

PROBLEMS WITH SECURITIZING STATE TOBACCO SETTLEMENTS

1. **States get only cents on the dollar.** Securitization is, by definition, the sale of future state tobacco settlement receipts for a much smaller lump-sum payment today, usually for about 40 cents on the dollar or less. And the market for the tobacco settlement bonds created by securitization is becoming saturated, which suggests even fewer cents per dollar for newly securitizing states.
2. **Securitizing makes underlying state budget problems worse.** Directing securitization revenues to state budget deficits does nothing to address the state's underlying spending and revenue problems – but actually makes them worse by eliminating future state revenue in each of the following fiscal years and for decades to come. Wisconsin, for example, securitized a portion of its settlement payments to address budget deficits, came back the next year and securitized the rest because of continuing budget deficits, and now faces budget deficits again (but all of its settlement revenues are gone).
3. **Securitizing threatens state bond and credit ratings, which can increase state costs.** Because securitization does not improve a state's fiscal situation but only makes it worse, five states that have securitized to address budget deficits have had their credit ratings lowered by the three main credit agencies or have been placed on alert, which can increase state bond-issuing and borrowing costs.
4. **States can't outsmart Wall Street.** Some state officials think that securitization eliminates the risk that future state settlement payments might shrink or disappear because of reduced nationwide cigarette sales or cigarette company bankruptcies. But the financial institutions that broker the securitization deals know all about those risks and fully take them into account when calculating how much the state will receive. If there were a significant danger that future state settlement payments would dwindle away or disappear, there would be no market for tobacco settlement bonds and states would get even fewer cents per future dollar sold, if they could securitize at all. But thanks to fees they charge, the only real winners when a state securitizes are the financial firms that manage the deal.
5. **Securitizing states may have to bail out investors.** States claim that if they securitize they will be free from any obligations to investors who buy the tobacco-settlement bonds backed by the sold settlement payments (and the securitization amounts the states receive are reduced because of the transfer of this legal liability to the financial institutions managing the deal). But bond analysts and others believe that if the value of the bonds dropped significantly political pressures would force the states to bail out the pension funds, retirees, and other investors holding the devalued settlement-bonds.
6. **State tobacco settlement payments should be used to address state tobacco problems.** The settlement payments to the states come from the settlement of state lawsuits seeking reimbursement from the cigarette companies for the states' smoking-caused expenditures caused by the companies' wrongful acts. Accordingly, the states have a moral obligation to use at least some of their settlement proceeds to prevent and reduce tobacco use and to treat smoking-caused disease and harms.
7. **There are more fiscally responsible ways to use state settlement payments.** It is more fiscally responsible for a state to direct its tobacco settlement payments to a dedicated trust fund, with the interest used to prevent and reduce tobacco use, address other public health problems, and fund other programs that reduce future state expenditures. Creating such a fund will strengthen a state's bond and credit ratings, produce new interest revenues for the state without additional taxation, and, by funding prevention programs, make the state both healthier and fiscally stronger.
8. **There are more fiscally responsible ways to address state budget shortfalls.** It is more fiscally responsible for a state to address budget shortfalls by finding constructive ways to increase annual revenues (e.g., by increasing state tobacco taxes), to minimize wasteful or unnecessary government spending, and to protect state programs that reduce future state expenditures (such as state tobacco prevention efforts, which can reduce a state's substantial smoking-caused Medicaid expenditures).

Campaign for Tobacco-Free Kids, December 4, 2002 / Eric Lindblom

For more information, see <http://tobaccofreekids.org/research/factsheets/pdf/0132.pdf>.