

ALASKA LEGISLATURE

2603

HOUSE and SENATE FINANCE COMMITTEE FILES, 2003-2004

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Electronic Disbursement Options White Paper



E-DO Work Group Electronic Benefits and Services Council

NACHA – The Electronic Payments Association
November 2003

I. PREFACE

A. Purpose and Scope

This paper describes the electronic disbursement options available to government agencies that disburse payments to citizens. This paper is primarily intended for state governments and may also provide useful information to federal and local governments.

Government agencies face increased pressure to reduce costs while simultaneously improving service delivery to the public. Agencies can gain significantly by adopting electronic payment delivery. The high cost of issuing paper checks has already resulted in a dramatic increase in the use of Electronic Funds Transfer (EFT) to deliver payments. (EFT is any transfer of funds that is initiated through an electronic terminal, telephone, computer, or magnetic tape for the purpose of ordering, instructing, or authorizing a financial institution to debit or credit an account.) Direct Deposit, the primary example of EFT, provides a low-cost way to disburse payments. However, while Direct Deposit is the disbursement option of choice, it does not work for so-called “cash consumers” (i.e., consumers who do not have a bank account) or for consumers who do not sign up for Direct Deposit. To reach these recipients, states and the federal government have created new financial products, such as Electronic Benefits Transfer (EBT) cards and Electronic Transfer Accounts (ETASM). Association-branded cards (Visa[®] and MasterCard[®]) have also been introduced and have recently gained rapid acceptance in the child support community.

This paper outlines the options for states to assist cash consumers in receiving electronic disbursements and discusses the features and capabilities for each option. The paper focuses specifically on the following disbursement options, with particular attention to card-based options:

- Direct Deposit
- EBT
- Electronic Payment Cards (EPCs), including Visa's Prepaid Card and the Prepaid MasterCard[™] Card

This paper also describes the implementation considerations, costs, benefits, and challenges some government agencies have encountered in putting these options to work. The goal of this paper is to provide decision-makers, such as state controllers, treasurers, and high-level program managers, with the information they need to assess the available options and choose the best one for their applications.

B. Background

Federal, state, and local governments are responsible for issuing a large proportion of the recurring payments made to individuals today. In most cases, government agencies deliver cash benefits to their recipients, but some agencies serve as a trustee, passing payments such as child support from one party to another. Traditionally, these payments have been made in the form of a paper check or warrant, but recently the number that are delivered electronically using the Automated Clearing House (ACH) Network has increased substantially.

Government agencies are under tremendous pressure to cut costs while ensuring the identity of the payee and increasing the convenience, security, and timeliness of payment delivery. The cost of achieving these goals using paper checks has increased substantially in recent years, due primarily to the exponential growth of check fraud. To combat check fraud, banks and their customers now rely heavily on technology, for which consumers often foot the bill through check-cashing fees. As a result, the use of EFT has increased markedly. EFT is simpler to implement than the controls necessary to issue checks safely. It offers payees a quick, secure way to receive payments, while payers benefit from low cost.

Recent figures provided by the U.S. Department of the Treasury's Financial Management Service (FMS) demonstrate the cost savings that can be achieved by using ACH rather than checks. FMS issued almost 253 million checks during fiscal year 2002, at a unit cost of \$0.745. FMS has determined the cost of an ACH disbursement to be \$0.126, for a savings of \$0.62.

Using checks is not only more expensive than using ACH, it also requires a high degree of human intervention to manage exceptions, which is time consuming, sometimes complex, and difficult to quantify. Check exception activities include checks returned as undeliverable, stale-dated or lost checks, and fraud (stolen, forged, counterfeit checks). The move away from checks to electronic delivery is cost-effective and provides additional benefits to both the payer and payee.

Today, consumers also have to wait for the mail to deliver their checks which may take 3 to 5 days. The consumer must then find a place to cash the check. Many custodial parents, for example, must go to a check-cashing location where fees between \$5 and \$10 may be charged. Electronic disbursement minimizes the interval between collection of funds and receipt of funds. In addition, the consumer usually can access the funds at many bank branches with, in many cases, no charge to the consumer.

Table 1 summarizes some costs of paper checks and payroll check exceptions.

Table 1: Some Costs of Paper Checks¹

• Americans without bank accounts spend roughly \$8 billion annually in check cashing and other financial services.
• Four million payroll checks are lost or stolen every year.
• Generating replacement checks and checks for the exception pay costs employers an average of \$8 to \$10 per check.
• Tracking and escheating ² unclaimed paychecks is a difficult, costly, and inefficient process for employers.

Organizations are making significant progress in moving to electronic disbursements. Private employers have made impressive headway implementing payroll Direct Deposit and FMS succeeded in disbursing nearly 74 percent of its payments electronically during federal fiscal year 2002. The Food Stamp Program now delivers 95 percent of its non-cash benefits electronically using EBT cards that are issued to recipients. However, the overall percentage of cash benefits and other payments delivered electronically remains low. For example, it is estimated that only about 25 percent of child support payments nationally are disbursed electronically.³

One issue that has prevented government agencies from delivering more payments electronically is that authorizing Direct Deposit to a consumer-owned asset account remains a voluntary choice for the consumer; many consumers simply do not get around to a Direct Deposit authorization. Another issue is the number of cash consumers without bank accounts. According to the 2001 Survey of Consumer Finances, 9 percent of families do not have any type of transaction account and 12.7 percent do not have a checking account.⁴ During the last decade, the government has made notable strides in delivering more payments electronically, especially to people without bank accounts. The federal government has sought to solve this problem by working with the financial industry to create the Electronic Transfer Account (ETA)⁵.

¹ Source: Visa USA, Inc., from "Payroll Cards: An Innovative Product for Reaching the Unbanked and Underbanked," Comptroller of the Currency white paper, October 2003.

² "Escheating" refers to state laws that provide that the state is entitled to certain types of abandoned property left in the hands of third parties after a specified period. Such property is said to "escheat" to the state. Deposit accounts are subject to escheat; banks, including national banks, are required in most states to file reports on escheated accounts.

³ Based on an informal survey of State Disbursement Unit officials (child support) in 38 states, each state's EFT percent was applied to that state's "child support collections distributed to families" (OCSE, FFY 2001 statistics) to approximate the national percent (24.72 percent). A total of \$16.6 billion in child support payments was distributed to families nationally during federal fiscal year 2002.

⁴ *Recent Changes in the U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances*, Ana M Aizcorbe, et al., Federal Reserve Bulletin, January 2003.

⁵ An ETA is a low-cost account offered at federally insured financial institutions for recipients of federal payments. The ETA was developed by the U.S. Department of the Treasury to allow such recipients to access an account at reasonable cost and with the same consumer protections as other account holders at the same financial institution. The ETA is not discussed in any detail in this paper since it is limited to recipients of federal payments.

The banking community has recently developed a promising new product with low operating costs: an association- and network-branded card-based instrument with no credit history qualification requirement for the consumer. The Visa Prepaid Card and the Prepaid MasterCard Card are two examples of this product. The product, called an Electronic Payment Card (EPC) in this paper, operates on the existing commercial automated teller machine (ATM) and point-of-sale (POS) networks, offering worldwide access to cash and the purchase of goods and services. (The term EPC is used only for convenience in this paper; its use is in no way intended to establish an industry term.) EPCs closely resemble payroll cards currently used by employers. EPCs are gaining rapid acceptance among state government agencies. Some are backed by consumer-owned asset accounts (i.e., bank accounts), while some are not. Several states have used this product to deliver child support payments⁶; others are in the process of using it for other cash benefits, such as unemployment insurance.

It should be noted that these EPC services are so new to the market that features, commercial terms and governing regulatory environment are in flux. For example, the Federal Reserve Board has yet to determine the extent of current banking regulations that would apply to them. Financial institutions offering them might also alter their services or features in the near future. As a result, this paper can only describe these cards as they exist and are used today. These cards could have significantly different characteristics in a year.

This paper focuses on disbursement options available to governments. While a government transmits the payment to an EPC via Direct Deposit, EPCs are included in the *Card-Based Disbursement Options* section, instead of in the *Consumer Asset Accounts* section. Direct Deposit is not an option for a person without a bank account. If a government wants to make an electronic payment to a recipient without a bank account, its options are EBT cards and EPCs.

Card-based products—both EBT cards and EPCs—have stimulated the recent growth in electronic payments. EBT cards and EPCs offer access to benefits and/or cash, goods, and services with no qualification required on the part of the cardholder. They offer a high level of security to all stakeholders and protect the cardholder from the potential overdraft costs and negative credit ratings associated with checking accounts. Government agencies have used these cards to deliver payments electronically to recipients without bank accounts as well as to those recipients who do not sign up for Direct Deposit.

However, while there are compelling reasons to use cards, government agencies must consider tradeoffs and potential barriers. Such tradeoffs include a reduction in float on funds (e.g., resulting from the time involved in the check clearing process) and the potential to lose track of the cardholder's address. Agencies may face barriers such as reluctance on the part of payees to let go of the tangible paper check, the perception that disbursement costs are being shifted to the payee or that bank accounts are being forced upon the constituency, or difficulty in issuing the card to the payee due to the involvement of a third party, such as a private child support agency.

⁶ As of the writing of this paper, 9 states (Colorado, Connecticut, Georgia, Iowa, Idaho, Indiana, Maryland, Minnesota, and Washington) and Puerto Rico have or are planning programs to disburse child support payments using EPCs. Descriptions of the Colorado and Maryland programs can be found in Appendix A.

Agencies that have implemented these products demonstrate that the result is worthwhile if time is taken to consider the tradeoffs carefully and invest in the education necessary to overcome the barriers.

II. OPTIONS FOR ELECTRONIC DISBURSEMENT

A. Consumer Asset Accounts

As defined by Federal Reserve Board Regulation E (Reg E), account means a demand deposit (checking), savings, or other consumer asset account (other than an occasional or incidental credit balance in a credit plan) held directly or indirectly by a financial institution and established primarily for personal, family, or household purposes. One of the most popular types of bank accounts by far is the demand deposit account.

Traditional demand deposit accounts typically include numerous features: the ability to write checks, use a bank teller, have access to an ATM, and receive a monthly statement.

Fees are associated with some of these features, with fees varying among institutions. Some institutions charge a maintenance fee or a flat monthly fee, regardless of account balance. Others may charge a monthly fee if the minimum balance in the account drops below a certain amount any day during the month, or if the average balance for the month drops below the specified amount. Some charge a fee for every transaction, such as for each check written or each ATM withdrawal. Many financial institutions impose a combination of these fees.

1. Benefits of Demand Deposit Accounts

Consumers with traditional demand deposit accounts can benefit from the ACH Network. The ACH is a processing and delivery system that provides for the distribution and settlement of electronic credits and debits among financial institutions. The ACH was developed as an efficient electronic alternative to checks. The alternative discussed in this paper is Direct Deposit.

Direct Deposit is the electronic transfer of funds from a company or organization to the checking or savings account of an employee, retiree, vendor, or shareholder. The most common use of Direct Deposit is for payroll, but Direct Deposit can also be used for annuities, bonuses and commissions, dividend and interest payments, pensions, benefit payments from the federal and state governments, and travel expense reimbursements.

More than half of all American employees (55 percent) receive their pay using Direct Deposit, and the use of Direct Deposit continues to grow. In 2002, more than 40 million consumers used Direct Deposit to receive their tax refunds.

A Direct Deposit payment can be divided among several different accounts and, in many cases, between different financial institutions. Direct Deposit is the safe, reliable, and confidential way to make a payment. Employers offer Direct Deposit as a free service to their employees at minimal cost to the employer (just a few cents per transaction).

For more information on Direct Deposit, visit <http://www.directdeposit.org/>.

2. Challenges of Demand Deposit Accounts

There are several challenges that are presented by demand deposit accounts.

Some consumers are skeptical about the security of their money in a financial institution. However, contrary to popular belief, a financial institution is one of the safest places to deposit money, since an account is FDIC-insured for up to \$100,000 per depositor.

Another challenge of demand deposit accounts is that they can be overdrawn. Financial institutions are permitted to impose fees for any overdrawn account.

Financial institutions also have the right to screen any consumer who applies for a bank account, regardless of the type of account. There is no guarantee that a consumer will be approved.

One additional challenge is that in the child support community, a third-party agency may be the payee recipient of a payment made on behalf of the parent receiving child support. Private Child Support Enforcement Agencies (PCSEAs) obtain a power of attorney from the parent receiving child support to receive payments from State Disbursement Units. PCSEAs then retain their fee and pass the remainder of the child support collection to the parent. State agencies implementing Direct Deposit for the payment of child support to parents who have contracted with a PCSEA should be aware of the additional information needed by the PCSEA to identify the non-custodial and custodial parent for each payment.⁷ Third parties typically have multiple clients in each state (the largest has over 30,000 clients nationwide), and it would be impossible to identify the custodial parent to whom the funds belong if the only information provided is the name of the state disbursing the funds. Identification of the non-custodial parent is important as well. If a custodial parent receives child support payments from more than one non-custodial parent, the third party must determine whether the payment is from the non-custodial parent from whom the third party is trying to collect.

3. Legal Framework for Demand Deposit Accounts

The ACH process is bound from beginning to end by a series of legal agreements. The *NACHA Operating Rules* is the primary document addressing the rules and regulations for the

⁷ This requires the state agency to use either the CCD+ or CTX formats in order to include the DEbit (deduction) data segment that specifies payment-related information for child support payment deductions (Child Support Banking Convention). Cash Concentration and Disbursement/Plus (CCD) and CCD+ formats are used to initiate a credit or debit entry by an organization to consolidate funds of that organization from its branches, franchises or agents, or from other organizations, or to fund the accounts of its branches, franchises or agents, or of another organization. A CCD+ carries one addenda record with 80 characters of additional payment-related information. The Corporate Trade Exchange (CTX) format is used to initiate a credit or debit entry by an organization to effect a transfer of funds to or from the account of that organization or another organization and accompanied by remittance information formatted in accordance with ANSI ASC X12.5 and X12.6 syntax. The CTX is a NACHA format for use in the ACH payment system. Remittance information carried in the CTX must be formatted in a syntactically correct ANSI ASC X12 transaction set containing a BPR or BPS data segment.

commercial ACH Network. The *NACHA Operating Rules* set out the rights and responsibilities of parties to ACH transactions.

Federal government ACH payments are controlled by the provisions of Title 31 Code of Federal Regulations Part 210 (31 CFR Part 210). FMS is the agency responsible for establishing the federal government's ACH policy. 31 CFR Part 210 was revised in 1999 to reflect the federal government's adoption of the *NACHA Operating Rules* as the rules governing federal government payments. At that time, 31 CFR Part 210 exempted 11 specific provisions of the *NACHA Operating Rules* for which special rules have been established as a matter of federal law. As new NACHA rules are implemented, the Treasury Department determines whether to adopt them as part of 31 CFR Part 210. FMS also publishes *The Green Book*, a procedural manual for federal government ACH payments.

Other laws that have a direct bearing on ACH operations are the Uniform Commercial Code Article 4 (which governs check transactions) and Article 4a (which governs wholesale EFT credit transactions), and the Electronic Funds Transfer Act (EFTA) as implemented by Reg E. The EFTA establishes the rights, liabilities, and responsibilities of participants in electronic funds transfer systems. Reg E protects the rights of consumers in their dealings with these systems. Reg E applies to any EFT that authorizes a financial institution to debit or credit a consumer's account. Reg E protection includes monthly statements, access through conventional ACH processing, full EFT network access, and access to mainstream services.

Certain other activities related to ACH payments are affected by the Right To Financial Privacy Act, Regulation D Regarding Reserve Requirements, Regulation CC Regarding Funds Availability, and other regulatory agency directives. Relationships between consumers and their banks are generally governed by Reg E and the *NACHA Operating Rules*.

Direct Deposit, Direct Payment, TEL transactions, and WEB transactions are subject to the requirements of the *NACHA Operating Rules*, the EFTA, and Reg E.

To learn more about the *NACHA Operating Rules* visit <http://pubs.nacha.org/>.

B. Card-Based Disbursement Options

1. Overview of Primary Card-Based Options

Cards have been used for decades to initiate financial transactions. Cards are safe and convenient, and association-branded (Visa and MasterCard) cards can be used in millions of locations worldwide.

The two leading candidates for card-based electronic disbursement are EBT cards and EPCs.

a. Electronic Benefits Transfer Cards

EBT is the electronic delivery of government services and payments. Instead of giving beneficiaries food stamp coupons or paper checks, state governments provide them with a debit-type card that gives them access to their benefits. Given government restrictions on the Food Stamp Program, EBT is the only electronic option for delivering food stamp benefits. As of this writing, 95 percent of food stamp benefits are being delivered using EBT, and in September 2003, the federal government shredded all remaining food stamp coupons. Most states also use EBT to deliver cash benefits.

EBT cards are not tied to a consumer asset account. The cards can be used at POS terminals at grocery stores and non-food stores and at ATMs that bear the QUEST[®] Mark or a state mark. EBT transactions are initiated using a personal identification number (PIN; see discussion below, under Electronic Payment Cards).

States maintain close oversight of EBT programs. They maintain administrative terminals to monitor the program and receive detailed reports from their EBT contractors.

b. Electronic Payment Cards

Government agencies can also employ EPCs to disburse government funds. As with EBT cards, governments contract with a service provider for card issuance. To date, states have contracted with a bank to issue a card bearing the Visa or MasterCard mark, but other EPCs are issued by service companies and do not necessarily display a card association mark. The Visa and MasterCard branded cards can be used like other debit cards at any ATM or merchant that accepts that card.

As used in this report, EPC describes two types of cards. One type, the prepaid card, is tied to an aggregated account rather than to a cardholder's consumer asset account. The other type, an account-based EPC, is tied to a cardholder's consumer asset account. Different consumer protections may apply to the two types of EPCs. For example, the Federal Reserve Board is reviewing whether Reg E protections extend to EPCs and prepaid cards in general. Reg E coverage currently does not apply to prepaid cards. Since account-based EPC cards are tied to

an individual consumer asset account, Reg E protections may already extend to this type of card. Whether Reg E protections apply to cards that are tied to an aggregated account is less clear.

States conduct little oversight over EPCs. As with Direct Deposit programs, the states' involvement is largely complete once it has transmitted a payment to the card issuer.

This paper views disbursement options from a government's perspective. Direct Deposit is only available to a government when a consumer has a bank account and chooses to authorize Direct Deposit. If the consumer does not have a bank account, the only electronic options open to a government are card-based options – EBT cards and EPCs. Thus, EPCs are addressed in this section, *Card-Based Options*, instead of in the *Consumer Asset Accounts* section of this paper, even though funds are transmitted to EPCs via Direct Deposit.

There are two ways for a cardholder to authorize an EPC transaction: a PIN or a signature. To authorize a transaction "online" using a PIN, the cardholder keys in a PIN on a PIN pad at the point-of-sale. Funds are immediately debited from the cardholder's account. The card issuer charges the merchant a fee (typically \$0.10 to \$0.30). This is a comparatively low-cost transaction for the merchant. PIN-based cards can be used at both merchant POS locations and ATMs. To authorize a transaction "offline" using a signature, the cardholder signs a paper receipt or electronic signature pad. Funds are not immediately debited from the cardholder's account but instead run through credit card networks. The merchant is charged a transaction fee that is a percentage of the total purchase amount. For merchants, this is a more costly transaction than a PIN-based transaction. Signature-based cards cannot be used at ATMs unless a PIN is assigned at the time of issuance.

c. Disbursements to Third Parties

It is also important to note that while cards are suitable for most disbursements, they are not viable when a third party is involved. In the child support community, a third-party agency (PCSEA) may receive a payment made on behalf of the parent receiving child support. PCSEAs obtain a power of attorney from the parent receiving child support to receive payments from State Disbursement Units. PCSEAs then retain their fee and pass the remainder of the child support collection to the parent. States that intend to pursue a mandatory EFT (card-based) program should be sure their systems allow for exceptions for payments to third parties.

2. Electronic Benefits Transfer Cards

a. Introduction

EBT was devised in the late 1980s to meet the needs of the Food Stamp Program and, optionally, some cash programs under the Administration for Families and Children. Its initial purpose was to transfer value electronically from the government to eligible recipients under certain entitlement and grant programs. During the early 1990s, several states successfully developed and implemented EBT projects and in 1996, EBT was federally mandated to be the benefit distribution method for all food stamp programs nationwide by the year 2002. Consequently, all 50 states, Puerto Rico, the Virgin Islands, and Guam now have or soon will have an operational EBT program. More than 10 million households regularly use an EBT card.

The basic requirements for a food stamp EBT program are found in the Federal Code of Regulations 7 CFR 274.12. All programs must conform to these requirements to be certified by the Food and Nutrition Service (FNS) and be usable for the distribution of Food Stamp Program benefits. Operating within the basic requirements for food stamps, states are allowed significant latitude in how they choose to implement EBT and in how they define the program content. Some states choose to implement a food-stamp-only program, while others choose to add certain cash programs to their EBT infrastructure.

As EBT has evolved, its merits over paper-based distribution for cost effectiveness, user acceptability, and program management have become apparent. States are now experimenting with an increasing number of value-transfer programs and are considering EBT the enabling platform for other citizen-to-government interactions (called "electronic service delivery" or ESD), in which the EBT card is used to verify participant identity but does not support an exchange of value. Examples of value-transfer programs that have used EBT infrastructure include child support payments, Women, Infants, and Children (WIC) benefits, energy assistance programs, and other state-sponsored aid programs such as general assistance. Examples of ESD include Medicaid eligibility and subsidized day care time and attendance.

The list of potential candidates for incorporation into an EBT-like program is extensive. Any time government uses a paper-based product (i.e., a check or a warrant) to transfer value to citizens (or accept value from citizens), there is a significant value proposition for accomplishing that transfer electronically. As a general strategy, EBT is most effective as a payment solution when the value transfer involves requirements specific to program policy or unique recipient needs that differentiate it from a simple payment product. Government specifies the characteristics of the EBT account, including access protocols. Government therefore has significant control over EBT and can impose policy restrictions or value-added design features as needed.

The government-specific features built into EBT should be considered in evaluating EBT as a solution for a specific payment process. Many or all of these features may not be needed for

most mainstream electronic payments. Another consideration is the difficulty of commingling different cash payments within the same EBT cash "account"⁸. When some payments require the unique EBT features and some do not, the result may be overly expensive, overly restrictive, or overly complex.

b. Card Characteristics and Features

One fundamental requirement for EBT is that, to the extent possible, the transfer should use the existing payment system infrastructure and closely resemble a private-sector consumer payment. EBT households are issued a magnetic stripe debit card secured by a PIN known only to the cardholder. This product is identical in look and technology to any bank-issued ATM or POS debit card. (This discussion does not include smart card strategies.) The card is linked to a centralized benefit record that reflects the cardholder balance. The records are typically held in a centralized database by an issuing processor under contract to the state government to provide EBT services.

i. Account structure

Government provides an EBT account to recipients of certain government benefits, generally by contracting with a third party entity to provide account management and transaction processing services. Consequently, government, within the overarching mandates of payment system processing, dictates the characteristics of the account. An EBT account is mandatory for the receipt of Food Stamp Program benefits.

Most EBT household accounts are divided into a food stamp account and a cash account. (A WIC account may also be included.) The EBT debit card is linked to all account types held by the household. That is, if the household has only food stamp benefits, the card is linked only to a food stamp account. If the household has both food stamps and cash, the card can be used to access benefits from both account types. However, one redemption transaction can only access benefits from one account type (e.g., a cash transaction cannot access benefits from a food stamp account).

EBT account structures and processing requirements are one of the major differentiators between EBT and other payment products. EBT accounts contain features imposed by government to satisfy program policy and meet the needs of a payment system.

Unique EBT account management features include the following:

- Multiple independent account types for a single household. The "day-of-draw" settlement process is separate for each account type (e.g., the food stamp settlement is separate from cash). Each account type has unique balances. In addition, transaction

⁸ This white paper uses the term EBT "account" for descriptive purposes. In EBT card programs, cardholders do not have a consumer-owned asset account. EBT cards are linked to a benefit record in a database that reflects the cardholder balance.

processing is specific to each account type (e.g., a food stamp transaction may not access benefits in a cash account).

- Client account management at the individual grant (deposit) level. For example, a cash account balance may contain funding from multiple different benefit programs, such as Temporary Assistance for Needy Families (TANF) and General Assistance/General Relief (GA/GR), and multiple deposits from each funding source. Funds are debited from accounts in the order that funds are deposited in the account. A defined hierarchy of accounts is used so that withdrawals are prioritized and benefits of one type can be depleted before benefits of another are debited. Balances are reported and reconciled by benefit type and grant. A batch process can be used for benefit deposits with the capability to accept future-dated benefits and make them available to the recipient on a particular date, case by case. The account is aged and benefits expunged grant by grant.
- The ability to cancel or void benefits sent to EBT but not yet posted to the account.
- Support for non-electronic transaction approvals (voice authorizations) with the capability to hold recipient funds, settle funds based on receipt of a clear transaction, and return funds to the recipient account after a certain time period in the absence of the clear.
- Support for specialized adjustment rules and processing consistent with FNS regulations and state program policies.

ii. Use of Bank Acceptance Marks

To ensure consistency and commercial viability, EBT transactions are governed by a set of rules to which all participants must agree. Rules have been developed by the NACHA Electronic Benefits and Services Council for EBT and, although not mandated, have been adopted by 37 states, the District of Columbia, and Puerto Rico. These rules are published by NACHA under the trademark name "Quest." States who have not adopted Quest[®] Operating Rules operate under state-specific rules.

The Quest Operating Rules clearly define the agreements, roles, and responsibilities for the participants in EBT transaction processing. They mandate technical standards, consistent with general industry standards, for the exchange and processing of EBT transactions. Further, they feature an acceptance mark. The QUEST Mark is carried on EBT cards in participating states and is displayed at merchant or ATM locations that accept Quest transactions.

iii. Relation to ATM and POS Networks

One goal of EBT is to leverage the existing payment system infrastructure as much as possible. Consequently, EBT cards are used in the same manner and in many of the same locations as private sector ATM and POS debit cards. EBT transactions executed on privately-owned equipment are identical to commercial transactions. However, EBT has imposed certain unique processing requirements on participating locations:

- Back-up telephone transaction authorizations must be supported in case online authorization through POS equipment has been disrupted (e.g., because of phone line or power issues).
- Food stamp transactions are limited to FNS-certified retailers.
- Food stamp balances are printed on receipts.
- Food stamp return transactions are supported.

EBT transactions can use most ATM and POS networks. Depending on each network's rules, the nature of participation may be slightly different. Transactions that are processed through these networks as Quest transactions must conform to the Quest Operating Rules. ATM and POS locations that participate in Quest display the QUEST Mark to identify the location as one that accepts Quest transactions and agrees to the Quest Operating Rules.

FNS requires interoperability for food stamp benefits and makes funds available to cover the additional costs of interoperable transactions. EBT cash transactions are also interoperable between most commercial terminals nationwide, although interoperability may be limited between some government-provided terminals.

iv. Fee Structures

The general rule for food stamp EBT is that neither the client nor the merchant can incur any costs additional to the costs imposed by using paper coupons. Consequently, no EBT transaction fees are imposed on either party for a food stamp transaction. The only exception is for merchants who use commercial transaction processing services, wherein EBT transactions are commingled with other payment transactions. Such merchants may pay their service provider a transaction fee for the food stamp transaction. Otherwise, government absorbs all transaction costs related to food stamp transactions.

There are no such limitations on cash transactions. Consequently, EBT cash transactions tend to follow the same fee model as private sector transactions. The exception is any POS transaction fee paid by the retailer to the card issuer. Since cards are issued on behalf of the state, there is no equivalent fee for EBT transactions.

EBT programs provide access to ATMs consistent with state policies. It is up to each state to allocate the cost of ATM access between the state and the cardholder. In some states, the state pays all or part of these fees. In other states, the fee is paid by the recipient. Surcharges are allowable at both POS and ATM locations. Generally, these fees are paid by the recipient.

c. Implementation Considerations

i. Card Design

EBT cards are issued to clients on behalf of states, generally through a third-party service provider. The cards carry artwork and logos that brand them specifically to the state that issued

the card. They also carry the QUEST Mark in states that have adopted the Quest Operating Rules .

The EBT cards are industry-standard magnetic stripe debit cards. The information on the front of the card varies by state. At a minimum, it includes the primary account number (PAN). It can also include the recipient name and case number. (Photos have been experimented with and deemed too expensive.) Some cards include holograms to improve security. The back of the card is required to carry a help desk number. Additional non-discrimination language is also a general EBT requirement.

Card use is protected by using an industry-standard PIN. Each cardholder is either assigned or selects a PIN, which is input and verified on all electronic redemption transactions. PINs are always transmitted in a secure, encrypted format and are never displayed.

EBT cards typically have no expiration date.

ii. Enrollment

A household account is established in the EBT system when a client is determined to be eligible for benefits under a participating benefit program. For food stamps, participation is mandatory; consequently, enrollment is automatic. For many participating cash programs, recipients often have the choice of receiving benefits through EBT or as a Direct Deposit. Households select their method of distribution during the eligibility process.

For households using EBT, the eligibility system creates an account set-up record that is transmitted to the EBT system, either as part of a nightly batch transaction or as an online transaction. Using this data, a household EBT "account" (e.g., a record in a database) is established, a card is issued, and a PIN is selected or assigned.

iii. Funds Transfer - Loading the Benefit Record

Eligibility systems create benefit data records that identify the receiving household, the benefit amount, the benefit type, and the date on which the benefit is to be made available to the client. This data is transmitted to the EBT system either as a nightly batch transmission or as an online transaction. The data is then posted to the household account.

Data transmission is both a daily and a monthly process. Newly eligible recipients may receive benefits on the day of eligibility. Recurring benefits are transmitted to the EBT system on a regular monthly schedule. Future-dated benefits received by the EBT system are withheld from the client until the issue date.

There are two major differences between the EBT data flow and other electronic solutions:

1. A government agency owns the account and therefore is able to define the business rules governing the account.

2. Benefit funds remain in government bank accounts until a client actually redeems all or part of the benefits at a retail or ATM location. Only the part that is redeemed is settled on that day (day-of-draw settlement process).

iv. Cardholder Services

One major differentiator between EBT and other payment systems is the level of customer service offered. Government prescribes the level of EBT customer service, which tends to be more encompassing than the service associated with most private-sector consumer accounts. The service requirement reflects perceived recipient needs and program policy requirements.

Service level options are determined by the individual states, and therefore, service levels can vary. The most commonly required options include the following:

- Same day account setup, card and PIN issuance, and benefit posting
- Expedited card replacement timeframes
- A 24-hour-per-day, 7-day-per-week full-service client help line supporting multiple languages (11 in California), with strict performance standards for call answering and time-on-hold, and regular quality measurements
- Receipts that print food stamp account balances
- Tools to manage, monitor, and assist clients
- Specialized dispute and adjustment processes
- Performance standards for benefit posting and transaction processing
- Cardholder training in multiple languages, including wallet cards, pamphlets, videos, and in-person training
- Multiple cards per household with individual PINs and unique account access privileges (food stamp only, cash only, or both)

v. Program Management

Reporting and data capture add significant value under an EBT program as compared to other payment systems. Reporting is designed to facilitate government management practices in many areas:

- Policy compliance
- Cost control
- Financial management
- Quality of service monitoring
- Error resolution
- Fraud detection and adjudication
- Outreach and cross-program management

d. Legal and Compliance

i. Pertinent Regulations

A large body of law and regulations govern EBT. Federal requirements are found at 7 CFR 274.12. Most states also have their own legislation enabling EBT. By contractual agreement, the Quest Operating Rules provide additional governing rules in most states.

The most significant regulatory difference between EBT and other electronic payment systems is the interpretation of Reg E, which is the body of federal regulations governing electronic payment transactions. This regulation, which primarily prescribes consumer protections under electronic payment systems, excludes "needs-tested" government-issued benefits. There is some disagreement about what needs-tested means. However, it seems clear that benefit programs for which recipients must prove eligibility based on income, such as food stamps and TANF, are excluded from coverage by Reg E. Child support and unemployment are not needs-tested and would not be excluded from Reg E if delivered electronically.

EBT systems generally do not conform totally to the requirements of Reg E. The requirement for a monthly statement and issuer liability for lost benefits are the two requirements most often excluded. Consequently, the commingling of needs-tested and non-needs-tested programs in one account can cause confusion. Applying Reg E to EBT becomes a cost issue.

This is not to imply that EBT sacrifices consumer protection for lower cost. The programs for which EBT was originally designed (food stamps and TANF) are supported by an extremely broad range of regulatory recipient rights that, along with state-contracted protections, ultimately provide a high level of consumer protection designed specifically for the needs of the targeted recipient population.

ii. Authentication (Know Your Customer)

Within traditional EBT, accounts are established only after completion of an extensive eligibility process wherein client credentials are scrutinized and verified. The process involves significantly more rigorous customer validation than do most private sector accounts.

iii. Patriot Act

The Patriot Act contains anti-money laundering provisions. However, these provisions probably are not germane to EBT systems, since deposits to EBT accounts are originated only by a government agency and the amounts tend to be relatively small. Under traditional EBT, a client cannot make personal deposits into an EBT account.

iv. Escheat

Traditional EBT systems generally expunge benefits after a certain number of days and return them to the government. Consequently, escheatment is not applicable to traditional EBT benefits. Commingling needs-tested programs with non-needs-tested programs in EBT accounts could subject non-government funds (such as child support) to expungement.

v. Fraud

EBT was conceived as a benefit distribution system, and all industry-standard electronic transaction fraud prevention methodologies were incorporated into the system. However, certain types of fraud do occur.

- Unauthorized use or theft of benefits. So far this has not been reported as a significant problem. Household accounts are PIN-protected, clients are educated to protect their benefits, and all industry standards for security are applied to EBT transactions.
- Unauthorized establishment and funding of an EBT account. While there have been cases of unauthorized accounts and deposits, the electronic footprint created by EBT makes such incidents easier to identify than under a paper-based system.
- Use of benefits inconsistent with specific program policy (e.g., food stamp trafficking).

One unique feature of EBT systems is the wealth of data that is made available to compliance officers and investigators to support the identification, verification, and prosecution of wrongdoers. The electronic audit trail left by an EBT transaction makes fraud visible and easier to track and prosecute.

e. Cost Considerations

i. Consumer Costs

By regulation, food stamps issued as part of an EBT system have no cost to the consumer. However, for cash programs, each state determines its own policy. Costs borne by the consumer might include the following:

- ATM interchange and switching fees
- ATM and POS surcharge fees
- ATM balance inquiry fees
- "Check cashing" fees paid to retailers providing this service
- Account setup and management fees
- Card replacement fees

In some states, the consumer is sheltered from all or some of these costs. In others, consumers participate fully in the cost of the program. Most EBT projects do seek to limit costs through

negotiations with ATM providers and by actively seeking cost-free solutions within the open market.

Consumer costs create a policy enigma when needs-tested benefits are commingled with non-needs-tested benefits. On one hand, a household receiving public assistance is having to pay a portion of that assistance in order to receive the remainder. This may conflict with program policy and statutory requirements for aid. On the other hand, when the household is receiving non-needs-tested payments, the government may be subsidizing the receipt of those payments.

ii. Merchant Costs

Regulations require that merchants be able to participate in the EBT Food Stamp Program at no cost. However, many merchants making use of third-party processing arrangements pay modest fees to their processor consistent with those paid for other debit transactions. No fees are charged by the issuer.

Fees associated with EBT cash transactions are not specifically restricted and tend to be consistent with fee structures for private-sector electronic debit transactions. The exception is that the transaction fee normally paid to the issuer is waived (since a government is the issuer), making an EBT transaction less expensive than a private sector transaction.

iii. Agency Costs

Government pays the bulk of the costs associated with EBT, which include these elements:

- System design, development, and implementation
- Initial card issuance and card replacement
- Training (client, staff, retailers)
- Client and retailer help lines
- Account setup and management
- Transaction processing
- ATM interchange fees
- Settlement and reconciliation
- Management reporting
- Project management

States pay these costs using various models and payment points. The typical approach is to pay an EBT contractor a monthly fee for each case managed by the EBT system. The fee varies from about \$2.00 to \$4.50, depending on level of service, case load, and client cost-sharing. States incur additional costs for project management, system enhancements, oversight activities, monitoring, infrastructure development, and quality assurance. Such costs may add \$0.50 to \$1.50 per case, depending on how actively a state manages its EBT project.

Evaluation of these EBT costs versus other payment systems must take into consideration the value added by the control and management elements inherent in EBT. In addition, in a traditional EBT system, funds remain in the government agency's bank account, earning interest, until the money is actually spent by the client. In a California analysis, a daily average of about 9 percent of the funds deposited in client accounts during the month remain in the account.⁹ That is, if \$10 million is deposited in client accounts, an average of \$900,000 will earn interest for 30 days. In contrast, funds disbursed using Direct Deposit are removed from government accounts on the first day.

iv. Vendor Costs

An EBT vendor provides services based on an arms-length contract with a state government agency. The contract defines the scope and terms of the EBT services that the vendor provides. It also specifies all payments due from the agency for provision of those services and any other fees allowable to the vendor related to provision of the services. Fees may include, for example, fees collected directly from the client, such as ATM charges or balance inquiry fees. The contract may also specify whether the vendor, operating as the state agency's card-issuing processor, can require merchants to pay transaction processing fees.

The vendor is responsible for all EBT service provision costs as contracted.

f. Challenges and Opportunities

i. Surcharges

A majority of ATM owners impose surcharges on EBT transactions. Most EBT projects allow the client to absorb this cost, based on the assumption that the client chose to use an ATM that imposed a surcharge. The same principal applies to clients that elect to use the services of a commercial check casher. Caveat emptor is the general rule.

However, EBT clients are sophisticated consumers and seek locations where they can access their benefits at little or no cost. In California, it has been found that about 26 percent of all ATMs used by clients do not surcharge and that over 50 percent of all ATM withdrawals come from surcharge-free ATMs.¹⁰ Further, the percentage of cash benefits redeemed at POS locations, presumably at little or no cost, has been steadily rising, to over 30 percent. In fact, Texas has successfully operated a POS-only cash EBT program for a number of years.

EBT projects manage this problem by seeking to remove or reduce ATM surcharges for EBT transactions. Retailers are actively encouraged to provide cash access to clients, either as cash back on a purchase or as full cash back in a service lane. Clients are trained to actively seek these no-cost cash access locations.

⁹ Source: California Department of Social Services.

¹⁰ Source: California Department of Social Services.

ii. Losing Track of the Cardholder

Maintaining a client's current address is a concern. However, for traditional food stamp and TANF EBT systems, obtaining the household address is a component of the eligibility process. Eligibility rules require clients to provide any change of address or risk losing their certification. Further, households are recertified regularly, generally every 6 months, requiring a visit to the agency office. At this time, current addresses are verified. Consequently, EBT systems depend upon address updates coming from the eligibility systems and do not typically accept address changes directly.

3. Electronic Payment Cards

a. Introduction

EPCs offer government agencies an opportunity to move toward complete electronic payment. EPCs are either debit cards that are tied to a consumer bank account or prepaid cards that are not tied to a bank account owned by the cardholder. The Visa Prepaid Card and Prepaid MasterCard Card are two examples of EPCs. This paper refers to such services collectively as EPCs simply for convenience.

b. Card Characteristics and Features

EPC offerings are differentiated by the underlying account structure and the range of services offered. It should be noted that EPCs are an emerging product; therefore, their features may be modified as issuers and governments gain experience with them. This paper covers current cards only. Card characteristics could be significantly different in a year.

i. Account structure

Some current EPC offerings are debit cards supported by and based on a consumer-owned asset account at a financial institution (i.e., a bank account owned by the consumer). Other EPC offerings are prepaid cards, tied to a single, aggregated funding account that is owned by an issuer or bank and that supports multiple cardholders.

One issue raised by differences in account structure is Reg E protection. Reg E provides minimum standards for the rights and responsibilities of persons who access a bank or bank-type account using an access device defined by the regulation. Reg E applies to electronic fund transfers that authorize a financial institution to debit or credit a consumer account (an account that can be accessed as an asset account, not a credit account, and are established for personal, family, or household purposes). The regulation includes requirements for providing terms and disclosures at the time a consumer contracts for an electronic funds transfer service or before the first electronic funds transfer is made. Reg E also addresses electronic terminal receipt requirements, periodic statement requirements, error resolution, and limitations on liability.

While the question of Reg E protection is currently under review by the Federal Reserve, it appears that Reg E governs debit cards tied to a consumer-owned account because of the card's account structure (i.e., it accesses a consumer account). Reg E protection for cards tied to aggregated accounts is more in question. To date, state agencies using the prepaid card structure have provided for Reg E protection through their contract with the service provider.

Both types of EPC cards can support government payment needs, as service criteria (rather than the underlying account structure) appear to be more germane to the ultimate success of any EPC implementation. EPCs can effectively deliver recurring government payments, supporting such

programs as TANF, child support, Unemployment Insurance, federal benefit payments, payroll and other repetitive payments. In most cases, one EPC could be used to deliver multiple payments to the client, enabling the client to receive both state and federal payments using the same EPC account. In addition, depending upon the structure and enrollment criteria, EPCs can also be used to receive Direct Deposit of payroll or other non-government payments, increasing the utility of the EPC to the client and expanding the "mainstreaming" benefit of the EPC in terms of financial service literacy and adoption.

ii. Use of Bank Acceptance Marks

MasterCard and Visa offline debit marks, the major innovation in the debit card service marketplace, enable improved delivery of services to clients. The incorporation of these banking association marks has several implications for use of EPCs by government and, ultimately, by low- and middle-income clients.

First, bank acceptance marks improve funds access. While most ATM/POS debit networks require PIN security for transactions, the MasterCard and Visa offline debit programs allow signature-based transactions. As a result, access at retail locations is expanded from approximately 3 million global locations for PIN-based debit to over 32 million global retail locations for MasterCard and Visa signature-based debit. Essentially, clients can use MasterCard- and Visa-branded debit cards at virtually every retail location that accepts MasterCard or Visa. MasterCard and Visa retailers not only provide "shopping" access to cardholders, but most also offer cash back with purchase. This feature provides clients with low-cost, convenient, and nearly ubiquitous access to their funds and minimizes their need to access funds at ATMs, which may impose a transaction surcharge.

Secondly, the use of the signature-based (offline) debit card at a retailer results in the payment of what is known as "interchange" to the issuer (i.e., the EPC financial institution or service provider). Because the retailer provides a supplemental revenue source to the issuer, EPC services can be more cost effective to the cardholder. Most EPC-related accounts do not charge cardholders for retail POS transactions. However, a surcharge may be levied if a cardholder uses an ATM not owned by the card issuer.

Lastly, the inclusion on a card of a bank acceptance mark means that clients are trained in and use mainstream financial services, including the global financial networks used by all categories of society. Government will not have to establish a separate retail and ATM network for its own debit services. Instead, government essentially acts as a purchasing agent on behalf of its clients to make this "account of last resort" available.

iii. Relation to ATM and POS Networks

EPCs offer client access to virtually every ATM and PIN-based debit retail location in the world, in addition to MasterCard/Visa signature-based network access. Access typically includes regional networks, such as STARSM, PULSE[®], NYCE, or SHAZAM[®], and usually includes

international networks, such as Cirrus[®] or PLUS[®].

ATM access also provides clients with a less expensive and more convenient alternative to check cashing services. Most EPCs offer surcharge-free access at the ATMs owned or operated by the issuing financial institution. While many out-of-network ATM transactions may be subject to a surcharge, clients typically adapt to the new debit card environment and find the lowest cost, most convenient financial services practices.

iv. Fee Structure

Issuers and providers face certain costs when providing EPC services. Fee types typically include the following:

- **Monthly account maintenance fee.** A monthly fee charged to each active account for core transaction processing and support services, 24-hour-per-day, 7-day-per-week toll-free help line, account setup/training material delivery, unlimited free POS transactions, Web account access, monthly statement, initial card issuance and activation, one annual card replacement and activation, Reg E coverage and ACH processing.
- **ATM withdrawal transaction fee.** A fee levied on each successful withdrawal of cash from an ATM.
- **Surcharge.** A fee charged by the financial institution owning the ATM for use of the ATM by cardholders who are not customers of that financial institution.
- **ATM balance inquiries fee.** A fee charged for each account balance inquiry transaction at an ATM. Clients may elect to use ATMs to check their account balances, although ATM balance inquiry fees can be avoided. Free alternatives are available for balance inquiries (e.g., Web account access, prior transaction receipt, help line).
- **POS transaction fee.** A fee charged for each POS transaction, providing access to funds at retailers with either PIN- or signature-based POS systems.
- **ATM denial fee.** A fee charged for each ATM transaction denied due to insufficient account balances (non-sufficient funds).
- **International ATM transaction fee.** A fee charged for each ATM withdrawal at an ATM located outside of the United States.
- **Card replacement fee.** A fee charged for each replacement card requested by a recipient. Policies frequently include one free replacement card per calendar year. Typically, overnight delivery of replacement cards can be requested by recipients for an additional fee.
- **Expedited card replacement/check issuance fee.** A fee charged for each expedited replacement card or check requested by a recipient for overnight delivery.
- **Check issuance fee.** A fee charged for each check requested by a client (usually requested to expunge account balances upon account closing).
- **Card-to-card transfer fee.** A fee charged for each transfer of funds from the primary card to a cash transfer card. The card-to-card transfer feature is currently in pilot, and fees for

this service may be subject to change with advance notice to states and to enrolled cardholders.

- **Customer service call fee.** A fee charged for each call to either an automated response unit or a live customer service representative. Such fees may be charged for the first call each month, for calls beyond a defined reasonable limit, or not at all.
- **Account inactivity fee.** A fee assessed on any account that has no deposit or withdrawal activity for a defined period. Such fees allow for recovery of maintenance costs by the issuer/provider and help eliminate nominal balance account support/escheatment costs by zeroing out abandoned balances.
- **Overdraft fee.** A fee assessed on any account that has overdrawn its cash balances during a particular month or other period of time.

These fees can be borne by the government or clients or shared. In most cases, the revenue derived from merchant POS interchange fees and float on funds has allowed card issuers to waive many of these fees. Some fees tend to be related, so that a lower monthly account maintenance fee (for example) is often tied to higher transaction fees (such as ATM withdrawals). It is possible to offer an account with no monthly maintenance fee in association with higher per-transaction fees.

v. Optional Features

Some providers offer additional services, such as Web account access services, automated bill payment, and acceptance of Direct Deposit of payroll. One service of particular interest is card-to-card transfer.

Card-to-card transfer is a cost-effective means for delivering funds from one consumer to another. The card-to-card transfer service allows the account holder of an EPC to establish a sub-account linked to the primary funds account and transfer a particular amount to this sub-account. A separate debit card and PIN allow a recipient to access the funds in the sub-account through an ATM or POS transaction. Through card-to-card transfer, the primary cardholder can allow a second recipient cardholder to access a defined amount of funds conveniently and at low cost (e.g., making funds accessible to a remote family member).

The card-to-card service allows for controlled and virtually immediate funds transfer, once the card or PIN is delivered to the recipient. Card-to-card transfers are especially effective for repetitive or frequent transfers and are far more cost-effective than historically available alternatives. The service is limited only by the requirement for ATM and POS access by the recipient and the need to deliver the recipient a card and PIN before completing the transfer.

c. Implementation Considerations

i. Card Design

The design of the EPC is the responsibility of the state government agency, subject to any constraints imposed by the financial institution, association, and EFT networks. If the agency

elects to implement a program with MasterCard or Visa, the hologram of the selected company, along with their service mark, must appear on the front of the card. The remainder of the front of the card can be designed to meet agency-specific requirements. Other card design requirements are being implemented in 2004 as part of the associations' need to more clearly label signature-based or offline debit cards.

The back of the card must also display the appropriate service marks. In the case of MasterCard, service marks may include Cirrus[®] for ATM and Maestro[®] for POS access. Similarly, a Visa card may include PLUS[®] for ATM and Interlink[®] for POS access. Both companies publish marketing and card design standards with which all members comply.

At present, Quest only supports EBT-based card programs, and most EPCs do not have access under the Quest Operating Rules or QUEST Mark.

When a government agency wants to disburse payments electronically for multiple programs, it is not necessary that the same card or card design accompany each program. In many cases, separation of programs and program funds is desirable.

ii. Enrollment

By implementing an EPC program, the government agency is taking the initiative to enroll recipients in EPC accounts. Recipients do not need to take that action themselves.

The enrollment process involves a form that can be signed by the beneficiary. The form usually details the specifics of the program, its use, and any cardholder fees, and discloses the ability of the card issuer to debit funds from the cardholder to recoup overdraft or Reg E liabilities. In some instances, a signature on a form is not required. The cardholder accepts the terms and conditions by using the card.

Typically, the government agency transmits the enrollment data to the card issuer, who then opens the account and issues the card to the recipient. There are currently two methods available for transmitting the enrollment data: online Web-based entry and batch transmission. The Web-based application allows an agency representative to enter cardholder data online in real time. The batch approach allows cardholder data stored in the agency's computer system to be transmitted to the card issuer as a batch file. In some cases, both methods are employed to enroll and manage the cardholder accounts.

iii. Funds Transfer – Loading the Card Account

There are two ways to load the card account with funds.

One way to load a card account is for the government agency to use its current Direct Deposit process. ACH transactions contain the information necessary to load each individual cardholder's account. The advantage of this approach is that it allows a government agency to

mainstream deposits to the EPC along with their current Direct Deposit processing to traditional bank accounts, thus minimizing change to current agency systems. Because this approach requires the agency to originate the ACH transactions through its financial institution, normal transaction fees for ACH transactions apply.

As an alternative, some card issuers will accept a file of individual load data along with an ACH transfer to the funding account for the total amount to be loaded. This method incurs no ACH origination fees. However, it may require additional reconciliation and monitoring by the government agency and the card issuer.

Regardless of how the card account is loaded, payments are deposited into an account at the bank, either an aggregated account for a prepaid EPC or an account owned by an individual for a debit EPC.

d. Legal and Compliance

EPCs can be used for almost any type of payment distribution or funds transfer, including payroll, incentives, rebates, disaster recovery, service provider reimbursements such as insurance and health care, tax refunds, child care, and child support payments. EPCs are subject to various consumer and other financial regulations such as the Patriot Act, the Bank Secrecy Act (BSA), the Money Service Business (MSB) Interim Final Ruling, Office of Foreign Assets Control financial sanctions, and escheatment requirements. The Federal Reserve Board is currently reviewing whether EPCs are covered by Reg E.

Minimal anti-money laundering/anti-terrorist financing risk is associated with a government agency using this payment vehicle. The source of the funds is a government agency and the recipients are identifiable. In any case, the Patriot Act specifically excludes government agencies and instrumentalities from the definition of customer for the purposes of identification and verification requirements. This means that EPCs provided to a government entity for distribution of payments to consumers are not subject to Patriot Act requirements. In this case, the government is the customer and there is no provision of formal banking relationship or services to a consumer. If the cards are being distributed with the ability to accept funds from sources other than a government agency, all identification and verification requirements clearly are applicable.

BSA applies to financial institutions that are subject to banking regulations. All BSA requirements are applicable when EPCs are provided by a financial institution to a consumer, when the source of funds is not a government agency or other financial institution, and/or when the consumer is a direct customer of the card-issuing financial institution. The Act has been amended by Section 326 of the Patriot Act Final Ruling. This amendment requires that financial institutions take the following actions:

- Implement reasonable procedures to verify the identity of any person seeking to open an account, to the extent reasonable and practicable.

- Maintain records of the information used to verify the person's identity.
- Determine whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency.

The ruling provides minimum requirements and a basis for a risk-based approach to determining requirements for identification and verification.

The MSB Interim Final Ruling is an amendment to the BSA issued by Treasury in April 2002. The Interim Final Ruling extended anti-money laundering and anti-terrorist financing requirements to financial institutions not previously subject to banking regulations, including:

- Mutual funds
- Operators of credit card systems
- Money service businesses
- Securities brokers and dealers registered with the SEC
- Futures commission merchants and brokers registered with the Commodity Futures Trading Commission

The MSB requirements, which are essentially the same as the BSA requirements, apply to EPCs issued both by the types of businesses listed above that are not subject to banking regulations and to those businesses that are established as part of a bank and are required to comply with the BSA.

Both the BSA as amended by the Patriot Act and the MSB Final Interim Ruling require the financial institution to establish an anti-money laundering program that at a minimum includes the following:

- The development of internal policies, procedures and controls, including verifying customer identification, filing reports, creating and retaining records, responding to law enforcement requests, and, when automated data processing systems are in use, integrating compliance procedures with such systems.
- The designation of a compliance officer.
- An ongoing employee training program.
- An independent audit function to test the program.
- Record keeping, reporting, and registration.

e. Cost and Benefit Considerations

i. Consumers

Payroll cards, which are virtually identical to EPC cards, have increased in use for cash consumers in the private sector. Table 2 below includes an evaluation of the types of fees associated with each type of financial service — payroll card/EPC, check casher and basic bank

account. The annual costs shown in the table suggest that EPC services may represent the lowest cost package of financial services available to cash consumers.

Table 2: Financial Service Cost Comparison¹¹

Costs	Payroll Card¹²	Check Cashier	Basic Bank Account
Minimum monthly balance required	N/A	N/A	\$0
Minimum deposit to establish account	N/A	N/A	\$100
Check cashing fee	N/A	\$8.77	0
Monthly fee (1)	\$3.00	N/A	\$5.95
ATM usage fee (2)	0	N/A	0
Money order fee (3)	\$1.00	\$1.00	N/A
Total monthly fees (4)	\$6.00	\$20.54	\$5.95
Checks (box of 150)	N/A	N/A	\$8.00
Total annual fees	\$72.00	\$246.48	\$79.40

Using EPCs makes it unnecessary for the consumer to visit a bank to receive funds. Millions of POS locations are available at which consumers can make purchases and even receive cash back. There are also literally hundreds of thousands of ATM sites at which consumers can make a withdrawal, although some fees may apply. Managed properly, however, these fees can be minimized and will be less than the fees charged by check-cashing organizations. Furthermore, the consumer has the additional security of not having to carry large amounts of cash.

Use of EPCs can also streamline the process of making child support payments to custodial parents living in other countries. Funds can be accessed at terminals around the world. The

¹¹ Source: "Payroll Cards: An Innovative Product for Reaching the Unbanked and Underbanked," Comptroller of the Currency white paper, October 2003. The table assumes two paychecks of \$400 each month and three payments needing money orders or checks each month. The bank account and check cashier costs in this table were obtained from a large bank and a large check cashing outlet in Los Angeles. These costs fell in the middle of the range from five cities surveyed. Notes: (1) Uses an average monthly fee for payroll cards issued by large banks. Assumes checking account customer does not use direct deposit. These fees may be waived or reduced. (2) Assumes customer does not use foreign ATMs to withdraw cash. (3) Assumes checking account customer will write personal checks to pay bills. Assumes payroll card holders and check cashing customers purchase 3 money orders through the U.S. Postal Service. (4) Typical payroll card and bank account fees may be understated as they do not include negative balance and excessive phone inquiry fees for payroll cards and bounced check and below minimum balance fees for checking accounts.

¹² Payroll cards, frequently offered as MasterCard or Visa prepaid card products, are virtually identical to the classes of EPC services described in this document and are used for this consumer cost comparison as a proxy for EPCs.

government agency therefore does not have to make international payments or be concerned with exchange rates.

A monthly statement, either mailed or available through an Internet site, allows consumers to keep records of all purchases and manage their funds appropriately.

In terms of cost, most of the current EPC programs minimize cost to the cardholder by allowing at least one free ATM withdrawal per month and often providing POS purchases and balance inquiries at no cost. Often fees do apply for extraordinary services, such as expediting card replacement or issuing a check to close out an account.

ii. Merchants

Merchants realize certain benefits from electronic disbursement of payments, but they must also consider transaction fees when evaluating the benefits of such programs. POS purchases may be PIN-based or signature-based, and merchants are responsible for paying fees to the credit card companies and networks for each acquired transaction. Most financial institutions that issue a card branded with a MasterCard or Visa mark collect an interchange fee for every signature-based transaction processed. Signature-based transactions are more expensive than PIN-based transactions for the merchant, while the issuing institution realizes greater income through a signature-based transaction.

iii. Agencies

The primary benefit to government agencies is the opportunity to move away from paper checks to electronic delivery of payments. The cost of producing a check and the postage to send it are a major expense. If these costs can be eliminated or drastically reduced, the agency saves money. Additionally, when payment recipients relocate, delivering checks can become a problem and often funds are not available on schedule. For example, many child support payment checks to custodial parents are returned because the custodial parent moved away and did not inform the child support agency of a new address. EPCs can help states reduce this type of undistributed collection, which are a fiscal and political problem.

iv. Vendors

EPC "vendors," or card issuers, include banks, EBT contractors, and other service providers who know how to manage transaction-based payment card programs.

Providers of such a service can derive income from issuer interchange fees, float, and excess transaction fees. Issuer interchange fees are a percentage of the value of an offline (signature-based) retail debit transaction that is paid to the card issuer. Float refers to the benefits realized when collected funds are deposited in the card issuer's program. The funds remain in that bank account until a cardholder makes a purchase or ATM withdrawal. Finally, most states want cardholders to be allowed a certain number of free ATM transactions per month. When a

cardholder exceeds the number of free transactions, additional revenue may accrue to the card issuer because subsequent transactions may be subject to a fee.

f. Challenges and Opportunities

i. Procurement

Government agencies interested in implementing an EPC program typically procure the product competitively and enter into an agreement with a card issuer. In light of how new these products are, the differences in underlying account structures, and the potential for rapid change, it is recommended that government agencies consider the following in their procurement process:

- The agency should clearly establish that the card issuer provides full Reg E type protections to cardholders, notwithstanding future legal or Federal Reserve Board decisions. This protects the agency and its clients.
- Card associations (Visa and MasterCard) typically offer a zero liability policy to their cardholders regarding fraudulent use of the card. While card issuers providing EPC today have extended this policy, contracts should state zero liability as an explicit policy.
- A set fee structure should be established for the term of the contract.
- Be aware of fee impacts to cardholders (e.g., surcharges or costs to close an account).
- An acceptable approach should be defined for inactive accounts and inactivity fees that cause an account to go negative. For example, regular child support payments cannot be guaranteed, and such an account may remain open for a long time with no payment. Closing the account due to inactivity defeats the purpose of an EPC.
- An acceptable approach to cardholder abuse of the account should be defined. A card issuer should only cancel an account as a last resort. An agency could require agency authorization prior to cancellation by the card issuer.
- Appropriate privacy protections and data-mining restrictions should be established.

Agencies are encouraged to ensure that they are dealing with a reputable vendor, especially if funds are held in an aggregated account rather than in individual consumer asset accounts. Any problems associated with vendor insolvency could be exacerbated if cardholder funds are held in an aggregated account.

ii. Implications of Retailers' Lawsuit

The lawsuit brought by retailers challenging the Visa and MasterCard associations' fee structure for offline debit transactions and their control over determining rules for those transactions resulted in an across-the-board reduction of the interchange rates that apply to EPCs. This reduction helps minimize the expense to retailers for supporting debit transactions and, over time, will help increase retail acceptance of EPCs.

However, the reduction also affects the costs borne by the client. Issuers seek a certain amount of revenue to offset the costs incurred to support EPC services. Float, one traditional source of banking revenue, is a minimal source of revenue to the issuer, given the low balances and immediate fund withdrawals associated with EPCs. Interchange fees, an important source of revenue paid by retailers, have been reduced as a direct result of the lawsuit. Client fees, therefore, are a potential source of revenue for EPC services.

Finally, the lawsuit resulted in an agreement to other important card labeling changes, with modified "debit" labeling requirements being phased in during 2004.

iii. Surcharges

ATM transactions may be subject to a surcharge (i.e., a fee charged by the financial institution owning the ATM for use of the ATM by cardholders who are not customers of that financial institution). These fees range from \$1 to \$2 but can be higher in certain locations such as airports, hotels, and casinos. Clients typically adapt to the new debit card environment and find the lowest cost, most convenient financial services.

iv. Losing Track of the Cardholder

To support EPC services requires innovative, non-traditional means of maintaining a banking or EPC relationship with the client. Government agencies also need to maintain contact with their clients—a challenge given the high level of mobility of the population involved. Often, the agency will work cooperatively with the EPC provider to mesh policies and databases for the clients and ensure that all parties' needs are met.

v. Account Overdrafts

Offline debit has developed rapidly over the past few years. One major reason for this development is the near-universal proliferation of online POS processing capability. As a result, merchants who previously were able to provide only offline authorization can now verify transactions online, which virtually eliminates the possibility of completing transactions that exceed the current account balance. As a result, there has been a dramatic decrease in costs to card issuers for fraud or overdraft losses.

However, in some circumstances an account overdraft can occur. These overdrafts generally are caused by "pay at the pump" pre-authorization practices, Internet purchases, and automatic debit payments (such as for magazine subscriptions). While issuers can control some of these conditions by limiting types of access (e.g., no "pay at the pump"), overdraft losses are still a consideration.

vi. FDIC Insurance

Another issue under review is whether both types of EPC cards (those tied to accounts and those that are not) are covered by FDIC insurance. Currently, the FDIC insures each account holder's total value of bank accounts held at an individual institution for a maximum of \$100,000. The FDIC is currently reviewing how insurance should be handled for various products.

vii. Third-party agencies

Card-based disbursement options are not viable for payments to a recipient when a third-party agency, such as a PCSEA, is involved. Government agencies implementing mandatory card programs should be aware that the involvement of a PCSEA in a child support case may not be obvious. Thus, a card can be set up in the name of the parent but mailed to the third party. Obviously, the third party cannot use the card to retrieve the funds, and if the card is passed on to the parent, the third party is bypassed. Therefore, agencies that intend to pursue a mandatory card-based electronic funds transfer program should be sure that their systems allow exceptions for parents using a third-party agency.

4. Comparison of Electronic Benefit Transfer Cards and Electronic Payment Cards

Direct Deposit of payments to a traditional bank account is the preferred method for government agencies to disburse to recipients. However, the EBT card and EPC provide a means for government agencies to make payments electronically to recipients who do not have a bank account or who, for some reason, do not elect to have payments deposited directly to a bank account. These cards should be considered a "bank account of last resort," to be used only when Direct Deposit of payments to a traditional bank account is not possible.

a. Summary of Card Characteristics

The following table compares the characteristics and features of the EBT card to the EPC to help government agencies determine which card is best suited to a particular payment application.

Table 3: Comparison of EBT Card and EPC Characteristics

Issue	EBT	EPC
How is the card paid for? Government cost	Determined by contract. Bears primary cost through fee to EBT processor (card issuer).	Determined by contract. Typically bears little or no cost.
Cardholder cost	Little or none. There may be a fee for ATM access	Little or none. Most costs are fee-based. There may be fees for non-core or convenience-oriented services.
Merchant cost (for point-of-sale transactions)	None if a government-provided terminal is used. No POS interchange fee paid to card issuer by merchants. Third-party processor fees apply.	Standard POS interchange fee is paid to card issuer for signature-based transactions. Third-party processor fees apply.
Who owns the funds in the underlying account?	Government agency	Varies, but typically is the cardholder. This is still subject to regulatory opinion.
Does the government agency have access to cardholder's transaction history?	Yes	No
Who benefits from float in the underlying account?	Government agency	Card issuer
How are abandoned/unused payments typically disposed?	Expungement, responsibility of sponsoring government agency	Escheatment, responsibility of card issuer
Cardholder rights and responsibilities are governed by which operating rules?	Government policy and Quest/state operating rules	Government policy and association/network rules
Does Reg E apply?	Not for needs-tested programs	Under review by the Federal Reserve. Association and card issuer rules may also apply.

Issue	EBT	EPC
Can access to cash and purchases be restricted?	Generally, yes. Via their EBT processor and regional network operators, governments can restrict access to certain ATMs (e.g., in casinos) and POS merchant categories that accept the EBT card.	Generally, no. Most card issuers offer worldwide POS access wherever the association's card is accepted. Nationwide ATM access is typically provided.
Who provides customer service?	EBT contractor with service levels determined by government	Card issuer consistent with commercial consumer accounts
How are disputes managed?	By EBT contractor per government specification and oversight	By card issuer consistent with association/network rules
Where can the card be used?		
ATMs	For cash, generally yes. However in-state and national access may be limited and varies by state. Out-of-network surcharges may apply.	Yes, typically nationwide. Out-of-network surcharges may apply.
Teller line	No	Generally yes, at an association member bank
Merchants	At FNS authorized merchants for food stamps. Access at non-food merchants is fairly limited.	Typically anywhere the association debit card is accepted
Mail order houses	No	Yes, depending on merchant
Internet sites	No	Yes, depending on contract and merchant
Are PIN-based (online) transactions supported?	Yes	Yes
Are signature-based (offline) transactions supported?	No (unless technical difficulties prevent an online transaction)	Yes

b. Selecting a Card

It is often possible for government to mix and match features of "off the shelf" products to create a hybrid product. In some cases, this approach may be viable. However, it is recommended that government agencies not attempt to merge the characteristics of EBT cards and EPCs to create the ultimate hybrid. Rather, agencies are encouraged to respect the distinct differences between these two cards and make a choice based on the following criteria:

- Payment type
- Program making the payment
- Costs
- Agency policies and objectives

An agency may face a situation in which a single recipient is issued both an EBT card and an EPC, to receive payments from multiple programs. The temptation may be to put all payments on a single card. But a single-card approach may not be practical unless the multiple program payments are fully compatible. This situation illustrates one reason why Direct Deposit to a

recipient's traditional bank account is the preferred method of electronic delivery, as it solves the multiple card issue.

i. Payment Type Considerations

In some instances, the type of payment will clearly dictate whether an EBT card or an EPC is the appropriate choice. In other instances, the choice will not be clear. For example, it would be costly for a card issuer to provide an EPC when needs-tested payments that are subject to expungement are commingled with non-needs-tested payments that are subject to escheatment. Instead, the agency may want to determine whether a payment is subject to expungement or escheatment and choose EBT or EPC accordingly. In the event that the payment could be subject to either expungement or escheatment, agencies might determine whether they must retain ownership of the funds (and if so use an EBT card), or whether they can give up ownership to the recipient (and deliver funds using EPCs).

ii. Program Considerations

When considering which card to use, government agencies must consider the nature of the program making the payments. If food stamps are being issued, EBT is the only option—the program mandates delivery using EBT. If an agency is considering how to deliver another non-cash needs-tested benefit where access is to be restricted, an EBT card is the only choice that provides this capability. Using an EPC is not viable.

There are distinct advantages to using an EPC to deliver non-needs-tested payments, such as child support. However, at least one state is successfully dispensing non-needs-tested payments using their EBT card.

It appears that needs-tested cash benefits could be dispensed using either card.

iii. Cost Considerations

When both approaches are equally suitable, cost can be used as a tiebreaker. In general, governments bear the cost of making payments using the EBT card, whereas, under the existing programs, governments generally do not pay much (if any) of the cost to make payments using the EPC. However, government agencies dispensing food stamps in addition to other payments must consider whether there is a cost advantage to issuing needs-tested and non-needs-tested payments using EBT cards. Delivering cash payments using EBT cards increases volume, which may reduce the overall cost of EBT or allow the cost to be spread among programs.

iv. Policy Considerations

Agencies must also consider whether the choice of a card for a particular payment has a public policy ramification. Agencies should consider the following parameters:

- Control over funds. EBT cards provide government agencies with a certain amount of control over payments. As a result, the agency earns float, and unspent funds are returned to the agency through the expungement process. If there are program requirements or the program must retain control, EBT is the better choice.
- Mainstreaming recipients into the commercial financial world. Since the EPC is a commercial product that operates on one of the two major association networks (Visa or MasterCard), the cardholder is indistinguishable from other mainstream credit and debit cardholders. An EPC provides the cardholder with the most flexibility and freedom over how funds are withdrawn and spent. Along with this freedom comes a greater degree of responsibility on the part of the cardholder. If the agency considers it advantageous to move their clients into the commercial financial world, the EPC has distinct advantages.
- Forcing recipients to use bank accounts. Since the EPC is a commercial banking product, there may be a perception that government is forcing recipients to embrace an unwanted responsibility. If politics or public perception issues along these lines would reflect negatively on the agency, EBT cards may have advantages over the EPC. However, it should be noted that an education program can also help to resolve this issue since EPC programs have no interest and do not require credit scoring.
- Stigma. Some states have reported that the EBT card, while overcoming the welfare stigma associated with paper food stamps, still carries a stigma for some recipients. If an agency is concerned about this issue extending to recipients of other payments made to an EBT card, an EPC may be preferable.
- Restricted access. Government agencies may decide that it is important for needs-tested cash benefits not to be used for certain purchases or withdrawn as cash from ATMs in certain places (e.g., in a casino). EBT cards offer advantages, since access cannot be restricted for EPCs.
- Ownership of funds. When an agency disburses non-public funds, those funds are typically "owned" by the recipient. In this case, the EPC offers distinct advantages over an EBT card.
- Enhanced customer service. Programs in certain states may require enhanced levels of customer service (e.g., customer service may be required in multiple languages). Special service requirements can be implemented as part of an EPC system, but they tend to burden the payment process with excessive requirements. EBT may be a better choice when such services are required.

III. SUMMARY

Checks are becoming a thing of the past. While many governments still rely heavily on checks, checks are expensive to issue and easily stolen, and they must be handled by a human from beginning to end. Checks are labor intensive, costly, and subject to fraud.

To disburse funds to clients electronically, Direct Deposit to a consumer-owned bank account is the preferred option. Direct Deposit is safe, reliable, and convenient and can be accomplished with a minimum of human intervention. When recurring payment amounts do not change, no additional human involvement is necessary once the required authorizations are in place and the process has been established. The cost for each Direct Deposit transaction is minimal (a few cents). Direct Deposit is also preferable because consumers select the bank account themselves. They make a conscious choice as to account characteristics, cost, and accessibility. In addition, there is no appearance that the government might be intruding into a citizen's private banking relationship.

If checks are becoming obsolete and Direct Deposit is preferred, why aren't more government payments delivered electronically? Perhaps the greatest impediments to accomplishing this goal are the significant number of citizens who do not sign up for Direct Deposit or who do not have bank accounts. A bank account is fundamental to receiving Direct Deposit of payments. Government cannot mandate that citizens establish a private and personal business relationship with a bank. As a result, adoption of Direct Deposit has generally remained voluntary.

One solution is for government to provide a card-based product to those who do not have a bank account or do not sign up for Direct Deposit. Cards provide the missing piece in the universal electronic delivery puzzle by allowing governments to strongly promote Direct Deposit while retaining the ability to enroll those who do not respond in an alternative account. Government agencies have therefore teamed with the banking community and the private sector to use debit-type cards for this purpose. These cards are non-qualifying and are virtually overdraft proof. This white paper looks at two different cards, Electronic Benefits Transfer (EBT) cards and Electronic Payment Cards (EPCs). Together, these two cards appear to offer government the necessary tools to pursue universal electronic payment delivery.

Since the two types of cards are distinctly different, government agencies must consider a number of factors, from political to financial, to determine which card is right for a particular payment application. Selecting the appropriate card requires multiple decisions.

Should the government make disbursements for a particular program using paper checks (or warrants) or electronically?

Various factors affect this decision, including the cost of associated systems changes, the type of client being served, the culture of the agency making the payment, and the support available to the agency in moving to electronic payments.

If the government opts for electronic disbursements, should it be mandatory to all recipients?

The federal government's experience in implementing the mandatory EFT provisions of the Debt Collection Improvement Act of 1996 indicates that it may be necessary to allow certain recipients to continue to receive a check (e.g., when the recipient lives outside the country or is mentally challenged). The presence of a third party in the payment stream is also a consideration. For example, a private child support enforcement agency may be an intermediary between a State Disbursement Unit and the parent. Issuing a card to this agent on behalf of the parent is unworkable.

If the government opts for electronic disbursements, should it use Direct Deposit to a traditional consumer-owned bank account or a card-based option?

Direct Deposit is the preferred approach. However, Direct Deposit is not an option for all clients or for all programs. In fact, Direct Deposit is impossible for clients who do not have a bank account. A card-based disbursement option will be necessary to reach these clients.

If the government opts for a card-based option, should it opt for EBT or an association- and network-branded card?

When consumers do not take advantage of Direct Deposit or have no bank accounts, an agency can consider both EBT cards and EPCs. For needs-based clients, EBT cards offer certain advantages. The government may want to play a role in overseeing the flow of funds, to protect the client. For example, the government may want a role in error resolution if too much money is mistakenly debited from a client's account. In addition, some states place restrictions on where TANF funds can be spent. Use of such funds at a casino, liquor store, or fireworks stand may be prohibited. If a card with an association mark is used instead of a government or QUEST Mark, it is doubtful that restrictions can be imposed. The EBT card may be the best option for agencies that want an oversight role in the flow of funds or that seek to restrict the use of funds.

For other cash payments, such as child support, government agencies do not have an interest in limiting use of the funds. For these types of payments, the EPC may be the most promising option. Clients have wide access to a variety of card acceptance terminals. They may be able to initiate a signature-based transaction and a PIN-based transaction, and the government may not have to assume a role in error resolution. Once the government sends an ACH file to the card-issuing financial institution, its responsibility for the payment has ended. For some types of cash payments, this may be desirable. For other types of payments, such as needs-tested payments, it may not.

If a government opts for an association- and network-branded card, how is it acquired?

To offer an association- and network-branded card, the government will have to enter into an agreement with a card-issuing financial institution or service company to enroll recipients and issue cards. Most government agencies have procured such products competitively to obtain the

lowest cost for the agency and their clients. Since these products are very new, structural differences still exist between vendors. It is likely that these cards will change rapidly in the near future in terms of structure, features, and (potentially) how they are regulated.

Important provisions that government agencies should consider including in procurements and contracts include locking in fees for the term of the contract, clearly establishing Reg E protections to cardholders (notwithstanding future legal or Federal Reserve Board decisions), and locking in a "zero liability" policy for cardholders regarding fraudulent use of the card.

IV. APPENDIX A: ELECTRONIC PAYMENT CARD CASE STUDIES – COLORADO AND MARYLAND

Colorado and Maryland initiated card programs within a year of each other. The Colorado Family Support Registry (FSR) card began in January 2002 as a pilot project for child support payments and is now a permanent program. Maryland's CashPay® Card was launched in January 2003. Both states use the ACH to electronically transmit payments to a bank in the name of a custodial parent. Both states' cards display the same commercial acceptance marks, and cardholders can access their payments at any ATM or merchant that displays these marks.

Colorado's FSR Card and Maryland's CashPay Card are both issued by banks that have contracts with the state. In both instances, the state SDU sends an ACH PPD (Preauthorized Payment and Deposit) file to its bank to load funds onto the card. Since Colorado's PPD file specifies the same Depository Financial Institution account number for all FSR cardholders, an aggregated account is used, and the card is a prepaid card. The PPD file sent by Maryland specifies a distinct bank account number for each cardholder. Maryland's card is a debit card.

Features of the Colorado and Maryland Cards

Both states initiated their card programs as a way of expediting child support payments to unbanked custodial parents and reducing state expenses. The two cards share the following features:

- Custodial parents access their funds through ATMs and POS terminals at merchant locations.
- The cards are largely "overdraft proof." Neither state allows cardholders to write checks on the account. With rare exception, virtually all POS transactions verify an adequate balance before authorizing the sale.
- The cards display the same association mark. They can be used at any ATM, bank branch, or POS terminal that accepts the card worldwide.
- Transactions initiated with the cards are transparent to merchants. That is, transactions initiated with the Colorado FSR Card or the Maryland CashPay Card are no different for merchants than commercial transactions.
- Merchants that accept the cards pay the same discount fee to their acquiring bank as they pay for any other payment card carrying the same acceptance marks.
- Cardholders can receive cash back on PIN-based purchases.
- Cardholders receive all consumer protections accorded to the brand's other cardholders. Reg E coverage is required for Maryland's card since it is a debit card. Colorado's bank provided Reg E coverage as required by their contract.
- No line of credit is associated with the cards. Since there cannot be an overdraft, custodial parents do not have to undergo credit screening or meet other bank requirements to qualify for the card.

- The issuing bank assumes all liability for fraud and operating exceptions associated with the card, so the states do not manage errors or exceptions.
- Because POS transactions provide revenue for the issuing bank, both states anticipate that the cards will be self-funded through merchant fees and cardholder fees for ATM withdrawals.
- The issuing banks provide 24-hour-per-day, 7 day-per-week customer service.
- Transaction histories are available over the Internet and monthly account statements are mailed to the cardholder.
- Cardholders can transfer funds to any traditional savings or checking account in the United States.
- Cardholders can pay bills as recurring ACH debits (Direct Payment) or over the phone.

Both states' cardholders receive at least one free ATM transaction per month to access their funds. After using the free transactions, cardholders pay \$1.50 per transaction.

Colorado Pilot

From January 2002 through January 2003, Colorado ran a pilot program for electronic disbursement of child support payments. The state sent out 10,000 random solicitations with their checks, and over 10 percent of the recipients applied for the card. During the pilot, the average benefit load was \$146. Cash withdrawals (at ATMs) made up 18 percent of the activity (average withdrawal of \$79) while POS transactions made up the other 82 percent (average purchase of \$24). Cardholders maintained an average balance of \$77 on their accounts, indicating that cardholders were not withdrawing the full payment amount. Merchant category statistics on POS activity are described in Table 4.

Table 4: Merchant POS Activity in Colorado EPC Pilot

Retail Outlet	% Activity
Supermarket	30
Fuel	12
Dining	10
Discount/drug stores	8
Telecom	8
Mail/telephone order	5

In May 2002, a series of focus group meetings were conducted to evaluate card acceptance and adjust the program if necessary. Custodial parents were interviewed and Colorado learned that users are quite happy with the card, see real benefits to having it, and would recommend using it to a friend. Users indicate that the card represents a more convenient way to make a purchase, builds self esteem, provides a solid budgeting tool for money management, and gives them a way to separate child support funds from other household money.

V. PUBLICATION ACKNOWLEDGEMENTS

This report was developed by the NACHA Electronic Benefits and Services (EBS) Council's Electronic Disbursement Options Work Group to discuss options for electronic disbursement and to describe card-based disbursement options. Publication of this document by NACHA does not imply the endorsement of any of the member organizations of NACHA.

NACHA wishes to thank the Electronic Disbursement Options Work Group members for their comments and contributions. Lead contributors to this report were:

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VI. ABOUT NACHA – THE ELECTRONIC PAYMENT ASSOCIATION AND THE ELECTRONIC BENEFITS AND SERVICES COUNCIL

NACHA – The Electronic Payments Association is the leading organization in developing electronic solutions to improve the payments system. NACHA represents more than 11,000 financial institutions through direct memberships and a network of regional payments associations, and 650 organizations through its industry councils. NACHA develops operating rules and business practices for the Automated Clearing House (ACH) Network and for electronic payments in the areas of Internet commerce, electronic bill and invoice presentment and payment (EBPP, EIPP), e-checks, financial electronic data interchange (EDI), international payments, and electronic benefits transfer (EBT). Visit NACHA on the Internet at www.nacha.org.

NACHA's Electronic Benefits and Services (EBS) Council (formerly the EBT Council) develops and maintains operating rules that lay the foundation for a nationwide electronic benefits transfer (EBT) system. The operating rules, known as the Quest® Operating Rules (the Rules) specify uniform rights and responsibilities for those involved in processing EBT transactions. Recently, the Council expanded its vision and mission statements to include governmental payments, beyond welfare, such as child support. The EBS Council is comprised of a broad cross-section of public and private sector EBT stakeholders and includes the Electronic Disbursement Options Work Group.

The Electronic Benefits and Services Council of NACHA has written this publication as an information resource concerning electronic disbursement options. The Electronic Benefits and Services Council, however, does not guarantee the accuracy, adequacy, or the completeness of any information, or fitness of any information for a particular purpose. Moreover, the materials in this publication do not offer any professional advice. If the reader requires the services of an attorney or other professional, the reader should seek a competent professional in the applicable field.

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SENATE COMMITTEE REPORT

DATE: 3/26/04

FURTHER: Finance

DATE TURNED IN TO OFFICE: 4/7/04

State Affairs Committee considered CS FOR HOUSE BILL NO. 494(FIN) am

HB 494 ELECTRONIC PAYMENT FOR STATE BUSINESS

"An Act relating to the methods of disbursement of money by the state, including employment compensation, unemployment payments, and permanent fund dividends, and to bank investments and deposits by the state; and providing for an effective date."

and recommends:

- be replaced with _____ CS _____ (_____)
- adopt previous _____ CS _____ (_____)
- attached amendment(s)
- adopt Letter of Intent by _____ Committee
- further referral to _____ Committee

Senate Bill:	
<input type="checkbox"/>	Same Title
<input type="checkbox"/>	New Title
House Bill:	
<input type="checkbox"/>	Same Title
<input type="checkbox"/>	Technical Title Change
<input type="checkbox"/>	New Title w/ SCR # _____

NEW FISCAL NOTE(S):

Department	Date	Fiscal	Indet.	Zero	FN#

APPROPRIATION - no fiscal note

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Indet.	Zero	FN#
H+SS	3/19/04			✓	1
H+SS	3/19/04			✓	2
H+SS	3/19/04			✓	3
L+WD	3/16/04			✓	4
L+WD	3/16/04			✓	5

DOR 3/19/04 ✓ 6
 ADM/ALL 3/16/04 ✓ 7

SIGNATURES AND RECOMMENDATIONS:	DO PASS	DO NOT PASS	NO REC	AMEND
<i>John J. Casadeu</i>			✓	
<i>Ben K. ...</i>				
CHAIR: <i>[Signature]</i>				

SENATE FINANCE COMMITTEE

S I G N - I N

HB 494-ELECTRONIC PAYMENT FOR STATE BUSINESS

✓ NAME: Debbie Bump Subject/Bill No: _____

Co./Dept./Title: DOA, Finance Admin Services Manager Phone: 465-5615

Address: _____ Zip: _____

Do you wish to testify? Yes No Respond To Questions

NAME: _____ Subject/Bill No: _____

Co./Dept./Title: _____ Phone: _____

Address: _____ Zip: _____

Do you wish to testify? Yes No Respond To Questions

NAME: _____ Subject/Bill No: _____

Co./Dept./Title: _____ Phone: _____

Address: _____ Zip: _____

Do you wish to testify? Yes No Respond To Questions

NAME: _____ Subject/Bill No: _____

Co./Dept./Title: _____ Phone: _____

Address: _____ Zip: _____

Do you wish to testify? Yes No Respond To Questions

SENATE FINANCE COMMITTEE

SIGN-IN

HB 494-ELECTRONIC PAYMENT FOR STATE BUSINESS

NAME: Kim Gamero Subject/Bill No: Electronic payments for State Gov't
 Co./Dept./Title: Director of Finance Phone: 465-3435
 Address: Dept. of Administration Zip: _____

Do you wish to testify? Yes No Respond To Questions
 ↑
 If it pleases the committee, I am available

NAME: _____ Subject/Bill No: _____
 Co./Dept./Title: _____ Phone: _____
 Address: _____ Zip: _____

Do you wish to testify? Yes No Respond To Questions

NAME: _____ Subject/Bill No: _____
 Co./Dept./Title: _____ Phone: _____
 Address: _____ Zip: _____

Do you wish to testify? Yes No Respond To Questions

NAME: _____ Subject/Bill No: _____
 Co./Dept./Title: _____ Phone: _____
 Address: _____ Zip: _____

Do you wish to testify? Yes No Respond To Questions

HB

495

HFIN

FILE

FISCAL NOTE

STATE OF ALASKA
2004 LEGISLATIVE SESSION

Fiscal Note Number: _____
Bill Version: HB 495
() Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: DCED
Title Four Dam Pool Joint Action Agency RDU AIDEA (125)
Component AIDEA
Sponsor Representative Williams
Requester House Finance Component No. 1234

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
----------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2004) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2005 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

On January 31, 2002, AIDEA loaned \$77.1 million to the Four Dam Pool Power Joint Action Agency (the "Agency") for the purchase, closing costs and initial funding of reserves related to the Agency's acquisition of the Four Dam Pool Project. This bill has no general fund impact and no fiscal impact to AIDEA.

This bill clarifies that a joint action agency's assets (including the Agency's) may be mortgaged for future financing by the joint action agency. In addition, the bill states that the joint action agency's assets may be transferred in connection with a foreclosure without legislative approval; however, this provision does not supercede the legislative approval required in the Memorandum of Understanding between the purchasing utilities and the Alaska Energy Authority adopted by reference in 2000 SLA Ch 60.

Prepared by: Ron Miller, Executive Director Phone (907) 269-4623
Division AIDEA/AEA Date/Time 3/1/04 2:24 PM
Approved by: Edgar Blatchford, Commissioner Date 3/1/2004
Agency Department of Community & Economic Development

adopted 3-2-04

23-LS1681\H

Craver
3/2/04

CS FOR HOUSE BILL NO. 495()

IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-THIRD LEGISLATURE - SECOND SESSION

BY

Offered:
Referred:

Sponsor(s): REPRESENTATIVE WILLIAMS

A BILL

FOR AN ACT ENTITLED

1 "An Act allowing a joint action agency to encumber property interests for security
2 purposes; declaring certain joint action agencies to be political subdivisions for certain
3 purposes; restricting the sale of property of the joint action agency; allowing the joint
4 action agency to transfer property to security interest holders under a security interest
5 or to other parties without legislative approval; and providing for an effective date."

6 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

7 * Section 1. AS 42.45.310(c) is amended to read:

8 (c) The agency is a body corporate and politic and an instrumentality of the
9 public utilities that form the agency, but has a separate and independent legal
10 existence from the public utilities. A debt, obligation, or liability of the agency does
11 not constitute a debt, obligation, or liability of a public utility or the state. A liability
12 incurred by the agency shall be satisfied exclusively from the assets or revenue of the
13 agency, and a creditor of the agency or any other person does not have any right of

1 action or claim against a public utility or the state, because of a debt, obligation, or
2 liability of the agency. The agency has the powers of a public utility under AS 42.05
3 and the immunities of a public utility. In addition to the powers granted to the agency
4 under AS 42.45.300 and this section, the agency has the power

5 (1) to adopt bylaws of the agency;

6 (2) to sue and be sued;

7 (3) to carry out the authorized purposes of the agency;

8 (4) subject to (e) of this section, to issue revenue bonds and other
9 obligations that are not obligations of either the state or the public utilities that are
10 parties to the agency agreement to provide financing to carry out the authorized
11 purposes of the agency; [AND]

12 (5) in addition to the powers of eminent domain in AS 42.05.631, to
13 exercise the powers of eminent domain and a declaration of taking to acquire land or
14 materials within the boundaries of the power project purchased by the agency from the
15 Alaska Energy Authority under the procedures set out in AS 09.55.240 - 09.55.460 to
16 carry out the authorized purposes of a joint action agency; and

17 (6) to use facilities, projects, and related assets owned, leased, or
18 operated by the joint action agency as security for bonds, notes, mortgages, credit
19 enhancement devices, or other obligations.

20 * Sec. 2. AS 42.45.310(h) is amended to read:

21 (h) An agency formed by, and that continues to include, one or more
22 municipal public utilities is a political subdivision for purposes of AS 38.05.810, and
23 functions as a political subdivision in the acquisition and ownership of the power
24 project under the agreement authorized by this section. Except as provided in
25 this subsection, the agency is not a political subdivision of the state.

26 * Sec. 3. AS 42.45.310 is amended by adding new subsections to read:

27 (j) The agency may not sell a project owned by the agency to any purchaser
28 without the approval of the legislature in advance of the effective date of the sale,
29 except that a sale made to a public utility that is a party to the agreement does not
30 require legislative approval.

31 (k) Notwithstanding (j) of this section, the project and related assets may be

1 transferred in connection with a foreclosure or other enforcement of a lien or security
2 interest to a party holding a lien or security interest acquired under (c)(6) of this
3 section or to another party without legislative approval. A party obtaining a property
4 interest under this subsection may transfer that interest without legislative approval.

5 * Sec. 4. The uncodified law of the State of Alaska is amended by adding a new section to
6 read:

7 LEGISLATIVE AUTHORIZATION TO AMEND MEMORANDUM OF
8 UNDERSTANDING REGARDING SALE OF FOUR DAM POOL HYDROELECTRIC
9 PROJECT. Notwithstanding the restriction imposed by sec. 15(a), ch. 60, SLA 2000, the
10 memorandum of understanding that authorizes the sale of the four dam pool hydroelectric
11 project may be amended consistent with the provisions of AS 42.45.310(j) and (k), added by
12 sec. 3 of this Act, if sec. 3 of this Act becomes effective.

13 * Sec. 5. This Act takes effect immediately under AS 01.10.070(c).

Alaska State Legislature

House Finance Committee

REPRESENTATIVE
BILL WILLIAMS

Co-Chair

(907) 465-3424

Fax: (907) 465-3793

INTERIM ADDRESS

50 Front Street, Suite 203

Kotchikan, Alaska 99901

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Fax: (907) 225-7157



REPRESENTATIVE
JOHN HARRIS

Co-Chair

(907) 465-4859

Fax: (907) 465-3799

INTERIM ADDRESS

State Capitol, Room 507

Juneau, AK 99801-1182

State Capitol, Juneau, Alaska 99801-1182

Sponsor Statement

House Bill 495

“An Act relating to the four dam pool joint action agency; and providing for an effective date.”

The main purpose of this legislation is to allow the Four Dam Pool Power Agency (FDPPA), the first agency formed under the statute allowing joint action agencies (JAA's), to refinance their approximately \$73 million loan owed to the Alaska Industrial Development and Export Authority (AIDEA).

HB 495 clarifies existing JAA statute to state explicitly that joint action agencies are political subdivisions of the state *for the purposes of securities law*. This is necessary if the FDPPA is to avoid certain expensive and damaging hurdles having to do with registration of securities under some bond sale circumstances.

Further, the legislation allows the agency to mortgage the four dam pool assets. Such a mortgage will likely be necessary in order to sell the bonds as contemplated. The assets are presently mortgaged to AIDEA, just as they would be mortgaged to the new lenders.

The legislation re-states the important principal established by the legislature that the Four Dam Pool assets may not be sold to a party outside the FDPPA without legislative approval. However, it makes it clear that mortgaging the assets- or a foreclosure under the terms of that mortgage- does not constitute a sale under this restriction, providing that certain requirements are met.

When this refinancing occurs and the AIDEA loan is retired, the state and consumers in a large part of Alaska will benefit by:

- Allowing the FDPPA to return approximately \$73 million to AIDEA for other uses
- Helping consumers of Four Dam Pool power by lowering interest rates and administrative costs associated with the acquisition

I urge your favorable consideration of this important legislation.

HB

495

SFIN

FILE

SENATE FINANCE COMMITTEE REPORT

DATE: 5/1/04

FURTHER:

REPORTED OUT
MAY 10 2004
SENATE FINANCE
COMMITTEE

DATE TURNED IN TO OFFICE: 10 May 2004

Finance Committee considered CS FOR HOUSE BILL NO. 495(FIN)

HB 495 4 DAM POOL JOINT ACTION AGENCY

"An Act allowing a joint action agency to encumber property interests for security purposes; declaring certain joint action agencies to be political subdivisions for certain purposes; restricting the sale of property of the joint action agency; allowing the joint action agency to transfer property to security interest holders under a security interest or to other parties without legislative approval; and providing for an effective date."

and recommends:

- be replaced with 5 CS CS HB 495 (FIN)
- adopt previous _____ CS CS forthcoming (_____)
- attached amendment(s)
- adopt Letter of Intent by _____ Committee
- further referral to _____ Committee

Senate Bill:
 Same Title
 New Title

House Bill:
 Same Title
 Technical Title Change
 New Title w/ SCR # _____

NEW FISCAL NOTE(S):

Department	Date	Fiscal	Indet.	Zero.	FN#

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Indet.	Zero	FN#
DCED	5/1/04			✓	#1

APPROPRIATION - no fiscal note

SIGNATURES AND RECOMMENDATIONS:	Do PASS	Do NOT PASS	No REC	AMEND
<i>[Signature]</i>			✓	
<i>[Signature]</i>			✓	
<i>[Signature]</i>			✓	
<i>[Signature]</i>	X			
COCHAIR: <i>[Signature]</i>			✓	
COCHAIR: <i>[Signature]</i>			✓	

MAY 10 2004

SENATE FINANCE
COMMITTEE

FISCAL NOTE

STATE OF ALASKA
2004 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: CSHB 495(FIN)
(H) Publish Date: 3/3/04

Revision Date/Time (Note if correction): _____ Dept. Affected: DCED
Title Four Dam Pool Joint Action Agency RDU AIDEA (125)
Component AIDEA
Sponsor Representative Williams
Requester House Finance Component No. 1234

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
----------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2004) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2005 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

On January 31, 2002, AIDEA loaned \$77.1 million to the Four Dam Pool Power Joint Action Agency (the "Agency") for the purchase, closing costs and initial funding of reserves related to the Agency's acquisition of the Four Dam Pool Project. This bill has no general fund impact and no fiscal impact to AIDEA.

This bill clarifies that a joint action agency's assets (including the Agency's) may be mortgaged for future financing by the joint action agency. In addition, the bill states that the joint action agency's assets may be transferred in connection with a foreclosure without legislative approval; however, this provision does not supercede the legislative approval required in the Memorandum of Understanding between the purchasing utilities and the Alaska Energy Authority adopted by reference in 2000 SLA Ch 60.

Prepared by: Ron Miller, Executive Director Phone (907) 269-4623
Division AIDEA/AEA Date/Time 3/1/04 2:24 PM
Approved by: Edgar Blatchford, Commissioner Date 3/1/2004
Agency Department of Community & Economic Development

SENATE FINANCE
COMMITTEE

Adopted

Amendment Number: #1
Bill Number: HB 495
Sponsor: Stevens Date: 5/9/04
Logged In By: Robin *B. Stevens*

AMENDMENT - HB495

As amended the section would read as follows:

Page 2, lines 17-19

(6) to use facilities, projects, and related assets owned, leased, or operated by the joint action agency as security **in accordance with applicable law.**

SENATE FINANCE COMMITTEE
 5 /10/ 2004 COMMITTEE ACTION

Bill Number	HB 495		
Amendment	#1		
Motion	to ADOPT		
<u>Motion by</u>	Stevens		
<u>Objection by</u>	Wilken		
<u>Removed</u>	✓		
<u>Second Objection by</u>			
<u>Committee Member</u>	<u>Y</u>	<u>Vote</u>	<u>N</u>
Senator Olson			
Senator Stevens			
Senator Bunde			
Senator Dyson			
Senator Hoffman			
Co-Chair Green			
Co-Chair Wilken			
<u>Tally</u>			
Yea			
Nay			
Absent			
<u>MOTION</u>	ADOPTED		

Attention: Sheila

Of Senator Wilken's office

RE: S CS CS HB 495 (FIN)

Date: 5/10/04 Time: 12:50 pm

The attached Senate Finance CS incorporates the amendment(s) your boss sponsored. Please review and approve so the bill can be forwarded to the Senate Secretary.

The CS is your copy.

Thanks,
Senate Finance Secretary
Mindy #4935

Robin #2618

Approved: _____
(please initial)

Return ASAP

Senator ^{Stevens}
Amend #1
proof
has been
delivered
to his
office

Looks
Good
AP

Attention: Plelan / Kristy
Of Senator Steven's office
RE: S CS CS HB 495 (FIN)
Date: 5/10/04 Time: 12:50pm

The attached Senate Finance CS incorporates the amendment(s) your boss sponsored. Please review and approve so the bill can be forwarded to the Senate Secretary.

The CS is your copy.

*Amend
#1*

Thanks,
Senate Finance Secretary

Mindy #4935

Robin #2618

Approved: CS FOR SENATOR STEVENS
(please initial)

Return ASAP

SENATE CS FOR CS FOR HOUSE BILL NO. 495(FIN)
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-THIRD LEGISLATURE - SECOND SESSION

BY THE SENATE FINANCE COMMITTEE

Offered:

Referred:

Sponsor(s): REPRESENTATIVES WILLIAMS, Foster, Ogg, Lynn

A BILL
FOR AN ACT ENTITLED

1 "An Act allowing a joint action agency to encumber property interests for security
2 purposes; declaring certain joint action agencies to be political subdivisions for certain
3 purposes; restricting the sale of property of the joint action agency; allowing the joint
4 action agency to transfer property to security interest holders under a security interest
5 or to other parties without legislative approval; and providing for an effective date."

6 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

7 * Section 1. AS 42.45.310(c) is amended to read:

8 (c) The agency is a body corporate and politic and an instrumentality of the
9 public utilities that form the agency, but has a separate and independent legal
10 existence from the public utilities. A debt, obligation, or liability of the agency does
11 not constitute a debt, obligation, or liability of a public utility or the state. A liability
12 incurred by the agency shall be satisfied exclusively from the assets or revenue of the
13 agency, and a creditor of the agency or any other person does not have any right of

1 action or claim against a public utility or the state, because of a debt, obligation, or
 2 liability of the agency. The agency has the powers of a public utility under AS 42.05
 3 and the immunities of a public utility. In addition to the powers granted to the agency
 4 under AS 42.45.300 and this section, the agency has the power

5 (1) to adopt bylaws of the agency;

6 (2) to sue and be sued;

7 (3) to carry out the authorized purposes of the agency;

8 (4) subject to (e) of this section, to issue revenue bonds and other
 9 obligations that are not obligations of either the state or the public utilities that are
 10 parties to the agency agreement to provide financing to carry out the authorized
 11 purposes of the agency; [AND]

12 (5) in addition to the powers of eminent domain in AS 42.05.631, to
 13 exercise the powers of eminent domain and a declaration of taking to acquire land or
 14 materials within the boundaries of the power project purchased by the agency from the
 15 Alaska Energy Authority under the procedures set out in AS 09.55.240 - 09.55.460 to
 16 carry out the authorized purposes of a joint action agency; and

17 (6) to use facilities, projects, and related assets owned, leased, or
 18 operated by the joint action agency as security in accordance with applicable law. #

19 * Sec. 2. AS 42.45.310(h) is amended to read:

20 (h) An agency formed by, and that continues to include, one or more
 21 municipal public utilities is a political subdivision for purposes of AS 38.05.810, and
 22 functions as a political subdivision in the acquisition and ownership of the power
 23 project under the agreement authorized by this section. Except as provided in
 24 this subsection, the agency is not a political subdivision of the state.

25 * Sec. 3. AS 42.45.310 is amended by adding new subsections to read:

26 (j) The agency may not sell a project owned by the agency to any purchaser
 27 without the approval of the legislature in advance of the effective date of the sale,
 28 except that a sale made to a public utility that is a party to the agreement does not
 29 require legislative approval.

30 (k) Notwithstanding (j) of this section, the project and related assets may be
 31 transferred in connection with a foreclosure or other enforcement of a lien or security

1 interest to a party holding a lien or security interest acquired under (c)(6) of this
2 section or to another party without legislative approval. A party obtaining a property
3 interest under this subsection may transfer that interest without legislative approval.

4 * Sec. 4. The uncodified law of the State of Alaska is amended by adding a new section to
5 read:

6 LEGISLATIVE AUTHORIZATION TO AMEND MEMORANDUM OF
7 UNDERSTANDING REGARDING SALE OF FOUR DAM POOL HYDROELECTRIC
8 PROJECT. Notwithstanding the restriction imposed by sec. 15(a), ch. 60, SLA 2000, the
9 memorandum of understanding that authorizes the sale of the four dam pool hydroelectric
10 project may be amended consistent with the provisions of AS 42.45.310(j) and (k), added by
11 sec. 3 of this Act, if sec. 3 of this Act becomes effective.

12 * Sec. 5. This Act takes effect immediately under AS 01.10.070(c).



Official Business

Alaska State Senate

Senate Finance Committee

Mail Stop 3100
State Capitol
Juneau, Alaska 99801-1182

FAX COVER SHEET

DATE: 10 May 2004 TIME: 10:45 am

TO: Legal Services

NUMBER OF PAGES, INCLUDING COVER SHEET: 2

FROM: MINDY ROWLAND
SENATE FINANCE COMMITTEE SECRETARY
PHONE: 465-4935
FAX: 465-2187

NOTES: Final Please

SCS CS HB 495 (FIN)

23-LS1681 \ I

Plus 1 amendment - attached

Call if any questions

The
Mundy

Alaska State Legislature

House Finance Committee



REPRESENTATIVE
BILL WILLIAMS

Co-Chair

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Co-Chair

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Fax: (907) 465-3799

INTERIM ADDRESS

State Capitol, Room 507

Juneau, AK 99801-1182

State Capitol, Juneau, Alaska 99801-1182

Sponsor Statement House Bill 495

“An Act relating to the four dam pool joint action agency; and providing for an effective date.”

The main purpose of this legislation is to allow the Four Dam Pool Power Agency (FDPPA), the first agency formed under the statute allowing joint action agencies (JAA's), to refinance their approximately \$73 million loan owed to the Alaska Industrial Development and Export Authority (AIDEA).

HB 495 clarifies existing JAA statute to state explicitly that joint action agencies are political subdivisions of the state *for the purposes of securities law*. This is necessary if the FDPPA is to avoid certain expensive and damaging hurdles having to do with registration of securities under some bond sale circumstances.

Further, the legislation allows the agency to mortgage the four dam pool assets. Such a mortgage will likely be necessary in order to sell the bonds as contemplated. The assets are presently mortgaged to AIDEA, just as they would be mortgaged to the new lenders.

The legislation re-states the important principal established by the legislature that the Four Dam Pool assets may not be sold to a party outside the FDPPA without legislative approval. However, it makes it clear that mortgaging the assets- or a foreclosure under the terms of that mortgage- does not constitute a sale under this restriction, providing that certain requirements are met.

When this refinancing occurs and the AIDEA loan is retired, the state and consumers in a large part of Alaska will benefit by:

- Allowing the FDPPA to return approximately \$73 million to AIDEA for other uses
- Helping consumers of Four Dam Pool power by lowering interest rates and administrative costs associated with the acquisition

I urge your favorable consideration of this important legislation.

The Four Dam Pool Power Agency

703 West Tudor Road, Suite 102
Anchorage, AK 99503-6650
907-258-2281 Fax: 907-258-2287

Representative Bill Williams
State Capitol, Room 515
Juneau, AK 99801-1182

Senator Gary Stevens
State Capitol, Room 417
Juneau, AK 99801-1182

Subject: HB495 and SB350 regarding Joint Action Agencies

Dear Representative Williams and Senator Stevens:

On behalf of the Cities of Petersburg, Wrangell, and Ketchikan, the Kodiak Electric Association, and the Copper Valley Electric Association, which constitute all of the members of the Four Dam Pool Power Agency (the "Agency"), I am writing to you to express the support of the members of the Agency for HB495 and SB350. By unanimous action, the Board of Directors of the Agency has directed me to send this letter of support.

HB495 (introduced by Representative Williams) and SB350 (introduced by Senator Stevens) provide certain technical corrections to earlier legislation authorizing the sale of the state's interest in four hydroelectric projects that constituted the Four Dam Pool Power Project to the Agency, a joint action agency formed by the above-listed members. The acquisition of these projects by the Agency was financed with a loan from AIDEA, at interest rates currently in excess of those available from other sources. This legislation:

- Clarifies the ability of the Agency to refinance the AIDEA debt and lower the cost of power for citizens of Alaska;
- Returns up to \$74 million to AIDEA
- Provides for the use of the hydroelectric resources as security for new debt; and
- Assures that the resources will continue to serve the members of the Agency, as intended by original authorizing legislation.

The members of the Agency urge your support in the passage of this important legislation.

Sincerely,



Thomas A. Lovas
Chief Executive Officer
The Four Dam Pool Power Agency

cc: Brian Bjorkquist, Esq., State of Alaska, Office of the Attorney General
Ron Miller, Executive Director, AIDEA



CITY OF PETERSBURG

P.O. BOX 329 • PETERSBURG, ALASKA 99833

TELEPHONE (907) 772-4511

TELECOPIER (907) 772-3759

March 5, 2004

Senator Gary Stevens
Mail Stop 3100
State Capitol
Juneau, AK 99801-1182

Subject: HB495 and SB350 re: Joint Action Agencies

Dear Senator Stevens:

The City of Petersburg is writing in support for HB495 and SB350 and ask your continued support in passage of this proposed legislation.

HB495, introduced by Representative Bill Williams and SB350, introduced by yourself, provide certain technical corrections to earlier legislation authorizing the sale of the state's interest in four hydroelectric projects that constituted the Four Dam Pool Power to a joint action agency formed by the participants in the Pool. The City of Petersburg is a member of the agency, along with the cities of Wrangell and Ketchikan, the Kodiak Electric Association and the Copper Valley Electric Association. The acquisition was financed with a loan from AIDEA, at interest rates currently in excess of those available from other sources. This legislation:

- Clarifies the ability of the joint action agency to refinance the AIDEA debt and lower the cost of power for citizens of Alaska;
- Returns up to \$74 million to the State of Alaska;
- Provides for the use of the hydroelectric resources as security for new debt; and
- Assures that the resources will continue to serve the members of the Pool, as intended by original authorizing legislation.

We urge your continued support in the passage of this important legislation.

Sincerely,

Theodore M. Smith, Mayor

SENATE FINANCE COMMITTEE

SIGN-IN

HB 495-4 DAM POOL JOINT ACTION AGENCY

NAME: TOM LOVAS Subject/Bill No: _____

Co./Dept./Title: FOUR DAM POOL JAA Phone: 907 258-2281

Address: 703 W. TADPOLE RD STE 102 ANCHORAGE Zip: 99503

Do you wish to testify? Yes No Respond To Questions

NAME: TOM BARRY Subject/Bill No: _____

Co./Dept./Title: AIDE TO REP. WILLIAMS Phone: _____

Address: _____ Zip: _____

Do you wish to testify? Yes No Respond To Questions

NAME: _____ Subject/Bill No: _____

Co./Dept./Title: _____ Phone: _____

Address: _____ Zip: _____

Do you wish to testify? Yes No Respond To Questions

NAME: _____ Subject/Bill No: _____

Co./Dept./Title: _____ Phone: _____

Address: _____ Zip: _____

Do you wish to testify? Yes No Respond To Questions

NOT HEARD

PRIOR TO RECESS OF 1:11 PM

SENATE FINANCE COMMITTEE

SIGN-IN

HB 495-4 DAM POOL JOINT ACTION AGENCY

NAME: TOM LOUAS Subject/Bill No: HB 495

Co./Dept./Title: FOUR DAM POOL - CEO Phone: 807-258-2281

Address: 703 W. TUDOR RD. STE 102 ANCH. Zip: 99503

Do you wish to testify? Yes No Respond To Questions

NAME: TIM BARRY Subject/Bill No: _____

Co./Dept./Title: AIDE TO REP. WILLIAMS Phone: _____

Address: _____ Zip: _____

Do you wish to testify? Yes No Respond To Questions

NAME: _____ Subject/Bill No: _____

Co./Dept./Title: _____ Phone: _____

Address: _____ Zip: _____

Do you wish to testify? Yes No Respond To Questions

NAME: _____ Subject/Bill No: _____

Co./Dept./Title: _____ Phone: _____

Address: _____ Zip: _____

Do you wish to testify? Yes No Respond To Questions

HB

503

HFIN

FILE

Alaska State Legislature

House Finance Committee



REPRESENTATIVE
BILL WILLIAMS

Co-Chair

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Fax: (907) 225-7157

REPRESENTATIVE
JOHN HARRIS

Co-Chair

(907) 465-4850

Fax: (907) 465-3799

INTERIM ADDRESS

State Capitol, Room 507

Juneau, AK 99801-1182

State Capitol, Juneau, Alaska 99801-1182

SPONSOR STATEMENT

HOUSE BILL 503: *An Act relating to the tobacco product Master Settlement Agreement; and providing for an effective date.*

In 1998, 46 states entered into the Master Settlement Agreement (MSA) with leading cigarette manufacturers resolving dozens of lawsuits. The state Attorney Generals realized, however, that the objectives of the agreement could be thwarted by non-participating cigarette manufacturers (NPMs). The NPMs are not bound by the marketing and other restrictions contained in the tobacco settlement agreement. Nor are they obligated to make payments to the states in satisfaction of health care cost related claims.

appended

To help ensure that funds would be available to the states to satisfy potential future legal claims, the MSA signatory states enacted legislation called "Model Statutes" because the model form agreed upon was annexed as an exhibit to the MSA. These model state statutes require cigarette and roll your own tobacco manufacturers to either join the MSA or make refundable deposits based on the number of cigarettes sold in the state into a qualified escrow account, which must be established with commercial lending institutions. Enactment and enforcement of the model statutes helps ensure that funds will be available should the state need to bring suit against the NPMs in the future.

House Bill 503 closes a loophole in the model statutes that costs states a significant amount in MSA payments every year. This loophole has enabled some NPMs to avoid making escrow payments under the states' model escrow statutes. A provision of the model escrow statute permits an NPM to obtain a release of funds from escrow "to the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow in a particular year was greater than the state's allocable share of the total payments that such manufacturer would have been required to make in that year under the Master Settlement Agreement ...had it been a participating manufacturer under the MSA...." Experience in several states has shown that this provision enables NPMs that concentrate their sales in a single state or a few states to obtain early releases of the great majority of their escrow deposits. This outcome was never contemplated and threatens to undermine the effectiveness of the Model Escrow statutes, Escrow funds so minimized are not adequate to provide security to the states nor do they prevent unfair profit taking.

RESOLUTION SUPPORTING ALLOCABLE SHARE LEGISLATION

WHEREAS, Cigarette smoking presents serious public health concerns to the States, requires the States to spend billions of dollars for the treatment of health conditions resulting from Cigarette smoking, and imposes substantial additional costs on the States, many of which costs occur years after the Cigarettes are sold; and

WHEREAS, 46 States, the District of Columbia, the Commonwealth of Puerto Rico, and four United States territories ("the Settling States") and more than 40 Cigarette manufacturers are parties to the tobacco Master Settlement Agreement of 1998 ("the MSA") under which Cigarette manufacturers who are parties to the MSA have agreed to significant limitations on the advertising, promotion, and marketing of Cigarettes and agreed to make substantial payments to the States in exchange for a release from liability for certain claims of the States related to Cigarette smoking; and

WHEREAS, in connection with the MSA the Settling States have enacted statutes that require Cigarette manufacturers who do not become parties to the MSA ("Non-Participating Manufacturers" or "NPMs") to make payments into an escrow fund of a specified amount for each of its Cigarettes sold in the State; and

WHEREAS, the Escrow Statute is designed to ensure that a Settling State that obtains a judgment against an NPM for the costs imposed by sales of the NPM's Cigarettes will have an Escrow Fund available against which to satisfy a judgment; and

WHEREAS, in the absence of a significant escrow fund, companies that choose not to enter into the MSA and are not subject to its restrictions on advertising and promotion would be able to sell cigarettes without making any provision for the costs imposed on the State by the sales of their cigarettes; and

WHEREAS, the existing escrow statutes as originally enacted by the Settling States contain language that inadvertently permits NPMs that concentrate their sales in only a few states to avoid the large majority of their obligation to keep funds in escrow and thereby confers on those companies an unfair competitive advantage over both Participating Manufacturers and over other NPMs; and

WHEREAS, as a result of this language several NPMs have enjoyed an unintended competitive advantage over the more than 40 companies that have chosen to join the Master Settlement Agreement and have thereby expanded their sales at the expense of those companies; and

WHEREAS, permitting NPMs to make sales in any State without requiring them to keep significant escrow funds on deposit jeopardizes the health care objectives and MSA payments of all States; and

WHEREAS, the availability of low-priced cigarettes made possible by the

deficiencies in the existing escrow statutes has reduced the effectiveness of State programs to discourage youth smoking; and

WHEREAS, a large number of States, recognizing the deficiency in the existing escrow statutes, jointly developed proposed legislation (the "Allocable Share legislation," attached as Tab A hereto) designed to eliminate this inadvertent deficiency and to serve the purposes for which the escrow statute was originally designed; and

WHEREAS, the Tobacco Committee of the National Association of Attorneys General considered and endorsed enactment of the Allocable Share legislation; and

WHEREAS, seventeen States have already enacted the Allocable Share legislation and the legislation is under consideration in other jurisdictions;

NOW, THEREFORE, be it resolved that the National Association of Attorneys General:

1. Reaffirms the principle that the purpose of the escrow statute is to preserve the public health gains of the MSA by ensuring that all Cigarette manufacturers selling Cigarettes in a State must either join the MSA, restrict their advertising and promotion, and make MSA payments to compensate the State for the costs imposed on the State by cigarette smoking or establish and maintain an escrow fund sufficient to ensure that significant funds will be available in the event that the State obtains a judgment for such costs; and
2. Recognizes that the existing escrow statutes as originally drafted and enacted do not always accomplish this objective; and
3. Endorses the enactment of the Allocable Share Amendment in each Settling State in order that this objective be accomplished; and
4. Directs the Executive Director to communicate this resolution to interested parties; and
5. Directs the Tobacco Project to provide support to attorneys general for the enactment of the legislation.

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CHANGES TO THE ALLOCABLE SHARE PROVISION
OF THE MODEL ESCROW STATUTE

INTRODUCTION AND ANALYSIS

WHY IS THIS LEGISLATION IMPORTANT?

Enactment of the proposed change to the Model Act is necessary to avoid hundreds of millions of dollars in losses to the States' tobacco payments under the MSA. The proposed change is also important to ensure that the central public health purposes of the MSA are met. The Model Escrow Statute was enacted to ensure that Settling States would receive the benefits of the MSA and that companies that refused to enter into the MSA would not thereby be able to profit unfairly from such refusal. Some companies that neither make MSA payments to the States nor observe any of the public health restrictions in the MSA are profiting from a loophole in the current law that allows them to avoid any significant responsibility under the State's Model Escrow Statute. This amendment is designed to ensure that the Model Escrow Statutes operate evenhandedly as originally intended, thereby advancing the legitimate health and safety goals contemplated by the MSA.

WHAT IS THE MSA AND WHAT DOES IT PROVIDE?

The MSA was executed on November 23, 1998 by 52 Settling States with the major tobacco companies and numerous smaller manufacturers (collectively known as "Participating Manufacturers" or "PMs"). The MSA provides that in exchange for the agreement of the PMs to make specified payments to the Settling States -- estimated to exceed \$200 billion through 2025 -- and their agreement to abide by extensive public health restrictions on the advertising, promotion and marketing of cigarettes, the Settling States agreed to release the PMs from claims by the States. Tobacco Product Manufacturers that did not sign the MSA ("Non-Participating Manufacturers" or "NPMs") were not released from potential State claims and did not undertake any of the payment obligations or agree to abide by the public health restrictions.

The parties to the MSA also proposed a "Model Statute" designed to prevent NPMs from taking advantage of the fact that they do not make payments under the MSA and are not bound by the public health, advertising and other MSA restrictions. The Model Statute requires all NPMs whose cigarettes are sold in a State to establish and annually fund a qualified escrow account in an amount determined by the sales volume in the State. Funds deposited in the escrow account are released to the NPM after 25 years if not used before then to pay a judgment in favor of the State against the NPM. All Settling States enacted a Model Escrow Statute.

WHAT ARE THE PURPOSES OF THE MODEL ESCROW STATUTE?

In the MSA the States released their claims against companies that joined the MSA and that thereby agreed to make MSA payments and abide by the public health provisions of the MSA. As noted, companies that chose not to join the MSA were not released from claims by the States. They do not make MSA payments and they are not required to abide by the public health provisions of the MSA.

There was a concern, however, that NPMs could sell cigarettes in the States, take advantage of the fact that they did not have to bear the cost of making MSA payments or abide by the public health provisions of the MSA, yet be unable to satisfy judgments that the States might eventually obtain for the costs imposed as a result of these sales. The Model Escrow Statute is designed to ensure that there will be a fund available to satisfy State claims in the event the State obtains a judgment against an NPM. In addition, under the MSA, Settling States that enact and "diligently enforce" a Model Escrow Statute are not subject to certain potential downward adjustments to their MSA payments.

HOW DOES THE MODEL ESCROW STATUTE WORK?

The Model Escrow Statute requires an NPM to make escrow deposits on its cigarettes sold in a Settling State at a set figure per cigarette sold (about 1.5¢ 2002 sales). Deposits remain the property of the NPM and the NPM earns currently-payable interest. Principal must remain in escrow for twenty-five years to be available to meet potential State claims. In order to fairly estimate the sum necessary to satisfy any potential judgment a State may obtain, the NPM escrow obligation is calculated to approximate the MSA payment on a per-cigarette basis (and does so almost precisely).

HOW HAVE THE PURPOSES OF THE MODEL ESCROW STATUTE BEEN SUBVERTED BY THE CURRENT ALLOCABLE SHARE RELEASE PROVISION?

A provision of the Model Escrow Statute permits an NPM to obtain a release of funds from escrow "to the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow in a particular year was greater than the State's allocable share of the total payments that such manufacturer would have been required to make in that year under the Master Settlement Agreement ... had it been a Participating Manufacturer under the MSA...." Experience in several states has shown that this provision enables NPMs that concentrate their sales in a single state or a few states to obtain early releases of the great majority of their escrow deposits. This outcome was never contemplated and threatens to undermine the effectiveness of the Model Escrow Statutes. Escrow funds so minimized are not adequate to provide security to the States nor do they prevent unfair profit taking.

HOW DOES THE CURRENT ALLOCABLE SHARE RELEASE PROVISION SUBVERT THE PURPOSES OF THE MODEL STATUTE?

Participating Manufacturers under the MSA make payments to the States based on their nationwide sales. The States share in the payments in accordance with fixed percentages, known as Allocable Shares. By contrast, under each State's Model Statute, NPMs make payments only on their cigarettes sold in that State. The payments are designed to be the same as the payments that would be made on an equivalent number of cigarettes under the MSA if the NPM had become a Participating Manufacturer. The loophole that this legislation seeks to close gives some NPMs an immediate release of nearly all of those payments.

By way of example, consider an NPM that makes all its sales -- 100 million cigarettes -- in a state whose allocable share of MSA payments is two percent. Under the current statute, that NPM would be entitled to an immediate release of that portion of its escrow deposit that exceeds what would have been the State's allocable share of the NPM's total MSA payment had it been an MSA participant. Under this example, because the NPM makes all its sales in a single State and because the escrow deposit per cigarette and the MSA payment per cigarette are approximately the same, the NPM's (hypothetical) total MSA payment is the same as its escrow deposit. However, because the State's allocable share of the total MSA payment is only two percent, under current law the NPM would be

entitled to a release of 98 percent of its Escrow deposit. In other words, although the NPM sold 100 million cigarettes in the State, the amount it would have to leave in escrow would be based on only 2 million cigarettes. Accordingly, some NPMs that sell large numbers of cigarettes in a given State are not being required to keep significant funds in escrow in that State despite the volume of cigarette sales that continue to impose substantial health and other costs on that State. This outcome frustrates the fundamental objective of the Model Escrow Statute.

As the example demonstrates, the current provision permits an NPM that has geographically concentrated sales to obtain a refund of the vast majority of its escrow deposits. This allows the NPM to significantly lower the cost of its cigarettes, because the NPM is not escrowing its full share of the future healthcare burden that its product imposes on the State. In lowering the cost, the NPM presents a product that is very attractive to kids, whose cigarette usage is sensitive to price.

HOW DOES THE PROPOSED AMENDMENT REMEDY THE PROBLEM?

The proposed amendment to the Model Escrow Statute eliminates the unintended consequence of the original language that has compromised the law's effectiveness. The amendment is necessary to accomplish the fundamental purpose of the law: to ensure that every NPM is required to post escrows for sales of its cigarettes in the State that provide a meaningful fund from which the State can recover damages in the event it obtains a judgment against the NPM.

This first part of the amendment would limit releases from escrow accounts to any amounts paid into escrow in excess of the MSA payments **that the NPM would have been required to make as a PM on account of cigarettes sold in the State for a particular year.** Thus, under the amendment the MSA payments relevant to release would not be limited to a State's allocable share of the NPM's (hypothetical) total MSA payments, but rather would be the NPM's MSA payments on the same number of cigarettes as are sold in the State. In other words, under the above example where the NPM sells 100 million cigarettes in a State, the NPM under the amendment would be entitled to a release only to the extent that its escrow payment exceeded what would have been its MSA payment on these 100 million cigarettes.

WEREN'T STATES TOLD THEY WERE NOT SUPPOSED TO AMEND THE MODEL STATUTE?

All States have Model Statutes. Their payments are potentially subject to reduction if Participating Manufacturers establish that the statute has been amended in a way that disqualifies them from being Model Statutes. All the Original Participating Manufacturers and all the major Subsequent Participating Manufacturers have signed letters of assurance declaring that the proposed amendment will not affect the status of the Model Statute. Thus, a State that enacts the amendment will continue to have the protection afforded by having a Model Statute. In fact, the amendment strengthens the Model Escrow Statute by eliminating the unintended consequence that confers an unfair competitive advantage on some NPMs.

The amendment is consistent with the purposes of the Model Escrow Statute: it sharply reduces the ability of an NPM to minimize its payments by concentrating its sales in one or two states and it sharply reduces the unintended disparity created by the current Model Escrow Statute.