125 HC HB 46 - HB 128

EFFECTS OF INITIATIVE 245:
Summary Statement

ADOPTION OF INITIATIVE 245 HAS IMPOSED MAJOR PENALTIES: UPWARD PRICE PRESSURE, REDUCED CREDIT AVAILABILITY, SMALL MERCHANT PROFIT SQUEEZE, AND LOSS OF BUSINESS FROM THE STATE.

The maximum one percent monthly service charge imposed on various types of consumer credit by passage of Initiative 245 in November 1968 is indefensible both in theory and in fact. The National Commission on Consumer Finance, in an exhaustive study to the President and to Congress stated, "Forced reduction in the decreed maximum rate on revolving credit to 10 percent per annum (as in Arkansas) or from 1½ percent to 1 percent per month (as in Minnesota, ... and Washington) have a twofold effect on consumers. First, credit sellers may make less credit available ... or second, they may try to make up the loss in income from some other source."[1] The Commission further noted that, "... on balance, rate ceilings are undesirable when markets are reasonably competitive."[2] With over ninety commercial banks and literally hundreds of credit unions, finance and small loan companies, and retail outlets providing credit in the State of Washington, competition appears to be adequate.

THE RESERVE OF SMALL ADJUSTMENTS TO 245 HAS BEEN EXHAUSTED.

Specific impacts of Initiative 245 are documented in a study published by the University of Washington in 1970[3] and are supported by current information. Firms report discontinuing free check cashing; charging for deliveries or increasing charges; instituting fees for layaways; discontinuing layaways; or discontinuing in Washington while maintaining service in Oregon and Idaho; exacting minimum service charges on charge accounts; discontinuing open charge accounts; and reducing employee discounts on major appliances. While in some cases services once available to consumers have been completely eliminated, in other cases the credit buyer has benefited from Initiative 245 by forcing the costs of miscellaneous services to bear directly on all users. Undoubtedly too, lenders subject to the rate limitation have become more efficient in administering credit. Certainly many small merchants, as reported in the attached Lynch study, have found temporary relief by accepting one or more of the bank credit card plans.[4]

MAJOR IMPACTS OF 245 ARE BOTH INEQUITABLE AND DETRIMENTAL.

The U of W study noted the following, "... the burden of supplying a service (credit), the cost of which may exceed the price that can be charged for it, seemed to have fallen on the merchants and possibly the banks. Banks and merchants have taken many of the small steps that can be taken but their basic problem is still unresolved because its solution requires more than that. The rate ceilings will have to be raised or banks and merchants will have to reduce costs and/or increase revenues from other sources."[5] And the National Commission report flatly states, "The effect of restrictive rate ceilings is to limit the number of borrowers who qualify for legal credit and reduce the amount of credit supplied. Sales credit rate ceilings may cause creditors to shift a portion of the finance charge into the cash price ..."[6] The U of W survey identified not only an increase in rejection rates on new credit applicants at banks, retailers, and auto dealers; a forced move of financing to banks, credit unions, and small loan companies; but also an increase in cash prices to maintain <u>total</u> revenue from sales and the provision of credit.[7] The Commission

report states, "Retailers must make a profit on their total sales of goods and services (including credit services) to remain in business. The only real issue is who should bear these credit costs -- credit buyers or cash buyers."[8] Credit operations of retailers, at best, typically do not cover costs. A Touche, Ross, Bailey, and Smart 1967 report on consumer credit costs in Washington once again verified that fact -- not only for thirty-day accounts but also for revolving credit and long-term installment accounts.[9] Obviously, provision of credit by retailers is considered an indispensible sales tool. At the same time, further restricting rates chargeable, when not offset by operating efficiencies and service repricing, must be made up by higher sales prices -- not just for credit customers but all customers, including those increasingly unable to obtain credit. The U of W survey reported, "The majority of retailers ... raised prices on all merchandise on the average of 5 percent in response to the passage of Initiative 245."[10] Automobile dealers continue to maintain gross margins by hiking all auto prices as revenue from financing has declined;[11] a major retailer continues to charge $5.00 more for appliances in Washington than in Oregon and Idaho. Is there any compelling reason why the Washington experience should differ from that of other states with artificially low rates? In an eight-state price survey in 1968, Arkansas (which has a 10 percent limit) was found to have higher cash prices than neighboring states which have 18 percent limits. The average markup appeared to be about 5 percent.[12] This is not inconsequential. Sales volume of Washington retailers typically offering credit has been estimated at just under $5 billion in 1972. If only half of these had raised their prices 5 percent the added cost to the consumer was close to $120 million.[13]

CONDITIONS HAVE NOT STABILIZED, BUT CONTINUE TO DETERIORATE.

With every year that has passed since adoption of Initiative 245, the twelve percent limit imposes further hardship in the face of rising costs. The prime rate, at 6¼ percent in December 1968, now stands at 9¼ percent. With inflation expected to be a continuing problem, there is every reason to expect money costs to retailers -- and to banks -- will continue at relatively high levels. The cost squeeze intensifies as operating efficiencies are more difficult to realize; as service repricing options are exhausted; as flexibility to raise cash prices further is limited. Particulary impacted are the consumer who can least afford to do without credit and the small retailer whose cash price ceiling is set by the majors or border-state competition.[14]

Credit card competition among banks has lowered merchant discounts since 1968. Increasingly, however, the small merchant faced with continuing cost hikes is finding Washington banks can pare discounts no further with service charges restricted. Either merchants discontinue the credit option or send their business out-of-state, where low discounts are offset against higher service charges. While not conclusive, evidence suggests Initiative 245 is not only limiting credit availability and raising cash prices, but also restricting the growth of business in the state. Between 1968 and 1971, the number of auto dealers in Washington fell 7 percent while the number in Oregon fell only 2 percent and in Idaho remained even. Excluding dealers in King and Snohomish Counties (which suffered a recession in 1969 and 1970) the number still fell by 7 percent. For home furnishings dealers, the number in Washington (excluding King and Snohomish Counties) remained barely level, while climbing 2 percent in Oregon and 3 percent in Idaho.[15]

FOOTNOTES

1. Report of the National Commission on Consumer Finance, Consumer Credit in the United States, U.S. Government Printing Office, December 1972, p. 105.

2. Ibid., p. 108.

3. Graduate School of Business Administration, University of Washington, The Impact of A Consumer Credit Interest Limitation Law, Washington State: Initiative 245, Seattle, 1970, pp. 20-25.

4. Lynch, Gene C., The Economic Impact of a Twelve Per Cent Finance Charge Ceiling, University of Arkansas, Fayetteville, 1973, p. 8.

5. University of Washington, Impact of Consumer Credit, pp. 25, 26.

6. National Commission, Consumer Credit, p. 113.

7. University of Washington, Impact of Consumer Credit, pp. 20-25

8. National Commission, Consumer Credit, p. 105.

9. Touche, Ross, Bailey and Smart, Study of Consumer Credit Costs in Retail Stores in Washington, Washington Retail Council, 1967.

10. University of Washington, Impact of Consumer Credit, pp. 24, 25.

11. Washington State Automobile Dealers Association.

12. Lynch, Economic Impact, p. 10.

13. Derived from: State of Washington Department of Revenue, Quarterly Statistical Report of the Revenue from Excise Taxes, May 1973, pp. 10, 11.

14. Lynch, Economic Impact, p. 11.

15. Derived from: U.S. Department of Commerce, County Business Patterns, Washington, U.S. Government Printing Office, 1968, 1971.

ALASKA RETAIL COUNCIL

- - -

ANALYSIS OF CONSUMER CREDIT COSTS IN RETAIL STORES IN ALASKA

- - -

AUGUST, 1968

SCHMITZ & KLINE
CERTIFIED PUBLIC ACCOUNTANTS
206 NATIONAL BANK OF ALASKA BLDG.
JUNEAU, ALASKA 99801

August 21, 1968

Alaska Retailers Association
Anchorage, Alaska

Gentlemen:

We have completed our analysis of the costs of consumer credit in retail stores in Alaska. The analysis is based on a study of costs of consumer credit for the State of Washington for the fiscal year ended January 31, 1966 prepared by Touche, Ross, Bailey & Smart, a national accounting firm.

Our analysis used the Washington data as compiled and set forth in the enclosed report, converting the data to costs and conditions faced by retail merchants doing business in Alaska. For comparative purposes we have included statistical results of the Washington study with this analysis. We used cost conversion methods which we deemed conservative and appropriate in setting forth costs of credit in total and by type of credit account.

In our opinion, based on the data compiled by Touche, Ross, Bailey & Smart of the costs of consumer credit in retail stores in Washington, the attached exhibits and report comments fairly present an analysis of credit costs for retail merchants doing business in Alaska.

Schmitz & Kline
Certified Public Accountants

ALASKA RETAIL COUNCIL

REPORT ON CONSUMER CREDIT COSTS IN RETAIL STORES IN ALASKA

CONCLUSION:

The conclusion to be drawn from the analysis of consumer credit costs in Alaska is that providing credit to the consumer is costly. This conclusion is in direct conflict with the common opinion that extending credit is a profitable business for the retailer. As set forth in Exhibit I, the average cost of credit per $100.00 of credit sales is $3.15 in excess of revenues derived from credit charges. Credit costs for Alaska are approximately 19% higher than Washington's.

SCOPE:

The basic study prepared by Touche, Ross, Bailey & Smart was conducted on three main types of accounts:

(1) Regular (30 day) charge account -

This category comprises those customer accounts on which no service charges are assessed, but which require payment of the account balance within 30 days of billing date.

(2) Revolving credit accounts -

This category includes the many multi-transaction, small unit sales types of accounts that permit payment of the account balance over a period of several months. Accounts offering an option payment feature, whether used or not, are included under this category. Service charge rates used by the participants were consistent, with a 1-1/2% charge on the outstanding account balance at a given day of the month.

(3) Long-term installment accounts -

This category includes several types of accounts which are basically similar as to length of credit repayment terms, unit sales activity and the size of each transaction. Included in this category are special promotional 30-60-90 day accounts for which there are no service charges. For the other types of installment accounts the number of transactions handled per year is significantly lower while the size of the average transaction is significantly higher. The length of the repayment period

SCOPE (continued):

is also generally longer than that for a revolving credit account. The service charges made for installment accounts were not uniform.

METHODOLOGY:

The study criterion, as used by Touche, Ross, Bailey & Smart for the Washington study, was to identify as credit costs only those costs which the store could eliminate if the credit function were discontinued, assuming no change in total store sales volume. By applying this criterion, expenses of providing services to credit customers were segregated from those of providing services available to both cash and credit customers. Total identified credit costs were then allocated by major type of credit account. Service charge revenues were also segregated by account type to permit comparision of service charge revenues with credit costs by major account type.

COST GROUPING:

In their Washington study, Touche, Ross, Bailey & Smart grouped credit costs in seven categories. The first three (new account costs, account servicing costs and account collection costs) represent those costs most directly identifiable with the credit operation. They represent the costs of obtaining new customer accounts, the costs of the day-to-day servicing of active customer accounts and the costs of the collection effort required on accounts with payments in arrears. Lists of items included in these three major categories are presented in Appendix A.

The fourth category represents interest on the capital required to finance customers' outstanding receivable balances. This is a direct cost for without credit there would be no receivable balances to finance and, therefore, no need for capital to finance them. An 8% rate was used in determining study results. This is considered a conservative rate for cost of capital. Since the actual cost of capital for the typical merchant is frequently higher than 8%, the "excess of cost over revenue" has been recomputed at the bottom of Exhibits I and II, using cost of capital rate of 10%, 11% and 12% for Alaska.

The fifth category is space and equipment costs. It depicts the cost of space used for credit activities as well as the cost of office equipment used in the credit operation. The sixth category covers the cost of the additional sales people required to handle credit customers. This additional cost results from the added sales check preparation time and credit authorization work necessary when a sale is made on credit rather than cash. The

COST GROUPING (continued):

seventh category (management expenses) represents that portion of general management expenses assignable to the credit operation. It represents the costs of service provided to the credit department by various other service activities within the store.

Although not incorporated in the study results, an additional cost category could be termed "other credit costs". This category is used to assure recognition of the fact that store costs, in addition to those specifically identified in the seven categories listed, are affected by the existence of the credit function in a store. The existence of credit affects the entire character of the store and of its expense structure. It results in the incurrence of additional costs, some of which are not susceptible to specific measurement. Among these "other credit costs" are the costs of handling extra merchandise returns and the extra deliveries required by credit customers as compared to cash customers. These and certain other costs are definitely credit costs since they contribute toward increasing total store operating costs. While recognition of their existence is important in assessing the costs of credit operations, no specific amounts are shown in study results for these costs since they could not be measured with the necessary degree of accuracy.

CONVERSION FACTORS AND ASSUMPTIONS:

In order to convert the data developed by the Washington study to Alaska conditions the following conversion factors and assumptions were used -

(1) Service Charge Revenues -

Service charge revenues for Washington and Alaska were set forth as both being the same per $100.00 of sales. Both Washington and Alaska have the same service charge maximums which are allowed by law. In discussing this subject with personnel with national retail stores operating in Anchorage, they confirmed that the rates charged in their Alaska stores were the same as those charged in the Washington stores.

It would seem valid to assume that if anything, service charge revenues per $100.00 of credit sales would be lower in Alaska than in Washington. Long-term credit to consumer for merchandise purchases is relatively new and it is probable that Alaska merchants as a whole do not charge for credit or extend the length of repayment over as long a period of time as Washington merchants. An example is a Juneau department store which does not have a service charge for credit but will probably start charging for credit in order to extend account repayment over a longer period of time, thus being more competitive with other merchants.

CONVERSION FACTORS AND ASSUMPTIONS (continued):

(2) Credit Costs -

(a) All credit costs as determined by the Washington study were reduced 15% in order to reflect higher sales prices of individual merchandise in Alaska. Since costs are presented in relation to $100.00 of sales, it follows that there would be less units sold in Alaska per $100.00 of sales and therefore less credit costs associated therewith because of the fewer transactions involved. The one cost exception to this would be the cost of interest (capital) which would have no relation to the number of transactions involved in $100.00 of sales.

The 15% sales price differential was arrived at by utilizing three sources. The first source was comparing individual sales prices of merchandise sold by a national retailer in its Anchorage store with its Seattle area stores; the second source was price statistics for cities in Alaska published by the U.S. Department of Labor, Bureau of Labor Statistics; the third source was the opinion of individual merchants involved in retail sales.

(b) All costs of credit except interest as determined by the Washington studies were adjusted upwards to reflect higher salaries and operating costs in Alaska. Salaries are assumed to be 35% higher in Alaska than in Washington for comparable positions. This assumption is supported by (1) the Anchorage store of a national retailer which gives an automatic 40% raise to all personnel transfering from Washington to Anchorage as a "cost of living" allowance (2) a Juneau merchant's salaries which are 35% higher than the average of salaries paid to department store personnel as determined by national statistics (3) the experience and opinions of various Anchorage retailers whose opinions were solicited in this regard.

Operating costs other than salaries were considered to be 16% higher than comparable Washington costs. These higher costs were derived from two sources (1) from an analysis of the operating costs of the Anchorage store of a national retailer as compared to its Washington stores (2) from statistics set forth in the Indexes of Intercity Differences in the Cost of Equivalent Goods and Services for various Alaskan cities as compared with Seattle, Washington, published by the U.S. Bureau of Labor Statistics.

CONVERSION FACTORS AND ASSUMPTIONS (continued):

In order to convert Washington costs of credit to Alaska costs, an assumption had to be made as to what percentage salaries were to total operating costs when related to costs of credit. In reviewing several retailers operating statements we found that salaries comprised from one-half to two-thirds of total operating costs. In reviewing the expense components of the main groupings of costs of credit (See Appendix A) we came to the conclusion that salaries comprised at least two-thirds of the total credit costs. When the increased salary costs (35%) are combined with increase operating costs (16%) the weighted average increase is 29% for those cost groupings that are composed of both salaries and other operating expenses.

(c) Interest costs for the average of accounts receivable investment were computed at 8% instead of the 6% used for the State of Washington. Most short-term business loans in the State of Alaska are made at 8% and for the present, 6% loans (with rare exceptions) are a thing of the past. Actually, investment in accounts receivable balances could be termed capital investment and when considered in this light, 8% is a low return on investment.

Using the above factors and assumptions, Washington credit costs were converted to Alaska costs as follows:

New Accounts Costs - Reduced 15% for unit sales price differential and the balance increased 29% for higher salaries and other operating costs;

Account Servicing Costs - Reduced 15% for unit sales price differential and the balance increased 29% for higher salaries and other operating costs;

Account Collection Costs - Reduced 15% for unit sales price differential and the balance increased 29% for higher salaries and other operating costs;

Interest Costs - Increased 33-1/3% (From 6% to 8%);

Credit Space and Equipment Costs - Reduced 15% for unit sales price differential and the balance increased 16% for other operating costs increases;

Additional Salespersons' Costs due to Credit - Reduced 15% for unit sales price differential and the balance increased by 35% for higher salaries;

Management - Reduced by 15% for unit sales price differential and the balance increased 35% for higher salaries.

LIMITATIONS:

Because of a shortage of available time, personnel and cost limits, we were unable to conduct an Alaskan study such as that prepared by Touche, Ross, Bailey & Smart for the Washington Retail Council. Because of the above mentioned limitations, we deliberately approached the conversion factors and assumptions in a conservative manner. Because of our conservative approach, we believe that the factors and assumptions utilized to convert Washington costs of credit to Alaskan costs of credit are valid and present fairly the cost of credit in Alaska.

In addition to the Washington study, there are also available costs of credit studies prepared for the Maryland Council of Retail Merchants, Inc. and one for the National Retail Merchants Association. All of the above studies support the conclusion that providing credit to the consumer is costly.

EXHIBIT 1

ALASKAN RETAIL COUNCIL

REPORT ON CONSUMER CREDIT COSTS IN RETAIL STORES IN ALASKA

COSTS AND SERVICE CHARGES FOR CREDIT ACTIVITY

	Credit activity per $100 of credit sales			
	All accounts	Regular (30-days) accounts	Revolving credit accounts	Long-term installment accounts
CREDIT SALES	$100.00	$100.00	$100.00	$100.00
SERVICE CHARGE REVENUES	$ 4.40	$ .01	$ 6.97	$ 6.06
CREDIT COSTS:				
New account	$ .48	$ .23	$ .46	$ .93
Account servicing	2.13	2.33	2.08	1.93
Account collection	1.32	.85	1.65	1.33
Interest @ 8% of average accounts receivable investment	2.89	1.27	3.45	4.45
Credit space and equipment	.15	.20	.16	.05
Additional salespersons' costs due to credit	.18	.20	.18	.14
Management	.40	.34	.44	.42
TOTAL CREDIT COSTS	$ 7.55	$ 5.42	$ 8.42	$ 9.25
EXCESS OF COST OVER REVENUE	$ 3.15	$ 5.41	$ 1.45	$ 3.19
EXCESS ASSUMING COST OF CAPITAL INVESTMENT (INTEREST) IN ACCOUNTS RECEIVABLE BALANCE AT:				
10%	$ 3.88	$ 5.73	$ 2.32	$ 4.31
11%	$ 4.24	$ 5.89	$ 2.75	$ 4.86
12%	$ 4.60	$ 6.05	$ 3.18	$ 5.42

EXHIBIT II

ALASKAN RETAIL COUNCIL

STUDY OF CONSUMER CREDIT COSTS IN RETAIL STORES IN ALASKA

TOTAL CREDIT COST COMPARISION - CREDIT ACTIVITY PER $100 CREDIT SALES

	Alaska Participants	Washington Participants
CREDIT SALES	$100.00	$100.00
SERVICE CHARGE REVENUE	$ 4.40	$ 4.40
CREDIT COSTS:		
New account	$ .48	$ .43
Account servicing	2.13	1.90
Account collection	1.32	1.17
Interest @ 8% (6% for Washington) of average accounts receivable investment	2.89	2.17
Credit space and equipment	.15	.15
Additional salespersons' costs due to credit	.18	.15
Management	.40	.35
TOTAL CREDIT COSTS	$ 7.55	$ 6.32
EXCESS OF COST OVER REVENUE	$ 3.15	$ 1.92

STUDY OF CONSUMER CREDIT COSTS IN RETAIL STORES IN WASHINGTON

APPENDIX A

LIST OF EXPENSES INCURRED BY RETAIL STORES IN PROVIDING CREDIT SERVICES TO CUSTOMERS

New accounts costs:

- Credit salaries related to opening new accounts
- Employee benefits on above salaries
- Postage on new account correspondence
- Credit supplies and unclassified expenses
- Charga-plate costs and services for new customers
- Credit research services of credit bureau

Account servicing costs:

- Billing salaries
- Bill adjustment salaries
- Employee benefits on above salaries
- Postage on customer statements
- Accounts receivable billing supplies
- Bill adjustment supplies
- Accounts receivable balancing differences
- Replacing lost or stolen charga-plates
- Addressograph services for credit or accounts receivable purposes
- Equipment rental and maintenance costs on equipment used primarily for the credit function
- Related credit costs (costs which are in part directly associated with rendering credit services) -
  - Sales audit salaries

Cash office salaries in handling collections

Mail service salaries

Statistical salaries

Employee benefits on above

Telephone cost related directly to credit operations

Taxes on net asset value of equipment and furniture used in credit

Insurance premiums paid on accounts receivable balances

Supplies and expenses related to credit operations

Sales audit

Cash office

Mail service

Sales books and credit books used on selling floor

Account collection costs:

Collection salaries

Employee benefits on above salaries

Postage on collection (dunning) mail

Collection supplies and unclassified expenses

Credit bureau services related to collection problems

Collection agency fees

Bad debt expense (net of recoveries)

NATIONAL **Bank of Alaska**

Main Office: Box 600 • Anchorage, Alaska 99510 • 907/272-5544

File

March 6, 1975

Representative Bob Bradley
Room 203 Assembly
Pouch E
Juneau, Alaska 99801

Re: House Bill 46--Act amending the Alaska Retail Installments Sales Tax

Dear Bob:

House Bill 46, introduced by Representative Tom Fink, is simply an act to reduce the existing interest rates on retail installment sales, and the retail charge program of which our credit cards program operates within the state.

This bill not only effects credit card programs, but also all companies who have financing programs to aid the consumer in purchasing items.

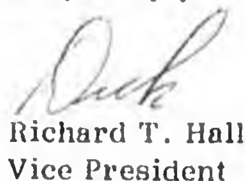
The rates proposed in the bill simply make it impractical to continue such programs.

Unfortunately, a bill such as this, that supposedly is intended to benefit the consumer, will create hardship on the person it is designed to help by drying up the availibility of funds.

I will be in Juneau soon and will be happy to explore this bill with you personally or the committee at your discretion.

If I can offer any additional information, I will be happy to do so. We are opposed to this type of legislation and request that it be reviewed in depth by your committee.

Very truly yours,



Richard T. Hall
Vice President

Bob we have 60,000 Credit cards out to Alaskans. Mastercharge has extensive acceptance too. The rates are not at all bad - Dick

OFFICES STATEWIDE

Sears, Roebuck and Co.

PACIFIC COAST LAW OFFICES
900 SOUTH FREMONT AVENUE
ALHAMBRA, CALIFORNIA 91802

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PHILIPPE J. MONET 576-4454
H. WARREN SIEGEL 576-4064
CHARLES P. McKENNEY 576-4058

March 11, 1975

File

Honorable Bob Bradley
Chairman, House Commerce Committee
Pouch V
State Capitol Building
Juneau, Alaska 99811

Dear Representative Bradley:

At the end of the hearing on HB 46 last week, Representative Fischer asked me what Sears' delinquent account experience is. You will remember I had said that this is one of the costs of granting credit. I was not able to answer Representative Fischer's question at that time but submit the following for your information.

Nationally, at the end of 1973, there were 168,560 Sears credit accounts delinquent three or more monthly payments. The number of defaulted accounts (less than one full monthly payment received during the previous six months) totaled 4,338. The provision for uncollectibles, after recoveries from charged off accounts, and the related percentage to credit sales was $45 million, which was .6% to credit sales.

Sears' experience in Alaska compares with these figures. In various studies I have seen which set forth retail industry statistics, the figures indicate that Sears' experience is slightly better than most. Therefore, an industry average would be closer to 1%, as a fair estimate.

I appreciated the opportunity to appear before the Committee. If you or any Committee member have further questions, we will be happy to try to answer them.

Sincerely yours,

Charles McKenney

CM/sm

cc: Rep. Helen Fischer
Don Magnuson

STATE OF ALASKA

JAY S. HAMMOND, Governor

OPR: Miles
2532

DEPARTMENT OF COMMERCE

OFFICE OF THE COMMISSIONER / *POUCH D — JUNEAU 99801*

File

March 20, 1975

The Honorable Bob Bradley
Alaska State House of Representatives
Pouch "V" State Capitol Building
Juneau, Alaska 99811

Dear Bob:

Attached is information concerning HB 46, an act amending the Alaska Retail Installment Sales Act.

The Department of Commerce opposes this bill. It appears that passage of HB 46 would:

1. Raise the cost of goods and services to the consumer as well as the retailer;
2. Reduce consumer credit lines and make new credit and credit extensions most difficult;
3. Hamper the availability of credit for "marginal" consumers;
4. Increase down payments on many items;
5. Increase requirements for consumer insurance.

Should you wish additional material or comment, feel free to call on me at any time.

Sincerely yours,

Langhorne A. Motley
Commissioner

LAM/pc

HB
50

HB 50

Tape No	Date
3	2/12
4	2/12

"An Act relating to insurance settlements."

1/23/75

COMMITTEE REPORT

HOUSE

Mr. Speaker: Date ______________

The Committee on ____Commerce____ has had ____HB 50____ under consideration. A Majority of the members of the Committee

(✓) recommends it DO PASS

( ) recommends it DO NOT PASS

(✓) recommends it DO PASS WITH ATTACHED AMENDMENT(S)

( ) recommends it BE REPLACED WITH CS FOR __________ AND THAT CS FOR ______________ DO PASS

( ) "and" recommends it BE REFERRED TO THE ______________ COMMITTEE

( ) reports it back WITHOUT RECOMMENDATION

( ) "other"

Members signing the Majority report:

Members NOT concurring in the Majority report:

______________ recommends:

______________ recommends:

______________ recommends:

______________ recommends:

______________ recommends:

______________ Chairman

A M E N D M E N T

Offered in the HOUSE

By Commerce Committee

To: ____________ HOUSE BILL NO. [illegible]

____________ SENATE BILL NO. ____

AMENDMENT: Page 1 Line 12, 14

Line 12

After the word "at" delete the words "the legal rate" and insert the words "the rate of four percentage points above the annual rate charged member banks for advances by the 12th Federal Reserve District that prevailed on the date of the notice of the loss or the date of settlement, whichever is greater."

Line 14

[illegible]

LAW OFFICES OF
FAULKNER, BANFIELD, DOOGAN & HOLMES
SUITE 201, 311 FRANKLIN STREET
JUNEAU, ALASKA 99801

HERBERT L. FAULKNER (1882-1972)
NORMAN C. BANFIELD
FRANK M. DOOGAN
MICHAEL M. HOLMES
RANDALL J. WEDDLE
WILLIAM B. ROZELL

JAN VAN DORT
LAWRENCE T. FEENEY
CHARLES N. DRENNAN

TEL. 586-2210
AREA CODE 907

February 19, 1975

The Honorable Bob Bradley
Chairman, House Commerce Committee
Pouch V
Juneau, Alaska 99811

Re: House Bill No. 50

Dear Mr. Chairman:

I am sorry that I did not have the opportunity to appear at the hearing that was held on this bill on February 12, 1975. The American Mutual Insurance Alliance is opposed to legislation such as this for serveral reasons.

First, Mr. Fink may believe that a bill such as this would gouge the insurance companies. However, all underwriting penses, including interest, are merely passed on to e consumer in the form of higher premiums.

Second, .n a garden variety automobile accident where the only loss is physical damage to the motor vehicle, it is certainly possible to settle the claim within 30 days. This is not the case when the situation involves a loss at sea, a major disaster such as the crash of the Alaska Airlines jet at Teardrop Lake, or personal injuries where a person may not be medically stable for quite some period of time. Often, it is extremely difficult if not completely impossible for an insurance company to put a value on the loss within 30 days from the date the loss occurs. A bill requiring interest on top of the amount of the settlement

penalizes the person paying premiums because the insurer does a thorough investigative job.

Third, in personal injury actions, a portion of a judgment award or settlement represents compensation for future losses. It is patently unfair to require insurance companies to pay interest on the portion of the award representing future loss. If anything, an insurance company should be entitled to a discount on that portion of the award for early payment.

Fourth, the Alaska Supreme Court has already held that a successful party is entitled to interest on the amount of his damages from the date the claim or cause of action arose. This and our famous Rule 82 attorney's fee provision are very much in the minds of insurance companies when they are dealing with injured claimants. It would be fair to say that a portion of each settlement would be labeled interest because of the effect that the Supreme Court holding has had on settlement negotiations.

I have not really thought about this in depth, but it would appear that the last sentence of the bill would tend to discourage insurance companies from raising earlier settlement offers.

I sincerely appreciate your consideration of my comments.

Very truly yours,

FAULKNER, BANFIELD, DOOGAN & HOLMES

By

Jan Van Dort

JVD/aw

HB
51
HB
52

HB 51 & 52

Tape #	Date
6	2/26
7	2/26
9	3/5

"An Act making a special appropriation to the Department of Commerce, division of insurance; and providing for an effective date."

1/23/75

COMMITTEE REPORT

FINANCE

HOUSE

Mr. Speaker: Date ____________

The Committee on Commerce has had HB 51 under consideration. A Majority of the members of the Committee

(X) recommends it DO PASS

( ) recommends it DO NOT PASS

( ) recommends it DO PASS WITH ATTACHED AMENDMENT(S)

( ) recommends it BE REPLACED WITH CS FOR ____________ AND THAT CS FOR ____________ DO PASS

( ) "and" recommends it BE REFERRED TO THE ____________ COMMITTEE

( ) reports it back WITHOUT RECOMMENDATION

( ) "other"

Members signing the Majority report:

Members NOT concurring in the Majority report:

____________ recommends:

____________ recommends:

____________ recommends:

____________ recommends:

____________ recommends:

____________ Chairman

"An Act creating an office of the public adjustor; and providing for an effective date."

1/23/75 COMMITTEE REPORT JUDICIARY

HOUSE

Mr. Speaker: Date ____________

The Committee on Commerce has had HB 52 under consideration. A Majority of the members of the Committee

( ) recommends it DO PASS

( ) recommends it DO NOT PASS

(✓) recommends it DO PASS WITH ATTACHED AMENDMENT(S)

( ) recommends it BE REPLACED WITH CS FOR ______ ____ AND THAT

CS FOR ____________ DO PASS

( ) "and" recommends it BE REFERRED TO THE ____________

COMMITTEE

( ) reports it back WITHOUT RECOMMENDATION

( ) "other"

Members signing the Majority report:

Members NOT concurring in the Majority report:

____________ recommends:

____________ recommends:

____________ recommends:

____________ recommends:

____________ recommends:

____________ Chairman

AMENDMENT

OFFERED IN THE HOUSE: BY: Commerce Committee

To: ______ HOUSE BILL No. 52

SENATE BILL No. ______

PAGE: Two LINE: 16, 18, 19

Page Two, Line Sixteen - Delete "director" and insert "governor"

Page Two, Line Eighteen - After the word commissioner, delete remainder of line eighteen and line nineteen and insert, 'but may be removed for cause or by the request of the governor and concurrence of a majority of the Legislature by concurrent resolution. When the Governor requests removal the public adjustor shall remain in office until removal by the action of the Legislature."

Alaska Independent
Insurance Agents & Brokers, Inc.

SEND REPLY TO:

SHATTUCK & GRUMMETT, INC.
301 SEWARD STREET
JUNEAU, ALASKA 99801

February 24, 1975

The Ninth State Legislature

To Whom it May Concern:

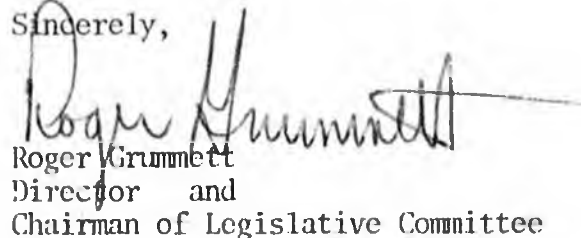
Re: HB 52 & HB 51

On behalf of the Board of Directors of the Alaska Independent Insurance Agents and Brokers, Inc., I would like to make the following statement regarding the Public Adjuster.

We are against your idea of a Public Adjuster. We feel that someone within the Department of Insurance should be designated to handle the consumer complaints. We also feel that the independence of this individual as proposed in HB 52 is far too strong for the position.

We, on the other hand, would like to see the Legislature pass on the $75,000 which was earmarked for HB 51 to go to the Division of Insurance to fund the additional personnel needed to run that department.

Sincerely,



Roger Grummett
Director and
Chairman of Legislative Committee

RG: eh

ENGSTROM AND EVANS

ATTORNEYS AT LAW

202 NATIONAL BANK OF ALASKA BUILDING TELEPHONE (907) 586-1445

JUNEAU, ALASKA 99801

ALLAN A. ENGSTROM
GORDON E. EVANS

February 11, 1975

Honorable Robert Bradley
Chairman, House Commerce Committee
Alaska State Legislature
Pouch V
Juneau, Alaska 99801

Re: House Bills 50, 51 and 52

Dear Chairman Bradley:

Blue Cross of Washington Alaska, Inc. has been asked by a representative of your committee to comment on the above bills. I represent Blue Cross as legislative counsel.

With reference to House Bill No. 50, Blue Cross does not have a position.

With reference to House Bills Nos. 51 and 52, Blue Cross does not oppose legislation creating an office of public adjuster.

Thank you for the opportunity to make these comments.

Very truly yours,

ALLAN A. ENGSTROM

AAE:rhm
cc: John Hopkins

02-001B

STATE of ALASKA

MEMORANDUM

TO: Honorable Bob Bradley
Chairman, House Commerce Committee
Alaska State Legislature

THRU: Andrew S. Warwick, Commissioner
THRU: A.M. Saylors, Director

FROM: John George
Risk Manager
Division of General Services & Supply
Department of Administration

DATE: February 19, 1975

SUBJECT: HB 51 and HB 52
Committee Hearing

At the request of Ms. Judy Whitney, comments on House Bills 51 and 52 for review by the House Commerce Committee are respectfully submitted.

The establishment of a public adjuster within the Department of Commerce will not have an effect on the State's Risk Management program. It is designed to protect the individual policyholder and claimant who lacks specific insurance expertise.

It is our opinion that the Department of Commerce, Division of Insurance, already provides a valuable service to the individual purchaser of insurance by investigating and regulating insurance companies and claims adjusters. Appointment of a public adjuster would unnecessarily overlap with work already carried out by the Division of Insurance. If there is a need for additional investigation and arbitration of claims settlement, it seems logical that the Division of Insurance should be expanded by one or more classified persons to handle this additional workload along with other regulatory duties.

To our knowledge, all persons requesting assistance from the Division of Insurance have received help. The number of these requests is relatively small and, in our opinion, does not justify either a full time, exempt position or an appropriation of $75,000 at this time.

File

HOUSE BILL 52

House Bill 52, an act entitled: "An act creating an office of the public adjustor; and providing for an effective date."

The purpose of HB 52 is to protect and assist the insurance claimant within the state of Alaska by providing for a Public Adjustor within the Division of Insurance, Department of Commerce.

A Public Adjustor as proposed in HB 52 acts as an ombudsman for members of the public needing help in the determination of the amount of claims or in the settlement of claims with insurers. The Public Adjustor would be of most benefit to the insurance claimant with a small claim.

Currently there is no public assistance for a person filing an insurance claim. If the claim is a large one, it is economically feasible to hire an attorney to negotiate with the insurance compnay or contest the settlement in court. In the case of the claimant with a small claim, in most cases it is not feasible to hire an attorney or take the company to court. The only recourse left to the claimant is to accept the settlement offered by the insurance company which is, in some cases, an amount far less than a fair settlement for the claim. The Director of the Division of Insurance stated that in some states insurance adjustors are brought in to assist the public in such matters.

An adjustor is one who investigates and reports to his employer concerning claims arising under insurance contracts. Their investigations are made on behalf of either the insurer or the insured, whichever employs them. There are three types of claims adjustors to help one when filing a claim. A company adjustor is an employee of the insurance company. An independent adjustor is employed by the insurance company as a private contractor, and is usually used when the company does not have its own company adjuster available. A public adjustor in some states is hired by the claimant and is paid by the claimant. Brokers and agents assist in claims also.

The Public Adjustor would be of assistance to the public not only in the settlement of claims but also in the determination of claims. Currently the only recourse a claimant has if there are problems with claims determination or settlement is to file a complaint with the Governor's office. A complaint received by the Governor's office is forwarded to the Commis-

sioner of Commerce who forwards it to the Director of the Division of Insurance. John O'Shea, the Director of the Division of Insurance stated that he and his staff handle one half of the complaints for the State while his Deputy in Anchorage handles the rest. I would question this system in that most people are unfamiliar with government and would not know where assistance was available to aid them in an insurance problem. I would also question the time involved in this procedure.

The Public Adjustor in accordance with HB 52 would be appointed by the Director fo the Division of Insurance. Once appointed this person would serve independently of the Division of Insurance. As it states in this bill the Public Adjustor can be removed for cause as determined by the Legislature by concurrence of a 2/3 vote. There may be problems here with the appointment by the Director of the Division and the removal of this person by the Legislature. As the Legislature's role is not to act as an administrator and this person must be in cooperation with the State administration, a better solution might be to have the Public Adjustor appointed by the Governor with confirmation by the Legislature. The Governor would then also be able to remove this appointee with concurrence of the Legislature. The term of the Public Adjustor as stated in the bill is four years. If the procedure of hiring and terminating is changed the term of service might also be investigated.

The Public Adjustor although independent of the Division of Insurance will be included under the Prohibited Interests Rewards section 21.06.040. This insures that the Public Adjustor has no conflict of interest in dealing with the public or insurers, as is easily understood in this amendment to the current law.

The direct responsibilities of this position, as stated before, are to assist the public in the determination of the amount of claims and aid in the settlement of claims. Through this assistance, the Public Adjustor will become familiar with the settlement practices of insurers and shall review their records on both settlement practices and claim payment records. During this process if it is discovered that an insurer is habitually uncooperative in settling claims, slow in making payments on claims, or engages in practices inconsistent with the purposes of this title, the Public Adjustor shall request the Director of Insurance to hold a hearing and if warranted suspend the license of an insurer not complying with the requirements of this title. This process reinforces the position of public ombudsman which the Adjustor will have in dealing with the insurance company.

House Bill 51 requests a special appropriation to the Department of Commerce, Division of Insurance to fund the office of the Public Adjustor. This act will take effect July 1, 1975

and requests the sum of $75,000, appropriated from the general fund, for this purpose. In talking with Mr. Fink, prime sponsor of this bill, he stated that he felt a good insurance adjustor could be hired for $25,000 yearly. This appropriation would allow for a small staff and funding for an information brochure.

The location of the office is not stated in the bill. The logical assumption would be that the office be located in Juneau. During the first year of business, while the public is becoming aware of this service, it seems more logical to place the office in Anchorage where the most people are and therefore the most claims. Although this is not an important facet of this legislation, there is currently a state insurance office located in Anchorage so the office of the Public Adjustor could be located in either Anchorage or Juneau.

Opinions of this bill are forthcoming from Mr. Roger Grummett, Legislative Representative for the State Association of Indepenedent Agents. Mr. Grummett is attending a board meeting of this organization in Sitka this weekend and will report their opinions to us on Monday. Attached is an opinion from John George, the Risk Manager for the State. I spoke with John O'Shea present Director of the Division of Insurance. He spoke against HB 52 and cited reasons for his opposition. He was opposed to this bill because the office of the Public Adjustor was not in keeping with the administrative process of his office and it would only compound administrative problems. He felt the ombudsman as proposed by the Governor and Senator Kerttula could handle these problems. He did emphasize the special expertise needed for such a position and felt that the costs to provide this would be tremendously high. He felt that the funds expended for this position could be better utilized within his own department and that there would be better claim settlements if there was more funding in his department. He objected to the Public Adjustor being appointed by the Director and then only removed by the Legislature. Mr. O'Shea was basically very concerned over his position and the administration of his division.

Mr. O'Shea stated that he knew of no state that had a public adjustor. He stated some states hire adjustors on public license, who work similarly to our concept of a Public Adjustor, for a small fee. I learned that Pennsylvania has a system similiar to this and am awaiting aresponse from them on how their system functions.

I have received information from the State of Washington concerning questions on who handles these responsiblities (meaning those delegated to the Public Adjustor in HB 52) within their state structure. The Washington Insurance Department has established a Comprehensive Consumer Division within the office of the Commissioner of Insurance. The Supervisor of

the Consumer Division is not independent of the Commissioner, but this system seems to be working. Attached are explanatory brochures on this system. The last page of the brochure explains to the reader how to file a complaint with the Commissioner. The State of Alaska Division of Insurance has no such literature on insurance and no way to inform the public on how and where to file a complaint. The State Consumer Protection Office refers insurance complaints to the Division of Insurance as do individual insurance agents.

As further information is gained in respect to this bill, it will be forwarded to your office.

HB
105

UNIFORM HOLD HARMLESS ACT

A Hold Harmless Agreement is a contractual arrangement whereby one party agrees to indemnify and hold harmless another party for negligent acts. Hold harmless agreements are classified as limited form, intermediate form or broad form depending on the degree of liability assumed for the negligent acts of others.

Under a limited form hold harmless agreement, the indemnifying party assumes liability for only its own negligence. The liability assumed under a limited form hold harmless agreement is no more than that imposed by common law.

Under an intermediate form hold harmless agreement, the indemnifying party assumes liability for its own negligence and the contributing negligence of the party being indemnified. In other words, the indemnifying party waives contributory negligence on the part of the party being indemnified and assumes responsibility as if the indemnifying party, alone, were responsible.

Under a broad form hold harmless agreement, the indemnifying party assumes liability for negligent acts without regard to which party is negligent, including acts for which a party other than the indemnifying party may be solely negligent. The scope of a broad form hold harmless agreement is limited only by the imagination of the legal counsel of the party being indemnified and the knowledge and bargaining position of the indemnifying party.

It is apparent, and experience has demonstrated, that hold harmless agreements tend to thwart the free working of the common law. Also, hold harmless agree-

ments create legal conflicts between public policy and the right of parties to freely contract with each other, and they often result in inequitable contractual relationships.

The Uniform Hold Harmless Act would prohibit hold harmless agreements whereby one party indemnifies another party against liability claims for bodily injury or property damage. The Act would permit the free working of the common law in an area where the common law has served the public well. It would promote the public policy that a wronged party should have a remedy at law for injuries suffered as a result of another party's negligence. It would outlaw a party negating its responsibility for its own negligence by contractual agreement.

The Uniform Hold Harmless Act would also clarify the law concerning the enforceability of hold harmless agreements. The courts have had difficulty with hold harmless agreements, finding them in conflict with, on the one hand, the common law concept that a party must be responsible for its own acts and, on the other hand, the right of a party to lawfully commit and bind itself under contract. Understandably, the courts have been inclined to protect the unwary and the uninformed and to interpret hold harmless agreements in their narrowest terms. The courts, in a number of cases, have held that hold harmless agreements were in violation of public policy. The Uniform Hold Harmless Act would resolve these legal conflicts in Alaska by declaring hold harmless agreements to be contrary to public policy and, as such, void and unenforceable.

The Hold Harmless Act would also promote more equitable contractual relationships between parties. A relatively small business firm is often at a disadvantage when negotiating a contract with a larger firm. The larger firm will often pre-

sent the smaller firm with a printed or standard contract containing an intermediate form or broad form hold harmless agreement. The smaller firm will often accept the hold harmless agreement as presented either because it does not understand the obligation which it is assuming or because its bargaining position is such that it is unable to negotiate a change.

An indemnifying party should arrange to insure the obligation which it has assumed, and this creates additional insurance cost. More serious is the situation where an indemnifying party does not insure the obligation which it has assumed either because the indemnifying party does not understand the obligation assumed or because the obligation assumed, for any number of reasons, is not insurable.

It is significant that at least nineteen states have now passed legislation limiting, restricting or prohibiting various types of hold harmless agreements.

The Uniform Hold Harmless Act would require that all persons and business entities in the State of Alaska stand as equals before the common law in the assessment of liability for their negligent acts.

STATE OF ALASKA

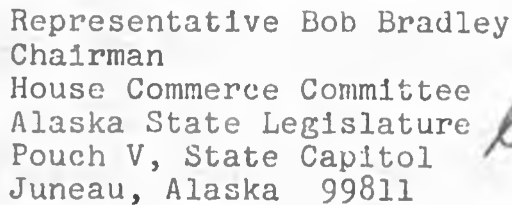
JAY S. HAMMOND, Governor

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

POUCH K — STATE CAPITOL
JUNEAU 99801

March 21, 1975



Representative Bob Bradley
Chairman
House Commerce Committee
Alaska State Legislature
Pouch V, State Capitol
Juneau, Alaska 99811

RE: HB 105.

Dear Representative Bradley:

You have asked us for a memorandum on the constitutionality of HB 105. This measure purports to adopt "the Uniform Hold Harmless Act" but it is not based upon any bill drafted by the National Conference of Commissioners on Uniform State Laws. We are writing to the Contracts Section of the American Bar Association to ascertain if it has done any studies on suggested legislation of this nature.

Our preliminary view, however, is that there is an obvious constitutional infirmity in that clause of proposed AS 45.47.020(b) which provides: ✓"This chapter applies to all contracts executed or performed in the state including. . . all contracts executed or performed before enactment of this chapter."

Article I, Section 10 of the U.S. Constitution provides: "No state shall. . . pass any. . .law impairing the obligation of contracts," and Article I, Section 15 of the Constitution of the State of Alaska provides: "No law impairing the obligation of contracts. . . shall be passed." These prohibitions apply to contracts which are already in existence. The Supreme Court of the United States has said of the federal proscription: "The contract clause of the Constitution of the United States has reference only to a statute of a state enacted after the making of the contract whose obligation is alleged to have been impaired. "Oshkosh Waterworks Co. v. Oshkosh, 47L ed 249, 253 (1903), 187 US 437.

There is no impairment where a contract is against public policy but HB 105 in proposed AS 45.47.010(4) declares the intention to promote a public policy which is not now recognized by the Alaska statutes so the impairment by AS 45.47.020(b) would not be

mitigated. At least three states which prohibit "hold harmless" agreements in building contracts as against public policy -- Hawaii, Idaho and Utah -- have express provisions in the statutes preventing them from being applied to contracts in force at the effective dates of the acts.

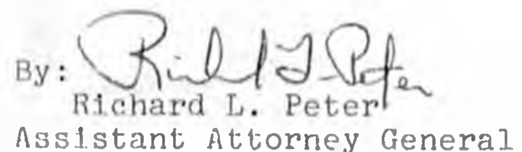
As to the application of HB 105 to agreements entered into after enactment, there is a constitutionally guaranteed freedom to contract which must be considered. The liberty and property rights secured by both the federal and state constitutions are interpreted to include freedom of contract. But this freedom is not absolute and limitations may be imposed prospectively as an exercise of police power to promote the general welfare "if they both relate to the claimed objective and employ means which are both reasonable and reasonably appropriate to secure such objective". Department of Financial Institutions v. Holt, 108 N.E. 2d 629, 635 (Indiana 1952).

Whether the Alaska courts would consider that HB 105 meets such a standard in prohibiting "hold harmless" agreements in future contracts, is a matter for conjecture. But we would conclude that this measure is obviously unconstitutional only in its application to contracts in force at its effective date.

We will advise you if we receive any pertinent information from the American Bar Association. If we can be of further assistance, please let us know.

Sincerely,

AVRUM M. GROSS
ATTORNEY GENERAL

By:

Richard L. Peter
Assistant Attorney General

RLP:jw

LaBOW, HAYNES OF ALASKA, INC.
A ROLLINS BURDICK HUNTER Company

Multinational Insurance Brokers / 840 K Street, Anchorage, Alaska 99501 (907) 279-2422

March 31, 1975

The Hon. Bob Bradley, Chairman
Commerce Committee
Alaska House of Representatives
Juneau, Alaska 99801

Re: Uniform Hold Harmless Act

Dear Mr. Bradley:

Enclosed are ten copies of a statement I have prepared to be read into the record of the joint Senate and House Commerce Committee hearing to be held April 1 on the Uniform Hold Harmless Act.

I will be pleased to answer questions from you or members of your committee.

Sincerely,

LABOW, HAYNES OF ALASKA, INC.

George S. Suddock, President

GSS:tm
enclosures

HB 105

Tape #	Date
4B L	4/28
3L	4/30

"An Act adopting the Uniform Hold Harmless Act."

1/30/75

COMMITTEE REPORT

HOUSE

Mr. Speaker: Date ____________

The Committee on Commerce has had HB 105 under consideration. A Majority of the members of the Committee

( ) recommends it DO PASS

( ) recommends it DO NOT PASS

( ) recommends it DO PASS WITH ATTACHED AMENDMENT(S)

( ) recommends it BE REPLACED WITH CS FOR ____________ AND THAT CS FOR ____________ DO PASS

( ) "and" recommends it BE REFERRED TO THE ____________ COMMITTEE

( ) reports it back WITHOUT RECOMMENDATION

( ) "other"

Members signing the Majority report:

Members NOT concurring in the Majority report:

____________ recommends:

____________ recommends:

____________ recommends:

____________ recommends:

____________ recommends:

____________ Chairman

A M E N D M E N T

Offered in the HOUSE By Commerce Committee

To: ____________ HOUSE BILL NO. 105

____________ SENATE BILL NO. ____

AMENDMENT: Page ______ Line 6

Line 6

After the words "[illegible]" delete the word "Uniform".

HB
115

HB 115

Tape #	Date
5	2/20
5	2/24
6	2/24
25	4/8

ALASKA PUBLIC INTEREST RESEARCH GROUP

P. O. BOX 1093
ANCHORAGE, ALASKA 99510

PHONE 274-6765

File with HB 115

April 22, 1975

Representative Bob Bradley
Chairman
House Commerce Committee
Pouch V
Juneau, Alaska 99801

Dear Representative Bradley:

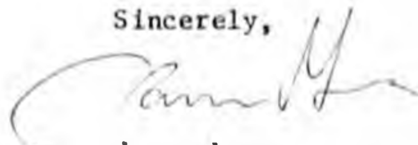
Enclosed is a copy of a proposed amendment to HB 115, an act which would compel mortgage lending institutions to pay interest on mortgage reserve account funds.

The proposed amendment should remove most of the difficulties inherent in tying the interest rate to the passbook savings rate, an objection often raised by the banking industry. With modern computerized accounts, the one-half percent margin for lending institutions provides ample income to cover the cost incurred in administering the accounts.

If this bill is passed as amended, each home owner with a mortgage will receive between $25 and $50 dollars each year in interest earned on <u>their</u> money being held in escrow.

Please advise me if this information is sufficient.

Sincerely,



James Love
Director

File under
HB 115

Alaska Public Interest Research Group

Mortgage Escrow Accounts

or

GIVING INTEREST WHERE INTEREST IS DUE

April 29, 1975

Remember the old-fashioned Christmas Clubs? Periodically, a small amount would be deposited into this account and at the end of the year the depositor would get back exactly the amount he had put into it. This scheme prevailed under the guise of another "free of charge" service from your friendly bank.

The depositors were overwhelmed by such service. Likewise the banks were overjoyed to have these interest free deposits! It took a while, but it finally dawned on people that they were simply contributing to the wealth of the banking industry. What had started as an added service, "free of charge" ultimately turned out to be just another form of swindle upon the slow-witted trusting consumer. Fortunately, people finally caught on, resulting in a marked decline of members in such "Clubs".

However, yet another form of "no interest" operation still goes on, accumulating several billion dollars a year on which savers do not earn a cent. And again, consumers are beginning to show a lot of interest in this "no interest" scheme.

It exists under several names-escrow, impounded funds, and T&I Accounts (Tax and Insurance). Every homeowner who makes monthly payments to a savings and loan association, mortgage company or local bank is donating hundreds of dollars to the multi-million dollar wealth of these lending institutions.

Unlike the Christmas Clubs though, the escrow account concept was a response to a critical problem. The depression of the thirties found Americans literally unable to buy homes. Few banks had sound liquid cash positions and lending for property and homes was considered very risky. Extremely high down payments were demanded, along with very high interest rates and very short periods were allowed for re-payment(thirty year mortgages were unheard of). The average American, even the employed ones, found such demands impossible to meet.

At this point the Federal government decided to intervene. In 1934 the Federal Housing Administration was created by the National Housing Act. It provided for low down payment loans with the FHA insuring the repayment of principle and interest. The FHA went to the lending institutions and argued for a situation where housing would be more in the reach of middle class Americans with the monthly loan payments closer to an average rental payment. The banks, shaky and fearful, claimed home loans were too big a risk, so the FHA said the government would insure them against loss. Not dollar for dollar, but enough to encourage a change in lending practices. Additionally, the FHA formulated regulations by which all insured loans would have to be governed. One of these regulations was the establishment of "escrow" accounts.

Prior to escrow, an owner of a mortgaged property was responsible for paying taxes and insurance as they fell due. As money became scarce, many owners could not meet insurance payments or simply did not buy any. Tax payments were often not met. Unnumbered citizens lost their property to foreclosure by the local taxing bodies or through uninsured damage. In the cases where the equity was low (little of the loan paid off), the banks suffered severe and heavy losses. Escrow accounts, where each monthly loan payment included payment toward future tax assesments and insurance payments, and those monies were set aside in special accounts, were the solution for both the person paying off their mortgage and the lender. It meant that when taxes or insurance fell due the money existed in the escrow account. The mortgagor did not have to scramble for the "extra" cash and the banks did not have to fear that the money they had loaned would be lost to foreclosure or uninsured damage.

The benefits of the establishment of escrow accounts cannot be underestimated. It played a large part in making home ownership possible for literally millions of Americans. And it has through the years supplied millions upon millions of dollars profit to lending institutions.

Now that we have given credit where credit is due, it is time to move on to discussing giving interest where interest is due.

While escrow accounts, as we have pointed out, arose from a genuine need and remain a real service to mortgage customers, it is a service you pay exorbitantly for.

For instance, the cost nation wide in monies lost to the home buying consumer, borrowing from just savings and loan associations alone, is in excess of $75.6 million annually! And, based on the GAO (General Accounting Office) estimate of the aggregate of escrow deposits in all lending institutions, this service costs in total are $470 million a year.

This rip-off works in a very simple manner. Each month, when you make your mortgage payment, you also pay 1/12th of your estimated tax and hazard insurance bill. This money is set aside in an escrow account. As far as the homeowner is concerned, it is sitting idle, growing payment by payment, until the bank receives the bills and pays them. (Taxes in Anchorage are paid twice yearly, insurance once.) However, it takes very little reflection on anyone's part to realize that "idle" money is an absolute anathema to a banker. In fact, it would be senseless to expect a business whose profits come from "using" money-buying, selling, investing-to allow perfectly good money to languish unused. Nor does it.

Your money is used. Lenders invest these funds in short term securities for financial gain. Such use of consumers money that is on deposit with a financial institution is a matter of course, an accepted and approved practice.

And in a straightforward transaction the depositor receives some of the profits his money makes. When the bank uses your money, it pays you interest-just as you pay interest to the lending institutions when you borrow and use their money. With one glaring exception. The overwhelming majority of lenders will pay you no interest on your escrow monies on deposit with them. No matter how much proft they make from its use.

The figure mentioned earlier of $470 million---four hundred-seventy million dollars---is the amount American homeowners who are paying off mortgages would have received in one year if they got even 5% interest on their impounded monies. (And lest you think impounded is a harsh term, try buying a home through a financial institution without agreeing to deposit your tax and insurance money with them!)

The arguements of lenders on this subject are curiously contradictory. Lenders repeatedly emphasize the benefits which the Escrow System provides them protection against unnecessary foreclosure. They also question the necessity of requiring payment of interest since the amounts involved would be so small as to not make it worthwhile. Yet at the same time they threaten to raise interest rates or cancel escrow services if payment of interest is required. If the interest on escrow would be so small, why should its payment affect an institution to the point that it would be forced to re-coup by raising the interest on money lent? If the escrow system is so beneficial to lenders, why would they abandon it simply because of the forced payment of a "paltry" sum?

Additionally, local lenders like to talk about the unique money problems of Alaska. They claim that the majority of the escrow money deposited with them is actually not theirs to use. Your mortgage is in fact usually sold to

bigger outside investors and the local institution is paid by them to service the account-bill you, collect payments, make payments etc. The claim is that escrow monies go, along with the principle payment, to the invester currently holding your mortgage. The example most often used is FNMA, the Federal National Mortgage Association (Fannie-Mae). They are the nations' single largest investor in residential mortgages, holding a net portfolio of 23.6 billion in mortgages and loans. Some local lenders claim that FNMA requires the original lender and servicing institution to pass along their escrow accounts. That if institutions do not, that FNMA will not buy the mortgages and Alaska will loose one of its major sources of capital, and therefore consumers will not be able to buy homes!

It is true that there is not enough money in Alaska to serve the needs of all those people qualified to borrow. If groups like FNMA refused to give our local lenders money for mortgage paper there would be a drastic reduction in available home loans.

It is not true that FNMA demands the use of the escrow money and is therefore the one using it, not our local institutions. It is not true that they will not invest in the mortgage market of Alaska without it. Not according to the public and printed statements by FNMA.

One page 41 of Background and History by FNMA, under "Treatment of Tax and Insurance Escrow Funds by Servicers" it is stated:

> "Prior to July 1949, servicers were required to remit all collections, including those for the payment of taxes, charges, assessments, and hazard insurance to the Association and such items were paid direct. Beginning in July 1949, such funds then held by the Association were transferred to the appropriate servicers and were deposited in a custodial account maintained by each such servicer in a depository institution approved by it, and the servicers thereafter paid taxes, hazard insurance, etc., as they became payable. In January 1953, the dollar amount of the funds that could be held on deposit by a

servicer in an approved custodial account was limited to $250,000, and in January 1954 these deposits were further limited to (a) a sum not exceeding $10,000 for any one mortgagor account, or (b) in any event not in excess of $250,000. Effective at the end of, and subsequent to, February 1955, the total amount of the deposits that could be held by a servicer in an approved custodial account or accounts could not exceed the greater of (a) $2,500 or (b) the sum equal to two times the average monthly collection of the deposits for taxes, hazard insurance, etc., but in no event in excess of $250,000.

With respect to home mortgages purchased after August 1970, all escrow funds are held by the servicers."

In a January, 1975 interview with Mr. Dickson of FNMA's Mortgaging Programing in Washington D.C., our researcher was assured that the above statement is FNMA's current policy. He also stated that as of August 1970, FNMA actually pays a servicing fee to the institutions which sold the mortgages.

Which brings us to another favorite arguement offered by lenders. That the sum in individual accounts are so small, and the servicing process so costly that virtually any money made from investing said deposits is eaten up. That in fact, if lenders are required to pay any meaningful interest it will cost them more than they make from the account and therefore they will have to cease offering escrow services.

As far as we can ascertain, this arguement has never been substantiated with facts and figures. Nor do we believe it can be. Figures given at national hearings in 1972 showed that for a median size savings and loan association (assets of 15 million) investing their escrow monies at 4% the yield would be 7 times greater than their labor costs involved in administering the accounts. (Presentation by Home Federal Savings and Loan Association made to the Senate Committee on Banking, Housing and Urban Affairs at a public meeting held in Souix Falls, Idaho on conventional mortgage forms.)

One need only take a look at the usual kind of investment made with escrow monies-short term Federal Securities-to see the kinds of profits that are available.

The U.S. Treasury Department issues securities whose interest rate is determined by bids from prospective investors prior to each issue. There are three types; the one most useful to investors of escrow monies are called Treasury Bills, or T-Bills. These Bills have a term of one year and usually come in $10,000 denominations, although twice in 1974 issues were made of $1,000 T-Bills.

These Bills are suited to escrow investors because they mature in time for the escrow funds to be available for payment of taxes and insurance. The last issue of T-Bills is returning on your money an interest yield of 5.04%, and the next issue will yield 6.31%.

With this kind of interest available the lending institutions could readily pay the costs of administering the escrow accounts and still give a 5% return to their depositors.

Of course, now the question arises, "What would this mean to me, individually?"

Perhaps the best way to answer that question is to take a look at the institutions in Alaska that give some kind of interest on escrow account. There are two.

Home Federal Savings and Loan Association of Anchorage pays passbook savings rate on ALL escrow account, from single family residences through commercial mortgages. The present rate of interest is 5 1/4%, compounded daily. Statements are issued quarterly showing how much is in the reserve account and how much interest has been earned. Home Federal has only been open a little over a year but they estimate the average gain to the home buyer is about $30 a year.

Alaska Mutual Savings bank also pays interest on escrow accounts, but only to owners who occupy a single family residence. The interest rate is much lower, 3 1/2% on balances up to $700, going to 5 1/4% on any monies accumulated over $700. An owner of a $60,000 home, paying $160 in taxes would receive $23.

This coupled with the fact that even without a mill rate increase for 30 years, as the value of your property goes up so will the amount of taxes and insurance you must pay into escrow. Over the life of a 30 year mortgage a homeowner could expect to receive over $1000 from the interest on his escrow.

The following box from CHANGING TIMES illustrates further.

Suppose you did it yourself

Ronald and Ruth Martin are fairly typical homeowners. In May 1963 they purchased a four-bedroom house for $20,500 with $3,500 down. Improvements and general appreciation have since increased its value to approximately $35,000. Their lender insisted on escrowed insurance and tax payments.

To see how they might have fared as do-it-yourselfers, *Changing Times* asked the Martins to go back and restructure the payments they have made over the past nine years, crediting each required deposit to a hypothetical savings plan at 4½% interest compounded quarterly and using this account to simulate payment of each tax and insurance bill as it had come due.

The Martins made a substantial lump-sum payment into the account at the time of settlement. Their monthly escrow payments, and hypothetical deposits, were just under $37 at the start and have gradually increased to about $57 as both taxes and insurance premiums have gone up.

After searching their files and doing all the arithmetic, the Martins found that as of May 1972 they would have been almost $300 ahead under the savings-account method.

Of course, they would have spent a small percentage of the difference on stamps and envelopes for bill payments and an occasional letter. As it turned out, they got involved in correspondence anyway. Twice during the nine-year period—in 1964 and again in 1968—their insurance was canceled because the lender didn't pay the premiums on time. This despite the fact that one of the justifications for mandatory escrow accounts is that they prevent such problems.

July 1972 CHANGING TIMES *The Kiplinger Magazine* 7

It becomes clear that not only can one argue persuasively for the payment of interest from a moral standpoint, but that there are compelling financial reasons. Plainly, the income loss to consumers is substantial. In a year of Federal tax rebates, the economic value of getting fair interest on any money one is required to deposit cannot be ignored.

It is important to note that the movement to resolve the present economic inequities inherent in no interest escrow account is nation wide. Solutions are being proposed and discussed in the U.S. Congress as well as in many state legislatures. Litigation in behalf of the consumer has been filed in states across the country. Despite the fact that for the last three months AkPIRG has been gathering information on what is happening in other areas, it is probable that we have just scratched the surface of available information. What we have found follows.

LEGISLATION

National

1.) Senator Wright Patman of Texas, Chairman of the House Committee on Banking and Currency, in 1972 introduced a bill, H.R. 13337, Real Estate Settlement Cost Reform Act, that would have required lenders to pay interest on money in escrow accounts at the rate of more than one percentage point below the lowest rate currently paid by the institutuion.

2.) Represenative Leonore Sullivan of Missouri introduced H.R. 12066 in December, 1973, the "Proposed Federal Real Estate Settlement and Escrow Account Act."" This bill was one of ten introduced in 1973 relating to escrow accounts. It provided that, among other things, on federally related mortgage loans the borrower may elect to pay his own taxes and insurance premiums when due, but if he elect to have the lender set up an escrow account for this purpose, the borrower and lender may mutally agree between then as to whether interest shall be paid and at what rate of interest.

3.) Representative George E. Brown, Jr. introduced two bill in 1973. H.R. 11460 (also known as H.R. 9315), "The Escrow Account System Improvement Act" which deals with reform within the present system of escrow accounts Under section 6, a ceiling interest rate of 6 3/4% would be required on all

escrow deposits. This figure is 3.4% less than the prevailing rate on loans by the Federal Reserve banks to member banks, that difference going for escrow account service costs. The 6 3/4% interest would not be paid directly to homeowners but would be credited toward reducing the balance. The rate could be revised downward but not below 4%

The second bill, H.R. 12275, "Escrow System Improvement Act" would replace escrow accounts with an "Escrow Service Plan" where monthly deposits would be "capitalized", payments not segregated into special accounts with interest calculated, but credited directly toward reducing the balance due on the loan.

States

1.) Connecticut - As of September, 1974, escrow accounts must pay 2% interest.

2.) Indiana - would require insurance companies and other companies engaged in the business of lending money secured by residential or commercial mortgages on real estate to pay interest at the annual rate of 4% to mortgagors on escrow monies.

3.) Minnesota - would require banks, savings and loans and other financial institutions engaged in home financing receiving monies for insurance coverage or real estate taxes to pay interest on such monies at not less than the same rate and on the same basis applicable to its "regular savings account".

4.) Utah - would provide that persons having monies deposited with an escrow agent for payment of taxes and/or insurance in connection with real property transactions shall be entitled to receive interest payments on such monies at least annually and at least equal to interest payable by banks on regular savings accounts.

5.) New York-recently-enacted-must pay 2% a year on home mortgage escrow accounts.

6.) Maryland-enacted 1974-must pay interest ou <u>new</u> mortgages where the loan interest in 10% or greater.

7.) Massachusettes - beginning on July, 1975, banks will credit interest to escrow but exact rate not yet set (as of 7/8/74).

8.) Oregon - Gerald Ansell, engineer, has been attempting since 1969 to win legislative acceptance of a plan that would either make interest mandatory on escrow accounts or have each payment capitalized to the credit of the borrower.

LITIGATION

Five Theories

There are in general, five theories for recovery that have been and are presently being pursued in litigation on behalf of the mortgage consumer.

Breach of Contract

This particular theory is the one presently being used in the case in Houston against 43 institutions. In a nut shell; when lending institutions arbitrarily and unilaterally change from a system like capitalization, a system from which the mortgage customer receives monetary benefit, to escrow, under the original contract and without notice, to the detriment of the customers and to the benefit of the lending institution, enriching them unjustly, it is argued that the lending institutions have breached the contract.

Express Constructive Trust

It is argued that since funds in an escrow account are deposited for a particular purpose and the mortgagee has notice of the expenses that the funds are to pay, a trust relationship is created. An express trust arises as a result of a manifestation of the intentions of the parties, that is, from contract

provisions; while a constructive trust is imposed by the court as an equitable doctrine to prevent unjust enrichment. Therefore, under the trust theory through conveants in the mortgage, lending institutions agree to act as agents of the mortgagors and discharge tax and insurance premium obligations giving rise to a fiduciary relationship of trustee and beneficiary. The payments for taxes and insurance premiums are a pre-deposit for a specific purpose, namely to pay property taxes and insurance premiums - obligations belonging to the mortgagor. Since such pre-deposit payments are deposited in an escrow account for a specific purpose, legal and equitable title does not pass to the mortgagee; instead mortgagee holds this money as a fiduciary for a specific purpose.

Under this interpretation, the earnings derived from escrow funds might be considered an unjust enrichment upon which the court could impose a constructive trust, requiring the payment of interest to all required to maintain mortgage escrows.

Truth-in-Lending

Quite simply, this arguement rests upon the premise that if a bank states it is charging the homeowners 8% but then collects from him an additional interest free loan every month, the effective rate of interest is higher than 8%. Since the substance of Truth-in-Lending is to deliver to the borrower "the truth", the lending institutions in failing to state the full annual percentage rate of the loan, are violating the Truth-in-Lending requirement, and unjustly enriching themselves at the expense of the taxpayer/homeowner.

Anti-Trust

The contention is that the lenders through conspiracies, tying arrangements, and conscious parallelism, are monopolizing the market which results in the borrowers having no alternative but to deal with the lender. Tying seems

the most widely applicable. An argument can be made that the non-payment of interest by lending institutions on escrow account is a tying agreement. In other words, the lending institution will loan money to the mortgagor only if the mortgagor agrees to put funds into the monthly escrow account held without interest by the lending institution. Hence, when a borrower is not allowed interest on the monthly escrow payments, he is in essence, giving up a certain amount of earnings (that he might receive elsewhere) which is analogous to the purchase of a tied product.

Usury and "Unconscionable" Theories

Usury laws basically provide one potential cause of action in which a mortgagor may seek cancellation of the mortgage debt. Such was the allegation in Graybeal v American Savings and Loan Association. As a rule usury is governed by state statue which limits the rate of return that a lender may exact from the borrower. The borrower is giving the lender additional funds when he makes monthly payments into the escrow account, and the lender's refusal to pay interest on the funds in effect increases the interest rate the borrower is paying on the principal debt. Since many home loans are usually made at the statutary maximum rate of interest, the additional of the "negative' charge will increase that rate in excess of the legal limit.

Cases

1.) In Sears v First Federal Savings and Loan Assn., 275 NE 2nd 300 (1971) the first appellate consideration of interest-free escrow accounts problem, the plaintiff brought a class action suit on behalf of all mortgage borrowers of the defendant alleging that the $19 million held by the defendant in escrow constitutes funds held in trust by the lender. The plaintiff argued that by commingling escrow and general deposit funds, the defendant violated its fiduciary duty and thus plantiff was entitled to an accounting of all profits earned on the

trust according to the theory of unjust enrichment. A strict construction of the contract clauses by the court resulted in a judgement in favor of the lending institution but did not resolve the question of whether lending institutions should pay interest on escrow funds.

2.) In Washington D.C., 1972, attorney William Dobrovir filed a class action suit against 16 of the city's lenders with usury and violation of both the Truth-in-Lending Act and the Sherman Anti-Trust Laws alleged. Dobrovir demanded an injunction against the continuence of the escrow practice as well as the restoration to the plaintiff of money lost through non-payment of interest. The case was settled in May, 1974 resulting in two leading S&Ls agreeing to give most mortgage customers the option of making their own insurance and tax payments in the future.

3.) As of July, 1973 a similar case was pending in Houston, Texas, which made the same allegations based on constructive and/or Express Trust.

4.) Another class action suit was brought in 1973 in Houston. It went before the Federal District Court in Houston, against 43 banks, savings and loan associations and mortgage companies authorized to do business in Texas and having a principle place of business in Houston. Briefly, the institutions are being sued for breach of contract for abandoning unilaterally the capitalization on monthly tax and insurance payments and without notice adopting standard non-interest paying escrow accounts.

5.) In California, Nathaniel Colley, a Sacramento lawyer contends that 17 area S&Ls have conspired to withhold interest and is pressing for a refund of at least $400,000,000 in past earnings and an agreement to pay interest in the future. The suit has inspired similar class actions in Arizona, Arkansas, Florida, Illinois, Iowa, Nebraska, New York, Pennsylvania, and Wisconsin.

RECOMMENDATIONS

The first step in finding a remedy for this untenable situation is for consumers to begin receiving a fair interest on the money they are <u>forced</u> to deposit if they wish to buy a home.

1.) Alaska Public Interest Research Group is recommending that House Bill 115, introduced by Representative Fink, which calls for interest to be paid "at the rate established by the Federal Deposit Insurance Corporation as the maximum allowable rate on passbook savings accounts; or, if no rate is so established, at the rate paid by the financial institution on passbook savings accounts; or, for those financial institutions or lenders which do not provide passbook savings account services, at the rate established semi-annually by the commissioner as the prevailing passbook savings account rate" be amended to read, "at the rate then established quarterly by the commissioner, as one-half of one percent less than the prevailing rate of return from Federal Securities, U.S. Treasury Department Treasury Bills".

This proposed amendment assures the payment of interest to all homeowners required by lenders to maintain escrow account <u>at a rate commensurate with the investment value of the money being held</u>. The lender would be allowed to retain income derived from the one-half point interest rate differential to cover the cost entailed in performing the customer service of administering the escrow account. However, the earnings from the customers' money would go to the customer, not the lending institution as in the past.

2.) The local tax bodies should examine the costs involved in an improved method of collecting taxes that would minimize the practice of borrowing on Tax Anticipation notes. Those costs should be weighed against the cost to the taxpayers to continue as we are, having paid $200,000 last year alone in interest on Borough borrowing. The facts and costs should be made public.

HB
116

HB
128

HB 128

Tape #	Date
14	3/18

"An Act requiring that coverage for newly born children be included in individual or group health and disability plans."

COMMITTEE REPORT

3/12/75

HOUSE

Mr. Speaker: Date 3/12/75

The Committee on COMMERCE has had HB 128 under consideration. A Majority of the members of the Committee

(✓) recommends it DO PASS

( ) recommends it DO NOT PASS

( ) recommends it DO PASS WITH ATTACHED AMENDMENT(S)

( ) recommends it BE REPLACED WITH CS FOR ____________ AND THAT

CS FOR ______________ DO PASS

( ) "and" recommends it BE REFERRED TO THE ______________________

COMMITTEE

( ) reports it back WITHOUT RECOMMENDATION

( ) "other"

Members signing the Majority report:

[illegible signatures]

Members NOT concurring in the Majority report:

______________ recommends:

______________ recommends:

______________ recommends:

______________ recommends:

______________ recommends:

[signature] Chairman

LASKA STATE

MEDICAL ASSOCIATION

1135 W. Eighth Avenue • Anchorage, Alaska 99501 • (907) 277-6891

March 10, 1975

File with other bill data — Make copies for Tues. meeting.

Representative Bob Bradley
Chairman, Commerce Committee
House of Representatives
Juneau, Alaska 99801

Dear Representative Bradley:

It is our understanding that House Bill 128 - "An Act Requiring that Coverage for Newly Born Children be Included in Individual or Group Health and Disability Plans" has been referred to the Commerce Committee for consideration.

As indicated in our "Health and Legislative Action - 1975 - position packet", the Legislative Committee for the ASMA strongly supports passage of this legislation. Attached is some information which may be helpful to your committee in its deliberation.

We will very much appreciate that your committee give careful consideration to this legislation and we urge its passage. If we can answer further questions or provide additional inforamtion, we are pleased to do so.

Thank you for this consideration.

Sincerely,

Carolyn Brown

carolyn V. Brown, M. D.
Chairperson, Legislative Committee

cVB:mlm
Enclosure

HEALTH INSURANCE ASSOCIATION OF AMERICA
CHICAGO · NEW YORK · WASHINGTON
LESLIE P. HEMRY, President

RESEARCH, STATISTICS, AND CONTROL DEPARTMENT
David Robbins, *Vice President and Controller*

New York Office
750 Third Avenue
New York, New York 10017

October 8, 1974

Mr. Vincent B. Jasso
Deputy Superintendent
State of New Mexico
Department of Insurance
Sante Fe, New Mexico 87501

Dear Mr. Jasso:

As I wrote you last week, we are in the process of developing estimated costs for the benefit provisions contained in the proposed New Mexico newborn infant coverage legislation. This data should be finalized in another few weeks.

In the interim, we learned from Mr. Young of the American Life Insurance Association that your Insurance Study Committee is scheduled to meet on October 10 and that you would be interested in the receipt of some preliminary results of our investigations. Our preliminary review of this matter indicates the following:

1. For those major medical contracts which now cover children from birth for sickness or injury and exclude only the first 7 days of hospital room and board charges while covering all other types of eligible expenses from birth, we estimate the additional cost of covering the first 7 days of nursery charges for sick infants to be about $.80 yearly per employee for group coverage and about $1.20 for individual coverage.

2. For a policy which provides no coverage at all for the first 14 days, we estimate the additional cost of the required coverage as approximately $3.20 yearly per employee for group coverage and $4.80 for individual coverage.

3. The exclusion of illegitimate children would make relatively little difference on the foregoing cost estimates.

Sincerely,

David Robbins
Vice President and Controller

DR:pw

cc: Mr. Franklin H. Young - ALIA
Mr. Caroll Callaway

Texas, Minnesota, Montana, North Carolina, and *Louisiana.* Thirteen other States have active pediatric committees working with their legislatures on laws that will include newborn care in comprehensive health insurance policies.

Another major concern is the manner in which coverage will be provided for children with handicapping conditions who require expensive, continuing care. At least some major medical insurance companies now exclude or limit payment for care of children with developmental disabilities. The Children's Hospital of *Pittsburgh, Pa.*, has reported difficulties in collecting fees from major medical insurance groups for care of such children. It cited these problems as being significant: employees are unaware of major medical fringe benefits for which they are eligible; special services, such as speech therapy and psychological testing, are frequently not covered by insurance plans; insurance companies do not reply after a bill is submitted.

The *New Jersey* State legislature has passed a bill establishing a program to provide funds to pay for health services for children with terminal illnesses. An advisory committee is being organized to prepare for the operation of the program.

The coverage of insurance currently available for mothers and children has been studied by Dr. Arthur J. Lesser, Director of MCHS. In a speech at Johns Hopkins Hospital in February 1973, Dr. Lesser identified six significant gaps that frequently occur in insurance coverage:

1. Family unit coverage excludes single people and people not living with a family. For example, most of the 200,000 unmarried adolescent girls who have babies each year are excluded from maternity and infant benefits, although they are a major high-risk group.
2. Maternity benefits do not begin until 9 months after the effective date of the policy. This means that many thousands of recently married couples find that their insurance does not include the birth of their first child.
3. Maternity benefits are reduced by deductibles and coinsurance intended to limit unnecessary hospitalization. The average hospital stay for obstetrics is less than 4 days; however, many policies do not cover the first 2 days and then require cost sharing by the patient.
4. Time limitations (coverage of the infant beginning 30 days after birth) and preexisting conditions (prior to birth) exclude insurance for premature infants and infants born with congenital anomalies.
5. Virtually all catastrophic illness insurance is planned for adults, yet the unexpected and unplanned costs of having a premature baby or a baby with congenital anomalies or costly acquired illnesses are enormous. Many young couples face "ruinous costs of a catastrophic nature under those circumstances."
6. Health insurance is basically a middle-class system and is not as responsive to the needs of many poor, disadvantaged, or handicapped. "It cannot be expected to substitute for many services characteristically provided by health departments and organized community health programs. This is particularly true of those services provided by staff other than physicians—that is, health education, screening and casefinding, public health nursing, social services, nutrition education, speech and hearing, and various appliances and prostheses."

In his speech at Johns Hopkins, Dr. Lesser went on to say he believes that clinical resources must be an integral part of any health care system financed by insurance.

Hospitals and Children

Among children under 17, the lower their family income, the greater the likelihood of hospitalization.

This is one of a number of facts that may be gleaned from data published by the National Center for Health Statistics on utilization of hospitals and other medical care. The data are based on health interviews conducted in 1968 and 1969.

For the 1968-69 period, hospital discharges per 1,000 population for children under age 17 amounted to 79.8 for children in families with less than $3,000 income, 74.3 for those with incomes from $3,000 to $3,999, dropped gradually to 58.9 when family income was $10,000 to $14,999, and reached the low point of 49.7 when incomes were $15,000 or more. On the other hand, only 23.3 percent of children living in families

STATE OF WASHINGTON

OFFICE OF THE GOVERNOR

OLYMPIA

DANIEL J. EVANS
GOVERNOR

February 16, 1974

To the Honorable, the House
of Representatives of the
State of Washington

Ladies and Gentlemen:

I am returning herewith without my approval as to certain items House Bill No. 1144 entitled:

"AN ACT Relating to health care."

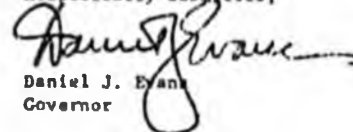
This bill provides for coverage to newborn infants in various forms of health care service insurance coverage to close a gap that has long existed by the exclusion from coverage of newborn infants until a certain number of days after birth. As a result of this exclusion, many families have been hard hit by major medical expenses that could not have been anticipated.

Sections 1, 2, and 3 of the bill each contains an item that would exclude from the coverage provided to newborn infants "benefits for routine well-baby care." Nowhere in the bill is there a definition of what constitutes routine well-baby care, and without such definition exclusions could be written into future coverage that could well defeat the purpose of this bill.

Moreover, experts in pediatric care have long maintained that there is no such thing as a "well-baby" during the first 48 hours of an infant's life. During those critical first 48 hours, a newborn infant is highly susceptible to a number of potentially serious physical malfunctions, and the high degree of care necessary to carry a newborn infant through this period could be discouraged by a broadly written well-baby care exclusion in health care insurance contracts.

For these reasons, I have determined to veto the referenced items in sections 1, 2, and 3 of the bill. With the exception of those items, the remainder of House Bill No. 1144 is approved.

Respectfully submitted,



Daniel J. Evans
Governor

DJE:bg

IN THE LEGISLATURE
of the

STATE OF WASHINGTON

CERTIFICATION OF ENROLLED ENACTMENT

HOUSE BILL NO. 1144

CHAPTER NO. ______

Passed the House January 25, 1974

Yeas [illegible] *Nays* 4

Passed the Senate February 6, 1974

Yeas 44 *Nays* 0

The House concurred in the Senate amendments and passed the bill as amended, February 8, 1974.

Yeas 94 Nays 3

CERTIFICATE

I, Dean R. Foster, Chief Clerk of the House of Representatives of the State of Washington, do hereby certify that the attached is enrolled House Bill No. 1144 *as passed by the House of Representatives and the Senate on the dates hereon set forth.*

Dean R. Foster

Chief Clerk

(5) Intestinal tract - no "routine" feedings until patency and mobility of intestinal tract demonstrated (meconeum ileus intestinal obstruction) - no "routine" feedings until age 48 hours.

(6) Blood oxygen level and oxygen supply to organs subnormal until 24-48 hours.

(7) Infection: Special care to prevent "colonization" until age 48 hours.

(8) Lungs: Abnormal per x-ray until average age of 12 hours.

(9) General physiology (homeostasis) - instability of interacting body organs, fluids and functions, until age 48 hours.

(10) Seizures - due to low blood sugar, hypothermia, brain hemorrhage, etc., first signs or onset up to age 48 hours.

(11) Jaundice - (high blood bilirubin) due to Rh factor, other blood group incompatibility, liver malfunction, infection, etc., first signs or onset up to age 48 hours.

(12) Meningitis, blood stream sepsis, etc., first signs or onset up to age 48 hours.

Further information regarding special (non-well) infant care necessity for minimum of 48 hours:

a. Newborn infants not released from quality newborn nurseries (i.e., U. of W.) until after age 48 hours without parents signing an A.M.A. (Against Medical Advice) statement.

b. This year, Washington State Chapter, AAP, obtained $25-50,000 March of Dimes grant for statewide "Infant Care Program," Janet Murphy, M.D., director, to conduct appraisal and consultation service for care of newborn infants in the 97 hospitals in Washington State with newborn infant nurseries.

c. University of Washington Medical School and School of Nursing students are taught the 48 hour minimum special infant care policy.

Conclusion: The non-well newborn infant or special newborn infant treatment + care situation prevails for a minimum of 48 hours.

Summary prepared by:

Robert Polley

Robert Polley, M.D.

2/3/74

ORIGINAL DRAFT OF POSITION STATEMENT ON NEWBORN INS.

WASHINGTON STATE CHAPTER

American Academy of Pediatrics

2/3/74

POSITION STATEMENT ON NEWBORN INFANT MEDICAL INSURANCE
WASHINGTON STATE CHAPTER, AMERICAN ACADEMY OF PEDIATRICS (AAP)
(WASHINGTON STATE SOCIETY OF PEDIATRICS).

Consensus Summary developed by:

Washington State Chapter, AAP, Fetus and Newborn Committee:

Donald Sutherland M.D., Bellevue, Chairman
William A. Hodson, M.D., Director Newborn Service, University of Washington
Errol Alden, M.D., Director Newborn Service, Madigan General Hospital, Tacoma
David E. Woodrum, M.D., Dir. Newborn Service, Children's Orthopedic Hospital, Seattle.
Robert Polley, M.D., Seattle.

David Sparling, M.D., Tacoma; State Chapter Chairman, 1974.

Michael Donlan, M.D., Spokane; State Chapter Alternate Chairman, 1974

Robert A. Tidwell, M.D., Seattle, Chairman Legislative Committee.

Robert Polley, M.D., Seattle, Chairman 3rd Party (Medical Insurance) Committee.

Blackburn Joslin, M.D., Mercer Island, Past State Chairman.

Abraham Bergman, M.D., Director Outpatient Clinic, Children's Orthopedic Hospital, Seattle; President, National Foundation for Sudden Infant Death.
THOMAS C. COCK CHMN. DISTRICT VIII AAP.

Topics:

a. "Neonates" (newborn infants) do not become candidates for routine or well newborn infant care until age 48 hours at the earliest.

b. Information:

(1) Disappearance of lung fluid and lung aeration (expansion), approximately 48 hours.

(2) Establish normal heart function with disappearance of murmurs and reverse blood flow through foramen ovale and ductus - 24 to 48 hours.

(3) Temperature (thermal) instability; inability to maintain adequate body temperature without external added heat source - 24 to 48 hours.

(4) Fluid balance, acid base balance, kidney function, urine production, etc., unstable until age 24-48 hours.

FINAL DRAFT - 3/4/74

POSITION STATEMENT ON NEWBORN INFANT MEDICAL INSURANCE
WASHINGTON STATE CHAPTER, AMERICAN ACADEMY OF PEDIATRICS (AAP)
(WASHINGTON STATE SOCIETY OF PEDIATRICS).

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Blackburn Joslin, M.D. Bellevue; Past State Chairman.

Al Skinner, M.D., Mercer Island; Past State Chairman.

Abraham Bergman, M.D., Director Outpatient Clinic, Children's Orthopedic Hospital, Seattle; President, National Foundation for Sudden Infant Death.

Thomas C. Cock, M.D., Chairman, District VIII, AAP.

During the first nine months of life the human dwells in a warm aquatic environment. He receives his total nutritional support from his mother and, with a few exceptions, his bodily functions (e.g. gas exchange, endocrinologic, excretory) are accomplished by the placenta. With birth, the above situation is drastically altered in a very short period of time. There is, in fact, no age during life when so many major adaptations necessary for intact survival occur in such a short time span.

Immediate survival is accomplished by clearance of lung fluid, its replacement with air, and activation of surface active material lining the gas exchange surface of the lung. The result of these processes is an elevation of the oxygen tension in the arterial blood, an increase in pulmonary blood flow, and gradual closure of the fetal shunts (Foramen, Ovale and Ductus Arteriosus).

Adaptive processes of a more gradual but equally important nature involve the gastrointestinal tract - which for the first time must manifest patency from the mouth to the anus; the renal and genitourinary tract - must assume control of fluid and electrolyte balance, and solute excretion; metabolic and endocrine activities vital to nutritional homeostasis, growth and modifications of drugs or bodily breakdown products (e.g. bilirubin) necessary to facilitate excretion.

The newborn is at a further disadvantage in terms of his or her ability to adjust to a new environment. Heat losses may be extensive due to the inordinately high body surface to weight ratio that the small infant manifests, hence the ability to withstand environmental cold stress is severely compromised. Furthermore, inadequate or immature immunologic defense mechanisms impair the ability to ward off certain types of infection.

All of these transitions and/or adjustments occur or have as their major time of impact during the first 48 to 72 hours of life, and the vast majority of potentially anatomic, physiolgoic or biochemical deviations from normal may be recognized during this time period. With this in mind, it is the policy of this Committee as well as the recommendations of the Department of Pediatrics, Division of Neonatal Biology, University of Washington School of Medicine that optimum care for all newborn infants include a comprehensive physical examination, competent physician and nurse medical care and hospitalization during the first 48 hours of postnatal life.

R. Palley
4/4/74.

HOUSE BILL NO. 1144

State of Washington
43rd Legislature
3rd Extraordinary Session

by Representatives Ceccarelli, Pardini and Perry

Read first time September 12, 1973, and referred to Committee on Financial Institutions.

1 AN ACT Relating to health care; adding a new section to chapter 48.20
2 RCW; adding a new section to chapter 48.21 RCW; adding a new
3 section to chapter 48.44 RCW; and declaring an emergency.
4 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:
5 NEW SECTION. Section 1. There is added to chapter 48.20 RCW a
6 new section to read as follows:
7 Any disability insurance contract providing hospital and
8 medical expenses and health care services, delivered or issued for
9 delivery in this state more than one hundred twenty days after the
10 effective date of this 1974 act, which provides coverage for
11 dependent children of the insured, shall provide coverage for newborn
12 infants of the insured from and after the moment of birth. Coverage
13 provided in accord with this section shall include, but not be
14 limited to, coverage for congenital anomalies of such infant children
15 from the moment of birth, but need not include benefits for routine
16 well-baby care.

vetoed DJE

17 NEW SECTION. Sec. 2. There is added to chapter 48.21 RCW a
18 new section to read as follows:
19 Any group disability insurance contract except blanket
20 disability insurance contract, providing hospital and medical
21 expenses and health care services, renewed, delivered or issued for
22 delivery in this state more than one hundred twenty days after the
23 effective date of this 1974 act, which provides coverage for the
24 dependent children of persons in the insured group, shall provide
25 coverage for newborn infant children of persons in the insured group
26 from and after the moment of birth. Coverage provided in accord with
27 this section shall include, but not be limited to, coverage for
28 congenital anomalies of such infant children from the moment of

1 birth, but need not include benefits for routine well-baby care.

2 NEW SECTION. Sec. 3. There is added to chapter 48.44 RCW a

3 new section to read as follows:

4 Any health care service plan contract under this chapter

5 delivered or issued for delivery in this state more than one hundred

6 twenty days after the effective date of this 1974 act, which provides

7 coverage for dependent children of the insured or covered group

8 member, shall provide coverage for newborn infants of the insured or

9 covered group member from and after the moment of birth. Coverage

10 provided in accord with this section shall include, but not be

11 limited to, coverage for congenital anomalies of such infant children

12 from the moment of birth, but need not include benefits for routine

13 well-baby care.

14 NEW SECTION. Sec. 4. There is added to chapter 48.52 RCW a

15 new section to read as as follows:

16 Any self insurer providing coverage or health care benefits or

17 services for dependent children shall include coverage or health care

18 service benefits or services for congenital anomalies of newborn

19 children from the moment of birth.

20 NEW SECTION. Sec. 5. This 1974 act is necessary for the

21 immediate preservation of the public peace, health and safety, the

22 support of state government and its existing public institutions, and

23 shall take effect immediately.

Passed the House February 6, 1974.

Speaker of the House.

Passed the Senate February 6, 1974.

President of the Senate.

Approved February 16, 1974
with the exception of certain
items which are vetoed.

Governor of the State of Washington -2-

HB 1144

Age of Majority—Amended various sections of the law to provide 18 as the age of majority. (Chapt. 94, Laws 1973.)

Autopsies—Amended the law "to require that a written report of all autopsies of a human body be sent to the physician attending the person at the time of death and to the hospital and skilled nursing facility where the person died in addition to other recipients as presently provided by law." (Sec. 69-5104, R.C.M. 1947).

Controlled Substances—Enacted a statute containing, to a substantial degree, the provisions of the Uniform Controlled Substances Act. (Chapt. 412, Laws 1973).

H.M.O.—A joint resolution provides for a study of Health Maintenance Organizations in other states. (S.J.R. 34.)

Malpractice—Added nursing home administrators and long-term care facilities to the list (which includes physicians, surgeons, and other health care professionals) of those: 1) against whom actions for malpractice must be commenced

> within three years after the date of injury or three years after the plaintiff discovers, or through the use of reasonable diligence should have discovered, the injury whichever occurs last, but in no case may such action be commenced after five years from the date of injury. However, this time limitation shall be tolled for any period during which such person (the defendant) has failed to disclose any act, error, or omission upon which such action is based and which is known to him, or through the use of reasonable diligence subsequent to said act, error or omission would have been known to him.

2) against whom cancellations or increases in premium rates of professional liability insurance by reason of unfounded claims is prohibited, 3) to whom 60 days written notice of cancellation or increase in premium rates of professional liability insurance is required. (Secs. 93-2624, 40-4413 and 40-4414, R.C.M. 1947.)

Mental Illness—Enacted statutes establishing a program of protective services for the mentally disabled, and allowing "non-profit organizations to establish community homes for the developmentally disabled . . ." (Chapts. 308 and 373, Laws 1973.)

A joint resolution was enacted "declaring the rights of mentally retarded persons as to opportunities for normalization." (H.J.R. 11.)

Newborn Infants—Enacted a statute requiring tests for "inborn metabolic errors" of newborn infants. (Chapt. 227, Laws 1973.)

Montana

Newborn Insurance Coverage—Enacted a statute providing that "disability insurance policies and plans covering members of the insured's family as well as the insured shall grant immediate accident and sickness coverage, from and after the moment of birth, to each newborn infant of any insured." (Secs. 40-4002, 40-4002.1, and 40-4102, R.C.M. 1947.)

Osteopathy—Amended the law regarding reciprocity for doctors of osteopathy, to provide that those osteopathic physicians holding a degree of Doctor of Osteopathy granted after 1955, "will be certified in the same manner as provided for physicians." (Sec. 66-1025, R.C.M. 1947.)

Prenatal Care—Enacted a statute requiring a standard serological test for women seeking prenatal care.

The term "standard serological test" means "a test for syphilis, rubella immunity, and blood group . . ."

The statute provides that "every female, regardless of age or marital status, seeking prenatal care from a physician, is required to submit blood specimen for the purpose of a standard serological test."

The statute mandates confidentiality of the test results. The unauthorized disclosure of such information is a misdemeanor.

A district court may waive the requirements of the Act if the judge is satisfied that