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EVALUATION OF THE APPLICATION OF REGULATION E TO EBT SYSTEMS:

PRELIMINARY FINDINGS

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John Kirlin
Project Director

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EVALUATION OF THE APPLICATION OF REGULATION E TO EBT SYSTEMS

PRELIMINARY FINDINGS

Electronic benefits transfer (EBT) systems have been implemented in a number of states across the country, and many more states are in the process of procuring the services of an EBT vendor. The systems are being used to issue benefits in the Food Stamp Program (FSP), the Aid to Families with Dependent Children Program (AFDC), state programs like General Assistance, and direct federal payment programs like Social Security (OASDI) and Supplemental Security Income (SSI).

Most EBT systems operate very much like commercial debit card networks. For delivery of cash benefits, a plastic card with an encoded magnetic stripe is used at ATMs (automated teller machines) or POS (point-of-sale) devices to withdraw cash or pay for purchased goods. The card is used at POS devices in program-authorized retail stores to access food stamp benefits to pay for eligible food items.

The Electronic Fund Transfer Act governs the operations of commercial debit card networks. An EFT regulation, called "Regulation E," implements the provisions of the Act.[1] Regulation E (or simply "Reg E") establishes a framework of legal rights and responsibilities for card issuers and card holders in electronic fund transfer systems. In March 1994, the Board of Governors of the Federal Reserve ruled that Reg E must be applied to all EBT systems by March 1997. In addition to establishing procedures for processing claims of lost benefits, Reg E limits a client's liability for loss resulting from unauthorized usage of his or her EBT card.

EBT systems delivering direct federal payments have been operating under Reg E since their development several years ago. These systems serve clients without existing bank accounts by establishing client-owned accounts with a financial institution that serves as the EBT vendor. If clients elect to participate, their federal payments are deposited into their accounts, and they pay the financial institution service fees for management of the accounts. In all respects these EBT accounts are treated like any other banking account and, as such, have been covered by Reg E protections. In contrast, EBT systems delivering cash assistance or food stamp benefits

[1] 12 CFR Ch. 11, §205.

establish government-owned accounts for program recipients. Recipients do not pay EBT account management fees, although they sometimes pay transaction fees when cash benefits are withdrawn at ATMs.

Many program administrators are worried that Reg E will increase EBT operating costs, making it no longer a cost-effective alternative to issuing paper checks and food stamp coupons. In an effort to learn more about the likely impacts of Reg E on benefit replacements and administrative costs, therefore, the Food and Consumer Service (FCS) of the U.S. Department of Agriculture, in collaboration with the Departments of Health and Human Services and the Treasury, sponsored several demonstrations where sites with EBT systems implemented the provisions of Reg E for a 12-month period. The sites were in New Jersey, New Mexico, and Texas. An EBT system in Camden County, New Jersey, which did not implement the provisions of Reg E, served as a comparison site for an evaluation of the demonstrations.

HIGHLIGHTS

Although the evaluation of the Reg E demonstrations is not complete, data for several months of Reg E operations are available for review. With the March 1997 date for full Reg E implementation nearing, FCS is releasing the evaluation's ***preliminary*** findings in this report. A final report of the evaluation's complete findings will be prepared and released later this year.

Based on the early months of site operations, the principal preliminary findings of the evaluation are:

- ***Reg E had little, if any, impact on claim submission rates.***

  Claims of unauthorized usage are the type of claim where the most substantial Reg E effect might be expected. Although two Reg E sites had higher claim rates of unauthorized usage than the comparison site where Reg E was not in effect, two other Reg E sites had lower rates. The average claim rate for unauthorized usage across all the Reg E sites was a bit lower, not higher, than the comparison site rate.

- ***Most claims of benefits lost through unauthorized usage of the EBT card were denied.***

  An average of only 14 percent of unauthorized usage claims involving cash benefits (and 13 percent of similar food stamp claims) were approved. The major reason for denial was client failure to provide documentation of the loss, possibly

due to the client's reluctance to file a police report and to support prosecution of the person who used the card.

- ***Most claims of benefits lost through non-receipt of funds or system or procedural errors were approved.***

  Across all sites and all programs, 77 percent of claims of ATM misdispenses or benefits lost through system or procedural errors were approved. When such claims were denied, the reason was nearly always that the investigation verified that no loss occurred.

- ***Reg E had only a very small impact on benefits needing to be replaced.***

  Government liability from benefits replaced due to unauthorized usage averaged only $0.02 per case month across the full Reg E sites for cash benefits, and only $0.01 per case month for food stamp benefits.

The above findings of small Reg E impacts were consistent across sites, despite the fact that the Reg E demonstrations included both state-administered and direct federal payment programs in a variety of settings. Such consistency is ***not*** found in Reg E's impacts on administrative costs:

- ***Reg E impacts on administrative costs are substantial, especially for state-administered programs.***

  For direct federal payment programs, the administrative costs of Reg E equalled $0.19 per case month, compared to costs of from $0.64 to $0.94 per case month for claims of lost cash benefits in state-administered programs.

  For claims involving food stamp benefits, which were fewer in number, the administrative costs of Reg E operations showed little variation around an average of $0.26 per case month.

  In contrast, the administrative costs of investigating claims in the comparison site averaged only about $0.02 per case month for AFDC claims and $0.01 per case month for food stamp claims.

Additional analyses are currently being conducted to assess the stability of these findings. These analyses include estimation of the administrative costs incurred when clients contact their caseworkers with questions about EBT losses, an assessment of benefit replacement experience in other EBT sites not operating under Reg E protections, an examination of the full 12 months of claims and administrative cost data from each site, separate estimation of administrative costs associated with different types of claims, and an analysis of how often (and

why) clients experience losses but do not report them. In addition, the effects of demonstration-specific factors (e.g., use of more senior staff than would otherwise be assigned and the need to provide data for the evaluation) on findings will be assessed. Finally, Reg E's possible impact on the cost-effectiveness of EBT will be examined. Once completed, these analyses will shed more light on the stability and import of this report's preliminary findings.

BACKGROUND: REGULATION E AND EBT SYSTEMS

The Board of Governors of the Federal Reserve ruled in 1994 that Reg E must be applied to EBT systems by March 1997. The purpose of the three-year implementation period was to give federal and state agencies time to:

- Learn more about the likely impacts of Reg E on administrative costs and benefit replacements;
- Assess the effectiveness of different strategies for implementing Reg E and controlling claims of benefit loss; and
- Prepare funding plans for any costs associated with the application of Reg E.

From the perspective of EBT systems, the Federal Reserve Board's ruling had two major implications:

(1) It extended client protections to a new category of loss—benefits lost through unauthorized usage of the EBT card. Although the recipient would be liable for a portion of the loss,[2] the card issuer is liable for the remaining lost benefits.

(2) If a claim of loss (of any type) cannot be fully investigated within a specified time period, the card issuer must provisionally credit the client's account for the lost benefits until the investigation has been completed. If the claim is subsequently denied, the card issuer is liable for any funds that cannot be recovered.

The Board's decision to extend the provisions of Reg E to EBT was controversial. Client advocates supported the decision, asserting that households receiving public assistance should have the same protections against debit card loss as anyone. Many federal and state proponents of EBT systems, however, believed that current program protections against EBT

[2] The regulation specifies that a client's liability be limited to $50 if the loss is reported within two days of discovery, or $500 if the loss is reported thereafter but within 60 days of discovery. After 60 days the client bears full liability for the loss.

loss were sufficient, especially when one considers that risk controls available to the private sector (e.g., revoking use of a bank card for clients who incur repeated losses) are either not available to public programs or are difficult to implement. These proponents worried that the potential cost of replaced benefits under Reg E, when combined with the administrative cost of processing and investigating Reg E claims, would increase the overall cost of EBT services to the point where EBT would no longer be a cost-effective alternative to issuing paper food stamp coupons or AFDC checks. To illustrate their concern, it is useful to note that the administrative costs of the Maryland EBT system averaged only $0.04 per case month less than the costs of issuing benefits by check or coupons at the time the system was evaluated.[3] Nevertheless, the Board of Governors believed that the permanent exclusion of a specific group (e.g., program recipients) from Reg E protection should be made only by Congress' modification of the EFT Act, not through the Federal Reserve's interpretation of who should or should not be covered by Reg E.

THE REG E DEMONSTRATIONS

In response to the Board's ruling, demonstrations in several sites were conducted to investigate alternative methods for applying Reg E to EBT systems and to determine the cost implications of having EBT systems operating in a Reg E environment. Exhibit 1 provides an overview of the demonstration sites. As one reads down the exhibit, the sites are listed in ***ascending order*** of the protections they provided clients against loss of benefits. For instance, the comparison site of Camden County, New Jersey, did not offer any "Reg E" protections against unauthorized card usage. As in all current EBT sites, however, Camden's EBT operating policy was to reimburse clients fully for any verified losses they incurred due to ATM misdispenses or system errors.

The protections offered clients in San Juan County, New Mexico, were nearly identical to those offered in Camden County. San Juan County participated in the Reg E demonstrations, however, as a "responsibility standard" site: losses due to unauthorized usage were not

[3] There is evidence to suggest that the Maryland EBT system's administrative costs have declined since the time of the evaluation. In addition, if EBT impacts on program loss are included, the overall savings attributable to Maryland's EBT system at the time of the evaluation were about $0.17 per case month. See Christopher Logan *et al.*, *The Evaluation of the Expanded EBT Demonstration in Maryland, Vol. 2, System Impacts on Program Costs and Integrity* (Cambridge, MA: Abt Associates Inc., May 1994).

Exhibit 1

OVERVIEW OF DEMONSTRATION SITES

Site	Programs Served	Total EBT Caseload	Demonstration Start Date	EBT Start Date[a]
Camden County, NJ (comparison site)	AFDC, FSP	22,700	March 1995	April 1994
San Juan County, NM (responsibility standard site)	AFDC, FSP	3,500	May 1995	July 1994
Citibank DPC System (TX) (full Reg E site)	OASDI, SSI, others	15,000	March 1995	April 1992
Hudson County, NJ (full Reg E site)	AFDC, FSP	31,000	March 1995	March 1995 - May 1995
Bernalillo County, NM (full Reg E site)	AFDC, FSP	24,700	May 1995	March 1992
Doña Ana County, NM (full Reg E site)	AFDC, FSP	10,300	May 1995	October 1994 - October 1995

[a] Except in the DPC system in Texas, the listed start date is the month in which a site completed its conversion to EBT. The DPC system was implemented in stages in Texas; April 1992 is the date it was first offered (in Houston). Finally, in the two sites where Reg E was implemented *prior* to full conversion to EBT, both the start and end dates of EBT conversion are listed.

reimbursed if the transaction in question was initiated with a valid EBT card and PIN (personal identification number). Reg E provisions regarding how quickly claims of loss must be investigated were in effect in San Juan County, however, as was the requirement that provisional credits be granted if investigations could not be completed before the Reg E deadlines.

The last four sites—the Citibank DPC system in Texas, Hudson County in New Jersey, and Bernalillo and Doña Ana Counties in New Mexico—operated under "full" Reg E protections during their demonstration periods. In these four sites, losses due to unauthorized usage were reimbursable if the client cooperated with the investigation and if the circumstances of the loss could be verified. Citibank's DPC system was the only demonstration site serving direct federal programs like Social Security and SSI.

Exhibit 2 presents greater detail on the similarities and differences in loss protections provided by the six sites.

Impacts of Reg E on Claims of Lost Benefits

This report examines all claims submitted during the first several months of demonstration operations in all sites. Nearly all claims of lost or stolen benefits are divided into three main categories:[4]

(1) Claims arising from ***unauthorized usage*** of a client's EBT card;

(2) Claims arising from ***non-receipt of funds*** (i.e., ATM misdispenses); and

(3) Claims arising from ***system or procedural errors*** (e.g., a transaction mistakenly entered twice at a store POS terminal).

Within each of these categories, the study examined the rate at which claims were submitted (expressed as the number of claims submitted per 1,000 case months of benefit receipt), their disposition, reasons for denial, and the resulting impact on liability due to replaced benefits. The actual number of claims submitted during the initial months of operation (as opposed to their rate of submission) is presented in the Appendix.

Claims of Unauthorized Usage

Program administrators have been worried that Reg E would lead to an influx of claims of unauthorized transactions, which in turn would lead to increased costs due to replaced benefits. The data do not support this concern, at least during the early months of operations in the demonstration sites. As shown at the top of Exhibit 3, claim rates for unauthorized card usage affecting cash benefits were all nearly at or well below an average of one claim per 1,000 cases per month.

No consistent Reg E effect is visible in the data. Two of the four full Reg E sites (Citibank's DPC system and Bernalillo County) had the highest rates, higher than Camden County's rate of 0.62 claims of unauthorized usage per 1,000 case months. But the other two full Reg E sites (Hudson County and Doña Ana County) had quite low rates, as did the responsibility standard site (San Juan County). At 0.58 claims per 1,000 case months, the

[4] There were two claims submitted that fell outside these three categories. One was a claim of a forced transaction (or possibly a robbery) in Camden County; the other was a claimed robbery of benefits in Hudson County after the transaction had been completed. Both were denied.

Exhibit 2

REIMBURSABLE LOSSES, BY SITE

Level of Protection	Current EBT	Responsi-bility Standard	Full Reg E			
Site	**Camden County (NJ)**	**San Juan County (NM)**	**Citibank DPC System (TX)**	**Hudson County (NJ)**	**Bernalillo County (NM)**	**Doña Ana County (NM)**
Unauthorized Usage						
Card lost or stolen, user unknown	No	No	Yes	Yes	Yes	Yes
Card stolen, client knows who used card	No	No	Yes[a] No[b]	Yes[a]	Yes[a]	Yes[a]
Client still has card	No	No	Yes	Yes	Yes	Yes
Shoulder surfing[c]	No	Yes	Yes	Yes	Yes	Yes
Non-receipt of Funds						
ATM underdispense	Yes	Yes	Yes	Yes	Yes	Yes
System or Procedural Error						
Loss occurs *after* card reported as lost or stolen[d]	Yes	Yes	Yes	Yes	Yes	Yes
Processing error[d]	Yes	Yes	Yes	Yes	Yes	Yes
Double debit at store[e]	Yes	Yes	Yes	Yes	Yes	Yes
Other						
Merchant charges fee	No[f]	Yes	NA[g]	Yes	Yes	Yes
Employee theft[h]	Yes	Yes	Yes	Yes	Yes	Yes
Forced transaction	No	Yes	Yes	Yes	Yes	Yes
Robbery (after withdrawal)	No	No	No	No	No	No

- continued -

Exhibit 2 (cont.)

NOTES:

[a] The loss is reimbursable under Reg E, but Reg E officials would require that the client file a police report and be willing to prosecute.

[b] Citibank will not reimburse the loss if the cardholder knowingly gave the card and PIN to this person at any earlier time.

[c] Shoulder surfing refers to a situation in which someone looks over a client's "shoulder" and sees the PIN as it is being entered. If that person can then determine the client's EBT card number (e.g., by picking up a thrown-away receipt), it is possible for a counterfeit card to be made up and used—with the PIN—to steal funds from the account.

[d] Liability would fall on whichever organization was responsible for the error. For cards reported as lost or stolen, the organization receiving the report is supposed to enter the information into the system's computer, thereby preventing further use of the card.

[e] The presumption is that, upon notification of the error by the EBT vendor, the store would process a refund for the client.

[f] The state would notify the merchant that, per their contract, fees are not allowed on EBT transactions. If the merchant continued to charge fees, the contract would be canceled and the EBT equipment removed. Any clients who paid fees, however, would not be reimbursed.

[g] "Not applicable"; the Reg E staff know of no restrictions against merchant fees in the DPC system.

[h] The presumption is that the employer would voluntarily credit the client's account if evidence confirmed the loss.

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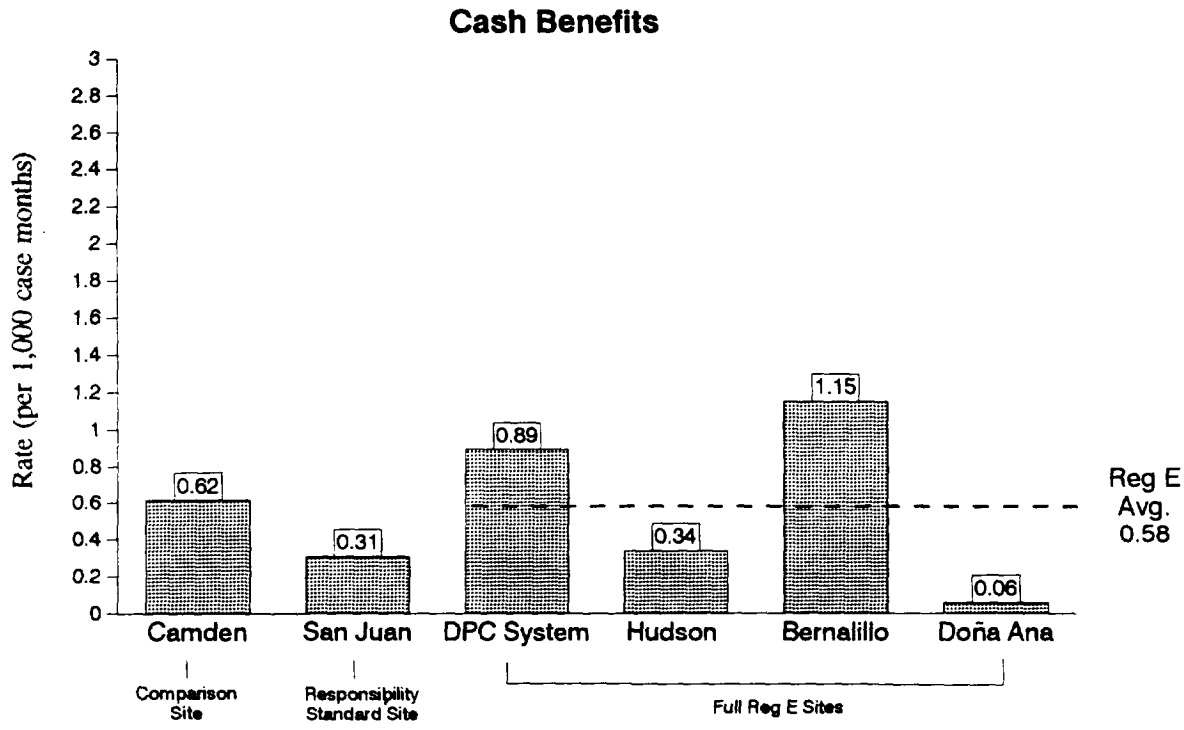
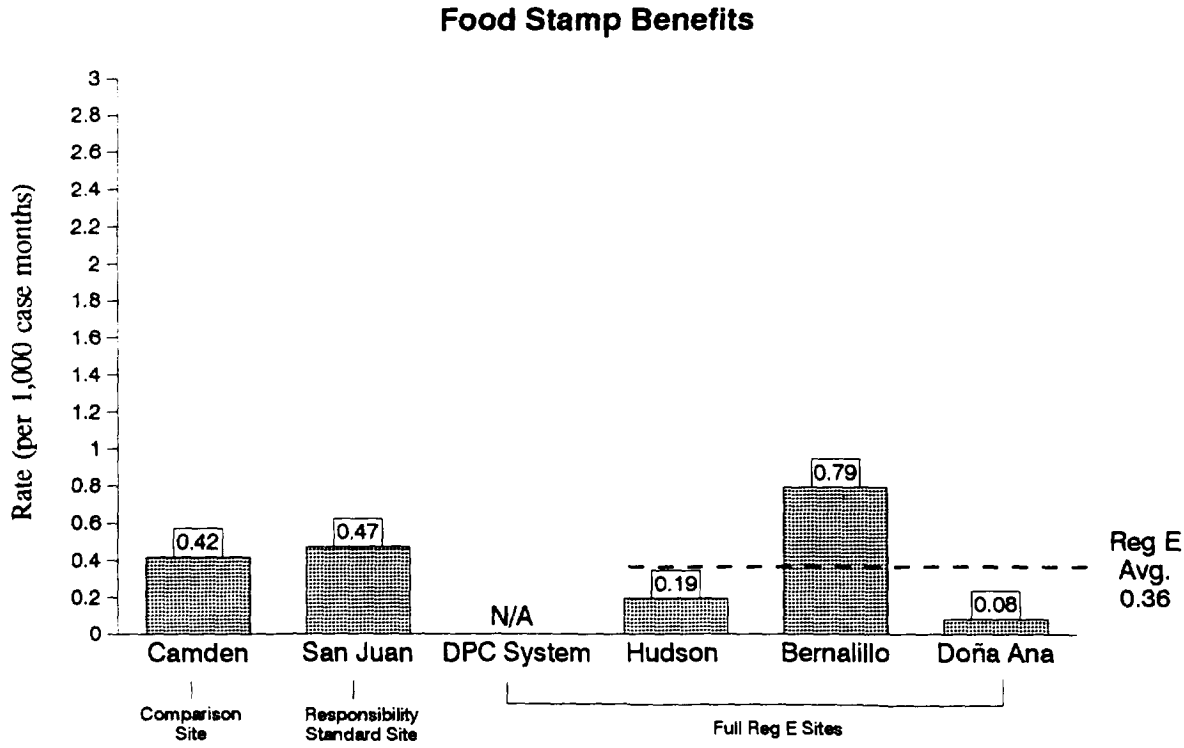
Exhibit 3

CLAIM RATES FOR UNAUTHORIZED USAGE





average claim rate of unauthorized usage across the four full Reg E sites (weighted by each site's caseload) was actually ***lower*** than the Camden County rate.

The story is much the same for claims of food stamp benefits lost due to unauthorized usage. Bernalillo County again had the highest rate of claims of unauthorized usage. The other two full Reg E sites, however, had the ***lowest*** rates of claims of unauthorized usage across the five sites issuing food stamp benefits. The weighted average for the three full Reg E sites was 0.36 claims per 1,000 case months, again below Camden County's rate of 0.42 claims per 1,000 case months.

Just as Reg E had little or no effect on the rate of claims of unauthorized usage, its impact on benefits replaced was quite small. As shown in Exhibit 4 (and in accordance with policy in these sites), no claims of unauthorized usage were approved in Camden or San Juan Counties. Even in the full Reg E counties, however, an average of only 14 percent of claims of unauthorized usage affecting cash benefits were approved (with another 7 percent still pending at the time these data were collected). For claims involving lost food stamp benefits, only 13 percent were approved in the full Reg E counties, with another 3 percent still pending. After deducting the client's portion of liability for losses due to unauthorized usage (and disregarding the claims still pending), the average dollar value of replaced benefits across the full Reg E sites was $250.19 per claim for cash benefits and $93.47 per claim for food stamp benefits.

With relatively few claims of unauthorized usage being approved, the potential liability for replaced benefits is small. The total liability for state or county agencies for replaced benefits averages just $0.02 per case month for cash benefits and less than $0.01 per case month for food stamp benefits. The pending claims in the exhibit will add, at most, only about a penny per case month in liability, even if all the pending claims in this group are approved.

Claims of Non-Receipt of Funds

The introduction of Reg E to EBT does not change EBT policy regarding whether or not a claim of lost benefits due to non-receipt of funds is reimbursable (refer to Exhibit 2). Further, for claims of non-receipt of funds that are approved, Reg E does not change levels of client liability (i.e., clients incur no liability for such losses with or without Reg E protections). Thus, one would not expect Reg E to have any major impact on such claim rates. A small

Exhibit 4

CLAIMS OF UNAUTHORIZED USAGE

Level of Protection:	Current EBT	Responsibility Standard	Full Reg E				
Site	**Camden County (NJ)**	**San Juan County (NM)**	**Citibank DPC System (TX)**	**Hudson County (NJ)**	**Bernalillo County (NM)**	**Doña Ana County (NM)**	**All Full Reg E Sites**
Cash Benefits							
Disposition							
Approved	0%	0%	9%	11%	22%	0%	14%
Pending	0%	0%	0%	6%	16%	0%	7%
Government Liability, $ per Case Month							
Approved	$0.00	$0.00	$0.04	$0.01	$0.05	$0.00	$0.02
Pending	$0.00	$0.00	$0.00	$0.01	$0.05	$0.00	$0.01
Total	$0.00	$0.00	$0.04	$0.02	$0.10	$0.00	$0.03
Food Stamp Benefits							
Disposition							
Approved	0%	0%	NA	3%	17%	33%	13%
Pending	0%	0%		3%	3%	0%	3%
Government Liability, $ per Case Month							
Approved	$0.00	$0.00	NA	<$0.01	$0.02	<$0.01	$0.01
Pending	$0.00	$0.00		<$0.01	<$0.01	<$0.01	<$0.01
Total	$0.00	$0.00		<$0.01	$0.01	$0.01	$0.01

Note:
NA = No food stamp benefits are issued through Citibank's DPC system.

impact might occur, however, if clients, upon learning that greater protections against loss due to unauthorized usage were now in place, were more likely to submit claims if ***any*** type of loss occurred.[5]

Food stamp benefits cannot be disbursed through ATMs, so no claims of non-receipt of FSP benefits were submitted. Comparing Exhibit 5 to Exhibit 3, however, shows that claims due to non-receipt of cash assistance benefits were submitted ***much*** more frequently than claims due to unauthorized usage. Three of the four full Reg E sites had claim rates much higher than Camden County, and the weighted average rate across the four sites (1.24 claims per 1,000 case months) is five times higher than in Camden County. Furthermore, the rate in San Juan County (which also can be viewed as a regular Reg E site for claims due to factors other than unauthorized usage) was ***very*** high.

The pattern of rates of non-receipt of funds across sites suggests that Reg E had a major effect on claim rates, but the pattern may be unrelated to Reg E. Until the evaluation's analysis of levels of unreported loss across the six sites is complete, we cannot discount the possibility that ***some*** of the difference in claim rates between the Reg E sites and Camden County is due to Reg E making clients more aware that benefits lost through ATM misdispenses could be replaced. This almost certainly cannot explain the entire difference, however. Indeed, when one sees that both New Jersey counties had relatively low claim rates, the most likely explanation for the difference in rates between the Reg E sites and Camden County is that the ATMs or ATM networks in New Mexico and Texas were more likely to experience misdispense difficulties than the ATMs in New Jersey. This hypothesis is buttressed by the fact that a substantial fraction of the claims in all three New Mexico counties, and to a lesser extent in the DPC system, were due to misdispense problems on a ***single day*** in each site (the cross-hatched portion of each bar graph).

Most claims of non-receipt of funds were approved in each site: for the period in question, the approval rates varied only from 72 percent in Hudson County to 90 percent in Camden County (see Exhibit 6). Unlike approved claims for unauthorized usage, no liability results when a claim of non-receipt of funds is approved. Funds returned to the client are taken from the ATM owner's account, merely correcting the original error.

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[5] Future evaluation reports will also examine rates of ***unreported*** loss, by type of loss, across all six sites.

Exhibit 5

CLAIM RATES FOR NON-RECEIPT OF FUNDS

Cash Benefits

3 2.96

Exhibit 6

CLAIMS OF NON-RECEIPT OF FUNDS
Cash Benefits

Level of Protection:	Current EBT	Responsi-bility Standard	Full Reg E				
Site	**Camden County (NJ)**	**San Juan County (NM)**	**Citibank DPC System (TX)**	**Hudson County (NJ)**	**Bernalillo County (NM)**	**Doña Ana County (NM)**	**All Full Reg E Sites**
Disposition							
Approved	90%	79%	81%	72%	75%	88%	78%
Pending	0%	0%	1%	2%	0%	0%	< 1%
Government Liability, $ per Case Month							
Approved	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Pending	a	a	$0.01	< $0.01	a	a	< $0.01
Total	$0.00	$0.00	$0.01	< $0.01	$0.00	$0.00	< $0.01

Note:
[a] No pending claims.

A few claims of non-receipt at Citibank and in Hudson County were still pending at the time these data were provided. Paradoxically, although an approved claim of non-receipt imposes no liability on the state or county agency (or the EBT vendor in the DPC system), a ***potential*** liability exists for claims still pending. This potential liability arises because Reg E requires that a provisional credit be granted if a claim cannot be investigated and resolved within 10 business days (for a loss at an ATM) or 20 days (for a loss at a POS device). If the claim is denied after the provisional credit has been applied to a client's account, a possibility exists

that the card issuer may not be able to recover the full amount of the provisional credit.[6] The small liabilities (about $0.01 per case month) shown at the bottom of Exhibit 6 for the Citibank DPC system and for Hudson County reflect this possibility. Their magnitudes, however, are based on the assumptions that ***all*** pending claims will be denied and that ***none*** of the outstanding provisional credits will be recovered. These assumptions are extreme; any final liability resulting from these pending claims is likely to be much smaller than the amounts shown in the exhibit.

Claims of System or Procedural Error

The final category of loss is loss due to system or procedural error. As with loss due to non-receipt of funds, Reg E does not change policy regarding whether such losses are reimbursable. Generally, in both the Reg E and comparison sites, losses due to system or procedural errors are reimbursable if an investigation verifies that the loss occurred.

Claims of loss due to system or procedural error were relatively rare in all sites for both cash assistance and food stamp benefits (Exhibit 7). With Camden County clients submitting virtually no claims of such losses, the possibility again exists that Reg E, through its impact on clients' knowledge that losses are reimbursable, may have had an indirect effect on claim rates. Nevertheless, with the very low rates in Hudson and Doña Ana counties, there is certainly no consistent pattern of an effect.

As with claims of non-receipt of funds, most claims of loss due to system or procedural error were approved. The only exception is Hudson County (see Exhibit 8), but the zero and 13 percent approval rates for AFDC and food stamp benefits are based on only three and eight claims, respectively.

None of the approved claims during this period led to a financial liability for the state or county agency or the EBT vendor. The only type of system or procedural error that could lead to a liability is when an unauthorized transaction is made ***after*** a client reports his or her EBT card lost or stolen, which did not occur in this period. As with pending claims for any

[6] The food stamp and AFDC programs require that recovery of overpayments be accomplished through a "recoupment" process that limits the amount of funds that can be recovered from the client each month. If a program recipient leaves the program before all funds are recovered, the state or county must follow regular collection procedures (or must wait until the recipient possibly reapplies for benefits) to recover the remaining benefits.

type of loss, however, a potential liability exists if pending claims are ultimately denied and any provisional credits are not recovered. The small food stamp liability shown in Exhibit 8 for Hudson County is probably much higher than any liability that actually will result from these pending claims, for the same reasons given for the pending claims in Exhibit 6.

Reasons for Denial

Reasons for denying a Reg E claim of benefit loss can be divided into two groups: procedural and non-procedural. Procedural grounds for denial vary a bit across the demonstration sites, but they generally include situations in which the client either fails to report the loss on time, fails to submit required documentation within specified time frames, or does not fully cooperate with the investigation of the claim. Procedural grounds for denial also include findings that the loss is not reimbursable under the site's policy or that the loss is less than the client's liability.

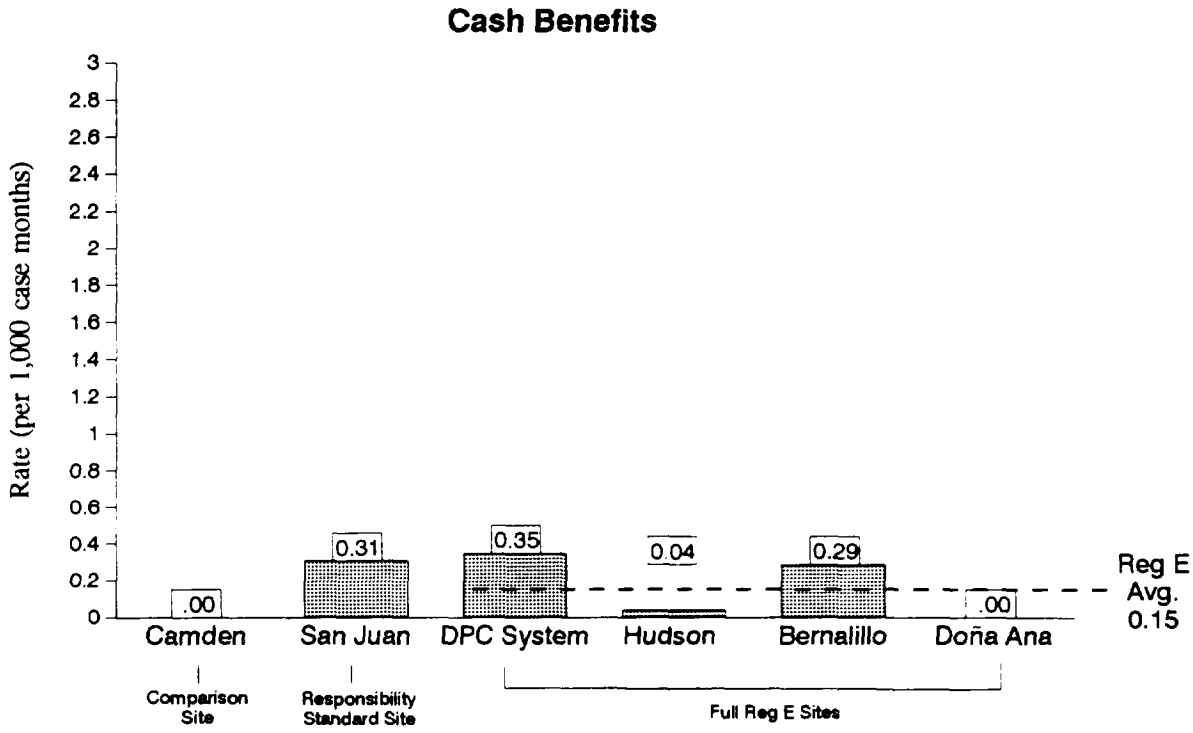
Non-procedural grounds for denial include situations in which either evidence confirms that no loss occurred, the client provides inconsistent information about circumstances of loss, or—as a contributing factor—the client compromised his or her PIN (e.g., by writing the PIN on the card or previously allowing someone else to use their EBT card and PIN).

Among denied claims, most were denied on procedural grounds—66 percent for claims involving cash benefits and over 97 percent for claims involving food stamp benefits. Most of these procedural denials were due to clients missing deadlines for providing documentation. Data from an ongoing survey that includes clients whose claims were denied may shed light on why they were not able (or not willing) to submit the required documentation. Possible reasons include that documentation requirements were too much of a burden, that the claim was not valid to begin with, and—for claims of unauthorized usage in which the client knew who took the funds—that clients were not willing to file a police report or support prosecution of the offender.

Among claims denied for non-procedural reasons, most were denied based on evidence confirming that no loss occurred (e.g., the ATM network verified that all requested funds were disbursed). The degree to which these claims represented efforts to defraud the program or simply client misunderstandings about whether a loss actually occurred is not known.

Exhibit 7

CLAIM RATES FOR SYSTEM OR PROCEDURAL ERROR



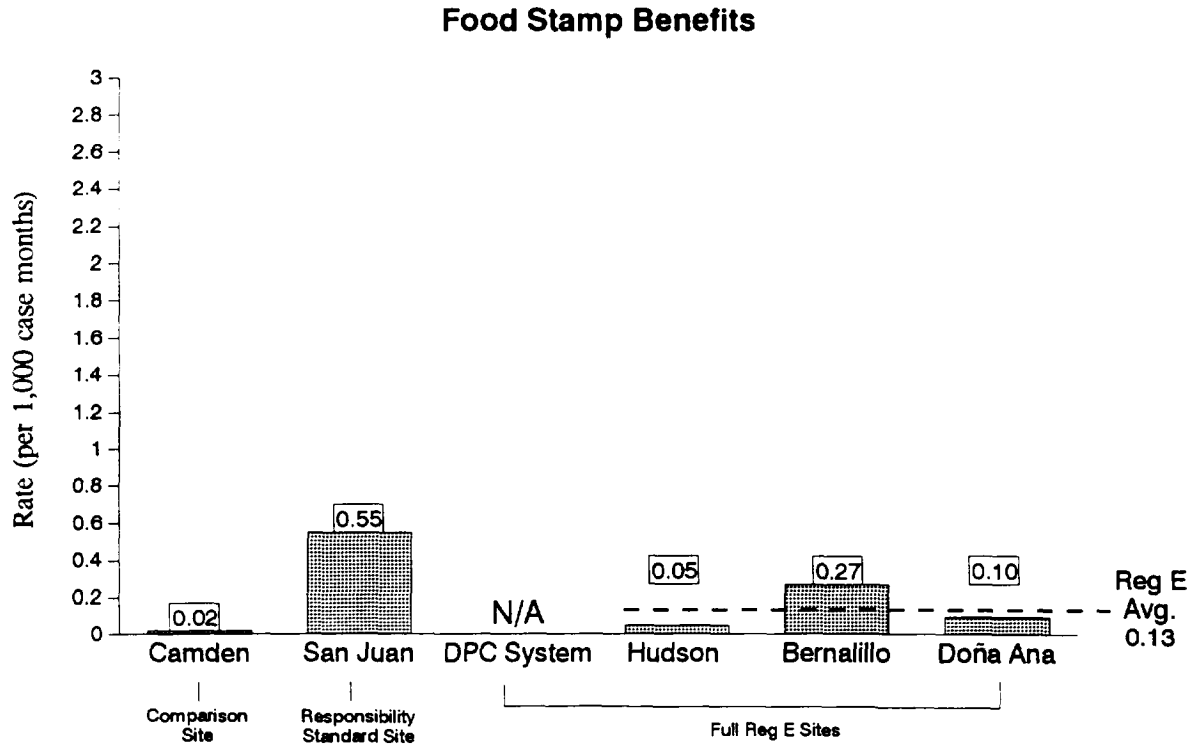


Exhibit 8

CLAIMS OF SYSTEM OR PROCEDURAL ERROR

Level of Protection:	Current EBT	Responsibility Standard	Full Reg E				
Site	**Camden County (NJ)**	**San Juan County (NM)**	**Citibank DPC System (TX)**	**Hudson County (NJ)**	**Bernalillo County (NM)**	**Doña Ana County (NM)**	**All Full Reg E Sites**
Cash Benefits							
Disposition							
Approved	a	100%	94%	0%	70%	a	77%
Pending	a	0%	0%	0%	0%	a	0%
Government Liability, $ per Case Month							
Approved	a	$0.00	$0.00	$0.00	$0.00	a	$0.00
Pending	a	b	b	b	b	a	b
Total	a	$0.00	$0.00	$0.00	$0.00	a	$0.00
Food Stamp Benefits							
Disposition							
Approved	100%	57%	NA	13%	69%	50%	55%
Pending	0%	0%		13%	0%	0%	3%
Government Liability, $ per Case Month							
Approved	$0.00	$0.00	NA	$0.00	$0.00	$0.00	$0.00
Pending	b	b		<$0.01	b	b	<$0.01
Total	$0.00	$0.00		<$0.01	$0.00	$0.00	<$0.01

Notes:

[a] No claims of system or procedural error filed.

[b] No pending claims.

NA = No food stamp benefits are issued through Citibank's DPC system.

IMPACTS OF REG E ON ADMINISTRATIVE COSTS

The impact of Reg E on program administrative costs was much greater than its impact on replaced benefits, at least during the early months of operations in the demonstration sites considered in this preliminary analysis. Even with some cost data not yet available for tabulation, the average cost of Reg E operations was $0.411 per case month across all Reg E sites (including San Juan County),[7] compared to just $0.012 per case month in the non-Reg E comparison site (Camden County). Although a portion of this difference is due to generally lower claim rates in Camden County, most of the difference is due to the additional resources (primarily labor) used by the Reg E sites to accept, investigate, track, and otherwise formally process claims of lost benefits. Differences in administrative costs are also almost certainly affected by cross-site differences in the mix of types of claims submitted.

The evaluation's current analysis of administrative costs relies on data from several sources: quarterly cost reports from New Mexico and New Jersey, which identify actual direct cost and indirect cost components as well as some labor costs; salary rosters, including fringe benefits; weekly timesheets from key Reg E personnel in each site; claim forms that indicate time spent by vendor customer service representatives or, in New Mexico, EBT specialists who record information from the client when a claim is first submitted; and interviews with key Reg E personnel and other state and county staff. Cost data not yet available for analysis include time spent initiating and tracking recovery of provisional credits (expected to be minimal) and time spent by county caseworkers responding to client questions (which will be present in both the comparison and Reg E sites, although not necessarily of the same magnitude), and costs associated with fair hearings.

The results of the administrative cost analyses are presented in Exhibit 9; the figures are broken out by labor costs incurred by customer service representatives, investigations and other operations, and other direct costs and overhead. The top third of the exhibit presents the average administrative cost for claims involving cash benefits. The middle third provides similar results for food stamp claims, and the bottom third presents the overall average cost per case month for all claims. When a claim in New Mexico or New Jersey included both AFDC and

[7] Administrative costs specific to claims submitted by recipients in San Juan County cannot be isolated from Reg E administrative costs in the other two New Mexico counties until additional analyses are conducted.

Exhibit 9

ADMINISTRATIVE COSTS PER CASE MONTH

Cost Category	Camden County (NJ)	Citibank DPC System (TX)	Hudson County (NJ)	New Mexico	All Reg E Sites
Cash Claims					
CSRs/EBT specialists[a]	$.005	$.006	$.006	$.008	$.007
Investigations/other operations labor	$.014	$.105	$.698	$.413	$.356
ODCs and overhead[b]	<$.001	$.075	$.234	$.223	$.174
Total	**$.019**	**$.186**	**$.938**	**$.644**	**$.536**
Food Stamp Claims					
CSRs/EBT specialists[a]	$.002	NA	$.002	$.003	$.003
Investigations/other operations labor	$.007		$.209	$.159	$.171
ODCs and overhead[b]	<$.001		$.070	$.086	$.082
Total	**$.009**		**$.281**	**$.248**	**$.256**
All Claims[c]					
CSRs/EBT specialists[a]	$.003	$.006	$.003	$.004	$.004
Investigations/other operations labor	$.009	$.105	$.393	$.230	$.285
ODCs and overhead[b]	<$.001	$.075	$.132	$.124	$.122
Total	**$.012**	**$.186**	**$.528**	**$.359**	**$.411**

Notes:

a "CSR" refers to customer service representative.

b Collectively, ODCs (other, nonlabor, direct costs) and overhead include all state, county, and vendor costs associated with such factors as telephone use, travel, postage, depreciation of equipment, use of space, and supporting administrative services. ODC and overhead costs for New Jersey's vendor, however, are included in the exhibit as part of labor costs.

c Cost per case month calculated using duplicated case counts (e.g., a household receiving cash assistance and food stamp counts as two cases).

NA = No food stamp benefits are issued through Citibank's DPC system.

food stamp benefits, it was counted as two claims in computing an overall average cost per claim.

Before discussing the variation across sites in estimated costs per case month, we note that, in New Jersey and New Mexico, administrative costs associated with processing claims of lost food stamp benefits were always considerably lower than costs associated with processing AFDC claims. This pattern simply reflects the lower submission rate for claims involving food stamp benefits, which is largely due to the fact that food stamp benefits were not disbursed through ATMs (and, hence, led to no claims of non-receipt of funds).

Turning to costs by site, Camden County had the lowest administrative costs associated with investigating claims of lost benefits ($0.012 per case month overall) because, as the comparison site, it did not implement Reg E procedures. Under standard EBT protections, however, New Jersey's EBT vendor (Deluxe Data Systems) did investigate claims of ATM misdispense and system error. In addition, Camden County staff issued checks for benefits replaced following a verified ATM misdispense or system error. These costs, together with other direct costs (ODCs) and overhead, averaged $0.019 per case month for cash assistance claims and $0.009 per case month for food stamp claims.

The highest-cost Reg E site is Hudson County, where Reg E costs averaged $0.938 per case month for claims involving cash benefits, $0.281 per case month for claims involving food stamp benefits, and $0.528 per case month for all claims combined. As in Camden County, Deluxe staff investigated all claims of ATM misdispense and system error in Hudson County. Deluxe's customer service representatives and supervisors also had the added Reg E responsibilities of filling out special Reg E claim forms and faxing them to Hudson County staff whenever a Reg E claim was filed. By far the largest component of Hudson County costs, however, is the amount of time county (and, to a much lesser extent, state) staff spent processing and investigating claims.

Hudson County's Reg E procedures differed considerably from the other Reg E sites' operations, and these procedures contributed substantially to the high costs of Reg E operations in the county. For instance, once a client reported a loss to the vendor's customer service representative, the client was told to go to the welfare office to meet with an investigator and to fill out an affidavit of loss. To accommodate this procedure, a county investigator was always available to meet with clients, even during periods when few claims were being filed. In

addition, Hudson County had a history of and a reputation for investigating claims of loss very thoroughly, and this commitment clearly affected the cost of investigating claims. Hudson County's method of implementing Reg E may help explain the relatively low rate of claims seen in the county, but it also resulted in high administrative costs.

New Mexico had the next highest average cost per case month for Reg E operations. Its average cost across the three counties was $0.644 per case month for cash claims, $0.248 per case month for food stamp claims, and $0.359 per case month for all claims combined. In New Mexico, clients reported their claims to the county office's EBT specialist, who then submitted information about each claim to the state's centralized Reg E unit. The Reg E unit, composed of a manager and a coordinator, contacted the client to begin and carry out the investigation.

Citibank incurred the lowest average administrative cost for Reg E operations—$0.186 per case month. Clients in the DPC system called the system's Help Desk to tell a customer service representative about incidents of lost benefits. Citibank's Reg E coordinator performed most of the investigations, although she occasionally sought the assistance of the bank's Security Unit investigators when she had questions about the validity of a claim.

When compared to the savings in administrative costs attributable to EBT in previous evaluations, the preliminary administrative cost estimates provided in Exhibit 9 are large. They suggest that, if these sites' Reg E procedures were adopted by other states, EBT system operating costs might no longer be less than the costs of issuing benefits via checks and food stamp coupons.

It is also the case that the estimates presented in Exhibit 9 are probably ***lower*** than the costs that will be estimated once all administrative cost data for the demonstrations are collected and analyzed (although the ***difference*** between the Reg E sites and Camden County could be either more or less once all data are available). For instance, the current cost estimates do not include any time spent by regular county caseworkers who responded to questions from clients about incidents of loss.[8] The cost estimates also do not include time spent by county or state staff who initiated and tracked recoupment of provisional credits for claims subsequently denied,

[8] This time may be greater in Camden County than the other New Mexico and New Jersey sites because, in the Reg E sites, clients were specifically instructed to contact the Help Desk or their EBT specialist, rather than their caseworker, when problems occurred.

although this time appears to be relatively small. Finally, the cost estimates presented here do not include any costs associated with client requests for fair hearings following a denial of a claim; only a few such requests were filed, however.[9]

To provide more perspective on these cost estimates, Exhibit 10 presents average time spent per claim and the associated average administrative cost per claim in each site, when no distinction is made between cash and food stamp claims. The Camden County and Hudson County figures stand out as extremes for reasons previously noted. Three aspects of these numbers are worth special note. First, because the operations in Hudson County had a greater fixed cost component than operations in the other sites (e.g., an investigator always available to meet with clients coming in to fill out an affidavit), the Hudson County averages would fall by a greater percentage than the other sites' averages if clients filed more claims. Second, although New Mexico spent only about 13 percent as much time per claim as did Hudson County, its average cost of $306 per claim is nearly 28 percent of the Hudson County average of $1,105 per claim in administrative costs. This reflects New Mexico's assignment of higher-salaried staff to the project, which—according to state officials—would not be repeated in a non-demonstration setting. Finally, New Mexico's average cost of $0.359 per case month (Exhibit 9) is only a third less than Hudson County's average of $0.528 per case month. This narrowing difference in costs is due to the higher rate of claims observed in New Mexico compared to Hudson County.

Exhibit 10

AVERAGE TIME AND ADMINISTRATIVE COST PER CLAIM

	Camden County (NJ)	Citibank DPC System (TX)	Hudson County (NJ)	New Mexico	All Reg E Sites
Hours per claim	0.49	2.39	42.67	5.73	10.96
Dollars per claim	$19	$51	$1,105	$306	$358

[9] To date, all fair hearings have supported the state or county's decision to deny the claim.

NEXT STEPS

At this point in the evaluation of the application of Reg E to EBT systems, the evidence suggests that, although Reg E may not impose much additional cost to governmental agencies and their EBT vendors in the form of replaced benefits, the added administrative costs of Reg E operations may be substantial. It must be emphasized, however, that these findings are preliminary. Later this year, when the evaluation's final report is available, it may show a somewhat different picture of the demonstration sites' experience with claims and administrative costs. Specifically, the final report will be based on data from the full 12 months of Reg E operations in each site. It will also include some administrative cost components not yet compiled (e.g., caseworker time, and costs associated with recoupment procedures and fair hearings), as well as an assessment of costs that likely would not be incurred in a non-demonstration setting. Of special interest will be the sites' own assessment of how Reg E staffing and operational procedures might be modified to achieve greater efficiencies in providing the client protections envisioned by the Federal Reserve's Board of Governors when the Board ruled that Regulation E should apply to all EBT systems.

Appendix

NUMBER OF CLAIMS SUBMITTED

Level of Protection:	Current EBT	Responsi-bility Standard	Full Reg E				
Site	**Camden County (NJ)**	**San Juan County (NM)**	**Citibank DPC System (TX)**	**Hudson County (NJ)**	**Bernalillo County (NM)**	**Doña Ana County (NM)**	**All Full Reg E Sites**
Cash Benefits							
Unauthorized usage	46	2	46	36	36	1	119
Non-receipt	19	19	124	59	52	26	261
System error	0	2	18	4	10	0	32
Total Claims[a]	**66**	**23**	**188**	**100**	**99**	**27**	**414**
Food Stamp Benefits							
Unauthorized usage	54	6	b	34	75	3	112
System error	3	7		8	26	4	38
Total claims[c]	**57**	**13**		**43**	**101**	**7**	**151**

Note:

[a] The numbers in this section of the exhibit include three claims in categories that were too small to warrant presentation in this table. The first of these claims was due to a forced transaction, and the second and third were due to robberies that occurred after the transactions had been completed.

[b] No food stamp benefits are issued through Citibank's DPC system.

[c] The numbers in this section of the exhibit include one claim in a category that was too small to warrant presentation in this table. This claim was due to a robbery that occurred after a transaction had been completed.