

August 2025

H.R. 1 State-Directed Payments

Overview

On July 4th, President Trump signed into law the reconciliation bill, known as H.R.1. One of the provisions in this legislation impacts how state-directed payments (SDPs) are calculated. Specifically, it reduces the maximum allowable value of these payments to either Medicare or 110% of Medicare payment levels or, for services without a Medicare equivalent, the approved Medicaid State Plan rate.

Currently, federal regulations allow states to use an average commercial rate as the ceiling for SDPs. The new legislation introduces a transition period: for SDPs that were approved or submitted in good faith within 180 days of the bill's enactment, the value of these payments will gradually decrease by 10% each year until they reach the new limit, starting January 1, 2028.

Additionally, the Centers for Medicare & Medicaid Services (CMS) began the process in June 2025 to issue a Notice of Proposed Rulemaking, which may provide further details on how these changes will be implemented. However, it's unlikely that the final rules will be in place in time to impact rates and contracts for the federal fiscal year 2026 or calendar year 2026.

H.R. 1 Requirements for SDPs (Section 71116)

- **Payment rate changes:** The legislation directs the Secretary to update the rules for certain payments, limiting the total payment rate for specific services to:
 - 100% of the published Medicare payment rate for expansion states (or, if no specific Medicare rate is available, the Medicaid State Plan rate).
 - 110% of the published Medicare payment rate for non-expansion states (or, if no specific Medicare rate is available, the Medicaid State Plan rate).
- **Grandfathering of certain payments:** Payments that received prior approval, were submitted in good faith to obtain approval before May 1, 2025, for rural hospitals submitted prior to the enactment date, or complete payments submitted prior to enactment and within 180 days of a rating cycle can be "grandfathered" in. For these payments:
 - They must be for a rating period that is within 180 days of the law's enactment, or if a preprint was submitted before May 1, 2025,

- The total payment amount will be gradually reduced by 10 percentage points each year starting January 1, 2028,
- Until the payment rate aligns with the new limits (either 100% or 110% of Medicare, depending on the state).

Knowns and Uncertainties with SPDs

The legislation directs the Secretary of Health and Human Services to update federal regulations for SPDs. These changes include capping SPD payment levels at either 100% (for states that expanded Medicaid under the Affordable Care Act) or 110% of Medicare, with some payments temporarily grandfathered if certain conditions are met.

While the bill introduces significant changes, there are still many uncertainties to consider.

What we know:

- **New SPDs requiring approval:** The law will impact any new SPD that needs written approval from CMS.
- **Existing approvals:** SPDs approved by CMS before May 1, 2025, are not affected immediately but are expected to decrease starting January 1, 2028. SPDs submitted for approval by May 1, 2025, are likely to be grandfathered before the transition begins.
- **Rural hospital payments:** Similarly, SPDs involving rural hospitals approved by CMS before July 4, 2025, are not impacted immediately but will be subject to reduction starting January 1, 2028. Those submitted for approval by July 4, 2025, are also likely to be grandfathered.

Areas of Uncertainty:

- **Scope of impact:** It's unclear which SPDs requiring prior approval will be affected. Specifically, will H.R.1 impact all SPDs or only those for inpatient, outpatient, nursing facilities, and professionals at academic medical centers?
- **Grandfathering details:** Which SPDs submitted between May 1, 2025, and July 4, 2025, will be grandfathered, and under what conditions?
- **Renewals in 2026:** What restrictions, if any, will apply to SPDs being renewed in managed care contracts for calendar or federal fiscal year 2026?
- **New SPDs:** What methodology will CMS require states to use to develop the new Medicare-based limits for SPD payments?

Caveats and Limitations

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