

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY

Minutes of June 25, 2014 Meeting

The Buckeye Tobacco Settlement Financing Authority (the Authority) held a meeting commencing at 2:30 p.m. on Wednesday, June 25, 2014, in the 35th Floor Conference Room, Office of Budget and Management, 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 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, reported that since the last meeting of the Authority a new designation, pursuant to Section 183.52 of the Revised Code, had been filed by the Treasurer of State designating Seth Metcalf or Dana Wasserman, in the alternative.

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

Michael Grodhaus, Office of the Governor

Timothy S. Keen, Office of Budget and Management

Dana Wasserman, Treasurer of State

Also present were Kurt Kauffman, Larry Scurlock and Cassie Sanfrey (Office of Budget and Management); Ryan Bilsky, Katie O'Brien and Lisa Eisenberg (Treasurer's office); Greg Stype (Squire Patton Boggs); and Carol Mosholder (Attorney General's Office).

The Assistant Secretary filed the certificate of compliance* with the public meeting notice provisions of Section 121.22 of the Revised Code.

Mr. Grodhaus requested approval of the June 19, 2013 meeting minutes. Mr. Keen moved, seconded by Ms. Wasserman, to approve the minutes of the June 19, 2013 Authority meeting. There being no discussion, the motion was approved upon roll call as follows: Ayes – Grodhaus, Keen, Wasserman; Nays – None. The Chair declared the motion passed.

Mr. Kauffman provided an overview of the fiscal year (FY) 2013 financial statement preparation and audit process and presented a brief summary of the audit results.* Mr. Kauffman noted that the FY 2013 audit opinion was 'unqualified,' that no material weaknesses or deficiencies in internal controls nor any instances of noncompliance with material laws or regulations were identified, and that the Authority did not receive a management letter.

Mr. Kauffman then presented an update on the tobacco settlement receipts (TSRs) received in calendar year (CY) 2014.* He explained that CY 2014 receipts were lower than CY 2013 receipts by \$4.9 million or 2.0% and that the reasons for the decline, though speculative, include higher cigarette taxes in several jurisdictions across the country and a possible substitution effect involving e-cigarettes that are not covered by the tobacco MSA. Mr. Kauffman noted that the TSRs along with estimated interest earnings on the Senior Liquidity Reserve Fund (Reserve Fund) and other pledged accounts are insufficient to fully pay the annual debt service for 2014. Barring the receipt of additional revenue in the near-term (e.g., a release from the disputed accounts), the consequence of this debt service shortfall is an anticipated December 1, 2014 draw on the Reserve Fund of an estimated \$31-32 million. This action would lower the Reserve Fund balance on that December 1,

2014 date to approximately \$339 million. A voluntary notice notifying bondholders of the potential 2014 draw on the Reserve Fund has already been released.

On behalf of the Treasurer's office, Mr. Bilsky then presented an overview of the current investment options for the Reserve Fund and considerations in choosing appropriate investments. He explained that the Reserve Fund is currently invested in short-term, high-grade commercial paper maturing every six months in advance of each distribution date. Mr. Bilsky further explained that the decision to invest in high-grade commercial paper balanced the need for safe, highly-rated and qualified investments with the desire to increase return and that commercial paper generally offered 6-10 basis points more in yield than comparable U.S. Treasury and Agency securities. Mr. Bilsky also explained that the Treasurer's office plans to continue with this approach to comply with the investment parameters of the Trust Indenture.

Ms. Wasserman then provided an update on the status of the Authority's claim regarding the Forward Delivery Agreement for investment of the Reserve Fund that was terminated in October 2008 due to a provider default. Ms. Wasserman explained that six years later the Authority is participating in a court-ordered mediation process in an attempt to settle the claim. The first mediation session was held May 30, 2014 and concluded with no progress being made toward a resolution or settlement. Both the Authority and the provider were asked to and have submitted a report to the mediator and are awaiting the mediator's ruling at which time the next steps will be determined. In response to a question from Mr. Grodhaus, Mr. Stype explained that the mediation was non-binding and next steps could include additional mediation or litigation of the claim through the court

Ms. Wasserman then provided an update, pursuant to a motion passed at the last meeting of the Authority, on the release of the RFP for preparation of the Authority's financial statements and the selection by the Treasurer's office of Rea & Associates. Ms. Wasserman explained that based on the assessment of staff pursuant to the evaluation criteria set forth in the RFP, Rea & Associates was determined to be the lowest qualified bidder and the Treasurer has negotiated and entered into a contract with that firm.

Ms. Mosholder then gave a presentation regarding the status of arbitration relating to tobacco settlement payments that were disputed by tobacco manufacturers and deposited into the disputed payments account. She reminded the Authority that with respect to the arbitration process for the 2003 Non-Participating Manufacturer (NPM) adjustment, Ohio was successful having been found to have diligently enforced its model statutes. As a result, Ohio's 2014 TSRs included releases of certain monies from the Disputed Payment Account (DPA) that were deposited in 2006 in connection with 2003 sales (i.e., there is a three-year lag between the NPM adjustment year and the payment year). Ms. Mosholder addressed the 2004 NPM adjustment arbitration noting that the 29 states including Ohio that have not yet settled for that year have begun discussions with the tobacco manufacturers to establish procedures and to select the arbitration panel. Following the presentation, the Authority asked clarifying questions regarding the chance of revisions to the non-pledged amounts paid to Ohio in connection with the 2003 NPM adjustment and the possible timing of future arbitration decisions.

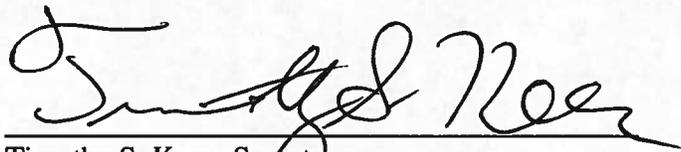
Mr. Scurlock then presented the Authority's operating budget for FY 2014 and its proposed operating budget for FY 2015.* He began by reviewing the FY 2014 year-to-date expenses, noting year-to-date under spending relative to the budgeted amount is largely due to fees and expenses of the quantitative consultant which have not yet been submitted for payment. Mr. Scurlock explained that the FY 2015 budget is comparable in total to the FY 2014 budget with lower financial

statement preparation costs offset by higher estimated legal fees as we work through the Authority's Reserve Fund claim.

Mr. Grodhaus requested a motion to approve an increase of 10% in the annual fee for bond trustee services. In discussion, Mr. Kauffman noted the original RFP for bond trustee services did not address annual increases nor did any of the three proposals submitted in response to that RFP. He further explained that the annual trustee fee was currently \$500 and that this increase was a one-time adjustment that would increase that annual fee to \$550 going forward. There being no further discussion, the motion was brought for a vote and was approved upon roll call as follows: Ayes – Grodhaus, Keen, Wasserman; Nays – None. The Chair declared the motion passed.

In other business, Mr. Kauffman noted that the IRS closed its audit of the Authority's 2007 Bonds with no change in the determination that the interest on those Bonds is exempt from the federal income tax.

There being no further business, the meeting was adjourned.



Timothy S. Keen, Secretary
Buckeye Tobacco Settlement Financing Authority



***** Public Meeting Notice *****

June 20, 2014

TO: Members of the Buckeye Tobacco Settlement Financing Authority and their designees

John R. Kasich, Governor
Josh Mandel, Treasurer of State

Mike Grodhaus
Seth Metcalf & Dana Wasserman

FROM: Timothy S. Keen, Secretary, Buckeye Tobacco Settlement Financing Authority

SUBJECT: **Meeting on Wednesday, June 25, 2014, at 2:30 p.m. in Conference Room A of the Office of Budget and Management (35th Floor, Rhodes State Office Tower)**

Pursuant to the Bylaws of the Buckeye Tobacco Settlement Financing Authority, I am notifying you of the meeting of the Authority to be held on Wednesday, June 25, 2014, commencing at 2:30 p.m. in Conference Room A of the Office of Budget and Management (35th Floor, Rhodes State Office Tower, 30 East Broad Street, Columbus, Ohio). Staff will present an overview of the Authority's fiscal year 2013 audit, its fiscal year 2014 and proposed fiscal year 2015 operating budgets, and the status of tobacco settlement receipts and debt service payments for calendar year 2014. The Treasurer of State's office will present information relating to the Senior Liquidity Reserve Account and the selection of Rea & Associates as preparer of the Authority's financial statement. The Attorney General's office will provide an update on the status of the arbitration process for monies paid into and being held in disputed payment accounts.

Enclosed please find: i) a meeting agenda; ii) minutes of the prior June 19, 2013 meeting; and iii) the operating budget for fiscal years 2014 and 2015, all as referred to in that agenda.

If you or members of your staff have any questions, please contact me or Kurt Kauffman of my staff at 466-0691.

cc. Mike DeWine, Attorney General
Kurt Kauffman, Debt Manager, Office of Budget and Management
Carol Mosholder, Tobacco Counsel, Office of Ohio Attorney General
Larry Scurlock, Assistant Debt Manager, Office of Budget and Management
Dana Wasserman, Deputy Director, Office of Debt Management, Treasurer of State



THE BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY

JOSH MANDEL, TREASURER
TREASURER OF STATE

JOHN R. KASICH, CHAIRMAN
GOVERNOR

TIMOTHY S. KEEN, SECRETARY
DIRECTOR OF BUDGET AND MANAGEMENT

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 25, 2014 at 2:30 p.m. was posted on Friday, June 20, 2014 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 20, 2014

Kurt Kauffman
Assistant Secretary of the
Buckeye Tobacco Settlement Financing Authority



BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY
STAFF PRESENTATION
June 25, 2014

FY2013 Audit Process

- U.S. Bank (bond trustee) and BTSFA staff provided the account statements, reports, and other information to Kennedy Cottrell Richards (KCR) for compilation of the FY 2013 financial statements.
- Once the financial statements were compiled, Secretary Keen, TOS and OBM met with KCR to review the 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 Auditor of State in August and the audit work took place in latter half of August through September.
- The FY2013 Audit Opinion was ‘unqualified’ and the financial statements were found to fairly present, in all material aspects, 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 nor any instances of noncompliance with material laws and regulations and there was no management letter.
- For FY14, Rea & Associates will begin its term as our financial statement compiler and there will be two new auditors on the AOS team so there will likely be some extra time and effort involved as the new participants get up to speed. The audited financial statements are due September 30, 2014.

CY 2014 Tobacco Settlement Receipts versus Debt Service Requirements

\$ in Millions

Calendar Year (CY)	Pledged MSA Tobacco Settlement Receipts	Interest Earnings*	Total Pledged Funds	Less Operating Expenses	Less Debt Service Payments	Shortfall
2008	\$333.1	\$22.3	\$355.5	(\$2.6)	(\$352.7)	--
2009	\$364.9	\$5.3	\$370.2	(\$2.6)	(\$367.8)	--
2010	\$305.6	\$1.7	\$307.3	(\$1.3)	(\$306.0)	--
2011	\$289.3	\$1.4	\$290.7	(\$0.3)	(\$297.7)	(\$7.3)
2012	\$294.6	\$1.2	\$295.8	(\$0.1)	(\$294.7)	--
2013	\$294.9	\$1.1	\$296.0	(\$0.2)	(\$309.4)	(\$13.6)
2014 Est.	\$289.0	\$1.0	\$290.0	(\$0.2)	(\$320.3)	(\$30.5)

* Includes SLRA interest earnings which are retained by the SLRA and thus not applied against the SLRA draw. Thus, the SLRA draw will be more than the shortfall shown here by that amount.



- Pledged Tobacco Settlement Receipts (TSRs) for CY 2013 totaled \$289.0 million, a decrease of 2.0% from CY 2012 TSRs.
 - The CY2014 TSRs reflect an overall decline of about 4.9% in domestic cigarette consumption in 2013 which was only partially offset by the minimum 3.0% inflation adjustment and other components of the MSA payment formula.
 - Domestic cigarette consumption decline was more pronounced in CY 2013 (4.9%) than in CY 2012 (2.0%) and CY 2011 (2.8%).
- As they did in 2013, the three largest participating tobacco manufacturers (Philip Morris, RJ Reynolds, and Lorillard) all paid a portion of their payment to disputed accounts.
- The 2014 TSRs along with interest earnings on those receipts are not sufficient to cover principal and interest payments required to be paid in 2014.
 - Assuming the status quo, a draw on the liquidity reserve fund in the amount of about \$31-32 million will be necessary to cover the December 1, 2013 debt service payment.
 - Following that expected December 1, 2014 draw, the reserve fund balance is estimated to be \$339 million (versus the reserve requirement of \$389 million).
- Amounts potentially due and payable to Ohio (and pledged to the BTSFA bond holders) currently on deposit in disputed accounts or withheld is approximately \$220 million.
 - This amount currently on deposit in disputed accounts and pledged to bondholders relates to sales years 2006 through 2011 due to the 3-year lag. Disputed amounts relating to the 2005 sales year and paid in 2008 were released to the States in April 2009.
 - Resolution of disputed amounts continues to be the subject of ongoing arbitration related to the Non-Participating Manufacturer (NPM) adjustment included in the MSA payment formula.
 - 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 this arbitration process later in today's meeting.