

Prepaid Debit Cards in the Government Benefit Sector

Finding Ways to Simplify the Confusion



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Introduction

Governments around the globe are finding ways to use prepaid debit cards to reduce their check processing costs. The Economist recently reported that in early 2009 the Pakistan government faced a challenge distributing aid to refugees in their Northwest Frontier and handed out, in one week alone, 230,000 cards to displaced families.

Visa reports that the governments of the Philippines, Brazil, Costa Rica and the Dominican Republic are supplying cards to over 800,000 families for aid subsidies. MasterCard is working with governments in Poland and Peru. In the United States, more than 38 states are currently distributing, or planning on distributing, prepaid benefits cards.

According to recent report to the congress on ‘Government Administered, General-Use Prepaid Cards’, in 2010 90 federal, state and local programs in 36 states issued 20 million cards representing transactions worth \$34.8 billion. Several studies have predicted the prepaid cards growth to be more than 20% and government cards will be a significant part of the pie.

The cost saving opportunities found in the use of prepaid debit cards make them very attractive for government use. For instance, by implementing transit cards many government entities charged with managing mass transit systems have been able to reduce their overhead significantly. However, government use of prepaid cards is not without its challenges.

In many places, the switch from checks to prepaid debit cards has been met with skepticism, resistance and mistrust from the people being asked to accept this form of payment. Much of the push back has come from a public that doesn’t understand the difference between a credit and a debit card. There are complaints of excessive fees that spring from a lack of information and possibly too many restrictions placed on the cards. However, control of the programs and better education may be solutions to ease those complaints.

In our white paper *Meeting the Challenges of Today’s Prepaid Market* we looked at some of the challenges and opportunities in the general prepaid market segments. In this white paper we will focus on the opportunities and challenges faced in the government prepaid sector.

Distributing Benefits -- a Quick Background

Until the introduction of prepaid debit cards, government agencies had three ways to disperse benefit funds: issue vouchers redeemable at select locations, cut a check, or make a direct deposit into a recipient’s account. Although distributing checks is one of the easiest ways to issue payments, this works best for one-time payments only.

Direct Deposit

For recurring reimbursements, it makes sense to find less expensive ways to render payment. The less costly alternative in many cases is transferring money from a government account into the payee’s account via direct deposit. With the proper support

systems, this method is a lot less costly than processing and mailing a check. This method also reduces the risks associated with lost checks and fraud.

Unfortunately, direct deposit faces some challenges that have prevented universal acceptance of this payment method. The first is the fear of change; many people like checks since they can hold them in their hands and they are assured the money has been sent to them. In addition, there are many people who are reluctant to allow any type of access to their bank accounts. Their concerns include the fear of the government monitoring their accounts, or the fear that the government will take money out of their accounts.

Another challenge government agencies face with direct deposit is that it loses control over how the recipient spends the money. This is particularly important to agencies that oversee food stamp programs. With food stamps, government agencies want to insure that the funds are spent on food items only at a grocery store.

The “Under Banked” Underserved Segment of Society

One of the largest challenges in financial services today, especially in underdeveloped countries, is that many people receiving government-issued checks simply do not have bank accounts. This group has come to be known as the “unbanked” or “under banked”. For these people, the cost of having a checking account is prohibitive and they don’t have enough funds to maintain a savings account.

In a recent study, the U.S. Federal Reserve estimates that there are 20 million under banked households in the U.S. today. And of that 20 million, 25% are low-income U.S. households with no checking or saving account. This lack of bank account access costs these households 2-3% of their annual income in fees paid to third parties to cash checks and handle other financial transactions and money exchanges including paying their bills.

Enter Debit Cards

Over the years the technology to support credit cards has advanced greatly to support the variety of programs that card issuers have created. Debit cards are one example of leveraging the new technology in a slightly different way.

In the simplest terms, with a credit card charges are put on to an account for payment at a later date. In the case of a debit card, charges are withdrawn from an account for payment immediately. In essence, when someone receives a debit card from a government agency, that agency has established a bank account for that person so that they may withdraw those funds. The money is not “on the card”, the money is in an account somewhere held in trust for the cardholder.

Prepaid Debit Card Segments

The acceptance of prepaid debit cards has grown into a very large industry with many variations and uses. The chart below will help the reader get an idea of how prepaid debit cards are being used in a variety of transactional situations.

Prepaid Card Segments

Employer to Employee	Government to Consumer	Consumer to Business	Business to Consumer
Payroll	Social Security	Gift	Rebates
Benefits	Food Stamps	Reloadable Store	Insurance
HSA/FSA	Unemployment	Teen	Store Refunds
Travel	Transit	Travel	Rewards
Fleet	Disaster Relief	Phone	Loyalty
Incentives	Medicare/Medicaid	Fuel	
	Prison		
	Federal Student Aid		

Many government agencies are leveraging prepaid debit cards to conduct transactions as shown in the first two columns. As an employer, government agencies can and should be looking at ways to implement the cost saving programs associated with moving payroll, benefits, etc., to prepaid debit cards. Since those are more general in nature and apply to any employer we will not be discussing them in this paper. Our focus instead will be on those uses that could be classified as benefits (i.e., social security funds, food stamps, transit, etc.).

Understanding Prepaid Debit Card Types

To better understand how prepaid cards operate it is necessary to understand how the different types of prepaid card work. Each of the descriptions below represents choices that need to be made when setting up a prepaid debit program. The choices can be leveraged in tandem; meaning a card can share multiple types to create a card program to fit the situation.

PREPAID DEBIT CARD TYPES	
Closed vs. Open Loop	Closed-loop cards are single payee cards. They can be used only at a specific location or at the locations of a given payee — most gift cards fall into this category. Open-loop or open "branded" cards are general-use prepaid cards, normally branded with a card scheme logo such as MasterCard or Visa, which can be used like credit or debit cards at most POS terminals. However, open-loop cards can be restricted and become more closed at the behest of the issuer — by restricting the type of merchant that the card may be used at either by business category or by store brand. Such restricted cards are of use to service providers such as healthcare providers and insurers that may want to use the cards to facilitate payout of funds, while ensuring that those funds are spent in the appropriate manner at an appropriate location.
Reloadable vs. Non-Reloadable	Typical gift card programs tend to be single-load (or non reloadable) cards — once the money is depleted, the card is no longer usable or reloadable. Reloadable cards may have new funds added at a physical POS terminal or

	via the Internet or phone. One example of a successful reloadable prepaid card is the Starbucks card.
Single vs. Multi-Application	This is where the prepaid functionality becomes part of a multi-application card. For instance, the Starbucks Duetto card is a fully functioning Visa-branded credit card, as well as a prepaid card. Cardholders can use it as a Visa credit card anywhere that Visa is accepted, or as a reloadable Starbucks prepaid card at most Starbucks locations.
Multi-Payment	This is where the underlying prepaid account is supported by more than the prepaid card. For instance, with Obopay in the U.S., and with Smart Communications in the Philippines, the underlying prepaid account can be accessed by a mobile-phone payment system, and is also a MasterCard-branded prepaid card.
Card Not Present	Some prepaid cards can be used only in a card-present environment, while others support card-not-present (CNP) purchases - but usually they have restrictions, especially for open-loop prepaid. For instance, the Italian post office's Postepay card can be used to make purchases at web sites that accept Visa cards, provided those web sites support online authorization.

If we examine a typical card issued for unemployment insurance payments we would find that it would normally have the following types associated with it: Open Loop “Branded”, Reloadable, Multi-Application, Card Not Present. Using the hierarchy above a transit card would might be issued in some cases as a Closed Loop, Non-Reloadable, Single Application format or in others as an Closed Loop, Reloadable, Multi-Application format.

So in essence, the desired end usage dictates the card type; therefore, a person may need to obtain more than one type of government-issued prepaid card. For example, the transit card can only be used on a transit system or in some cases in business at the transit terminal, but not at a grocery store. And the food stamps card can only be used to buy groceries and not for a ride on mass transit. However, the number of cards a recipient receives increases the opportunity for user confusion and higher costs for both the government agency and the recipient, as described below.

The Cost Factor

Before we continue, let's look at why government agencies want to get out of the check writing business. The primary reason for switching from checks to cards is the potential to reduce process and mailing expenses. The Nebraska State Treasurer estimated it cost the state 1 cent to put money on an existing card and 60 cents to send a check. Secondary reasons for switching from checks to cards include the ability to speed the time between issuing and receipt with an opportunity to reduce loss and fraud.

In 2008, the state of Pennsylvania expected to save \$2 million annually by reducing mailing and check processing costs. New Mexico expected to save \$1.5 million and Kansas a more modest \$300,000. But in some cases these savings are actually shifting

the cost burden from the government agency to the recipients. This cost shifting has come under criticism from a number of consumer advocacy groups and will most likely increase as more government agencies switch to using prepaid debit cards to pay benefits.

Shifting the Costs

Many of today's government run prepaid debit card programs come with the standard bankcard type fees, such as withdrawal fees, ATM fees, balance inquiry fees, and customer service fees. Even when the government agency works with the issuing banks to limit those fees and provides a number of free transactions each month, users still don't fully understand the differences between a government-issued prepaid debit card and a personal credit card.

Even though banks and some retailers like Wal-Mart are waiving fees at their outlets, recipients are upset with any charges being applied to transactions related to the usage of these cards. Keep in mind that the "under banked" don't have regular bank accounts as they feel they can't afford them; however, this means when they receive their checks, they must pay fees to get those checks cashed. It is interesting to note that even though check cashing fees are accepted by the recipients there is still resistance to paying fees on government-issued prepaid debit cards. This is true even if the transaction fees for withdrawing the whole amount are less than the cost of cashing a check.

The fee complaint arises when recipients elect to use the card in place of cash and they exceed the number of free transactions during the month causing them to lose money from their accounts as banks collect fees on these additional transactions. Paying a one-time check cashing fee may have been uncomfortable; paying transaction fees becomes painful.

Many government agencies have embarked on new or enhanced educational programs to better teach recipients the proper usage of the cards but further study is needed and new ideas will need to be implemented before user acceptance increases.

The Problem of Receiving Benefits from Multiple Agencies

As discussed earlier, there are situations where the recipient has only one government-issued prepaid debit card. Consider for a moment the person receiving multiple benefits, such as unemployment benefits, food stamps and Medicare. Toss on top of that the recipient experiencing a disaster (such as a flood) and they receive disaster assistance on yet another card. This individual could now have four or more government-issued debit cards from four different local, state and/or federal agencies.

For all practical purposes the government has created four or more separate "bank" accounts for the individual. Yes, each government agency is saving money by using cards instead of checks, but the recipient now has to keep track of four or more accounts and may have four times the fees to pay. Keep in mind that this person may have never had a bank account before.

The One Card Approach

In some countries their governments are addressing this multi-card problem with a one card approach. In a recent article on the growth of prepaid it was reported that the government of Scotland is working to move benefit recipients to a single card. This means each government agency in Scotland deposits funds into just one prepaid card account per person.

Scotland's National Entitlement Card Program has reportedly signed up over 1/3 of their residents for this program. Although they should be congratulated on their success in the integration of payments by government agencies on to one card, we should remind the reader that the population of Scotland is slightly less than the population of Wisconsin at 5.6 million residents.

Building a similar program in the U.S. with a population in excess of 306 million and countless local, state and federal agencies paying benefits would be a much larger undertaking. It would require the cooperation of all of the local, state and federal agencies along with the cooperation of many different national, regional and local banks.

This does not mean that it can't be done on a large scale; India with a population in excess of 1.2 billion people is taking a similar approach to the one in Scotland. They are however going one step further with what has been dubbed the largest IT project in the world and are creating a multipurpose National ID card program. In India today they have multiple ID cards issued by various local authorities that are very difficult to manage. By combining a National ID card with a benefit payment program they hope to achieve a streamlined system that eliminates waste and fraud in the current system. At the same time streamlines the ease of obtaining any necessary benefits as their citizens relocate from one region of the country to another.

Is One Card is the Answer for the U.S.?

In the U.S. many people have put a lot of time into making debit cards work locally. There have even been attempts to institute a National ID card program in place of the Social Security cards which along with Passports and local driver's licenses serve as the current default National ID cards. However, the idea has met with much resistance in the states and has unfortunately become a very divisive political issue.

Yet, there may be a way to solve the "problem" but first we must make sure we understand what problem we are trying to solve. So let's take a minute and restate the problems government agencies and benefit recipients face.

The Problems

From a government agency perspective the problems are:

- To reduce the costs associated with processing and mailing checks
- To distribute funds in a secure and timely manner to benefit recipients

Government solutions to date include:

- Direct deposit into the recipient's bank account

- Give recipients a prepaid debit card into which the agency can deposit funds

Recipient problems:

- If they don't have a bank account the government agencies end up creating a de facto bank account with a debit card.
- The more agencies the recipient deals with the more cards they get.
- People who felt they couldn't afford a bank account can now end up with multiple accounts and find themselves incurring higher costs in terms of card usage fees that can in some instances exceed what they experienced with check cashing fees

The Solutions

If the National ID card is a non-starter in the U.S. due to political reasons it doesn't mean we can't get to a private single benefit solution. We just need to look at the problems we have defined from a different perspective.

For recurring benefits a recipient is always asked if they would like direct deposit. When they refuse direct deposit for whatever reason, they normally get a check or when a check is not an option a prepaid card is issued in their name by the government agency.

Many banks have worked with government agencies to create the necessary programs to support government-issued prepaid cards, but the relationship is between the bank and the government agency. If we shift the relationship to becoming one supported by the government but between the recipient and the bank we may have a new way of looking at this. In this model the government is helping the recipient obtain a debit card good only for deposits from government agencies.

To get there, the government needs build on the program they have crafted today and to encourage the associations to partner with local, regional and national banks to offer a low cost prepaid debit "benefit" cards as an option. Benefit recipients applying for aid without any banking affiliation could select the local participating bank at the time they sign up for benefits. If sometime in the future they qualify for additional benefits, they would then have their own benefit account which funds from other agencies could be deposited.

All of the elements for this type of national program are in place today in the existing offerings. The various plans in place today would need to be examined to make sure they fit the new guidelines and an agreement on the standardization of terms would have to be established. Some of the standard terms could include:

- Cards would be branded by an association (i.e., Visa or MasterCard)
 - The cards could then be accepted everywhere those association cards are accepted
- Easy to establish the account with the bank
 - No credit check required
- Only funds from government agencies may be deposited

- This account is for government agency payment only (even the IRS could deposit tax refund money here)
- Each government agency could cover the cost of two withdrawals a month
 - Payable to the bank when monies are deposited
 - Tracked like “free minutes” in cell phone plans
- No overdraft may be incurred
 - Charges up to the balance only may be incurred
- Monthly statement of transactions will be provided on-line
 - Printed and mailed statements will be available for a nominal fee to cover the cost of production and mailing
- Lost and stolen cards would be treated in the normal fashion

Not All Systems Are Up to the Challenge

As we have spoken with many prepaid debit card providers around the country we have learned that their systems may not be robust enough to handle a variety of new and different programs. As these suppliers have gotten into the prepaid space many companies have taken short cuts that are now preventing them from expanding their offerings with new robust programs.

Some of the problems they report encountering include:

- Systems built on old mainframe technologies that are costly to reprogram and support.
- Systems may have been designed to support what is now just a small segment of the market and they lack the ability to add new programs to support other new more profitable segments
- Systems may not have a complex enough customer/account hierarchy to support all of the relationships that may need to be tracked

At CoreCard we believe we have a better and less costly solution to handling government prepaid debit cards. Our solutions built on CoreENGINE and leveraging our CoreISSUE product, providing a solution that can be deployed on less costly hardware, with flexible parameters, supporting a robust customer hierarchy in a modular, real-time credit/debit card account management and transaction processing system.

CoreENGINE

CoreENGINE is a network-centric, highly flexible, real-time software platform designed to solve the problems inherent in financial service applications. While CoreENGINE itself is not an application in the typical sense of the word, it meets most of the needs of a financial service or billing application with powerful, pre-built components.

Typical financial service applications have been built to address specific processes or functions. The result is that organizations often have separate systems for new accounts,

authorizations, case management and other elements of financial transaction management. Not only does this approach create the difficulty of having to modify several separate applications should a change be required, it also makes it time-consuming to develop new applications that meet new and evolving business processes. This is why, over the last couple of decades; organizations have continually tweaked and tinkered with existing code, attempting to update applications instead of creating new applications.

CoreCard recognized that this never-ending cycle required a different approach to the development of financial service applications. Instead of going in for a “quick fix” that would only create future problems, CoreCard took a step back from the mindset that financial applications must be developed for specific purposes. Instead, CoreCard asked a fundamental question that is at the heart of why CoreENGINE is so different from existing technology platforms: *What is common across all these applications?*

This simple question allowed CoreCard to view application development with a fresh perspective. All financial service applications boil down to three basic elements:

- Accounts
- Transactions that are posted to those accounts
- Rules by which those transactions are processed

Accounts, transactions, and rules: the basic elements and building blocks for any financial service application. The key difference from one application to another is how the data is defined: what type of account, what type of transactions, and what type of rules.

While most component-based programming techniques focus on defining the methods and inheriting those methods across the development environment, CoreENGINE gets to the heart of the matter. The methods for applications don’t vary much over time, what changes is the data. The challenge then was to build a platform that would allow the implementation of what’s common across all financial applications in a common way, while also allowing what’s different to be implemented in a way that was unique and appropriate for that particular application.

CoreISSUE

CoreISSUE is a comprehensive, highly modular, real-time credit/debit card account management and transaction processing system designed to eliminate the high costs and complexities associated with the administration, processing and management of credit/debit card accounts. Developed using the company’s **patent-pending** CoreENGINE™ software platform, the system provides advanced features that enable them to cost effectively develop and provide innovative credit/debit card plans that retain existing customers and facilitate the acquisition of new ones.

Previously, the lack of viable technology alternatives forced card issuers to either continue using their monolithic mainframe systems, or outsource the function completely. Mainframe systems are inherently rigid and require manual changes to be made to the source code for even the smallest of customizations. These systems were not built for

change and issuers using these types of systems are unable to affordably or easily provide card products that meet their end-customers' needs.

With outsourcing, issuers incur a relatively small monthly expense but have to contend with long-term contracts, costly termination fees and very little product differentiation. All of which hinder an issuer's ability to make strategic decisions that could promote loyalty, and increase customer retention and acquisition.

CoreCard offers issuers a third alternative and the opportunity to realize additional revenues from their card portfolios at a lower cost. The CoreISSUE credit card account management and transaction processing system combines the flexibility, extensibility and rich features of web applications with the robustness, fault-tolerance and performance associated with mainframe systems to deliver next-generation functionality.

Summary

Society is changing rapidly and the way we exchange money for good and services is undergoing rapid change also. We may not be too far away from the time when we become a cashless society -- the transition is taking place now with more consumers and retailers adapting cutting edge mobile payment solutions. In the midst of all this, government agencies and the people they serve are facing the reality that in some way every family they assist is going to need some type of financial account to help them manage their day to day finances.

One solution is for government agencies to distribute benefits via prepaid debit cards. Government agencies are rarely the adapters of more cutting edge practices; instead they tend to wait for solutions to mature. In the case of using prepaid debit card technology by government agencies this falls safely in the model of a late adaptation of a popular technology. In this paper, we have examined the downside of issuing multiple cards to a family; and we've discussed the added costs associated with multiple accounts needed to receive multiple benefits.

While we prefer not to advocate more government intervention to solve this problem, we believe that financial institutions of all kinds have an opportunity to develop and offer the under banked, along with the government agencies that serve them, a low cost alternative to normal bank accounts. To do so, financial institutions will need low cost, robust, forward thinking software solutions to manage these accounts. And government agencies will need to rethink how they can encourage families to obtain a low cost debit account for receipt of their funds.

Together, government agencies, working with the private sector, can serve the public's benefits needs, save tax dollars, and increase operational efficiencies and controls with the right credit/debit card account management and transaction processing system.

About CoreCard Products

CoreISSUE

CoreISSUE[®] is CoreCard's browser-based solution for managing credit accounts and transaction processing for the card issuing (including prepaid cards) side of the credit business. CoreISSUE provides intuitive information organization, easy navigation, and the ultimate flexibility in cardholder management. CoreISSUE provides cardholder management in a client-server environment, creating working screens that have a familiar look and feel to users accustomed to accessing the Internet.

CoreCOLLECT

CoreCOLLECT[®] is CoreCard's browser-based solution for managing and working delinquent credit accounts. CoreCOLLECT is a rules-driven collections system that offers customizable workflows to handle and route accounts that are delinquent to the appropriate personnel within an internal or external collections department. CoreCOLLECT's case management capabilities and workflows automatically monitor the payment schedules. CoreCOLLECT enables collectors to set an individual Promise to Pay, or a series of recurring PTPs, on an account.

CoreACQUIRE

CoreACQUIRE[®] is CoreCard's merchant processing application, supporting authorization processing from an acquirer's perspective. CoreACQUIRE provides the ability to receive authorization requests from a network switch (or gateway) and routes authorization requests back to a switch (or gateway). The application also provides the ability to verify the merchant as part of an authorization request, to identify and process an authorization request for a merchant, cardholder, or for merchants and cardholders.

CoreDASHBOARD

CoreDASHBOARD[®] offers Operations staff members the ability to monitor and control all the servers where CoreCard applications such as CoreISSUE are running. Dashboard can be used to monitor individual computers and groups of computers, establish alarms that are generated if certain conditions arise in a single computer or a group of computers, send notifications via email when certain conditions and alarms are generated, run live queries against the database, and more.

CoreSALES

CoreSALES[®] is CoreCard's application for acquirers and issuers who want to pay commissions to sales agents. Interface output transactions and files are received from CoreISSUE, CoreACQUIRE and CoreCOLLECT for posting to CoreSALES. Activity from sales agents, sales managers, and related account activity is tracked, settled and reported accordingly. Commissions are settled at both the sales representative and sales manager level based on many types of activity, such as cardholder and merchant monetary activity. A commission notification (much like a cardholder statement) is available on the Internet.

About CoreCard Software, Inc.

CoreCard Software, Inc. licenses transaction processing and account management software and offers boutique processing services as well. CoreCard's solutions provide easy to use parameter-driven controls, real-time transaction processing, built-in fault-tolerance, and a fully scalable architecture. CoreCard's software provides the market's most feature-rich platform for processing and managing accounts receivables and a full range of card products including prepaid/stored-value, fleet, credit, debit, commercial, government, healthcare and private-label cards.

CoreCard's server-based architecture provides the speed, flexibility and control to effectively manage electronic and card-based payment products. CoreCard's software is ideally suited for program managers to create and manage card programs, merchant acquiring and authorization.

As a custom processor, CoreCard processes card programs with a built-in option for the customer to license the software and become its own processor in the future.

Headquartered in Norcross, GA, CoreCard is a subsidiary of [Intelligent Systems Corporation](#) [NYSE Alternext: INS].

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