September 19, 2019

Budget Primer

Tobacco Settlement Fund

Patrick Shaughnessy, Senior Budget Analyst

The Tobacco Master Settlement Agreement (MSA) is a settlement between 46 states (along with Washington D.C. and some U.S. territories) and America's largest tobacco companies that involved outstanding class action lawsuits by several states' attorneys general arguing the tobacco industry's deliberate misinformation about tobacco's negative health effects inflated states' healthcare costs.

Pennsylvania received its first MSA payment in 1999. Since then, Pennsylvania has received $7.56 billion in revenue. In 2001, the commonwealth passed Act 77, which established the Tobacco Settlement Fund to receive MSA payments. The law also created a number of programs funded by those payments.

In 2017, Act 43 directed the governor to securitize $1.5 billion worth of future MSA payments in order to close the 2017/18 General Fund deficit. The debt service payments on that securitization total $2.3 billion over 20 years.

This primer will describe the creation and evolution of the Tobacco Settlement Fund and the various programs it funds.

Master Settlement Agreement Background

Mississippi's attorney general filed the first state lawsuit against tobacco companies in 1994. The majority of states would eventually initiate litigation against the major tobacco companies as well. Four states settled with the tobacco companies individually, while the remaining 46 (including Pennsylvania) entered into the Master Settlement Agreement in 1998. In addition to other provisions, the MSA established a series of payments from tobacco companies in perpetuity, including more than $200 billion in the first 25 years.

Pennsylvania Legislative History

Act 77 of 2001 (Tobacco Settlement Act)

Act 77 effectuated the MSA in Pennsylvania by creating the Tobacco Settlement Fund (TSF) to serve as the repository for all MSA payments. The law also specified which programs would be eligible for TSF funding.

Act 71 of 2013 (Fiscal Code)

In 2013, Act 71, an omnibus amendment to the Fiscal Code, repealed the original distribution formula for tobacco-funded programs and created a new one.

Act 43 of 2017 (Fiscal Code)

Act 43 authorized the governor to securitize future MSA payments and issue bonds worth $1.5 billion to close the 2017/18 budget deficit. These bond funds were issued the following year.

Act 20 of 2019 (Fiscal Code)

The omnibus Fiscal Code amendment passed as part of the budget package for 2019/20 by repealing and replacing the funding allocation formula in Act 71 of 2013 with a new formula.

Allocations

The TSF pays for a number of important programs in whole or in part. However, since Act 77, the allocation formula for MSA revenues has been amended several times. Recent practice has been to write the allocation formula into the omnibus Fiscal Code amendment passed each year as part of the overall budget package. Over time, some allocations and programs were eliminated (such as PACEnet) while others have been added.

Tobacco Settlement Fund			
Health-Related Programs	**Act 77 of 2001** **Allocation %**	**Act 71 of 2013** **Allocation %**	**Act 20 of 2019** **Allocation %**
Home and Community-Based Services	13%	13%	0%
Tobacco Use Prevention and Cessation	12%	4.5%	4.5%
Health and Related Research (CURE)	19%	13.6%	13.6%
Hospital Uncompensated Care	10%	8.18%	8.18%
Medical Assistance for Workers with Disabilities	30%	30%	30%
PACEnet	8%	8%	0%
Health Endowment Account	8%	0%	0%
Health-Related Purposes	0%	22.72%	43.72%

(TSF allocation formula over time)

The following list describes programs that still receive allocations from the TSF:

Tobacco Use Prevention and Cessation – The Department of Health uses MSA funds to support a number of programs around the state designed to reduce tobacco product use. About 70 percent of these dollars are in the form of grants for contractors operating local programs; the balance is for statewide programs.

Life Sciences Greenhouses – The Department of Community and Economic Development supports three life sciences greenhouses around the commonwealth, which act as incubators for new technologies and new companies in areas such as biomedical research. After allocating $100 million in start-up funds in 2001/02, the General Assembly has continued to appropriate approximately $3 million annually to the greenhouses.

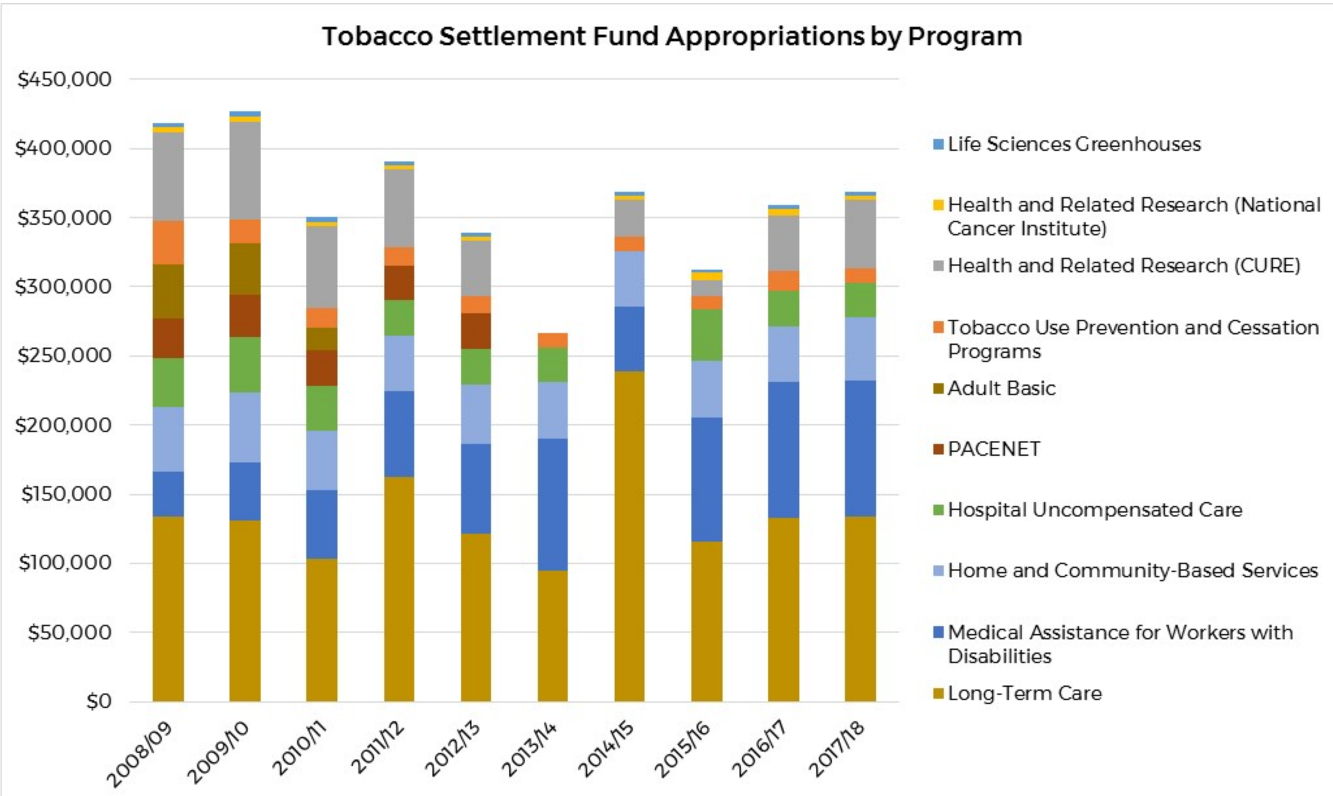
Commonwealth Universal Research Enhancement (CURE) Program – The CURE program, administered by the Department of Health, provides grants to researchers and research institutions throughout the commonwealth. A small portion (1 percent) of the MSA funds directed to CURE are earmarked specifically for cancer research, while the remainder may be used for broad-based health research.

Hospital Uncompensated Care – The Department of Human Services compensates hospitals for a portion of their costs to treat patients with inadequate – or no – insurance. Most funds are allocated for uncompensated care (85 percent), while the balance represents extraordinary expense payments to hospitals for uninsured patients whose cost of care exceeds twice the hospitals average cost per stay. Hospitals can receive either uncompensated care payments or extraordinary expense payments, but not both.

Medical Assistance for Workers with Disabilities (MAWD) – MAWD is a health insurance purchase program for individuals between the ages of 16 and 65 with income below 250 percent of the federal poverty income guideline. Program participants must pay a premium equal to five percent of their monthly income unless DHS receives federal approval to adjust the percentage.

Medical Assistance Long-Term Care – One of the major allocations of MSA payments has historically been nursing facility care provided to Medicaid eligible populations. However, these allocations have fallen in recent years as the Department of Human Services has rolled out its Community HealthChoices program.

Community HealthChoices – In 2018, the commonwealth began rolling out Community HealthChoices, a managed care program for dual Medicare/Medicaid eligible Pennsylvanians with physical disabilities. The program is designed to improve the coordination of care while allowing more Pennsylvanians to remain in their communities. As the program has been expanded to cover more of the state (complete statewide rollout will be completed in 2020), it has received a larger share of MSA payments while the allocation for long-term care has fallen.



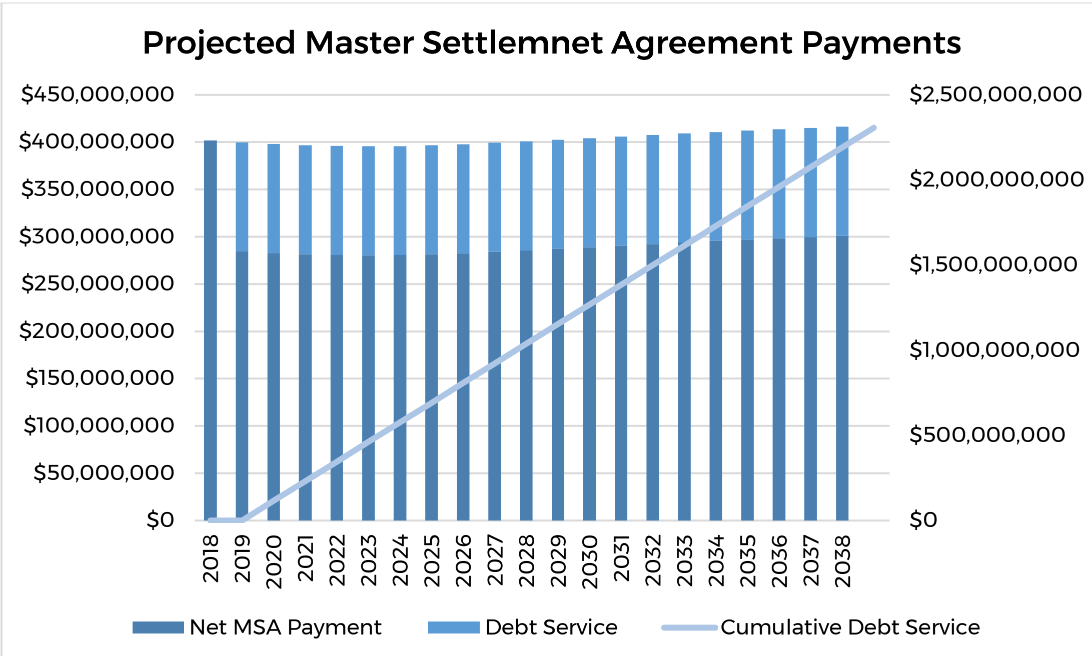
(10-year history of major programs funded by the TSF)

MSA Securitization

Act 43 of 2017 authorized the Commonwealth Finance Authority to issue $1.5 billion in bonds backed by future revenues due to Pennsylvania under the MSA. In February 2018, CFA issued $1.487 billion worth of bonds with a term of 20 years and an interest rate of five percent. The annual debt service payments for these bonds total $115 million, which is roughly one-third of the annual payments Pennsylvania will receive under the MSA.

While MSA revenues were pledged as security for these bonds and identified as one source for debt service payments, Act 43 also permitted other revenues (from general taxes, etc.) to be used for debt service.

The 2019 Fiscal Code (Act 20 of 2019) requires revenues from the MSA to be used to pay the debt service on the bonds issued by CFA. However, it also includes a provision for 2019/20 that requires funds equal to the debt service payment be transferred from cigarette tax revenues to the Tobacco Settlement Fund, essentially holding the TSF harmless for that year. If this final provision is not reauthorized each year, however, it would lead to a direct reduction in the amount of revenue to the TSF and require a corresponding reduction in funding for programs reliant on the fund.



Appendix A. Legislation Impacting Program Allocations

The following table shows the allocation percentages in Section 306 of the Tobacco Settlement Act (Act 77 of 2001) used to distribute annual MSA payments among programs, beginning in 2001/02, and the subsequent legislative changes to the allocation percentages for 2005/06 through 2012/13. The funding provisions in Act 77 were repealed July 1, 2013.

	Act 77 (2001) Program Allocations	Fiscal Code Modifications to Act 77 Allocations							
		Act 41 (2005) FY 2005/06	Act 66 (2006) FY 2006/07	Act 42 (2007) FY 2007/08	Act 53 (2008) FY 2008/09	Act 50 (2009) FY 2009/10	Act 46 (2010) FY 2010/11	Act 26 (2011) FY 2011/12	Act 87 (2012) FY 2012/13
Health Insurance for Adults	30%	26.25%	26.25%	20%	20%	20%	20%	20%	20%
Home and Community-Based Services	13%	13%	13%	13%	13%	13%	13%	13%	13%
Tobacco Use Prevention and Cessation	12%	9%	9%	9%	9%	4.5%	4.5%	4.5%	4.5%
CURE Health Research:									
Broad-Based Research	18%	18%	18%	18%	18%	18%	18%	18%	13%
Cancer Research	1%	1%	1%	1%	1%	1%	1%	1%	1%
Hospital Uncompensated Care Payme	10%	10%	10%	10%	10%	10%	10%	8.18%	8.18%
PACENET Expansion	8%	8%	8%	8%	8%	8%	8%	8%	8%
Health Endowment Account	8%	8%	8%	8%	8%	0%	0%	0%	0%
Balance of Allocation (per Fiscal Code):									
Redirect for Health-Related Purposes		*6.75%*	*6.75%*	*13%*	*13%*	*21%*	*21%*	*27.32%*	*32.72%*
*Transfer to General Fund **						4.5%	4.5%		

* Act 50 of 2009 transferred 37.5% of the annual allocation for prevention and cessation programs to the General Fund in fiscal years 2009/10 and 2010/11.

The following table shows the funding formula added to 1713-A.1 of the Fiscal Code, under Act 71 of 2013, and the subsequent legislative changes. The percentages in Act 71 largely reflect the reductions enacted in Act 87 of 2012 to the allocation percentages for the tobacco use prevention and cessation, CURE health research, and hospital uncompensated care payments programs.

	Act 71 (2013) Program Allocations Effective FY 2013/14	Fiscal Code Modifications to Act 71 Allocations						
		Act 126 (2014) FY 2013/14	Act 126 (2014) FY 2014/15	Act 25 (2016) FY 2015/16	Act 85 (2016) FY 2016/17	Act 44 (2017) FY 2017/18	Act 42 (2018) FY 2018/19	Act 20 (2019) FY 2019/20
Medical Assistance for Workers with Disabilitie	30%	30%	15.12%	30%	30%	30%	30%	30%
Home and Community-Based Services	13%	13%	13%	13%	13%	13%	0%	0%
Tobacco Use Prevention and Cessation	4.5%	2.93%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
CURE Health Research:								
Broad-Based Research	12.6%	6.3%	12.60%	12.60%	12.60%	12.60%	12.60%	12.60%
Cancer Research	1%	0.5%	1%	1%	1%	1%	1%	1%
Hospital Uncompensated Care Payments	8.18%	4.09%	8.18%	8.18%	8.18%	8.18%	8.18%	8.18%
PACENET Expansion	8%	0%	0%	0%	0%	0%	0%	0%
Health-Related Purposes	22.72%	43.18%	45.6%	30.72%	30.72%	30.72%	43.72%	43.72%