



THE SECRETARY OF HEALTH AND HUMAN SERVICES
WASHINGTON, D.C. 20201

JUL 17 2007

The Honorable Max Baucus
Chairman
Committee on Finance
U.S. Senate
Washington, DC 20510

The Honorable Charles Grassley
Committee on Finance
U.S. Senate
Washington, DC 20510

Dear Chairman Baucus and Senator Grassley:

I have had the opportunity to review the "Description of the Chairman's Mark of The Children's Health Insurance Reauthorization Act of 2007." Let me say at the outset, the President and I are committed to reauthorizing a program that has made a significant difference in the health of lower income children. Through 10 years of experience and bipartisan support, the State Children's Health Insurance Program (SCHIP) serves as a valuable safety net for children in families who don't have the means to purchase affordable health care. We are committed to its continuation, have proposed its reauthorization in the President's Budget and we urge Congress to complete its work and send the President a bill he can sign before the program expires September 30, 2007.

However, it is clear that the health care conversation needs to be not just about how we insure uninsured children, but how we ensure that every American has access to a private basic, affordable plan. Only the free choices of American consumers and the competition of an organized marketplace can keep costs in check, and only by keeping costs in check can we achieve our common goal that Americans have access to affordable insurance. If this legislation were presented to the President as it is currently proposed, the President would veto it.

The challenge we face is to make sure that the uniquely American approach to health care, based on a free, competitive marketplace and organized to make private

health insurance affordable for all Americans, is preserved. I fear the Finance Committee's approach would undermine the common goal of an affordable private health insurance market and an effective safety net so that the vulnerable get help from the government when needed. The President believes the reauthorization of SCHIP as originally intended should be coupled with a better approach that includes a federal tax policy that eliminates discrimination against those who buy health insurance on their own and not through their employers, and with working with the states to ensure that their citizens have access to basic private health insurance.

The Mark is based on a massive budget "gimmick," which is an admission the proposal sets up an unsustainable program and causes millions of children to lose coverage in the future. Under current law, States have access to a set amount of funds determined annually, referred to as allotments. The Mark would effectively balloon the allotments in 2012 to \$16 billion, then plunge them to \$3.5 billion in 2013. This is clearly not a credible assumption. Under normal budgetary assumptions, the Congressional Budget Office (CBO) would have assumed that the allotment levels in its baseline for 2013-17 would carry about \$80 billion (carrying \$16 billion in 2012 forward each year for five years). By dropping the appropriations to \$3.5 billion in the out years, the Mark essentially creates a funding "cliff" and understates the amount of funding required to maintain the program by at least \$60 billion in allotments.

This method of funding the program allows the Committee to avoid its responsibility for making recommendations that comply with Senate budget rules and sound public financing. Under the Chairman's Mark, SCHIP outlays in 2013 would be cut in half, causing any temporary gains in coverage for children to be lost. SCHIP outlays in 2014 would actually be below the current CBO baseline.

The Chairman's Mark would dramatically shift costs to the federal government and increase the number of individuals who become dependent on government programs for health insurance coverage. This cost is disproportionate when compared to the modest net gain in the number of children who would gain health insurance through the proposal in its first five years. According to CBO, 3.3 million individuals would be newly insured under the bill in 2012,

and an additional 1.6 million individuals (or approximately 33% of the total) who were previously covered under private insurance would be enrolled in SCHIP. Billions of dollars for health insurance coverage would be shifted from the private sector to the public sector and from the state governments to the federal government with little actual gains in insurance coverage for children. In addition, expansions to new populations (those previously not eligible for SCHIP) are offset by the estimated reductions in private coverage.

Many of the costs of the bill are unnecessary to meet the mission of SCHIP to insure low-income children. Under the Chairman's Mark, billions of dollars would be spent to maintain enrollment of adults by shifting costs from Medicaid to SCHIP. The Administration agrees with Senators Grassley, Hatch and Roberts on how important it is to clearly "return SCHIP to the original focus of covering low-income children." In fact, we are working with states to move their adults into Medicaid. Approximately 54 percent of the adults enrolled in SCHIP in FY 2006 will be transitioned into Medicaid by October 1, significantly lowering the funds needed for SCHIP in FY 2008. This important reform is put in jeopardy by the proposed legislation which reinforces misguided financial incentives, by developing a new reimbursement level - the Reduced Enhanced Matching Assistance Percentage (REMAP) - for the coverage of parents. States should not be rewarded and given higher levels of Federal reimbursement for covering populations that could be covered through Medicaid.

Without any justification, the Mark increases the federal share of the costs of the Medicaid program which could in turn lead to further cost shifting from state responsibility to the federal government. The legislation creates two multi-billion dollar federal programs - the Incentive Bonuses Pool and the Contingency Fund - that do not currently exist. Both have little accountability and are unnecessary given the allotment levels assumed in the Mark. With the interactions between the allotments, the Bonuses Pool and the Contingency Fund, it appears that, rather than reauthorizing SCHIP, a wholly new and different program is being created.

To offset SCHIP reauthorization, this legislation imposes a massive, regressive tax increase that relies on an

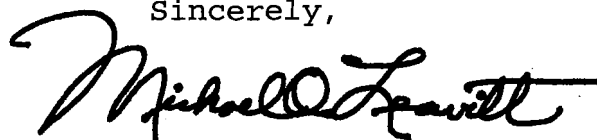
uncertain revenue stream for future funding. The Administration strongly opposes the proposed 61-cent increase in the federal excise tax on a pack of cigarettes to fund this expansion. Federal revenues relative to the size of the economy are already above their historical average level and the use of tax increases to fund spending increases is undesirable and inadvisable. The Administration is also concerned about the impact the proposed tax increase would have on state budgets, which have become increasingly dependent on tobacco-related taxes. Estimates suggest that a 61-cent per pack increase in the retail price of cigarettes would reduce state cigarette tax receipts by as much as 5 percent, or \$750 million. An increase in federal cigarette taxes is also among the most regressive revenue raising measures one could propose.

Ironically, the proposed legislation would increase taxes on low-income taxpayers as a way to fund health coverage for low-income individuals. At the same time, the Mark would allow children who live in higher-income families to become eligible for government-run health care.

The Office of Management and Budget advises that there is no objection to the transmission of this report as regards the program of the President.

Our views on the major parts of the Chairman's Mark are attached.

Sincerely,

A handwritten signature in cursive script that reads "Michael O. Leavitt". The signature is written in dark ink and is positioned above the printed name.

Michael O. Leavitt

Enclosure

Enclosure

The Administration expects to have additional comments on the bill when actual legislative language is available for review.

Section 101—Extension of CHIP

The Mark appropriates specific amounts in each fiscal year from 2008 through 2012. (\$9.1 billion in FY 2008; \$10.7 billion in FY 2009; \$11.9 billion in FY 2010; \$13.8 billion in 2011; and, \$3.5 billion in 2012).

The annual national appropriation amounts reveal the budget gimmicks involved in this legislation. This legislation would use a budget gimmick to fund a five-year reauthorization that ultimately jeopardizes children's health care. This legislation would increase the annual nation-wide SCHIP allotments to \$16 billion in 2012, only to drop the baseline allotment level in 2013 to \$3.5 billion. Under the Chairman's Mark, States would be left with \$1.5 billion less funding in 2013 than they have access to now.

The Mark creates a funding cliff of over \$60 billion after reauthorization expires. Once SCHIP funds decrease in 2013, millions of children could lose critical access to health insurance. This is simply a budgeting trick to avoid having to pay for the level of spending being sought.

Annual appropriation levels do not reflect any logical pattern of expected spending and should be changed to predictable and sustainable levels more consistent with trend rates, take-up rates, health care expenditures, and population growth among low-income populations.

Section 102—Allotments for the 50 States and the District of Columbia

The Mark provides a detailed allotment formula based on several factors (such as a state's federal SCHIP spending, a state's federal SCHIP allotment, state projected spending) and adjustment. This offers a variety of ways to arrive at an allotment amount. If the initial allotment method proves to be wrong, then a second method is called into play with yet other adjustments.

This section is unnecessarily complex and will have the opposite effect of being understandable, stable, and predictable. This provision allows states to receive more than they would actually plan to spend. The allotments are based on projected spending rather than prior year spending, which could lead to gaming.

Section 103—One-Time Appropriation for FY 2012

This section appropriates \$12.5 billion in 2012 for one year only. This is in addition to the \$3.5 billion provided under Section 101. In total, \$16 billion has been appropriated for 2012. The allotment then would plunge to \$3.5 billion in 2013. This is clearly not a credible assumption. Under normal budgetary assumptions, CBO would have assumed that the allotment levels in its baseline for 2013-2017 would carry about \$80 billion (carrying \$16 billion in 2012 forward each year for 5 years). By dropping the appropriations to \$3.5 billion in the out years, it essentially creates a funding cliff and understates the amount of funding required to maintain the program by at least \$60 billion in allotments.

Section 105—Incentive Bonuses for States

A new multi-billion dollar SCHIP Incentive Bonuses Pool is set up with a \$3 billion appropriation and half of unexpended allotments from FY 2006 and FY 2007 (which states were previously allowed to spend over a period of three years). Currently, there are \$3.9 billion in unexpended allotments. The Pool would grow as more unexpended appropriations (which seems likely given the excess appropriations amount and that enrollment growth occurs over time not all at once) are added to the Pool along with transfers from other sources.

There may be multiple ways states can gain payments from the Pool. The incentive payment rewards increased enrollment, not necessarily state behavior, as there are a number of factors that may lead to increases in enrollment in Medicaid/SCHIP (e.g. unfavorable economic conditions). It does not seem appropriate to simply reward increased enrollment that is not related to state activities. For example a state may be rewarded for doing nothing in a time of an economic downturn when more children are added to the program simply as a result of the economic situation. By the same token, a State may perform significant outreach efforts in a time of economic boom and not be rewarded since more children may be otherwise covered during that period through other insurance. Given payments are available for FY 2008, states could potentially be rewarded for poor performance in FY 2007. It appears that much of the Pool will simply be a way of increasing the effective federal match rate for both Medicaid and SCHIP.

States already have access to financial incentives by virtue of the enhanced Federal Medical Assistance Percentage (EFMAP). Under this financing structure, States receive higher Federal reimbursement – 15 percentage points on average – under SCHIP when compared to Medicaid. States do not need another source of incentive payments.

CBO did not breakout how much of the spending is expected to be distributed through this Section though it could potentially be in the billions of dollars. Payments can be used for any purpose the State determines is likely to reduce the percentage of low-income children in the State without health insurance. The bill does not require the funds to be spent on health services. In our view, first and foremost, resources should be spent

on health coverage. Instead, an open-ended allowance may result in shifting state costs to the federal government. At the very least, it appears that billions of dollars are likely to be spent with little or no accountability for their actual use.

Section 106--Phase-out of coverage for nonpregnant childless adults under CHIP, conditions for coverage of parents

Despite the title of this section, the Mark would, at best, delay, and at worst, prevent the ongoing transition of adults from SCHIP into Medicaid or other coverage. This section allows the continued coverage of adults under SCHIP and allows states to continue to receive enhanced federal funding. Under current Administration policy and with the cooperation of states, more than half of adults (54%) will be transitioned by October 1, 2007. Yet under the Chairman's Mark, by 2012, adults in grandfathered states will still be covered with SCHIP dollars. Therefore, this section simply serves as a federal earmark benefiting only a select group of states.

Section 107--State option to cover low-income pregnant women under CHIP through a State plan amendment

This section is an expansion of current law and is inconsistent with current regulatory and waiver authority. It would create an inequity for unborn children and their mothers. In FY 2006, just over 4,000 pregnant women were served through SCHIP waivers. Under these waivers, coverage was required to be "allotment" neutral, that is, the population group could not cost any more than what was available to the state through its allotment. In addition, States already have the option of covering unborn children and their mothers through regulation. In this proposal, pregnant women would continue to be subject to the 5 year bar on non-citizens, while those covered under the current regulation are not. Thus, a state choosing coverage under this new section may disadvantage other unborn children and their mothers. The section also allows for presumptive eligibility which is susceptible to high eligibility error rates.

Section 108--SCHIP Contingency Fund

This section establishes a new multi-billion dollar Fund to address potential state overspending; it is not clear why this is needed. It is difficult to conceive of a situation under the Mark in which States will run out of SCHIP funds over the first five years given 1) the extremely high levels of presumed spending under the allotment levels and 2) the fact that allotment levels are much higher than current projections of State spending. The existence of the fund appears to concede that the new allotment formulas are either wildly inaccurate or that the Mark is actually encouraging states to spend beyond their means.

Section 109—2-year availability of allotments; expenditures counted against oldest allotments

Parts of this section create loopholes for states to game federal funds. It would be a state choice to count expenditures against incentive bonuses and such bonuses are not subject to any time limitation in the proposal. So a state could receive a bonus payment while submitting a claim to be a shortfall state and receive federal funds from the Contingency Fund. The Incentive Fund may become a potential windfall for states with little or no accountability for the uses of the funds provided.

Section 110—Limitation on matching rate for States that propose to cover children with effective family income that exceeds 300 percent of the poverty line

The title gives the impression the Mark would lower the match rate for individuals at higher income levels. However, current law provides states receive the higher match rate only for children with family incomes at or below 200 percent of the federal poverty level (FPL) or within 50 percentage points of their level of coverage in 1997. It has been through SCHIP waivers and State Plan Amendments (SPAs) that states have been able to expand over these levels. These waivers and SPAs were approved under the condition of excess funds in those particular state allotments at the time. The result of the Mark's policy is to provide a clear incentive for states to cover higher income levels and to federalize all health care for children. The Mark grandfathers in not only New Jersey's level of coverage at 350 percent of poverty (\$72,275 for a family of four) at the enhanced match rate, but also seems to grandfather in New York's request to cover at 400 percent of poverty (\$82,600 for a family of four) at the enhanced match rate and potentially other states.

Additionally, the provision allows for exceptions that may render the title to be meaningless. Given the creation of the Incentive Bonuses Pool and the Contingency Fund and their interactions, there is no limitation on income eligibility in 19 states while the other states would be subject to limitations. Since this bill increases funds substantially, there is no incentive to focus these funds on low-income children at or below 200% FPL. We oppose this expansion and urge that Congress reduce the match rate to the regular rate for children above 200% of FPL, as proposed in the President's budget.

Section 111—Option for qualifying states to receive the enhanced portion of the CHIP matching rate for Medicaid coverage of certain children

When Congress created SCHIP 10 years ago, it understood at the time that some states had already expanded Medicaid coverage and that the federal government was already paying its share for such expansion. For the new SCHIP program, it did not want to use the new funds to simply buy out existing state spending. In recognition, it allowed those 11 states (Connecticut, Hawaii, Maryland, Minnesota, New Hampshire, New Mexico, Rhode Island, Tennessee, Vermont, Washington, and Wisconsin) a limited substitution of federal funds for state funds. Under this new provision, previous restrictions are removed so that certain states are permitted to use annual SCHIP allotments, without limitation, to

substitute even more Federal funds for a larger portion of Medicaid children. This change could result in a greater Federal buy-out of state funding.

Section 201—Grants for Outreach and Enrollment

We are concerned that the Mark adds translation and interpretation services to be reimbursed at an enhanced match of 75% or the States' enhanced FMAP plus 5 percentage points (whichever is higher), when these services can already be included as child health assistance services at the applicable State match for SCHIP.

Section 202 – Increased Enrollment and Outreach of Indians

The elimination of the 10 percent cap on outreach for American Indian/Alaskan Natives under SCHIP would permit an unlimited amount of expenditures for this purpose within the State's overall SCHIP allotment. According to the Mark, SCHIP funds could be used to pay for enrollment and outreach activities that can be paid for under Medicaid.

We are concerned that this provision unnecessarily expands the enhanced Federal reimbursement to Medicaid activities. It is more appropriate to pay for Medicaid outreach at the Medicaid match rate.

Section 301—Verification of declaration of citizenship or nationality for purposes of eligibility for Medicaid and SCHIP

The implementation of the citizenship documentation requirements under the Deficit Reduction Act of 2005 (DRA) is proceeding without significant barriers to those eligible for Medicaid. The enhanced match rates of as much as 90 percent for certain administrative activities are unnecessary and providing the Secretary with discretion to waive noncompliance with error rates could undermine the integrity of enforcement of statutory requirements. The provision on "deeming of newborns" has been adequately addressed in the final regulation which was published on July 13, 2007. The provision to begin benefits prior to the determination of eligibility, expands the Medicaid entitlement and overthrows decades of Medicaid eligibility procedures. This in turn subjects the states and the federal government to a high risk of waste, fraud and abuse. In addition, according to CBO, this provision would cost \$4.3 billion over 10 years, suggesting that the proposal is intended to dramatically liberalize the citizenship documentation requirements included in the DRA.

Section 401—Additional State option for providing premium assistance

Through state experience, we know that premium assistance for employer-based coverage needs to be simple to administer for the states, employees and employers. This provision creates uncertainty for all involved, allowing families to move between employer-sponsored coverage and other SCHIP coverage.

Section 503—Application of Certain Managed Care Quality Standards to CHIP

It is unclear from the Mark whether Medicaid provisions that would expand benefits and convey an individual entitlement will apply to SCHIP. However, the elimination of states' ability to administer non-Medicaid programs would not be acceptable. Quality measures must not be allowed, through stealth, to become new mandates lest the underlying construction of SCHIP be overturned.

Section 602 – Payment Error Rate Measurement (PERM)

The provision increases the Federal match rate for PERM activities from the enhanced Federal match rate (on average, 72 percent) to 90 percent and excludes PERM spending from the states' 10 percent administrative cap. The higher FMAP will increase the amount the Federal Government has committed to this project. There does not seem to be a policy rationale for these additional funds.

The changes to PERM in the Chairman's Mark impose unnecessary prescriptive new requirements. These provisions have the effect of reducing the Administration's ability to quickly implement changes that could improve the program and reduce a State's burden as the PERM program matures. Further, the provision does not apply a consistent approach to measure improper payments across states.

Section 603—Elimination of counting Medicaid child presumptive eligibility costs against Title XXI allotment

This provision was to protect the federal government against high state error rates and fraud. Its elimination is likely to result in both.

Section 605—Deficit Reduction Act Technical Correction

A similar provision has appeared several times since the DRA was passed and has been rejected as not technical. Depending on actual legislative language, the provision could significantly undermine states' ability to modernize their Medicaid programs. The DRA provided flexibility to the states to provide coverage to families in Medicaid as under SCHIP. More than half of the adults enrolled in SCHIP in FY2006 have been moved to Medicaid, where parents and their children can be covered under the same benefit package including through employer-based coverage. However, a change in DRA flexibility could reverse their progress.

This section also contains a retroactive provision that requires the Secretary to publish certain information in the Federal Register. Depending on actual legislative language, this provision could set the stage for judicial challenges to states that have adopted benefit flexibility provided under the DRA.

Together, these provisions represent potentially grave threats that would overturn key provisions of the DRA.