Q. Why is this a good idea for the state?
A. The Department of Finance analysis estimates that the plan will reduce the State’s pension contributions by more than $11 billion over the next 20 years by reducing the amount of interest the State will have to pay on the unfunded pension liability. It is like an individual who pays down a portion of his or her credit card debt. The less debt one has, the less interest is paid on debt. Right now, the State has a $59 billion unfunded pension liability and is paying 7% interest on that obligation. By reducing the liability by $6 billion, the State will pay interest on $53 billion, instead of $59 billion. The money the State saves by reducing its interest costs can be used to invest in public safety, environmental protection, health care, and other vital public programs.

Q. Where does the payment come from?
A. The money comes from the Surplus Money Investment Fund (SMIF), managed by the State Treasurer’s Office (STO). The SMIF holds cash that is not immediately required to support State operations. The money in the account is generally invested for very short term periods so that it can be quickly accessed for payments. Consequently, it gets a very low rate of return, currently less than 1%. As California’s chief investment manager, Treasurer John Chiang believes it is fiscally responsible to reallocate reasonable amounts of the SMIF money that is earning a low rate of return, to pay down a debt that is costing the state 7% in interest. The upshot is better returns on investment and a reduction in the State's unfunded pension liability.

Q. How does this proposal work?
A. The State is borrowing money from itself. The Surplus Money Investment Fund (SMIF) will loan $6 billion to the State of California to pay down the State’s unfunded pension liability. The State will pay the SMIF back with interest based on the two-year U.S. Treasury interest rate.

By paying down the unfunded pension liability, without having to reach deeper into the pockets of taxpayers, we are strategically and prudently reallocating cash reserves to reduce the long-term cost of unfunded pension liability that would otherwise be passed along to future generations of Californians.

Q. If there is a downturn in the economy and interest rates increase, how does this proposal pencil out?
A. The State must deal with an existing $59 billion unfunded pension liability regardless of whether we pursue this plan or not. If the interest rate gap between PERS earnings and this cash loan from SMIF narrows, that means we might save less, but the scale of savings remains significant. The chance of the State losing money in this proposal is highly unlikely when looking at historical data. (See Figure Below)

This plan calls for modestly whittling down that obligation in as little as eight to 10 years and a maximum of 12 years.
Q. Is this proposed plan a “pension obligation bond”?
A. No. A pension obligation bond is an external debt – money borrowed from a third-party to be used for investment purposes. This proposal is internal borrowing – the State is borrowing from itself. Instead of leaving all of our surplus funds in an account that currently earns less than 1%, we are using some of it to pay down a debt that is costing us 7% interest. And to be clear, these are surplus monies from existing state funds, not new sources of cash outside of the State.

Q. Why use the Surplus Money Investment Fund (SMIF) for this $6 billion payment to CalPERS?
A. The “S” in SMIF stands for “Surplus.” That means they are funds that are not currently needed by the departments and programs that control them. Using surplus funds enables the State to avoid turning to more complicated and costly financing operations. The State has a long history of using these surplus funds to manage the greater cash flow needs by borrowing among the funds that make up SMIF. This proposal is consistent with that long history.

Q. Where will the money come from to repay the SMIF?
A. When Proposition 2 was created by voters in 2014, one of its two intended uses was to pay down specified types of State debts. Under this proposal, the supplemental payment to a pension contribution constitutes a debt that can be repaid from funds set aside by the terms outlined in Proposition 2.

The General Fund portion of the $6 billion loan for the supplemental payment to PERS will be repaid with Proposition 2 debt payment authority.

Q. What is the justification for using a special fund to pay State employee pension contributions? Does this set a precedent?
A. Special funds are already used proportionally to pay pension costs for State employees in agencies they fund. For example, highway patrol officers’ pensions are partially paid through car registration fees. The funds used to pay back the SMIF loan are the same that would be used to pay the existing pension liability.

Q. Is this proposal “risky”?
A. Any investment decision involves risk. We believe this is a prudent move for California that reduces risk and saves the State money in the long-term by better using our surplus funds to chip away at our burgeoning unfunded pension liability. The State already owes this money, so we have come up with an efficient and economical way to pay it down.

Q. Is the Treasurer’s Local Agency Investment Fund impacted by this proposal?
A. Absolutely not. The money of LAIF account holders is strictly segregated and not at risk. Its members can make withdrawals at any time.

Q. What interest rate will the State pay to SMIF?
A. It is a floating rate based on the two-year U.S. Treasury rate.

Q. Is the State tying the interest rate on this obligation to the State’s general obligation bond interest rate?
A. No. As the Department of Finance’s background materials make clear, the rate will be based on the two-year constant maturity Treasury rate, which is currently approximately 1.3%.

Q. Is the repayment term for this obligation 20 years?
A. No. As Department of Finance’s background materials make clear, the repayment term is a maximum of 12 years, but is anticipated to be less than 10 years.