IV. Stakeholder Comments and Concerns
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The United States Department of Agriculture, Food and Nutrition Service (FNS) held several meetings with various stakeholders from the EBT community, including representatives from state EBT projects, EBT vendors, and the retail industry. Subsequent to these meetings, members of the Phoenix MAXIMUS staff have had discussions with additional representatives from the EBT stakeholder community, specifically representatives from third party processors (TPPs) and potential future EBT vendors. The goal of both the FNS meetings and the Phoenix MAXIMUS discussions was to gain an understanding of stakeholder concerns as well as identify changes that can be made to address the trends of declining competition and rising prices in the marketplace and to address any other obstacles that may exist as EBT moves forward into the second generation.

This section provides a summary of the concerns and issues revealed during the various stakeholder group meetings and subsequent discussions. Because the state stakeholders and the EBT vendors discussed many of the same issues, these sections have been separated into the same topics: limited competition, EBT cost model, federal regulations and policy, FNS role in EBT, and issues specific to the stakeholder group. While the retailers share some of the same concerns and issues as the other stakeholders, their discussion covered issues more specific to their needs, including: the EBT Gateway change, the need for uniformity, federal regulations and policy, retailer choice, and options for the future of EBT. It should be noted that the comments and opinions provided in this section were shared by all stakeholders within each group.

A. STATE STAKEHOLDERS

FNS held a series of meetings with a number of state EBT project directors during the summer of 1999 to discuss the current state of EBT. Three meetings were held in various regions of the country, specifically in Virginia, Nevada, and Louisiana. Following is a summary of the comments.

Limited Competition

One of the biggest concerns among state EBT project directors is the current environment of limited competition within the EBT market. States have witnessed a reduction in the number of potential EBT vendors, while large upfront development costs and substantial risks have caused potential vendors to choose not to enter the market. What concerns the state stakeholders the most about the current market environment is that with a limited number of bidders for EBT projects, state agencies cannot be assured that the Request for Proposals (RFP) responses they are receiving are fairly priced. Many EBT vendors claim they have lost money on earlier contracts because they did not anticipate the large decline in caseloads due to welfare reform. Some states are concerned that vendors are now trying to make up for these losses by increasing the ongoing prices to the states, although in some cases price increases are warranted.

In addition, states with low recipient caseloads that have not implemented EBT cannot be assured that they will receive any bids at all, as was evidenced recently in the State of Delaware. There are still a few states remaining to implement EBT; and those without contracts are feeling the pressure of the 2002 deadline.[1]

It is also felt by some state stakeholders that consortiums may have limited overall competition. Although consortiums were organized with the intent to obtain lower prices through economies of scale, some believe that Citibank Services, Inc. (CSI) was given a competitive edge over all other vendors after it was awarded the contract for the Southern Alliance of States (SAS) coalition.

When asked how to get more companies involved in EBT and create more competition, states suggested making the Food Stamp Program more like cash assistance programs, potentially luring more banks and financial institutions into the industry. Others suggested bringing new technologies into EBT, such as the Internet and offline systems.

EBT Cost Model

There are several reasons why the cost per case month (CPCM) cost model has been used in the past for the procurement of EBT services. One reason is that cost neutrality is measured using CPCM, therefore its use in EBT procurement facilitates the comparison to paper issuance costs. Another reason is that CPCM limits liability and variability in costs making it easier for state governments to budget for EBT projects.

While there are valid reasons for the use of the CPCM model, some state stakeholders felt that the CPCM structure is not the best business model for EBT. The structure does not produce the desired results in terms of pricing. States believe they need a pricing model that is more flexible and clearly shows the costs per EBT component. With the CPCM model it is very difficult for states to know what they are really paying for and what risks have been factored into the overall cost.

Some of the state stakeholders felt that the CPCM model has helped to limit competition within the industry. Because CPCM forces vendors to assume much of the risk, potential new vendors cannot make a solid business case for entering the market. Many of those who have considered bidding on EBT projects have found that the perceived risks far outweigh the anticipated revenue.

States would like to see a model that is more effective in promoting market competition. Some state stakeholders said they would welcome a departure from the all inclusive CPCM model for a model that might still include a CPCM component, but also breaks out some of the costs such as EBT-only POS terminals and upfront development costs. Some of the more recent contracts have used this model.

[1] The Welfare Reform Act of 1996 requires all states to implement EBT by October 2002.

Others are hoping that the Texas model, procurement by EBT component, will be the answer to bringing companies into the bidding process that might not have otherwise bid on a turnkey system EBT project. Others are more skeptical about procurement by component. While the method might introduce more vendors to the industry, there is a concern that it will make the overall management of the project by the states more difficult, while not decreasing costs.

Federal Regulations and Policy

State stakeholders feel that some federal regulations have had a part in creating the current market environment. Many requirements for EBT, such as transaction processing requirements, card issuance timeframes, and adjustment policies, are not in line with commercial practices. They believe if some of these restrictive requirements were adjusted to more closely resemble the commercial world more companies would consider bidding on EBT projects.

The federal requirement of no additional costs to retailers under EBT has been problematic for the states. Retailer management and terminal deployment is one of the most costly components of EBT. Costs include point-of-sale (POS) terminal installation, maintenance, supplies, and in some cases phone line installation. An additional complaint by many has been that under the coupon system most of the contact with retailers was handled at the federal level. EBT created the additional task and cost of retailer deployment. Some feel that the retailer management tasks involved in EBT should be included in the FNS certification/recertification process.

While waivers have been granted to allow POS terminal deployment only for those stores with $100 or more in redemptions per month, it was suggested that a higher redemption threshold would be more favorable. However other state stakeholders are concerned that if such an increase were approved, there would be additional costs due to increased manual voucher usage.

Food and Nutrition Service Role in EBT

While some are content with FNS, there is a feeling among some state stakeholders that FNS should be more involved and have an increased role in EBT. One area in particular is retailer management and EBT-only terminal deployment. Some states have expressed that under coupons FNS was responsible for most retailer contact through the certification process, but now EBT requires states to have the additional cost and responsibility associated with the deployment of EBT-only terminals. Some have suggested that FNS should take on the task of terminal deployment as part of the retailer certification process. In addition to retailer management, state stakeholders suggested that another role that could be taken on by FNS recommending that FNS operate the EBT Gateway.

Other stakeholders stated that they would like more assistance in the procurement of EBT services. This assistance could include a catalog of approved EBT vendors. Some stakeholders suggested that FNS develop or procure a standard package of EBT software to be used by the states.

Some state stakeholders also suggested that FNS could facilitate meetings for states procuring services from the same vendor. These meetings would be a forum where states could discuss their mutual circumstances, vendor issues, and problem resolution efforts.

Some stakeholders also stated that they would like to see an update of the basic EBT core specifications. The core specifications for EBT were developed by the Federal EBT Task Force and subsequently used by the SAS, NCS, and WSEA coalitions as well as several other states in their EBT procurement efforts. Because the EBT market has matured many states have suggested that they would like to see these specifications updated prior to their next procurement.

Some state stakeholders have suggested that they would like more support from FNS in areas of policy and regulation review. Specifically states have proposed that FNS revisit federal regulations regarding EBT. States stakeholders have indicated that they would like to see FNS:

- Review retailer certification/re-certification policies;
- Review system performance standards, which as currently written in 7CFR §274.12[2], are much more strict than the commercial world. The perception is that this is creating additional costs to the states. State stakeholders are suggesting that these standards be brought more in line with current industry standards;
- Raise the redemption threshold for which retailers receive POS terminals (currently $100); and
- Develop an adjustment policy that is more in line with commercial practices. While the states feel that recent changes to the adjustment policy are an improvement over the past, they would like to see a policy that more closely conforms to the commercial practices.

Issues Specific to State Stakeholders

While states are pleased that FNS has adjusted federal cost neutrality policies, they are more concerned about meeting their own cost neutrality. With rising EBT costs, states are becoming increasingly concerned that they will not be able to afford their half of EBT costs under the federal cost cap.[3]

Another issue concerning state stakeholders is the difficulty of overcoming the cultural differences between the government and private sector companies. It was indicated that the state agencies feel they are not respected by contractors in the same way as their private sector clients. It is also felt by some state stakeholders that private contractors have been ignorant to

[2] The regulations allow use of prevailing regional standards, however states have opted to use the standards outlined in 7CFR §274.12. The complete text of 7CFR §274.12 can be found in Appendix A.

[3] While the administrative costs for the Food Stamp Program are shared fifty/fifty between the federal government and the states, the federal cap includes some federal only costs (i.e., printing, shipping, redemption, and mail losses) that are not included in the state cap. Therefore because of these additional costs states can have difficulty affording their half up to the federal cap.

government processes and unwilling to adapt their own processes to meet the government's needs. Some state stakeholders suggested that EBT vendors are reluctant to make system changes, especially if those changes stray too far from commercial standards.

States were also vocal about the declining level of service that they were receiving on their contracts. Some felt that the decline was a result of limited competition, while others thought it might be due to declining revenues. Regardless of the cause, states believe they are receiving less for their money.

B. EBT VENDORS

FNS met with the existing EBT vendors as a group on November 4, 1999. In addition, Phoenix MAXIMUS has had additional conversations with potential new EBT vendors regarding their thoughts on the issues and constraints that are keeping them from entering the market. Both the comments from the FNS meeting and the comments from the subsequent dialog are summarized below.

Limited Competition

Most EBT vendors agreed that EBT in its current state of affairs would continue to promote limited competition in the EBT marketplace. It was stated that there are significant barriers to entry as well as obvious advantages to those already established in the market. The largest barrier for EBT is the significant amount of risk that must be assumed by the EBT vendor. When vendors compare risks with the expected revenues, many times, especially for new vendors, the risks outweigh the revenues.

One of the major risk factors cited was that vendors do not receive payment from the state until they begin processing transactions, which can be up to a year after beginning the project. The impact is that all of the development and implementation costs fall upon the vendor, and do not begin to be recovered until the EBT system is live. This gives established vendors a particular advantage. Since they have already developed an EBT system, the upfront development costs are less, as is the implementation risk.

Another risk factor is liquidated damages. Many states have required the inclusion of liquidated damage or penalty clauses to safeguard themselves against such problems as project delays, unscheduled system downtime, and below standard processing times. Vendors feel that in many cases the potential liquidated damages are unreasonably high. In some projects the amount of potential liability for a single outage exceeds the revenue for the month. Therefore, when a vendor considers bidding on a project they factor liquidated damages into their overall risk.

When asked how the EBT environment should look in the future, EBT vendors provided the following suggestions. Although the vendors did not agree on each one, all suggestions discussed are provided below.

- More risk sharing between the state and EBT vendor;
- Move away from CPCM pricing to transaction based pricing;
- Base bids on EBT components such as call centers, transaction processing, training, and retailer deployment/management;
- Use tiered pricing model with case floors;
- Capping of liabilities; and
- An environment that more closely follows the commercial model.

EBT Cost Model

As stated in the previous section, EBT vendors believe the all inclusive CPCM model along with liquidated damages create more risk than most vendors are willing to assume. Before bidding on a project, vendors look at potential revenues verses the liabilities, and in most cases vendors felt the liabilities outweighed the potential revenue.

Vendors provided several suggestions for changes to the cost model. Many felt that a modification of the CPCM model would be effective in reducing some of the risk. CPCM has proven to be an effective way to capture certain operational costs, but it was suggested that those costs, such as development costs and POS devices, do not tie well into caseload fluctuations and should be removed and priced separately. It was also suggested that risks could also be reduced if tiered pricing and caseload floors were used more effectively.

Some vendors felt that EBT pricing should move away from the CPCM model completely and suggested that transaction based pricing might be effective in reducing the risk of caseload fluctuations. Another pricing option cited by vendors was pricing by component currently being used by the State of Texas.

Federal Regulations and Policy

EBT vendors were specifically concerned with the federal requirements for performance and technical standards. As discussed earlier, they believe the standards to be over and above what is required in the commercial world. The vendors suggested that these requirements be reviewed and adjusted to be more in line with commercial standards.

Vendors have also said that they have found the FNS requirement of cost neutrality to be problematic. For the most part, states are only willing to accept bids that will fit into their combined state and federal cost caps. For some states that figure is quite low, thus making it impossible for most vendors to provide a bid that fits the state's needs without losing money.

The vendors also stated that they have found the requirement of no additional cost to retailers to be a challenge. They raised the question, "What costs should the retailers bear?"

Food and Nutrition Service Role in EBT

When the issue of the role of FNS was raised, the vendors discussed the potential for more involvement by FNS in the future, but first, the problems in the current environment needed to be pinpointed before a solution could be crafted. The vendors felt that FNS should review its current EBT policies, rules, and regulations and make changes to them where necessary, for example:

- The minimum amount of Food Stamp sales for retailers to receive POS terminals and phone lines at no cost;
- Provision of phone lines at no cost to retailers; and
- Cost neutrality.[4]

There are two other areas where EBT vendors would like to see more involvement; they include:

- The strict standards for customer service and transaction processing that are much higher than commercial standards; and
- Penalties and liquidated damages.

While there are no FNS policies or regulations regarding these areas, states have grown more stringent (due in part to poor contractor performance).

Issues Specific to EBT Vendors

One concern voiced by some EBT vendors is that the standards and level of service have been set much higher for EBT than the commercial environment, making it difficult for potential vendors to change their processes in order to be certified. Examples given were call center response standards, transaction processing times, and POS maintenance/replacement timeframes. Vendors stated that they would like to use the same standards that exist in the commercial market, but they also agree that there are no set commercial standards that can be identified.

EBT vendors discussed some of the reasons why there were no bids submitted for the Delaware EBT project. Vendors felt that the overall level of service and project requirements, combined with the low caseloads in the state, make it difficult to recover costs and make a profit. In addition, proposal development is a costly undertaking, with costs estimated between $50,000 and $100,000 per proposal. It did not in their judgment make good business sense to bid on the project.

Vendors also felt the timeframes to respond to RFPs are often not sufficient to prepare an adequate response. The vendors stated that FNS should take a more active role during the proposal phase, ensuring that states are reasonable in their timeframes, including the time that vendors have to respond to the RFPs.

[4] Required by statute.

C. RETAILERS

FNS held a meeting with the large retailers and representatives from some of the retailer associations, such as Food Marketing Institute (FMI), National Grocers' Association (NGA), and the National Association of Convenience Stores (NACS), on July 19, 1999. Subsequent to this meeting, Phoenix MAXIMUS staff has had additional conversations with representatives from the TPPs that are acquiring EBT transactions for the retailers. Following are comments gathered from this group.

Need For Uniformity

Retailers expressed that they would like more uniformity in EBT because systems and policies can differ from state to state. One of the major concerns of many large chain retailers who operate in multiple states is conforming their processes to the EBT operations of each state in which they have stores.

From a technical standpoint, most EBT systems are uniform because they conform to ISO standards. There are a few exceptions such as the off-line systems in Ohio and Wyoming, as well as those using the Transactive[5] system in the states of Texas and Illinois. The real problem for retailers is the differences in policy implementation between the states. For example, a major area of frustration for retailers has been adjustment policies, which can differ greatly between states. Retailers have identified these policies as an area requiring clarification. The new adjustment rule developed by FNS provides clearer guidelines for adjustments creating more standardized policy in this area.

Additionally retailers stated that they would like to see uniformity in the following areas:

- Interoperability between all states;
- Quest® rules should be used by all states with no variances allowed;
- Contracts, voucher processing, floor limits, and fees should be the same across states; and
- Fees for cash back should be the same nationally and comparable to ATM fees. (This suggestion only applies to cash benefits, not Food Stamp benefits.)

[5] Transactive has not implemented the American National Standards Institute (ANSI) 9510 implementation of the ISO 8583 standards used for financial transaction switching. Transactive is instead using their implementation of ISO 8583, from which there is enough of a difference from the ANSI 9510 version to conflict with transaction switching. Because it will be exiting the EBT market at the end of its contracts, Transactive does not plan to implement the ANSI 9510 standards used by both CSI and Deluxe.

Federal Regulations and Policy

While the regulations require that EBT must operate with no additional cost to retailers, some retailers feel that this is not necessarily the case. Those retailers opting to use commercial equipment (anything other than state supplied EBT-only POS devices) must pay additional costs – transaction fees to TPPs for EBT transactions. The retailers recommended that in these cases the retailer should be reimbursed for all fees related to EBT transactions.

Retailers do not agree with the formula for equipping EBT-only stores as it is currently written in federal regulations. Because full lane coverage is not required, not all lanes will be open to those purchasing goods with their EBT card. Retailers expressed that there needs to be full lane coverage in order to avoid discrimination against clients. While the regulations define the minimum requirements for equipage, the retailers feel the states view them as maximum requirements and are unwilling to provide terminals over and beyond what is required by regulations. Ideally retailers would like to see a change in the federal regulations; if this were not possible they would like to see states change their view about the regulation and provide merchants with full lane coverage regardless of redemption volume.

Another issue that was raised by the retailers and TPPs was the adjustment policy of the EBT vendors. They believe that adjustments should be allowed to occur immediately in order to expedite the return of money to customers. Retailers stated that adjustment policies between EBT vendors are inconsistent, and that sometimes it takes up to 30 days for the EBT processors to make an adjustment although the funds were returned much earlier. Retailers would like to see a regulation that is more in line with commercial environment and brings consistency to adjustment processes.[6]

Retailer Choice

Retailers feel as if they have no choices when it comes to EBT processes, policy, and requirements. An example of this are the retailer contracts that they feel are “contracts of adhesion” and they feel forced to accept the terms of the contracts because the alternative is to not have EBT in their stores.

Another issue raised by some retailers was that some processors would not negotiate or pay for phone lines for terminals.[7] Again, in this situation the only alternative is for the retailer to choose not to have EBT in their store(s). Another more temporary issue where retailers feel there has been a lack of choice is Y2K testing on both TPP and EBT-only terminals for which some retailers have been required to set up test time and pay a fee.

[6] Since these stakeholder discussions took place, the Final Interim Rule on Adjustments has been put into effect. This rule requires client-initiated adjustments to be processed more quickly and also allows retailer-initiated adjustments to occur.

[7] FNS has allowed states and their EBT vendors to use a threshold of a minimum of $5,000/month in Food Stamp sales for the installation of additional phone lines for EBT. As part of this guideline, it has been indicated that retailers must be given a phone line if the retailer indicates that not receiving one will be a disruption to their business.

Options For the Future of EBT

Retailers have had strong support for more federal involvement in EBT stemming from their desire to see as much uniformity in the systems as possible. They see advantages in eliminating variations between states either through less state choice or less state control. With that preference in mind, the retailers discussed several options for the future of EBT including a national EBT system operated by the federal government, a national switch operated by the federal government, the Texas model of procurement by component, and alternative technologies.

<u>National EBT System Operated by the Federal Government</u>

Retailers showed support for a federally operated EBT system because of the uniformity it would provide. Some believed that host authorizing should be a federal responsibility. In addition, retailers stated that Quest® rules should be required in a federally operated EBT system. If the decision were made for FNS to run a national EBT system, the retailers would like to be able to provide input as to design and policy needs.

<u>National Switch Operated by the Federal Government</u>

Retailers would be interested in seeing FNS do more in the area of transaction switching and feel it would be a start in minimizing connection to multiple EBT points. The retailers believe that a national switch would achieve some of the standardization that they have been calling for.

<u>Texas Model: Procurement by Component</u>

Retailers are not convinced that procurement by EBT component will save money. They are concerned that state savings will come by putting more costs on to the retailers. They also worry that the added layers of multi-vendor communication will cause adequate retailer assistance to be more difficult, especially during a crisis. The retailers are unsure of how fault will be determined in the case of a disturbance in the system. They are also concerned that this option will create even more inconsistencies between systems.

<u>Alternative Technologies</u>

Retailers discussed the use of smart cards and biometrics as potential technologies for use in EBT. Retailers did not feel that smart cards are practical. Even if additional programs are added to the card (i.e., WIC) it may still not be cost effective for stores to be equipped with smart card readers.

The retailers were more favorable toward biometrics. They felt there was more potential for this technology, especially in the area for fraud detection. As to specific biometric technologies, retailers thought that iris scanning would be more dependable than finger print imaging.