

MEMORANDUM



DATE: November 6, 2009
TO: Interested Parties
FROM: Kyle I. Jen, Associate Director
RE: Merit Award Trust Fund

This memo provides updated information on Merit Award Trust Fund revenues and appropriations for fiscal years (FYs) 2008-09 and 2009-10.

Background Information

In 1998, 46 states entered into a Master Settlement Agreement with the four largest U.S. tobacco companies. A number of smaller tobacco companies have since joined the agreement. The agreement included provisions requiring annual payments by the tobacco companies to those states in perpetuity for past tobacco-related health care costs. Those payments are adjusted annually based on multiple factors specified in the agreement, including inflation and the volume of cigarette sales.

Public Act 489 of 2000, the Michigan Trust Fund Act, provided for the state's annual revenue from the Master Settlement Agreement to be split between two new state restricted funds: the Merit Award Trust Fund and the Tobacco Settlement Trust Fund. As part of legislative changes related to securitizing a portion of Michigan's annual tobacco settlement payments, the Michigan Trust Fund Act was amended by Public Act 232 of 2005 to eliminate the Tobacco Settlement Trust Fund.

Under current law, all tobacco settlement revenue received by the state that has not been securitized under the provisions of the Michigan Tobacco Settlement Finance Authority Act (Public Act 226 of 2005) or designated for transfer to the 21st Century Jobs Fund is deposited in the Merit Award Trust Fund. The Michigan Trust Fund Act specifies the following purposes for the appropriation of funds from the Merit Award Trust Fund:

- (a) Michigan merit award scholarships under the Michigan merit award scholarship act, 1999 PA 94, MCL 390.1451 to 390.1459, or to a successor to that program.
- (b) Expenses properly incurred in the administration of the Michigan merit award scholarships and the test by which awardees of the Michigan merit award scholarships are determined.
- (c) Funding of the tuition incentive program as described in section 310 of 1998 PA 271 or a successor to that program.
- (d) Funding of the Michigan nursing scholarship program as described in the Michigan nursing scholarship act, 2002 PA 591, MCL 390.1181 to 390.1189.
- (e) Other expenditures as determined by law.

The Michigan Promise Grant Program was established in 2006 as a successor to the Michigan Merit Award Program. The Tuition Incentive Program continues to be authorized under boilerplate language contained in the annual Higher Education budget act.

The final provision listed above, providing for "other expenditures as determined by law," has allowed the Merit Award Trust Fund to be utilized as a discretionary funding source in the state budget over the past decade. Various programs in addition to those listed above have been funded with revenue from the trust fund. The fund has been utilized at various times to help balance the state's General Fund/General Purpose (GF/GP) budget—both by direct transfers of fund revenue to the state's General Fund and by appropriations for Medicaid base funding that would otherwise have been funded with GF/GP revenue.

An attachment to this memo shows estimated revenues to and appropriations from the Merit Award Trust Fund for both FYs 2008-09 and 2009-10.

FY 2008-09 Revenues and Appropriations

Michigan's tobacco settlement payment for 2009 was \$294.8 million. This amount was lowered by approximately \$20.5 million as a result of a decision by various tobacco companies to withhold and place a portion of the amount otherwise due in escrow under a continuing dispute between the tobacco companies and states involved in the Master Settlement Agreement. Since FY 2005-06, approximately \$110 million has been withheld by the participating tobacco companies under a provision of the Master Settlement Agreement related to non-participating cigarette manufacturers. The states that are part of the agreement dispute the tobacco companies' interpretation of the agreement.

The ultimate resolution of this matter, which centers on measures taken by the states to enforce the provisions of the agreement regarding non-participating manufacturers, remains uncertain. It appears a resolution could be reached through a national arbitration panel within the next year. The possibility exists that some or all of the revenue that has been withheld will be paid to Michigan at some point and become available for appropriation. It's also possible that Michigan will be subject to a financial penalty exceeding the amount of revenue that has been withheld to date.

As part of the recent agreement to arbitrate the matter, the tobacco companies involved released approximately \$23.5 million to the state in February of this year, representing funds that they withheld in April 2008.

Two payments of tobacco settlement revenue reduce the funds available for appropriation from the Merit Award Trust Fund in FY 2008-09:

- \$39.3 million is needed to make the annual debt service payment required on the bonds issued to securitize a portion of the state's annual tobacco settlement revenue under legislation enacted in 2005. The securitization of those funds yielded a one-time revenue amount of \$400.0 million for the 21st Century Jobs Fund.
- \$75.0 million transferred to the 21st Century Jobs Fund. In addition to authorizing the securitization of tobacco settlement revenue, the 2005 legislation provided for \$75.0 million to be deposited in the 21st Century Jobs Fund each year from FY 2007-08 to FY 2014-15. (Funding in the 21st Century Jobs Fund is utilized for various programs, grants, and loans related to economic diversification. For FY 2008-09, only \$53.0 million of the \$75.0 million transferred to the 21st Century Jobs Fund is currently appropriated; it is anticipated that the remaining \$22.0 million will be transferred to the General Fund to help balance the GF/GP budget.)

Appropriations from the Merit Award Trust Fund for FY 2008-09 total \$186.1 million. Fund shifts contained in the enacted version of House Bill 4311 resulted in \$72.5 million in appropriations from the trust fund for financial aid programs in the Higher Education budget being replaced with an equal

amount of appropriations from the trust fund for field staff and Family Independence Program costs in the Human Services budget. An offsetting shift in Temporary Assistance for Needy Families (TANF) revenue between the two budgets occurred. These adjustments were made to position the state to be able to leverage TANF contingency revenues available from the federal government.

The projected ending balance of \$24.6 million for FY 2008-09 (which becomes the fund's beginning balance for FY 2009-10 and was assumed as part of FY 2009-10 budget decisions) is largely a function of the \$23.5 million in funds released by the tobacco companies in conjunction with the agreement to arbitrate the ongoing legal dispute.

FY 2009-10 Revenues and Appropriations

The FY 2009-10 budget assumes receipt of an estimated \$324.0 million under Master Settlement Agreement. This amount is not lowered to account for any funds withheld under the ongoing legal dispute.

Beginning in FY 2009-10, an additional annual debt service payment is required for a second round of securitization; this securitization was enacted in 2007 to balance the FY 2006-07 state budget. The Legislature authorized securitization sufficient to yield a total of \$415.0 million, which was deposited to the state's General Fund and School Aid Fund.

For FY 2009-10, then, three obligations reduce the funds available for appropriation from the trust fund:

- A projected debt service payment of \$43.2 million for the first (2005) round of securitization.
- A projected debt service payment of \$34.9 million for the second (2007) round of securitization.¹
- The transfer of \$75.0 million to the 21st Century Jobs Fund. (Only \$37.5 million of the \$75.0 million transferred to the 21st Century Jobs Fund is appropriated for FY 2009-10; it is anticipated that the remaining \$37.5 million will be transferred to the General Fund to help balance the GF/GP budget.²)

An estimated \$196.4 million is available for appropriation from the trust fund in FY 2009-10. Only a total of \$56.3 million, however, has been appropriated as part of FY 2009-10 budget acts. Major changes from FY 2008-09 include the following:

- The appropriation of funds for Medicaid costs in the Community Health budget is reduced from \$77.0 million to \$18.4 million.
- Appropriations for three items historically funded from the trust fund—the Promise Grant Program, the Nursing Scholarship Program, and the Michigan Education Savings Program—have been eliminated. (The FY 2008-09 appropriations from the fund for the Promise Grant and Nursing Scholarship programs had been reduced by the fund shift with TANF revenue described above.)
- The single remaining appropriation from the trust fund for state financial aid is \$30.1 million for the Tuition Incentive Program.

¹ The terms of second round of securitization were more favorable to the state, resulting in a lower percentage of annual revenue dedicated to debt service: 10.77% for the 2007 securitization vs. 13.34% for the 2006 securitization.

² The version of House Bill 4182 reported by the Senate Appropriations Committee on October 6 would transfer funds from the 21st Century Jobs Fund to the General Fund for both FYs 2008-09 and 2009-10.

The FY 2009-10 Executive Recommendation for the Promise Grant Program was \$140.0 million. Under the legislative leadership target agreement for the FY 2009-10 budget, those funds will instead be used to help balance the state's GF/GP budget, presumably through a transfer of \$140.0 million from the Merit Award Trust Fund to the General Fund.

Accounting for enacted appropriations and the assumed transfer to the general fund, the projected Merit Award Trust Fund balance at the end of FY 2009-10 is less than \$100,000. Depending on the developments related to the ongoing legal dispute with participating tobacco companies discussed above, adjustments to appropriation from the fund could be necessary at some point during the fiscal year.

Attachment

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ATTACHMENT
Merit Award Trust Fund Balance Sheet
Fiscal Years 2008-09 and 2009-10

<u>Item</u>	<u>FY 2008-09</u> <u>Year-to-Date</u>	<u>FY 2009-10</u> <u>Enacted</u>	<u>Notes</u>
Beginning Balance	\$5,808,102	\$24,631,157	
<u>Revenues</u>			
Master Settlement Agreement payments	\$294,848,084	\$324,000,000	(A)
Less 2006 securitization payment (13.34%)	(39,332,734)	(43,221,600)	
Less 2007 securitization payment (10.77%)	--	(34,894,800)	
Release of funds in dispute	23,528,705	--	(A)
Less 21st Century Jobs Fund deposit	(75,000,000)	(75,000,000)	(B)
Estimated Interest	900,000	900,000	
Available Resources	\$210,752,157	\$196,414,757	
<u>Appropriations</u>			
Attorney General: Administration	(\$408,600)	(\$408,600)	
Community Health: Medicaid Base Funding	(76,976,800)	(18,431,200)	
Community Health: Respite Care	(4,787,500)	(4,468,700)	
Higher Education: Merit Award Program	(5,200,000)	(100)	
Higher Education: Promise Grant Program	(16,370,800)	0	(C)
Higher Education: Tuition Incentive Program (TIP)	(2,100,000)	(30,100,000)	(C)
Higher Education: Nursing Scholarship Program	(1,509,600)	0	(C)
Higher Education: Tuition Grants	(3,100,000)	0	
Higher Education: Children of Veterans Tuition Grants	(30,000)	0	
Human Services: Field Staff, Salaries and Wages	(12,489,600)	0	(C)
Human Services: Family Independence Program	(60,000,000)	0	(C)
State Police: Tobacco Tax Enforcement	(152,500)	(610,000)	
Treasury: Merit Award/TIP Administration/Info. Tech.	(2,295,600)	(2,330,800)	
Treasury: Michigan Education Savings Program	(700,000)	0	
Total Appropriations	(\$186,121,000)	(\$56,349,400)	
Transfer to General Fund	\$0	(\$140,000,000)	(D)
Ending Balance	\$24,631,157	\$65,357	

Notes

(A) FY 2008-09 payment lowered by \$20.5 million due to tobacco companies' decision to place funds in "Disputed Payment Accounts"; assumes no funds withheld/released in FY 2009-10; resolution of dispute could have substantial impact on final available fund resources for FY 2009-10.

(B) For FY 2008-09, only \$53.0 million of the \$75.0 million transferred to the 21st Century Jobs Fund is currently appropriated; remaining \$22.0 million to be transferred to the General Fund to help balance the GF/GP budget; anticipated transfer to General Fund for FY 2009-10 is \$37.5 million.

(C) FY 2008-09 amounts reflect fund shifts between Higher Ed and Human Services budget contained in House-passed HB 4311 in order to leverage available TANF contingency revenues.

(D) Anticipated FY 2009-10 transfer to General Fund of funds available due to defunding of Promise Grant Program under Higher Education budget act.