

# Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## DEPARTMENT OF AGRICULTURE

### Food and Nutrition Service

#### 7 CFR Part 274

[Amendment No. 345]

RIN 0584-AC44

#### Food Stamp Program, Regulatory Review: Electronic Benefit Transfer (EBT) Provisions of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996

**AGENCY:** Food and Nutrition Service, USDA.

**ACTION:** Proposed rule.

**SUMMARY:** On August 22, 1996, the President signed the Personal Responsibility and Work Opportunity Reconciliation Act of 1996. This rule proposes to implement the Electronic Benefit Transfer provisions found in Section 825 of this law which affect the Food Stamp Program. These provisions are meant to encourage implementation of Electronic Benefit Transfer systems to replace food stamp coupons.

**DATES:** Comments on this rulemaking must be received on or before July 26, 1999 to be assured of consideration.

**ADDRESSES:** Comments should be submitted to Jeffrey N. Cohen, Chief, Electronic Benefit Transfer Branch, Benefit Redemption Division, Food and Nutrition Service, USDA, 3101 Park Center Drive, Alexandria, Virginia, 22302. Comments may also be datafaxed to the attention of Mr. Cohen at (703) 305-0232. All written comments will be open for public inspection at the office of the Food and Nutrition Service during regular business hours (8:30 a.m. to 5 p.m., Monday through Friday) at 3101 Park Center Drive, Alexandria, Virginia, Room 718.

**FOR FURTHER INFORMATION CONTACT:** Questions regarding this rulemaking should be addressed to Mr. Cohen at (703) 305-2517.

#### SUPPLEMENTARY INFORMATION:

##### Executive Order 12866

This rule has been determined to be significant and was reviewed by the Office of Management and Budget under Executive Order 12866.

##### Executive Order 12372

The Food Stamp Program is listed in the Catalog of Federal Domestic Assistance under No. 10.551. For the reasons set forth in the final rule in 7 CFR 3015, Subpart V and related Notice (48 FR 29115), this Program is excluded from the scope of Executive Order 12372 which requires intergovernmental consultation with State and local officials.

##### Regulatory Flexibility Act

This rule has been reviewed with regard to the requirements of the Regulatory Flexibility Act of 1980 (5 U.S.C. 601-612). Shirley R. Watkins, the Under Secretary for Food, Nutrition, and Consumer Services, has certified that this proposed rule will not have a significant economic impact on a substantial number of small entities. State and local welfare agencies will be the most affected to the extent that they administer the Food Stamp Program.

##### Paperwork Reduction Act

This rule does not contain additional reporting or recordkeeping requirements other than those that have been previously approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 and assigned OMB control numbers 0584-0083 and 0505-0008.

##### Executive Order 12988

This rule has been reviewed under Executive Order 12988, Civil Justice Reform. This rule is intended to have preemptive effect with respect to any State or local laws, regulations or policies which conflict with its provisions or which would otherwise impede its full implementation. This rule is not intended to have retroactive effect unless so specified in the "Effective Date" paragraph of this preamble. Prior to any judicial challenge to the provisions of this rule or the application of its provisions, all applicable administrative procedures must be exhausted. In the Food Stamp Program the administrative procedures are as follows: (1) for Program benefit recipients—State administrative

procedures issued pursuant to 7 U.S.C. 2020(e)(1) and 7 CFR 273.15; (2) for State agencies—administrative procedures issued pursuant to 7 U.S.C. 2023 set out at 7 CFR 276.7 (for rules related to non-quality control (QC) liabilities) or Part 283 (for rules related to QC liabilities); (3) for Program retailers and wholesalers—administrative procedures issued pursuant to 7 U.S.C. 2023 set out at 7 CFR 278.8.

##### Public Law 104-4

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA), Pub. L. 104-4, establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments and the private sector. Under section 202 of the UMRA, the Food and Nutrition Service generally must prepare a written statement, including a cost-benefit analysis, for proposed and final rules with "Federal mandates" that may result in expenditures to State, local, or tribal governments in the aggregate, or to the private sector, of \$100 million or more in any one year. When such a statement is needed for a rule, section 205 of the UMRA generally requires the Food and Nutrition Service to identify and consider a reasonable number of regulatory alternatives and adopt the least costly, more cost-effective or least burdensome alternative that achieves the objectives of the rule.

This rule contains no Federal mandates (under the regulatory provisions of Title II of the UMRA) for State, local, and tribal governments or the private sector of \$100 million or more in any one year. Thus today's rule is not subject to the requirements of sections 202 and 205 of the UMRA.

##### Background

On April 1, 1992, the Department issued a final rule establishing standards for operation of the Food Stamp Electronic Benefit Transfer System (EBT) as an alternative to coupons. Those regulations were promulgated in accordance with section 1729 of the Mickey Leland Memorial Domestic Hunger Relief Act of 1990 (Leland Act) (title XVII, Pub. L. 101-624) as part of a package of items aimed at improving the efficiency and effectiveness of program operations. With the exception of some minor corrections issued September 29, 1992,

these regulations have not been amended since their promulgation though other proposed changes are being considered through separate publications.

FNS is proposing this rule to implement the provisions of section 825 of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) (Pub. L. 104-193) on August 22, 1996, which amends Section 7 of the Food Stamp Act of 1977, as amended (7 U.S.C. 2016(i)) (the Act). The specific provisions are discussed below.

#### **Mandate EBT**

The Leland Act established EBT systems as operational issuance systems to provide food stamp benefits to eligible households. The PRWORA goes further by mandating that each State agency implement EBT for issuance of food stamp benefits no later than October 1, 2002, unless the Secretary provides a waiver for a State agency that faces unusual barriers to implementing an EBT system. Each State agency is encouraged to implement an EBT system as soon as practicable.

In order to meet the requirement, State agencies must be issuing EBT benefits for food stamps statewide by October 1, 2002. Currently, all but a very few State agencies have submitted planning documents for the eventual implementation of EBT systems. Therefore, we expect that only a small pool of States or territories will be forced to take action as a result of this provision or request a waiver from the Secretary for timely implementation of EBT under the law. This rule proposes adding language in Section 274.12 (a), to mandate that each State agency implement an EBT system by the specified date unless a waiver is granted to the State. Any State agency that is not granted a waiver and is not fully implemented by October 1, 2002, will be out of compliance with these rules and may be subject to disallowance of administrative funds pursuant to the provisions of 7 CFR 276.4.

#### **Off-Line Technology**

7 CFR 274.12 established rules for the approval, implementation and operation of on-line EBT systems for food stamps. The Leland Act did not authorize the utilization of off-line EBT technology in which a self-contained benefit access device, such as a microprocessor card, commonly known as a smartcard, is used to access benefits. Off-line systems could only be approved under the waiver authority of section 17 of the Act (7 U.S.C. 2026) as a demonstration project.

The term "on-line" is deleted from the Act by section 825 of PRWORA, thereby eliminating the requirement that EBT systems be on-line systems. This rule proposes to amend 7 CFR 274.3 to define an off-line EBT system as a benefit delivery system in which a benefit allotment can be stored on a card and used to purchase authorized items at a point-of-sale terminal without real-time authorization from a central processor.

The system architecture and functionality of off-line payment systems differs from that of on-line applications. As such, some of the technical standards codified in the existing rule may require revisions to relax or broaden language, supplement stated standards, or introduce new standards and requirements. Because industry standards for off-line electronic payment systems are still evolving, the Department is not in the position to propose standards specific to off-line systems in this rulemaking. However, we are interested in soliciting comments from the public at this time to provide input into our decision regarding what changes we should propose in the future as standards for off-line systems. We will also be looking at the experience gained in off-line demonstration projects in Ohio and Wyoming as we assess the need for further standards.

In the meantime, this rule proposes the regulations be amended to simply allow for the implementation of off-line EBT systems by adding language to that effect. Pending publication of new off-line standards, proposals from State agencies to implement off-line systems will be evaluated on a case-by-case basis. The Department will base approvals on the on-line standards currently in our rules where they apply, on the most current off-line industry information available and on knowledge gained from off-line EBT systems operating at the time.

#### **Cost Neutrality**

This section proposes several changes to the regulations. First, we are removing the requirement that EBT systems be cost neutral in any one year, since the requirement that cost neutrality be measured on an annual basis was removed from the Act by PRWORA. Section 7(i)(2)(A) of the Act prior to the PRWORA stated that EBT systems must be cost neutral to the Federal government. The regulations require State agencies to calculate a coupon issuance cap and at 7 CFR 274.12(c)(3)(vi)(B) require that State agencies be responsible for the post-EBT implementation issuance costs that exceed the coupon issuance cap in any

one year. Section 825 of PRWORA amends the Act to strike the language, "in any 1 year", effectively providing more flexibility in the determination and tracking of cost neutrality. The regulations are being modified to reflect this change. The State agencies will, however, still be required to submit an issuance cost cap, and the Federal Government will still be required to verify the cost cap submitted.

*National Cap.* As a discretionary change, the Department is also proposing to amend the regulations at 7 CFR 274.12(c)(3)(i) to establish a national issuance cost cap figure. The Department would calculate the national issuance cost cap based on the State issuance costs that have been approved by FNS and on the direct Federal costs that are attributable to coupon issuance. The rule would allow State agencies to use the National issuance cost cap instead of conducting their own cap analysis. State agencies would still have the option of calculating their own cost cap if they wanted to do so. The current regulations at 7 CFR 274.12(c)(3)(i) through (vi), which specifically delineate the cost neutrality guidelines and the procedures for calculating the State coupon issuance cap, have been a repeated source of misunderstanding for States. Therefore, in the interest of clarifying these provisions, this section has been redrafted and reorganized to be more explicit.

*Prospective Certification.* Finally, the Department is proposing a second discretionary provision to assess whether State agencies have met Federal cost neutrality requirements through prospective certification at the time the cap is submitted, eliminating the need to track operational costs throughout the life of the system. Currently, at the end of the EBT contract period, the State agencies are required to compare the actual EBT operational costs for the life of the EBT system to the coupon issuance cost cap to see that the actual costs do not exceed the cap. Prospective cost neutrality certification for EBT would follow the same approach that has been used for State eligibility systems, whereby the EBT cost projections are compared to a coupon issuance cap before system implementation to assess the cost neutrality of the system. If the comparison demonstrates the proposed system will cost less than the coupon system, no further measurement will be required for the life of the EBT system unless there is a substantial increase in system costs due to contract renegotiation or some other change. Any such cost increase will require prior

approval and submittal of an Implementation APD Update. Cost neutrality will be reassessed for any significant cost increases during system life, and for any subsequent EBT systems the State agency may develop and implement. This method will significantly simplify the process used to determine a State's EBT system cost neutrality.

#### **Differentiate Food Stamp Eligible Items**

The PRWORA requires, to the extent practicable, the establishment of system approval standards for measures that permit a system to differentiate items of food that may be bought using food stamps from items that may not. This resulted in a study to determine to what extent optical scanner technology, the only technology currently able to differentiate between eligible and non-eligible items, could be used in tandem with EBT to meet this requirement. A report of the study was delivered to Congress in August 1998, explaining there must also be a linkage of the scanner to an electronic cash register at the point-of-sale (POS) so that the information from scanned and eligible items can be passed to the EBT system. Technically, this is feasible in about 95 percent of all authorized retailers. However, this would be cost prohibitive, requiring the introduction of hardware and software in all Food Stamp authorized stores at an estimated initial cost of \$4.60 billion, of which \$3.30 billion is for the estimated 68 percent of program authorized stores that do not currently scan. To maintain this functionality, an additional \$752 million annually is estimated. Based on this information, no regulatory change is being proposed.

#### **Replacement Card Fee**

The PRWORA amends the Act to allow a State agency to collect a charge for replacement of an EBT card by reducing the monthly allotment of the household receiving the replacement card. Prior to the enactment of the PRWORA, the EBT regulations allowed for approval of a card replacement fee; however, the fee could not be collected from a household's food stamp benefit allotment. This rule proposes to amend current regulations at 7 CFR 274.12 (f)(5)(v) to add this provision.

State agencies with currently operating EBT systems need to inform FNS if they intend to institute a process for collection of replacement card fees from client households' allotments. If a State agency is in the process of developing an EBT system and intends to charge households for replacement cards, they must include the procedure

for collection of the fees in their EBT system design documents. FNS will need to know how replacement card fees will be accounted for by the State agencies.

If FNS is already sharing in the cost for replacement cards with the State agency through an existing contract, the amount collected must be reported as program income on the SF-269 report. Alternatively, the State agency's EBT processor may handle collection of the replacement card fee and reduce the billing to the State by the amount collected. At the State agency's request, FNS can establish a special authorization number in the FNS retailer database to be utilized by the State agency for the purpose of reconciling the funds drawn for the replacement fees.

#### **Photograph on EBT Card**

The PRWORA specifies that State agencies may require that EBT cards contain a photograph of one or more members of a household. This does not change what is allowable under current regulations. However, the language in the PRWORA further specifies that the State agency must establish procedures to ensure that any other appropriate member of the household or any authorized representative of the household may utilize the EBT card if a photo is used. Any State agency wishing to use photos on the EBT cards should specify in their plans how they intend to address this concern of the Agency. This rule proposes to amend the current regulations accordingly by adding paragraph (iv) at CFR 274.12(h)(6).

#### **Anti-Tying Restrictions**

Section 825 of the PRWORA includes the following provision: A company may not sell or provide EBT services, or fix or vary the consideration for EBT services, on the condition or requirement that the customer obtain some additional point-of-sale service from the company or an affiliate of that company; or not obtain some additional point-of-sale service from a competitor of the company or competitor of any affiliate of the company. The law also states that the Department must consult with the Board of Governors of the Federal Reserve System before promulgating any regulations regarding this provision. After consultation with the Federal Reserve, the Department has determined that this provision serves no purpose in the EBT environment.

It is the Department's understanding that this anti-tying provision was intended to prevent large EBT contractors that might underprice their

commercial service offerings from squeezing smaller banks out of the point-of-sale marketplace. Some had hoped this language would diminish the competitive advantage of a State agency's chosen EBT contractor to provide these other commercial point-of-sale services at retail locations for which they were already providing EBT services. However, the legislative language states that the cost of EBT services cannot be varied, rather than the cost of commercial services cannot be varied. In fact, there is already no way to tie EBT services to receiving additional commercial point-of-sale services when EBT is provided by the Government at no cost to authorized retailers. Anti-tying prevents the conditioning of any service on the purchase of another service or product. Since EBT is non-conditioned, the Federal Reserve agrees that the existing anti-tying laws are not relevant in the EBT environment. Therefore, the Department is not proposing any regulation change at this time, but does welcome any comments on the anti-tying provision.

#### **System Compatibility**

PRWORA included that it is the sense of Congress that States operate EBT systems in a manner that is compatible with one another. The Department is not proposing any changes since the current regulations already require system compatibility. EBT regulations at 7 CFR 274.12(h) Performance and Technical Standards, require that States ensure EBT systems comply with point of sale (POS) technical standards as established by the American National Standards Institute (ANSI) or International Organization for Standardization (ISO), where applicable. FNS has further worked to develop a technical specification for EBT food stamp transactions from a POS by bringing together a Technical Specification Committee comprised of EBT processors in association with the Electronic Funds Transfer Association (EFTA) EBT Operating Rules Committee. The purpose of creating this specification was to provide a standard POS/EBT system interface that retailers could use in multi-state retail operations and to allow for interstate transactions.

Also, 7 CFR 274.12(h)(5) Third Party Processors, requires State agencies to afford retailers the opportunity to use third party processors and to provide interface specifications and certification standards in order for the third party processors to participate in the EBT system. Because most third party processors operate in more than one State, we are supporting compatibility

by requiring access for third party processors. FNS also supports compatibility by working with the National Automated Clearing House Association (NACHA) EBT Council on issues related to interoperability including the recent implementation of a test to determine the volume and cost of interstate transactions.

#### Regulation E

Section 907 of the PRWORA amends Section 904 of the Electronic Funds Transfer Act, commonly known as Regulation E, to exempt from coverage government EBT accounts held for recipients of State-administered needs-tested assistance programs, including the Food Stamp Program. This provision does not amend the Food Stamp Act and therefore, there is no change proposed to our current regulations.

#### Implementation

The Department is proposing that the provisions of this rulemaking become effective no later than 30 days after publication of the final rule. State agencies may implement the provisions anytime after publication, however, EBT systems must be in place no later than October 1, 2002, unless the State is granted a waiver by the Department.

#### List of Subjects in 7 CFR Part 274

Administrative practice and procedure, Food stamps, Fraud, Grant programs—social programs, Reporting and recordkeeping requirements, State liabilities.

Accordingly, 7 CFR part 274 is proposed to be amended as follows:

#### PART 274—ISSUANCE AND USE OF COUPONS

1. The authority citation for 7 CFR part 274 continues to read as follows:

**Authority:** 7 U.S.C. 2011–2032.

2. In § 274.3, a new paragraph (a)(5) is added to read as follows:

##### § 274.3 Issuance systems.

(a) \* \* \*

(5) An off-line Electronic Benefit Transfer system in which benefit allotments can be stored on a card and used to purchase authorized items at a point-of-sale terminal without real-time authorization from a central processor.

\* \* \* \* \*

3. In § 274.12:

a. Paragraph (a) is revised.

b. Paragraph (b)(1) is amended by removing the second sentence and removing the word “However,” from the third sentence.

c. Paragraphs (c)(3)(i) through (c)(3)(vi) are removed.

d. Paragraphs (e), (f), (g), (h), (i), (j), (k), (l), and (m) are redesignated as paragraphs (f), (g), (h), (i), (j), (k), (l), (m), and (n), respectively, and a new paragraph (e) is added.

e. Newly redesignated paragraph (g)(5)(v) is revised.

f. In newly redesignated paragraph (i), a new paragraph (i)(6)(iv) is added.

The revisions and additions read as follows:

##### § 274.12 Electronic Benefit Transfer issuance system approval standards.

(a) General. This section establishes rules for the approval, implementation and operation of Electronic Benefit Transfer (EBT) systems for the Food Stamp Program as an alternative to issuing food stamp coupons. State agencies must implement EBT systems no later than October 1, 2002, unless the Secretary provides a waiver for a State agency that faces unusual barriers to implementing an EBT system. In general, these rules apply to both on-line and off-line EBT systems, unless stated otherwise herein, or unless FNS determines otherwise for off-line systems during the system planning and development process.

\* \* \* \* \*

(e) Cost Neutrality. The State agency must operate its EBT system in a cost-neutral manner, whereby the Federal cost of issuing benefits in the State after implementation of the EBT system does not exceed the Federal cost of delivering coupon benefits under the previous coupon issuance system. The amount up to which the State agency may consider its EBT system cost neutral is defined by the coupon issuance cap. The issuance cost cap is expressed in terms of a cost per case month derived by dividing the annual total cost of issuance by the total number of households issued food stamp benefits during the year the costs were incurred. In determining its coupon issuance cap, the State agency shall use either the national issuance cap, as determined by FNS, or calculate a coupon issuance cap based on the State agency's statewide issuance costs under the current coupon issuance system.

(1) The National Coupon Issuance Cap is a case-month issuance amount, as calculated by FNS. The national issuance cost cap is based on nationwide Federal coupon issuance costs, as validated by FNS, and includes the issuance costs identified in paragraphs (e)(2)(i) and (e)(2)(ii) of this section. FNS will make the national cost cap figure available to State agencies who opt for this method of determining the cost neutrality of their EBT systems.

(2) A State Coupon Issuance Cap is based upon individual States' statewide coupon issuance costs, multiplied by the percentage of Federal financial participation, plus Federal-only coupon issuance costs. Such costs, to be represented as a cost per case-month, shall be calculated using State issuance costs for the four consecutive Federal fiscal quarters preceding the submission of the EBT Implementation APD. An alternative base period may be used with approval from FNS, if the State agency can demonstrate that the alternative period would be more accurate or other circumstances prevent the use of the required base period. A State agency may also request approval from FNS to develop coupon issuance caps based on costs from individual counties, selected project areas, or other subdivision of the State operating EBT which will then be combined into a blended statewide coupon issuance cap prior to statewide EBT implementation.

(i) State coupon issuance costs shall include, but not be limited to, direct allowable costs for personnel, fringe benefits, travel, equipment, supplies, contracts, construction and other direct costs associated with coupon issuance. Such costs may be direct charges to the State agency for Food Stamp Program administration that have been allocated from a larger cost pool to the Food Stamp Program and to the coupon issuance function. Indirect costs, defined as costs which are included in the State agency's indirect cost proposal and approved for cost charging through an indirect cost rate, shall not be included in determining the cap.

(ii) Federal coupon issuance costs associated with coupon issuance in the State agency that shall include:

(A) Costs for coupon printing, shipping, processing and reconciliation. The case-month figure associated with these costs is provided by FNS;

(B) Monthly mail issuance losses up to the tolerance limit approved by FNS;

(C) Monthly duplicate issuance losses, except for mail issuance losses, absorbed by FNS; and

(D) Allowable State coupon issuance costs multiplied by the applicable percentage rate of Federal financial participation.

(iii) The State agency shall provide narrative explanations and satisfactory supporting documentation to clarify each cost item and how it was calculated. When allocated costs are included in the coupon issuance cap, the State agency must provide a narrative explanation of how the charge was allocated to the Food Stamp Program and to coupon issuance. The allocation method must be objective,

demonstrate a reasonable cause and effect relationship between the type of cost and the basis for the allocation, and represent consistent application for all similar costs. If time studies are used as the basis for allocation of costs to issuance, FNS must approve the definition of issuance used in the instructions to study participants.

(iv) All issuance costs included in the coupon issuance cap are subject to validation by FNS prior to FNS approval. Validation entails the review of the State's accounting system and applicable source documentation to determine that the costs were actually incurred, were reasonable, were allocated properly to the Food Stamp Program and to the issuance functional category, and were reported to FNS on the standard financial Status Report (Form SF-269).

(3) The State agency should submit its coupon issuance cap or indicate it has opted to use the national coupon issuance cap as part of the Implementation APD process. The coupon issuance cap must be approved prior to implementation of the pilot, and shall be effective from the first date benefits are issued to households through the EBT system during the pilot project.

(4) Coupon Issuance Cap Inflation. Each State's approved issuance cap and the national cost cap will be adjusted each Federal fiscal year based on the percentage change in the most recently published Gross Domestic Product Implicit Price Deflator Index (GDP Price Deflator) calculated from the percentage change in the index between the first quarter of the current calendar year and the first quarter of the previous year, as published each June by the Bureau of Economic Analysis. FNS will compute the inflated cap for each State each year and provide the revised cap to State agencies annually.

(5) Calculating Cost Neutrality. The determination of cost neutrality will be assessed on a prospective basis; that is, FNS will make a determination prior to system implementation whether the proposed EBT system will be cost neutral based on a comparison of the coupon issuance costs to the projected costs of the EBT system as proposed in the Implementation APD. The State Agency may choose how they determine coupon issuance costs; either according to paragraph (e)(1) or paragraph (e)(2) of this section. After approval of its coupon cost cap and prior to system implementation, the State agency shall submit to FNS an analysis comparing the coupon issuance costs to the projected EBT costs over the seven years of system operation or other specified

period of time defining the life of the system. The State shall project the statewide issuance costs including EBT system design, development, start-up and operations through the defined life of the system. For cost per case month comparisons, the projection will include the same caseload estimates as the coupon cap calculation. Statewide cost projections for issuance costs after EBT implementation must include all of the direct EBT costs, and projections for all categories of allocated costs which were included in the coupon cost cap calculation using the same allocation methodology as in the cost cap calculation. The State agency may request approval to limit the issuance cost comparison for cost neutrality purposes to only the costs incurred for the area served by EBT and to not include residual coupon issuance costs; that is, costs associated with issuing coupons to recipients in areas not yet converted to EBT. Cost neutrality would then be measured by comparing the coupon issuance cap multiplied by the number of EBT cases to the EBT cost of operation. With the addition of each new area served by EBT, the State agency would then be required to recalculate a blended State cap figure, incorporating the coupon issuance costs of the newly added area with the previously approved issuance cap, for use in comparison to the EBT costs for the areas served by EBT. The projection shall include any costs allocated to an EBT cost pool if applicable.

(i) EBT planning costs are to be excluded from the cost neutrality assessment and shall include costs attributed to the preparation of the Planning APD, all activities leading to the development of the EBT implementation plan and the completion of the documentation contained in the FNS approved Implementation APD.

(ii) The cost neutrality assessment must include system design and development and start-up costs. For assigning the costs to start-up, the start-up period for the EBT project shall begin from the approval date of the Implementation APD or with the ratification of a contract for EBT services, whichever is earlier and end with the first EBT benefit issuance in the pilot area.

(iii) The operations phase is defined as beginning with the first EBT issuance in the pilot area. The State agency shall identify the allowable EBT operational costs which include, as appropriate, but are not limited to: labor hours and costs by job category and by program for each unit, direct non-labor costs by program for each agency, vendor charges, if any,

computer usage (CPU, disk storage, tapes, printing), the equipment amortization/lease and maintenance (including POS hardware and installation costs), telecommunications installations, recurring telecommunications costs, benefit card stock and equipment, supplies, printing and reproduction, travel, postage, automated clearinghouse charges, wire transfer fees and other such settlement fees, and other direct costs. Indirect costs, as defined in paragraph (e)(2)(i) of this section, shall not be included as EBT system operational costs.

(iv) For the purposes of claiming Federal financial participation in State capital expenditures and for the purposes of projecting the cost to EBT, costs for EBT equipment purchased directly by the State agency shall be charged from the time operations begin in accordance with § 277.18(i)(3) of this chapter and § 277.18, Appendix A of this chapter. Equipment costs shall include the cost of installation and shall be separate from those transaction costs identified in the EBT contract. Costs for EBT equipment purchased directly by the State agency shall be identified in the EBT system budget as a separate component, both for the pilot and the fully operational system and shall be applied to the issuance funding cap as amortized.

(6) FNS must review and approve the cost neutrality analysis submitted by the State.

(i) If the comparison demonstrates the proposed system will cost less than the coupon issuance system, no further measurement will be required for the life of the system unless there is a substantial increase in system costs requiring prior approval as described in § 277.18(c)(2)(ii)(C) of this chapter and the submittal of an Implementation APD Update as outlined in the FNS Handbook 901 (APD Handbook).

(ii) Any State agency that cannot show cost neutrality will be required to track EBT costs throughout the life of the system and reimburse FNS for any excess at the end of the defined system life.

(iii) Any subsequent EBT systems developed or implemented will require an updated cost neutrality assessment incorporating the revised costs of the new system.

\* \* \* \* \*

(g) \* \* \*

(5) \* \* \*

(v) The State agency may impose a replacement fee by reducing the monthly allotment of the household receiving the replacement card, however the fee may not exceed the cost to

replace the card. If the State agency intends to collect the fee by reducing the monthly allotment, it must follow FNS reporting procedures for collecting program income. States agencies currently operating EBT systems must inform FNS of their proposed collection operations. States in the process of developing an EBT system must include the procedure for collection of the fee in their system design document. All plans must specify how the State agency intends to account for card replacement fees and include identification of the replacement threshold, frequency and circumstances in which the fee shall be applicable.

\* \* \* \* \*

(i) \* \* \*

(6) \* \* \*

(iv) State agencies may require the use of a photograph of one or more household members on the card. If the State agency does require the EBT cards to contain a photo, it must establish procedures to ensure that all appropriate household members or authorized representatives are able to access benefits from the account as necessary.

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Dated: May 17, 1999.

**Shirley R. Watkins,**

*Under Secretary for Food, Nutrition, and Consumer Services.*

[FR Doc. 99-13554 Filed 5-26-99; 8:45 am]

BILLING CODE 3410-30-U

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## FEDERAL RESERVE SYSTEM

### 12 CFR Part 201

[Regulation A; Docket R-1038]

#### Extensions of Credit by Federal Reserve Banks

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Proposed rule.

**SUMMARY:** The Board is proposing to amend its Regulation A to establish a special lending program under which Federal Reserve Banks will extend credit at a rate above the Federal Open Market Committee's targeted federal funds rate to eligible institutions to accommodate liquidity needs during the century date change period. Unlike adjustment credit, borrowers would not be required to seek credit elsewhere first, uses of funds would not be limited, and the loans could be outstanding for a considerable period.

**DATES:** Comments must be submitted on or before July 2, 1999.

**ADDRESSES:** Comments, which should refer to Docket No. R-1038, may be mailed to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, D.C. 20551. Comments addressed to Ms. Johnson also may be delivered to the Board's mail room between 8:45 a.m. and 5:15 p.m. and to the security control room outside of those hours. Both the mail room and the security control room are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, NW. Comments may be inspected in Room MP-500 between 9:00 a.m. and 5:00 p.m.

**FOR FURTHER INFORMATION CONTACT:**

James A. Clouse, Chief, Monetary and Financial Market Analysis Section (202/452-3922), or William R. Nelson, Economist (202/452-3579), Division of Monetary Affairs; Oliver I. Ireland, Associate General Counsel (202/452-3625), or Stephanie Martin, Senior Counsel (202/452-3198), Legal Division. For the hearing impaired only, contact Diane Jenkins, Telecommunications Device for the Deaf (TDD) (202/452-3544), Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, D.C. 20551.

**SUPPLEMENTARY INFORMATION:** The Board is requesting comment on proposed amendments to its Regulation A (12 CFR part 201), Extensions of Credit by Federal Reserve Banks, to provide an additional mechanism under which Federal Reserve Banks will make discount window credit available to depository institutions in the months surrounding the century date change. The Board expects that, with advance planning, depository institutions will be able to meet their liquidity needs during the century date change period relying on their usual sources of funds, including adjustment credit at the discount window. The Board recognizes, however, that uncertainty surrounds potential developments over the period. The proposed Special Liquidity Facility is intended to provide that an assured source of funds is available to relieve unusual liquidity pressures that depository institutions may experience.

#### Background

Depository institutions and their customers are now making plans to meet possible credit needs in the period surrounding the century date change. Uncertainty exists, however, as to the extent of demands and the cost and availability of credit in the market during the year-end period. Furthermore, banks are handicapped in

playing their traditional role as lenders to non-banks by the possibility that the banks themselves will be under some liquidity pressure at that time. Liquidity pressure could come from conversion of deposits to currency and shifting of credit demands to banks from markets. Moreover, the incidence of credit demands is extremely difficult to predict and could involve pressures on small or medium-sized depository institutions that are customarily suppliers of funds to larger institutions and markets and hence would not have well-established borrowing relationships.

To a considerable extent, Federal Reserve open market operations can meet liquidity demands in reserve markets, such as the large seasonal increase in demand for currency in November and December of each year. During the century date change period, however, demands for and supplies of reserves will be very difficult to predict. The unusual funding situations of institutions and uncertainty about the status of potential borrowers may disrupt the normal distribution of reserves and liquidity through markets. Volatility in the demand for reserves could be compounded by a drop in required reserve balances at the Reserve Banks as depository institutions increase vault cash holdings to meet potential customer demands.

Banking supervisors have urged depository institutions to make firm contingency plans for meeting unexpected liquidity demands during the century date change period. Supervisors have encouraged depository institutions to make the Federal Reserve's discount window part of those plans. Although borrowing through the usual adjustment credit facility of the discount window should be adequate to meet most unusual needs and alleviate possible pressures on money markets, in practice depository institutions have been reluctant in the past to take advantage of such credit. Moreover, adjustment credit requires borrowers to seek funds elsewhere first, limits uses of such credit, and is usually limited in duration.

#### Special Liquidity Facility

The proposed Special Liquidity Facility would make collateralized Federal Reserve Bank credit more freely available, albeit at an interest rate somewhat above depository institutions' normal cost of funds. By assuring the availability of Reserve Bank credit, the Facility should enable depository institutions and their customers to commit to meeting possible credit needs with greater confidence. The Facility