

CMS GUIDANCE ON OBBBA MEDICAID STATE DIRECTED PAYMENT (SDP) PROVISIONS

KEY TAKEAWAYS

- The Centers for Medicare & Medicaid Services' (CMS') preliminary guidance issues a more restrictive interpretation of the One Big Beautiful Bill Act (OBBBA) provisions related to state directed payments (SDPs).
- SDP rating periods must occur within 180 business days¹ of the OBBBA's July 4, 2025, date of enactment, to qualify for grandfathering. CMS preliminarily grandfathered SDPs approved before February 2, 2026.
- Grandfathered SDPs cannot increase the aggregate dollar amount of their SDP above the amount listed in the approved preprint application.
- CMS says it could limit SDP payment amounts for other services beyond the four services specified by the legislation.
- Further guidance and rulemaking are needed, including clarification on how CMS will calculate the Medicare rate and the 10 percentage point reduction to grandfathered SDPs beginning in 2028.

BACKGROUND

On July 4, 2025, President Trump signed the One Big Beautiful Bill Act ([OBBBA, P.L. 119-21](#)) into law, which included several provisions and policies modifying Medicaid financing, eligibility, and enrollment. On Feb. 2, [CMS issued updated guidance on Section 71116 on the OBBBA](#), interpreting provisions of Section 71116 of the OBBBA relating to grandfathering and the reduction in the total payment rate limit for SDPs. This guidance rescinded and replaced earlier CMS [guidance from Sept. 9, 2025](#). While this new guidance maintains several parts of the Sept. 9, 2025 guidance, it differs in a few key respects. CMS' new preliminary guidance adopts a restrictive interpretation of the legislative text but does provide some additional flexibility compared to the Sept. 9, 2025 guidance, which is likely to impact academic health systems and teaching hospitals that rely on SDPs to bolster their Medicaid payment rates.

DISCUSSION

Section 71116 of the OBBBA

SDPs are additional Medicaid payments made to providers through managed care plans that supplement Medicaid base payment rates. SDPs give states more leverage over how managed care organizations (MCOs) pay network providers and enable states to direct MCOs to advance specific state goals. In 2024, CMS finalized a rule to allow states to set SDP payment rates up to the average commercial rate.² Section 71116 modifies this limit for SDP rates. Beginning July 4, 2025, new SDP applications are capped at 100 percent of the Medicare rate for expansion states and 110 percent of the Medicare rate for non-expansion states. Existing SDPs that meet certain qualifications may be grandfathered at their current rates until a phasedown begins

¹ CMS defines business days as Monday through Friday, excluding the Federal holidays as determined under 5 U.S.C. § 6103. These holidays include the 12 Federal holidays, including Inauguration Day, as recognized by the Office of Personnel Management (<https://www.opm.gov/policy-dataoversight/pay-leave/federal-holidays>).

² 89 FR 41002.

January 1, 2028. This phasedown will reduce the payment rate for grandfathered SDPs by 10 percentage points per year until the SDP reaches these new limits.

Section 71116 includes a grandfathering provision for SDPs that meet one of the following criteria:

- The state received written approval for an SDP pre-print from CMS before May 1, 2025 (or made a “good faith effort” to receive such approval),
- For SDPs for rural hospitals,³ the state received written approval from CMS (or made a “good faith effort” to receive such approval) prior to July 4, 2025, or
- The state submitted a completed preprint to CMS prior to July 4, 2025. While the preprint does not have to be approved by July 4, it is implied that if the pre-print did not ultimately receive approval from CMS, then the SDP would not be eligible for grandfathering, even if the preprint met the submission deadline.

Section 71116 also requires that in addition to meeting one of the above requirements, an SDP must have a rating period that falls within 180 days of July 4, 2025, to be grandfathered. An SDP rating period is the 12 month period for which the SDP is approved. The text of Section 71116, however, is ambiguous as to which category of SDPs the rating period requirement applies to (i.e., only SDPs for rural hospitals, those with a completed preprint before July 4, or non-rural hospitals). The preliminary guidance provides additional information on how CMS has interpreted Section 71116 of the OBBBA, and which SDPs will be subject to the grandfathering provisions. Additional rulemaking will be required and will need to further clarify this ambiguity in CMS’ guidance.

CMS’ Interpretation of the Grandfathering Provision

In the guidance, CMS clarified the definition of a “completed preprint” and a “good faith effort” to receive approval for purposes of determining grandfathered status of SDPs. The agency clarified that a “good faith effort” means having submitted a completed pre-print to the agency by the date required in section 71116 (July 4, 2025). Referencing a 2023 Informational Bulletin,⁴ the agency defined “completed pre-print,” clarifying the pre-print form and applicable addendum tables would need to be fully filled out with all provided information included in the fillable sections.

Further, CMS’ interpretation of the grandfathering provision limits the timeframe of the applicable rating period. In a significant departure from its interpretation in the Sept. 9, 2025, guidance, CMS clarifies that for purposes of the grandfathering provision, a rating period must occur within 180 *business days* of July 4, 2025 (as opposed to 180 calendar days in the Sept. 9 guidance). This will include SDPs in rating periods that include days from October 11, 2024, to July 3,

³ Sec. 71116 (d)(2) of P.L. 119-21 defines rural as (A) a subsection (d) hospital (as defined in paragraph (1)(B) of section 1886(d) of the Social Security Act that—(i) is located in a rural area (as defined in paragraph (2)(D) of such section);(ii) is treated as being located in a rural area pursuant to paragraph (8)(E) of such section; or (iii) is located in a rural census tract of a metropolitan statistical area (as determined under the most recent modification of the Goldsmith Modification, originally published in the Federal Register on February 27, 1992 (57 Fed. Reg. 6725)).(B) A critical access hospital (as defined in section 1861(mm)(1) of such Act).(C) A sole community hospital (as defined in section 1886(d)(5)(D)(iii) of such Act).(D) A Medicare-dependent, small rural hospital (as defined in section 1886(d)(5)(G)(iv) of such Act).(E) A low-volume hospital (as defined in section 1886(d)(12)(C) of such Act).(F) A rural emergency hospital (as defined in section 1861(kkk)(2) of such Act).

⁴ <https://www.medicaid.gov/federal-policy-guidance/downloads/cib11072023.pdf>

2025, or July 7, 2025, through March 27, 2026, effectively covering SDPs in calendar year (CY) 2024, state fiscal year (SFY) 2025, CY 2025, SFY 2026, and CY 2026 rating periods. SDPs with rating periods occurring in SFY 2027 (i.e., beginning on or after March 30, 2026) occur more than 180 business days after July 4, 2025, and will not be grandfathered.

CMS' new interpretation will capture SDPs with rating periods occurring in CY 2024 and CY 2026, which were previously ineligible for grandfathering based on CMS' rescinded Sept. 9 guidance. Lastly, CMS's issue of this new guidance extends preliminary grandfathered status to SDPs approved by February 2, 2026.

Limits for Total Rate of Grandfathered SDPs

The guidance from CMS also clarifies how the total grandfathered SDP payment rates will be capped. The agency states the grandfathered amount will equal the total aggregate dollar amount specified in item four of the current SDP preprint form, instead of being determined on a per-service basis or as a percentage. The total dollar amount listed in the SDP preprint typically varies from the actual amount of Medicaid dollars paid in an SDP rating period as this number is an estimate that is revised based on actual Medicaid utilization rates during the rating period. This interpretation remained unchanged from the Sept. 9, 2025, guidance to the Feb. 6 guidance.

Reduction in SDP Rates

As discussed, Section 71116 of the OBBBA calls for the reduction of grandfathered SDPs payment rates beginning January 1, 2028. These payment rates will be reduced by 10 percentage points per year until the SDP reaches the new limits for payment rates. Questions remain for CMS to address in future guidance and rulemaking on how the 10 percentage point reduction for grandfathered SDPs will be calculated and applied. Further, CMS' preliminary guidance, capping grandfathered preprints based on aggregate dollar amounts, effectively implements payment reductions prior to the January 1, 2028, phasedown. By capping at the aggregate dollar amount, SDP rates cannot increase to account for changes in utilization or account for the impact of inflation.

IMPLICATIONS

As noted, the agency's interpretation of Section 71116 originally appeared to be generally more restrictive as it relates to which SDPs will qualify for the grandfathering provision and how payment rates will be capped. However, the new Feb.6 guidance provides slightly more flexibility by capturing SDPs with rating periods that run through CY 2024 or begin in CY 2026. This could result in more SDPs receiving grandfathering prior to the 2028 phase down to 100 percent of Medicare rates for expansion states and 110 percent of Medicare rates for non-expansion states if they wish to continue these SDP programs in 2028 and beyond.

Further, utilizing the total dollar amount as specified in item four of the current SDP preprint form as the cap on the total payment rate for grandfathered SDPs may reduce SDPs earlier than the total payment rate limit reductions take effect in 2027. By utilizing an estimated aggregate dollar amount submitted by states rather than per-service payments, SDPs may be underpaid as states will not be able to adjust payments upward to account for increased utilization. This shifts CMS' historical thinking on SDPs, which have been made on a per-service basis based on the utilization of services.

CMS further did not clarify if states can increase the per-service amount for grandfathered SDPs, so long as they do not exceed the aggregate payment amount in the preprint, or whether states may adjust the eligible class of providers for grandfathered SDPs. CMS will also need to clarify if states need to continue submitting preprint applications to CMS annually or if they will be approved through one application until the phasedown begins in 2028.

AAMC'S TAKE

CMS' guidance effectively caps grandfathered SDPs at their grandfathered estimated aggregate dollar amount, instead of allowing for payment up to ACR at a service-specific level. Further, CMS indicated the agency may pursue limits on additional services not specifically called out in the SDP limits in the OBBBA. Should the agency include such proposals in formal rulemaking, Medicaid payments may be further restricted. CMS could use a more restrictive stance in future guidance and rulemaking to further limit SDPs, including grandfathered SDPs.

It will be critical for states and providers to monitor how CMS implements the 10 percentage point reductions, which could mean sharp or gradual reductions in payments depending on the agency's interpretation.

RESOURCES

[One Big Beautiful Bill Act](#) (OBBBA, P.L. 119-2) – Section 71116

CMS Guidance "[Section 71116 of the Working Families Tax Cuts Legislation on State Directed Payments](#)" (Feb. 2, 2026)

CMS Guidance "[Section 71116 of One Big Beautiful Bill Act on State Directed Payments](#)" (Sept. 9, 2025)

[Medicaid Program; Medicaid and Children's Health Insurance Program \(CHIP\) Managed Care Access, Finance, and Quality Final Rule](#) (June 24, 2024) Vol. 89 of the Federal Register at 52389

CMCS Informational Bulletin "[Medicaid and CHIP Managed Care Monitoring and Oversight Tools](#)" (Nov. 7, 2023)

MACPAC, [Medicaid Base and Supplemental Payments to Hospitals](#) (May 2024)

Additional [AAMC Medicaid and Payment Financing Resources](#)

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