

To: Brandon Metzler, Clerk of the Legislature
From: Ellen Hung, CFA, State Investment Officer
Date: September 13, 2024



Re: NEB. REV. STAT. §71-7611 SUSTAINABILITY OF HEALTH CARE TRANSFER

Neb. Rev. Stat. §71-7611 creates the Nebraska Health Care Cash Fund. The Nebraska Investment Council manages the Fund investments. The law requires specified annual transfers into the fund from the Nebraska Tobacco Settlement Trust Fund. The law also requires the state investment officer to report to the Legislature on or before October 1 in even-numbered years on the sustainability of the transfers.

The Nebraska Investment Council reviewed and discussed the attached "Health Care Endowment Sustainability" report prepared by investment consultant Aon during the September 11, 2024 board meeting.

Key Findings

The Health Care Endowment has a very good chance of meeting its investment goals to:

- Provide funds for current spending needs, and
- Increase the size of the portfolio to support future needs.

cc: Senator Robert Clements, Chair, Appropriations Committee
Governor Jim Pillen
Keisha Patent and Bill Biven, Legislative Fiscal Office
Director Lee Will, DAS Budget Division



Nebraska Investment Council

Health Care Endowment Sustainability

September 2024

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Overview of Health Care Endowment

- The Health Care Endowment (Nebraska Tobacco Settlement Trust) had a market value of \$615.7 million as of June 30, 2024
- The investment goals of the Endowment are twofold:
 - 1) Provide funds for current spending needs
 - 2) Increase the size of the portfolio to support future needs
- NIC determines asset allocation policy only (i.e., not distribution policy)
- Spending policy is determined by legislation; historically a fixed dollar amount rather than a % of assets:

2007	\$52.0 million	2016	\$60.4 million
2008	\$55.0 million	2017	\$60.4 million
2009	\$56.4 million	2018	\$61.2 million
2010	\$53.6 million	2019	\$61.6 million
2011	\$56.1 million	2020	\$62.0 million
2012	\$59.1 million	2021	\$61.0 million
2013	\$56.3 million	2022	\$49.4 million
2014	\$56.1 million	2023	\$45.8 million
2015	\$60.3 million	2024	\$53.3 million

Overview of Health Care Endowment (Cont'd)

- Tobacco Master Settlement Agreement (MSA) payments received by the State of Nebraska each year are contributed in to the endowment
- Forecasts for Tobacco MSA payments exist through 2035, though it should be noted that there is a great deal of uncertainty in projecting these payments
- Additional detail on Tobacco MSA payment projections can be found in the Appendix of this document
- NIC determines asset allocation policy; the endowment targets 75% return-seeking assets / 25% risk-reducing assets

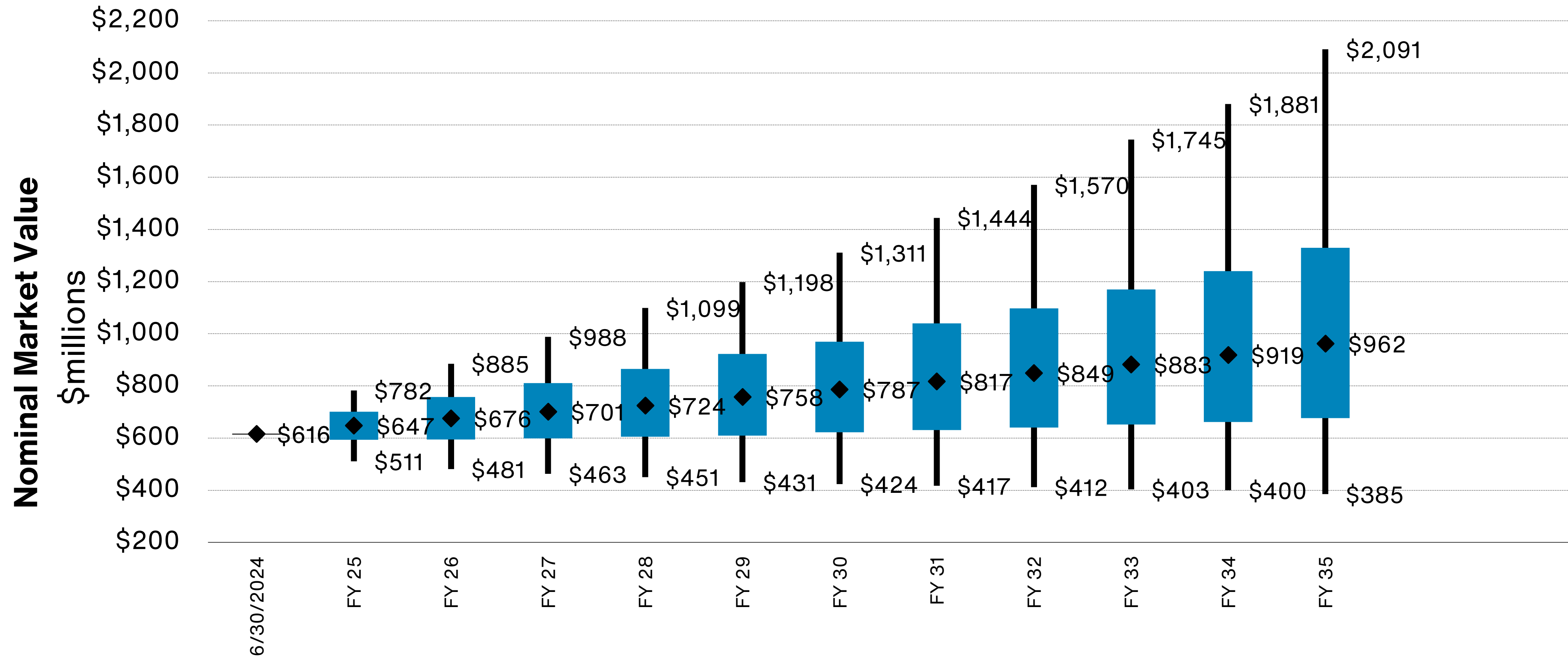
	Policy Allocation
U.S. Equity	27.5%
Non-U.S. Equity	13.0%
Global Equity	24.5%
Real Estate	5.0%
Private Equity	5.0%
Fixed Income	25.0%
Total Health Care Endowment	100.0%
Projected Returns*	6.8%
Projected Volatility*	12.9%

*Based on Aon CMAs

Overview of Health Care Endowment (Cont'd)

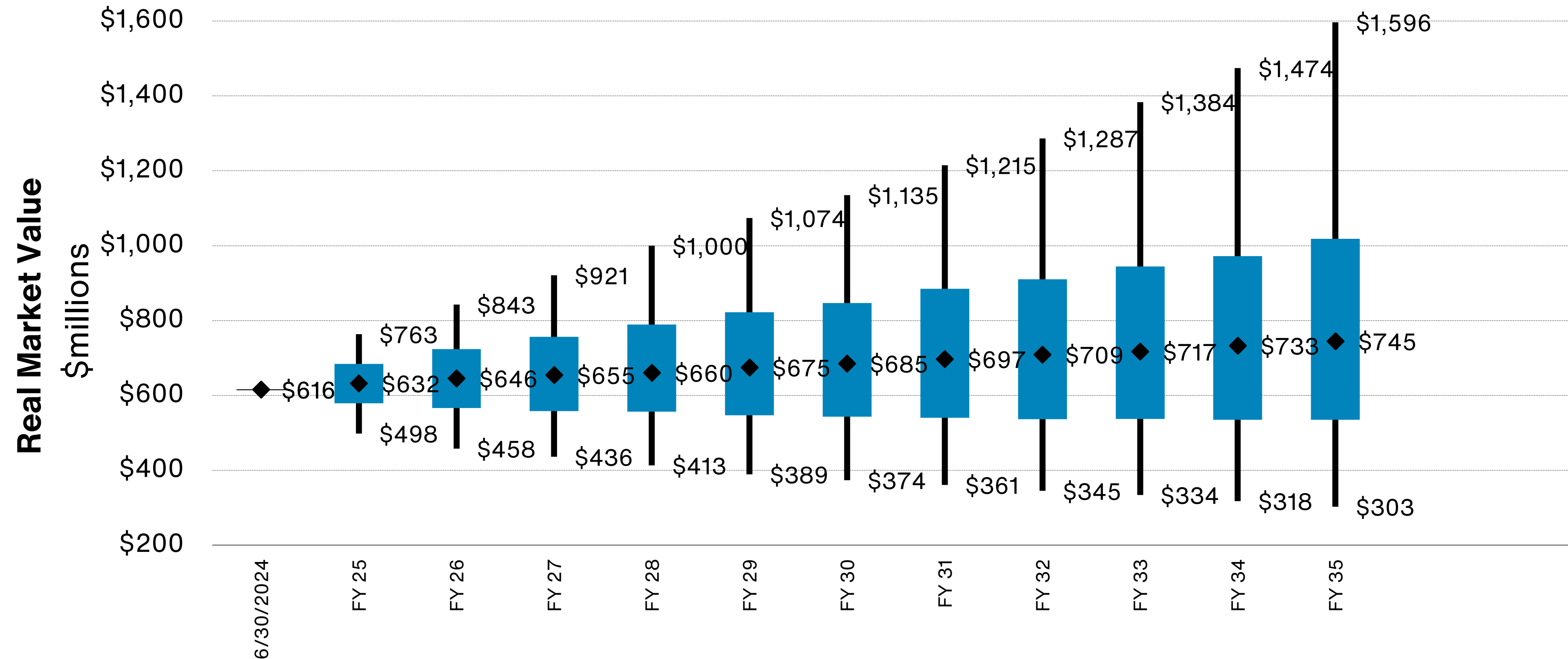
- The following two slides provide our forecasted market values for the Health Care Endowment through 2035
 - I.e., as far out as we have forecasted values for Tobacco MSA payments
- We provide forecasts on both a nominal and real (i.e., net of the impact inflation) basis
- Ideally, real market value would remain stable (or increase) under the median scenario
 - This would imply that the Health Care endowment could continue to provide the same level of funding (at least) to the various programs it supports in the future as it does today
- The forecasts shown on the following slides suggest the Health Care Endowment has a very good chance of meeting its investment goals, which are:
 - 1) Provide funds for current spending needs
 - 2) Increase the size of the portfolio to support future needs

Health Care Endowment – Future Market Value Forecast (Nominal)



- The chart above provides our distribution of nominal forecasted market values for the Health Care Endowment through 2035
 - I.e., as far out as we have forecasted values for Tobacco MSA payments

Health Care Endowment – Future Market Value Forecast (Real)



- The exhibit above recreates the analysis on the previous slide on a “real” (i.e., net of inflation) basis
 - As shown, forecasted median real market values increase over the next 11 years

Appendices



Appendix I: Health Care Endowment Cash Flow Forecasts

Fiscal Year	Estimated Contribution	Estimated Distribution	Net Distribution
2025	\$36,103,447	\$54,000,000	-\$17,896,553
2026	\$35,802,745	\$54,150,000	-\$18,347,255
2027	\$35,508,521	\$54,150,000	-\$18,641,479
2028	\$35,220,796	\$54,150,000	-\$18,929,204
2029	\$34,939,592	\$54,150,000	-\$19,210,408
2030	\$34,664,936	\$54,150,000	-\$19,485,064
2031	\$34,396,855	\$54,150,000	-\$19,753,145
2032	\$34,135,383	\$54,150,000	-\$20,014,617
2033	\$33,880,552	\$54,150,000	-\$20,269,448
2034	\$33,632,400	\$54,150,000	-\$20,517,600
2035	\$33,390,966	\$54,150,000	-\$20,759,034

Appendix II: Additional Detail on Tobacco MSA Payment Projections*

- The table below represents the most recent estimates of Tobacco Master Settlement Agreement (MSA) payments to be received by the State of Nebraska.

Nebraska MSA Payment Projections

3% Infl. Adj.

4% Vol. Adj.

Fiscal Year	Total Est. Annual MSA Payments
2025	36,103,447
2026	35,802,745
2027	35,508,521
2028	35,220,796
2029	34,939,592
2030	34,664,936
2031	34,396,855
2032	34,135,383
2033	33,880,552
2034	33,632,400
2035	33,390,966

Appendix II: Additional Detail on Tobacco MSA Payment Projections* (Cont'd)

- It should be noted that there is a great deal of uncertainty in projecting Tobacco Master Settlement Agreement payments. The NPM adjustment, disputed amounts, and credits allowed to participating manufacturers are very difficult to estimate as little of any certainty is known in advance about the factors that led to these adjustments.
- One cautionary note—if at any point Nebraska is found to have not diligently enforced the NPM escrow provisions of the MSA, it could result in a complete loss of the MSA payment for Nebraska (though that is a worst-case scenario).

Appendix II: Additional Detail on Tobacco MSA Payment Projections* (Cont'd)

NOTES:

A. While the Master Settlement Agreement provides that the payments will continue in perpetuity, only the next 11 years through 2035 are shown in this analysis.

B. The payment projections make certain assumptions about cigarette consumption and the rate of inflation. If the rate of increase in the CPI-U is higher than the assumption, the actual payments could be higher. Likewise, if cigarette consumption varies from the assumption, the payments could be higher or lower. And, if more consumption shifts from Participating Manufacturers to Non-Participating Manufacturers, the payments could be lower.

C. The projections ignore the possibility of default by any Participating Manufacturer. If experience is any indication of the future, some of the Participating Manufacturers, especially the smaller ones, are likely to fail to pay, go out of business, and/or file bankruptcy. The projections also ignore back payments and interest, but such amounts tend to be quite marginal relative to the total. Finally, the projections do not include any assumptions regarding future distributions from the dispute account.

D. The annual estimates in both scenarios are based on the following assumptions:

1. Annual Inflation Adjustment of 3.0% (the minimum adjustment pursuant to the MSA)
 - a) For example, actual CPI-U growth for calendar year 2023 was 3.352%. The ten-year average CPI-U increase through 2022 was 2.62%. An increase less than 3% results in application of the 3% minimum.
2. Annual Volume Adjustment of 4.0% (Source: NAAG)
 - a) The actual volume adjustment to be applied for any one year is not typically known until March or April of that year. The volume adjustment over the last fifteen years has averaged 5.546%.

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