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CENTERS FOR MEDICARE & MEDICAID SERVICES
CENTER FOR MEDICAID & CHIP SERVICES

SMD # 26-003
RE: Budget Neutrality and Certification by the Chief Actuary of CMS for Section 1115 Medicaid Demonstration Projects

June 11, 2026

Dear State Medicaid Director:

Section 1115(a) of the Social Security Act (the Act) gives the Secretary of Health and Human Services (Secretary) authority to approve experimental, pilot, or demonstration projects that are found by the Secretary to be likely to assist in promoting the objectives of the Medicaid program. These demonstrations give states additional flexibility to design and improve their programs and help the federal government and states evaluate state-specific policy approaches to better serve Medicaid populations.

Section 71118 of Public Law 119-21, which the Centers for Medicare & Medicaid Services (CMS) refers to as the Working Families Tax Cut (WFTC) legislation, adds budget neutrality for Medicaid section 1115 demonstration projects as a new statutory requirement at subsection 1115(g) of the Act. New subsection 1115(g)(1) of the Act requires that, beginning January 1, 2027, the Secretary may not approve an application for (or an amendment or renewal of) a Medicaid section 1115 demonstration project unless the Chief Actuary of CMS certifies that such project is not expected to result in an increase in the amount of federal Medicaid expenditures compared to the amount that such expenditures would otherwise be in the absence of such project. New subsection 1115(g)(2) of the Act describes the treatment of current demonstration period budget neutrality savings during the subsequent demonstration renewal period. Section 1115(g) of the Act is applicable to Medicaid section 1115 demonstration projects in all states, the District of Columbia, and all territories; this section is not applicable to Children's Health Insurance Program (CHIP) section 1115 demonstration projects. While budget neutrality is a key component of the review of 1115 demonstrations, the Secretary will approve a proposed section 1115 demonstration only if he determines that it is likely to assist in promoting the objectives of the Medicaid statute. CMS performs a case-by-case review of each state proposal for section 1115(a) demonstrations.

CMS is preparing a notice of proposed rulemaking to propose revisions to 42 CFR part 431 subpart G related to section 1115 demonstration projects. CMS intends to propose a rule to facilitate the Chief Actuary's certification of budget neutrality under section 1115(g) of the Act, including changes to the analyses and documentation states would need to submit to CMS for the Chief Actuary's review and determination of budget neutrality prospectively. As part of this rulemaking, CMS will propose a methodology for determining whether a demonstration project meets the requirements of section 1115(g) of the Act. Overall, CMS's intended approach to implementing section 1115(g) is tied to CMS's current policy goals: ideally, section 1115 demonstrations should deliver better outcomes and operate as, or more, efficiently than the existing Medicaid program. This includes an approach to budget neutrality that is expected to reduce overall expenditures in section 1115 demonstrations thereby reducing federal outlays. CMS anticipates that implementation of section 1115(g) of the Act will result in significant changes relative to the approach to determining budget neutrality described in the 2024 State Medicaid Director Letter (SMDL) (hereinafter referred to as the "current approach," as it will continue to apply until January 1, 2027). CMS expects to continue current review practices for section 1115 demonstration project approvals issued prior to January 1, 2027.

To aid state planning efforts, CMS is publishing this SMDL to provide states with early notice regarding the changes to budget neutrality that CMS intends to propose. If a final rule on this topic is not effective before January 1, 2027, CMS expects to begin applying the approach described in this letter on a provisional and temporary basis to new demonstration,[1] amendment, and renewal approvals until a final rule is effective, in light of the statutory language requiring the Chief Actuary's certification for these demonstration approvals on or after January 1, 2027. For any approvals issued on or after January 1, 2027, but before the final rule is effective, CMS would renegotiate budget neutrality if necessary to reflect changes to the methodology published in the final rule.

CMS expects to provide additional details, guidance, and technical assistance to states before January 1, 2027.

Background

Under section 1115(a) of the Act, the Secretary or CMS, operating under the Secretary's delegated authority, may authorize a state to conduct demonstration projects that, in the judgment of the Secretary, are likely to assist in promoting the objectives of title XIX of the Act. The Secretary may, (1) under section 1115(a)(1), waive provisions in section 1902 of the Act; and/or (2) under section 1115(a)(2)(A), authorize federal financial participation (FFP) for state expenditures that would not qualify for FFP under section 1903 of the Act (i.e., provide "expenditure authority"). Section 1902 of the Act lists the elements the Medicaid state plan must include, such as provisions relating to eligibility, beneficiary protections, benefits, services, and premiums. Additionally, section 1903, "Payments to States," generally describes expenditures that may be "matched" with federal title XIX dollars, allowable sources of non-federal share, and managed care requirements.[2]

CMS previously issued two SMDLs describing its approach to determining budget neutrality for Medicaid demonstration projects authorized under section 1115 of the Act. On August 22, 2018,

[1] CMS interprets the reference to "an application…" in subsection 1115(g)(1) of the Act to mean new demonstration applications. See discussion below regarding how CMS expects to apply section 1115(g) of the Act to demonstration amendments and temporary extensions.
[2] CMS reviews state requests for waiver or expenditure authority under section 1115 on a case-by-case basis to determine whether each such request is consistent with the requirements of section 1115 and other applicable laws.

CMS issued the 2018 budget neutrality SMDL.[3] On August 22, 2024, CMS issued the 2024 budget neutrality SMDL[4] that updated and superseded the 2018 budget neutrality SMDL.

Under long-standing practice, CMS has generally not approved a demonstration project under section 1115 of the Act unless the project is expected to be budget neutral to the federal government, meaning the demonstration project does not result in Medicaid costs to the federal government that are greater than what the federal government's Medicaid costs would likely have been absent the demonstration. The overarching goal of CMS's current approach to budget neutrality is to limit federal financial exposure resulting from the use of section 1115 authority in Medicaid. This existing goal is further bolstered by WFTC legislation's requirement to use an actuarially based approach to budget neutrality, which is expected to strengthen fiscal integrity.

To assess budget neutrality, CMS currently subjects each demonstration to a budget neutrality test, which results in limits that are placed on the amount of federal Medicaid funding the state may receive over the course of the demonstration approval period. Under the current approach, demonstration costs may not exceed what costs likely would have been absent the demonstration to pass the budget neutrality test. CMS refers to the projected expenditures that could have occurred absent the demonstration as the "Without Waiver" (WOW) expenditures. WOW expenditures are the basis for the budget neutrality expenditure limit. CMS refers to the actual expenditures under the demonstration as the "With Waiver" (WW) expenditures. The Medicaid Expenditure Groups (MEGs) represent the populations and projected cost of services included in or affected by the demonstration. The difference between the aggregate WW and WOW baseline expenditures is currently used to assess the budget neutrality of section 1115 demonstration projects and to measure any savings accrued or overages for those demonstrations. If a state exceeds the WOW expenditure limit, it is required to return excess federal funds to CMS. Additional information regarding CMS's current budget neutrality approach, including rebasing, midcourse correction, and savings roll over, is described in the 2024 budget neutrality SMDL.

Changes to Determining Budget Neutrality for Medicaid Demonstration Projects Required Under Section 1115(g)

Summary: Prior to section 1115(g) of the Act, the Chief Actuary for CMS did not have a role in reviewing section 1115 demonstrations or certifying demonstration budget neutrality. With this statutory change, the Chief Actuary will now need to certify that a demonstration project is not expected to cost the federal government more in Medicaid than what federal government costs would be absent the demonstration based on actuarial principles. The information states provide under the current demonstration application requirements and the current budget neutrality test are not sufficient for the Chief Actuary to certify budget neutrality, necessitating changes to the methodology. CMS intends to focus its review under section 1115(g) for budget neutrality certification on demonstration activities that are not otherwise allowable under the Medicaid state plan or other Medicaid authority.

[3] https://www.medicaid.gov/federal-policy-guidance/downloads/smd18009.pdf
[4] https://www.medicaid.gov/federal-policy-guidance/downloads/smd24003.pdf

Section 1115(g) of the Act provides as follows:

1. Beginning January 1 2027, the Secretary may not approve an application for (or renewal or amendment of) an experimental, pilot, or demonstration project undertaken under subsection (a) to promote the objectives of title XIX in a State (in this subsection referred to as a "Medicaid demonstration project") unless the Chief Actuary for CMS certifies that such project, or, in the case of a renewal, the duration of the preceding waiver, is not expected to result in an increase in the amount of federal expenditures compared to the amount that such expenditures would otherwise be in the absence of such project. For purposes of this subsection, expenditures for the coverage of populations and services that the state could have otherwise provided through its Medicaid state plan or other authority under title XIX, including expenditures that could be made under such authority but for the provision of such services at a different site of service than authorized under such state plan or other authority, shall be considered expenditures in the absence of such a project.

2. In the event that expenditures with respect to a state under a Medicaid demonstration project are, during an approval period for such project, less than the amount of such expenditures that would have otherwise been made in the absence of such project, the Secretary shall specify the methodology to be used with respect to the subsequent approval period for such project for purposes of taking the difference between such expenditures into account.

Table 1 summarizes the key elements of budget neutrality under the current approach and how they change under the new approach discussed throughout this letter. The new approach also introduces new elements to budget neutrality, which are summarized in the table below.

Table 1. Overview of Key Changes

Budget Neutrality Topic	Current Approach	New Approach
Budget Neutrality Determination	Analysis of With Waiver (WW) and Without Waiver (WOW) expenditures based on state submitted expenditure data. Initial budget neutrality analysis prior to approval; budget neutrality assessed post demonstration period.	Actuarial, economic, statistical or other comparable rigorous analysis of the projected financial impacts of individual demonstration activities. CMS Chief Actuary certifies budget neutrality of a demonstration prior to approval.
Budget Neutrality Expenditure Limit	States cannot exceed the expenditure limit published in the state's STCs, including for hypothetical expenditures. Excess federal funds must be returned to CMS.	No expenditure limits or budget neutrality cap. Demonstrations expected to result in an increase in federal Medicaid expenditures would not be approved.

Budget Neutrality Topic	Current Approach	New Approach
Expenditures in Absence of the Project	"Hypothetical" expenditures are defined as populations **or** services that the state could have otherwise covered.	Medicaid Authorizable Populations and Services (MAPS) would be defined as populations **and** services that the state could have otherwise covered, subject to guardrails. MAPS would also include SUD/SMI and re-entry (excluding infrastructure) based on site of service.
Budget Neutrality Monitoring	Quarterly and Annual reporting on budget neutrality.	States would be expected to monitor key indicators, program outcomes and expenditures, and manage the demonstration within CMS guardrails, to be defined. CMS would utilize new special terms and conditions (STCs) related to monitoring of expenditures and would require states to complete corrective actions if expenditures substantially deviate from a state's projection.
Demonstration Savings and Savings Rollover into Subsequent Renewal Period	Hypothetical and deemed expenditures do not generate savings. Current demonstration savings plus rollover of 10 years of legacy savings can be used to offset costs not otherwise matchable.	MAPS activities would not generate savings. Current demonstration period savings plus rollover of previous demonstration period savings (limited to 5 years) could be used to offset current demonstration period costs.

Chief Actuary's Role: CMS interprets the statutory language to mean the Chief Actuary must provide an actuarial opinion that meets professional actuarial standards. This includes an independent actuarial determination and attestation that a section 1115 demonstration is projected to cost the federal government no more than what the federal government would have spent absent the section 1115 demonstration in Medicaid, based on sound actuarial methods and reasonable assumptions.

New Budget Neutrality Standard: The new actuarial certification requirement introduces a new standard for determining budget neutrality and requires a change from the current approach. The current budget neutrality methodology is not based on actuarial methods, nor is the data CMS currently requires from states sufficiently detailed for the Chief Actuary to assess how the demonstration is expected to impact expenditures based on actuarial principles.

Demonstration Activities: As discussed above, section 1115 gives the Secretary two distinct authorities for approving Medicaid demonstration projects: waivers of section 1902 of the Act under section 1115(a)(1) of the Act and expenditure authority under section 1115(a)(2) of the Act. Through these authorities, states perform various “activities” under the demonstration, such as modifying Medicaid benefits and coverage, testing different eligibility criteria, implementing managed care arrangements, piloting new delivery systems, and testing alternative approaches to healthcare delivery. In this letter we use the term “activity” to refer to both waiver and expenditure authorities under a demonstration.

Overall Changes to Budget Neutrality Approach: Under the current budget neutrality approach, CMS approves demonstrations based on a preliminary assessment and expectation that the demonstration will be budget neutral at the end of the demonstration. This methodology includes a comparison of anticipated “with waiver” (WW) expenditures and “without waiver” (WOW) baseline expenditures; however, budget neutrality is determined retrospectively after the demonstration period by comparing actual WW expenditures to the WOW baseline. The current approach also allows for midcourse corrections and rebasing of the WOW baseline to account for certain situations, such as changes in circumstances outside the state’s control. Detailed information about implementation of the demonstration is generally collected post-approval.

In contrast, section 1115(g) requires the Chief Actuary’s certification as a condition of demonstration approval. As a result, the Chief Actuary’s certification is prospective, which would require a more rigorous and evidence-based analysis prior to the approval of a new demonstration, amendment, or renewal of a demonstration. There would not be a retrospective assessment of budget neutrality under the new approach; however, CMS would review current demonstration period spending and savings in the context of reviewing budget neutrality for any renewal or amendment requests. The prospective methodology would not require the use of WW and WOW baselines or expenditure limits, thus making mid-course correction and rebasing unnecessary. If actual expenditures under the demonstration result in a net increase in federal expenditures during the current demonstration period, the state would need to show how the demonstration would be budget neutral for the upcoming demonstration renewal period to qualify for certification in a renewal application. Demonstrating budget neutrality for the upcoming renewal period might require the state to make changes to the demonstration.

States would perform a separate analysis for each activity that can only be authorized under section 1115 demonstrations. CMS anticipates that states would need to provide more specific details regarding the state’s intended implementation of the demonstration prior to approval, including fully identifying eligibility and service coverage criteria, payment methodologies, and payment rates as part of the state’s financial impact analyses of demonstration activities. Transparent analysis of financial impacts on an activity-specific basis would allow states and CMS to isolate impacts of the demonstration activity, providing a more accurate assessment of how activities that could only be authorized under section 1115 demonstrations impact expenditures. The analysis would exclude impacts related to activities that a state could provide under the Medicaid state plan or other title XIX authorities. CMS anticipates that this approach would result in an overall reduction in savings available to states and would ultimately reduce federal expenditures under section 1115 demonstrations. Section 1115(g) of the Act requires the CMS Chief Actuary to certify that a demonstration project "is not expected to result in an increase in the amount of federal expenditures" generally, without differentiating between benefit and non-benefit expenditures. Therefore, CMS interprets the language in section 1115(g) of the Act to mean that all expenditures under the demonstration, including administrative costs resulting from the demonstration, need to be considered when determining budget neutrality, a change from the current approach where administrative costs are not considered as part of determining budget neutrality.

Former Hypothetical Expenditures and New MAPS Activities: CMS is changing the current approach to treating certain expenditures as "hypothetical" for purposes of budget neutrality, as further explained below. In this letter, CMS will refer to activities (applicable populations, services, and interventions) that states could otherwise have implemented under the Medicaid state plan or other title XIX authority, including expenditures that could be made under title XIX authority but for the provision of such services at a different site of service than authorized under title XIX, as Medicaid Authorizable Populations and Services (MAPS) activities.

Overview of New Approach to Determining Budget Neutrality for Medicaid Demonstration Projects Under Section 1115(g)

In the new approach, states would classify demonstration activities as 1) MAPS or 2) section 1115-only activities. The state would need to analyze the cost and savings impacts for each section 1115-only activity, inclusive of administrative costs, to determine the net financial impact of that activity. The net financial impact of the demonstration would be determined across all section 1115-only activities and used by the Chief Actuary to certify budget neutrality. The budget neutrality approach would consist of the following steps:

- Classification of Activities
- Financial Impact Analysis of each Section 1115-Only Activity
- Net Financial Impact of the Demonstration
- Determination and Certification of Budget Neutrality by the Chief Actuary
- Calculation of Current Period Demonstration Savings and Consideration of Rollover Savings

Classification of Activities

States would be required to assess each authority requested under a new demonstration application, renewal, or amendment to identify the specific activities that would be performed through the demonstration. Activities could be defined narrowly, such as for one specific section 1115 authority, or broadly, such as for a group of section 1115 authorities that together support a specific demonstration objective. For example, an uncompensated care pool might be an activity tied to one specific section 1115 authority, while providing coverage of specified home and community-based services (HCBS) to a specified, targeted population and mandating enrollment in a single dental PAHP are examples of activities which might involve multiple section 1115 authorities. Each activity should be defined by the state in a way that is consistent with its programmatic goals and how the state can measure its financial impacts. CMS would approve or request changes to a state’s classification of activities as part of approval of a state’s application, renewal, or amendment.

States would classify each proposed demonstration activity into one of the following two categories for the purpose of determining budget neutrality.

1. **Medicaid Authorizable Populations and Services (MAPS) Activities**: MAPS activities would be associated with the coverage of populations and services the state could otherwise have implemented through the Medicaid state plan or other title XIX authority, including services provided at different sites of service (DSS) than authorized under title XIX (see MAPS Definition and Relation to “Hypothetical Expenditures” section of this letter for details). Expenditures for MAPS activities under the demonstration would equal otherwise allowable expenditures absent the demonstration (including administrative costs), subject to payment methodology requirements described below, resulting in a net impact of zero on expenditures compared to expenditures absent the demonstration. MAPS activities could include activities authorized under waiver authorities, expenditure authorities, or both. CMS anticipates that activities authorized only under section 1115(a)(1) waiver authorities will predominantly be MAPS activities.

2. **Section 1115-only activities**: These activities would be defined as those that could not otherwise be implemented through the Medicaid state plan or other title XIX authority, including administrative costs. Section 1115-only activities could include waiver authorities, expenditure authorities, or both; however, CMS anticipates that section 1115-only activities will predominantly include activities authorized under expenditure authorities. These activities drive the demonstration's impact on federal expenditures and would be central to determining budget neutrality.

CMS will offer technical assistance to states in determining how to categorize section 1115 authorities into activities for purposes of determining budget neutrality.

MAPS Definition and Relation to "Hypothetical Expenditures"

Summary: In the new approach, activities providing for the coverage of populations and services that the state could have provided through its Medicaid state plan or other title XIX authority would be referred to as Medicaid Authorizable Populations and Services (MAPS), and the current approach to hypothetical expenditures would not continue. Some activities that are currently approved as hypothetical would not be considered MAPS activities. The coverage of populations and services under MAPS activities would either be equivalent to, or a subset of, the coverage that could otherwise be provided through the Medicaid state plan or other title XIX authority. Expenditures that could otherwise be made under the Medicaid state plan or other title XIX authority, but for a different site of service (DSS) such as an Institution for Mental Disease (IMD) or carceral setting, will be treated as MAPS activities. For activities to be considered MAPS, the payment terms must be consistent with the payment terms available under the Medicaid state plan or other authority under title XIX.

Hypothetical Expenditures

Under the current approach to budget neutrality, expenditures for demonstration coverage of services for a population are considered hypothetical if ***either*** the population ***or*** the services could be covered under the state plan or a section 1915 waiver. This includes expenditures for services that could not be covered under the state plan or a section 1915 waiver for the population receiving them under the demonstration. For example, under the current approach, expenditures on coverage of section 1915(c) waiver assistive technology for state plan beneficiaries who cannot be eligible for those services under title XIX (because they cannot be eligible for a section 1915(c) waiver) could be treated as hypothetical. Beginning in September 2022, CMS also treated certain social determinants of health (SDOH) expenditures that are authorized under section 1115 authority as "hypothetical" expenditures in demonstration approvals. This is described in detail in the 2024 Budget Neutrality SMDL. Under the current approach, savings are not generated from hypothetical expenditures.

Section 1115(g) of the Act refers to populations ***and*** services that the state could have otherwise provided under its state plan or other title XIX authority. Because section 1115(g) of the Act uses "and," not "or," to refer to these populations and services, after January 1, 2027, CMS would no longer use its current definition of hypothetical expenditures and would instead interpret this language in section 1115(g) of the Act to apply only when the specific combination of population and services could otherwise have been covered under the Medicaid state plan, or other title XIX authority. This includes coverage for a subset of what could have otherwise been provided under the Medicaid state plan or other title XIX authority, such as partial new adult group expansions with coverage meeting the requirements of section 1937 of the Act, and coverage of family planning services less than state plan coverage for a population eligible to receive family planning services under the state plan. We refer to these activities as Medicaid Authorizable Populations and Services (MAPS). CMS anticipates that under the new definition, some activities that are currently approved as hypothetical would not be considered MAPS. In particular, providing Medicaid services for a population that could not otherwise be eligible to receive those services under state plan or other title XIX authority (like section 1915) would not be considered MAPS. For example, under the new approach, expenditures for coverage of section 1915(c) waiver assistive technology for state plan beneficiaries who are not eligible for a section 1915(c) waiver could not be treated as MAPS, because the services could not be covered for this specific population under section 1915(c). See additional examples of hypothetical expenditures that CMS has previously approved, and how they would be classified under the new approach, in Appendix B. CMS anticipates that in most cases, activities authorized only under section 1115(a)(1) waiver authority would be a MAPS activity.

Treatment of MAPS Activities for Net Financial Impact of Demonstration

If an activity qualifies as MAPS, expenditures for the activity would be treated as equivalent to expenditures absent the demonstration and therefore would have a net financial impact of zero for the purpose of the budget neutrality determination. States would not have to provide a detailed financial impact analysis for MAPS activities; however, states would need to demonstrate that MAPS activities could otherwise have been provided through the Medicaid state plan or other title XIX authority and would need to attest that payment terms would not be different for MAPS activities when provided under the demonstration (versus provided under the Medicaid state plan or other title XIX authority). Consistent with its longstanding approach with respect to hypothetical expenditures, CMS would not allow states to generate savings from MAPS activities.

In its application, a state would need to demonstrate to CMS that requested MAPS activities meet the MAPS definition. If a state requests a new MAPS activity, or requests that an existing expenditure previously considered hypothetical be renewed as a MAPS activity, CMS would confirm that the activity meets the MAPS definition. When requesting that activities be treated as MAPS activities, a state would be required to show how the coverage of populations and services are, or otherwise could have been, provided through its Medicaid state plan or other authority under title XIX. While a detailed analysis of the financial impacts of the activity would not be required for MAPS, a state would still be required to provide the federal budget impact for MAPS activities. Projected MAPS expenditures would need to be provided for each year of the upcoming demonstration period, and historical MAPS expenditures would need to be provided for each year of the current demonstration period for renewals and amendments. If an activity is determined not to meet the definition of MAPS, it would be considered a section 1115-only activity and the state would be required to submit a detailed analysis of the financial impacts of the activity.

Different Site of Service (DSS)

Section 1115(g) of the Act describes certain expenditures that could otherwise be made under the Medicaid state plan or other authority under title XIX, but for the provision of such services at a different site of service (DSS) than authorized under state plan or other title XIX authority, for example, expenditures which would have been otherwise allowable under Medicaid were it not for the institution for mental diseases (IMD) payment exclusion. These activities are also considered MAPS activities because the services provided and the populations covered are all state plan populations and services for which these populations are eligible. The following expenditures (which are currently considered to be hypothetical expenditures) would qualify as MAPS at a DSS:

- Expenditures for services furnished to beneficiaries who are residing in an IMD primarily to receive treatment for a substance use disorder (SUD), serious mental illness (SMI), or serious emotional disturbance (SED) — which would have been otherwise allowable under Medicaid were it not for the IMD payment exclusion[5, 6] and

- Expenditures for pre-release services (not infrastructure) furnished to certain incarcerated individuals who are soon-to-be former inmates of a public institution during a specified pre-release period – which would have been otherwise allowable under Medicaid were it not for the public institution payment exclusion (also referred to as the inmate payment exclusion).[7]

Payment Methodology Requirements

If an activity meets the MAPS definition, then it would be considered equivalent to expenditures absent the demonstration, subject to the following guardrails. First, as part of the state's analysis, state would be required to show that the populations and services could have otherwise been provided through its Medicaid state plan or other authority under title XIX. Second, the state would be required to attest that the payment methodology for these populations and services is authorized under the Medicaid state plan or other title XIX authority, or consistent with the payment terms under the Medicaid state plan or other title XIX authority. The second guardrail is intended to prevent payment methodologies under the demonstration project that exceed what the state could pay for the same or comparable services under Medicaid state plan or other title XIX authority.

Financial Impact Analysis of Each Section 1115-Only Activity

Summary: States would be required to provide an analysis of the financial impacts of each section 1115-only activity to facilitate the Chief Actuary's certification of budget neutrality for a demonstration. States would analyze the costs and savings resulting from each specific section 1115-only activity. The state's analysis may be actuarial, economic, or statistical, or another comparable rigorous approach. CMS does not intend to prescribe a specific type of analysis, but it should be well-documented to enable the Chief Actuary to assess its conclusions, including the data, assumptions, and methodologies used in its development. Prospective analyses for the upcoming demonstration period will be required for new demonstrations and new activities in renewals or amendments, while both historical and prospective analyses will be required for renewals.

States would be required to analyze the specific ways in which each section 1115-only activity results in increases and/or decreases in Medicaid expenditures to determine each activity's net financial impact. This would include analyzing direct costs associated with the activity (e.g.,

[5] See State Medicaid Director Letter #17-003, Strategies to Address the Opioid Epidemic. Available at https://www.medicaid.gov/federal-policy-guidance/downloads/smd17003.pdf.

[6] See State Medicaid Director Letter #18-011, Opportunities to Design Innovative Service Delivery Systems for Adults with a Serious Mental Illness or Children with a Serious Emotional Disturbance. Available at https://www.medicaid.gov/federal-policy-guidance/downloads/smd18011.pdf.

[7] See State Medicaid Director Letter #23-003, Opportunities to Test Transition-Related Strategies to Support Community Reentry and Improve Care Transitions for Individuals Who Are Incarcerated. Available at https://www.medicaid.gov/federal-policy-guidance/downloads/smd23003.pdf.

costs of services included in the activity, providing coverage to additional populations, etc.) and any other impacts in costs or utilization specifically resulting from the activity (e.g., increased utilization of preventative services, reduced emergency department visits, shifting utilization to different care settings, etc.). This approach would exclude the effects that are not directly related to the activity from consideration in budget neutrality so that the effects of the activity on expenditures can be better identified. Analyzing data on the effects of each section 1115-only activity would allow states and CMS to assess how specific activities under the demonstration affect expenditures and could inform states and CMS about cost-effective activities and initiatives.

For all section 1115-only activities, states would be required to provide an analysis of the financial impacts for each of these activities for the duration of the requested authority. The analysis could be actuarial, economic, or statistical, or another comparable rigorous approach. The analysis and applicable context and rationale would also need to be sufficiently thorough and well-documented to enable the Chief Actuary to assess its conclusions, including the data, assumptions, and methodologies used in its development. This analysis would generally be on a Per Member Per Month (PMPM) basis or a percentage cost basis, except for lump sum amounts (such as uncompensated care and disproportionate share hospital pools, delivery system investments, etc.), which would be provided as aggregate costs for each year of the requested duration of the initiative. Where PMPM analyses are used, enrollee count estimates should also be included to develop aggregate impacts for all years of the demonstration approval period.

At this time, CMS does not intend to prescribe a specific type of analysis that states would be required to conduct in analyzing the financial impacts of an activity. Given the vast variation in the scope of demonstrations and the types of demonstration activities included in demonstrations across states, we believe that states are best positioned to determine the most appropriate type of analysis for the activities in their demonstrations. States would not need an actuary to perform the analysis. States could also draw on robust analytic approaches used in demonstration evaluations. For example, CMS has issued technical guidance on the economic evaluation of demonstrations that outlines quantitative methods that may be applicable in this context.[8, 9] While that guidance does not apply directly to the current budget neutrality framework—and may require adjustment depending on the scope of the demonstration and specific financial impacts analyzed for activities—it may still serve as a useful reference as states begin planning efforts to transition to the new budget neutrality approach. We expect to provide additional details and technical guidance to assist states in developing analyses of the financial impacts of demonstration activities before January 1, 2027.

1. **Analysis of increases in expenditures (i.e. costs) resulting from the activity**. As part of the analysis of each section 1115-only activity, states would need to identify and quantify all increases in expenditures related to the activity, including direct costs of providing the section 1115-only activity (e.g., costs of services, benefits, populations that could only be covered under section 1115 authority) and any changes the activity has on utilization or costs for services and populations not specifically accounted for in the direct costs of the

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[8] https://www.medicaid.gov/medicaid/section-1115-demonstrations/downloads/section-1115-demo-eval-design-reporting.pdf
[9] https://www.medicaid.gov/medicaid/section-1115-demonstrations/downloads/section-1115-demo-guide-assessing-demo-cost.pdf

activity (e.g., increased state plan service utilization due to improved access or care coordination). While a MAPS activity itself would result in a financial impact of zero, a section 1115-only activity could have impacts on populations or services provided through MAPS, and these impacts would also need to be considered in the state's analysis (see the illustrative example below).

2. **Analysis of administrative costs.** Additionally, when analyzing increases in expenditures resulting from a section 1115-only activity, all administrative costs associated with the section 1115-only activity would need to be considered. Administrative costs would be analyzed by comparing the administrative costs under the demonstration to those that would have been paid absent the demonstration. CMS expects to provide additional details and technical guidance on the treatment of administrative costs to states before January 1, 2027.

3. **Analysis of decreases in expenditures (i.e. savings) resulting from the activity.** States would also need to identify and quantify the specific ways the activity results in decreases in expenditures, which might include reductions in utilization or costs for other services and populations, avoided costs due to improved health outcomes or care efficiency, or any other demonstrable decreases in expenditures attributable to the activity. States would need to clearly show that these financial impacts result directly from the demonstration activity.

For example, if a state used expenditure authority to add a new service that could only be covered under section 1115 for state plan eligible populations, the state would analyze and quantify the direct costs of providing the new service, including administrative costs, and any increases or decreases in costs or utilization in state plan services, other title XIX services, MAPS activities, or other section 1115-only activities resulting from providing the new service.

States would also need to provide the financial impacts of the activity for each year of the demonstration period, and across all years in the demonstration period. For each activity, the net financial impact would be calculated as the total increase in expenditures minus the total decrease in expenditures across the entire demonstration period. The budget neutrality determination would be made on the net financial impact across all activities for the entire demonstration period.

Example of Interaction Between MAPS and Section 1115-only Activities

The following is an example of how the analysis may consider the impacts a section 1115-only activity has on a MAPS activity. In this example, a demonstration has two activities:

1. The state expands eligibility of state plan services to a population that could be included in an optional coverage group under the state plan using state plan payment methodologies; and

2. The state adds coverage of 1915(c) waiver assistive technology for state plan beneficiaries who are not eligible for a 1915(c) waiver, including for individuals in the new group covered in the demonstration.

The services for the new eligibility group that could be covered under the state plan would be a MAPS activity because the state could have covered these services for this group under the state plan and the state is covering this population using state plan approved payment methodologies. The costs of covering these individuals under the demonstration would be considered equivalent to expenditures absent the demonstration, and thus the net financial impact of covering this population would be considered to be zero for the purposes of determining budget neutrality.

The 1915(c) waiver assistive technology for state plan beneficiaries who are not eligible for a 1915(c) waiver would be considered a section 1115-only activity because the state could not cover assistive technology for this population under the state plan or other title XIX authorities. The specific ways in which the activity results in increases and/or decreases to expenditures would need to be analyzed as part of the budget neutrality determination. For example, the provision of the assistive technology, including administration, would be a direct cost of providing the activity. Further, states may seek to test if populations receiving the assistive technology experience health improvements that reduce their reliance on and utilization of state plan services. Should there be reduced utilization of state plan services, this would result in decreased expenditures. The state would need to demonstrate that the decrease in utilization of state plan services results from the assistive technology.

The analysis of the increases and/or decreases in expenditures resulting from the assistive technology would include any financial effects on all populations receiving it, including those in the new eligibility group in the MAPS activity. For example, if the net impact of providing the 1915(c) assistive technology was a decrease of $10 PMPM for individuals in the new MAPS eligibility group, such decreases could be credited as decreases in expenditures for the purposes of budget neutrality. Similarly, if the net impact was an increase of $10 PMPM for the new MAPS eligibility group, such increases would be treated as increases in expenditures for the purposes of budget neutrality.

New Demonstrations and Renewals

For new demonstrations and new activities in renewals or amendments, states would be required to provide prospective analyses only. The analysis of the financial impacts resulting from each activity would likely rely on modeling, simulation, estimation, or other experience and research of comparable activities already used or tested elsewhere. This could be experience in other Medicaid programs or other healthcare programs in the state or other states.

For demonstration renewals, states would provide a historical analysis of the activities in the current demonstration period and a prospective analysis for the upcoming demonstration period. The financial impacts for the upcoming demonstration period would generally be informed by the financial impacts in the historical analysis but would also consider how the financial impacts may change in the future. For example, when analyzing a historical activity, there may be early start-up costs that are not likely to be incurred again, or the level by which an activity decreases expenditures may be projected to increase over time. The historical analysis for the current demonstration period would also be used to determine the amount of current demonstration period savings a state could use in the subsequent renewal period, described further below in this letter.

Each renewal application would include two financial analyses:

1. A historical analysis covering the demonstration period immediately preceding the requested renewal period, reflecting actual experience during that period.

2. A prospective analysis covering the upcoming requested renewal period, reflecting projected estimates for that period.

The two analyses would cover consecutive demonstration periods. For example, a state requesting renewal for demonstration years 6–10 would submit a historical analysis for years 1–5 and a prospective analysis for years 6–10. If the state later requests renewal for years 11–15, the state would submit a historical analysis for years 6–10 and a prospective analysis for years 11–15.

Table 2. Renewal Request Financial Analysis Timeframes

Renewal Request	Historical Analysis	Prospective Analysis
1st Renewal (Years 6–10)	Years 1–5 (actual data)	Years 6–10 (projected estimates)
2nd Renewal (Years 11–15)	Years 6–10 (actual data)	Years 11–15 (projected estimates)

The same demonstration period might appear in both a prospective analysis, at the first renewal, and a historical analysis, at a subsequent renewal. CMS expects the financial figures for that period might differ between the two analyses because the prospective analysis reflects assumptions about expected future experience, while the historical analysis reflects actual experience in the demonstration.

The historical analysis of the current demonstration period would include the financial impacts of all activities approved during the current demonstration period, and the prospective analysis for the upcoming demonstration period would include all activities the state was seeking approval for in the upcoming demonstration period. If a state were seeking to renew a demonstration, but not seeking to renew all activities approved in the current demonstration period, the authorities related to the activities the state is not seeking to renew would expire at the end of the current demonstration period. The state would include the financial impacts of the discontinuing activities as part of the historical analyses of the current demonstration period but not include the discontinuing activities as part of the prospective analyses for the upcoming demonstration period.

Net Financial Impact of the Demonstration

Once the net financial impact is determined for each section 1115-only activity, the impacts across all activities would be added together to determine the net financial impact of the demonstration. All data and analyses provided by states would be on a total computable basis, with state share and federal share identified. CMS's review of budget neutrality would consider total and federal expenditures. The Chief Actuary's certification of budget neutrality would be based only on federal expenditures. CMS's monitoring of demonstration spending after approval would consider total and federal expenditures.

Determination and Certification of Budget Neutrality by the Chief Actuary

Summary: CMS would review the state's analysis of the financial impacts of each section 1115-only activity in the demonstration, and determine the net financial of the demonstration for the upcoming demonstration period. The net financial impact of the demonstration for the upcoming demonstration period would be used by the Chief Actuary to determine budget neutrality.

CMS would review the state's analyses and accompanying narrative support, including the state's detailed analysis of the financial impact for each specific activity (including data, assumptions, and methodology used to develop costs and savings) and the net financial impact across all activities.

CMS would determine the net financial impact of the demonstration for the upcoming demonstration period as the sum of the net financial impacts across all activities for the upcoming demonstration period. If the projected net financial impact of the demonstration is less than or equal to $0 for the upcoming demonstration period, then the Chief Actuary could determine the demonstration is not expected to increase expenditures and certify it to be budget neutral. However, if the projected net financial impact of the demonstration is greater than $0 for the upcoming demonstration period, then the demonstration is expected to increase expenditures. The Chief Actuary would not certify budget neutrality, and the demonstration would not be approved, unless the state is projected to have sufficient rollover savings to offset the projected costs in the upcoming demonstration renewal period.

CMS anticipates that it would have questions about the state's analysis and CMS would issue requests for additional information as part of the review and determination of budget neutrality. This may include multiple rounds of questions and could require reclassification of activities and additional analysis from states. For this reason, CMS would not have a fixed time frame for its review of budget neutrality. If changes are made to the proposed demonstration during negotiations between the state and CMS after the initial analysis is submitted and prior to approval, additional review would be required and CMS may require the state to provide additional analysis before a certification of budget neutrality can be finalized.

Calculation of Current Period Demonstration Savings and Consideration of Rollover Savings

Summary: If a demonstration results in net savings during the current demonstration period these net savings would roll over into the immediately following renewal period to offset projected increases in expenditures, but would not carry forward beyond that single renewal period. A transition period would be established for the first renewal after January 1, 2027, allowing states to use savings calculated under the existing 2024 budget neutrality methodology, limited to the most recent five years of the current demonstration period and the 15 percent cap on rollover savings described in the 2024 SMDL would no longer apply. After this transition, rollover savings would be calculated using a new methodology based on historical analysis of section 1115-only activities.

Calculation of Current Period Savings

Under the new budget neutrality methodology, when a state requests to renew a demonstration, current period demonstration savings would be calculated during CMS's review of budget neutrality for the upcoming demonstration period. As illustrated in Table 3, using the state's historical analysis for the current demonstration period, CMS would determine the net financial impact of the demonstration for the current demonstration period as the sum of the net financial impacts across all activities for the current demonstration period. If the net financial impact of the demonstration in the current demonstration period is less than $0, then net savings were generated for the current demonstration period. These current demonstration period net savings would be available for use in the upcoming demonstration period. However, if the net financial impact of the demonstration in the current demonstration period is $0 or more, no current period net demonstration savings were generated for use in the upcoming demonstration period.

Table 3. Examples of Calculation of Current Period Savings (for DYs 1-5) available to roll over to Subsequent Demonstration Renewal Period (DYs 6-10) (in millions)

Example #	Historical Analysis of Current Demonstration Period (DYs 1-5) Net Financial Impacts			Current Period Savings Available to Roll Over to Upcoming Demonstration Renewal Period (DYs 6-10)
	Section 1115-Only Activity 1	Section 1115-Only Activity 2	Demonstration	
	(a)	(b)	(c = a+b)	(d = min (c, 0))
Example 1	$10.0	-$5.0	$5.0	$0.0
Example 2	$5.0	-$15.0	-$10.0	-$10.0

Table 3 Explanation

1. *Example 1*. From the historical analysis of the current demonstration period, section 1115-only activity 1 has a net financial impact of $10 million, shown in column (a) and section 1115-only activity 2 has a net financial impact of -$5 million, shown in column (b). The net financial impact of the demonstration, shown in column (c), is $5.0 million. The demonstration did not generate savings in the current demonstration period; therefore, no savings are available to roll over to the upcoming demonstration period, as shown in column (d).

2. *Example 2.* Section 1115-only activity 1 has a net financial impact of $5 million, shown in column (a) and section 1115-only activity 2 has a net financial impact of -$15 million, shown in column (b). The net financial impact of the demonstration, shown in column (c), is -$10 million. Therefore, the current demonstration period saved $10 million, which rolls over to the next demonstration period.

Because the budget neutrality certification for a renewal would generally need to be completed before the actual savings from the current period are known, CMS expects that the budget neutrality determination would need to be completed using estimated savings from the current period. These estimated savings would be based on data available up to the date of the state submitting its analysis (for example, the first 4 years of a demonstration period) and could include projected savings for the remaining time of the current demonstration period. CMS would review the historical analysis of the financial impacts for the current demonstration period, and any resulting net savings, as part of the budget neutrality review for the upcoming demonstration renewal period. States would be required to provide supporting documentation of the data, assumptions and methodologies used to calculate actual and estimated savings.

Rollover Policy

Rollover savings would be limited to those accrued during the current demonstration period, or the most recent five years, whichever is shorter, and would not include any temporary extension period. Application of a five-year limit would promote consistency across states by applying the same timeframe for calculating rollover savings, regardless of varying demonstration approval periods and length of temporary extensions. It also would promote fiscal responsibility by limiting the amount of unused savings that can roll over into the next renewal period.

Current period savings could be rolled over and considered in determining budget neutrality for a renewal of a demonstration if the net financial impact of the demonstration for the upcoming renewal period is greater than $0, as illustrated in the examples in Table 4. The amount of current demonstration period net savings that could be rolled over into the subsequent renewal period would be determined at the time of the renewal application and calculated from the historical analysis of the current demonstration period. Current period savings would only be rolled over into the first renewal period immediately following the current demonstration period and would not roll over into subsequent approval periods. This limitation reflects the statutory language of section 1115(g)(2) of the Act, which does not reference the use of rollover savings in approval periods beyond the subsequent approval period. This approach also aligns with CMS's intent to limit federal financial exposure by not permitting unused savings to continue to roll over into future demonstration periods. This approach is expected to give states access to less demonstration savings than would have been available under the current approach, under which savings rollover has been permitted as described in the 2018 budget neutrality SMDL and the 2024 budget neutrality SMDL. The table below shows two examples of demonstrations and how rollover savings would be used in the upcoming renewal period.

Table 4. Examples of Consideration of Rollover Savings in the Determination of Budget Neutrality for the Subsequent Demonstration Renewal Period (DYs 6-10) (in millions)

Example #	Rollover Savings from Current Demonstration Period (DYs 1-5)	Prospective Analysis of Upcoming Demonstration Period (DYs 6-10)				
		Net Financial Impacts				
		Section 1115-Only Activity 1	Section 1115-Only Activity 2	Demonstration	Consideration of Rollover Savings	Budget Neutrality Certification Outcome
	(a)	(b)	(c)	(d = b+c)	(e) if d>0, d+a	(f) is d<=0 Or is d+a<=0
Example 1	$0.0	$5.0	-$10.0	-$5.0	N/A	Certify
Example 2	-$10.0	$5.0	$0.0	$5.0	-$5.0	Certify

Table 4 Explanation

1. *Example 1.* As shown in column (a), there are no rollover savings from the current demonstration period. From the prospective analysis of the upcoming demonstration period, the net financial impact of the demonstration, column (d), is -$5 million. Because the net financial impact is less than $0, the demonstration can be certified as budget neutral for the upcoming demonstration period without consideration of rollover savings.

2. *Example 2.* As shown in column (a), there is $10 million in rollover savings from the current demonstration period. The net financial impact of the demonstration is $5 million in the prospective analysis of the upcoming demonstration period, which is greater than $0. As shown in column (e), rollover savings from column (a) are used to offset the net cost of the demonstration from column (d). Because the available rollover savings are greater than the net cost of the demonstration, the demonstration can be certified as budget neutral for the upcoming demonstration period.

Savings Transition Period (First Renewal After January 1, 2027)

CMS will provide a savings transition period for the first renewal of a demonstration project after January 1, 2027. During this transition, states would be permitted to roll over current period demonstrations savings calculated under the state's current STCs using the budget neutrality policy described in the 2024 SMDL, which compares WW to WOW expenditure limits. However, the transition period savings amount that could be used in the upcoming renewal period would be calculated at the time of CMS's review of budget neutrality for the renewal. Rollover savings would be limited to those accrued during the current demonstration period, or the most recent five years, whichever is shorter, and would not include any temporary extension period. After the savings transition period, the amount of current period demonstration savings that could be used in the next renewal period would be determined under the new approach for calculation of current period savings.

For the first renewal of a demonstration after January 1, 2027, CMS will do a final assessment of budget neutrality for the current demonstration period using the 2024 SMDL policy to determine the amount of transition period demonstration savings available for the upcoming demonstration period. This one-time rollover of up to five years of current period demonstration savings using the current budget neutrality methodology is anticipated to aid a state's transition from the current budget neutrality approach to the new approach under section 1115(g) of the Act, giving states that rely on demonstration savings one demonstration period to make changes to their demonstration if necessary for the next certification of the demonstration project.

Amendments to the Demonstration

Summary: For amendments to demonstrations that the Chief Actuary has not previously certified to be budget neutral, the Chief Actuary would review all demonstration activities and certify that the entire demonstration is budget neutral. For amendments to demonstrations that the Chief Actuary has already certified to be budget neutral, the Chief Actuary would review only the demonstration activities that are amended or affected by the changes in the amendment. States would not need to resubmit analyses for activities that are not affected by the amendment and were previously reviewed by the Chief Actuary. However, the Chief Actuary would still certify budget neutrality for the entire amended demonstration. A state that amends its demonstration project on or after January 1, 2027, but prior to renewal, would not generate the maximum level of rollover savings that would have otherwise generated under the current budget neutrality methodology by the end of the current demonstration period. Once the amended demonstration project is certified by the Chief Actuary the state will no longer be able to generate demonstration savings under the 2024 SMDL budget neutrality approach.

Budget Neutrality Analyses and Certification for Amendments

States may request amendments to existing demonstrations during the current demonstration approval period. A budget neutrality certification from the Chief Actuary must be in place for the entire duration of the current demonstration period (the currently approved demonstration period before the amendment and the amended demonstration period) before CMS could approve an amendment on or after January 1, 2027.

For amendments to demonstrations that the Chief Actuary has not previously certified to be budget neutral, CMS expects that the Chief Actuary would need to certify that the entire demonstration for the full current demonstration period is budget neutral as a condition of approving the amendment. States would therefore need to provide analyses of the financial impacts of all activities in the demonstration (including activities not being amended) for the entire duration of the current demonstration period (the currently approved demonstration period before the amendment and the remainder of the current demonstration period after the amendment). States would also be required to provide a historical analysis for the demonstration period immediately prior to the current demonstration period. The historical analysis for the prior demonstration period (that is, the demonstration period prior to the current demonstration period the state is seeking to amend) will be used to assess the reasonableness of projections for the current demonstration period, including before and after the amended period of the current demonstration period.

For amendments to demonstrations that the Chief Actuary has already certified to be budget neutral, the Chief Actuary would review only the impacts of the amendment, with consideration of the previously determined aggregate net financial impact of the demonstration, before the amendment could be approved. The Chief Actuary's review would include impacts directly related to the changes in the amendment (such as discontinuing a current activity, changing a current activity or adding a new activity), but could also include interactions with other parts of the demonstration (which may include MAPS and section 1115-only activities) that are affected by the changes in the amendment. States would therefore need to provide prospective analyses of the financial impacts of the activities being amended and for any other activities affected by the amendment for the amended portion of the current demonstration period. States would not need to resubmit analyses for activities that are not affected by the amendment and were previously reviewed by the Chief Actuary. The Chief Actuary would review the changes in the amendment and certify budget neutrality for the entire amended demonstration with consideration of the analyses of the activities not affected by the amendment which were previously reviewed by the Chief Actuary.

If a state amends a current demonstration to discontinue a current activity, the state would not need to quantify the financial impacts of the activity the state is requesting to discontinue for the amended portion of the current demonstration period; however, the state would need to analyze how the discontinued activity impacts the costs and utilization of other activities in the demonstration and quantify those financial impacts in the prospective analyses for the amended portion of the current demonstration period.

At the subsequent renewal request, the state's historical analysis of the current demonstration period would account for the duration for which the changes in the amendment were in effect during the current demonstration period. For example, if a state's current demonstration approval period was demonstration years 1-5 and the state amended its current demonstration to discontinue an activity at the start of year 4, when the state applies for renewal for demonstration years 6-10, the state would quantify the financial impacts of the discontinued activity for years 1-3 only in the historical analyses of the current demonstration period. Similarly, if the state had amended the demonstration to add a new activity at the start of year 4, and was seeking renewal for demonstration years 6-10, the state would provide the financial impacts of the new activity for years 4 and 5 only for the historical analyses of the current demonstration period.

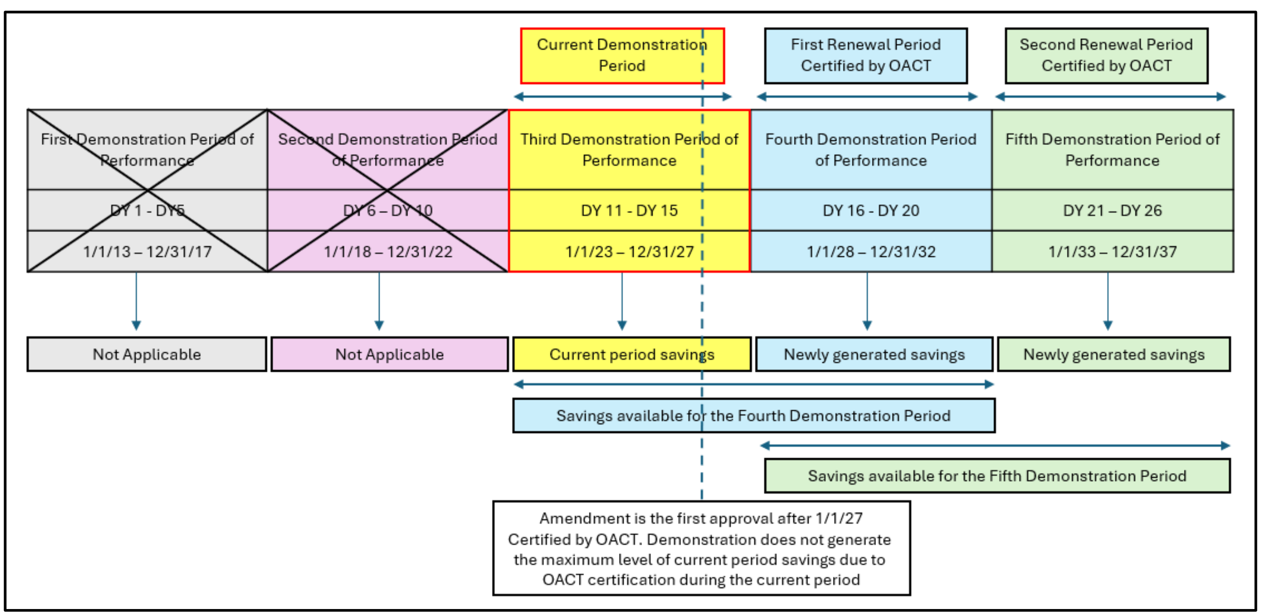
Impact on Savings of Mid-Period Amendments on or After January 1, 2027

A state that amends its demonstration project on or after January 1, 2027, but prior to renewal, would not generate the maximum level of rollover savings it could have otherwise generated under the current budget neutrality methodology by the end of the demonstration period. Once the amended demonstration project is certified by the Chief Actuary and approved by CMS, the STCs will change to reflect the new budget neutrality approach. An assessment of the savings generated under the demonstration STCs will be made prior to the date of the amendment, and after that point the state will no longer be able to generate demonstration savings under the 2024 SMDL budget neutrality approach. For the remainder of the demonstration approval period following amendment approval, CMS would apply the new approach to measuring financial impacts of the demonstration. This would impact the amount of transition period savings available to the state during the amended demonstration period and the amount of rollover savings that could be used in the subsequent renewal period

Example: If a state has a five-year demonstration period and generates $1 million in savings per year, under the 2024 SMDL budget neutrality approach, it would accumulate $5 million in savings over the full period. However, if the state has an amendment approved after January 1, 2027 at the end of year four, it will have accrued only $4 million under the current methodology, forgoing the final year of rollover savings that would have been calculated under the 2024 SMDL approach. Savings generated in the 5th year will be determined based on the financial impact analysis of the demonstration's activities during the 5th year. During the amended demonstration period, the state would have access to the $4 million determined under the 2024 SMDL approach and any aggregate net demonstration savings calculated in the prospective analysis for the 5th year. At the subsequent renewal for demonstration years 6-10, the historical analysis would determine the current period savings that could be rolled over to the subsequent renewal, which would include the $4 million determined under the 2024 SMDL approach and any aggregate net demonstration savings or costs calculated in the historical analysis for the 5th year.

Figure 1 provides an overview of demonstration savings accumulated in various demonstration periods and when the demonstration savings from each demonstration period may be used in a future renewal period.

Figure 1: Overview of Demonstration Savings by Demonstration Period



Authorities Deemed Budget Neutral

Summary: CMS no longer anticipates deeming certain expenditures to be budget neutral. Instead, states would submit a detailed financial analysis for all demonstration authorities previously deemed budget neutral for the purpose of determining budget neutrality certification. In limited circumstances, CMS would expedite the budget neutrality review for demonstration applications, renewals, or amendments that would address public health emergencies (PHE) under the conditions outlined below.

Under CMS's current budget neutrality approach, CMS excepts certain demonstration expenditures from budget neutrality limits by deeming them budget neutral, while still requiring states to report total expenditures and member months for these expenditures in demonstration monitoring reports. Under the current approach, savings are not generated from demonstration expenditures that are deemed budget neutral. Authorities currently deemed budget neutral include demonstration initiatives that include only section 1115(a)(1) waiver authorities, demonstration coverage for out-of-state Former Foster Care Youth (FFCY), demonstrations for U.S. Territories, authority for Traditional Health Care Practices (THCP), and authority for a state to operate a single managed care plan. Under the new budget neutrality methodology, CMS anticipates no longer deeming demonstration expenditures budget neutral. All demonstration authorities previously deemed budget neutral would be required to meet the budget neutrality requirements set forth in section 1115(g) of the Act for new demonstration approvals, or at the next amendment or renewal approval on or after January 1, 2027 for currently approved demonstration projects.

CMS no longer anticipates deeming certain expenditures to be budget neutral because this approach was based on a theoretical principle that certain demonstration authorities are likely to be budget neutral to the federal government. This theoretical principle is not expected to meet the actuarial standards for certification by the Chief Actuary. Also, in some instances, CMS chose to deem certain demonstration authorities budget neutral that could have met the definition of "hypothetical" as described above, and CMS seeks to apply a more streamlined approach to budget neutrality certification. Some activities previously deemed budget neutral might be considered a MAPS activity under the new approach (see Appendix B for examples).

Public Health Emergency Demonstration Projects

In limited circumstances, CMS would expedite the budget neutrality review for demonstration applications, renewals, or amendments that would address public health emergencies (PHE). Expedited budget neutrality review for a PHE-related demonstration request would be considered only when the President declares a state of emergency under the Robert T. Stafford Disaster Relief and Emergency Assistance Act[10] or the National Emergencies Act,[11] and the Secretary of Health and Human Services also declares a public health emergency in the affected geographic area under section 319 of the Public Health Service Act.[12]

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[10] The Robert T. Stafford Disaster Relief and Emergency Assistance Act, codified at 42 U.S.C. §§ 5121–5207.
[11] The National Emergencies Act, codified at 50 U.S.C. §§ 1601–1651.
[12] Section 319 of the Public Health Service Act, codified at 42 U.S.C. § 247d.

In addition, expedited budget neutrality review for PHEs would be considered only with respect to state requests for section 1115(a)(1) demonstration waiver authority for comparability (section 1902(a)(10) or 1902(a)(17)), statewideness (section 1902(a)(1)), and certain waivers of the requirement to provide for methods of administration necessary for the proper and efficient operation of the Medicaid state plan (section 1902(a)(4)). Expedited budget neutrality review for PHEs would also be considered when approving section 1115(a)(2) expenditure authority to address a PHE for an eligibility group covered under section 1115 demonstration authority that could have otherwise been covered through the Medicaid state plan or another authority under title XIX, if the new expenditure authority to address the PHE is comparable to PHE-related authorities available under the Medicaid state plan or waiver authorities for the same population. For example, CMS may approve an Appendix K through section 1915(c) waiver authority to address a PHE. If a state's section 1115 demonstration project includes coverage for a population that could have otherwise been covered under 1915(c) waiver authority, CMS may approve an Appendix K for the demonstration population, as long as it is comparable to what is otherwise allowable under the 1915(c) waiver Appendix K authority.

Expedited review of budget neutrality for PHE-related applications, amendments, and renewals would be considered only when it is determined that only section 1115 demonstration authority is available to address the PHE-related request, and no other authorities, such as section 1135 waivers, the Medicaid state plan, or 1915 waivers, could be used to address it. Any other requests for demonstration authority to address a PHE would not be subject to an expedited budget neutrality review process.

Applicability to Children's Health Insurance Program (CHIP)

In addition to section 1115 demonstration projects for Medicaid, CMS also approves section 1115 demonstration projects for CHIP, authorized under title XXI of the Act. Section 2107(e)(2)(A) of the Act provides that section 1115 (relating to waiver authority) applies to a state under title XXI in the same manner as it applies to a state under title XIX. The only reference to title XXI (CHIP) in section 1115 of the Act is in section 1115(d), added by the Affordable Care Act in 2010, which describes transparency requirements for section 1115 demonstrations. Title XXI is not expressly mentioned in section 1115(g) of the Act, which was enacted after section 1115(d) of the Act. Although section 2107(e)(2)(A) of the Act provides that section 1115 (relating to waiver authority) applies to a state under CHIP in the same manner as it applies to a state under Medicaid, the mention of title XXI in the section 1115(d) transparency requirements and subsequent omission of title XXI in the later-enacted budget neutrality requirements at section 1115(g) of the Act supports the interpretation that section 1115(g) does not apply to CHIP demonstration projects.

The requirements in section 1115(g) of the Act would not apply to CHIP section 1115 demonstration projects. Consistent with current practice, a state would be eligible to receive title XXI funds for allowable title XXI demonstration expenditures, up to the amount of its title XXI allotment. Title XXI funds would first be used to fully fund costs associated with CHIP state plan populations. CHIP section 1115 demonstration project expenditures would be limited to remaining funds.

Transitional Impacts

Assessment of Current Demonstration Projects

Under the current budget neutrality approach, expenditure limits are established in the demonstration project's STCs. CMS expects to continue to monitor and assess budget neutrality using the approved STCs for all currently approved demonstration projects through the end of each demonstration's current approval period, including those with an approval period that extends past January 1, 2027. After the end of the current demonstration period, CMS would conduct a final assessment of budget neutrality using the current approach outlined in the budget neutrality agreement in the STCs, including a comprehensive review of state-reported expenditure data once expenditure reporting is complete and all allowable claims have been submitted and adjudicated following the applicable Medicaid timely filing period and federal claiming deadlines for the current demonstration period to confirm that the state has not exceeded its budget neutrality limits.

Under the current approach, a demonstration project is budget neutral if actual expenditures are equal to or less than its budget neutrality expenditure limit and current demonstration period savings (if applicable). One of three outcomes applies at the end of a demonstration period:

1. Expenditures are equal to or less than the budget neutrality expenditure limit. The demonstration is considered budget neutral under the current approach outlined in the budget neutrality agreement in the STCs.

2. Expenditures exceed the budget neutrality expenditure limit, with current period savings available. If the demonstration has accumulated current period savings under the current approach outlined in the budget neutrality agreement in the STCs that are sufficient to offset expenditures in excess of the limit, no overage is assessed.

3. Expenditures exceed the budget neutrality expenditure limit, with no or insufficient current period savings available under the current approach outlined in the budget neutrality agreement in the STCs. The demonstration project has a budget neutrality overage. As a condition of demonstration approval, states currently agree to return excess funds to CMS if the state is found to have exceeded its budget neutrality expenditure limit at the end of its demonstration's period of performance. This requirement applies, even if the demonstration project's current approval period extends past January 1, 2027. States return funds by entering a negative adjustment to expenditures claimed on their CMS-64 reports.

Additional Proposed Changes

Application Completeness per 42 CFR Part 431 Subpart G and Approved STCs

Applications for new section 1115 demonstration projects or for extensions of section 1115 demonstration projects that are received prior to the effective date of a final rule will continue to be reviewed for completeness using the process and requirements described in 42 CFR part 431 subpart G. CMS intends to propose changes to section 42 CFR 431.412, regarding the contents of demonstration applications, to facilitate certification of budget neutrality. Any changes to the rules' requirements for an application to be considered complete would take effect upon the effective date of a final rule. CMS intends to propose application requirements for amendments, but any applications for amendments to section 1115 demonstration projects received prior to the effective date of the final rule will continue to be submitted to CMS in accordance with the state's STCs. As noted above, if a final rule is not yet effective as of January 1, 2027, then beginning January 1, 2027, CMS will provisionally apply the budget neutrality approach outlined in this guidance. We remind states that consistent with 42 CFR 431.412(a)(2) and (c)(3), CMS might request additional information from states as needed to evaluate their submitted demonstration proposals, including as needed to apply the approach outlined in this guidance on a provisional basis.

Terminology and Temporary Extensions when Renewal Applications are Under CMS Review

Section 1115(g) applies to "an application for (or renewal or amendment of)" a demonstration project. As noted above, CMS interprets the reference to "an application for…" in subsection 1115(g)(1) to mean new demonstration applications, and CMS's approach to applying the requirement to amendments is also discussed above. To align with the "renewal" terminology used in section 1115(g), CMS intends to propose changes to terminology used in section 42 CFR part 431, subpart G. We intend to define the renewal of a section 1115 demonstration as CMS's approval of a state's application to continue the demonstration beyond the current period under section 1115(a), (e), or (f), in accordance with the federal public notice and approval process under 42 CFR 431.416. CMS intends to issue future guidance regarding a temporary extension of a current demonstration project which gives CMS additional time to continue negotiating a pending renewal application with the state. CMS issuance of a temporary extension is at its sole discretion and on a case-by-case basis.

Length of Demonstration Approvals

Demonstrations approved for long periods, such as ten years, often have outdated STCs that may not align with the evolution of CMS policies and priorities. To help ensure demonstrations align with CMS policy, CMS intends to propose not approving a demonstration project period of more than five years, except in situations when the expiration date is in the middle of a fiscal quarter. In these cases, CMS intends to propose aligning the demonstration expiration with the end of the next fiscal quarter, to avoid potential disruptions and changes to state reporting.

Use of Section 1115 Demonstration Authority

As states reassess their demonstration authorities to prepare for upcoming changes to budget neutrality under section 1115(g), CMS encourages them to reduce reliance on section 1115 authority where alternative Medicaid authorities are available. This would allow CMS to strengthen oversight and ensure consistent monitoring of services coverable under state plan or waiver authority, while reserving section 1115 authority for supporting state innovation. CMS recognizes that states may, in certain circumstances, require concurrent section 1115 authority layered over another Medicaid authority to achieve programmatic goals. In such cases, CMS is committed to providing technical assistance to help states navigate this process effectively.

Monitoring & Evaluation

Under the approach CMS intends to propose, we would utilize new budget neutrality monitoring STCs for a state's projected expenditures and would require states to complete corrective actions if expenditures substantially deviate from a state's projection. Furthermore, states would be required to demonstrate sustained, promising section 1115 demonstration evaluation findings that show, through robust research analyses approved by CMS, that the state is effectively meeting the majority of its policy goals. CMS intends to propose that if findings indicate that demonstration policy has not been successful (e.g., is not meeting the state's intended goals) or is not likely to assist in promoting the objectives of Medicaid or CHIP, CMS may determine not to approve a renewal of the demonstration or demonstration policy. CMS also intends to propose revised evaluation expectations for demonstrations meeting their goals to help ensure sustained achievement in outcomes and to help ensure that no new challenges arise during subsequent demonstration periods.

Closing

CMS is committed to improving the program and fiscal integrity of the Medicaid program and ensuring that section 1115 demonstration projects comply with federal requirements, including section 1115(g) of the Act. If you have any questions about this guidance, please contact Sarah Aker, Acting Director of the State Demonstrations Group at CMCS, via e-mail at Medicaid1115BudgetNeutrality@cms.hhs.gov.

Sincerely,

/s/

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Appendix A: Summary of Implications by Application Type

Table 5. Summary of Implications by Application Type

	New demonstration after 1/1/27	First demonstration renewal after 1/1/27	Second demonstration renewal after 1/1/27	Amendment is the first approval after 1/1/27 and demonstration was approved before 1/1/27	Amendment after the demonstration has been certified by the Chief Actuary after 1/1/27
Analyses Provided by States	Prospective analysis of projected financial impacts of all section-1115 only demonstration activities for the upcoming demonstration period. For MAPS activities provide the annual federal budget impact. An analysis of financial impacts is not required.	Historical analysis of financial impacts of all section-1115 only demonstration activities for the current demonstration period and prospective analysis of projected financial impacts of demonstration activities for the upcoming demonstration period. For MAPS activities provide the annual federal budget impact. An analysis of financial impacts is not required.	Historical analysis of financial impacts of all section-1115 only demonstration activities in the first renewal after 1/1/27 and prospective analysis of projected financial impacts of demonstration activities for the upcoming demonstration period. For MAPS activities provide the annual federal budget impact. An analysis of financial impacts is not required.	Historical analysis of financial impacts of all section 1115-only demonstration activities for the prior demonstration period and the current demonstration period (prior to the amendment) and prospective analysis of projected financial impacts of all demonstration activities, including the activities in the amendment, for the remainder of the current demonstration period. For MAPS activities provide the annual federal budget impact. An analysis of financial impacts is not required.	Prospective analysis of the financial impacts of amended section-1115 only demonstration activities and any other activities affected by the amendment for the remainder of the current demonstration period. For MAPS activities provide the annual federal budget impact. An analysis of financial impacts is not required.

	New demonstration after 1/1/27	First demonstration renewal after 1/1/27	Second demonstration renewal after 1/1/27	Amendment is the first approval after 1/1/27 and demonstration was approved before 1/1/27	Amendment after the demonstration has been certified by the Chief Actuary after 1/1/27
Treatment of Currently Deemed Budget Neutral Authorities	n/a	State demonstrates the activity is MAPS or provides analysis of the financial impacts of the demonstration activity.	n/a	State demonstrates the activity is MAPS or provides analysis of the financial impacts of the demonstration activity.	n/a
Impact on Existing Hypotheticals	n/a	State demonstrates hypothetical is MAPS or provides analysis of the financial impacts of the demonstration activity.	n/a	State demonstrates hypothetical is MAPS or provides analysis of the financial impacts of the demonstration activity.	n/a

Appendix B: Examples of Section 1115 Authorities and Budget Neutrality Treatment

Table 6 provides examples of demonstration authorities that are approved as hypothetical expenditures or deemed budget neutral under the current budget neutrality approach and how these expenditures would be treated when assessing budget neutrality starting January 1, 2027 under section 1115(g) of the Act. Table 6 indicates whether the expenditure would be considered MAPS or whether it would be considered section 1115-only. This is not an exhaustive list of all previously approved hypothetical or deemed expenditures and CMS would review the specifics of each state's demonstration to determine budget neutrality treatment.

Table 6. Examples of Section 1115 Authorities and Budget Neutrality Treatment

Description of Demonstration Authority	Budget neutrality treatment before implementation of section 1115(g) before January 1, 2027	Budget neutrality treatment after implementation of section 1115(g) after January 1, 2027*
Expenditure authority to cover services furnished to beneficiaries who are residing in an institution for mental diseases (IMD) primarily to receive treatment for a substance use disorder (SUD), serious mental illness (SMI) or serious emotional disturbance (SED) — which would have been otherwise allowable under title XIX were it not for the IMD exclusion.	Hypothetical	MAPS *Rationale: Payment could otherwise be provided under title XIX at a different site of service.*
Expenditure authority to cover pre-release services furnished to certain incarcerated beneficiaries who are soon-to-be former inmates of a public institution during a specified pre-release period – which would have been otherwise allowable under title XIX were it not for the inmate payment exclusion.	Hypothetical	MAPS *Rationale: Payment could otherwise be provided under title XIX at a different site of service.*
Expenditure authority for infrastructure funding to support implementation, expansion, or maintenance of services or capacity building in reentry demonstrations or health related social needs (HRSN) demonstrations.	Hypothetical	Section 1115-only Rationale: *Payment could not otherwise be made through the Medicaid state plan or other title XIX authority.*

Description of Demonstration Authority	Budget neutrality treatment before implementation of section 1115(g) before January 1, 2027	Budget neutrality treatment after implementation of section 1115(g) after January 1, 2027*
Expenditure authority to cover home and community-based services (HCBS) (1915(c) or 1915(i)) for state plan eligible adults who meet section 1915 eligibility criteria for the specific services – no alterations to eligibility or benefits.	Hypothetical	MAPS *Rationale: Coverage could otherwise be provided under title XIX.*
Expenditure or waiver authority to cover targeted HCBS, limited to a geographic region within the state, for state plan eligible adults who meet section 1915 eligibility criteria for the specific services.	Hypothetical	MAPS *Rationale: Coverage could otherwise be provided through title XIX. Under title XIX authority, the coverage would be broader in scope.*
Expenditure authority to expand eligibility for HCBS beyond what is authorizable under the state plan or a section 1915 waiver.	Hypothetical	Section 1115-only *Rationale: Coverage goes beyond what could otherwise be provided under title XIX because it is extended to populations not eligible under title XIX.*
Expenditure authority for partial new adult group expansions with coverage meeting requirements under section 1937 of the Act (coverage of state plan Medicaid benefits provided to adults who would otherwise be eligible under the state plan in the new adult group, up to an income threshold below the new adult group income limit of 133 percent of the Federal Poverty Level (FPL)).	Hypothetical	MAPS *Rationale: Coverage could otherwise be provided under title XIX. Under title XIX authority, the coverage would be broader in scope.*

Description of Demonstration Authority	Budget neutrality treatment before implementation of section 1115(g) before January 1, 2027	Budget neutrality treatment after implementation of section 1115(g) after January 1, 2027*
Expenditure authority to provide coverage of family planning services that is less than state plan coverage for a population eligible to receive family planning services under the state plan.	Hypothetical	MAPS *Rationale: Coverage could otherwise be provided under title XIX. Under title XIX authority, the coverage would be broader in scope.*
Waiver authority to cover a Medicaid state plan service only for a targeted group of individuals eligible for the services under the Medicaid state plan.	Hypothetical	MAPS *Rationale: Coverage could otherwise be provided through the Medicaid state plan or title XIX authority, but targeted to a subset of the Medicaid population who would receive it under that authority. Under title XIX authority, the coverage would be broader in scope.*
Expenditure or waiver authority to provide coverage of populations and services that could be provided under section 1915(i) HCBS authority, with wait list.	Hypothetical	MAPS *Rationale: Could otherwise be provided through the Medicaid state plan or 1915 waiver. Under title XIX authority, the coverage would be broader in scope.*

Description of Demonstration Authority	**Budget neutrality treatment before implementation of section 1115(g) before January 1, 2027**	**Budget neutrality treatment after implementation of section 1115(g) after January 1, 2027***
Expenditure authority to cover services authorized under the Medicaid state plan or other title XIX authority for Medicaid state plan eligible individuals who are not otherwise eligible for the services under the Medicaid state plan or other title XIX authority.	Hypothetical	Section 1115-only *Rationale: Population could not otherwise receive the services through the Medicaid state plan or other title XIX authority.*
Expenditure authority for payment of Marketplace subsidies through qualified health plans, including payment for part or all of the cost of premiums or for payments to reduce cost sharing requirements.	Hypothetical	Section 1115-only *Rationale: Payment could not otherwise be made through the Medicaid state plan or other title XIX authority.*
Expenditure authority for payment of wrap-around services for Medicaid state plan eligible individuals who are otherwise eligible for the services but are receiving coverage through premium assistance in lieu of direct coverage.	Hypothetical	MAPS Rationale: Could otherwise be provided through the Medicaid state plan as long as it meets all state plan requirements.
Expenditure authority for uncompensated care pool expenditures	Cost not otherwise matchable (CNOM) that requires savings	Section 1115-only *Rationale: Could not otherwise be authorized through the Medicaid state plan or other title XIX authority.*

Description of Demonstration Authority	Budget neutrality treatment before implementation of section 1115(g) before January 1, 2027	Budget neutrality treatment after implementation of section 1115(g) after January 1, 2027*
Waiver authority to allow a state to pay premiums directly to a Medicaid beneficiary to help them pay for qualified employer sponsored insurance or purchase health insurance on their own when the premium assistance subsidies otherwise meet Medicaid state plan requirements, including cost effectiveness.	Deemed	MAPS *Rationale: Cost effective premium assistance subsidies could otherwise be provided through the Medicaid state plan. This waiver allows the state to make a payment directly to the beneficiary.*
Waivers of comparability and amount, duration, and scope to allow a state to provide state plan services to individuals eligible for the services under the state plan, but within a limited geographic area, such that the services would not otherwise be available to all beneficiaries in the same eligibility group.	Deemed	MAPS *Rationale: Could otherwise be provided through the Medicaid state plan or other title XIX authority. Under title XIX authority, the coverage would be broader in scope.*

* While a detailed analysis of the financial impacts of the activity would not be required for MAPS, a state would still be required to provide the federal budget impact for MAPS activities.