From the Impossible to the Ordinary – a Brief History of State Disbursement Units

State Disbursement Units (SDUs) emerged experimentally in the early 1990s as pilot efforts by states to improve the timely delivery of child support payments to families. As a result of a 1996 federal mandate for every state to have one, SDUs have become an integrated and indispensable part of today's state child support operations. This article takes a quick historical trip through the development of the SDU implementation and shows how this innovation in program operating methods follows a predictable life cycle from creative inception to standardized processes. Finally, this article examines the major forces within the child support environment that have been an influence on SDU evolution.

Administratively, SDUs addressed two types of child support program organizations – those where the program was state operated and those where it was state administered and county operated. Additionally, some payment processing operations were government operated and others were outsourced to a private sector vendor. Clearly, centralizing the payment processing and disbursement operation that had been historically performed at the county level was a major challenge fraught with risk of failure. While state-operated SDU-like operations had already been implemented in Iowa and Texas, it was New York in 1993 that first chose both to centralize and to fully outsource payments, disbursements, printing, and customer service to a private sector vendor.

The early days of SDUs were dominated by what Geoffrey Moore, in his book, Living on the Fault Line, describes as "disruptive innovation" as both states and contractors attempted to adapt standardized commercial processes to the extremely non-standard child support situations. Traditional remittance environments used coupons to process checks from customers; however, in the child support program, most payments came from employers and did not include coupons to help identify the right case. Furthermore, individual payors often sent just a check with some cryptic message or number in the memo line. This would frequently result in a treasure hunt only to discover the payment was a misrouted mortgage payment. Early operations were characterized by massive amounts of paper processed by a sea of envelope-opening and data-entering clerical staff. Smaller states like Massachusetts, Arkansas, and Hawaii joined the centralization scheme with largely the same result – lots of paper, lots of exceptions, and a lot of new experiences for contractors operating these new environments. Something had to change.

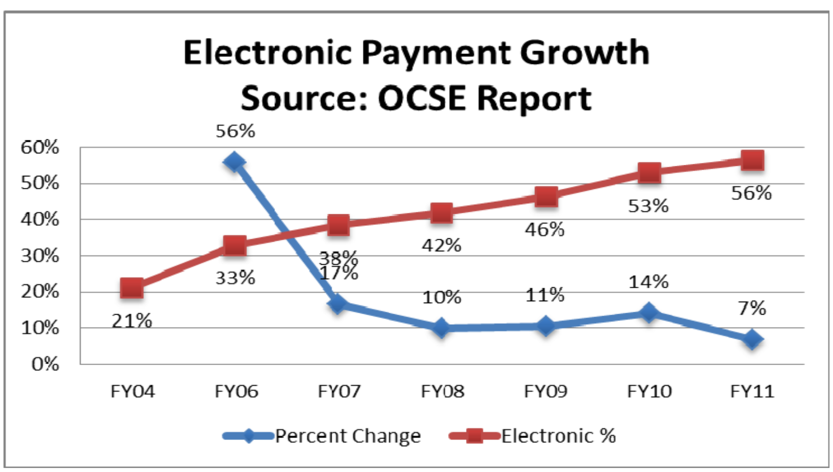
In the mid-90s, a number of the vendors began to contemplate a new approach, "If we could just convert all of this paper to images and then process the images, not the paper, life would be good!" Geoffrey Moore defines this stage of the life cycle as "product leadership," in which solutions emerged that solved many of the prevailing issues with exceptions and processing capabilities. Early innovators suffered with balky, slow systems that did not work well across networked computers. However, the accelerating speed of Intel's Pentium chip allowed most of these hurdles to be quickly overcome. Processing centers, soon to be named State Disbursement Units, were opening mail, converting paper to images and processing those images into payments and deposits every day at much higher rates of speed and with fewer staff than previously experienced.

The late 1990s was packed with changes for the child support community. The most critical changes resulted from the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PROWRA). The new legislation mandated that each state designate a single location, to serve as the State Disbursement Unit, for receipt and disbursement of child support payments from payors, including employers. Of critical importance was the Act's requirement that the SDUs had to be established by the close of 1999 or there would be penalties assessed for failure to perform this centralization on time. At risk were Pennsylvania, New Jersey, Ohio, Indiana, Illinois, California, Wisconsin, Texas, Florida, Michigan, Georgia, North Carolina and a dozen others that had processed payments locally at the county level, in some cases for a hundred years or more. A lot of work had to be completed quickly and most states turned to the private sector to supply the solution, the labor, and the plan to get the transition completed in time and without any delayed payments to families.

When Y2K rolled around, most states had established the mandatory SDUs. The road was bumpy for many but by the end of 2000, most SDUs were up, running, and performing the required work. By the time Texas, Illinois, and Indiana established their SDUs in the mid-2000s, the national picture settled into its current configuration: thirtyone states have outsourced their SDUs to private sector providers and nineteen states continue to do the work themselves. From a monetary perspective, 14% of child support payments are processed by state operations and 86% by private sector SDU operators.

Two other technology and market forces also deeply impacted SDU operations in the mid-2000s – the rise in electronic funds transfer (EFT) payments and the introduction of the child support debit card. Early in SDU history, employers began to tell IV-D program directors and SDU operators, "We are not going to send electronic payments to New York and write checks to every county in New Jersey. When the government can do it one way for everyone, we will consider going to EFT."

As it turned out, PRWORA fueled momentum in the direction favored by employers. States like Indiana, Illinois, and Pennsylvania followed suit by mandating electronic payments for larger employers. The ratio of paper to electronic payments began to shift about 10 points per year as 2010 approached. The latest program metrics indicate a majority of payments – almost 60% -- are received electronically. Certainly, the conversion of large government organizations like Treasury and the Defense Finance Accounting Service (DFAS) as well as major employers like Walmart have aided in tipping the ratio to the faster, more efficient EFT.



Likewise, in the mid-2000s the disbursement side of SDU got a boost from the debit card capability of the financial industry. Building on the growing stored value card (SVC) concept, a number of banks and SDU providers teamed to create the idea of a branded card (MasterCard or VISA) that could be used as a means of disbursing support payments. Early experiments in Colorado and Georgia led to a rapid expansion of the program and all but the elimination of the paper check. Ninety-eight percent electronic disbursement of payments became the common standard with direct deposit and the debit card having about equal shares of the disbursements. This innovation created value in the child support program, mainstreamed child support recipients, reduced postage costs for states, and virtually eradicated check fraud and theft as exception issues.

PRWORA is arguably the key driver for the creation, perfection, and pervasiveness of centralized payment and disbursement processing; however, imaging, electronic funds transfer, and the debit card are the innovations that have created new value for states and improved services for the program stakeholders. These important changes in cost effectiveness and overall service improvement would have been nearly impossible had the functions remained local.

Again, Geoffrey Moore defines the period from 2005 through 2010 as one of “customer intimacy” in which the SDU business was characterized by a better customer experience, improved response times, and a collaborative culture between states and vendors and states and their stakeholders. Except for South Carolina, every state had an SDU by 2010, and most had been operating in the same fashion for more than five years – whether internal state operations or external contractor operations. If outsourced, most vendors had been in place for at least two consecutive contracts and if in-sourced, it looked like it would stay that way. The final phase of the life cycle of an SDU would be realized in the years 2011 and beyond.

The economic downturn of 2009 still affects us today and has an ongoing impact of state budgets and child support payments – both of which are down to prior years. Unemployment remains around 8% and even higher in some states with the expected effect on both child support payments and payroll taxes. State budgets are tight and furlough has become a frequently used word in the state employee vocabulary. A no-frills approach, where cost is the main driver is the prevailing theme for most SDU operations today. As a result of these events and trends as well as the natural evolution of the operations lifecycle, the SDUs have entered the phase Moore calls “operational excellence.” In this stage, cost efficiency is king, coupled with highly predictable processes driven by common technology and common expectations for performance, predictability, and cost-efficiency. The days of 250 employees opening mail, processing payments, and handling exceptions are gone; that same SDU today might only have 50 staff members essentially doing the same work as 1993, just a lot more efficiently and with a greater reliance on both technical innovation and process consolidation.

Indeed, the SDU business has transitioned from what seemed an impossible task – the centralization of locally-operated payment centers to a single site in each state. Through the life cycle process we have witnessed the dramatic, yet predictable, change from complex experimentation, fueled by governmental policy change to standardization; what was an extraordinary effort in 1993 is now ordinary and expected.

To all the early adopters like New York, Colorado, Massachusetts, and Arkansas we owe thanks for their willingness to pioneer. For the championing of PRWORA and the official creation of the SDU concept, we owe thanks to OCSE, private leadership, and Congress. And, to all of the private sector vendors who have provided these valuable services, we owe praise for their willingness to invest, to innovate, and to compete with each other with the natural result of a lower cost, higher value service to the child support community.

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