premium that is high enough to cover projected Lottery insurance claims but also the operating expenses of the insurer.

SELF-INSURANCE

With self-insurance, the organization will analyze risk and budget funds to compensate itself for potential expenses associated with actualized risk. Any insurable risk could be self-insured. Self-insurance can be beneficial to the organization because the added cost from an insurance provider would not be incurred to the organization. It is rare for an entity to be exclusively self-insured; typically, predictable losses from insurable risks are self-insured with commercial insurance covering risk above a set self-insurance limit.

INSURABLE RISKS OF THE LOTTERY

PROPERTY LOSSES

The Lottery has a headquarters building and multiple district offices, warehouses and an emergency backup facility. Of these facilities, the Lottery has maintained a mix of purchased and leased facilities. A facility on a property would carry potential exposure for its contents as well as relocation, temporary accommodations and salary continuation. Because Lottery facilities are located throughout the State, it is not likely that a catastrophic event would impact each location equally.

GENERAL LIABILITY EXPOSURES

General liability exposures are negligent acts on the part of the Lottery which result in injury to third parties. Because of the high volume of cash transactions, the exposure of the Lottery is higher than that of a standard public entity. As an enterprise, it is expected that risk exposures such as cash transactions may be outside the norm of a standard public entity.

AUTOMOBILE LIABILITY AND PHYSICAL DAMAGE EXPOSURES

Auto liability coverage protects third parties against negligent operators of vehicles. The Lottery maintains a fleet of hundreds of vehicles that are operated throughout the state.

CRIME EXPOSURE INCLUDING EXPOSURES TO THIRD PARTY AND EMPLOYEE THEFT

Crime exposures include the potential for criminal activity by Lottery retailers, vendors, third parties, and employees. The Lottery has tens of thousands of retailers selling its products throughout the state.

DIRECTORS, OFFICERS, AND PUBLIC OFFICIALS ERRORS & OMISSIONS EXPOSURES

Lottery directors, officers and public officials are afforded governmental immunities and coverage against third parties for liability claims arising from conduct within the course and scope of their employment by the California Tort Claims Act under Government Code Section §800 et. seq.

PROFESSIONAL LIABILITY EXPOSURES

The sole area of professional liability identified as an exposure for the Lottery is its Security and Law Enforcement Division.

CYBER CRIME

Cyber crime results from an external party's breach of network security and obtaining information from that network.

ADVERTISING INJURY

Advertising injury is the vulnerability to a competing entity claiming that a slogan or phrase is too close to one already marketed by that entity.

IV. CAPITAL RISK TOLERANCES

Capital risk tolerances are a measure of the Lottery's ability to absorb insurance related expense without exceeding the statutory allocation limit for administrative expense, currently no more than 13 percent of sales of Lottery products.

Beyond the standard capital risk tolerances contained within the Lottery's annual administrative expense, the Lottery also has a capital expenditure capability that provides the organization with the ability to manage the highest and least probable type of insurable or non-insurable catastrophic loss. It should be noted that utilizing any funding beyond the unallocated administrative authority would violate administrative expense parameters of the Lottery Act.

V. INSURANCE STRATEGY

Certain insurable risks are estimated to be at such a probable financial level that they expose the Lottery to an unacceptable risk. Our current policy is to transfer most insurable risk that is identified to be above $15 million to an insurance provider. Probable exposures to this level expose the Lottery to potentially exceeding the mandated 13 percent administrative expense cap for a given fiscal year. Participation in State-sponsored auto liability insurance coverage is referenced in Government Code Sections 16378, 16379, and 11290.

Insurable risk that is identified to be above the self-insurance threshold, as determined by the Lottery's Enterprise Risk Analysis (Analysis), will be transferred to an insurance provider unless an exception is identified in the Analysis and approved by the Director. A reserve for insurable risk shall be budgeted to afford for the management of probable insurable risks and deductibles of insured risks. The decision to insure or maintain self-insurance for each type of insurable risk shall be based on the Director approved Analysis.

VI. PERIODIC INSURABLE RISK ANALYSIS

The Lottery will conduct the Analysis every five years to ensure that the organization's risk exposures and established management approach to each remains appropriate in allowing the Lottery to most effectively manage the Lottery's insurable risk. The Analysis will be submitted to the Director for approval.

VII. CLAIMS AGAINST THE LOTTERY

As a state agency, the Lottery is generally immune from suit, except as provided by the California Tort Claims Act (CTCA). Under the CTCA, an official written claim must be filed with the Victim Compensation and Government Claims Board (VCGCB) within a specific time period in order for members of the public to obtain compensation from a state agency for physical injuries or property damage. The Government Claims Program (GCP) of the VCGCB processes claims for money or damages against the state.
Anyone who wishes to file a lawsuit against the State or its employees for damages must first pursue an administrative remedy through the GCP.

IX. AUTHORITY AND RESPONSIBILITIES

Commission: The Commission provides guidance and direction regarding the Lottery's approach to managing insurable risk. Such guidance shall be in accordance with the purpose and intent of the Lottery Act. The Commission reviews and adopts this Insurable Risk Policy as well as any amendments to the policy.

Director: The Lottery Director shall carry out all activities necessary to comply with this Insurable Risk Policy, including overseeing Lottery staff in the implementation of this policy.

Chief Risk Officer (CRO): Under the general oversight of the Director, the CRO is authorized to direct periodic assessments, procurements of insurance, and self-insurance management directives as prescribed in this policy. The CRO maintains management responsibility over the Lottery's approach to managing insurable risk. The CRO shall supervise and administer all policies related to insurable risk per Commission guidance and direction.

Enterprise Risk Management Team (ERM): Manages the Lottery's insurance contracts to cover specified insurable risk that is deemed appropriate for insurance. The ERM reviews the risk policy on an annual basis to ensure all amendments are incorporated and the current policy upholds the Lottery's mission to provide supplemental funding for public education. Further, the ERM oversees policy execution and ensures all relevant insurance policies are maintained and that the prescribed budget allocation is maintained and set at an appropriate level annually based on the Analysis.

Senior Staff in consultation with the ERM: Maintains responsibility for the daily operations and manages actionable occurrences associated with realized insurable risks. Senior Staff will execute policy and ensure that insured claims are recovered as appropriate and that claims filed against the Lottery are managed in accordance with policy and State law.

Collections Analyst in consultation with the Legal Division: Processes VCGCB claim forms and coordinates with Lottery staff to develop the Lottery response to the GCP regarding claims for damages against the Lottery. If the claim is approved by VCGCB, the Collections Analyst will provide the appropriate account for SCO to process payment to the claimant.

XI. ADOPTION OF INSURABLE RISK POLICY AND PERIODIC REVIEW

Insurable Risk Policy Adoption:

The Lottery Director or designee (including the CRO) may propose policy changes to the Commission at any time. The Commission shall review and adopt this Insurable Risk Policy as well as any amendments to the policy. This policy shall be reviewed by the CRO and the ERM every five years following the completion of the Analysis. All changes to the Insurable Risk Policy must be approved by the Commission.