

February 13, 1998

Dear State Health Official:

The Children's Health Insurance Program (CHIP) was created, with bipartisan support, to provide health insurance to uninsured children. The new law contains provisions explicitly designed to ensure that funds are targeted only to uninsured, and not already insured, children. Some of these provisions relate to Medicaid, while others are intended to prevent CHIP from substituting for private coverage. We are writing to provide guidance on the standards that the Department of Health and Human Services (DHHS) will use to evaluate State strategies to prevent this type of substitution of coverage. These strategies are necessary to maximize the use of Federal dollars and to provide more coverage to children who currently lack health insurance.

#### The Potential for Substitution

The potential for substitution of CHIP coverage for private group health coverage exists because CHIP provides reduced-price coverage that some individuals and employers currently purchase with their own funds. Specifically, employers with lower-wage employees could potentially save money if they stop offering dependent coverage (or if they reduce or eliminate their contributions for such coverage) and encourage their employees to enroll their children in the CHIP plan. At the same time, families that currently are making significant contributions towards dependent coverage (either through their employer plan or through an individual plan) could have an incentive to drop their current coverage and enroll their children in the CHIP plan as long as the benefits would be comparable and their out-of-pocket costs would be reduced. There also may be an incentive for States to substitute CHIP for Medicaid coverage, since CHIP has an enhanced matching rate.

#### Medicaid Substitution Provisions

Title XXI contains three provisions aimed at preventing CHIP from substituting for current Medicaid coverage. First, the State plan must include assurances that the State will coordinate its CHIP program with other public and private programs, including Medicaid. Second, there are "maintenance of effort" provisions for Medicaid eligibility. In a State that chooses to create a non-Medicaid CHIP program, the State cannot adopt income and resource methodologies for Medicaid children that are more restrictive than those in effect on June 1, 1997. In a State that chooses to create a Medicaid CHIP program, children are not eligible for enhanced matching under CHIP if they would be eligible for Medicaid in their State under the standards in effect on March 31, 1997. Third, any child who applies for CHIP must be screened for Medicaid eligibility and, if found eligible, enrolled in Medicaid.

### HHS Review of Strategies to Protect Against Substitution of Private Coverage

The Balanced Budget Act of 1997 requires that States submitting applications to operate a State program with Federal funding through the Children's Health Insurance Program (CHIP) include a description of the procedures to ensure that coverage provided under CHIP does not substitute for coverage under either Medicaid or private group health plans. DHHS will review State CHIP plans to determine if the State has included procedures designed to address any potential substitution concerns. We believe that there are two distinct cases that need to be addressed: (1) insurance coverage provided directly through CHIP or Medicaid; and (2) using CHIP funds to subsidize coverage provided through employer-sponsored group health plans.

We will apply particular scrutiny to States whose State CHIP programs furnish coverage through employer-sponsored group health plans because we believe there is a greater potential for substitution of public for existing private spending on health insurance in these types of arrangements. First, we believe that this approach may increase the likelihood that families currently covered by employer-sponsored plans will seek the publicly subsidized coverage since these families could get premium assistance while still remaining in their existing group coverage plan. Many families may be reluctant to split up their family's health insurance to cover their children

through CHIP, but could be more likely to choose CHIP if they would not have to disenroll their children from their current plans. Second, employers with low-wage workers may have incentives to reduce or eliminate their premium contributions for dependent coverage if the CHIP assistance replaced that contribution. The Department will review State CHIP plan submissions as follows:

- Insurance Coverage Provided Directly through CHIP or Medicaid

States that provide insurance coverage through a children's only and/or a State plan (as opposed to subsidizing employer-sponsored coverage) or expand through Medicaid will be required to describe procedures in their State CHIP plans that reduce the potential for substitution. The crowd out concerns increase at higher levels of poverty, and the Department will be applying greater scrutiny in these cases. After a reasonable period of time, the Department will review States' procedures to limit substitution. If this review shows that they have not adequately addressed substitution, the Department may require States to alter their plans.

- Subsidizing Employer-Sponsored Group Health Plans

States that use CHIP funds to subsidize employer-sponsored group health plans should incorporate provisions in their State CHIP plan that are substantially equivalent to each of the following five provisions. We will work with States that have other methods to prevent crowd out to ensure that they are substantially equivalent to these requirements.

1. To ensure that coverage is targeted to children in families that previously were unable to afford dependent coverage, children in a family will not be eligible for subsidies through an employer-sponsored group health plan if the family had employer-sponsored group coverage for these children within the previous six months. States will have the option to require a longer period of uninsurance, but that period could not exceed 12 months. Exceptions would be allowed if the prior coverage was involuntarily terminated (by other than a current employer). Newborns who are not covered by dependent coverage would not be subject to any such waiting period.

2. To discourage employers from lowering their existing contributions for dependent coverage, States only will be permitted to make subsidies available for the purchase of dependent coverage through employer-sponsored group health plans in cases where the employer contributes at least 60 percent of the cost of family coverage, which is the median employer contribution nationwide. We can consider a somewhat lower level if States have additional provisions to limit employers ability to lower contribution levels. For ease of administration, the State may establish a minimum dollar employer contribution or some other method that is equivalent to the 60 percent requirement to assure that employers continue to pay a meaningful share of the costs in these programs.

3. To ensure that the provision of child health assistance through employer-sponsored group health plans is cost effective and that the State is not inappropriately subsidizing coverage for the adults in a family, a State's payment for a child enrolled in an employer-sponsored group health plan can be no greater than the payment that the State would make for the child if they were enrolled in a separate CHIP plan offered by the State (or in Medicaid if appropriate). If the State subsidizes children's coverage only, there is no need for a State to seek a family coverage waiver under Section 2105(c)(3). If the State intends to cover any adults, however, the State must seek a waiver under this section.

4. To promote cost effectiveness, families electing to receive child health assistance through an employer-sponsored group health plan will be required to apply for the full premium contribution available from the employer. This contribution will reduce the CHIP contribution toward the premium.

5. To demonstrate cost effectiveness, the State will be required to collect information and conduct an evaluation that examines the amount of substitution (if any) that has occurred under the program and the effect of these provisions on access to the program. States must assess the prior insurance coverage of enrolled children. Information on prior coverage can be obtained through the enrollment process, separate studies of CHIP enrollees, or other means that reliably gather information about prior health insurance status. To determine the level of substitution, States are encouraged to analyze

the number of families who choose to enroll in CHIP who might have retained or bought private insurance had they not received CHIP funding for employer-sponsored insurance. States will conduct this evaluation within a specified time period. Based on the State evaluations, the Department will reevaluate its position on these requirements for States that subsidize employer-sponsored group health plans.

States that choose to subsidize children's coverage through employer-sponsored group health plans would report in their State Child Health Plan their compliance with these guidelines. Including this information in the Plan will be deemed as meeting the requirement in the law that insurance provided under the State child health plan does not substitute for coverage under group health plans.

## **Summary**

This guidance is intended to contribute to our national goal that CHIP provides coverage to uninsured children rather than children who are already covered.

Sincerely,

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