

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY

Minutes of June 21, 2019 Meeting

The Buckeye Tobacco Settlement Financing Authority (the Authority) held a meeting commencing at 2:30 p.m. on Friday, June 21, 2019, in the 35th Floor Conference Room, Office of Budget and Management (OBM), James A. Rhodes State Office Tower, 30 East Broad Street, Columbus, Ohio, pursuant to notice of meeting given by the Secretary of the Authority pursuant to Section 4.2 of its Bylaws.

*[Copies of the items marked * are attached hereto and made a part of these minutes.]*

The Chairman called the meeting to order.

Mr. Kauffman, as Assistant Secretary of the Authority, reported that three new designations had been filed since the last meeting of the Authority. The Governor of the State of Ohio designating John Danish, the OBM Director designating Kathleen Madden and Kurt Kauffman, in the alternative, and the Treasurer of State designating Jonathan Azoff and Lisa Eisenberg, in the alternative.

Pursuant to Section 183.52 of the Revised Code and Section 3.1 of the Bylaws, Mr. Danish presided as Chair of the meeting. Upon roll call, the Chair declared a quorum to be present. The following designees of members of the Authority, eligible to vote at the meeting, were present:

John Danish, Office of the Governor

Kathleen Madden, Office of Budget and Management

Jonathan Azoff, Office of the Treasurer of State

The Assistant Secretary filed the certificate of compliance* with the public meeting notice provisions of Section 121.22 of the Revised Code and requirements of the Authority in Article 4 of the Bylaws.

Mr. Danish requested approval of the June 19, 2018 meeting minutes. Mr. Kauffman noted that an incorrect reference to the year of the Authority's prior operating budget had been corrected since distribution of the draft minutes. Mr. Azoff moved for approval with the correction, seconded by Ms. Madden. There being no further discussion, the motion was approved upon roll call as follows: Ayes – Madden, Azoff, and Danish; Nays – None. The Chair declared the motion passed.

Mr. Kauffman provided an overview of the Fiscal Year (FY) 2019 financial statement preparation and audit process.* Mr. Kauffman noted that the FY 2019 financial statements were found to fairly present, in all material respects, the financial position of the Authority in accordance with Generally Accepted Accounting Principles. He also noted that the audit opinion was 'unqualified' and the audit did not identify any material weaknesses or significant deficiencies in internal controls or any instances of noncompliance with material laws and regulations.

Mr. Kauffman then presented an update on the tobacco settlement receipts (TSRs) received in calendar year (CY) 2019.* He explained that CY 2019 receipts were 10% lower than CY 2018 receipts and that the decrease is primarily attributable to an increase in the amount deposited into the disputed payment account (DPA) as RJ Reynolds/Lorillard did not make a DPA deposit in 2018 having deposited two-years of such disputed amounts in 2017. Mr. Kauffman reported that the TSRs, together with estimated interest earnings, are sufficient to fully pay the required debt service for 2019 and fund the redemption of \$11.8 million of turbo term bonds. Mr. Kauffman also noted the Reserve Fund balance was \$240.2 million as of June 1, 2019 and that for the second year no draw on the

reserve fund would be necessary. Mr. Azoff asked Mr. Kauffman why the TSRs were sufficient to pay required debt service and to make turbo redemptions in the last two years, but not in prior years. Mr. Kauffman noted that the bonds were structured with serial principal maturities in 2009 through 2017 and that post 2017 the annual debt service requirements consisted solely of the interest due on the bonds, with any remaining TSR balance used to redeem outstanding principal.

Jennifer Croskey, Office of the Attorney General, then provided an update of the arbitration process for tobacco settlement payments that have been deposited into the DPA*. She explained that the tobacco payment is reduced when the tobacco companies that are parties to the MSA lose market share to non-participating manufacturers (NPMs). This loss of market share has been occurring annually and participating manufacturers have generally chosen to pay the NPM adjustment into the DPA. This means the monies attributed to the NPM Adjustment will not be paid until a panel of arbitrators determines whether Ohio has “diligently enforced” certain statutes. With respect to the current arbitration for the 2004 sales year, Ms. Croskey noted that while Ohio’s state specific hearing concluded in March 2018, no ruling would be made until hearings were completed for all ten arbitrating states. The Attorney General is optimistic for a favorable ruling, but a ruling is not expected until late 2019 or early 2020. In response to questions by Mr. Azoff, Ms. Croskey reiterated that the NPM adjustment dollars for the 2004 sales year is the last sales year that is not part of the Buckeye Tobacco securitization. The next arbitration is expected to commence in FY 2020 and the Attorney General’s Office (AGO) is working with the tobacco companies to litigate the next three-years of NPM adjustments in a single arbitration proceeding.

Ms. Croskey then noted that the AGO anticipates that expenditures will exceed available MSA enforcement funds by approximately \$600,000 in FY 2020. Mr. Azoff asked what the plan is if funding runs out to which Ms. Croskey responded that potential sources of funds include the NPM adjustment dollars for sales year 2004 which assuming a favorable ruling would be returned to the state. Ms. Madden questioned if the arbitration uses expedited discovery and Ms. Croskey responded that the MSA does not set arbitration procedures so those must be set each time. Ms. Madden followed-up by asking if future expenses are expected to be lower since we’ve done this before. Ms. Croskey responded no because the activity level is similar with each new arbitration. Mr. Danish asked if estimated expenditures for FY 2020 included costs of an outside counsel and Ms. Croskey responded affirmatively noting that outside counsel for this purpose was currently Barnes & Thornburg.


Mr. Scurlock then presented the Authority’s operating budget for FY 2019 and its proposed operating budget for FY 2020.* He reviewed FY 2019 year-to-date expenses, noting that underspending is due to lower-than-budgeted expenses for legal and financial advisory services. Mr. Scurlock then reviewed the proposed FY 2020 budget, noting that it includes all of the customary expense items plus \$170,000 for the procurement of a new/replacement rating on the existing bonds and that this item would be addressed later in the meeting. Mr. Scurlock noted the FY 2020 budget included additional funding for the Authority’s financial advisor to review proposals and that any amounts not expended in FY 2020 would be used to offset the next year’s operating budget request.

Mr. Danish then recognized Mr. Azoff for an explanation of the next item on the agenda. Mr. Azoff explained that the Authority is required by law to annually prepare financial statements and that the Authority’s current financial statement preparation contract is entering the last year of a six-year term. Thus, it is now necessary to undertake a request for proposal (RFP) and selection process and that the contemplated term was again six years (FY 2020 through 2025). Mr. Danish asked if there was a motion to authorize the Treasurer to: i) release an RFP for preparation of the Authority’s

annual financial statements; and ii) to evaluate the proposals received and enter into a contract with the firm submitting the lowest qualified bid. Ms. Madden moved the motion and Mr. Azoff seconded. There being no further discussion, the motion was approved upon roll call as follows: Ayes – Madden, Azoff, and Danish; Nays – None. The Chair declared the motion passed.

Mr. Kauffman was recognized by the Chairman to provide background on the next item on the agenda. Mr. Kauffman noted that the Trust Indenture requires the Authority, to the extent possible, to maintain the same number of ratings on the Buckeye Tobacco Bonds as were assigned at the time of initial issuance. Given that Fitch ratings withdrew its ratings on all tobacco bonds in late 2016 and that Kroll Bond Rating Agency (KBRA) has since made significant inroads in the tobacco bond rating space, staff is recommending the Authority secure a replacement rating from KBRA. Ms. Madden moved and Mr. Azoff seconded a motion authorizing the Secretary to seek a rating from a nationally recognized rating organization and to execute any necessary agreements in connection with that rating. There being no further discussion, the motion was approved upon roll call as follows: Ayes – Madden, Azoff, and Danish; Nays – None. The Chair declared the motion passed.

There being no further business, the meeting was adjourned.



Kimberly Murnieks, Secretary
Buckeye Tobacco Settlement Financing Authority



Mike DeWine, Chairman
Governor

Kimberly Murnieks, Secretary
Director of Budget and Management

Robert Sprague, Treasurer
Treasurer of State

CERTIFICATION REGARDING NOTIFICATION OF MEETING TO THE PUBLIC AND NEWS MEDIA

The undersigned, Assistant Secretary of the Buckeye Tobacco Settlement Financing Authority, hereby certifies that the notice of the time, place and purposes of the meeting of the Authority of June 21, 2019 at 2:30 p.m. was posted on Wednesday, June 19, 2019 in the State House press room, the Office of Budget and Management (34th Floor, 30 East Broad Street), and the Office of the Treasurer of State (9th Floor, 30 East Broad Street), all in accordance Section 121.22 of the Revised Code and the Open Meetings Rule for notification of meetings to the public and news media adopted by the Authority July 2, 2007.

Dated: June 21, 2019

Kurt Kauffman

Kurt Kauffman
Assistant Secretary of the
Buckeye Tobacco Settlement Financing Authority



Buckeye Tobacco Settlement Financing Authority
Staff Presentation
June 21, 2019

FY 2018 Audit Process

- U.S. Bank (bond trustee) and BTSFA staff provided the account statements, reports, and other information to Rea & Associates (REA) for compilation of the FY 2018 financial statements.
- Once the financial statements were compiled, the Secretary and TOS and OBM staff met with REA to review the draft report, confirm the cash balances, and examine all line-items that experienced a variance of 5% or more from its prior fiscal year value.
- Financial Statements were turned over to the Independent Auditor (Kennedy Cottrell Richards, LLC) in late August and the audit work was completed in late September.
- The Report of the Independent Auditor, including the audited financial statements, was reviewed and accepted by the Auditor of State and filed on November 8, 2018.
- The Opinion of the Independent Auditor was 'unqualified' and the financial statements were found to present fairly, in all material respects, the financial position of the Authority in accordance with Generally Accepted Accounting Principles.
- The Audit did not identify any significant deficiencies or material weaknesses in internal controls, any instances of noncompliance with material laws and regulations, and did not include a management letter.

Financial Matters Update

CY 2019 Tobacco Settlement Receipts v. Debt Service Requirements (\$ in Millions)

Calendar Year (CY)	Pledged MSA Tobacco Settlement Receipts ¹	Interest Earnings ³	Total Pledged Funds	Less Operating Expenses	Less Debt Service Payments	Surplus/ (Shortfall)
2008	\$333.1	\$22.4	\$355.5	(\$2.6)	(\$352.7)	\$0.2
2009	\$364.9	\$5.4	\$370.2	(\$2.6)	(\$367.8)	(\$0.3)
2010	\$305.6	\$1.7	\$307.3	(\$1.3)	(\$306.0)	\$0.0
2011	\$289.3	\$1.4	\$290.7	(\$0.3)	(\$297.7)	(\$7.4)
2012	\$294.6	\$1.2	\$295.8	(\$0.1)	(\$294.7)	\$0.9
2013	\$295.0	\$1.1	\$296.0	(\$0.2)	(\$309.4)	(\$13.5)
2014	\$292.5	\$1.0	\$293.5	(\$0.3)	(\$320.3)	(\$27.1)
2015	\$285.8	\$1.2	\$287.1	(\$0.3)	(\$321.7)	(\$34.9)
2016	\$297.1	\$1.7	\$298.8	(\$0.2)	(\$328.5)	(\$29.9)
2017	\$270.2	\$4.5	\$274.8	(\$0.1)	(\$330.6)	(\$56.0)
2018	\$331.8	\$6.1	\$337.9	(\$0.1)	(\$334.2) ²	\$3.6
2019 Est.	\$297.7	\$5.5	\$303.2	(\$0.4)	(\$299.8) ²	\$3.1

¹ Excludes receipts in 2017 and later years from the reserve fund settlement (those receipts are paid into the SLRA).

² Includes term bond redemptions of \$44.7 million in 2018 and \$11.8 million in 2019.

³ Beginning in 2011, Includes interest earnings that must be retained in the senior liquidity reserve account.



Buckeye

**Tobacco Settlement
Financing Authority**

- Pledged Tobacco Settlement Receipts (TSRs) for CY 2019 totaled \$297.7 million, a decline of \$34.1 million (10%) from the prior year.
 - RJ Reynolds / Lorillard, Altria / Philip Morris, and Imperial participating tobacco manufacturers all paid a portion of their 2019 payment (\$45.4 million) into the disputed payment account (DPA). Recall, RJ Reynolds / Lorillard did not make a DPA deposit in 2018 after a making a DPA deposit for two sales year as part of their 2017 payment.
 - The CY 2019 TSRs reflect an estimated decline of 4.7% in domestic cigarette consumption in CY 2018 which was partially offset by the minimum 3.0% inflation adjustment.
 - The 4.7% decline in CY 2018 domestic cigarette consumption reflects an acceleration from recent years in which consumption declined by 4.5% in 2017 and 4.0% in CY 2016.
- The 2019 TSRs along with interest earnings on those receipts are sufficient to cover principal and interest payments required to be paid in CY 2019.
 - Current interest turbo term bonds totaling \$11.8 million were redeemed on June 1, 2019.
 - The reserve fund balance as of June 1, 2019 was \$240.2 million and no reserve fund draws are anticipated this calendar year.
- Amounts potentially due and payable to Ohio (and pledged to the BTSFA bond holders) currently on deposit in disputed accounts or withheld is approximately \$436.4 million.
 - This amount currently on deposit in disputed accounts and pledged to bondholders relates to sales years 2005 through 2016 due to the 3-year lag.
 - Resolution of disputed amounts continues to be the subject of ongoing arbitration related to the Non-Participating Manufacturer (NPM) adjustment provisions of the MSA.
 - The NPM adjustment is disallowed if States can demonstrate 'diligent enforcement' of their qualifying statutes that require NPMs to make escrow deposits analogous to the MSA required payments.
 - The Attorney General's office will be providing an update on the status of this arbitration process later in today's meeting.



FY 2019 Operating Budget

Service or Activity	FY 2019 Budget	FY 2019 Year-to-Date	Variance	Approved & Submitted For Payment	Notes
Rating Agency Annual Surveillance Fees:					
-- Moody's	25,000	25,000	0	11/14/18	annual surveillance
-- S&P	10,000	10,000		10/29/18	annual surveillance
U.S. Bank Annual Trustee Fee	15,000	15,000			
-- Annual Trustee Fee	550	550	0	11/7/18	annual invoice
Financial Statement Preparation	6,450	5,450	1,000	10/17/18	financial statement preparation
-- REA & Associates		4,000		11/13/18	financial statement preparation
Financial Statement Audit	33,400	32,604	796		
-- KCR on behalf of AOS	32,400	25,920		9/25/18	FY18 financial statement audit
-- Auditor of State	1,000	6,480		10/16/18	FY18 financial statement audit
Financial Advisor	25,000	204		11/1/18	FY18 financial statement audit
Continuing Legal, Disclosure & Reporting	30,000	9,780	15,220	6/21/19	financial advisory services
Contingency/Other	9,600	2,109	27,891	5/20/19	annual disclosure and credit rating
		0	9,600		
FY 2019 Total:	130,000	75,493	54,507		



FY 2020 Operating Budget

Service or Activity	FY 2020 Budget	FY 2020 Year-to-Date	Variance	Approved & Submitted For Payment	Notes
Rating Agency Fees:	195,000	0	195,000		
-- Kroll - New Rating	170,000				
-- Moody's Annual Surveillance	10,000				
-- S&P Annual Surveillance	15,000				
U.S. Bank Annual Trustee Fee	550	0	550		
-- Annual Trustee Fee					
Financial Statement Preparation	5,600	0	5,600		
-- REA & Associates					
Financial Statement Audit	34,615	0	34,615		
-- KCR on behalf of AOS	33,615				
-- Auditor of State	1,000				
Financial Advisor	50,000	0	50,000		
Continuing Legal, Disclosure & Reporting	30,000	0	30,000		
Contingency/Other	40,235	0	40,235		
FY 2019 Total:	356,000	0	356,000		