

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY

Minutes of June 9, 2017 Meeting

The Buckeye Tobacco Settlement Financing Authority (the Authority) held a meeting commencing at 2:00 p.m. on Friday, June 9, 2017, 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 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, reported that one new designation had been filed by the Governor of the State of Ohio designating Kevin Stanek since the last meeting of the Authority.

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

Kevin Stanek, Office of the Governor

Tim Keen, Office of Budget and Management

Jonathan Azoff, Office of the Treasurer of State

Among others present were Larry Scurlock (Office of Budget and Management); Allison Binkley (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. Keen then moved, seconded by Mr. Azoff, to approve the minutes of the June 17, 2016 Authority meeting. There being no discussion, the motion was approved upon roll call as follows: Ayes – Stanek, Keen, Azoff; Nays – None. The Chair declared the motion passed and those minutes approved.

Mr. Kauffman provided an overview of the Fiscal Year (FY) 2016 financial statement preparation and audit process and presented a brief summary of the audit results.* Mr. Kauffman noted that the FY 2016 financial statements were found to fairly present, in all material aspects, the financial position of the Authority in accordance with Generally Accepted Accounting Principles (GAAP). He also noted that the audit opinion was 'unqualified' with no material weaknesses or deficiencies in internal controls or any instances of noncompliance with material laws or regulations.

Mr. Kauffman then presented an update on the tobacco settlement receipts (TSRs) received in calendar year (CY) 2017.* He explained that pledged CY 2017 receipts were lower than CY 2016 receipts by \$26.9 million, or 9.0%, and that the decrease can be attributed to R.J. Reynolds making an additional payment to the Disputed Payments Account (DPA) for the 2015 NPM adjustment because Ohio conceded that provisions of the Master Settlement Agreement (MSA) were a significant factor contributing to R.J. Reynold's market share loss for 2015. He further explained that without this additional payment to the DSA, TSR receipts would have been very close to the prior year levels, and that CY 2018 TSR receipts should be higher because R.J. Reynolds is not expected to make any payments to the DPA next year. Mr. Kauffman noted that the TSRs, together 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 2017 and that, barring the receipt of additional

revenue in the near-term (e.g., a release from the Disputed Payments Account), there will be a draw on the Reserve Fund estimated at \$60 million for the December 1, 2017 debt service payment on the Authority's bonds. He said this would lower the Reserve Fund balance to approximately \$228 million at that time. Mr. Kauffman noted that a voluntary disclosure notifying bondholders of this anticipated December 1, 2017 draw on the Reserve Fund has already been filed on EMMA (the Electronic Municipal Market Access system maintained by the MSRB). In response to a question from Mr. Keen, Mr. Kauffman explained that the monies received in connection with the settlement of the Authority's claim against the provider of the Forward Delivery Agreement were deposited into the Reserve Fund as required under the Trust Agreement for the Authority's bonds.

Ms. Mosholder then gave a short presentation regarding the status of arbitration relating to tobacco settlement payments that were disputed by tobacco manufacturers and deposited into the Disputed Payments Account provided for under the MSA. She explained that the arbitration process for the 2004 Non-Participating Manufacturer (NPM) adjustment is moving along under the three-member arbitration panel and that she expects the entire process to be completed prior to the end of CY 2018. Ms. Mosholder further explained the 2004 NPM adjustment process is largely the same as the 2003 NPM adjustment. Following the presentation, Mr. Keen noted the arbitration related to the 2003 NPM adjustment concluded in 2014 and asked if the entire arbitration process can be accelerated. Ms. Mosholder explained the arbitration advances each sales year consecutively and that the 2004 NPM adjustment must be completed before the 2005 NPM adjustment begins arbitration.

Mr. Scurlock then presented the Authority's operating budget for FY 2017 and its proposed operating budget for FY 2018.* He reviewed the FY 2017 year-to-date expenses, noting that overspending relative to the budgeted amount is primarily due to costs and expenses in connection with enforcement of the Authority's rights under the Reserve Fund claim. Mr. Scurlock explained that additional monies were available to the Authority to pay those FY 2017 costs and expenses including (i) \$800,000 constituting Priority Payments under the Trust Indenture that were transferred to the Operating Account in May 2016, and (ii) approximately \$330,000 in unspent balances from FY 2016 and prior fiscal years. Mr. Scurlock further explained that after settlement of Reserve Fund claim, staff determined there was \$900,000 of excess monies in the Operating Account, and in November 2016 the Authority transferred that amount from the Operating Account to the Senior Debt Service Account for payment of debt service on the Authority's bonds. Mr. Scurlock then reviewed the proposed FY 2018 budget, noting that it includes all of the customary expenses. In response to a question from Mr. Keen, Mr. Scurlock explained that if monies in the Operating Account are insufficient to pay the Authority's FY 2018 operating expenses, the Authority can at any time request that the Trustee transfer additional TSR receipts to the Operating Account.

Following a short presentation by Mr. Azoff, Mr. Keen then moved, seconded by Mr. Stanek, on a motion to authorize the Treasurer to negotiate and enter into an agreement with Public Financial Management (PFM) to serve as the Independent Registered Municipal Advisor (IRMA) to the Authority. In response to a question from Mr. Keen, Mr. Azoff explained that by designating PFM as its IRMA, municipal underwriting firms may submit ideas and recommendations with respect to the Authority's 2007 bonds and remain in compliance with the Securities and Exchange Commission (SEC) Municipal Advisor rule. The motion was approved upon roll call as follows: Ayes – Stanek, Keen, Azoff; Nays – None. The Chair declared the motion passed.

Mr. Azoff then presented an update on the Authority's claim against the provider of the Forward Delivery Agreement for investment of the Reserve Fund that was terminated in September 2008 due to that provider's default. He explained that both parties entered into a settlement agreement in October 2016, pursuant to which the Authority received allowed nonpriority general unsecured claims against the provider, with payment on the claims not to exceed \$13.5 million. Mr. Azoff also

explained that the Authority received a distribution of \$8.437 million on its claims in April 2017. Mr. Keen then noted that the Authority has only received about 62% of the settlement amount and asked how much of the remaining funds the Authority can expect to receive. Mr. Azoff responded by saying he expects future distributions from the provider's bankruptcy estate to be much smaller and that the Authority will likely never receive the entire amount of its claims.

In other business, Mr. Kauffman informed the Authority that staff will be working with the Attorney General's office to select counsel for routine legal matters such as continuing disclosure and ongoing reporting. He explained that the Authority has retained Squire Patton Boggs throughout the litigation process for the Reserve Fund because of their knowledge and expertise with the Authority's 2007 Bonds. Mr. Kauffman noted that staff will consult with the Attorney General's office for selection of counsel, as required under Ohio Revised Code section 183.51(E). It was then moved by Mr. Keen, seconded by Mr. Stanek, on a motion to authorize OBM in consultation with the Attorney General's Office, to take all necessary and appropriate steps to select counsel for the Authority for Fiscal Year 2018, subject to appointment of that counsel by the Attorney General. There being no discussion, the motion was approved upon roll call as follows: Ayes – Stanek, Keen, Azoff; Nays – None. The Chair declared the motion passed.

There being no further business, the meeting was adjourned.

Timothy S. Keen, Secretary
Buckeye Tobacco Settlement Financing Authority



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 9, 2017 at 2:00 p.m. was posted on Monday, June 5, 2017 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 9, 2017

Kurt Kauffman
Assistant Secretary of the
Buckeye Tobacco Settlement Financing Authority



BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY
STAFF PRESENTATION
June 9, 2017

FY 2016 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 2016 financial statements.
- Once the financial statements were compiled, Secretary Keen, TOS and OBM met with REA 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 Independent Auditor (Kennedy Cottrell Richards, LLC) in late August and the audit work was completed by early October.
- The Report of the Independent Auditor, including the audited financial statements, was reviewed by the Auditor of State and accepted on November 28, 2016.
- The Opinion of the Independent Auditor was 'unqualified' and the financial statements were found to present fairly, 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.
- The Audit did not include a management letter.

Financial Matters Update

CY 2017 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)	(\$7.4)
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	\$292.5	\$1.0	\$293.5	(\$0.3)	(\$320.3)	(\$27.9)
2015	\$285.8	\$1.2	\$287.0	(\$0.3)	(\$321.7)	(\$35.0)
2016	\$297.1	\$1.7	\$298.6	(\$0.2)	(\$328.5)	(\$30.9)
2017 Est.	\$270.2*	\$1.7	\$271.8	(\$0.1)	(\$330.6)	(\$58.8)

* Does not include \$8.5 million received from the settlement of the reserve fund claim that was deposited to the SLRA.



- Pledged Tobacco Settlement Receipts (TSRs) for CY 2017 totaled \$270.2 million, a decrease of 9.0% from CY 2016 TSRs.
 - The CY 2017 TSRs reflect an estimated decline of 2.4% in domestic cigarette consumption in CY 2016 (based on OPM data) which was offset by the minimum 3.0% inflation adjustment component of the MSA formula and a true-up of a prior-year underpayment.
 - The decline in Domestic cigarette consumption accelerated compared to the CY 2015 decline of 0.1% and more closely resembled historical declines of 3.5% in CY 2014, 4.9% in CY 2013, and 2.0% in CY 2012.

- The largest participating tobacco manufacturers (Philip Morris and RJ Reynolds) paid a portion of their 2017 payment to disputed accounts.
 - Philip Morris and RJ Reynolds made a payment to the disputed account related to the 2014 NPM adjustment.
 - In addition, and as a result of Ohio's agreement to concede that provisions of the MSA were a significant factor contributing to the Market Share Loss for 2015 within the meaning of the MSA, RJ Reynolds made a payment to the disputed account for the 2015 NPM adjustment.

- The 2017 TSRs along with interest earnings on those receipts are not sufficient to cover principal and interest payments required to be paid in 2017.
 - Assuming the status quo, a draw on the liquidity reserve fund in an approximate amount of \$60 million will be necessary to cover the December 1, 2017 debt service payment.
 - Following that expected December 1, 2017 draw, the reserve fund balance is estimated to be \$228 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 \$371 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. Disputed amounts relating to the 2003 sales year and paid in 2006 were released to the States in April 2014.
 - 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.



**Buckeye Tobacco Settlement Financing Authority
FY 2017 Operating Budget**

Service or Activity	FY 2017 Budget*	FY 2017 Year-to-Date	Variance*	Approved & Submitted For Payment	Notes
Rating Agency Annual Surveillance Fees:	35,000	25,000	10,000		
-- Moody's	10,000	10,000		10/18/16	annual surveillance
-- Fitch	10,000	0		-	rating withdrawn June 2016
-- S&P	15,000	15,000		11/3/16	annual surveillance
U.S. Bank Annual Trustee Fee	550	550	0	11/8/16	annual trustee fee
-- Annual Trustee Fee		550			
Financial Statement Preparation	5,150	5,150	0		
-- REA & Associates		2,472		9/6/16	financial statement preparation
		2,060		10/5/16	financial statement preparation
		618		2/9/17	financial statement preparation
Financial Statement Audit	29,970	30,514	(544)		
-- KCR on behalf of AOS		23,976		10/17/16	FY16 financial statement audit
		5,994		11/28/16	FY16 financial statement audit
		408		12/1/16	FY16 financial statement audit review
-- Auditor of State		136		2/1/16	FY16 financial statement audit review
Financial Advisor / Claim Consultant	25,000	50,000	(25,000)		
-- Public Financial Management		25,000		12/15/16	SDSR Claim and Mediation
		25,000		6/5/17	TSR Economic Performance
		0			
Continuing Legal, Disclosure & Reporting (incl. reserve fund litigation)	226,000	409,585	(183,585)		
-- Cornerstone Research		29,005		10/17/16	SDSR litigation
-- Rene Stulz		10,350		10/17/16	SDSR litigation
-- Cornerstone Research		35,011		10/26/16	SDSR litigation
-- Cornerstone Research		4,321		10/26/16	SDSR litigation
-- Squire Patton Boggs		330,443		12/22/16	SDSR litigation
-- Squire Patton Boggs		456		6/5/2017	Disclosure reporting
Contingency/Other	4,430	0	4,430		
FY 2017 Total:	326,100	520,799	(194,699)		

* \$800,000 in Priority Payments was also received in May 2016 to cover costs and expenses in connection with the enforcement of the Authority's rights under the Senior Liquidity Reserve Account Forward Delivery Agreement, including litigation expenses.



**Buckeye Tobacco Settlement Financing Authority
FY 2018 Operating Budget**

Service or Activity	FY 2018 Budget	FY 2018 Year-to-Date	Variance	Approved & Submitted For Payment	Notes
Rating Agency Annual Surveillance Fees:					
-- Moody's	25,000	0	25,000		
-- S&P	10,000				
	15,000				
U.S. Bank Annual Trustee Fee	550	0	550		
-- Annual Trustee Fee					
Financial Statement Preparation	5,300	0	5,300		
-- REA & Associates					
Financial Statement Audit	30,720	0	30,720		
-- KCR on behalf of AOS	29,970				
-- Auditor of State	750				
Financial Advisor	25,000	0	25,000		
Continuing Legal, Disclosure & Reporting	53,000	0	53,000		
Contingency/Other	10,430	0	10,430		
FY 2018 Total:	150,000	0	150,000		