DRAFT: Unapproved

MINUTES
of the
FOURTH MEETING
of the
TOBACCO SETTLEMENT REVENUE OVERSIGHT COMMITTEE

October 25, 2010
State Capitol, Room 311
Santa Fe

The fourth meeting of the Tobacco Settlement Revenue Oversight Committee (TSROC) was called to order on Monday, October 25, 2010, at 10:15 a.m. in Room 311 of the State Capitol in Santa Fe. Committee members and staff introduced themselves. The co-chair announced that the meeting was being webcast.

Present
Rep. Gail Chasey, Co-Chair
Sen. Dede Feldman
Sen. John C. Ryan
Rep. Gloria C. Vaughn

Absent
Sen. Mary Jane M. Garcia, Co-Chair
Rep. Danice Picraux

Advisory Members
Rep. Ray Begaye
Sen. Linda M. Lopez
Sen. Mary Kay Papen
Sen. Rod Adair
Sen. Sue Wilson Beffort
Rep. Karen E. Giannini

Staff
Sandy Mitchell
Roxanne Knight
Karen Wells

Guests
The guest list is in the meeting file.

Handouts
Copies of all handouts and written testimony are in the meeting file.

Monday, October 25

Tobacco Settlement Permanent Fund Performance and Balances
Steve Moise, state investment officer, Vince Smith, deputy state investment officer, and Charles Wollman, public information officer, State Investment Council (SIC), provided an update on the status of the Tobacco Settlement Permanent Fund. Mr. Moise began by identifying

changes that have taken place in the SIC due to a legislatively required audit. New governance provisions and structures have been implemented, the investment policy has been updated and investment allocation procedures have been revised. Through the work of a nationally recognized executive search firm, very high-quality applicants were generated for the position of chief investment officer. Mr. Smith, the number one choice of the search committee, was selected and will assume the position of chief investment officer.

Mr. Wollman provided current information regarding the Tobacco Settlement Permanent Fund. The fund was created in May 2000 with a market value of $49.0 million; as of August 2010, the fund was valued at $137.8 million. Mr. Moise identified the contributions, distributions and returns since the fund's inception. By statute, the fund is to be invested "as the land grant permanent fund". Previously, the fund was conservatively managed, and a high percentage was maintained as a cash balance. Although this approach protected the fund during the recent economic downturn, the fund has not benefited from the recent recovery. Over the last five years, distributions from the fund averaged $33.1 million per year. From 2003 to 2006, all funds were distributed to tobacco programs; since 2006, 50% of the funds have been retained in the permanent fund. Mr. Wollman stated that the fund is not yet self-sustaining. In order to maintain recent program fund distribution, the fund would need $700 million in assets.

Mr. Smith reviewed the allocation of the assets of the fund into investments. The long-term benchmark allocation represents an aggressive investment strategy. Returns, on average, have shown modest growth despite recent losses.

Representative Chasey reviewed New Mexico's history of the Tobacco Settlement Permanent Fund and annual contributions to the fund. It was noted that tobacco companies that experience losses due to the settlement due to a state's inability to manage the funds are able to request a reduction in the required payments. Due to the innate instability of the fund, New Mexico decided to invest a portion of tobacco contributions into a permanent fund to ensure long-term protection for programs that rely on distributions from this fund. Representative Chasey noted that the committee is expecting that as the economy improves and the state's reliance on these funds for such programs as Medicaid is reduced, a percentage of the contributions once again will be made to the permanent fund and not distributed to programs. She also noted that the state is currently involved in federal arbitration regarding the state's management of the funds.

Questions from committee members addressed the long-term effect on investments of changes in the political environment. Mr. Smith noted that the SIC is basing investment decisions on conservative treasury bond experience. Mr. Moise noted that New Mexico is engaged in legal action to recover some funds lost due to questionable investment practices. An observation was made that the investments should be looked at over a longer period of time than the annual budget. Clarification was sought regarding the reforms to the SIC that were adopted during the last legislative session and whether they have been successful. Mr. Moise noted that the SIC is preparing some proposed legislation to be introduced in the 2011 session.

Representative Chasey reviewed several enclosures in members' packets, including a matrix that reflects input from agencies and presenters before the TSROC regarding potential agency efficiencies for presentation to the Government Restructuring Task Force (GRTF). She also reviewed a draft of a letter that was prepared in response to a request from Senator Beffort encouraging the federal Food and Drug Administration (FDA) to focus equal attention on smokeless tobacco products as is being given to tobacco products. Input on the matrix and letter was sought from committee members; however, the co-chair did not feel a formal vote was necessary. Representative Begaye commented that Native American students are disproportionately affected by tobacco use and should be shielded from cuts and efficiencies proposed by the Department of Health (DOH). Larry Elmore, program manager for the Tobacco Use Prevention and Control (TUPAC) program, provided clarification regarding the process for determining budget cuts at the DOH. The department sought recommendations from the Centers for Disease Control and Prevention (CDC) and changed funding priorities based on the CDC input. Some DOH contracts were discontinued based on that; others were discontinued based on an internal, systematic evaluation of the successes and accomplishments of funded contracts. Contractors whose funds were cut were told the reason for the cut. As new requests for proposals are issued, guidelines for performance and continued funding will be clearly specified. A question was asked about enforcement of anti-smoking policies at public schools, including the use of e-cigarettes and heroin. Mr. Elmore noted that a DOH youth resiliency survey report reflects a reduction in smoking among high school students but does not specifically report on increased heroin use or smokeless tobacco use.

Proposed Legislation for 2011 Legislative Session

Claudia Ravanelli, tobacco specialist, and Nan Erdman, assistant attorney general, Office of the Attorney General (OAG), provided background information about the impact of nonparticipating manufacturers on the Master Settlement Agreement (MSA). Ms. Erdman stated that due to the exemption of tobacco products sold on tribal lands, New Mexico did not collect escrow on these products. Manufacturers are now contending that New Mexico is out of compliance with the MSA and demonstrated a lack of diligence because the state did not collect escrow on these products. The OAG strongly disagrees and is defending its position through ongoing arbitration. A 2009 bill established a tax-credit stamp for the purpose of determining products subject to the escrow collections. The bill, which became law in July 2010, contained an error, which the OAG is seeking to correct. A draft bill was presented that includes cigarette packs stamped with tax-credit stamps in the definition of "units sold" for the purpose of determining escrow payments. Elements of the MSA were described, including inflation, nonparticipating manufacturer adjustments and market share loss of participating manufacturers due to these adjustments. Following the identification of these elements, an economic firm makes an independent assessment and determination regarding the causes for market losses and whether the state enacted legislation to address this. These factors affect whether participating manufacturers will receive a downward adjustment in any given year. If the error in the 2010 bill is not corrected, New Mexico could lose between $4 million and $12 million per year in the amount received through the MSA.

Ms. Erdman provided a report on the status of the process of arbitration. Three former federal judges have been selected to serve on the New Mexico panel, and hearings have been taking place in Chicago. Agreements have been reached on rules to apply to the process. Significant legal issues have been submitted to tobacco lawyers. Responses are awaited.

Ms. Ravanelli reported on work being done by the OAG regarding e-cigarette sales and distributions. The issue is being closely followed by the OAG, with California taking the lead of regulating these non-tobacco products.

Joe Thompson, lobbyist, Native Trading Association, respectfully disagreed that a drafting error occurred, contending that no change to the law is needed. In his view, New Mexico's law complies with the MSA requirement for qualifying legislation, and amending the law would raise the risk of enacting legislation when nothing has been done that is wrong. Drew Setter, lobbyist for a number of Native American tribes, commented that legal review of the proposed bill is underway.

Questions and comments by committee members addressed the following areas:

- whether an arbitration settlement option is imminent; no;
- clarification regarding the process of identification regarding collecting escrow; the manufacturers are required to identify products that are sold in New Mexico that are subject to the tobacco escrow payments;
- complications that arise with the Navajo Nation due to the tri-state nature of the tribe;
- whether other states facing this issue are facing similar problems; most other states with Native American tribes require the collection of an excise tax;
- whether a bill such as the one proposed would draw attention to New Mexico's noncompliance with the MSA; failure to implement this law would not imply that New Mexico is not in compliance with the MSA; it strengthens New Mexico's position in arbitration;
- clarification regarding the estimate that New Mexico could lose $4 million to $12 million annually without this legislative fix; it is based on anticipated market share loss;
- whether the issue addressed by the proposed legislation is currently part of the arbitration that is underway; no, it puts New Mexico in a stronger position to have an escrow account; and
- a suggestion that the OAG, the Legislative Finance Committee (LFC), the Taxation and Revenue Department (TRD) and the tribes all need to be at the table discussing the proposed bill to determine whether this bill should be supported.

Tobacco Settlement Permanent and Program Funds; Revenue Projections

Tom Clifford, chief economist, LFC, offered background information on the MSA revenues. The LFC estimates that the fund lost close to $8 million between FY09 and FY10. Mr. Clifford's forecast reflects the following factors: a base payment, plus a 3% inflation factor, plus a volume adjustment of 4%, minus the anticipated loss of market share by participating manufacturers and minus the nonparticipating manufacturers' withholding of $4.3 million per year due to their belief that New Mexico is not meeting the terms of the MSA. Based on these components, the net revenue is expected to be $40 million for FY11 and $39.6 million for FY12. Mr. Clifford commented on the OAG's belief that further reductions in escrow payments will occur unless the current statute is amended. The TRD does not believe that the statute as currently written will have a material effect on revenues. He noted that the language in the statute does not align with the MSA with regard to "tax exempt stamps". Lobbyists for the nonparticipating manufacturers have testified that the inclusion of that language was intentional. More analysis is needed and the fiscal and revenue projections should be updated before the general fund projections in December are presented.

A question was asked about which figures will be potentially affected by the proposed amendment to the statute. The importance of reconciling differing opinions was stressed. The original intent of the 2010 law was to enhance tax revenues with the creation of tax-credit stamps, and this intent should not be lost. A question was asked about the possible propriety of waiting a year before taking any action, allowing time for the differences to be resolved and to evaluate the impact of the statute in its current form.

Public Comment

Nathan Bush, American Cancer Society, suggested that the tobacco companies be asked how they project their contributions, how they estimate downward adjustments and what their strategies are for withholding funds for purposes of the MSA. The co-chair suggested that Mr. Clifford and Mr. Bush consult about the type of information that should be sought from the tobacco companies.

Review of FY10 and FY11 Program Funding Levels and FY12 Funding Recommendations

Ms. Mitchell, staff attorney, Legislative Council Service (LCS), reviewed a spreadsheet reflecting recommendations and appropriations for tobacco settlement funds in FY10 and FY11, including reductions and final appropriations. In FY10, the final appropriations were reduced by 7.9%, and in FY11, the total funds were reduced by 10.3%. Amounts requested of the TSROC were reflected on the chart. An additional chart shows a retrospective history of funding from FY99 to the present. The Tobacco Settlement Permanent Fund currently has a balance of $134,011,700. Clarifications were sought between the charts prepared by the LCS and the information provided by the SIC and the LFC. The co-chair suggested that the figures reflect a need to increase funding for TUPAC, which has lost significant funding in the last two years. Mr. Elmore noted that the DOH eliminated 20 TUPAC contractors altogether and the remainder were cut. Committee members discussed the agency requests and the known need for additional Medicaid funding that exceeds the request of the Human Services Department (HSD). Clarification was sought regarding the requests from the University of New Mexico Health Sciences Center and its desire for additional flexibility in allocating appropriated funds where needed. A suggestion was made to at least identify the programs by name that are to be funded with the money so that important programs are not lost. Clarification was sought regarding whether the funding requests represent the total needs of an agency; no, the request is just a part of the total need. The co-chair suggested that the Medicaid expansion should be higher than what the HSD requested, but the total should be determined by what is left over after funding the other agency requests. Final adjustments should reflect all the 2011 appropriations to the agency, plus an additional amount for Medicaid beyond the HSD request. It was recognized that, ultimately, the LFC will make the determination about what amounts are appropriated to what programs. A committee consensus was reached.

The co-chair invited Bob Barberousse, lobbyist for Lovelace, to comment on concerns regarding citations assessed on Lovelace for use of animals in research. He will provide additional information to the committee.

Representative Chasey asked committee members whether they had any additional feedback on the matrix of recommendations for the GRTF and the letter to the FDA. She requested that Ms. Mitchell date the matrix of recommendations with clarifying information regarding the DOH and submit it to the GRTF.

Public Comment

Mr. Bush noted that materials he submitted to the committee with funding requests were one year off; they should indicate FY12 instead of FY11. He highlighted that the TSROC has done a great job; however, there remains a great need for more emphasis on tobacco reduction programs.

The co-chair recognized and thanked Representative Vaughn for her participation and work, as she will not be returning to the legislature next year. Committee members thanked the co-chair and the staff for their work during the interim.

There being no further business, the committee adjourned at 2:35 p.m.