

Upfront, lump-sum payment

## Securitizing Texas' Tobacco-Settlement Receipts

Nine states have moved to securitize all or part of the money they are due to receive from their legal settlements with the tobacco industry, seeking to obtain the funds sooner and with greater certainty. Securitization refers to replacing cash flows with negotiable securities, such as bonds, issued in public capital markets. In this case, a state or other public entity sells bonds backed by future tobacco-settlement receipts in order to receive money up front in a lump sum, rather than in a series of future payments.

State governments have used their tobacco-settlement funds for a wide variety of purposes. In Texas, these funds have become a key source of funding for state health-care initiatives, especially those for children. For the current biennium, lawmakers appropriated \$575 million of settlement funds to pay for the Children's Health Insurance Program (CHIP), simplification of Medicaid enrollment, and other programs that benefit children, plus about \$500 million for other health and higher education programs under Article 12 of the general appropriations act.

Because of the way the state's settlement with major tobacco firms is structured, however, settlement payments could decline in the future. If that occurred, the Legislature would have to replace this revenue source

with other funds or else trim CHIP and other programs that the tobacco funds support.

States have opted to securitize their tobacco-settlement funds to protect against such revenue declines and to sever their fiscal ties with the tobacco industry. This approach would present both benefits and drawbacks for Texas in using its settlement funds to pay for health care and other programs.

### Texas' settlement funds

In 1996, Texas filed a federal lawsuit accusing the tobacco industry of violating conspiracy, racketeering, consumer protection, and other provisions of state and federal law. The state sought to recover billions of tax dollars it had spent to treat tobacco-related illnesses. In settling the lawsuit, the industry agreed to

[\(see Tobacco, page 2\)](#)

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## "Don't Call Us, We'll Call You": Telemarketing No-Call Lists Debut

On January 1, Texas joined 24 other states with statutory "no-call" lists intended to shield telephone customers from unwanted telemarketing sales calls. HB 472 by Solomons, enacted by the 77th Legislature in 2001, established a comprehensive statewide no-call list of residential customers who do not wish to receive telemarketing calls from companies with whom the customers do not have an existing business relationship. SB 7, the electric utility restructuring bill enacted in 1999, also established a no-call list for residential and business customers who do not wish to receive marketing calls from retail electricity providers.

The Public Utility Commission of Texas (PUC) maintains both no-call lists. By the end of January, nearly 170,000 Texans had signed up for the statewide list and nearly 140,000 had signed up for the "electric" list, according to the PUC.

### HB 472 provisions

The new law applies to any telemarketing firm, even from out of state, that wants to call telephone customers in Texas. Telemarketers must purchase the statewide no-call

[\(see No-call list, page 5\)](#)

**(Tobacco, from page 1)**

pay the state \$15 billion over 25 years and to pay about \$2.3 billion through fiscal 2003 to Texas counties and hospital districts that had intervened in the settlement. Florida, Minnesota, and Mississippi also reached separate settlements, while 46 other states joined the Master Settlement Agreement. The total value of all settlements between states and the tobacco industry is \$246 billion, the largest of its kind.

Actual payments by the industry are subject to adjustment formulas related to tobacco sales, inflation, and industry profitability. Under Texas' settlement terms, payments from the industry rise or fall in proportion to U.S. consumption of cigarettes each year as compared to consumption in 1997.

The 76th Legislature in 1999 used \$1.5 billion of the initial receipts to create endowment funds for health and human services and higher education and created sources

of ongoing program funding out of interest earnings. Lawmakers also reserved the first settlement money available to the state each fiscal year to support CHIP, a state-federal program for children of low-income families. CHIP is not an entitlement. Should federal funding or tobacco-settlement funds cease, the Legislature would need to authorize spending of other funds or the program would be shut down, as required by SB 445 by Moncrief, which created CHIP.

For fiscal 2002-03, lawmakers appropriated \$945 million in tobacco-settlement receipts, plus \$134 million of income from the endowments created in 1999. The 77th Legislature added no new money to existing endowments but created a new endowment for the Rural Communities Health Care Investment Program. CHIP appropriations from tobacco-settlement funds total \$419 million. Lawmakers also used settlement funds in the current budget to pay for simplifying access to Medicaid for children (\$123 million), increasing rates paid to Medicaid providers (\$120 million), and other programs. (See House Research Organization

### Endowments created with tobacco-settlement revenues

The 76th and 77th Legislatures used \$1.5 billion of tobacco-settlement funds to establish permanent endowments for health programs and higher education institutions. Interest earnings from the endowments are appropriated to individual agencies and institutions to fund ongoing programs. The table below shows the initial capitalization of those funds from tobacco-settlement appropriations.

#### Health-related endowments

Tobacco education and enforcement	\$200 million
Children and public health	100 million
Emergency medical services and trauma care	100 million
Rural health facility capital improvements	50 million
Community hospital facility improvements	25 million
Rural communities health care investment	2.5 million

#### Higher education-related endowments

Health-related endowments for institutions of higher education	\$595 million
Permanent health fund for higher education	350 million
Nursing and allied health fund	45 million
Minority health research and education	25 million

State Finance Report 77-3, *Texas Budget Highlights for Fiscal 2002-03*, September 28, 2001, pages 26-27.)

## Benefits of securitization

Some states and localities have chosen to securitize their tobacco-settlement funds by selling bonds backed by all or part of their future payments. Securitization offers three benefits: it removes the risk of declining or no payments, provides a one-time infusion of funds, and eliminates the public stake in tobacco sales.

In securitization, the bond buyer assumes all risk associated with the future value of the payments. In return for assuming that risk, the buyer receives a discount and pays less today to receive the full value over time. For example, South Carolina securitized \$2.3 billion in tobacco receipts over the next 25 years for \$934 million in 2001.

According to research by Morgan Stanley's public finance division, Texas could sell \$14.2 billion of tobacco-settlement receipts expected over 30 years. Discounting this figure at a rate of 6.5 percent to account for future interest, the state's net proceeds from securitizing the settlement receipts would be \$5.8 billion.

A bond investor bears the risk that, over the long term, settlement funds might drop below the discounted amount the investor pays the state. However, the investor will reap the benefit of the discount if the payments turn out to be closer to the original settlement amount.

Investors also bear the risk of future bankruptcies caused by litigation. Although the Master Settlement Agreement insulates the tobacco industry from additional government litigation, the industry still can be sued by individuals and groups. In 2000, a Florida class-action lawsuit resulted in a \$145 billion award against tobacco manufacturers, in response to which the companies filed an appeal in late November 2001. Similarly large judgments in other suits could bankrupt some companies and could jeopardize future settlement payments to states.

DRI-WEFA, an economic consulting and forecasting firm, projects that U.S. cigarette consumption will decline to half of 1999 levels by 2042, an annual contraction of

## Tobacco-settlement securitization in other states

- Alabama** — sold \$50 million in bonds in September 2000 for economic development projects and an additional \$104 million in December 2001.
- Alaska** — sold \$116 million in bonds (40 percent of its settlement) in October 2000 for school construction and repairs. Sold an additional \$126 million (another 40 percent) in August 2001, also for school construction.
- Arkansas** — sold \$60 million in bonds in September 2001 for biosciences and public health projects at state universities.
- Iowa** — sold \$644 million in bonds for capital projects in October 2001. General revenue that would have been spent on capital projects will be used instead to fund a health-care services endowment.
- Louisiana** — sold \$1.2 billion in bonds in November 2001. Proceeds will be used to fund education and health endowments.
- North Dakota** — sold \$32 million in bonds in March 2000 for a state water development and management program.
- South Carolina** — sold \$934 million in bonds in March 2001 and used proceeds to fund a health-care endowment to support a pharmaceutical assistance program for senior citizens and economic development trust funds.
- South Dakota** — legislature approved a securitization plan, proceeds of which will be placed in an education trust fund.
- Wisconsin** — legislature approved sale of about \$1.3 billion in bonds (about 20 percent of the state's settlement) for general revenue and endowments.

*Sources: National Conference of State Legislators, Morgan Stanley, and House Research Organization.*

1.7 percent. Because Texas' future settlement payments are tied to tobacco sales, a greater-than-expected reduction in tobacco sales would result in lower payments to the

state. Investors would assume that risk if the state chose to securitize its settlement payments.

Securitization results in a single large payment rather than smaller payments over time. Other states have chosen to securitize their settlement payments to obtain immediate revenue to pay for capital projects or to pay down debt. Securitizing settlement payments would enable Texas to use the funds as general revenue or to create additional endowments.

Texas used its initial settlement funds to establish permanent endowments for public health and education. If the state securitized its future payments, it could add to those endowments or create additional endowments for programs that received Article 12 funds in fiscal 2002-03, such as CHIP and the Medicaid simplification initiative. These endowments then could earn interest to support ongoing program costs.

Finally, advocates say, securitization removes a conflict of interest between the state's fiscal and public-health interests, because the settlement money no longer is tied to tobacco consumption. As Texas' settlement is structured, the more people who quit smoking, the lower the payment to the state. This vested interest in the continuing viability of the tobacco industry could make policymakers less likely to take actions that would result in lower cigarette sales. Some states, including Florida and Oklahoma, have enacted laws to protect tobacco companies from bankruptcy while they appeal class-action damage awards; critics say such moves protect settlement revenue at the expense of public health.

Texas may have enough distance already between its interest in continued receipt of tobacco-settlement funds and the public health threat posed by smoking. In 1999, the Legislature established a \$200 million permanent endowment for tobacco education and enforcement (HB 1676 by Junell). For fiscal 2002-03, lawmakers appropriated \$18 million of interest earned by that fund to the Texas Department of Health for tobacco education and enforcement programs. With the endowment in place, future funding for education and enforcement does not depend on the tobacco industry's viability.

## Objections to securitization

Not all states that have evaluated securitization have decided to proceed with it. The main objection to the sale of future settlement payments is that the state must forfeit too much of its potential future revenue to investors. Bond investors are compensated for the risk of declining payments by a sale price that is significantly lower than the total expected payout.

Because the proceeds of a securitization bond sale would be lower than what Texas is projected to receive over time, the proceeds might not be sufficient to create endowments that would produce enough interest income to fund all state programs that depend on tobacco-settlement funds. For example, the CHIP program requires more than \$400 million each biennium, and an endowment to fund that program likely would require more than \$4 billion, assuming that it earned 10 percent in interest income each biennium. Assets held by the endowment could decrease in value or fail to generate additional interest. Also, the Legislature might be tempted to spend the extra money now to avoid politically painful revenue increases or spending cuts, leaving little or nothing for the future.

Securitizing payments through the sale of bonds could limit the Legislature's flexibility in appropriating future settlement funds. So far, the Legislature has chosen to use the settlement funds for health and higher education programs, but other states have used theirs for a wide variety of activities, including tax relief, debt reduction, and water resource projects. Under Securities and Exchange Commission regulations, if Texas sold its future settlement payments through bonds, it would have to use the sale proceeds for the purposes stated in the official statement at the time of the sale. Although the official statement could list broad purposes, it would limit future legislatures' ability to move money between broad categories such as "health care" or "transportation."

— *by Kelli Soika*

**(No-call list, from page 1)**

list from the PUC every three months at a cost of \$45 for each list. A telemarketer subject to HB 472 may not place an unsolicited call to a consumer on the no-call list.

The PUC will investigate customers' complaints and can assess administrative penalties of up to \$1,000 per violation. A telemarketer that calls someone on the no-call list more than once can be sued by the consumer. If a court finds that the violator willfully and knowingly violated the law, it can increase the penalty to \$3,000 per violation. Anyone wishing to register a complaint against a company for a violation may contact the PUC's Customer Protection Division or the Attorney General's Consumer Protection Division.

The law prohibits a telemarketer from blocking the identity of the telephone number from which a call is made and from interfering with the capacity of a caller identification service to provide information regarding the call. It also offers similar protections against unsolicited facsimile (fax) advertisements.

Certain callers are exempt from the no-call restrictions, including debt collectors, charities, nonprofit organizations, political groups, and companies that have had business relationships with specific customers in the previous 12 months. State licensees, including insurance agents and real estate agents, also are exempt from the restrictions under certain circumstances.

An example of a prior business relationship would be a bank that holds a person's mortgage or credit card, or a telephone service provider. Some call this exemption a loophole in the law, because if a consumer has purchased an item from a company, thus establishing a prior business relationship, that company could continue to call for a year. As another example, a credit card company could place telemarketing calls concerning an affiliated product, such as insurance, to a person who held a credit card with that company.

According to Rep. Burt Solomons, even though some organizations are exempt from the no-call list restrictions, consumers still are protected from those types of calls. For example, if a business with whom a customer has had a prior relationship, such as a telephone service provider, calls the customer with a new offer, the customer can ask the provider not to call again, and the provider must abide by that request.

**No-call list implementation**

The PUC will publish the initial no-call list April 1 and will update the list four times each year: January 1, April 1, July 1, and October 1. The deadline for getting on the initial list is the week before April 1.

Telemarketers are allowed 60 days to update their no-call lists after each state update, so up to five months could elapse between the time a customer gets on the list and when telemarketing calls must cease, according to the PUC.

Customers may add their names to the statewide list by logging on to the Internet at <http://www.texasnocall.com>;

by calling the toll-free number 1-866-896-6225; or by mailing a request for an application to Texas No Call, P.O. Box 313, East Walpole, MA 02032. A customer must pay a \$2.25 fee to be listed for three years and must pay to renew the listing thereafter. Customers who

obtain new telephone numbers must pay the fee to add the new number to the no-call list, as coverage does not "travel" with an individual.

A consumer or business can be placed on the "electric" no-call list for five years at a cost of \$2.55. According to the PUC, the statewide, comprehensive list includes retail electricity providers as telemarketers, so telephone customers who live in areas where retail electricity customers have a choice of providers do not need to sign up for both lists. However, residential numbers may be included on both lists for a cost of \$4.80 per number and will remain on both lists for five years.

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*The PUC will publish the initial statewide no-call list on April 1 and will update the list in January, April, July, and October of each year.*

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## Statutory background

Federal and state laws prohibit telephone marketers from calling anyone who asks not to be called. The federal Telephone Consumer Protection Act (TCPA), enacted in 1991, imposes restrictions on calls made by automatic telephone dialing systems and fax machines. The TCPA directed the Federal Communications Commission (FCC) to adopt regulations to protect residential telephone subscribers' privacy, including a no-call rule. The FCC's no-call rule requires a person or entity placing telephone calls to residential phones to maintain a record of do-not-call requests.

In 1995, the Federal Trade Commission's (FTC) telemarketing sales rule took effect. The purpose of the rule is to protect consumers from deceptive and abusive telemarketing practices. The rule forbids late-night calls, prohibits a telemarketer from calling a customer if asked not to, and requires the seller or telemarketer to maintain an in-house do-not-call list.

In Texas, the Public Utility Regulatory Act of 1995 establishes certain protections for persons who receive telephone solicitations. It requires telephone solicitors to make their best efforts to comply with customers' no-call requests.

Since 1985, the national Direct Marketing Association (DMA) has maintained a no-call list that all members must use, but not all telemarketers are DMA members. To get on that list, consumers can send a letter with their name, home address, telephone number, and signature to DMA, Attention: Preference Service Manager, P.O. Box 3079, Grand Central Station, NY 10163.

Supporters of HB 472 claimed that even with all of these federal and state laws in place, consumers still were being inundated by unsolicited telemarketing calls because the laws allow companies to make one initial phone call. Also, they said, the no-call requests applied only to the person or entity placing the call, so consumers had to request to be placed on each company's internal no-call list.

Opponents said a statewide list was unnecessary because federal law already required telemarketers to

## No-Call Contacts

*To register a complaint against a company for violating the no-call list restrictions:*

Public Utility Commission, Customer Protection  
Division, toll-free 1-888-782-8477  
Office of the Attorney General, Consumer  
Protection Division, toll-free 1-800-621-0508

*To be listed on the statewide no-call list:*

<http://www.texasnocall.com>  
or toll-free 1-866-896-6225

*To be listed on the Direct Marketing  
Association's national no-call list:*

DMA, Attn.: Preference Service Manager, P.O.  
Box 3079, Grand Central Station, NY 10163

keep in-house no-call lists. A statewide list, they claimed, would impede future economic development in Texas and would inhibit a company's ability to market its products or services to prospective customers by preventing initial contact with customers who might be receptive to receiving information. They argued that the bill would be anticompetitive in preventing a new company from marketing its products and services and would deprive many people of prospective employment. Opponents also said a statewide list would not prevent fraudulent telemarketing because "bad actors" probably would not abide by any new law.

## National registry proposal

The FTC has proposed creating a national do-not-call registry that would be free to consumers. The proposal would enable consumers to call a single toll-free number to get on the list. Telemarketers would have to update their no-call lists monthly from the national list, and a telemarketer that called people on the list could be fined

up to \$11,000 for each violation. FTC commissioners plan to schedule public hearings on the proposal in June with final action possible as soon as a year from now. For information on the proposal and how to submit comments, visit the FTC's website at <http://www.ftc.gov>.

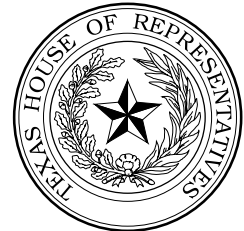
Theresa Gage of the PUC said, "Should the FTC implement a national do-not-call list, it will give Texans another tool they can use to stop unwanted telemarketing calls." According to Gage, the FTC list would apply only to calls made to Texas from another state. Texas

consumers still could sign up for the Texas list to stop calls made within the state.

Telemarketers say that a national registry is not needed and that the federal government may be overstepping its boundaries by spending taxpayer dollars to limit communication. Some claim that the proposal would hurt the telemarketing industry and would drive companies out of the country to avoid the regulations.

— *by Rita Barr*

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