LFC Requester:	Chenier

AGENCY BILL ANALYSIS - 2025 REGULAR SESSION

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SECTION I: GENERAL INFORMATION

{Indicate if analysis is on an original bill, amendment, substitute or a correction of a previous bill}

Date Prepared: *03/07/25*
Bill Number: *SB 88/aSFC/aSLF*

Check all that apply:
Original __ Correction _x
Amendment x_ Substitute __

Sponsor: Munoz, Sharer, Woods
Short Title: Medicaid Trust Fund & State Supported Fund

Agency Name and Code Number: 337 – State Investment Council
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SECTION II: FISCAL IMPACT

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY25	FY26		

(Parenthesis ( ) indicate expenditure decreases)

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY25	FY26	FY27		
	($279,700.0)	**($262,800.0)**	Recurring	**General Fund** *(treasury earnings**)*
	$279,700.0	**$262,800.0**	Recurring	**Medicaid Trust Fund** *(treasury earnings**)*

(Parenthesis ( ) indicate revenue decreases)

*****Note, as written, this bill may not be administrable – see discussion below*****

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY25	FY26	FY27	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	This bill will require additional time from investment, accounting, and administrative staff (see administrative implications)				Recurring	SIC (LGPF/STPF)

(Parenthesis ( ) Indicate Expenditure Decreases)

SECTION III: NARRATIVE

BILL SUMMARY

Synopsis of Senate Floor Amendment #1:

The Senate Floor amendment to Senate Bill 88 corrects an issue with renumbering bill sections following the SFC amendment.

Note, this amendment does not address critical issues with crediting state treasury losses to the Medicaid Trust Fund. *In discussions with the State Treasurer's Office, we believe this provision is likely not administrable and, if enacted, could result in audit findings and potentially impact the state's bond ratings. See more detailed discussion below.*

Synopsis of Senate Finance Committee Amendment:

The SFC amendment to Senate Bill 88 removes state agency reversions, general fund unexpended/unencumbered balances, and general fund capital outlay reversions as potential funding sources for the Medicaid Trust Fund (MTF). The amendment also allows any amount to be appropriated from the trust fund to support the state Medicaid program from FY26 to FY29 under certain conditions. It also adds an effective date of July 1, 2025.

Notably, the amendment **does not address the critical issues** with crediting state treasury realized/unrealized interest earnings to the MTF. *[see fiscal implications, performance implications, and technical issues]*

The State Treasurer's Office FIR for this bill states "It is not a prudent practice to transfer money based on unrealized gains or losses."

Because the bill credits the MTF with all treasury earnings, the trust fund would presumably have to send cash from its corpus to the state treasury for any month the treasury experiences losses, even when those losses are unrealized.[1] It is unclear exactly how this would work in practice, and it amplifies the MTF's risk exposures and significantly complicates the fund's optimal asset allocation. Additionally, it does not address what would happen if trust fund balances were insufficient to cover treasury losses.

If the intent is to provide the MTF with recurring revenues from positive, realized interest earnings on state treasury balances, then **the bill should be amended to instead create an ongoing *distribution* of realized interest income** from the state treasury to the MTF. This would send all positive treasury earnings to the trust fund, without making the trust fund responsible for covering treasury losses.

Additionally, while the provisions to appropriate directly from the corpus may be prudent for state budgeting, it can constrain the effective investment of the MTF as a long-term trust fund.

[1] An unrealized loss is a paper loss that occurs when an investment's value decreases but the asset has not yet been sold. This can happen, for example, when interest rates rise, which can erode the value of assets like bonds and securities. Unrealized losses turn into realized losses when an asset that has lost value is ultimately sold.

Uncertainty around the size and timing of potential appropriations from the fund can limit the types of assets in which SIC can invest, which could lower expected rates of return or increase the amount of risk needed to achieve target goals.

Generally, funds with direct appropriation authority have higher liquidity needs and are often better suited for management by the State Treasurer's Office.

Synopsis of Original Bill:

Senate Bill 88 creates a new Medicaid Trust Fund ("MTF"), which would be seeded with a $300 million appropriation from the general fund. The new MTF would also receive revenues from state agency reversions, unexpended/unencumbered balances from prior year general appropriation acts, and interest earnings on state treasury balances, until the fund reaches $2 billion.

Additionally, the MTF would receive all reversions from general fund capital outlay appropriations made between 2021-2024 that have not already reverted to the general fund before the bill's effective date.

Starting in FY30, the MTF will make annual distributions to a newly created State-Supported Medicaid Fund ("SSMF"), which would be administered by the Health Care Authority and available for appropriation by the legislature to support and match federal funds for the state Medicaid program.

This bill has no effective date; the assumed effective date is 90 days following the end of the session (June 20, 2025).

FISCAL IMPLICATIONS

Crediting State Treasury Earnings to the Medicaid Trust Fund

The SFC-amended bill temporarily credits treasury earnings from the general fund to the MTF, until the balance of the MTF reaches $2 billion.[2] The December 2024 consensus revenue estimate includes the following estimates for general fund revenues from state treasury earnings:

FY26	FY27	FY28	FY29
$279.9 million	$262.8 million	$264.9 million	$267.8 million

The above table reflects the annual cost to the general fund, and annual inflow to the MTF, for each fiscal year in which the MTF is below $2 billion. **However, there are potential significant issues with the mechanism by which this bill credits treasury earnings to the MTF.**

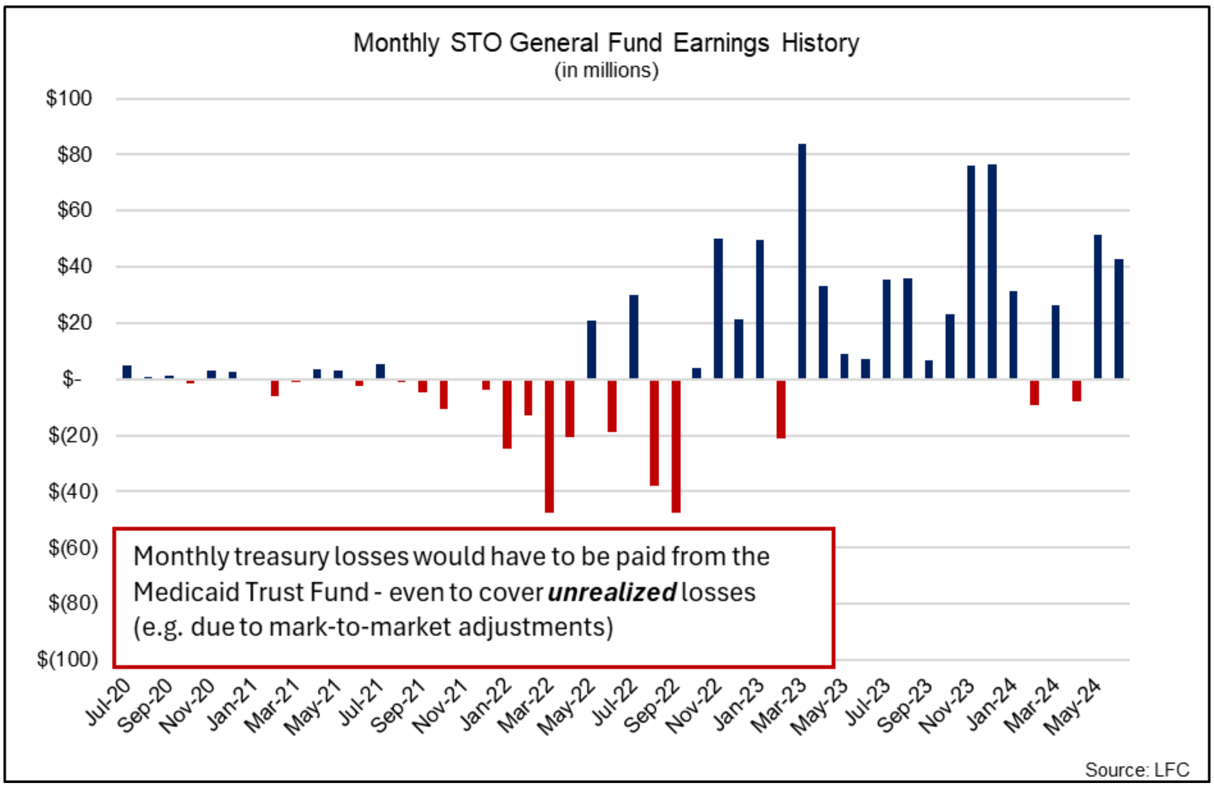
Practical Implementation Issues. This bill would require all earnings, including realized and unrealized gains and losses, to be credited to the Medicaid Trust Fund instead of the general fund. **It is unclear exactly how the MTF would absorb unrealized losses on treasury earnings.** Presumably, the MTF would have to make a transfer to the state treasury for each month in which treasury earnings were negative. In some cases, the trust fund may have to sell

[2] Note, this would not affect funds in treasury in which the law specifically credits to those funds their own interest earnings, or where such transfer would otherwise be prohibited by law.

some of its investments to generate cash for transfer to the state treasury to cover *unrealized* treasury losses.

Treasury Earnings Can Be Negative. While the annual treasury return estimates are positive, annual returns on treasury balances can be negative. For example, in FY22, treasury balances lost a total of $118.6 million due to market conditions at the time. Had this bill been in effect, the Medicaid Trust Fund presumably would have transferred $118.6 million from its corpus, in irregular monthly installments, to the general fund to cover the losses.

Additionally, while total earnings over the fiscal year can be positive, earnings for individual months during the fiscal year may be negative. **For example, there has been at least one month of negative treasury earnings in every one of the last five fiscal years** – those monthly losses ranged from $222 thousand to nearly $48 million.



Trust Fund Balances Could Be Insufficient to Cover Treasury Losses. Because treasury earnings are the sole source of revenue for the trust fund, and treasury earnings/losses are credited monthly, it is possible the MTF could be responsible for treasury losses without sufficient funds to cover those losses.

For example, in July 2022, the general fund received $30.1 million in treasury interest earnings. The following month, August 2022, the general fund took an earnings loss of $37.8 million. If a similar situation were to occur after this bill is enacted, the MTF would not have enough money to cover the treasury losses. **The bill does not address how the remainder of the treasury losses would be accounted for in the event the Medicaid trust fund is not large enough to cover the losses.**

Increased Risk. It is possible the trust fund could experience its own market losses at the same time as the state treasury, increasing the MTF's risk exposures and complicating the fund's optimal asset allocation. [see *Performance Implications]*

MTF Spending Policy

Beginning July 1, 2029 (FY30), the new MTF will make an annual distribution of 5 percent of the prior 3-year average ending balance to a newly created State-Supported Medicaid Fund, provided that the MTF has a balance of at least $500 million.

The bill also allows the MTF to be appropriated for *any purpose* should federal matching funds for the state Medicaid program (1) decline by at least 7.5% from the previous fiscal year, or (2) are less than a 1:1 match with money appropriated by the legislature for the Medicaid program.

The SFC amendment also allows any amount of the MTF to be appropriated to support the state Medicaid program if there were federal Medicaid funding cuts that would cause the state to reduce coverage or benefits below current levels.

In addition to the regular distribution, money in the trust fund may be appropriated to cover budgetary shortfalls following complete expenditure of the general fund, the general fund operating reserve, appropriation contingency fund, tax stabilization reserve, and early childhood education and care fund (commonly known as the "Early Childhood Trust Fund").

State Supported Medicaid Fund

The new State-Supported Medicaid Fund (SSMF) is an interest-earning fund in the state treasury that will be administered by the Health Care Authority. Unspent balances in the SSMF at the end of a fiscal year revert to the MTF.

The table below provides a simplified example of potential investment returns for the Medicaid Trust Fund and subsequent distributions to the SSMF.

Medicaid Trust Fund ($millions)						
Calendar Year	Beginning Balance	Approp.	Contrib. from GF treasury earnings	Gains & Losses	Distrib.	Ending Balance
2025	$0.0	$0.0	$208.9	$5.2	$0.0	$214.1
2026	$214.1	$0.0	$271.3	$17.5	$0.0	$502.8
2027	$502.8	$0.0	$263.9	$31.7	$0.0	$798.4
2028	$798.4	$0.0	$266.4	$46.6	$0.0	$1,111.3
2029	$1,111.3	$0.0	$103.4	$57.1	-$40.2	$1,231.7
2030	$1,231.7	$0.0	$103.4	$62.9	-$52.4	$1,345.6
2031	$1,345.6	$0.0	$103.4	$68.3	-$61.5	$1,455.9
2032	$1,455.9	$0.0	$103.4	$73.7	-$67.2	$1,565.9
2033	$1,565.9	$0.0	$103.4	$79.1	-$72.8	$1,675.6
2034	$1,675.6	$0.0	$103.4	$84.4	-$78.3	$1,785.1
2035	$1,785.1	$0.0	$103.4	$89.7	-$83.8	$1,894.5
2036	$1,894.5	$0.0	$103.4	$95.1	-$89.3	$2,003.8
2037	$2,003.8	$0.0	$0.0	$97.8	-$94.7	$2,006.9
2038	$2,006.9	$0.0	$0.0	$97.9	-$98.4	$2,006.4
2039	$2,006.4	$0.0	$0.0	$97.8	-$100.3	$2,003.9
2040	$2,003.9	$0.0	$0.0	$97.7	-$100.3	$2,001.3

Distribution to State-Supported Medicaid Fund ($MM)		
Fiscal Year	Distrib Date	Amount
FY25	Jul-24	$0.000
FY26	Jul-25	$0.000
FY27	Jul-26	$0.000
FY28	Jul-27	$0.000
FY29	Jul-28	$0.000
FY30	Jul-29	$40.209
FY31	Jul-30	$52.357
FY32	Jul-31	$61.478
FY33	Jul-32	$67.222
FY34	Jul-33	$72.791
FY35	Jul-34	$78.290
FY36	Jul-35	$83.776
FY37	Jul-36	$89.254
FY38	Jul-37	$94.725
FY39	Jul-38	$98.421
FY40	Jul-39	$100.285

Expected long-term compound returns for funds under the Council's management range from 5.2 percent (Tax Stabilization Reserve) to 7 percent (the long-term return target for the Land Grant Permanent Fund). Due to the significant uncertainty of the appropriate asset mix for the MTF, staff assume a long-term annual investment return of 5 percent. However, actual return expectations would ultimately depend on the fund's asset allocation.

The table above only assumes revenues from state treasury earnings, since the SFC amendment strikes the general fund appropriation and other revenue sources from the original bill. We use consensus revenue estimates for treasury earnings for FY26-FY29, then assume average earnings over the last 5 years.

Under these assumptions, the MTF's first distribution in FY29 could be about $40 million, and it could take 8-12 years for the Medicaid Trust Fund to reach the $2 billion threshold. These estimates do not include any potential appropriations directly from the fund's corpus.

PERFORMANCE IMPLICATIONS

The State Investment Officer, with the approval of the State Investment Council would manage the Trust Fund in accordance with the Uniform Prudent Investor Act and would seek to ethically optimize risk-adjusted returns and grow the fund over time.

The Council does not currently have a "boilerplate" asset allocation for any fund, including the proposed MTF, but it is a fair assumption that the new fund could/would be constructed in a manner similar to other permanent/trust funds managed by the SIC.

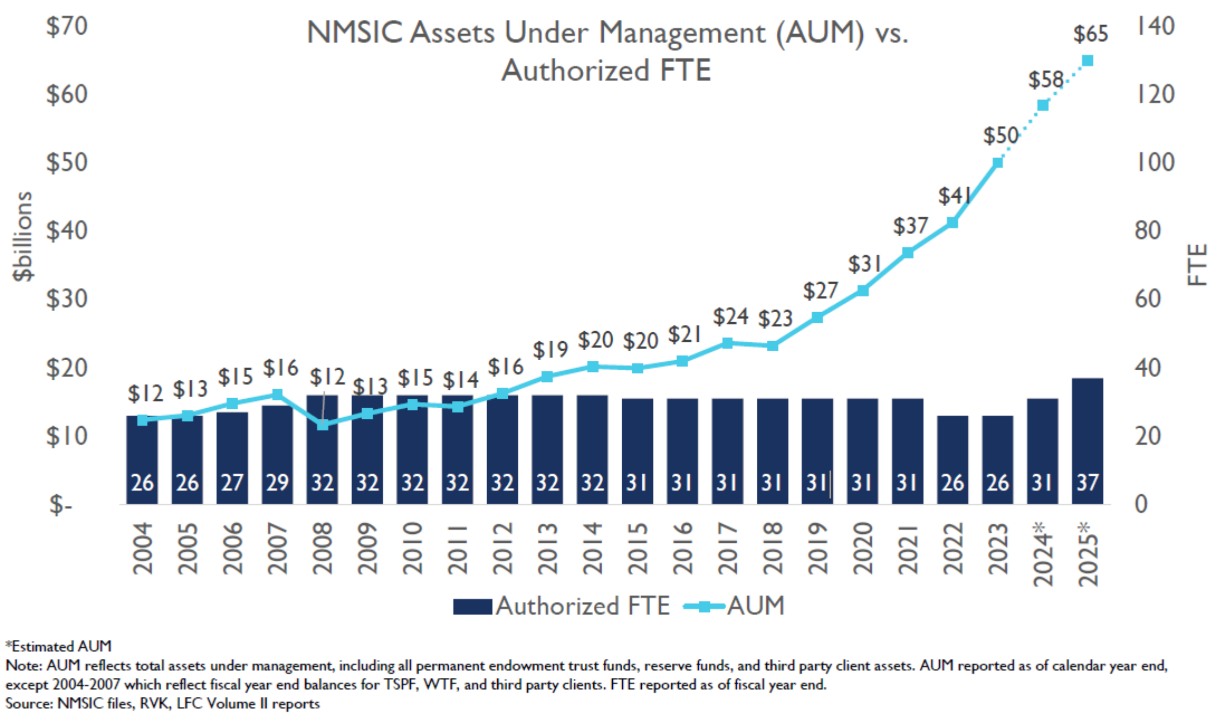
As noted above, the bill gives the legislature unlimited authority to appropriate from the Medicaid Trust Fund under certain conditions, which may lead the Council to allocate MTF assets more conservatively to ensure capital preservation and enhanced liquidity while this provision is in effect.

Additional Risk from State Treasury Earnings Exposures. The Council would need to make special considerations for the MTF's asset allocation given the trust fund will be exposed to the economic and market risk of state treasury investments. For example, the trust fund could be required to make transfers to shore up state treasury losses at the same time at which the MTF is experiencing its own market losses. There are practical limits to the Council's ability to mitigate these effects, and certain economic events can cause even well-diversified assets to experience losses simultaneously. Therefore, regardless of asset allocation, the MTF would be exposed not only to the risks of its own investments but also the entirety of the risk, and reward, of state treasury investments. *[see Technical Issues and Fiscal Implications sections]*

ADMINISTRATIVE IMPLICATIONS

This bill will require additional time from investment, accounting, and administrative staff at the SIC. The SIC's budget is funded out of the land grant and severance tax permanent funds and does not receive general fund support.

Despite rapid growth in AUM, authorized FTE for the State Investment Office has not kept pace, as shown in the chart below. The SIC's budget request for FY26 included full funding for all 37 authorized FTE, and expert opinions discussed at the SIC's strategic retreat in December 2024 suggested a need to double the number of investment staff and increase the number of legal and accounting staff to facilitate increased workloads, mitigate risk and maintain proper ongoing due diligence of investments.



This bill is one of several bills introduced so far this session that seek to create new funds to be placed under SIC management:

- House Bill 7 creates a new Children's Future Fund to be managed by the SIC and created with $5M initial appropriation from General Fund.
- House Bill 11 creates a new Paid Family Medical Leave Fund to be managed by the SIC (however, SIC noted in its fiscal impact report that this is an expenditure fund that would

be best managed by STO).

- House Bill 25 creates a new Land Grant-Merced Infrastructure Trust Fund to be managed by the SIC. The bill seeks to seed the trust fund with a $20 million general fund appropriation.
- House Bill 113 creates a new Animal Welfare Trust Fund to be managed by the SIC. The bill seeks to seed the trust fund with a $10 million general fund appropriation.
- House Bill 330 creates a new Land Grant-Merced & Acequia Infrastructure Trust fund to be managed by SIC. Gets funding from STB capacity.
- House Bill 475 creates a new Transportation Trust Fund to be managed by SIC funded with a $400 million general fund appropriation.
- House Bill 520 creates a Sustain the Families Trust Fund to be managed by SIC in consult with HCA; to be expended by the legislature; no source funding provided
- House Bill 531 creates a new Osteopath Medicine Escrow Fund to be managed by SIC and funded with a $40 million transfer from the Tobacco Settlement Permanent Fund

- Senate Bill 1 creates a new Behavioral Health Trust Fund to be managed by the SIC. The bill seeks to seed the trust fund with a $1 billion general fund appropriation.
- Senate Bill 88 creates a new Medicaid Trust Fund to be managed by the SIC. The bill seeks to seed the trust fund with a $300 million general fund appropriation.
- Senate Bill 234 creates a new Tribal Education Trust Fund to be managed by the SIC. The bill seeks to seed the trust fund with a $100 million general fund appropriation.
- Senate Bill 358 creates an Equine Welfare Trust Fund to be managed by SIC and funded with a $40 million general fund appropriation.
- Senate Bill 374 creates a Land Grant-Merced & Acequia Infrastructure Fund to be managed by SIC; gets funding from STB capacity.
- Senate Bill 380 creates the Physician Graduate Medical Education Trust Fund to be managed by SIC with $100 million general fund appropriation.
- Senate Bill 397 creates the Next Generation Trust Fund (Baby Bonds) to be funded with $500,100 general fund appropriation and managed by the SIC in consultation with the Treasurer.

TECHNICAL ISSUES

While allocating state treasury earnings to the Medicaid Trust Fund could result in substantive funding for the MTF, it creates potential issues wherein the MTF must also absorb all market losses on treasury fund balances. Such losses can occur monthly even if total treasury earnings for the fiscal year are positive. Presumably, monies would have to be transferred out of the MTF to the State Treasurer for each month in which market losses on state treasury balances occur.

It is also possible the MTF could be responsible for treasury losses without sufficient funds to cover those losses. The bill does not address how treasury losses would be accounted for in the event the Medicaid trust fund is not large enough to cover the losses.

OTHER SUBSTANTIVE ISSUES

Unlike other trust funds that have provisions to shore up general fund budgets to avoid a fiscal deficit, this bill includes the Early Childhood Trust Fund in this provision and requires the balances of that fund to be exhausted before the MTF could accessed for this purpose. The Early Childhood Trust Fund is not technically considered a “reserve fund” of the state at this time.

AMENDMENTS

As mentioned above, if the intent is to provide the Medicaid Trust Fund with recurring revenues from positive, realized interest earnings on state treasury balances, then **the bill should be amended to instead create an ongoing *distribution* of positive realized interest income** from the state treasury to the MTF. This would send all positive treasury earnings to the trust fund without making the trust fund responsible for covering treasury losses.

However, its important to note this could increase general fund volatility, requiring the general fund to still cover all treasury investment losses while sending all its investment gains to the Medicaid trust fund.