Electronic Benefits & Services Council

Co-Branding Work Group

Enhance Government.
Electronically.

Co-Branding of EBT Cards: Review and Identification of Issues

White Paper

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Electronic Benefits and Services Council

NACHA – The Electronic Payments Association
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I. Introduction

A. Purpose

This paper describes the issues that government agencies are encountering as they explore card-based options for disbursing funds electronically. Specifically, the paper explores the growing interest in issuing government benefits and payments for multiple programs, with a variety of requirements, on a single card. This technological evolution is known as co-branding. Co-branding combines the functionality and governance of Electronic Benefits Transfer (EBT) and a commercial payment company on a single card. For the purposes of this paper, a commercial payment company is defined as Discover, MasterCard Worldwide, Visa USA, or possibly other national or regional commercial payment networks.

Co-branding is defined as follows:

> A plastic payment card issued and transactions processed in accordance with the rules of multiple payment networks, including national, commercially branded card networks, whereby government-issued unrestricted funds and restricted funds are associated with a single payment card.

EBT is the electronic delivery of government services and payments using a debit-type card. Congress required that food stamp benefits be disbursed by EBT, and state EBT programs are governed by regulations issued by the U.S. Department of Agriculture (USDA) and individual states. EBT cards display either a QUEST Mark, indicating that they are issued in compliance with the Quest® Operating Rules issued by NACHA's Electronic Benefits and Services Council (EBS Council), or a network/state mark indicating that they comply with state EBT rules.

In recent years, governments have increasingly turned to the use of commercially branded electronic payment cards (EPCs) that display the marks of commercial payment companies. As with EBT, governments contract with a service provider for card issuance.

Information on EBT and EPCs is provided in the next section of this paper (Section I.B, "Background") and is also available in a NACHA white paper entitled "Electronic Disbursement Options," posted on the Electronic Benefits and Services Council's web site at http://ebt.nacha.org.

This paper is issued by the Co-Branding Work Group of the EBS Council and is intended to be educational in nature. The EBS Council has taken no position on the advisability of using co-branded cards, nor does it advocate adoption of a specific routing or fee model. Instead, the paper provides background information on issues that are central to the issuance of co-branded cards. It also addresses open issues that must be considered in formulating a co-branded solution for any government. The audience for the white paper includes state and federal agencies, merchants, processors, issuers, acquirers, payment networks, and financial institutions with an interest in the electronic disbursement of government payments. While this paper is intended for a broad audience, it may be of particular use to governments that are considering contracting for issuance of a co-branded card.

Finally, while the issues discussed in the paper focus primarily on payments to individuals, they are also relevant to payments to certain service providers, such as child care or employment training providers.

B. Background

Electronic issuance of benefits and payments by government entities has evolved significantly since the inception of EBT in the early 1990's. Initially, EBT was implemented as an alternative to the use of coupons and paper checks for making payments to individuals. Building on the success of this technology, the states and federal agencies are now pursuing additional alternatives for providing an increasing array of benefits and services electronically, with EBT as one of the options.

EBT was originally introduced by the U.S. Department of Agriculture's Food and Nutrition Service (FNS) to replace food stamp coupons. The original pilot demonstrations were closed systems, not designed to communicate across states or systems. As system platforms were developed for use by multiple states in an open environment, many states took advantage of EBT technology and added cash assistance programs such as Temporary Assistance for Needy Families (TANF), state general assistance, child support, and child care subsidies. Current EBT systems support FNS regulations that restrict use of food stamp benefit purchases to approved food items in authorized merchant locations. Access to cash benefits is provided through ATMs and point of sale (POS) devices in retail stores, which will typically allow cardholders to make cash purchases with the option of getting a limited amount of cash back. Recognizing the benefits and cost savings of eliminating paper coupons and checks, many states began exploring how certain programs, such as unemployment insurance and child support, might be better supported by other electronic payment technologies.

As governments sought to expand the kinds of program funds that could be disbursed electronically, they also wanted to build on EBT's success in reducing the stigma associated with using paper food stamp coupons, increase the number of acceptance locations where benefits and payments could be accessed, and decrease the administrative overhead required for the oversight of needs-based programs.

Individual states are looking at co-branded cards for a variety of reasons. Some states have surveyed their clients and learned that the clients would like a single card. For example, 87 percent of the clients surveyed in Texas would like to have a single card. Other states would like to simplify their back-office processes or save money. The Gulf Coast states are seeking the best and easiest way to disburse funds after a disaster.

When reviewing the co-branding issues described in this white paper, it is valuable for states to define clear objectives. If one of the goals is to provide additional merchant locations where benefits are accepted, states should consider, at least as a short-term measure, promoting EBT acceptance by general retail merchants, not just food stamp merchants. The retail merchant population is not widely aware that EBT transactions can be easily added to merchants' systems, usually with only a phone call to their merchant provider, at very low cost. States might accomplish at least some of their objectives by this additional promotion, accomplished perhaps by posting a notice on the website where retailers pay taxes or renew business licenses. This may produce noticeable results while states continue to examine the details of co-branding.

All states and territories must issue EBT cards for food stamps, and most use it for the nation's major cash entitlement program, TANF. A total of 35 states also issue an EPC for a variety of programs. As a result, many states are looking for a solution that will allow them to issue all or a variety of payments on a single card.

In a 2005 survey of 54 states and territories, 44 responded to the question "Have you considered using a branded EBT card (e.g., Visa, MasterCard)?" Of those 44, 16 replied in the affirmative. Of those 16, three responded that they had considered it but rejected it for various reasons, including not wanting a separate card for cash programs and not wanting multiple cards. The remaining 28 state respondents said that they had either already implemented an EPC program or that they intended to.

Today, 35 states use EPC for the following services:

- A total of 6 issue cash assistance, such as TANF.
- A total of 33 issue child support.
- A total of 5 either issue state payroll or plan to.
- A total of 18 issue unemployment insurance benefits.

II. Overview of Central Issues

A. Policy Issues

1. The United States Department of Agriculture's Position on Co-Branding

FNS issued detailed regulations to implement Food Stamp Program (FSP) legislation that requires EBT to be used by all states, territories, and the District of Columbia for the distribution and redemption of food stamp benefits to eligible households. As a result, FNS approves all state procurements of EBT services and will require federal approval of any solution that incorporates food stamp benefits on a co-branded card.

The FNS EBT regulations (7 CFR 274.12) contain no provisions that address the concept of co-branding. FNS is open to co-branding and is willing to work with states and industry representatives on co-branding options. Its basic position is that any co-branded card program must conform to FSP legislation and regulations. FNS has the authority to approve waivers of regulatory provisions, as long as the alternative process is not contrary to the law and does not have an adverse impact on recipient service levels or the rights of program participants. Therefore, if a co-branding solution requires deviation from a regulation, a state may request that FNS approve a waiver.

Following is a list of some of the FSP regulatory requirements that must be maintained under any co-branding project:

- FSP adjustment process and timeliness requirements (including fair hearing rights) – 274.12(f)(4)(ii)
- Prohibition against establishing transaction limits (that is, no minimum dollar amount per transaction or maximum limit on the number of transactions allowed) – 274.12(f)(1)
- Equal treatment of cardholders in lane compared to other branded-card cardholders – 274.12(g)(4)(i)
- The requirement to include a securely encrypted PIN in all electronic transactions (except for voucher clear transactions) – 274.12(e)(2)(ii), (h)(3)(ii)(C) and (h)(7)(iii)
- Acceptance of manual vouchers by non-traditional/route vendors and by retailers when the host system is not available – 274.12(g)(1)(i)
- Replacement of lost or stolen cards within 2 business days for over-the-counter issuance (for centralized issuance systems card must be in cardholder's hand within 5 calendar days) – 274.12(f)(5)(ii)
- Minimum card requirements, including mailing address to return found cards and non-discrimination statement – 274.12 (h)(6)(i)(A) and (B)
- Conformance with X9.58 (current FSP version of ISO 8583) message standard – 274.12(h) and (h)(10)(ii)

- Financial settlement to retailers or third-party processors within 2 business days of the daily cut-over period for retailers' settlement – 274.12(g)(5)

2. The Food and Nutrition Service's Position on Fees for Food Stamp Transactions

Federal regulations do not allow retailers to impose any transaction fees on EBT cardholders for food stamp transactions—274.12(f)(1). The regulations also prohibit charging service, transaction, or interchange fees to food stamp authorized retailers that opt for state-provided EBT equipment and processing—274.12(g)(2). These merchants, commonly known as EBT-only retailers, may be charged reasonable fees only in the following circumstances:

- To replace lost, stolen, or damaged equipment
- To pay telecommunication costs for any non-EBT use when lines are provided by the state

Many food stamp merchants use commercial processing equipment and services so that they can accept credit, debit, and EBT transactions on a single terminal. Whether to use commercial equipment or state-supplied equipment is a business decision made by each retailer. However, by opting not to use state-supplied equipment, the merchant forfeits the right to cost-free services for EBT.

The FSP Act and pertinent regulations do not prevent retailers who use commercial processing services from being charged monthly service fees, per-transaction processing costs, or network charges. Currently, merchants agree to pay established pricing for processing services or negotiate more favorable rates with their merchant services providers.

Co-branding introduces an additional element: commercial payment company interchange fees. Federal regulations prohibit charging EBT-only retailers for interchange fees. However, there is no prohibition against charging interchange fees to retailers who have opted to use commercial processing services for food stamp transactions.

Retailers who incur interchange fees may not directly pass any part of those fees on to food stamp cardholders, except by increasing the shelf price of stock for all customers, including those paying with cash.

3. Categories of Programs and the Applicability of Co-Branding

State and federal government benefit programs can be divided into two major categories: needs-tested and non-needs-tested. This section addresses the use of co-branded cards for programs in both categories and describes how state policy, such as fair hearing requirements, will affect cash transactions.

a. Program Categories

Needs-tested programs are based on the recipient's need. Because needs-tested programs are designed to benefit people with low incomes, it is particularly important that benefits be delivered with minimal cost to the recipient. Major programs in the needs-tested category include:

- Food stamps
- TANF
- Refugee assistance
- Emergency assistance for the elderly, the disabled, and children.

Eligibility for non-needs-tested state and federal programs is not based primarily on need. Since the government is not necessarily assisting people with low incomes, it can place a significant emphasis on saving money in the benefits distribution process. Minimizing the cost pass-through for the cardholders and merchants is a goal, but not the overriding goal, in non-needs-tested programs. Major non-needs-tested programs include:

- Child support
- Unemployment insurance
- Foster care payments

b. The Impact of Government Policy on Cash Transactions

As described above, federal and state government policies for needs-tested programs affect EBT systems and operating procedures. In 1996, Congress enacted legislation that exempted needs-tested EBT programs established or administered under state or local law from the consumer protections afforded by the Federal Reserve's Regulation E. Congress granted the exclusion in part for two reasons: the benefits provided by these programs are not automatically replaced if lost or stolen, and the cost associated with Regulation E coverage could have compromised the cost effectiveness of EBT use by states. As a result, EBT cardholders do not receive interim settlements or the other consumer protections available to commercial card holders.

However, a cardholder may request a fair hearing in accordance with federal and state policies and procedures, and states may obtain Regulation E coverage for any program by requiring it in the contract for service.

What is a fair hearing? EBT cardholders have the right to appeal any action or inaction taken by the agency that administers the program. A fair hearing is a review of the cardholder's claim by an appointed hearing officer. This right is important, because once benefits/funds are available to the cardholder, they cannot be taken back without written permission. If a cardholder believes that the cardholder's available balance has been reduced unfairly, the cardholder has the right to a fair hearing.

How do fair hearings impact co-branded card cash programs? Questions remain as to how each individual state's fair hearing process would be affected by the issuance of a co-branded card. State fair hearing requirements would apply to disputes involving co-branded cards because the state, not the contractor, is ultimately responsible for determining and transmitting information on benefits and authorization levels. Because state fair hearing requirements would take precedence over the rules of commercial payment companies or the Quest Network, the impact of issuing co-branded cards would vary from state to state.

4. Information on Cardholders

Governments who are exploring electronic payment options may want to consider how much spending or transaction history information—particularly client-specific information—they actually need. EBT provides the state with more cardholder information than is available when paper checks or EPCs are used. When checks are used, a client's spending cannot be tracked. If a client is issued a check, the state receives no information on how or where the funds are spent. EBT contractors provide states with a wide variety of information, including where a specific card is used and the amount of the transaction. When EPCs are used, privacy laws limit the information that commercial payment companies can release on an individual's transaction history or shopping patterns. Information on the fees charged to EPC cardholders or information on cardholder spending could be provided on an aggregate basis, but personally identifiable information is protected by law.

B. Technical Issues

1. Personal Identification Number vs. Signature-Based Authentication

There are two ways for a cardholder to authenticate a POS transaction at a retailer: a personal identification number (PIN) or a signature. To authorize a transaction online using a PIN, the cardholder keys a PIN onto a PIN pad at the POS. Funds are immediately debited from the cardholder's account. PIN-based transactions can originate at retailer POS locations and ATMs.

To authenticate a transaction offline using a signature, the cardholder signs a paper receipt or an electronic signature pad. Funds are not immediately debited from the cardholder's account. Instead, the transaction is run through a commercial payment company's credit card network. Signature-based transactions can originate only at a retailer's POS.

Retailers pay fees for both PIN-based and signature-based transactions. PIN-based transactions are comparatively low-cost transactions for the retailer. The fees for signature-based transactions are usually a percentage of the total purchase amount, and such transactions are more costly to retailers than PIN-based transactions.

All electronic food stamp transactions must be authenticated using a PIN, as opposed to a signature. For cash transactions, some large retailers can configure their terminals to prompt customers to use one type of authentication over another. Some debit cards can only be authenticated using a PIN. For instance, Visa, MasterCard and Discover have the Interlink, Maestro and PULSE networks, respectively, which service PIN-only products.

Additionally, there is a difference in administrative overhead between the two types of transactions in the event of an inquiry. Because PIN-based transactions carry the authentication of the cardholder in the transaction message, cardholders are less likely to dispute them than they would be to dispute signature-based transactions. On the other hand, PIN-based transactions require a PIN entry device at the merchant location, while signature-based transactions do not require this additional hardware.

2. Account Structure

The account structure for co-branded cards can vary, depending on how transactions are routed. For most EBT-based applications, states submit demographic and benefit authorization files to their EBT contractor. The contractor then establishes a card/account database that is used for customer service, transaction authorization, and account management, including funds settlement, transaction history, reporting, administrative system support, investigative services, and disaster services support. This approach can be described as a *single authorization endpoint* approach, meaning that the state submits data for all benefit types to a single endpoint. To comply with federal regulations with this model, food stamp benefits are established as a unique account, with specific purchase restrictions and authorization requirements. Cash benefits, which are commonly funded by state agencies, may be established under a single cash account, or may be segmented by funding option, distinguishing day-of-draw benefits (such as TANF) from prefunded entitlements (such as Supplemental Security Income, or SSI).

The following discussion explores the impact of co-branding on the account structure under the two approaches: single authorization endpoint and multiple authorization endpoints.

a. Single Authorization Endpoint

An authorization endpoint is the entity that authorizes or declines a transaction request. For EBT, it is the state's contractor or an organization that operates the cardholder authorization system (CAS) on behalf of the state's contractor. For a commercial payment company, it is the issuing financial institution.

For EBT, states submit all cardholder demographic and benefit authorization data to a single endpoint (the contractor). The contractor establishes a card/account database and applies program specific parameters to each account type within this structure (food stamp account or cash account) to support that program's transaction authorization and reporting requirements. In an online authorization environment, cash benefits are commonly authorized based on PIN validity and available balance. Additional account types may be created to support programs with unique authorization or processing requirements, such as restricted cash distribution or unique allowable transaction types. Separate account types may also be designated to support prefunded as opposed to day-of-draw cash programs.

(1) Commingled Cash

The term *commingled* is used when multiple benefit types are added to a single account type. For example, a cash account might include several benefit types such as TANF, low income energy assistance, and unemployment insurance. These benefits may be sent to the single authorization endpoint by one or several agencies, depending on the needs of the specific state.

If multiple benefit types are added to a single cash account, the authorization rules governing that account type are applied to all benefits. For example, if a state prohibits a certain transaction type for a cash account, that transaction will not be allowed for any benefit established within that account. When cash benefits are commingled in a single cash account, states may designate a hierarchy for distribution of funds, selecting individual benefit types to be disbursed in order of preference. To the cardholder, all benefit types assigned to a single cash account appear as a single cash balance.

(2) Funding Options for Accounts

In general, cash benefits are funded in one of two ways: *day-of-draw* or *prefunded*.

Most EBT cash benefits are funded as day-of-draw benefits, allowing states to retain benefit funds until the cardholder redeems them through POS or ATM withdrawals. Under this approach, EBT contractors draw funds paid out to retailers and other acquirers from state settlement accounts as part of their end-of-day processing.

Prefunded benefits are paid out to cardholders in advance, like a paycheck or other payment that is deposited to an individual's bank account. Common types of prefunded benefits are unemployment insurance, child support payments, and social security payments.

Prefunded and day-of-draw benefits can be loaded onto a single card. States can establish different authorization parameters for the different benefit types. For example, a state may allow off-line purchases (i.e., no PIN required for authorization) for prefunded account types but not for day-of-draw benefits. In this way, states can mitigate the risk associated with off-line processing while offering cardholders ubiquitous access through commercial credit card devices.

b. Multiple Authorization Endpoints

If a state establishes different authorization endpoints for its different card programs, it must then send separate demographic and benefit information files to each endpoint. Each endpoint would be reconciled separately, eliminating the ability to commingle benefits in a single account. This approach can increase back office overhead to states. States can use this approach to separate day-of-draw programs from prefunded programs, issuing multiple cards to cardholders. This approach is sometimes preferred, depending on the program types and the populations served. For example, the population receiving prefunded child support payments may not receive day-of-draw food stamp or TANF benefits, making it unnecessary to create a co-branded card to support this group.

3. Transaction Routing

a. Current EBT Environment

Currently, each EBT card carries a card number that is unique to the cardholder and begins with a 6-digit prefix, or Bank Identification Number (BIN). For EBT, the state is technically the issuer and the BIN is specific to the state issuing the card. The BIN is attached to all activity and reporting within the EBT system related to that cardholder and that cardholder's program benefits. The card prefixes are loaded into BIN files at merchants/processors and used by the merchant or processor to identify the state and its primary contractor and to route the transaction to the correct authorization endpoint for the cardholder.

If the POS device is an EBT-only terminal, cardholders may be asked whether they want to access food stamp benefits for eligible purchases or whether the cash account should be used. In some states, EBT-only terminals can only access the food stamp subaccount (i.e., they cannot be used to access the cash subaccount). EBT-only terminals are available to merchants through the state's EBT contractor.

Many merchants have integrated EBT transactions into a multi-purpose POS device that accepts commercial card brands and networks. When an EBT cardholder presents a card for payment, the cardholder is prompted by the POS device to select the type of transaction. Once EBT is selected, the cardholder is prompted to select "food stamps" or "cash benefits." Again, the BIN file recognizes the card as an EBT card and enables the transaction to be routed to the appropriate authorization endpoint for the cardholder. However, how to route a transaction initiated with a co-branded card may not always be clear.

b. Co-Branded Card Environment Routing Options

In a co-branded card environment, where the card carries both the EBT brand and a commercial brand, routing could take place in one of two ways.

- Option 1: Split routing of cash and food stamp transactions
- Option 2: Routing of all transactions over the commercial card network

Both routing options make the following assumptions:

- **Applicability of Rules**. FNS regulations will apply to food stamp transactions. In addition, the rules of the network (Quest or a commercial payment company) used to authorize the transaction (whether food stamps or cash) will apply.
- **Card Acceptance**. Only retailers who have been approved by FNS can accept cards for food stamps, and only approved food items can be purchased. Food stamp benefits are established as a separate account type from cash benefits, providing the ability to restrict transactions to food-only purchases at specific authorized locations. Co-branded cards will be accepted for unrestricted cash transactions at all commercial payment companies' acceptance locations. In addition, cards will be accepted in allowable Merchant Category Code (MCC) specified locations for restricted cash transactions pursuant to each state's requirements.
- **Bank Identification Number**. For a state to have a co-branded card, it must use a financial institution's BIN. This has implications for changing the BINs on existing cards or for combining programs that have different issuers on the same card. In addition, while the BIN on an EBT card leaves no doubt about where a transaction should be routed for authorization, routing is less clear with a commercial BIN, especially since cardholders can direct a transaction to the wrong endpoint when prompted to select an option in the checkout lane. (See Section III.B, "Implications for States," for more detail.)
- **Card Security.** Cards will adhere to commercial payment companies' security and design specifications.
- **Card Issuance.** Cards will be issued using the standard issuance method. Accounts and cards are personalized, and cards are issued through a commercial payment company member bank following all "Know Your Customer" and anti-money laundering guidelines.

How a co-branded transaction is routed for authorization is important. Routing has an impact on which rules govern transactions and on the fees incurred by the various participants. (For a fuller discussion of the various types of fees paid for commercial transactions, see Appendix A.)

Routing Option 1: Split Routing of Cash and Food Stamp Transactions

For this option, the BIN resides in both the EBT BIN table and the commercial payment company's BIN table. The cardholder would be prompted at the POS to select either EBT or debit as the payment type.

In this scenario, if EBT is selected, the merchant processor routes the transaction for authorization by the EBT contractor, just as the processor does today. USDA FNS and state regulations would govern program policies, purchase item eligibility, transaction format, authorization, reporting, settlement and exception processing (such as fair hearing requirements).

If debit is selected, the transaction is routed through the commercial payment company's network to the authorization endpoint for settlement, reporting, and dispute resolution. The routing is governed by network rules and applicable federal regulations, including, but not limited to Regulation E, pursuant to the Electronic Funds Transfer Act.

Because the current commercial card authorization transaction format does not widely support product-level detail on items purchased, any restrictions on items purchased may only be able to be managed at the MCC level. For example, if the cash benefits were intended for child care costs only, then the contractor managing the authorization could approve or deny the transaction based on an agreed-on list of industry standard MCCs associated with day-care providers or other like-service providers. Discover also has options of managing restrictions down to the merchant ID level and/or geographic locale, in addition to the MCC. In the child care example given, the state could restrict card usage to only certain child care facilities (i.e., certain merchant IDs or certain zip codes).

Contractors can also use the MCC data included in each authorization message to manage multiple cash benefit grant or needs-tested programs. For example, if a card can access child care benefits, job retraining benefits, and housing benefits, the MCC passed in the transaction can indicate which account type should be decremented. This also enables reporting to the individual funding agency at a granular program or grant-level basis.

When a transaction involves unrestricted cash benefits, the transaction is authorized by the contractor on the basis of card validation and available balance. However, there are currently no unique identifiers for cash transactions that could be used to achieve split routing for different cash programs.

This routing option depends on the merchant, acquirer, or processor having the ability to route a BIN to two different authorization endpoints. This ability is widely available today for MasterCard, VISA, or Discover-branded cards that are also branded with a regional network, such as STAR, NYCE or SHAZAM. The routing decision is usually made by the consumer, who selects how to process the transaction (PIN debit or signature debit/credit.) However, in some cases the merchant may attempt to influence the cardholder's decision because of fees, agreements, and other business and economic factors.

Commercial payment company rules do not currently accommodate FNS rules for food stamp transactions, so unless the commercial networks change their rules, food stamp transactions must be routed under the QUEST Mark or individual network/state marks. Under split routing, a unique identifier in the message (the processing code) would identify the transaction as a food stamp transaction, and the transaction could be routed as it is today. The same card could initiate a commercial cash transaction that could be routed in a different manner.

Routing Option 2: Routing All Transactions over Commercial Card Networks

For this option, the commercial payment company's BIN resides only in the commercial payment company's BIN file. All transactions are routed over the commercial card networks. The state has the option of supporting various authentication methods and can support PIN-only for EBT food stamp transactions and both PIN and signature for cash benefit purchase transactions.

For this option to be feasible, a number of challenges must be addressed:

- To maintain interoperability throughout the country, merchant processing systems and POS devices would have to recognize commercial payment company BINs as EBT-eligible and provide cardholders with an opportunity to make a decision to access either food stamp or cash benefits.
- Differing commercial payment company rules, FNS, and Quest Operating Rules must be reconciled, especially the rules covering manual voucher transactions, exception item processing, and dispute resolution.
- There must be general agreement on whether federal regulations such as Regulation E would apply to food stamp transactions.
- Commercial payment companies' transaction formats must be enhanced to include FNS-specific data, such as merchant information and state-specific data for restricted cash programs. Any change to transaction formats requires significant advance notification to merchants and a certification process.
- Different settlement and funding timeframes and methods must be supported through the central source (day-of-draw as opposed to prefunding).
- State contractors must modify transaction reporting to ensure compliance with state mandates, such as escheatment of funds and funding hierarchy.
- Commercial floor limits for transaction approval must be re-examined (explored in greater detail in Section III.B, "Implications for States").

4. Compliance with Payment Card Industry Standards

The payment card industry (PCI) consists of five major commercial payment companies:

- Visa
- MasterCard

- American Express
- Discover Financial Services
- JCB International

Originally, each card issuer established its own proprietary programs to store and secure card data. Merchant concern and confusion concerning rival and intersecting brand-specific requirements, along with massive card data breaches at many high profile organizations, prompted the card issuers to create a single standard for protecting card data—the PCI Data Security Standard (PCI DSS). Under the PCI DSS, a business or organization should be able to assure customers that their card data/account information and transaction information are safe from hackers or any malicious system intrusion.

In June 2005, the major commercial payment companies founded the PCI Security Council. (The PCI DSS requirements are based on ISO 17799—the internationally recognized standard for information security practices.) The PCI Security Council is not a policing organization. It neither enforces the PCI DSS nor determines the appropriate remediation for violations of the PCI DSS. Enforcement is left to the individual commercial payment companies and acquirers. Nor does PCI DSS replace individual commercial payment company compliance programs. Each commercial payment company determines who must be compliant, including any brand-specific enforcement programs.

Terminals that accept a commercial payment company's transaction must comply with PCI requirements for both data security and PIN encryption.

However, terminals do not have to accept all transactions that can be initiated with a co-branded card. For example, if a card bears a QUEST Mark and a commercial payment company mark, the terminal does not have to allow both Quest and commercial transactions. EBT-only merchants could allow Quest food stamp transactions but not commercial payment company cash transactions. EBT-only terminals that do not allow commercial payment company transactions do not have to comply with the PCI requirements.

C. Cost Issues

All stakeholders' cost structures will be affected by a shift from EBT to a co-branded card. As a result, states that are considering the use of an EPC or a co-branded card to deliver benefits should be aware of the various types of fees that will be incurred by all parties to a transaction. Fees that the various parties pay, or are likely to pay under co-branding, are discussed below. (Appendix A explains the various types of commercial transaction fees.)

1. Consumer Costs

By regulation, food stamps issued as part of an EBT system are cost-free to the consumer. However, each state determines its own policy for cash programs. Costs borne by the consumer might include the following:

- ATM and/or 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 many states, the consumer is sheltered from all or some of these costs. In others, consumers may participate fully in the cost of the services. Most states limit cardholder costs through negotiations with EBT contractors, service providers, ATM providers, and others 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 the one hand, a household receiving public assistance may pay a portion of that assistance for service convenience or receive the remainder. On the other hand, when the household is receiving non-needs-tested payments, the government may seem to be subsidizing the receipt of those payments.

2. Merchant Costs

FNS regulations require that merchants have the option of participating in the EBT Food Stamp Program at no cost. Merchants participating in the Food Stamp Program as an EBT-only merchant can receive equipment from the state contractor and not be charged any fees. However if the equipment is not state supplied, the parties must establish their own business arrangements, which may include fees paid by the merchant for food stamp transactions.

Co-branding will not affect these options. EBT-only merchants will still be exempt from fees on food stamp transactions. However, if the food stamp benefits are on a co-branded card that the merchant’s terminal can read, the terminal will probably have to be PCI-compliant, and the associated costs will have to be borne by someone (see Section III.C, “Implications for Merchants”).

Fees for EBT cash transactions are not specifically restricted and tend to be consistent with the fee structures for private-sector electronic debit transactions. However, the interchange fee paid to the issuer is waived for EBT transactions because the state government is the issuer. This makes EBT POS transactions less expensive than the equivalent commercial transactions. If, in a co-branding arrangement, the government is no longer the issuer, then an interchange fee may be charged. Some merchants have indicated that they may consider accepting state provided-equipment to avoid this cost, rather than using their own integrated equipment, which is used for commercial payment company cards.

3. Agency Costs

Federal and state governments pay most of the costs associated with EBT, which generally include these elements:

- System design, development, and implementation
- Card issuance and replacement

- PIN assignment, selection, and modification
- Training (cardholders, staff, retailers)
- Cardholder and retailer help lines, including integrated, interactive voice response services and live customer service representatives
- Account setup and management
- Transaction processing
- ATM interchange fees
- Settlement and reconciliation
- Management reporting
- Investigative services
- Disaster related services
- Project management

States pay some or all of 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, depending on level of service, case load, and cardholder cost-sharing. States may incur additional costs for project management, system enhancement, oversight activities, monitoring, infrastructure development, and quality assurance. Such costs vary, depending on how actively a state manages its EBT project.

Comparison of these EBT costs to 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 today’s EBT programs, cardholders typically receive a number of “free transactions” to be sure that they are able to access their benefits with no charge. While these transactions are free to the cardholder, someone, typically the state, pays for these transactions though a contract for EBT services. If transaction costs are higher for commercial EPC cards than for government EBT cards, the subsidy paid by states for free transactions will increase.

For a discussion of other issues that will affect state costs, see Section III.B, “Implications for States.”

4. Contractor Costs

An EBT contractor provides services based on a contract with a state agency. The contract defines the scope and terms of the EBT services that the contractor provides. It also specifies all payments due to the contractor for provision of those services and other fees that the contractor may charge other participants to provide EBT services. For example, fees may include amounts collected directly from the cardholder, such as ATM charges or balance inquiry fees. The contract may also specify whether the contractor can require merchants to pay transaction processing fees.

The contractor is responsible for all EBT services as negotiated and contracted.

5. Other Cost Issues

Issuing bank business case. Many banks today have already made the business case for issuing EPC cards for state cash programs. A co-branded card will support the existing structure and business case for the EPC card but must go further and cover the business case for the EBT benefits. The EBT benefits may not be routed through the issuing bank but go through the current EBT settlement process. If the EBT benefits go through the current settlement process, then the issuing bank will not need to consider them as part of the business case for issuing a co-branded card. The co-branded card business case will be justified by the existing benefits to the bank for any cash benefits on the co-branded card.

New card issuance cost. Currently the cost of issuing new cards for EBT services may be incorporated in the cost per case month. The cost of issuing new cards for existing prepaid debit programs is borne by the contractor. For a co-branded card, the cost of issuing new cards may be a combination of EBT costs per case month and the contractor's debit card program costs.

III. Implications for Stakeholders

A. Implications for Issuers

Under the Quest Operating Rules, an issuer is a government entity or an organization that has contracted with a government entity to serve as issuer.[1] This definition is in marked contrast to the requirements for commercial payment companies, which stipulate that issuers must be financial institutions. This section addresses the implications of co-branding for financial institutions. (For a discussion of the implications for Quest issuers, see Section III.B, "Implications for States").

In servicing the needs of state agencies, issuers will want to collaborate with states to identify which funding options are best suited to the goals of each individual state program. For day-of-draw food stamp and cash programs, the currently established architecture provides the framework for supporting EBT distribution, since it was developed to support state and federal specific requirements. For prefunded cash programs, issuers will need to work with states to identify the architecture for benefit distribution and settlement processing that is best suited to each state's program objectives.

As a co-branded card may be issued *by* a financial institution at the request of and in cooperation with a state, the implications for issuers and states are often combined. In addition, the entity that authorizes a transaction, be it a financial institution, a state, or a state contractor, is responsible for resolving system errors and providing other customer service, such as fair hearings.

B. Implications for States

States should consider the concerns of all stakeholders in assessing the issues and benefits of combining multiple program benefits on a single card. These factors include the purpose and feasibility of issuing a single card. States should examine the EBS Council's November 2003 white paper, "Electronic Disbursement Options," and consider the information contained in this paper in assessing co-branding as an alternative approach for streamlining electronic payments. Because states are the initiators of this change in electronic payments technology, the issues and concerns of all stakeholders become, to varying degrees, the issues and concerns of the states.

1. BINs and Transaction Routing

For EBT, state BINs are currently assigned by the American Bankers Association. This BIN is typically within the private label card range assigned by the International Standards Organization (ISO). The state BINs are embedded in the EBT systems and are connected with all aspects of financial and administrative transactions for all cardholders of a given state. The BIN is also used for card history, account management, and reporting, and may also be tied to state

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[1] It should be noted that Discover Financial Services allows an issuer to be a non-financial institution. The government entity can serve as the issuer. The bank is only needed to hold various accounts for payment on behalf of the issuer and report to any regulatory agencies about money on deposit.

eligibility and financial systems. The state BIN is part of each card number, embossed or printed on the card, and used for authorization and clearing of all transactions, including food stamp manual vouchers. In addition, states using EPC-based platforms for certain cash programs will have a separate BIN applicable to the commercial payment company involved in the provision of those services.

Current state EBT BINs will change with co-branding because the BIN must be within the number range assigned to the respective commercial payment company. This change will have some critical implications.

a. BIN conversion, management, and tracking for implementation of a co-branded solution will require detailed planning and preparation, as well as complete user acceptance testing, by states, the USDA, EBT contractors, retailers, and acquirers. Because historical records for financial and administrative transactions must be retained, certain programs and services may require that the new BIN be mapped to the old BIN.

b. Converting to a co-branded card could require the re-issuance of all cards to the state's EBT cardholders. Conversion of the state's EPC cards could also be required, if a different commercial payment company were selected following a procurement. Card issuance methodologies may also be affected for states that support local, over-the-counter card issuance to cardholders, because of the stringent controls and audits that apply to commercial payment company card stock.

c. The BIN for EPCs or co-branded cards might not be assigned exclusively to a state. Under commercial payment company rules, the issuer may be a financial institution, and the BIN is assigned to the financial institution. With the execution of appropriate agreements, the commercial BIN may be transferred from one financial institution to another. In addition, a change in commercial payment company could result in changes in the commercial BIN. Therefore, states choosing to issue a co-branded card will need to ensure, through procurement requirements and contract negotiation, that the BIN is specific to the state, that it remains with the state, and that it is transferable upon contract termination. The question of what happens if there is a change of commercial payment company and (therefore commercial BIN) should also be examined.

d. Transaction routing for authorization is currently performed by BIN. In the current EBT systems, all transactions are routed to the EBT contractor for the authorization and settlement. The EBT contractor may also include an entity that operates the cardholder authorization system on behalf of the contractor.

   The options for routing transactions performed with a co-branded card include split routing and routing all transactions through the commercial payment company. If split routing is used, food stamp transactions would continue to be routed to the EBT contractor through the current network paths. The network would reject attempts to route food stamp transactions over a commercial payment company's network unless the commercial payment company makes changes to accommodate food stamp transactions. Cash transactions would, at a retailer's or third party processor's option, be routed through the various networks and entities that switch commercial card transactions. Split routing may be more feasible for co-branded cards because of the special FNS rules that apply to food stamp transactions. Commercial payment companies would have to make significant modifications to adhere to government requirements for the Food Stamp Program if all transactions were routed through the commercial networks.

e. The process of routing a single BIN through different paths for authorization requires comprehensive evaluation by all parties. Acquirers and third-party processors would have to look beyond the BIN for accurate routing. A processing code in the transaction determines whether the transaction is a food stamp transaction or a cash transaction. Based on this processing code, food stamp transactions might be routed to the EBT contractor. If the transaction is a cash transaction, the acquirer or third-party processor will normally route the transaction through the appropriate commercial payment company network. However, the acquirer or third-party processor could also route cash transactions directly to the EBT contractor for authorization.

State conversion plans for implementing a co-branded card solution will have to contain detailed steps for handling any change in the BIN. Such plans must also consider: administrative and transaction processing system modifications and testing; public awareness and informational materials; stakeholder involvement and training as needed; analysis and identification of the impact on state interfaces; card issuance; cardholder help lines; settlement and reconciliation; and investigative support.

2. Transaction Floor Limits for Cash Transactions

The use of EPCs for certain cash benefit and payments programs requires a better understanding of the differences between commercial payment company rules and EBT operating rules. The Quest Operating Rules require that all transactions be authenticated using a PIN. After the cardholder enters a PIN, the transaction is sent for authorization, the account balance is checked, and the amount of the transaction is debited on-line, real-time for cash or food stamps. Cardholder transactions are denied for insufficient funds or for other reasons, including a bad PIN.

Under commercial payment company rules, retailers may have an assigned limit for the amount of a transaction, called a “floor limit,” that applies to signature-based transactions without end-to-end authorization. Floor limits are based on MCCs and are standard throughout the industry. Retailers who accept a signature-based transaction under this floor limit are guaranteed payment of the full transaction amount by the issuer of the card, so floor limits also have implications for issuers.

Floor limits are an acceptable risk in the commercial signature-based card environment because no restrictions are placed on collecting overdrafts through future deposits, charging overdraft fees, or closing accounts for abuse. In the government or public sector, federal regulations and state law may contain provisions that make floor limits an unacceptable risk. These provisions include those restricting collection through the representment of denied transactions, limiting fees charged to cardholders, and requiring service to cardholders regardless of negative account balances.

Commercial payment company rules may further limit risk by placing restrictions on cards at the BIN level that limit transactions to those initiated using a PIN. Visa and MasterCard both have POS networks that are solely PIN-based. (For Visa, the network is Interlink and for MasterCard it is Maestro.) This restriction eliminates the availability of signature-based transactions and their associated floor limits. However, it also reduces the utility of the card in locations where the merchant does not have a PIN pad.

The potential risk associated with floor limits is particularly significant at unattended terminals, such as gas pumps, which rely on the pre-authorization of a nominal amount to guarantee the transaction for a much larger amount up to the floor limit. Gas stations typically pre-authorize a card for $1.00 to ensure that the card is in good standing with the issuer before allowing the sale. If the cardholder has $1.00 in his or her account at the time of authorization, the sale is guaranteed. The actual amount may be higher, resulting in a negative balance in the account. One option for addressing this risk is to prohibit the use of the card at a gas pump or other unattended terminal, requiring the cardholder to use the POS inside the station to purchase gas.

States will have to decide how to limit the risk associated with floor limits. Procurement documents should specify the state's requirements and the responsibilities of the parties to any contract, including the assignment of liabilities for various types of transactions.

3. Account Closures

As states examine the use of an EPC or co-branded card for government-administered programs, the commercial rules and practices regarding account abuse, monitoring and potential closure will require options for benefit/payment issuance should a cardholder's account be closed by the financial institution or contractor for continued abuse.

Presently, with EBT's specialized requirements, a cardholder's ability to abuse their account is limited by on-line, real-time transactions, the need to obtain an authorization number to hold a purchase amount with a food stamp manual voucher, and program rules that do not provide for the replacement of benefits except under specific situations. Trafficking, the sale of food stamps, does occur but is significantly less than experienced in the prior paper coupon system. When a system is down, cardholders may use the opportunity to obtain more than is available in their account(s). This can occur whether the system is down at the retailer location or system-wide, and whether the downtime is scheduled or unscheduled. While there are policies and procedures that are intended to restore lost funds, as previously noted, state and/or federal laws, rules and regulations may restrict how and when corrections may be made or the amount of a correction.

Under commercial payment company rules and practices, accounts are monitored, and repeated abuse can eventually result in closure of the account. If multiple program benefits are included on a co-branded card, account closure would affect all of the programs on the card. Current EPC contracts may contain provisions for the contractor to issue a check should an account be closed.

States must consider how benefits can be issued if the co-branded account is closed or restricted. Because food stamp benefits must currently be issued using EBT, states may be required to maintain EBT cards for distribution of food stamps. Additionally, writing checks or using EBT for cash should be factored into a state's planning and decision-making for co-branding.

4. Customer Service

In the current environment with separate EBT and EPC cards and services, separate platforms typically support specific programs and cardholders, including customer service using two web-based cardholder-driven applications and two automated telephone response systems with customer service representatives. Cardholders call a single toll-free number, printed on the back of the card, for either EBT or EPC information, including: reporting that a card has been lost, stolen, damaged, or not received; inquiring about balances; selecting PINs; making claims and adjustments; or contacting a customer service representative.

Current customer service centers may specialize at the product level. Depending on states' requirements, one center may handle EBT-related calls exclusively, while another may be designated for EPC calls. Cardholders can also access web-based applications specific to the programs and services they receive.

Given the extensive customer service options made available to cardholders, states should consider several customer service issues when specifying their requirements for a co-branded card.

a. **Toll-free Numbers and Customer Service Centers**. With a co-branded solution, alternatives will have to be identified to continue cardholder use of one toll-free number. To ensure the cardholder is efficiently served and routed to the correct customer service center, automated response systems will need an overarching functional script responsive to generic cardholder questions and an option to select food stamps or cash for program/benefit specific information.

b. **Web-based Customer Service**. Cardholders will also need access to the separate cardholder web-based systems. One possible solution would be the development of a generic authentication portal that could validate access to both cardholder accounts.

Additionally, customer service for merchants and retailers will need to be reviewed for necessary changes. In some cases, a retailer-assistance toll-free number is printed on the back of EBT cards. This number is used by authorized food stamp retailers to obtain authorization for manual vouchers. This requirement will persist with co-branding.

5. Positive Identification of Cardholders

Co-branding implies the ability to support multiple program benefits and payments using a single card. One of the issues for many states will be to establish unique “universal” or enterprise-wide identification for an individual that can be used across information systems within an agency or by multiple agencies. Some states or agencies may have established this unique ID. However, because most state information systems were built to meet the needs and requirements of specific programs, cardholder demographic data is not standard, nor is it commonly shared. In some programs, confidentiality rules may prevent the sharing of data. It will be critical to identify individuals uniquely to enable the commingling of funds in a cash account for the right individual and to assure that the food stamp account can be accessed by the eligible household.

Additionally, regulations governing the process of validating client identity may vary between programs. In recent years, the enactment of laws such as the U.S. Bank Secrecy Act and Section 312 of the US PATRIOT Act places stringent requirements on identity validation and transaction monitoring for commercial accounts. Some of these requirements are fulfilled by agency staff during the eligibility process and may need to be shared across agencies in a co-branded environment. State agencies will want to ensure that these requirements are being fulfilled, particularly where multiple benefit types are established under a single account structure, since the states could incur a legal liability for non-compliance.

6. Other Conversion Considerations: Operations, Reporting, Settlement and Reconciliation

Conversion to co-branding from EBT or a combination of EBT and EPC requires many of the same activities as conversion from paper payments to electronic payments. In addition to the considerations already identified, states should identify the impact, discover alternatives, and determine workable solutions in the following areas.

a. Benefits Issuance

States will need to review the policies and procedures for distribution of cash from multiple sources. Many states currently use various frequencies for benefit issuance, including daily, weekly, bi-monthly, and monthly issuance for cash assistance and food stamp benefits. With monthly staggered issuance, cardholders receive their benefits on the same calendar day each month (for example, cash may be distributed over the first three calendar days in a month and food stamps over the first 15 calendar days). In addition, states may split the issuance of some benefits over several different times during the month. With the addition of each program's benefits, policies and procedures regarding benefit distribution will need to be examined. If cash moves from a day-of-draw process to a prefunded process with co-branding, eligibility systems and financial settlement and reconciliation processes will need to change. For example, states may need to consider the financial impact if they currently use short-term investments to maximize revenue with the day-of-draw process.

b. Card Issuance

Converting to a co-branded card could require that all cards be reissued to the state's EBT cardholders and could also require conversion of the state's EPCs if a different commercial payment company were selected following procurement.

States should determine how they will handle card reissuance. The options are mass reissuance of all cards, phased reissuance of all cards, and reissuance only of cards for cardholders with cash accounts. Each of these options requires support through other activities, such as public awareness, cardholder service centers, technological modifications, card bureau service capabilities, and administrative system revisions for monitoring and trouble-shooting. Mailing co-branded cards appears to be the most streamlined process and is the least prone to problems for cardholders with a current cash account. This option would maintain the current EBT card and system for food-stamp-only cardholders. If a cardholder also received cash assistance, a co-branded card would be issued to replace the EBT card.

Ongoing card issuance processes may also be affected for states that support local over-the-counter card issuance to cardholders. Commercial card stock is subject to stringent controls and audits, and the card bureau services that manage and produce these cards are certified to those requirements. Use of co-branded cards may require revision of local production or distribution processes. Card replacement for cardholders with food stamp accounts would still have to be accomplished within 2 business days for over-the-counter issuance or within 5 calendar days for centralized issuance systems.

c. Cash Access

Currently, EBT contracts may specify the formulas a contractor is required to use to assure that cash access redemption points are available. With co-branding, these requirements will change, and in most locations cash access points will increase significantly.

However, in rural, less populated areas, retailers who now offer cash-back or cash-only transactions to cardholders may decide not to provide cash transaction services rather than pay the increased fees associated with commercial payment company rules. If a retailer requests EBT-only POS equipment for food stamp transactions, the state and its EBT contractor are required to provide and install the POS system without cost to the retailer. Should retailers make this decision, two results are possible: an area of the state may not have sufficient cash access for local cardholders as required under the contract, or the number of EBT-only POS terminals could increase. Depending on the state's contract, the contractor could be responsible for locating additional cash access points, and the cost of the increased numbers of EBT-only POS system would be the responsibility of the state or its contractor.

d. Regulation E

Needs-tested programs are exempt from Regulation E coverage. Food stamps, TANF, and some of the other cash program benefits distributed through EBT are needs-tested and therefore have not been subject to Regulation E. In the early days of EBT, Congress specifically excluded needs-tested programs from Regulation E coverage because funds provided by these programs are not replaced automatically if they are lost or stolen, and the cost associated with Regulation E coverage was a potential uncovered liability for states. Specifically, Food Stamp Program regulations state that benefits are not replaced if lost or stolen, therefore any replacement would be a cost to the state. In addition, state cash programs are typically governed by state statute and administrative rules, which dictate policies and procedures for benefit issuance and replacement.

From the standpoint of Regulation E protection, states are likely to encounter few obstacles in moving non-needs-tested programs from EBT to a co-branded card. However, including needs-tested cash programs in a commingled account will require careful analysis. Just because benefits are prefunded does not mean that Regulation E applies to those benefits. Regulation E coverage may need to be planned by sub-account.

e. Settlement and Reconciliation

At least two processes are used for settlement and reconciliation in EBT today: one for cash programs and the other for food stamp benefits. If a state's EBT system is used to distribute multiple cash benefits, some may be prefunded and others may be day-of-draw. Day-of-draw is also used by the Food Stamp Program.

If co-branding is adopted, at least two processes will still be required for settlement and reconciliation: one for cash programs and the other for food stamp benefits. Changes will be required if state cash programs that operate on a day-of-draw basis are to move to a prefunded process. Planning for the transition should involve state program officials, financial management officers within agencies (including the state's Comptroller), and the state's contractor. Loss of short term investment capabilities will require evaluation.

Additionally, settlement time frames for retailers and merchants will change with commercial rules. EBT processes generally operate with settlement required within 2 business days of the retailer's end-of-day.

Reconciliation for all programs will still be required; however, cash reconciliation should be modified to review deposits instead of benefits redeemed. Reports will require enough detail to identify the program and the area (e.g., region, county) within the state responsible for the funding and expenditures.

f. Reporting

States are accustomed to an array of reports that are available through EBT, either using the administrative systems, ad hoc requests, cardholder service centers, and data warehouses. As states consider their reporting needs when adding multiple programs to EBT, they will also want to consider what reports and data are needed in a co-branded environment. Program accountability and responsibility will continue for funds issued and expended (this may be deposits authorized to those deposited in individual accounts with co-branding), cards issued vs. activated, actions performed by state and contract staff, special investigative accounts, and settlement and reconciliation. The requirement to produce reports to assist in assuring this accountability will persist.

Many of the reports currently available through EBT may not be provided in the co-branded commercial environment. A review of all reports used and decisions on future needs will be important conversion considerations. A particular state may need specialized reports beyond what an issuer normally produces, emphasizing the requirement for a close relationship between states and issuers.

g. Specialized Services

Many states have included specialized requirements in EBT contracts. These requirements include provisions for such things as a comprehensive menu of disaster services, complete with prepared vault stock cards; an automated response unit for training purposes; benefit recovery payments; and special investigative accounts for law enforcement. Each state's comprehensive services will require thorough examination for any impact from co-branding as part of conversion planning.

7. Software Changes for Multiple Bucket Scenario

The implementation of a co-branded card can also affect how a cardholder interacts with the POS system to select the source of funds to be used for the transaction. Cardholders could access funds as a "single bucket," where the decision of where the funds come from is handled in the back-end, or as "multiple buckets," where the cardholder would select the program during the POS transaction.

States should be aware that significant software changes will be required in a multiple bucket scenario where the contractor is responsible for implementation of multiple programs in a co-branded environment. For example, particularly in scenarios that involve multiple applications on a single card, the programming on the authorization side could be very complex and would need to be able to consider and address customer needs that may not fit into a programmed schematic. An example is a mother who has benefits on a multi-application card for restricted government payments, such as food stamps and child care, and unrestricted payments, such as TANF or child support. In a programmed schematic, she would be able to access all of the unrestricted benefits, but if she has children with different fathers, she may want to limit purchases to the child support benefits of a particular father. Some states may pool this benefit, however, so that unrestricted benefits, even though paid by different fathers, would be placed together and used by all children.

C. Implications for Merchants

For cardholders to be able to access their benefits electronically, merchants or ATMs must be willing to accept their cards. Merchants who accept EBT cards fall into one of two categories:

- Merchants using state-supplied POS terminals (sometimes referred to as "EBT-only merchants")
- Merchants using equipment that connects to a third-party processor

Merchants using state-supplied POS terminals connect to the state contractor’s cardholder authorization system. Generally, these are small merchants who do not accept branded credit or debit cards.

Merchants using equipment that connects to a third-party processor combine credit, debit, and EBT transactions on a single line. Such merchants typically receive payment for all transactions at the same time. Merchants may be direct customers of the processors, or they may use the processor of their acquiring bank, with the processor being a barely visible link in the transaction chain. These merchants vary in size from sole proprietors to multi-location corporate retailers, with a wide range of accompanying system configurations. They send transactions to their processors, who route them to the issuer identified by the BIN in the transaction message. The processors receive an approval or decline message back from the issuer and send the response to the merchants. Processors maintain accounting and fund the merchants appropriately.

1. Impact on Fees

Statutory language prohibits retailers who use state-provided equipment from being charged fees for food stamp transactions. Currently, retailers who choose to use their own integrated equipment may incur fees. For example, they may be charged for equipment and telecommunications (phone lines) and pay transaction fees to process the EBT transactions.

Because EBT cards are currently state-issued, transaction fees have remained relatively low. A high percentage of FNS-authorized retailers have chosen to pay those fees to provide an enhanced benefit to their customers by having EBT payments integrated into the commercial POS system. However, in a co-branded marketplace, fees could be increased to approximate current commercial interchange fees more closely, which could result in a fee increase for retailers. The table below summarizes current EBT card and potential co-branded card fees for merchants.[2]

	Current EBT Card		Co-Branded Card	
	EBT-only Merchant	**Integrated Merchant**	**EBT-only Merchant**	**Integrated Merchant**
Food stamps	No fees	Processing fees	No fees	Processing fees plus potential commercial card fees
EBT cash ("needs-tested")	No fees	Processing fees	N/A	Processing fees plus potential commercial card fees
Other government payments	N/A	N/A	N/A	Processing fees plus potential commercial card fees

2. Reprogramming POS Systems/Terminals

In most instances, the contractor will be responsible for implementation of multiple programs, so the only required POS system change for retailers would be changing the BIN tables.

3. Routing Transactions for Different Benefit Types

With a co-branded card, transactions for different benefit types (i.e., restricted cash, unrestricted cash or food stamps) might have to be routed to different endpoints for authorization. Different routings not only have programming implications for systems and terminals, they also have potential cost implications. There will be a charge for denied transactions routed to the improper endpoint. For more information on transaction routing, see Section II.B, "Technical Issues," and Section III.B, "Implications for States."

D. Implications for Processors

Processors are key participants in most EBT transactions. However, because processors operate behind the scenes and do not have any direct contact with states or the cardholders, the effects of changes on processors are not always apparent. Experience with both EBT and EPCs indicates that processors might be affected in the following ways.

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[2] FNS regulations prohibit fees from being charged to cardholders, but the regulations do allow commercial card fees to be charged to merchants. See Section II.A.2.

- **Transitional impact**. If a state opts to issue cash benefits on a co-branded card, processors would have to add the new BINs to their BIN tables. They would probably also have to adjust their billing processes, as is periodically done for debit networks. After the transition, there would be little or no technical impact on processors.
- **Merchant reporting**. If co-branded EBT transactions have to be reported to merchants separately from commercial payment company debit transactions, processors would have to reprogram their systems to add the commercial payment companies' EBT BINs to a table for reporting purposes.
- **Transaction set**. Co-branding would appear to have no impact on transactions sets (those transactions that a system handles) if only cash benefits are under consideration for co-branding. (The Voucher Clear transaction applies to food stamps only.) The Balance Inquiry transaction already exists for commercial payment companies' debit and prepaid cards.
- **Transaction speed**. Handling a co-branded card would have a negligible impact on processing speed.

E. Implications for Cardholders

The trend toward issuing a variety of benefits using different electronic payment methods increases the likelihood that recipients will carry multiple cards. In some states, recipients may have at least two cards—one for food stamp benefits and one for cash benefits. There is some concern that this may be confusing for recipients as they may have difficulty remembering which card is used to access which benefit. However, in 2005, the average American reportedly carried over seven payment cards, including credit cards, retail store cards, and bank debit cards.

Co-branding potentially allows the cardholder to access all government-issued benefits using a single card. Additionally, cardholders would have the ability to make purchases with their cash benefits at any retailer who accepts a commercial payment card. Currently in some states, a limited number of non-food retailers accept EBT cards, giving EBT cardholders a limited number of access points. It may also be necessary to inform cardholders that they may not really have some of the advantages/protections of a commercial payment company's card if some of the transactions are being routed via the Quest Network.

F. Implications for Quest Operating Rules

The Quest Operating Rules permit the co-branding of EBT cards with other service marks. There is currently no need to modify the rules to permit the co-branding of Quest cards with a commercial mark. However, the Quest Operating Rules currently define a cardholder as "An individual who has been issued or authorized to use a Card." The EBS Council will review this definition, because Quest cards are currently issued to institutions as well as to individuals. (For example, some elder care facilities may be issued cards.)

The definition is already consistent with the practice within commercial payment companies of only issuing cards to individuals under consumer payment programs. Commercial payment companies issue cards to corporate entities under their corporate payment programs.

All stakeholders in the EBT process collaborated to develop the Quest Operating Rules. The Operating Rules for commercial card companies are updated unilaterally twice a year (the Spring release and the Fall release). Changes are presented as mandatory or optional, and mandatory changes can require significant programming changes in short amounts of time. Interchange fees are usually revised at these times as well.

IV. Open Issues

This paper identifies issues that may need to be considered by various stakeholders before designing and implementing co-branded card programs. The paper is not intended to make recommendations. Instead, it is intended to provide relevant background for decision makers, who will primarily be government officials.

Some of the issues that must be addressed by those deciding whether to opt for EBT, an EPC, or a co-branded card in disbursing funds for individuals are still open. These issues are discussed below.

A. PIN vs. Signature-Based Cards

Co-branded transactions may be initiated by a cardholder using either a PIN or a signature. However, federal regulation limits food stamp transactions to PIN-based transactions, and merchants strongly favor the use of PIN-based transactions. States should carefully consider which type of authentication to adopt before drafting their RFPs. (For more information, see Section II.B.1, "Personal Identification Number or Signature-Based Authentication.")

B. Dispute Resolution and Fair Hearings

FNS and the Quest Operating Rules contain detailed requirements for resolving disputed transactions, and there are limits on accessing cardholder accounts to make corrections. It is important to understand the requirements governing error resolution and to ensure that government requirements are met by any solution that is adopted.

For example, questions remain as to how individual states' fair hearing processes would be affected by issuance of a co-branded card. State fair-hearing requirements would apply to disputes because the state, and not the contractor, is ultimately responsible for determining and transmitting information on benefits and levels. Since an individual state's fair hearing requirements would take precedence over the rules of commercial payment companies or the Quest Network, the impact on fair hearings would vary from state to state.

Provided that all government requirements are met, it appears that the procedures adopted by the entity that authorizes the transactions will be the default for dispute resolution. (For more information, see Section II.A.3, "Categories of Programs and the Applicability of Co-Branding.")

C. Routing

In a co-branded environment, states should be aware that they are not in a position to control routing or the fees charged for transactions. States may specify a goal, such as merchants not being charged certain types of fees, but routing and fees will be established by the business agreements executed between the contractor and other parties.

In addition, routing decisions will have an impact on the cost and ease with which transactions are processed. If the parameters established by some states result in split routing, while others result in routing by commercial payment companies, the resulting complexity could drive up the cost of serving states. In addition, commercial payment companies will have to make some changes to their operating rules if they want to route food stamp transactions. (For more information, see Section II.B.3, "Transaction Routing.")

D. Implications of EBT-Only Terminals

Unlike commercial transactions, commercial payment company representatives have observed that there is no acquirer for transactions performed by EBT-only merchants. This poses a challenge for the commercial card companies to overcome. In addition, states must be sure that they understand the implications of PCI requirements for terminals and that those EBT-only terminals are brought into compliance. (For more information, see Section II.B.4, "Compliance with Payment Card Industry Standards.")

E. Financial Implications

Commercially branded cards are designed as a revenue-producing product for issuers, who receive interchange income from acquirers and income from cardholders through interest and/or fees. Interchange is an expense to acquirers, who pass that expense through to their merchants. As a result, states should be aware that co-branded cards are a revenue opportunity for issuers, and that merchants ultimately bear the largest expense for commercially branded transactions.

Furthermore, as individual state solutions are designed, it is important to resolve who pays for:

- The cost of issuing new cards

  Currently, the cost of issuing new cards for EBT services is incorporated into the cost per case month. The cost of issuing new cards for current prepaid debit programs is borne by the contractor. The open question is who pays for issuing new co-branded cards. (For more information see Section II.C.5, "Other Cost Issues.")

- PCI compliance

  The cost of bringing EBT-only terminals into compliance with PCI DSS should be clearly understood and specified in contracts for services. (For more information, see Section II.B.4, "Compliance with Payment Card Industry Standards.")

- Failed transactions

  Parties to a contract must decide who will bear the costs of failed transactions, including instances of insufficient funds, use of a bad PIN, and transactions routed to the wrong endpoint. (For more information, see Section III.C, "Implications for Merchants.")

- Fees

  FNS regulations prohibit charging service, transaction, or interchange fees to food stamp authorized retailers who opt for state-provided EBT equipment and processing. States implementing co-branded card programs should understand the fee implications for merchants, issuers, processors, and others. At issue are not just transaction and interchange fees, but fees for denied transactions as well. (For more information, see

Section II.A.2, “The Food and Nutrition Service’s Position on Fees for Food Stamp Transactions,” and Section III, “Implications for Stakeholders.”)

F. Account Closures

Because multiple program benefits may be included on a co-branded card, account closure could affect all of the programs on the card. Current EPC contracts may contain provisions for the contractor to issue a check if necessary when an account is closed. States should consider how benefits can and will be issued if a co-branded account is closed or restricted. (For more information, see Section III.B.3, “Account Closures.”)

G. Positive Identification of a Cardholder

Because most state information systems were built to meet the needs of specific programs, cardholder demographic data is not standard across states, nor is it commonly shared. In some programs, confidentiality rules may prevent the sharing of data. It will be critical to identify individuals uniquely to enable the commingling of funds in a cash account for the right individual and assure that the food stamp account can be accessed by the eligible household. (For more information, see Section III.B.5, “Positive Identification of Cardholders.”)

H. Benefits Issuance

Many states currently stagger or split the issuance of cash, food stamp and other benefits. Cardholders receive their benefits on the same calendar day each month (e.g., cash may be distributed over the first three calendar days in a month and food stamps over the first 15 calendar days). In the instance of split-issuance, a month's benefits may literally be split up and issued over several different times during the month. As additional program benefits are added, states will need to examine their policies and procedures regarding benefit distribution. (For more information, see Section III.B.6, “Other Conversion Considerations.”)

I. Card Issuance

Converting to a co-branded card could require the re-issuance of all cards to the state’s EBT cardholders and conversion of the state’s EPCs if a different commercial payment company is selected following a procurement. The state should determine how it will timely handle any card re-issuance that may be required. (For more information, see Section III.B.6, “Other Conversion Considerations.”)

J. Cash Access

In rural or less populated areas, retailers who now offer cash-back or cash-only transactions to cardholders under EBT may decide not to provide cash transaction services rather than pay the increased fees associated with commercial payment company rules. Depending on the state’s contract, the contractor could be responsible for locating additional cash access points. (For more information, see Section III.B.6, “Other Conversion Considerations.”)

K. Regulation E

In 1996, Congress enacted legislation that exempted needs-tested EBT programs established or administered under state or local law from the consumer protections afforded by the Federal Reserve's Regulation E. Including needs-tested cash programs in a commingled account requires careful analysis. The prefunding of benefits alone does not mean that Regulation E applies to those benefits. Planning may be needed for Regulation E coverage by sub-account. (For more information, see Section III.B.6, "Other Conversion Considerations.")

L. Settlement and Reconciliation

In planning for co-branding, at least two processes will still be required for settlement and reconciliation: one for cash programs and the other for food stamp benefits. Changes will be required for state cash programs that operate on a day-of-draw basis to move to a prefunded basis. (For more information, see Section III.B.6, "Other Conversion Considerations.")

M. Reporting

Many of the reports currently available through EBT may not be provided in the co-branded commercial environment. All reports will need to be reviewed and decisions made on future reporting needs. (For more information, see Section III.B.6, "Other Conversion Considerations.")

V. Conclusions

This educational white paper was developed to provide the reader with general information on co-branded Electronic Benefits Transfer (EBT) cards. Several open issues are identified and discussed. Although work group members took care to include as many relevant topics as possible, it is possible that as yet unidentified issues and circumstances related to co-branded EBT cards are not addressed in the paper.

Members of the work group represented a broad spectrum of stakeholders that are members of the EBS Council. All work performed by the work group members was done on a voluntary basis, without compensation. The work group members were careful about not stating either a pro or con position regarding the use of co-branded EBT cards. There was concerted effort to remain neutral on various issues so that the white paper could be as informative as possible, recognizing that if states adopt co-branded cards, there will be variations that are yet to be determined.

The authors of the paper were mindful that it will be reviewed by the various stakeholders involved in the EBT industry. For that reason, perspectives and issues relating to the diverse reading audience were covered as comprehensively as possible.

Co-branding of an EBT card mixes aspects of Quest EBT with the commercial debit card environment, generating questions about: the impact on current state systems; the customer service centers for merchants and cardholders and their supporting toll free numbers; the needed infrastructure and technological architecture changes, if any; cost and business models; and the impact on cardholders, merchants, states, electronic funds transfer (EFT) processors and contractors.

The cost models of traditional EBT programs will likely change with the advent of co-branded cards. This paper attempts to identify cost shifts, possible new costs, and possible cost savings for particular stakeholders related to co-branded card programs. It is difficult to forecast specific, ultimate cost models due to unknowns about how states and other regulatory agencies would structure programs, and what requirements would be placed on contractors that would impact the EFT processing systems.

With the intertwining of the commercial debit industry and EBT cards, there is also the unknown as to whether commercial point-of-sale (POS) transaction interchange fees will apply to co-branded Quest card transactions. POS interchange in the commercial debit market is paid by the financial institution (acquirer) that is sponsoring merchants to the card issuing institution. The acquirer passes this per-transaction fee through to the merchant. Since the issuing institution would be acting on behalf of the state, co-branded EBT card transactions at POS terminals may create a revenue stream not currently recognized in today's EBT environment.

In addition to the input of work group members representing subject matter experts in their areas of responsibility, the work group received advice and input from external sources aware of the white paper development. Correspondence was received from: the National Association of Chain Drug Stores; Wal-Mart; the Food Marketing Institute; and Discover Financial Services.

With the growing interest in issuing government benefits and payments for multiple programs on a single card and the success of EPC initiatives in multiple states, co-branding of traditional EBT cards may seem to be a logical next step. Co-branded cards, however, require a major shift in processes, and business and cardholder relationships. Before taking this step, states need to carefully review all of the issues discussed in this white paper and evaluate the complete business model, transaction flow, and changes to state systems that may be required to support co-branding.

VI. Publication Acknowledgements

This report was developed by NACHA's Electronic Benefits and Services (EBS) Council's Co-Branding Work Group to outline issues states may want to consider when deciding whether to use a co-branded card to deliver government benefits. Publication of this document by NACHA does not imply the endorsement of any of the member organizations of NACHA.

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VII. 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 specify uniform rights and responsibilities for those involved in processing EBT transactions. The EBS Council is comprised of a broad cross-section of public and private sector EBT stakeholders and includes the Co-Branding Work Group.

The Electronic Benefits and Services Council of NACHA wrote this publication as an information resource concerning the co-branding of EBT cards. 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.

VIII. Glossary

The terms in this Glossary are applicable to the body of this report. In some instances, the definitions differ from those commonly used by commercial payment companies, as discussed in Appendix A.

Account Types. There are two account types: food stamp accounts and cash accounts.

Acquirer. A depository institution that owns, operates, or controls ATMs or POS terminals, or that sponsors ATMs or POS terminals owned, operated, or controlled by a third party.

ATM: Automated Teller Machine.

Cardholder. An individual who has been issued or authorized to use a card.

Co-branding. A plastic payment card issued and transactions processed in accordance with the rules of multiple payment networks, including national, commercially-branded card networks, whereby government-issued unrestricted funds and restricted funds are associated with a single payment card.

Commercial Issuer. An institution that issues a card in compliance with the rules of commercial payment companies.

Commercial Payment Companies. Discover, MasterCard Worldwide, Visa USA, and possibly other national or regional commercial payment networks that link financial institutions, businesses, cardholders, and merchants.

Contractor. A firm selected and awarded a contract with a government entity for the design, development, and/or operation of an electronic payments system to process electronic transactions and as contracted for other processing and payment services.

Endpoint. The entity that authorizes or declines a transaction.

Fees. Definitions of commercial EFT network transaction fees, ATM transaction fees, and POS transaction fees are contained in Appendix A.

Manual Food Stamp Transaction. A food stamp transaction that is initiated and transmitted for authorization in paper form by a merchant.

Merchant. Merchants and other retailers that provide goods and services to cardholders. Merchants must be sponsored into commercial payment networks and the Quest Network by a financial institution.

Merchant Category Code (MCC). A MCC is a four-digit code used by commercial payment companies to classify merchants by their primary line of business to indicate whether they predominantly furnish services (for which payments are reportable for tax purposes) or predominantly provide goods (for which payments are not reportable).

On-line Transaction. A single financial transaction used to authorize and settle payment. The transaction message may contain a personal identification number (PIN) used to initiate the financial transaction in order to access benefits or secure a balance inquiry through an ATM or POS device.

Off-line Transaction. A dual message financial transaction whereby a transaction is authorized at the time of purchase and then settled at a later time. For purposes of this paper, an off-line transaction is distinguished from a manual food stamp transaction or a store and forward transaction, which are defined separately in this paper.

POS. Point of sale terminal at a merchant location.

Processor. Any company processing transactions on behalf of an issuer, acquirer, or merchant, including any terminal operator that is not also an acquirer or a network.

Quest Issuer. A government entity that has agreed to, or an entity that has entered into an agreement with a government entity or prime contractor to undertake the responsibilities of an issuer.

Store and Forward Transaction. A food stamp transaction that is electronically stored with an encrypted PIN by a POS terminal operator when the POS terminal operator is unable to communicate with a cardholder authorization system and that is later forwarded to the cardholder authorization system.

IX. Appendix A: Commercial POS and ATM Transaction Terms and Fees

Acquirer. A financial institution responsible for acquiring EFT transactions and routing transaction messages to the appropriate network to gain an authorization or decline for the transaction. Although an ATM or POS terminal may be deployed and/or operated by a merchant or other third party, there must be an acquiring financial institution to warrant validity of transactions, in that transactions are routed from terminals that are certified on a particular network that is involved in transaction processing.

ATM. Automated Teller Machine. These terminals are capable of dispensing cash as a cash withdrawal or cash advance (credit card transaction), and some ATMs dispense merchandise, such as event tickets, stamps and other items of value. Full function ATMs are capable of accepting deposits of cash or checks, and can print receipts reflecting current balance. Cardholders can utilize full function ATMs to transfer funds between accounts, such as between primary savings and primary checking. Limited function ATMs, typically found in convenience stores, support all transaction types as a full function ATM, except for taking deposits.

EFT. Electronic Funds Transfer

Gateway. A gateway is a transaction processing entity that is typically a branded or non-branded network or third party processor. Gateways provide processing services to acquirers, issuers, third party processors and networks. Their essential role is to connect to other networks or authorization facilities to provide connectivity between a merchant, acquirer, issuer, third party processor or network that does not have direct connectivity to the entity the gateway is connected to.

Issuer. An issuer is an institution that issues debit and/or credit cards or other payment cards such as prepaid cards. An issuer maintains consumer accounts and provides cardholder services. It may be required that card issuers be insured depository financial institutions. This is required to assure that debit and credit card programs are administered by state and federal agency regulated institutions. Issuers typically participate in a national branded network, such as Visa, MasterCard, American Express and/or Discover. By such participation, the issuer gains rights to use the national networks brand(s) (e.g., Visa/Interlink/Plus; MasterCard/Maestro/Cirrus).

Merchants. Merchants and other retailers that provide goods or services to EFT cardholders are required to be sponsored into a commercial EFT network by a financial institution. The merchant-sponsoring institution is an acquirer, and is responsible for compliance on the part of the merchant with regional or national network rules, as well as numerous security requirements to preserve the integrity and safety of the EFT industry. Merchants can link directly to an EFT network, contract with a third party processor to obtain access to an EFT network, and utilize the services of a gateway service provider to gain access to an EFT network. For mail order and Internet merchants, EFT transactions are referred to as “card not present” transactions, as the card information is transmitted via the Internet, telephone or mail order.

Networks. Commercial EFT networks operate switching facilities for routing transactions between acquirers and issuers. Both acquirers and issuers can be directly connected to one or more networks, or merchants and other non-financial institution entities operating ATM and/or

POS terminals can be directly connected to the network. On the issuing side, issuers can be directly connected to an EFT network, or there may be a third party processor that provides card authorization services to financial institution issuers. Most networks have one or more brands that can be displayed on cards and terminal locations to signify card acceptance. However, there are some non-branded networks operating within the U.S. Networks maintain operating rules and if a network brand appears on a card and terminal, that network's rules apply to the transaction. Networks typically require acquirers and issuers to designate an account that can be debited or credited via ACH to perform transaction settlement and to collect network fees, switch fees and interchange.

A network can be a regional EFT network or national network such as Visa, MasterCard and Discover. It is permissible for both issuers and acquirers to participate in multiple networks.

POS. Point of sale terminal at a merchant location. Financial institutions may also maintain a POS device at a teller window to allow for cash advances using a credit card. Since 1996 when surcharge bans imposed by Visa and MasterCard were repealed, ATM surcharging is very common. The surcharge is a fee established by an ATM acquirer or other operator of an ATM. The surcharge fee is assessed to the cardholder, and collected from the cardholder's account along with any cash withdrawn by the cardholder. To avoid ATM surcharges, many EFT cardholders now use the POS feature called purchase with cash back. In addition to the purchase of goods or services via PIN debit, a cardholder can request additional cash. It is up to the merchant to determine whether they allow purchases with cash back transactions, and to set limits on the amount of cash back.

Third Party Processor. Third party processors (TPPs) can provide services to acquirers, issuers or both. These are typically non-branded entities that can be: service providers to merchants to support terminal operations; entities that are linked to acquirers, issuers or networks to transmit transaction data; ATM and/or POS terminals owners and operators; transaction authorization service providers for issuers; and/or front-end transaction processing service providers to acquirers and/or merchants. Regional EFT networks may become third party processors on other regional EFT networks to acquire transactions of the other network and/or to receive transactions from the other network for issuers within its network.

COMMERCIAL EFT NETWORK TRANSACTION FEES

Regional and national networks charge a myriad of fees. The primary categories include a one-time initiation fee, a network certification fee, annual membership or participation fees, monthly service or participation fees, and transaction fees that include network switch fees plus interchange.

One-time initiation fee. This is charged to fund the operational and conversion expenses for a new network member, whether an issuer, acquirer, third party processor or gateway. All such entities need to go through a certification process to assure proper connectivity and transaction processing integrity. A certification fee may be charged in lieu of an initiation fee. The fee may vary based upon the type of entity participating in the network and/or the number of network cards issued or terminals deployed.

Annual membership or participation fees. These may be charged to cover administrative and operational expenses of the network. The fees may be based upon deposit size of the participating institution, number of terminals and/or number of cards issued.

Monthly service or participation fees. These typically are ongoing fees charged to cover communication costs, settlement services, gateway access, third party processor connections and/or stand-in processing costs. Monthly service fees may also offset costs for disaster recovery systems maintained by the network.

Transaction fees. Network transaction fees include a network switch fee and interchange fees. Switch fees are charged by the network for services provided by the network to its members or participants. Interchange fees are collected by the network from the issuer or acquirer, depending on whether the transaction type is for an ATM transaction or a POS transaction.

ATM TRANSACTION FEES

Switch fee. For all ATM transaction types, the switch fee is paid by the issuer to the network. This would be for any financial transaction, as well as non-financial transactions such as balance inquiry or transfer between funds. The logic for having the issuer pay the switch fee is that the network provided switching services for a transaction initiated by an issuer's cardholder. Some networks may consider dispensing merchandise at an ATM a POS transaction rather than an ATM transaction. In such cases, the acquirer typically pays the switch fee or the fee may be shared by the issuer and the acquirer pursuant to the network's POS switch fee allocation.

Interchange fee. ATM interchange fees are paid by the issuer. The fee is collected by the network from the issuer and paid to the acquirer. The logic behind having the issuer pay the interchange fee is that the issuer's cardholder had the benefit of utilizing an ATM sponsored by the acquirer. If a non-financial institution, independent service organization or other third party owns and/or operates the ATM, there may be an arrangement for splitting interchange between the third party and the acquirer. This is established by contract between the acquirer financial institution and the third party terminal operator. ATM interchange fees vary based upon the transaction type.

As noted above, a surcharge fee may be assessed against foreign cardholders utilizing an acquirer's ATM. The surcharge fee is added onto the financial transaction amount and the amount is debited via the EFT transaction to the cardholder's account and collected by the acquirer or ATM operator. A surcharge fee would be part of the settlement processed by the network between the issuer (accountholder) and the acquirer (ATM operator). In addition to surcharge fees, issuers may charge their own cardholders a foreign terminal fee. This fee is assessed whenever an issuer's cardholder utilizes an ATM other than those maintained by the issuer. This fee is established by accountholder documentation between the issuer and its cardholders.

POS TRANSACTION FEES

POS transaction fees are comprised of a switch and interchange fee. POS debit transactions can be initiated through the use of a personal identification number (PIN), or initiated through use of a cardholder's signature. Regional EFT networks typically have schedules setting interchange rates for POS PIN debit transactions. National associations have schedules for interchange rates for both POS PIN debit and signature-based transactions.

Switch fee. A POS switch fee may be shared between the issuer and the acquirer or paid in full by the acquirer. Most commonly, if the switch fee is shared between the issuer and acquirer, the acquirer is allocated a greater amount than that paid by the issuer.

Interchange fee. The acquirer pays the issuer the POS interchange fee. Many regional and national networks have established interchange rates based upon merchant category such as general retail, supermarket/grocery and petroleum retailers. Interchange rates may be a fixed amount per merchant category, or may be tiered based upon transaction counts per month. Some networks have established interchange rates based upon a percentage of the transaction amount, with a fixed fee and minimum and maximum rates in addition to the transaction monthly volumes being tiered.

Most commonly, the acquirer institution passes the interchange fees on to the merchant. Interchange is the amount of a bank card transaction that is paid by the merchant acquirer to the issuer of the card the buyer used for a purchase. In addition to the interchange being charged to the merchant, acquirers may add on additional amounts to cover the processor's cost as well as a nominal network fee. The total fees a merchant pays its acquirer for accepting cards include interchange plus the additional discount rate established by the acquirer.

Additional regional/national network fees. In addition to the fees described above, a network has a myriad of other fees that may be charged upon occurrence of particular events. Examples of these fees include:

- Transfer of participation or membership type fee
- Merger fee
- Change of sponsorship fee
- Quarterly assessments that may be based on the network member's cardholder volume, and issuer's cardholder quarterly retail sales volume
- Brand volume fees payable by acquirers based on interchange retail sales and cash disbursements
- Minimum annual assessments
- New member assessments – a fee payable by new network members or participants for a set period of time.
- Disaster recovery fees
- Brand usage fees
- Telecommunication connectivity fees
- Warning bulletin fees
- Hot card and BIN/country blocking fees incurred due to fraud incidence

- Report fees
- Late fees on quarterly fee payments
- Reversal processing fees
- Stand-in fees
- Adjustment fees
- Chargeback fees

If a third party processor or gateway is utilized for particular EFT transactions, additional fees would be charged by the third-party processor for services rendered, and the gateway would charge a switch fee for processing a transaction. The network whose issuer's cardholder initiated an ATM transaction would pay the ATM gateway service provider, which would retain its gateway (switch) fee before passing on the remainder of the interchange fee to the acquirer or terminal owner. The network that paid the fee would recoup it from the cardholder's issuer. In contrast, the acquirer would pay the POS gateway fee.