LFC Requester:	Chenier

AGENCY BILL ANALYSIS
2024 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}

Check all that apply:

Original x **Amendment** ____
Correction ____ **Substitute** ____

Date 1/31/24
Bill No: SB 223

Sponsor: Sharer
Short Title: Medicaid Trust Fund

Agency Name and Code Number: SIC-337
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SECTION II: FISCAL IMPACT

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY24	**FY25**	**FY26**		
	($428,100.0)	($130,200.0)	Recurring	**Early Childhood Education and Care Fund** (excess oil & gas school tax revenue)
	($663,100.0)	($246,500.0)	Recurring	**Early Childhood Education and Care Fund** (excess federal royalty revenue)
	Negative, reduced future early childhood trust fund distributions (approx.. $18 million to $80+ million in FY27+, see fiscal implications)		Recurring	**Early Childhood Education and Care Program Fund**
	$1,091,200.0	$376,700.0	Recurring	**Medicaid Trust Fund - NEW** (excess oil & gas school tax and federal royalty revenue)
	Positive, future Medicaid Trust Fund distributions, approx. $27 million to $80+ million in FY27+, see fiscal implications		Recurring	**State Supported Medicaid Fund - NEW** (Medicaid Trust Fund distributions)

(Parenthesis ( ) Indicate Expenditure Decreases)

SECTION III: NARRATIVE

BILL SUMMARY

Synopsis:

Senate Bill 223 creates the Medicaid Trust Fund ("MTF") to be invested by the State Investment Officer with approval by the State Investment Council. The funds are to be managed in accordance with the Uniform Prudent Investor Act and in consultation with the State Treasurer.

Beginning in FY26, the new MTF will distribute 5 percent of the prior 3-year average ending balance to the State-Supported Medicaid Fund, which this bill also creates. The SSMF is a non-reverting, interest-earning fund in the state treasury that will be managed by the Health Care Authority, with money in the fund available for appropriation by the legislature to support and match federal funds for the state Medicaid program.

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, the appropriation contingency fund, and tax stabilization reserve.

Beginning in FY25, the bill redirects excess (above the five-year average) royalty revenue from oil and gas production on federal lands and excess oil and gas school tax revenue from the Early Childhood Education and Care Fund (often referred to as the "Early Childhood Trust Fund" or "ECTF") to instead flow into the Medicaid Trust Fund.

However, if the MTF distribution to the State-Supported Medicaid Fund in the previous fiscal year is greater than or equal to half of the amount appropriated for the state Medicaid program for that fiscal year, excess federal royalty revenue and school tax revenue for that fiscal year will not be deposited into the MTF. In effect, should the excess revenue not flow into the MTF, that revenue would instead be deposited into the Severance Tax Permanent Fund (STPF).

The effective date of this bill is July 1, 2024.

FISCAL IMPLICATIONS

The new Medicaid Trust Fund (MTF) will receive revenues from above average revenue from Federal Mineral Leasing (royalties for production on federal lands) and the Oil and Gas Emergency School Tax, beginning in FY25. Currently, these revenues flow into the Early Childhood Trust Fund (ECTF), which as of 12/31/2024 had a market value of $5.721 billion. In practice, this bill would have two primary effects:

- It would provide for a (potentially) recurring source of excess oil and gas revenues to populate the balance of the new MTF, which would then provide a source of recurring revenue to the new State-Supported Medicaid Fund via regular distributions from the MTF; and,
- It would remove sources of future funding for the Early Childhood Trust Fund, which would reduce future distributions to the Early Childhood Education and Care Program Fund relative to the size those distributions under current law (although overall the size of the distributions would still be expected to grow over time).

The December 2023 consensus revenue estimate projects above-average revenue from the oil and gas school tax and federal royalties to be about $1.091 billion in FY25 and $376 million in FY26. Because the five-year average is expected to increase over time, the consensus estimating group is not currently expecting there to be any amounts above the five-year average after FY26. Therefore, any future revenue to the Medicaid Trust Fund under this bill would depend entirely on the potential for windfall oil and gas school tax and federal royalty collections.

The tables below provide a simplified example of the potential impact to the Early Childhood Trust Fund and potential investment returns for the Medicaid Trust Fund, and well the estimated impacts to the distributions from both trust funds.

Early Childhood Trust Fund (ECTF) Estimated Ending Balance ($MM)				ECTF Estimated Distribution to Early Childhood Education and Care Program Fund ($MM)				NEW Medicaid Trust Fund (MTF)		NEW State-Supported Medicaid Fund ($MM)	
CY	Current Law	Under SB223	Diff.	FY	Current Law	Under SB223	Diff.	CY	Est. Ending Balance ($MM)	FY	Est. Distrib. from MTF
2023	$5,721	$5,721	$0	FY23	$30	$30	$0	2023	n/a	FY23	n/a
2024	$8,905	$8,905	$0	FY24	$150	$150	$0	2024	n/a	FY24	n/a
2025	$10,339	$9,236	$ (1,103)	FY25	$150	$150	$0	2025	$1,103	FY25	$0
2026	$11,039	$9,495	$ (1,544)	FY26	$301	$301	$0	2026	$1,535	FY26	$0
2027	$11,320	$9,710	$ (1,610)	FY27	$416	$398	$(18)	2027	$1,600	FY27	$28
2028	$11,579	$9,926	$ (1,653)	FY28	$505	$461	$(44)	2028	$1,643	FY28	$44
2029	$11,837	$10,146	$ (1,691)	FY29	$545	$474	$(71)	2029	$1,680	FY29	$71
2030	$12,100	$10,371	$ (1,728)	FY30	$566	$486	$(80)	2030	$1,718	FY30	$80
2031	$12,368	$10,601	$ (1,767)	FY31	$579	$496	$(83)	2031	$1,756	FY31	$82
2032	$12,642	$10,836	$ (1,806)	FY32	$592	$507	$(85)	2032	$1,795	FY32	$84
2033	$12,923	$11,077	$ (1,846)	FY33	$605	$519	$(86)	2033	$1,835	FY33	$86
2034	$13,209	$11,322	$ (1,887)	FY34	$619	$530	$(88)	2034	$1,875	FY34	$88
2035	$13,502	$11,574	$ (1,929)	FY35	$632	$542	$(90)	2035	$1,917	FY35	$90
2036	$13,802	$11,830	$ (1,971)	FY36	$646	$554	$(92)	2036	$1,959	FY36	$92
2037	$14,108	$12,093	$ (2,015)	FY37	$661	$566	$(94)	2037	$2,003	FY37	$94
2038	$14,421	$12,361	$ (2,060)	FY38	$675	$579	$(96)	2038	$2,047	FY38	$96
2039	$14,740	$12,635	$ (2,106)	FY39	$690	$592	$(99)	2039	$2,093	FY39	$98
2040	$15,067	$12,915	$ (2,152)	FY40	$706	$605	$(101)	2040	$2,139	FY40	$100

The above analysis assumes the expected compound annual return for the Early Childhood Trust Fund per our most recent asset allocation study conducted in conjunction with general consultant RVK, which was 7.11 percent as of May 2023. For simplicity, the analysis assumes the same return for the new Medicaid Trust Fund; however, actual return expectations would depend on the new fund's asset allocation.

Under these assumptions, the MTF could potentially distribute approximately $28 million to the State-Supported Medicaid Fund in FY27 and, depending on the returns earned on the MTF's investments (and any additional appropriations in subsequent years), the distribution may be expected to increase over time. Any increase in the trust fund's market value (and subsequent distributions), however, would be wholly dependent upon actual returns in the future market environment and cannot be predicted with certainty.

Conversely, removing new sources of revenue from the Early Childhood Trust Fund would reduce the expected long-term growth of the fund and, as a result, reduced the expected future distributions to the Early Childhood Education and Care Program Fund. While both the trust fund and its distributions would still be expected to grow over time, the relative sizes would be smaller compared to the current growth potential.

One important caveat to the above analysis is the bill's limitation on the distribution of oil and gas school tax and federal royalty revenues to the Medicaid Trust Fund. Depending on the ability of MTF transfers to the State-Supported Medicaid Fund to cover half or more of the state's Medicaid spending needs in a given fiscal year, the revenue contribution to the MTF may not occur. In this event, those tax and royalty revenues would instead be deposited into the Severance Tax Permanent Fund. However, staff is currently unable to quantify the potential impact of this limitation.

SIGNIFICANT ISSUES

It is important for the Council as manager of the new Medicaid Trust Fund to properly understand the long-term goals and risk/return appetite of the fund's "client" to appropriately allocate the funds in question. In this case, we would suggest the Secretary for the Health Care Authority be properly consulted in this regard, and could replace the state treasurer (page 2, line 7), who will already be involved in the management process around the new Trust Fund due to her ex-officio role on the State Investment Council.

The SIC supports public policy that encourages maximizing the long-term benefits that endowments can and do provide to the state and its various needs. The endowment model acts not only to stabilize budgets for planning purposes, but also as a revenue engine to benefit current and future generations.

PERFORMANCE IMPLICATIONS

The State Investment Officer, with the approval of the State Investment Council would manage the new Medicaid 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 trust fund, 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.

Below is the latest fund valuation and performance data for the Early Childhood Trust Fund. Returns are annualized for periods longer than one year and are reported net of fees.

Fund Valuations ($Millions)	**12/31/2020**	**12/31/2021**	**12/31/2022**	**12/31/2023**
Early Childhood Education and Care Fund	$306.1	$314.1	$3,462.0	$5,721.2

As of 11/30/23	QTD	1 year	3 years	5 years	7 years	10 years
Early Childhood Education and Care Fund – Net returns	2.16	4.13	4.26	n/a	n/a	n/a

Given the significant size of inflows into the Early Childhood Trust Fund over the last two years, the Council approved a new strategic asset allocation in May 2023 to change the primary focus of the fund from capital preservation to capital appreciation. This change resulted in significant improvements to the long-term expected compound return, but since the change was made relatively recently, it will take some time for the adjustments to be reflected in the historical performance data.

ALTERNATIVES

This bill draws language identical to that in existing statute 6-4-2.2, which calls for the state investment officer to invest the Tax Stabilization Reserve (TSR) "…in consultation with the state treasurer."

When the legislature changed law to transfer management of the Tax Stabilization Reserve from the State Treasurer's Office to the State Investment Council several years ago, the inclusion of the Treasurer as a special advisor to the State Investment Officer was deemed appropriate. However, in this case, this bill's trust fund will be a completely new fund, to be managed and overseen by the 11-member Council, which already includes the State Treasurer. For the new Medicaid Trust Fund, there is no particular reason to grant the Treasurer additional powers over and above the other 10-members of the Council.

For the Council to properly understand the long-term goals and risk/return appetite of the fund's "client", we suggest the Secretary for the Health Care Authority could replace the state treasurer (page 2, line 7), who will already be involved in the management process around the new Medicaid Trust Fund due to her ex-officio role on the State Investment Council.