



The California Commission on Health and Safety and Workers' Compensation

CHSWC White Paper on Cost/Benefit of Implementing Electronic Deposit for Unemployment and Disability Benefits in the State of California

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Electronic Deposit for Unemployment and Disability Benefits in the State of California**

A. Proposal

The purpose of this proposal is to improve administrative efficiency and reduce the transaction costs of processing paper checks for the payment of unemployment and disability benefits in the State of California. Over 2.8 billion dollars of administrative savings over a five year period could be achieved by:

- Utilizing electronic deposit by mandating that it be offered by payors to payees in lieu of paper check disbursements.
- Utilizing electronic benefit transfer cards (EBT) for un-banked recipients.

These efficiencies could be used for unemployment insurance (UI), state disability insurance (SDI), workers' compensation, non-industrial disability (NDI), uninsured employers, and other administrative systems. Exploration of the feasibility of other programs such as Temporary Assistance for Needy Families (TANF) is not included in this document.

Some of the benefits of moving to an electronic payment system include:

- Cost savings.
- Timely delivery of benefits to recipients.
- Elimination of the problem of checks being lost in the mail.
- Potential for fraud reduction since electronic payment transactions leave a specific footprint and are highly auditable.

B. Background

The Commission on Health and Safety and Workers' Compensation (CHSWC) is required to assist the Administrative Director in making a report, on or before July 1, 2004, that offers recommendations on how to improve farm workers' access to workers' compensation benefits. Labor Code 4651(c). [*Labor Code section 4651(c) states, "On or before July 1, 2004, the administrative director shall present to the Governor recommendations on how to provide better access to funds paid to injured workers in light of requirements of federal and state laws and regulations governing the negotiability of disability indemnity payments. The administrative director shall make specific recommendations regarding payments to migratory and seasonal farm workers. The Commission on Health and Safety and Workers' Compensation and the Employment Development Department shall assist the administrative director in the completion of this report."*]

The access to funds issue will be covered under a separate attachment of this document (Attachment D). It was in the course of this investigation that staff identified potential areas for administrative savings that are discussed below.

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CHSWC staff have contacted and worked with the Employment Development Department (EDD), the State Controller's Office, Division of Workers' Compensation, State Compensation Insurance Fund, The California Workers Compensation Institute, and the States of Ohio, Iowa and Wisconsin. Additional contacts were made with federal government benefit programs.

C. Review of Administrative Systems

Staff conducted a preliminary review of California administrative systems with the potential of administrative savings by adopting electronic deposit and/or EBT.

- State Disability Insurance (SDI). The SDI program provides benefits for non-industrial injuries or illnesses covering approximately 12.8 million California workers. The program is funded by employee contributions with most private-sector employees eligible for SDI. Benefits for the SDI program are paid by Employment Development Department. For disabilities beginning on or after January 1, 2004, the program's maximum weekly benefit is \$728. In 2003, benefits paid totaled approximately \$3.05 billion.¹ These benefits are projected to increase to \$3.66 billion in 2004 and \$4.22 billion in 2005. The increase is partially attributable to the Paid Family Leave Program (PFL) which will begin accepting and processing claims in July 2004. It is estimated that the PFL will process approximately 139,900 claims from July-December 2004, totaling approximately \$181,869,000. Both SDI and PFL payments are bi-weekly.
- Non-industrial Disability Insurance (NDI): State government workers who are disabled by a non-industrial condition or whose injury may be in dispute for workers' compensation are entitled to up to 26 weeks of Non-industrial Disability Insurance benefits. State employees do not presently qualify for SDI, although they may collectively bargain for coverage. NDI is an employer-paid benefit, and weekly payments are considerably less than SDI. The payment is limited to \$125 or \$135 per week, depending on the collective bargaining agreement that covers the employees. Benefits are paid once per month. There are approximately 7,800 claims per year. In fiscal year 2002/03, benefits paid totaled approximately \$14 million.²
- Unemployment Insurance
Unemployment insurance is a unique federal-state program based on federal law but executed in its relationship to the employer and the unemployed worker through state

¹ "Disability Insurance Program." Employment Development Department Fact Sheet. <http://www.edd.ca.gov/direp/de8714c.pdf> and "California Disability Insurance Fiscal Transactions and Activities from 200 to 2002" from EDD.

² "Non-Industrial Disability Insurance" Conversation with Barbara Ernst, Manager of NDI Unit at EDD. <http://www.dpa.ca.gov/benefits/health/workcomp/pubs/Disability/page4.shtml>

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law and administered by state employees. The Unemployment Insurance Program, commonly referred to as UI, provides weekly unemployment insurance payments for workers who lose their job through no fault of their own. Eligibility for benefits requires that the claimant be able to work, be seeking work, and be willing to accept a suitable job. The payments for unemployment insurance are issued bi-weekly. Currently, the unemployment insurance trust fund is facing some insolvency problems due to an antiquated financing structure (See Attachment B).

California employers pay a maximum tax rate of up to 5.4% on the first \$7,000 of wages per employee per year (CA taxable wage ceiling is \$7,000). Currently (2004), an emergency surcharge of 15% is in effect due to the Fund's low solvency level (it is not solely insolvency that triggers this surcharge). This surcharge is expected to stay in effect in 2005. The \$7000 taxable wage ceiling represents the minimum taxable wage ceiling allowed by Federal law. Federal law also requires a State's maximum tax rate to be at least 5.4%. Many CA employers pay at less than the maximum allowed based upon the CA UI experience rating system.

UI is financed by unemployment program tax contributions from employers. Part of the employer's tax goes directly to the federal government to pay for the administration of the system. The greater portion goes into a special UI Trust Fund from which benefit payments are made to the workers who are laid off. The maximum amount of a regular UI claim is either 26 times the claimant's weekly benefit amount or one-half of the claimant's base period wages, whichever is less. Maximum weekly benefits are \$410 per week. Effective 2005, the maximum weekly benefit amount is scheduled to increase to \$450.

In 2003, there were 2,954,617 initial UI claims filed and approximately \$6 billion were paid out.³

D. Other States and Other Systems with Electronic Payment Systems.

Several states have implemented or are in the process of implementing an electronic deposit or debit card system. The State of Ohio's Bureau of Workers' Compensation, an exclusive state fund, gives injured workers the option to have electronic deposit of benefit payments and has also instituted a debit card for its un-banked workers. According to the State of Ohio, about 50% of injured workers elect to have their benefits transferred via direct deposit. The cost of processing a payment by check is about \$2.50. The cost from processing a payment via an electronic transfer is about 4.5 cents.

The State of Wisconsin is initiating a project whereby Uninsured Employers Fund (UEF) and unemployment insurance payments would be provided via the stored value card. Workers who voluntarily elect to have their payment of benefits transferred to this card could access their

³ Unemployment Quick Statistics, www.edd.ca.gov

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benefits free of charge at banking facilities.⁴ Colorado, Washington and Minnesota have implemented electronic payment system cards for child support. The State of Iowa mandates the use of the electronic payment system card or direct deposit for child support.⁵

In addition to other State systems, the California Department of Health and Human Services (CDHHS) uses electronic payment systems to distribute cash benefits and food stamps to clients. According to CDHHS Electronic Benefits Transfer Project, conservatively, California could save more than \$1.00 on every warrant payment it converts to a direct deposit⁶ (See Attachment C). Other estimates based on information from California Workers' Compensation Insurance Institute ICIS report indicate a savings of \$10.00 per transaction.⁷

E. Recommendation (Legislation)

CHSWC recommends that the Governor and the Legislature require EDD to offer benefit payments by direct deposit and authorize EDD to require benefit payments to be made by electronic transfer for recipients not electing direct deposit. CHSWC recommends that the Governor and the Legislature authorize the Administrative Director of the Division of Workers' Compensation to mandate the payment of Workers' Compensation benefits by direct deposit at the election of the payee and to permit or mandate the payment of benefits by electronic benefit transfer for recipients who do not elect direct deposit. The recommended language for these proposals can be found in Attachment A.

F. Cost / Benefit Analysis

Staff received different documented estimates for determining savings from implementing the Electronic Fund Transfer System. We will therefore display all three alternatives.

The three estimates are based on information from the Ohio Bureau of Workers' Compensation, California Department of Health and Human Services Data Center, the California Workers' Compensation Institute ICIS report, and the Workers' Compensation Insurance Rating Bureau.

Transaction Data Sources

Estimates of the Number of Check Transactions for each program were derived in the following way:

- Unemployment Insurance: Number of checks issued in 2003 per EDD was 17,913,765.

⁴ Conversation with Brian Krueger, Director, Bureau of Insurance Programs, Wisconsin Department of Workforce Development.

⁵ Conversation with Kipp Sonnentag, Controller, Wisconsin Department of Workforce Development and Ann Rezarach, Program Specialist for Contracts, Bureau of Collections, Iowa Department of Human Services.

⁶ California Health and Human Services Data Center. "Concept For EBT Phase II: The California Payments System" July 3, 2003.

⁷ "ICIS Report - Average Number of Medical Payments by Claim Type., CWCI January 2000."

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- State Disability Insurance: Number of checks issued in 2003 per EDD was 5,087,331.
- NDI: The number of checks issued in the FY 2002/03 per State Controller's Office was 24,688.
- Paid Family Leave (PFL): The estimated number of checks to be issued for July 2004-June 2005 is approximately 467,530.
- Workers' Compensation Indemnity Payment transactions: Total indemnity benefits paid in workers' compensation for insured employers were about \$4 billion in 2002. If the average weekly benefit (TD and PD, etc) was \$300, that would give an estimate of about 6.5 million checks.⁸ Since self-insureds comprise 20% of the market, the estimated check transactions would be 8.1 million.

Workers' Compensation Medical Payment Transactions: Workers' compensation medical payment transactions over a life of the claim average about 32 transactions per claim.⁹ With about 612,000 workers' compensation claims per year¹⁰, there are about 19.6 million medical payment transactions per year. Since self-insureds comprise 20% of the market, the estimated medical payment check transactions would be 24.5 million.

⁸ Estimates prepared by Frank Neuhauser of UC Berkeley.

⁹ "ICIS Report - Average Number of Medical Payments by Claim Type., CWCI January 2000." Analysis was updated by CWCI in July 2004.

¹⁰ "California Workers' Compensation Policy Year Statistics: WCIRB Bulletin No.2003-16, WCIRB July 14, 2003." Number of claims based on Policy Year 2000.-1st Report of Insured Employers.

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Alternative 1: Cost/Benefit Analysis Based on the Experience from State of Ohio, Bureau of Workers' Compensation.

As noted above, in the State of Ohio, about 50% of injured workers elect to have their benefits transferred via direct deposit. The cost of processing a payment by check is about \$2.50. The cost from processing a payment via an electronic transfer is about 4.5 cents.

Assumptions:

- The same percentage of workers will volunteer to have their benefits paid via direct deposit as in the State of Ohio (50%)
- Estimated cost savings would be similar in California as in Ohio. The costs savings are estimated to be about \$2.46 per transaction

Estimated savings using \$2.50 per transaction for the current costs and 4.5 cents per transaction for estimated electronic deposit costs:

Agency	Estimated Check Transactions per year	Current Estimated Costs (Using \$2.50 per transaction)	Estimated Cost with Electronic Deposit (using 4.5 cents per transaction)	Estimated Savings
UI	17,913,765	\$44,784,413	\$806,119	\$43,978,294
SDI	5,087,331	\$12,718,328	\$228,930	\$12,489,398
PFL	467,530	\$1,168,825	\$21,039	\$1,147,786
NDI	24,688	\$61,720	\$1,111	\$60,609
WC indemnity payments	8,100,000	\$20,250,000	\$364,500	\$19,885,500
WC medical payments	24,500,000	61,250,000	1,102,500	\$60,147,500
UEF	22,484	\$56,210	\$1,012	\$55,198
TOTAL:	\$56,115,798	\$140,289,495	\$2,435,211	\$137,854,284

Source: EDD, UEF, SCO, WCIRB, CWCI, Ohio Bureau of Workers' Compensation, and CHSWC Staff Calculations

Assuming a penetration rate of 50%, the savings would be about \$69 million.

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Alternative 2: Cost/Benefit Analysis Based on the Transaction Costs from California Department of Health and Human Services

Annual Savings

Estimated savings of \$1.00 per transaction if converted from check to electronic deposit:

Agency	Estimated Check Transactions per year	Estimated Savings (\$1.00 per transaction that is converted to a direct deposit)
UI	17,913,765	\$17,913,765
SDI	5,087,331	\$5,087,331
PFL	467,530	\$467,530
NDI	24,688	\$24,688
WC indemnity payments	8,100,000	\$8,100,000
WC medical payments	24,500,000	\$24,500,000
UEF	22,484	\$22,484
TOTAL:	56,115,798	\$56,115,798

Source: EDD, UEF, SCO, California Department of Human Services Data Center EBT Project, WCIRB, CWCI
CHSWC Staff calculations

Assuming a 50% penetration rate, the estimated saving would be about \$28 million

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Alternative 3: Cost/Benefit Analysis Based on Estimates from the CWCI ICIS Report

Annual Savings

Assumption:

As noted above, the estimates of savings are based on information from a CWCI ICIS report. The report estimated that the cost of generating a medical benefit notice is \$10. For the purposes of the estimates below, we are assuming that generating and mailing an indemnity or medical benefit check costs the same generating and mailing a benefit notice.

Estimated savings of \$10.00 per transaction if converted from paper/check transaction to an electronic deposit system¹¹.

Agency	Estimated Check Transaction per year	Estimated Savings (\$10.00 per transaction that is converted to a direct deposit)
UI	17,913,765	\$179,137,650
SDI	5,087,331	\$50,873,310
PFL	467,530	\$4,675,300
NDI	24,688	\$246,880
WC indemnity payments	8,100,000	\$81,000,000
WC medical payments	24,500,000	\$245,000,000
UEF	22,484	\$224,840
TOTAL:	56,115,798	\$561,157,980

Source: EDD, UEF, SCO, California Department of Human Services Data Center EBT Project, WCIRB, CWCI, CHSWC Staff calculations

Assuming a 50% penetration rate, the savings would be about \$281 million.

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Cumulative Savings

Cumulative Savings Based on Estimates from CDHSS

**Estimated Cumulative Savings Based on
California Department of Health & Human Services Estimates of Transaction Costs**

Agency	Year 1	Year 2	Year 3	Year 4	Year 5
UI	\$17.9 million	\$35.8 million	\$53.7 million	\$71.6 million	\$89.5 million
SDI	\$5.1 million	\$10.2 million	\$15.3 million	\$20.4 million	\$25.5 million
PFL	\$467,530	\$935,060	\$1,402,590	\$1,870,120	\$2,337,650
NDI	\$24,688	\$49,376	\$74,064	\$98,752	\$123,440
WC indemnity payments	\$8.1 million	\$16.2 million	\$24.3 million	\$32.4 million	\$40.5 million
WC medical payments	\$24.5 million	\$49 million	\$73.5 million	\$98 million	\$122.5 million
UEF	\$22,484	\$44,968	\$67,452	\$89,936	\$112,420
TOTAL	\$56.1 million	\$112.2 million	\$168.3 million	\$ 224.4 million	\$280.5 million

Source: EDD, UEF, SCO, California Department of Human Services Data Center EBT Project, WCIRB, CWCI, CHSWC Staff calculations

Note: Please note that all totals are rounded and do not include the 50% penetration rate.

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Cumulative Savings Based on CWCI Estimates

**Estimated Cumulative Savings Based on
California Workers' Compensation Institute Estimates of Transaction Costs**

Agency	Year 1	Year 2	Year 3	Year 4	Year 5
UI	\$179.1 million	\$358.2 million	\$537.3 million	\$716.4 million	\$895.5 million
SDI	\$50.9 million	\$101.8 million	\$152.7 million	\$203.6 million	\$254.5 million
PFL	\$4.7 million	\$9.4 million	\$14.1 million	\$18.8 million	\$23.5 million
NDI	\$246,880	\$493,760	\$740,640	\$987,520	\$1.2 million
WC Indemnity payments	\$81 million	\$162 million	\$243 million	\$324 million	\$405 million
WC medical payments	\$245 million	\$490 million	\$735 million	\$980 million	1.2 billion
UEF	\$224,840	\$449,680	\$674,520	\$899,360	\$1.1 million
TOTAL	\$ 561.2 million	\$1.1 billion	\$1.7 billion	\$2.2 billion	\$2.8 billion

Source: EDD, UEF, SCO, California Department of Human Services Data Center EBT Project, WCIRB, CWCI, CHSWC Staff calculations

Note: Please note that all totals are rounded and do not include the 50% penetration rate.

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G. Overall Savings

Based on the above alternatives and assuming 100% compliance, the range of annual savings would be from \$56 million to \$ 561 million. Five-year cumulative savings could be about \$2.8 billion. These figures could be reduced depending on the penetration rate.

Proposed Legislative Language

**Electronic Payment of Benefits by Direct Deposit or Electronic Access Card
Labor Code (LC) Section 4651, Unemployment Insurance Code (UIC) Section 1339, and
UIC Section 2701**

Problem:

The transaction cost of processing checks for the payment of unemployment or disability benefits adds to the cost of the system, whether it is in workers' compensation or EDD.

Some workers have no bank accounts and limited access to banking institutions where disability checks can be cashed.

Solution:

Require the payor to offer the payee the choice of receiving indemnity benefits by direct deposit, and authorize the option of payment by means of an electronic access card.

Claimants for EDD benefits who do not elect direct deposit may be required to receive their payments by electronic funds transfer to an account accessible by an electronic access card issued by EDD. The statute would allow the EDD to determine the extent to which it will implement this payment method. Claimants who cannot use an electronic access card may request an exemption.

Claimants for workers' compensation benefits who do not elect direct deposit may be offered the option or may be required to receive payments through an electronic access card. The extent to which electronic payment will be implemented, either as an option or as a requirement, will be determined by regulations to be adopted by the Administrative Director of the Division of Workers' Compensation. One important consideration for the Administrative Director will be the availability of banking and related services to provide the infrastructure for a full-scale system of electronic benefit transfers.

Proposed language for unemployment compensation:

Unemployment Insurance Code § 1339.

(a) The department shall pay unemployment compensation benefits through public employment offices or such other agency as may be prescribed by authorized regulations of the director.

(b) Each check or certification (pay order) issued in payment of unemployment insurance compensation benefits shall have prominently imprinted upon it: "State unemployment insurance benefits under the California Unemployment Insurance Code are paid for by employers."

(c) Not later than four weeks after the issuance of the first payment of a claim, the department shall give the claimant the choice to receive payments of unemployment compensation benefits by electronic deposit in an account in any bank, savings and loan association or credit union of

Attachment A

the claimant's choice in this state. Unless a claimant has elected to receive payments by electronic deposit, the department may issue an electronic access card to a claimant and pay unemployment compensation benefits by electronic funds transfers to an account accessible by that electronic access card. The director shall by regulation establish procedures for election of electronic deposit, procedures for revocation of the election, procedures for claimants to be request exemption from receiving payments by direct deposit or electronic access card, and other matters necessary or convenient for the administration of this subdivision.

Proposed language for disability compensation:

Unemployment Insurance Code § 2701.

(a) Disability benefits shall be paid by the department through public employment offices or other agencies approved by the director.

(b) Not later than four weeks after the issuance of the first payment of a claim, the department shall give the claimant the choice to receive payments of unemployment compensation disability benefits by electronic deposit in an account in any bank, savings and loan association or credit union of the claimant's choice in this state. Unless a claimant has elected to receive payments by electronic deposit, the department may issue an electronic access card to a claimant and pay unemployment compensation disability benefits by electronic funds transfers to an account accessible by that electronic access card. The director shall by regulation establish procedures for election of electronic deposit, procedures for revocation of the election, procedures for claimants to be request exemption from receiving payments by direct deposit or electronic access card, and other matters necessary or convenient for the administration of this subdivision.

Proposed language for workers' compensation:

Labor Code Section 4651.

(a) No disability indemnity payment shall be made by any written instrument unless it is immediately negotiable and payable in cash, on demand, without discount at some established place of business in the state.

Nothing in this section shall prohibit an employer from depositing the disability indemnity payment in an account in any bank, savings and loan association or credit union of the employee's choice in this state, provided the employee has voluntarily authorized the deposit, nor shall it prohibit an employer from electronically depositing the disability indemnity payment in an account in any bank, savings and loan association, or credit union, that the employee has previously authorized to receive electronic deposits of payroll, unless the employee has requested, in writing, that disability indemnity benefits not be electronically deposited in the account.

(b) It is not a violation of this section if a delay in the negotiation of a written instrument is caused solely by the application of state or federal banking laws or regulations.

~~—(c) On or before July 1, 2004, the administrative director shall present to the Governor recommendations on how to provide better access to funds paid to injured workers in light of the requirements of federal and state laws and regulations governing the negotiability of disability indemnity payments. The administrative director shall make specific recommendations~~

Attachment A

~~regarding payments to migratory and seasonal farmworkers. The Commission on Health and Safety and Workers' Compensation and the Employment Development Department shall assist the administrative director in the completion of this report.~~

(c) On or before January 1, 2006, in consultation with the Commission on Health and Safety and Workers' Compensation, the administrative director shall adopt and may from time to time amend, after public hearings, regulations requiring the payment of disability indemnity by electronic benefit transfer. At a minimum, the regulations shall require that, upon conditions specified by the administrative director, the payment of disability indemnity benefits shall be made by direct deposit in an account where the employee has previously authorized to receive electronic deposits of payroll unless the employee has requested in writing that disability indemnity benefits not be electronically deposited in the account, or in an account of the employee's choice provided the employee has voluntarily authorized the deposit. In addition, as the administrative director determines that adequate banking and payment processing resources become available, the administrative director may adopt or amend regulations requiring the payment of indemnity benefits by means of a stored value card where the employee does not utilize direct deposit. The administrative director shall prescribe the conditions where electronic payments are required, which may include a minimum number of expected payments, a minimum amount of a single payment, an effective date or dates for the regulations, and such other conditions as the administrative director may prescribe for the purposes of maximizing efficiency, economy, and accessibility of funds. The regulations shall specify the notices to be given to an employee, including notices to be given to recipients of electronic benefit transfers for temporary disability benefits in lieu of the notices required by Section 1871.8 of the Insurance Code to be given to recipients of checks for temporary disability benefits. The regulations shall specify the manner in which an employee may exercise the options available to the employee regarding payments by electronic benefits transfer.

(d) For the purpose of subdivision (c), the following meanings shall apply:

(1) "Direct deposit" means deposit in an account in any bank, savings and loan association, or credit union designated by the employee.

(2) "Electronic benefit transfer" means the payment of benefits by direct deposit or by stored value card.

(3) "Employee" includes the dependents of a deceased employee.

(4) "Employer" includes a self-insured employer, an insurer of an insured employer, the state, the Subsequent Injuries Benefits Trust Fund, and the Uninsured Employers' Benefits Trust Fund.

(5) "Stored value card" means a device provided to the employee by the employer, by which the recipient of a benefit may access the funds electronically, such as by use of automated teller machines or point of sale terminals or other means that may be prescribed by the administrative director, without the requiring the recipient to maintain an account in any bank, saving and loan association or credit union.

LC § 4603 – Electronic Payment of Medical Bills

Problem:

Attachment A

Processing bills and payments by paper is inefficient and susceptible to errors. Existing law requires insurers and employers to accept electronic billing by July 1, 2006, but it does not require insurers and employers to pay those bills electronically.

Solution:

Require that if a bill is submitted electronically, the payment shall be made electronically.

Proposed language:

4603.4. (a) The administrative director shall adopt rules and regulations to do all of the following:

(1) Ensure that all health care providers and facilities submit medical bills for payment on standardized forms.

(2) Require acceptance by employers of electronic claims for payment of medical services.

(3) Ensure confidentiality of medical information submitted on electronic claims for payment of medical services.

(b) To the extent feasible, standards adopted pursuant to subdivision (a) shall be consistent with existing standards under the federal Health Insurance Portability and Accountability Act of 1996.

(c) The rules and regulations requiring employers to accept electronic claims for payment of medical services shall be adopted on or before January 1, 2005, and shall require all employers to accept electronic claims for payment of medical services on or before July 1, 2006.

(d) Payment for medical treatment provided or authorized by the treating physician selected by the employee or designated by the employer shall be made by the employer within 15 working days after electronic receipt of an itemized electronic billing for services at or below the maximum fees provided in the official medical fee schedule adopted pursuant to Section 5307.1. If an initial billing for a medical service is submitted by electronic billing in accordance with the rules and regulations of the administrative director on or after July 1, 2006 and the electronic billing contains the information required for electronic payment, then the payment shall be made by the employer by electronic funds transfer. If the billing is contested, denied, or incomplete, payment shall be made in accordance with Section 4603.2.

California Budget Project

**BUILDING A SOUND FOUNDATION FOR CALIFORNIA'S
UNEMPLOYMENT INSURANCE SYSTEM:
KEY FINDINGS AND RECOMMENDATIONS**

California's Unemployment Insurance Trust Fund Faces Insolvency

- California's Unemployment Insurance (UI) trust fund lacks sufficient resources to pay benefits owed to jobless workers. The state expects to begin borrowing from the Department of Labor to meet its obligations in April 2004.
- The financial crisis in California's unemployment insurance system stems from the fact that the system is structurally incapable of generating sufficient revenues to pay the benefits owed to unemployed workers during an economic downturn. In 2004, the Employment Development Department predicts that, even on the highest F+ tax rate schedule, the gap between employer contributions of just under \$5.0 billion and benefits payments of over \$6.8 billion will equal \$1.9 billion. In 2005, if no changes are made to the system, the gap between employer contributions of \$5.1 billion and benefit payments of \$6.5 billion will equal \$1.4 billion.
- Among the roots of the problem is the state's low "taxable wage base" – the maximum amount of a worker's wages on which an employer must pay UI taxes. California's taxable wage base has remained fixed at \$7,000, the minimum allowed by federal law, since 1983. In the second quarter of 2003, California was one of ten states with a taxable wage base of \$7,000. In contrast, 24 states had a taxable wage base between \$7,001 and \$12,000; seven states had a taxable wage base between \$12,001 and \$20,000; and nine states – including Oregon, Washington, and Nevada – had a taxable wage base of \$20,001 or higher. As a percentage of average annual wages, California's taxable wage base is the lowest among the 50 states.
- In 1983, taxes paid into the UI trust fund equaled \$1.6 billion, while benefits paid out of the trust fund totaled \$2.2 billion. By 2002, payments into the trust fund had increased to \$2.6 billion (65.4 percent), while benefits had increased to \$5.6 billion (161.7 percent). By keeping the taxable wage base constant, increases in trust fund revenues were driven almost entirely by a rise in the number of covered employees. Benefit payments, on the other hand, rose due to an increase in the number of persons drawing benefits as the labor force expanded, wage increases (thereby boosting benefit payments owed to jobless workers), and benefit increases enacted in 1989 and 2001.

California's Unemployment Insurance System in Context

- □□ California's UI benefits are moderate in comparison to those of other states. In the fourth quarter of 2003, California ranked 28th among the states with respect to average weekly UI benefits. California's average weekly benefit was \$250.69, as compared to the US average of \$261.44. In mid-2003, California's average weekly UI benefit replaced only 31.4 percent of the average weekly wage of UI recipients. On this wage replacement measure, California ranked 45th among 50 states.
- California ranks modestly higher than other states with respect to the share of jobless workers who receive UI benefits. In 2003, 15 states had a higher UI "reciency rate" than did California. The reciency rate reflects the number of insured unemployed in the regular UI program as a percentage of the total unemployed workforce.
- Employer contributions to California's UI system have declined as a share of total wages. In 1967, during Governor Reagan's first year in office, UI taxes stood at 1.58 percent of total wages. In 2002, the last year for which a full year's worth of data is available, the UI taxes paid by California employers were 0.53 percent of total wages, just one third of the 1967 level.

Unemployment Insurance Eligibility Requirements Disadvantage Low-Wage Workers

- California's UI eligibility requirements do not take into account workers' earnings during the current and most recently completed calendar quarters. Evidence suggests that this practice disadvantages low-wage workers. Today, 18 states and the District of Columbia use "alternate base periods" to include workers' more recent earnings. Three of these states (Hawaii, New Mexico, and Virginia) adopted an alternate base period during 2003.

Restoring the Foundation of California's Unemployment Insurance System

- Policymakers should raise California's UI taxable wage to at least the average of the 50 states. This will allow the trust fund to bring in sufficient revenues to pay benefits owed to jobless workers. In the second quarter of 2003, the average of the 50 states was \$12,768, as compared with California's \$7,000.
- □□ California's policymakers should also index the taxable wage base – that is, adjust it annually to reflect changes in average weekly wages. Without indexing, a capped taxable wage base will prevent the UI trust fund from meeting the demands of a changing labor force.
- Policymakers should consider modifications to the state's tax rate schedule that move the UI system toward greater solvency. For example, the solvency of the UI trust fund could be improved by requiring a larger reserve in order to trigger a movement to a lower UI tax rate schedule.

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- □□California should adopt a system-wide solvency goal to inform future UI policy debates. For example, if policymakers were set an “average high cost multiple” of 1.0 to 1.5 as a goal, this would mean that the trust fund would have a reserve sufficient to cover 12 to 18 months of benefit payments at any time, sufficient to meet the challenge of a serious economic downturn.
- California should follow the lead of 18 other states by adopting an alternate base period. This action would make the state’s unemployment insurance eligibility rules more fair to low-wage workers.

Source: <http://www.cbp.org/workwages.htm>

Health and Human Services Data Center

Concept for EBT Phase II

**The
California Payments Project**

July 3, 2003

Next Steps for EBT

Introduction

The Electronic Benefit Transfer (EBT) project has successfully converted over ¼ million households from a paper based benefit to the use of electronics. When the project is fully rolled out, there will be close to ¾ million California social service households receiving and redeeming government benefits electronically. Annually, over 4 million warrants and 7 million food stamp packets will have been eliminated. This project has clearly demonstrated the viability of electronics as a payment vehicle for the transfer of value from government to its citizens.

Based on this success, a natural next step would be to leverage the technology, momentum and infrastructure of EBT into a focused effort to move a broader segment of Health and Human Service recipients and vendors to electronic payments. The goal would be to completely eliminate checks and other forms of paper based exchange of value.

The value proposition is straight forward. Electronic payments are:

- More client friendly - With electronic disbursement, clients receive transfers timely, within minutes, not the three to seven days required by mail. The funds are available on the expected day and lost-in-the mail becomes an anachronism.
- Less expensive - It is difficult to know the actual cost of warrants as a payment vehicle, but when all costs are considered, estimates place it at between 2 to 3 times more expensive than, for example, a direct deposit. Conservatively, California could save more than \$1.00 on every warrant payment it converts to a direct deposit.
- Highly auditable - Unlike paper-based payment forms, electronic payment transactions leave a specific footprint that supports a high degree of accountability, financial integrity, and possibilities for fraud reduction.

Background

The drive to the use of electronics as a highly effective payment alternative is widely recognized on a national basis, with a number of initiatives in place. Momentum is building. EBT was one of the earliest and is probably the most evolved of these programs. It is now in use in fifty states, minimally, to issue food stamp benefits, but in a number of cases, its use is being expanded to cover many government transfer payments.

Based partly on the success of EBT, the Federal Government in the 1996 "Debt Collection Improvement Act" mandated that all Federal Payments be made by Electronic Funds Transfer (EFT). This effort, covering a range of programs including social security, veterans administration and federal pensions has been highly successful in eliminating warrants. However, certain case

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specific restrictions have prevented reaching the ultimate goal of all federal payments being converted to EFT by 1999.

Within State governments, there are many programs in process. A couple of good examples are Texas and Colorado. Texas has developed a comprehensive ten-year Electronic Service Delivery (ESD) plan for moving a large number of paper based services to an electronic medium. The centerpiece of this initiative is the Texas "Lone Star" EBT card. The State's intent is to make this a universal and secure citizen to government service enabling tool. Within the present scope of the Texas program are the addition of child support, WIC, and Medicaid along with a variety of other cash based programs.

Colorado is also a great proponent of the use of electronic payments. Within their Social Services agency, they have been very active in the use of their EBT program for a wide variety of value transfer programs. The agency purposefully made the decision to eliminate paper warrants as a payment option and has been actively moving payments to electronics. Along with the usual list of cash programs, they have implemented energy assistance on their EBT card and have rolled out a minimum cost card to support child support payments.

The Challenge

It is clear that electronic payments are advantageous, both to the State and its citizens. It is equally evident that this is the wave of the future, a positive use of technology that will soon be the national norm for government to citizen transfers of value. California should, now, begin investigation and planning for the inevitable move to all electronic payments. Strategies should be developed that encompass the various payer / payee scenarios and that integrate the available electronic payment technologies all to provide a seamless and highly cost effective payment infrastructure for California.

Payment Scenarios:

- State / county to citizen cash payments (e.g. child support disbursements, Unemployment, etc.)
- State / county to provider cash payments (e.g. Child care, IHHS, Medicaid, etc.)
- Citizen to state / county cash payments (e.g. child support receipts, tax payments. etc)
- Non cash benefit programs (e.g. WIC)

Electronic Payment Technologies:

- Direct deposit - the most widely implemented and economically advantageous (to the state) option but it does require the recipient to have a commercial bank account.
- Electronic Data Interchange - a technology that allows the coupling of payment advice data (invoice number, payer name, etc.) with a direct deposit transfer of funds. It is well suited to provider payments and child support receipt processing.
- Low cost bank accounts - minimum service accounts designed to make electronic payments available to the un-banked. Many variations exist including an Electronic Transfer Account (ETA) designed by the US Treasury to facilitate its move to all EFT and a "pre-

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paid" Visa or MasterCard account provided by private sector banks in response to State's needs.

- Electronic Benefit Transfer - designed primarily to support transfers of value under benefit programs for needs-tested households. It is especially effective when used for programs whose benefits have usage restrictions, such as Food Stamps and WIC.
- IC Cards (Smart Cards) - this is an emerging technology in which account balances as well as a possible array of other data, such as medical records, are carried in a memory chip directly on the card. It makes possible a high level of security as well as portability of data. It is being piloted in a variety of uses such as a Health Passport application, WIC applications, transportation applications and as an electronic purse. However, its viability as a mainstream payment vehicle is still in question.

The Opportunity

In these tough economic times, a cost reduction program such as the elimination of warrants is a laudable government response that has the potential to free up resources and contribute to the funding of more urgent programs. California is well positioned to mount such an initiative. The State currently has in process automation projects for IHHS and Child support, both of which generate a large number of warrants each month. Further, while the total is not known, other State funded programs and State operated Federal grant programs must generate hundreds of thousands of warrants each month. Moving all of these payments to an electronic medium has the potential to generate millions in savings.

State Programs	Cases
Children's Services	176,380
Medical	6,268,000
Foster Care	91,000
SSI/SSP	1,133,800
IHHS	320,600
Child Welfare Services	170,800
Healthy Families	768,200
Vocational Rehabilitation	80,851

Cash programs that pay either the citizen directly or a third party provider on behalf of the citizen, should be the first target for electronic payments. These are the most straight forward and capable of leveraging commercial payment infrastructure.

However, California has the largest WIC program in the country, serving approximately 1.3 million recipients. Benefits under this program are paper based and, while they have financial value, they are extremely prescriptive, making this an ideal candidate for EBT technology. In fact, several pilots are in process around the country in an attempt to identify the best model for WIC benefit automation. It would be in California's interest, because of its size and complexity, to be at the forefront of WIC benefit automation to ensure consistency with any vision for a paperless payment strategy.

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A key component for California moving ahead now in the development and implementation of an electronic payments strategy is the momentum provided by the EBT project. Success feeds well on success. Over the last four years, California, with its EBT project resources, has developed an extensive tool kit for movement to electronics.

- Expertise - knowledge base on the technology of electronic payment systems, their implementation, training in their use, managing on-going operations, characteristics, regulation, statute, and policy
- Contacts - working relationship with the banking community, retail community, ATM and POS networks, rules organizations, vendor community, ombudsman organizations, advocacy groups, and the EBT Oversight committee
- Infrastructure - Automated reconciliation system, county user group, central support for county mission critical financial system
- County access - EBT coordinators in every county plus viable working relationship with CWAs and CDWA, operations procedures that enable a statewide EBT system to function independently in all counties.
- Payments contract - oversight and management of EBT contract with ability through work authorizations to add additional payment programs and options.

The Proposal

The recommendation of this paper is that the EBT project's charter be expanded to a more encompassing role in hastening California's entry into the era of all electronic payments. The EBT project team, with its existing resource base is well positioned to lead this effort, with strategic analysis, planning activities, alternatives design, and feasibility studies. The focus would center around the following steps:

- Fully understand the tools and alternatives,
- Understand the environment and impediments,
- Design products that address the needs and perform preliminary feasibility analysis
- Undertake the procurement, and implementation of these efforts.

The first three steps above can be accomplished by leveraging existing project resources and minimal funding. It is not until the last step that the State would have to make any financial commitments to move forward.

The technology to support this project exists in the commercial market place. This paper is not suggesting an on-the-edge systems development effort. The true challenge is devising effective means for facilitating the acceptance of EFT as the preferred payment vehicle and in moving California's citizens and third party providers to electronic payments. For example, direct deposit, the most cost effective of the electronic payment options, has been around for many years and is in wide use in California. However, many citizens still receive checks. The goal of this electronic payments project would be to explore and define effective ways to market the program so as to be embraced by a broader range of citizens and providers as the only way to receive (or remit) government transfers. A possible outcome of the project might be marketing strategies, materials,

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and assistance for counties and the state all aimed at encouraging greater participation in EFT programs.

Another possible outcome might be the packaging and integration of technologies to facilitate a simple and seamless approach to electronic payments. For example, direct deposit relies on passing a properly formatted message containing the recipients account, routing and transit numbers and the deposit amount to a financial institution for origination through the Automated Clearing House (ACH) system. This is straight forward. However, underlying this is the need for a database containing recipient personal and bank data so that the ACH files can be formatted on a recurring basis. There must be a capability to update this information as recipients change address or exit programs. Vendor payments might further complicate the approach because of the need for remittance data (i.e. for whom or what invoice is the vendor being paid) Finally, there is a service component necessary to deal with rejects (e.g. recipient provided invalid bank data) or perhaps file transfer problems. A recipient customer service line supported by an activity history database may be an appropriate component.

These needs are shared by all potential users of direct deposit services. Consequently, possible outcomes of this payments initiative might be:

- State sponsored payment systems specialists that can consult with and advise potential state and county users of electronic payments,
- A standardized package of software and products that can be ported to each user,
- Centralized process and management of payment services with interfaces to the user community.

Another barrier that the project proposes to confront is how best to address the needs of those citizens that, either because of economic circumstances or by choice, do not have bank accounts (a pre requisite for direct deposit). A study by the Federal Government General Accounting Office (GAO) estimated that a surprisingly high 26% of US citizens fall into this category. This is not a new problem and solution sets have been devised. These fall into two general categories.

- Establish a minimum function low cost account for these clients. This is the approach taken by the US Treasury with their ETA. Treasury pays a one time \$12.26 to have these accounts established and the client pays an on-going \$3.00 per month (maximum). Visa and MasterCard have responded to the un-banked with a pre-paid account that costs between \$3.00 and \$5.00 per month plus varying amounts in transaction fees. A third option is low cost "lifeline" checking accounts offered by many financial institutions. Unfortunately, all of these products have service and feature limitations that some advocates and many clients view as negative. One of the largest drawbacks, from the un-banked recipient's view, is having to pay for what had previously been free. (This assumes the recipient has an established network of no-charge check cashing options.)
- Electronic Benefit Transfer (EBT) as a means to address the un-banked. This technology is already established in California for the distribution of CalWorks and other cash program benefits. Unfortunately, its applicability in its current form to a wider range of cash transfers is limited because of the federal regulation that covers electronic banking, Regulation E.

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This law specifically excludes needs-test benefits (e.g. CalWorks or General Assistance) but holds all other transfers accountable to the legal standard. Two specific clauses, the requirement for a monthly statement and limits on account holder's liability for transactions against their account make a full "Reg E" implementation more expensive than EBT in its current form.

Ultimately, moving California to all electronic payments will require a combination of solutions including direct deposit, minimum function commercial accounts and some form of EBT all working together to meet the circumstances of individual clients and programs. These products will be integrated with a combination of marketing and technology integration to create a seamless and highly cost effective payments solution for California.

The first steps of this proposed electronic payments initiative would be the understanding of what exists, what is needed, and how can California best meet its objectives. Following is a preliminary list of activities that the project team believes are appropriate to this task:

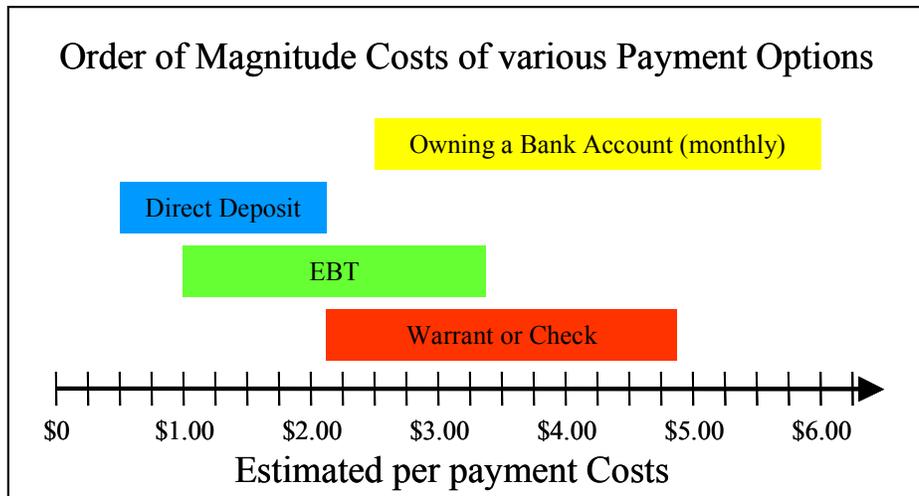
- Implement an oversight committee to 1.) provide direction and scope 2.) actively engage the multiple departments that could benefit from this project. 3.) provide statewide credibility for the effort
- Develop stakeholder groups at the state and county level to explore opportunities and understand obstacles
- Develop an understanding of approaches being implemented elsewhere in the country.
- Develop alternatives for achieving the objectives that might include marketing plans, outreach, technology integration, and procurement initiatives.
- Define and Implement minimum scope proof of concept efforts that can be accomplished within the resource constraints of the existing EBT project staff and its vendor contract.
- Develop and present a strategic and tactical plan for moving California to all electronic payments.
- Provide leadership and direction for implementation of the California Payments Plan.

Cost and Benefits of various payment options

There are many ways to transfer value from government to citizens including various paper and electronic options. It is very difficult to determine the true cost, and consequently a comparative analysis, for each of these payment options. The variability depends largely upon:

- Efficiency and scale of the payer's processes
- Program requirements unique to the payer
- Synergy with the payee's financial capabilities (banked versus un banked)
- Cost sharing and cost shifting between payer and payee.

In the subsequent sections, cost considerations for several payment models are discussed. As a summary, this chart provides comparative estimates, within an order of magnitude, of costs associated with some of the options. This data must, however, be viewed with extreme trepidation, taking into consideration all of the caveats covered in the following discussion.



In the final analysis, California must use multiple payment options so as to make the overall solution cost effective as well as cost efficient. This strategy will allow a specific solution to be tailored to the individual recipient's needs and capabilities as well as provide consistency with policy requirements of the paying programs.

Warrants or Checks

Warrants and checks are paper-based documents, created by the payer to transfer value to the payee. Typically they are conveyed to the payee through the mail, a three to seven day process. The paper document is then "cashed" by the payee and the value is subsequently transferred through the banking system from the account of the payer to the account of the entity cashing the check (may be the payee's bank or a third party.)

It is very difficult to know the true cost of writing and processing a warrant. A primary reason is that the total costs are spread across all of the participants in the system including the payer, the bank on which the warrant is drawn, the payee, the point of presentation (i.e. where the check is cashed), the bank where first deposited, the ACH and Federal Reserve Systems. Each of these performs functions and incurs costs necessary to enable warrants as an effective means of transferring value.

In general, all of the costs are ultimately born by either the payer or the payee but often in ways that make them difficult to understand and quantify. For example, the bank against which the check is drawn incurs significant costs for processing the check when it clears, for carrying reserves to cover the check, for providing statements to the payer and potentially for fraud. In some cases, this bank will charge fees to the payer to cover these costs but more often these bank costs are hidden in reduced interest payments on outstanding account balances and in other bank servicing fees.

As another example, the point of presentation for the warrant may be the payee's bank or it may be some third party entity that provides a check cashing service such as, for example, a large grocery store or a commercial check casher. This entity incurs costs related to having cash available to cash the check, for processing the check, and for fraud in the event of a bad check. Many times, the

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payee is charged a fee for cashing the check, but often the costs are recovered in less tangible ways, such as the payee buying product and service in the location providing the check cashing service.

The following list provides examples of cost elements potentially experienced by each sector of the system.

- Payer (Entity writing check)
 - Supplies and stuffing the envelope
 - Mailing
 - Accounting and data processing
 - Reconciliation of check ledger
 - Exception (e.g. returned check) handling and processing
 - Bank servicing fees
 - Lost and stolen checks
- Payee (entity receiving check)
 - Check cashing fees
 - Banking fees
- Point of presentation (Bank, retailer or commercial check casher)
 - Cash carrying costs
 - Fraud and theft
 - Bank service fees
 - Accounting and data processing
- Financial Institutions
 - Issuing Bank (bank against which check is drawn)
 - Settlement and reconciliation
 - Maintenance of reserves
 - Accounting and data processing
 - Exception processing
 - Bank of first presentation
 - Encoding and sorting
 - Accounting and data processing
 - Exception processing (e.g. returned check)
 - Federal reserve banks
 - Accounting and data processing
- Secondary costs (i.e. once a recipient has cashed a warrant there may be additional costs related to using that value to pay bills.)
 - Writing checks – the payee’s bank may charge fees associated with check writing privileges.
 - Money orders – in the event the payee does not deposit the warrant in a checking account, they may be required to rely on money orders or some other commercial payment document to pay bills. These have per item fees associated with them.

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For the above reasons, it is very difficult to assess the full cost of a warrant, and clearly, the cost will vary depending on individual situations. For example, a recipient that deposits the check in their bank account and writes checks against the amount to pay bills will have a different cost structure than one that relies upon the services of a check casher and the use of money orders to pay bills. However, several studies, referenced below, do attempt to estimate these costs.

The following chart, taken from a World Bank analysis paper concludes that a warrant costs close to \$3.00 while an electronic debit costs less than half that amount. The source for this data is an article by K. Wells, "Are Checks Overused?" published in the Federal Reserve Bank of Minneapolis Quarterly Review, 20 (Fall, 1996).

Per Transaction expense for	Paper based Payment (check)	Electronic Payment (ACH)
Payer	\$1.39	\$.80
Payee	\$1.25	\$.23
Bank	\$.29	\$.28
Total	2.93	1.31

Payer costs, in this study, are an average of consumer, business, and government payments. Consequently, the cost to government to write a check is probably understated primarily because government pays for services related to check processing for which consumers have no cost (e.g. balancing their check book or that their bank absorbs in exchange for a minimum account balances.)

An astonishing fact from the World Bank article is, "Weighted by the shares of paper-based check and electronic (credit card, debit card ACH) payments, the average US payment transaction costs \$2.60 and totals \$204 billion a year. This represents 3% of GDP. On a per person basis, each adult directly or indirectly pays \$1,050 annually just to make payments. Since a consumer payment averages around \$50, transaction costs make up 5% of the value of a typical consumer payment."

Another study, by William Dudley, published in the Federal Reserve Bulletin, November 1984 concludes that, "Comparing the cost of direct deposit with the cost of checks that are deposited by mail, the savings generated by direct deposit increases to \$.664 per payment." Elevating the .664 in savings to reflect the last 19 years of inflation, this becomes \$1.15. This study was limited to government payments and does not include expenses incurred by the payee. The \$1.15 is roughly equivalent to the \$1.39 payer costs in the above World Bank analysis.

More specific to California and the California Department of Social Services, the EBT project team did a survey of counties, asking each what it costs to create, process, and support a paper warrant. A detail worksheet was provided as a part of this survey to assist the counties in estimating the true cost. The answers were all over the map, ranging from a high of \$29.21 in Yuba County to a low of \$.68 in Sonoma. This would indicate that: a) Counties don't really have a good sense of what a warrant costs as a payment vehicle and b.) Depending on county business processes and scale economies, the full cost of a warrant can be significantly different.

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To develop a bellwether estimate of the actual cost of a warrant, using this county provided data, the responses from three larger counties, with presumably more sophisticated processes, cost accounting and with reasonable scale, were considered.

1. Los Angeles.....\$1.95
2. San Francisco.....\$3.84
3. Sacramento.....\$5.02

A simple average of the cost in these three counties is \$3.30. The average cost for the entire sample of counties that responded to the survey is \$3.50.

Also specific to California, the State Comptrollers office has provided a very informal estimate that their cost for issuing a warrant is in the range of about \$.50 which they feel covers all costs except possibly those for audits and investigations. This estimate, when compared to what others believe are the costs associated with a warrant seems low.

Three of the above four estimates for the cost of a warrant, while showing significant variability, are still within the same order of magnitude. As a conclusion, it is probably conservative (and safe) to estimate that every time California generates a paper warrant, it costs in excess of \$2.50.

Electronic Benefit Transfer

Electronic Benefit Transfer is the government-sponsored program to electronically distribute food stamp and certain means-tested cash benefits to eligible recipients. This program has been operational in California since July 2002. It is expected to be operational in all 58 counties by September 2004. Consequently, there is some good cost information available.

The on-going California EBT cost, as reflected in actual contractor billings, for providing cash benefits to a household is somewhere between \$1.90 and \$2.50 per month. This number reflects only EBT contractor costs and is based on certain allocation methodologies used to spread fixed costs between food stamp and cash programs. It does not include implementation costs that, for the purpose of this discussion, are considered sunk costs.

This seemingly wide range is a result of three factors:

- Size of each county's program and consequent scale efficiencies
- Use by each county's cash clients of unit price services such as ATM transactions and help desk calls
- The relative proportion of cash recipients to the total number of households being served

This cost is not directly comparable to processing a paper warrant for several reasons.

- Four no-charge cash withdrawal transactions per household per month are included in the cost. It turns out that on average, actual experience shows that households are using slightly less than two of these transactions each month at a total monthly cost of about \$.90.

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- Experience also shows that cash households are receiving on average 1.2 grants per month or the equivalent of 1.2 warrants per month. To make the EBT costs somewhat equivalent to a warrant cost, it is divided by 1.2.

After eliminating the cost of ATM withdrawals and scaling the 1.2 payments down to one, the cost of providing a single cash payment (comparable to issuing a warrant) to a household using EBT is between \$.83 and \$1.33 per month. This amount includes only contractor costs for maintenance and operations.

Certainly there are additional on-going costs, for example, the State EBT project team and EBT specialists in the counties. Unfortunately, these costs are not readily available but probably add another \$.50 to the total monthly amount. The implementation costs for the existing EBT program are treated as sunk in this analysis and consequently and not included in the quoted cost. However, adding some additional cash programs to EBT would probably have some incremental cost that must be considered. This might add in the neighborhood of \$.25 to the overall cost.

As a result of this use of actual data coupled with some gross estimation and a risk multiplier to account for unknowns, a safe estimate of the cost of using EBT for new cash programs (as a replacement for a warrant) is probably in the range of \$1.25 to \$3.00.

There are some additional cost considerations. A client receiving cash through EBT may either perform an electronic debit transaction to purchase goods (and potentially receive additional cash back) in a participating retail location or may perform a cash withdrawal transaction at an ATM or the customer service counter at a retail location that provides check cashing services. These transactions are not always without cost.

Many times, the client pays a service charge, above what the state is paying, to convert their EBT benefit to cash. At ATMs, surcharging is common and the client may pay from \$1.00 to \$3.00 and more for the transaction. Commercial check cashing locations usually charge a fee that is a percent of the amount withdrawn.

After converting their benefit to cash, EBT clients must then, generally, incur the cost of purchasing money orders using their EBT benefits to pay their bills. (Generally because many bills may be paid directly at the customer service counter in many large stores.) There is no equivalent, in EBT, to a client depositing a check in their checking account and then writing checks to pay their bills. (However, most California counties have a direct deposit option available to cash recipients that eliminates this as an issue.)

Experience in California has shown that for cash households:

- About 27% of cash benefits are redeemed at retail locations generally for no charge. Because it is not available, this does not include fees that may have been paid to commercial check cashing locations.
- Of all ATMs used by California cash households, about 25% do not surcharge. This 25% provides over 50% of all cash withdrawn at ATMs.

- About 23% of households receiving cash benefits pay no ATM fees.
- All fees and surcharges paid by cash households, divided by the total of all households that receive cash yields an average of close to \$2.20 per household per month.

Direct Deposit

Direct deposit is when a payment is transmitted electronically directly into a payee's bank account from the payer's account. It generally allows a deposit originated today to be deposited and available in the payee's account the next banking business day. This is the least expensive of the payment options with a typical charge for an ACH transaction being \$.25 or less. A direct deposit assumes that the payee has a bank account, something that is true for about 75% of Californians. For the sake of this discussion, it is assumed that the bank account is held by the recipient to meet their general banking needs and is not held specifically to accommodate direct deposit. Therefore, the cost of ownership related to the bank account is not considered as a cost for direct deposit.

The technology for direct deposit is well proven. Most federally chartered banks have the capability to originate and receive direct deposits on behalf of their customers, through the Automated Clearing House (ACH) system, using well-defined technology interfaces. This process is supported by very specific rules that govern processes flow, timing, technology, and transaction liability that make it very efficient and low risk. Commercial software is available to allow government entities to create for themselves the ACH transactions to implement direct deposit and subsequently transmit to their bank for origination in the ACH system.

In addition to the basic charge for an ACH transaction, direct deposit does have other costs; e.g. account setup and maintenance and for handling of exception transactions. It is the payer's responsibility to maintain data, such as name, address, and bank account information for each payee signed up for direct deposit. This is necessary to adequately complete the ACH transaction and to manage the payee relationship. (Of course, maintaining name and address data necessary to mail a warrant to the payee has the same cost implications.) Another set of expenses are those related to the marketing of direct deposit and generally trying to attract payees to convert from paper to direct deposit.

In the World Bank analysis cited above, it is estimated that Direct Deposit, when all of these processes are considered, costs in the range of \$1.25 per payment. This is the cost to government, as the payer. For this analysis, there are really no additional costs to the payee since their bank account is considered a sunk cost.

Direct deposit is also an effective method by which government may make payments to a vendor on behalf of a client. Subsidized housing, energy assistance, and childcare are good examples. The mechanism for transferring value is the same, using an overnight ACH transaction.

However, this type of process is more complex because of the need for remittance data. The payee needs to know for whom the payment is being made and for which invoice(s) or time periods. This remittance data providing supporting detail may be transmitted after the fact as a separate process, either as a paper document or in some electronic format. It may also be incorporated directly into

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the payment transaction using specific standardized Electronic Data Interchange (EDI) formats. Use of the later process requires that both the payer and the payee agree upon the format and have software capable of processing transactions using this format. This is more difficult to implement but once it is in place, it is a highly efficient mechanism for transferring value along with the supporting documentation. There are many off the shelf products that can be integrated into such a payment structure.

Bank Account

The electronic forms of value transfer all rely upon some sort of bank account into which to transfer the value and that provide the payee with access to the funds. A difficulty for Government when entering into an all-electronic payments environment is addressing those payees that do not have a bank account. Many variations of accounts have been proposed to meet these needs. Some are owned by the client and some are owned by private providers. Even EBT relies upon a pseudo bank account like structure, owned by government, to hold the recipients funds.

An ideal solution would be to have every government payee own a bank account at a private sector financial institution that affords all of the legal protections and rights available to ordinary consumers. However, there are really three issues surrounding such an ideal solution: Cost, creditworthiness, and want.

Addressing the last issue first, many un-banked households are un-banked because, as a GAO study discovered, they choose to be and not because of financial considerations. They may choose so because of trust issues, privacy issues, or they feel they have adequate access to financial systems without having a bank account.

Secondly, a condition for establishing a normal consumer bank account is often some degree of creditworthiness that prevents access by many un-banked to financial institutions. It may seem counter intuitive that you have to be credit worthy before a bank will hold your funds for you. However, consider a checking account wherein you are writing drafts against your account based solely upon your signature with no verification of the account balance and holding of funds pending the check clearing. In this case, the financial institution is granting a limited form of credit during the time it takes to clear the check.

The final issue is cost. Bank accounts do not come without some cost, although, for most consumers, the recurring account maintenance fee is hidden within the minimum balance requirements and low interest rates associated with the account. There are a wide range of account types and services that may be associated with a bank account and consequently, a wide range of pricing. However, basic monthly account maintenance fees start at about \$2.50 for a no-frills lifeline account aimed at the marginal low-end consumer. As verification, the United States Treasury in formulating its Electronic Transfer Account put a cap on the recurring costs of owning the account of no more than \$3.00. However, the Treasury is paying banks over \$12 for the initial account setup.

These low-end accounts may or may not:

- Offer check writing
- Offer ATM access
- Offer POS access
- Pay interest
- Have minimum balances

In addition to the recurring account maintenance charges, banks are increasingly adding many usage fees to services associated with the accounts. It is estimated that approximately one third of bank revenue comes from these service fees. One of the most onerous of these, especially for the less sophisticated account holder is the fee, often greater than \$25, for a bad check. Other fees of interest include ATM fees, POS debit fees, check writing fees, and teller transactions, the mention a few.

In summary, any electronic payment scheme that requires a client bank account has a number of costs that must be considered when evaluating the options. The amount of these fees is certainly variable according to the type of account and features selected.

Float

Another cost element to be considered is the interest that may be earned by government on funds it holds pending redemption by the payee. This will vary according to the payment option. For warrants it might average three to four days, with a small percentage never being cashed, while for a direct deposit payment, it is essentially zero days. In the EBT program, a daily average of about 9% of the total benefit issuance remains in the account. Additionally, about .35% of the total benefit issuance is eventually expunged and returned to government.

Interest earned on \$10 million in benefit issuance at 3% interest

Direct Deposit.....	\$0
Warrants.....	\$3,287
EBT.....	\$2,219

Policy Issues

When looking at warrants and the other available options, the State, because of its public sector presence and the often economically disadvantaged nature of the constituency, has to be aware of cost shifting as opposed to overall cost reduction and to understand the policy ramifications of the choices. For example, going to direct deposit for certain government transfers may be less expensive for government, but if the target client is un-banked, then there is a cost of probably more than \$4.00 per month for that client to open a bank account so they can receive the direct deposit. This is not cost efficient, ignoring the problem of credit worthiness often required as a prerequisite for a bank account. Often the true ownership of a checking account is much higher for financially less sophisticated account holders. Banks have long lists of fees, in addition to the basic monthly charge for the account (\$25 and upwards for a bad check is a good example.)

Attachment C

The preceding discussion of client costs is only to illustrate that care must be exercised when attempting to compare the total cost of one type of payment against another. Certainly, an EBT cash household or an un-banked household receiving a warrant has a different cost structure for converting the benefit to cash and for bill paying than does one that is depositing a payment directly into their bank account. However, remember that owning a bank account into which to deposit the benefit is not without its own costs. This will be discussed later. This comes back to the message of knowing your customer and their capabilities.

Instrument	Description	Comments	Attachment C
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Warrant	Payer creates paper check usually mailed to payee.	<ol style="list-style-type: none"> 1. Burden is on payee as to how to convert warrant into cash or other tender that can be used in commercial transactions. Generally, warrant is deposited in payee owned bank account and checks are written. However, for un-banked, while there are free options for check cashing, fees are often involved. Further, money orders are often purchased to pay bills. 2. Security involves payee signature. Medium is vulnerable to theft especially during mailing. Further, for payees choosing not to deposit into bank account, entire amount is converted into cash at once, creating a greater security hazard. 3. Costs are generally higher than with other value transfer options. 4. Commonly used for direct government to citizen transfers, provider payments, third party payments, and citizen to government payments (i.e. child support remittance). These later three often require manual collection and encoding of the remittance data associated with the transfer an expensive process. 5. Very little customer service is provided 	
Direct Deposit	Payer electronically transmits (using ACH) credit to payee bank account	<ol style="list-style-type: none"> 1. Generally the lowest cost value transfer option. 2. Requires payee to have an account with a financial institution capable of accepting ACH credits. Varying forms of accounts are available and are described below. Each has its own cost sharing characteristics. 3. Transfer, since it is electronic between banks is fairly secure. Audit and problem investigation are well supported by electronic foot prints of all debit and credit transactions and specific rules are in place for error correction and financial liability. 4. Requires payee agreeing to accept direct deposit as their payment option and providing (and keeping current) the necessary data including address, SSN, bank account number along with the routing and transit number. 5. Can be used for vendor payments as well as citizen to government payments (i.e. child support remittance). For this purpose it is often coupled with electronic data interchange (EDI) technology to carry remittance data (who is the payee, what invoice is being paid, etc.) 	
Checking and Savings account	Main stream bank account owned by the payee into which a warrant may be deposited or direct deposit transmitted.	<ol style="list-style-type: none"> 1. Competitive commercial account at a financial institution. 2. Selected and paid for by the payee based on needed banking services and costs. Features such as Checking; savings, interesting bearing, fee schedules, direct 	

Instrument	Description	Comments	Attachment C
		<p>deposit, electronic bill paying, debit card access, credit card availability, overdraft protection are a few of the options to be considered.</p> <ol style="list-style-type: none"> 3. These accounts generally require a minimum level of credit worthiness and consequently are not available to everyone. 4. The full range of banking law covers these types of accounts including Reg. E and FDIC. 	
Minimum function Check account	Minimum function bank account owned by payee with emphasis on low cost. Typically designed to meet needs of financially disadvantaged or un-banked. Compatible with direct deposit.	<ol style="list-style-type: none"> 1. A Minimum level of credit worthiness is generally required. 2. Usually require direct deposit as a pre-requisite. 3. Account is selected by the client based on perceived needs which may or may not include checking, debit cards, credit cards, etc. 4. Generally there are no minimum balances 5. Generally have same protection as do other bank customers (i.e. Reg. E and FDIC) 	
Electronic Transfer Account (ETA)	Bank account owned by payee but with minimum function prescribed by US treasury. Offered by many Federal Banks as a means to receive Federal benefits.	<ol style="list-style-type: none"> 1. Recipient selects his/her financial institution from list provided by Treasury. (these Fis have an ETA Financial Agency Agreement with Department of Treasury) 2. Treasury pays \$12.26 to have these accounts set up for recipient 3. Maximum monthly charge to recipient is \$3.00 4. Recipient gets 4 withdrawals and 4 balance inquiries at no additional cost 5. Probably non-interest bearing (at banks discretion) 6. No minimum balance required 7. Provides monthly statement and same consumer protections afforded other account holders 8. Access to funds is through debit card (no check writing capabilities) 9. Can non-government funds also be deposited in account? 10. Does not require test for credit worthiness 	
Pre-paid account or payroll card	An account opened by the payer on behalf of the payee into which recurring deposits are electronically deposited. Payee is given access through an electronic debit card. VISA and MasterCard along with several banks offer variation, all designed to	<ol style="list-style-type: none"> 1. Financial institution is selected by the payer; cards are issued to payees 2. Deposits are all electronic 3. Account is non-interest bearing 4. There may or may not be transaction fees 5. All account access is via debit transaction (no checks or credit cards) 6. Generally do not require test for credit worthiness 7. Level of customer service is at discretion of financial institution 	

Instrument	Description	Comments
	meet needs of financially disadvantaged or un-banked.	<ol style="list-style-type: none"> 8. Can other amounts be deposited to account? 9. Unclear as to law and regulation that applies 10. Can there be more than one cardholder on an account? 11. Do funds expunge from these accounts?
Electronic Benefit Transfer Account (EBT)	An electronic account sponsored and owned by government into which certain government benefits are deposited. Payee uses government issued debit card to access benefits at commercial locations. Excluded from requirements of Reg. E when applied to needs-tested benefits.	<ol style="list-style-type: none"> 1. Cards issued, accounts managed, redemptions approved, and funds settled by an entity contracted by government to provide service. This allows government some flexibility in determining overall content and flexibility of program. 2. Funds are held by government until actually redeemed 3. Access to benefits is all electronic using debit cards at a network of ATM and retail locations 4. Government pays costs of accounts and client's access to benefits (with exception of ATM surcharges and costs associated with more than 4 cash withdrawal transactions) 5. High level of customer service (multiple languages, 24 hour service, performance standards) with terms dictated by government. 6. Exempted from Reg. E as long as benefits meet needs-tested standard. 7. Client liabilities are broader than with commercial accounts and subject to program policy and rules.
PayPal	This is a brand name for a payment process, used widely in the on-line auction business that supports world wide exchange of value between parties. It relies upon e-mail and the internet as requirements for its business processes. A payer can use a credit or debit card or a check to put funds into a Paypal held account. The intended payee is notified via e-mail that funds are available, and can access these funds through the Paypal web site and have the funds electronically transferred to a bank account or have a check sent.	<ol style="list-style-type: none"> 1. PayPal holds the funds 2. Non interest bearing to recipient 3. Limited customer service 4. Recipient pays fees 5. Only options are to have funds transferred to your bank account or receive a check. It is burden of recipient to get value converted to cash or other negotiable form. 6. Unclear as to what law and regulation is applicable

Farmworkers' Access to Workers' Compensation Payments

A. Current Problems

The current system of paying workers' compensation benefits by paper check poses practical and financial problems for farmworkers. Banks are not located in many low-income neighborhoods. Even where there is a local bank, low-income families often cannot afford the minimum balance or the fees required to maintain an account with the bank, and banks often refuse to cash checks for noncustomers. Only some banks whose name appears on the check will cash the check without deducting a fee.

As a result, injured farmworkers and their families often rely on check-cashing businesses, which are allowed to charge up to 3.5% of face value for cashing payroll checks and up to 15% of face value for cashing personal checks. Civil Code § 1789.35. According to staff of California Rural Legal Assistance, Inc. (CRLA, which serves farmworkers and other low-income rural clients), there are many "pay day" and "cash advance" services in low-income neighborhoods, as well as jewelry stores ("joyerias") that will cash checks if the customer purchases jewelry.

B. Electronic Benefit Transfer Cards

To address problems in cashing checks, it has been suggested that electronic benefit transfer (EBT) cards be issued to allow injured farmworkers to use automated teller machines (ATMs) to withdrawal cash from an account or accounts that hold workers' indemnity payments. In addition, electronic depositing could result in substantial savings for employers and insurers, compared to the traditional method of paying by check.

All states now issue EBT cards in lieu of paper food stamps. This is required by federal welfare law. See Personal Responsibility and Work Opportunity Reconciliation Act of 1996, codified at 7 U.S.C. § 2061(I). In California, no fees are charged when an EBT card is used to buy food. Most counties in California have also opted to offer EBT cards to pay cash-assistance benefits (i.e., CalWORKs, General Assistance, and General Relief). A transaction fee is deducted if the recipient makes more than four cash-only withdrawals in a one-month period, and some ATMs also deduct a surcharge whenever an EBT card is used to obtain cash. See California Electronic Benefits Transfer Act of 1997, codified at Welf. & Inst. Code §§ 10065 et seq.

C. Legal and Practical Issues

Before instituting an EBT card system for workers' compensation payments in California, however, further information needs to be gathered and evaluated concerning the legal requirements governing these payments, as well as practical issues for farmworkers.

In paying indemnity benefits, employers and insurers must either: pay with a written instrument (e.g., a check) that does not require deduction of fees when cashed; or obtain prior

Attachment D

consent from the injured worker to electronically deposit the benefits into a bank account.¹² If the EBT system currently used in California for food stamps and governmental cash-assistance benefits were used as a model for paying workers' compensation benefits through electronic deposit, some changes would need to be made -- to ensure that injured workers can use EBT cards to withdraw cash without paying fees, and to ensure that the worker consents to participate in an EBT system.

Further investigation would also be required to ensure that EBT cards can be used conveniently throughout California in neighborhoods where farmworkers live or work. This would require coordination with the state's EBT project and with organizations that provide services to farmworkers.

According to CRLA staff, past problems with EBT cards have included: late deposits; machine failures; inability to withdraw the full amount unless it is in multiples of \$20.00; and limited numbers of local ATMs accepting EBT cards. These types of problems should also be addressed in the process of designing and implementing an EBT system for workers' compensation payments.

¹²Labor Code section 4651(a) requires that workers' compensation indemnity payments paid by written instrument be "immediately negotiable and payable in cash, on demand, without discount at some established place of business in the state." Employers may deposit indemnity payments "in an account in any bank, savings and loan association or credit union of the employee's choice in this state, provided the employee has voluntarily authorized the deposit," or may electronically deposit indemnity payments if "the employee has previously authorized to receive electronic deposits of payroll, unless the employee has requested, in writing, that disability indemnity benefits not be electronically deposited in the account."

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