ALASKA LEGISLATURE COMMITTEE FILES 2001-2002 8672
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Section Two:
Get ready for July 1, 2001

A bank's strategy for achieving full compliance by July 1, 2001, will vary depending on the complexity of the bank and the progress it has already made in complying with the requirements of the rule. The level of effort a bank will expend depends in large part on:

- the bank's previous efforts to assess or disclose information sharing practices
- the bank's decisions about sharing nonpublic personal information after July 1, 2001
- the volume, if any, of consumers and customers who must receive an opportunity to opt out before information sharing with nonaffiliated third parties can take place.

Nearly all banks, however, can take the following four steps to create a comprehensive and effective privacy compliance strategy:

- establish a timeline for compliance
- develop privacy policies and notices
- deliver notices
- prepare to respond to consumers

1. Establish a timeline for compliance

A timeline designating important checkpoints prior to July 1, 2001, is a good place to start and can be instrumental to ensuring timely compliance.

A specific process for certifying completion of the various steps identified in the bank's privacy compliance strategy will help managers keep track of progress. When establishing due dates for specific activities, build in time to receive input and feedback from senior management and other stakeholders. Every bank should consider:

- **Involving the Board of Directors:** A board-approved privacy policy is not required by the rule, but it can be an effective way to involve the board of directors in developing a privacy compliance strategy. A board-sanctioned privacy policy can be useful in communicating the bank's overall privacy commitment and strategy to the entire organization.

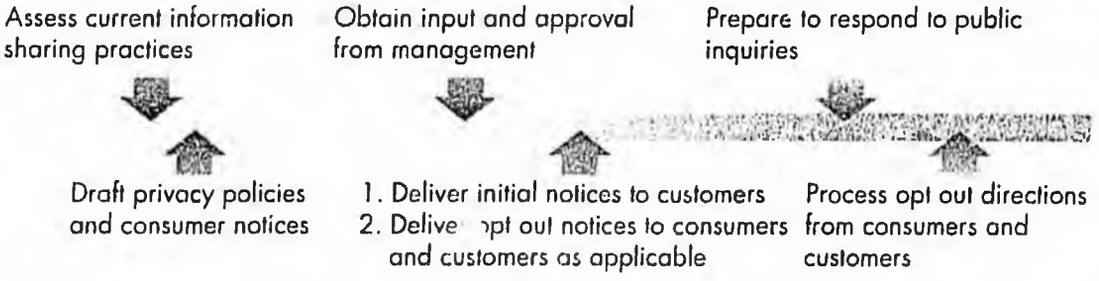
- **Involving representatives from each bank department:** Most likely a senior bank officer will oversee development and implementation of the privacy compliance strategy. Nevertheless, participation from each department in the bank will help ensure nothing is overlooked. This approach will also help policy makers identify information sharing practices or consumer privacy issues unique to a specific department or to a financial product or service.

2. Develop privacy policies and notices

Use this opportunity to evaluate and establish institutional privacy objectives, and communicate to potential customers and consumers the bank's customer service philosophy.

- *Create a comprehensive inventory* of information collection and information sharing practices at the

A bank may want to establish timeframes to:



bank. The inventory will help ensure practices are properly disclosed in the bank's privacy notices. For every department, review:

- all applications and forms used to collect information about consumers
- marketing practices
- vendor contracts
- electronic banking and Internet activities
- fee income accounts
- record retention policies

Affiliates: If a bank has any affiliates, the inventory should include information-sharing practices with affiliates. Although the privacy rule does not place any restrictions on information sharing with affiliates, it does require disclosure of these practices in the initial and annual notices. Furthermore, the privacy rule requires the initial and annual notices to include applicable Fair Credit Reporting Act affiliate information sharing opt out notices.

- *Assess current information collection and information sharing practices* in light of the privacy rule obligations and the bank's objectives. Determine which practices should continue after July 1, 2001. This may be a good time to involve the bank's Board of Directors. Consider:
  - whether any current practices would be prohibited under the rule
  - which practices must be disclosed in the privacy notices and whether opt out rights apply
  - whether account numbers are shared only as permitted by the rule
  - whether information received from other financial institutions is shared only as permitted by the rule's reuse and redisclosure limitations
  - whether to adopt voluntary privacy standards developed by relevant trade associations. Those standards could be good indicators of industry norms and consumer expectations
- *Draft privacy notice(s).* Create a list of information collection and information sharing practices that must be disclosed to consumers. This list can help you categorize practices per the rule requirements and decide how to structure notices. The privacy rule provides a variety of disclosure options. For example, banks may develop:
  - one initial privacy notice that covers all the information sharing practices of the bank
  - an assortment of initial notices for different customer relationships or different types of financial products or services
  - one initial notice that covers the practices of the bank along with one or more of its affiliates

Likewise, the opt out notice may be structured in a variety of ways.

When drafting privacy notices, consider:

- **Sample clauses** provided in Appendix A in the rule. Banks may use the sample clauses to the extent they accurately reflect the bank's practices.

Most likely, the initial and annual privacy notices will be identical. If required, the opt out notice may be combined with the initial and annual notices.

- **Fair Credit Reporting Act requirements and information security standards.** The federal banking agencies have issued two proposed rules that may affect the compliance strategy and the content of privacy notices.

The *Proposed Security Standards for Customer Information* describe the agencies' expectations for implementing technical and physical safeguards to

protect customer information. ***The Proposed Fair Credit Reporting Regulations*** cover the opt out provisions of the Fair Credit Reporting Act.

Both proposals will be finalized in the near future. When issued, the final rules will be available on the FDIC's Web site: www.fdic.gov. In the meantime, the proposals are posted on the Web site.

3. Deliver notices

- **Identify consumers and customers who must receive the initial and opt out notices.** It is important to identify all groups of existing customers, consumers, and former customers who must get the initial privacy notice and opt out notification. Some banks may need to coordinate several databases and a variety of departments to identify everyone who must receive a notice.

  Opt out notices for joint account holders: *The privacy rule allows banks to provide a single privacy and opt out notice when two or more consumers jointly obtain a financial product or service. However, any of the joint consumers may exercise the right to opt out. The opt out notice provided to joint account holders must explain how the bank will treat an opt out direction by a joint consumer and must give one joint consumer the ability to opt out on behalf of all the joint consumers.*

- ***Establish timeframes for mailing or otherwise delivering notices.*** Remember:

  - **All existing bank customers must receive an initial privacy notice no later than July 1, 2001.**

  - **Existing bank customers, consumers who are not customers, and former bank customers have the right to opt out if the bank is sharing nonpublic personal information about them with nonaffiliated third parties outside the exceptions.**

  - Information sharing subject to opt out cannot continue after July 1, 2001, until the initial and opt out notices are delivered and a reasonable opt out period has elapsed. Therefore, banks that intend to share nonpublic personal information outside the exceptions after July 1, 2001 should deliver notices well before July 1.

4. Prepare to respond to consumers

- ***Develop opt out procedures.*** All banks sharing nonpublic personal information outside of the exceptions will need to develop procedures for consumers to exercise an opt out, as well as procedures for processing and complying with opt out directions. The opt out procedures should include:

  - tracking the initial opt out opportunity (e.g., the first 30 days after the initial notice is delivered)

  - recording opt outs received from consumers

  - maintaining the opt out mechanism(s), such as a toll-free telephone number, electronic mail, or an opt out form with boxes to check

  - complying with opt out directions received after the initial opt out opportunity elapses

- ***Respond to public inquiries.*** Customer service representatives and other bank employees should be prepared to answer questions from consumers about the new privacy notices. Depending on the number of employees answering consumer phone calls, it may be a good idea to provide scripts to help employees respond to questions from the public. In addition, it may be helpful to have extra copies of the privacy notice readily available for mailing or handing out to consumers.

Section Three: Maintaining Compliance Beyond July 1, 2001

The following activities can help a bank achieve and maintain compliance with the privacy rule.

- **Develop controls to monitor ongoing compliance.** Consider mechanisms for monitoring:
  - delivery of initial and annual notices to customers
  - delivery of initial notice to consumers who are not customers, if applicable
  - compliance with opt out directions, if applicable
  - accuracy of privacy notices, including prior approval for:
    - new marketing arrangements
    - new or renewed vendor contracts
    - disclosure of account numbers
    - affiliate-referral programs
    - reuse of consumer information received from another financial institution
- **Train employees.** All employees should understand the bank's policies and procedures for complying with the privacy rule. Some employees will need to be able to explain the bank's privacy policies to customers and to businesses providing services to the bank.
- **Audit for compliance.** Periodic audits will help management assess risk and verify the effectiveness of the compliance program. The Federal Financial Institutions Examination Council (FFIEC) will release interagency privacy examination procedures before July 1, 2001. The exam procedures will be a useful tool in developing a privacy audit program.

The interagency exam procedures will be mailed directly to insured depository institutions as soon as they are finalized. The procedures will also be available on the FDIC's Web site at www.fdic.gov when complete.

Section Four:
Learn the Lingo

Learning the lingo will help you understand and comply with the privacy rule. This section provides an explanation of key terminology.

Who must comply with the FDIC's privacy rule?

The FDIC's privacy rule refers to financial institutions that must comply with the rule as "you." For example, when the rule states that "you must provide a notice" it means all entities subject to this rule must provide a notice. The following definition of "you" explains the types of entities subject to the rule:

You: The banks that must comply with the FDIC's rule are -

(1) FDIC-supervised banks

(2) insured state branches of foreign banks

(3) subsidiaries of FDIC-supervised banks and insured state branches of foreign banks, with certain exceptions, such as insurance and securities or brokerage subsidiaries

Although the FDIC's rule only applies to certain banks and some of their subsidiaries, all financial institutions must comply with similar privacy rules adopted by their supervisory agencies. For example, although securities subsidiaries of FDIC-supervised banks do not have to comply with the FDIC's privacy rule, they do have to comply with a similar privacy rule adopted by the Securities and Exchange Commission.

Who is protected by the privacy rule?

The privacy rule protects "consumers." **All consumers receive the same privacy protections.**

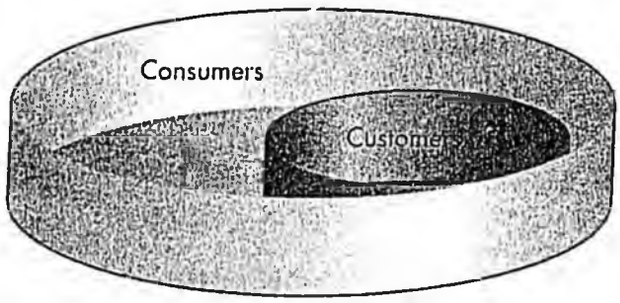
However, a subset of consumers defined as **customers** must receive certain disclosures, such as an annual privacy notice, that need not be provided to consumers who are not customers.

Thus, it is important to know the distinction between consumers and customers to understand the different disclosure requirements under the privacy rule.

Consumer: Any individual who is seeking to obtain or has obtained a financial product or service from a bank for personal, family, or household purposes is a consumer of that bank. The definition of consumer includes individuals who:

- **apply for** a financial product or service (e.g., a loan or a deposit account) for personal, family, or household purposes
- **actually obtain** a financial product or service (e.g., a loan or a deposit account) for personal, family, or household purposes

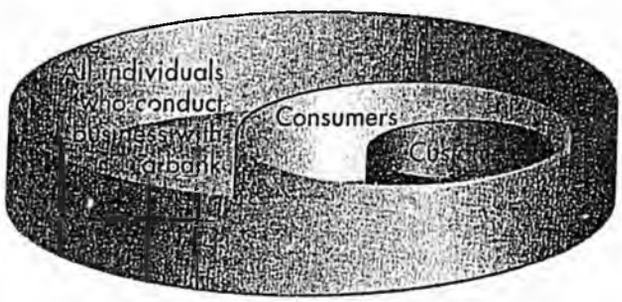
Customer: As the following diagram reflects, customers are a subset of consumers. A customer is a consumer with whom a bank has a **continuing relationship**. Although the rule does not define "continuing relationship," it provides examples of transactions that are and are not considered continuing relationships. Consumers who have a deposit account, obtain a loan, or obtain an investment advisory service are considered custome See Section 332.3(i).



Additional guidance regarding the customer relationship can be found in the Supplemental Information (the preamble) of the rule, which notes that a continuing relationship is established

"where a consumer typically would receive some measure of continued service following, or in connection with, a transaction." See page 35168, Federal Register, Vol. 65, No. 106.

The next diagram depicts the relationship between all individuals who do business with a bank and those who meet the regulatory definitions for **consumers** and **customers**. As the diagram shows, only a portion of the individuals who conduct business with a bank are consumers under the privacy rule. For example, individuals are not considered consumers under this rule if they are commercial clients, grantors or beneficiaries of trusts for which the bank is trustee, or participants in an employee benefit plan that the banks sponsors.



= information protected by the privacy

The rule identifies three primary categories of information:

- publicly available information
- personally identifiable financial information
- nonpublic personal information

Nonpublic personal information **is the category of information protected by the privacy rule.** The definitions for publicly available information and personally identifiable financial information work together to describe and define nonpublic personal information.

- ***Publicly available information*** is any information a bank reasonably believes is lawfully publicly available. The **nature** of the information, **not the source** of the information, determines whether it is publicly available information for purposes of the privacy rule. For example, even if a bank obtains customers' telephone numbers or the assessed value of their residences directly from the consumers, this information will be considered publicly available if the bank has a reasonable basis to believe the information could have been lawfully obtained from a public source. A reasonable belief exists if a bank has determined that (a) the information is of the type that is generally available to the public and (b) the individual has not blocked such information from public disclosure. This means, for example, that a bank can consider a customer's phone number to be publicly available, **but only** if the bank takes steps to determine the phone number is not unlisted.

- ***Personally identifiable financial information*** is any information a bank collects about a consumer in conjunction with providing a financial product or service. This includes:

  - information provided by the consumer during the application process (e.g., name, phone number, address, income)
  - information resulting from the financial product or service transaction (e.g., payment history, loan or deposit balances, credit card purchases)
  - information from other sources about the consumer obtained in connection with providing the financial product or service (e.g., information from a consumer credit report or from court records)

Personally identifiable financial information also includes any information that "is disclosed in a manner that indicates that the individual is or has been your consumer." See Section 332.3(o)(2)(i)(D). **Thus, the very fact that an individual is a consumer of a bank is personally identifiable financial information.**

- *Nonpublic personal information*, the category of information protected by the privacy rule, consists of:

  1. Personally identifiable financial information that is **not** publicly available information; and

  2. Lists, descriptions, or other groupings of consumers that were either

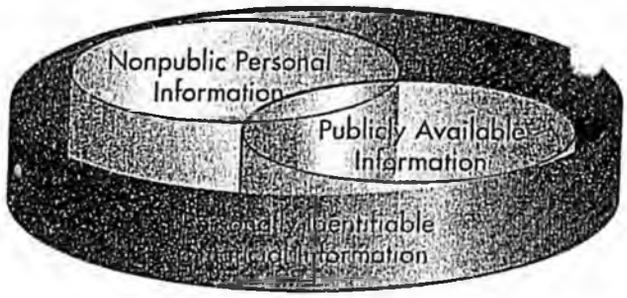
     a. **created using** personally identifiable financial information that is not publicly available information, or

     b. **contain** personally identifiable financial information that is not publicly available information.

A list is considered nonpublic personal information if it is **generated** based on customer relationships, loan balances, or other personally identifiable financial information that is not publicly available. A list is also considered nonpublic personal information if it **contains** any nonpublic personal information.

For example, in jurisdictions where mortgage documents are public records, the names and address of all individuals for whom a bank held a mortgage would not be nonpublic personal information since it was generated using publicly available information and contained only publicly available information. The list would become nonpublic personal information, however, if it contained current loan balances or if it was generated using only those customers with current mortgage loan balances in excess of a certain amount.

The two categories of nonpublic personal information are depicted in the following diagram.



Who are nonaffiliated third parties?

The privacy rule restricts information sharing with nonaffiliated third parties. The rule defines nonaffiliated third parties as persons or entities except affiliates and persons jointly employed by a bank and a nonaffiliated third party. Affiliates generally include a bank's subsidiaries, its holding company, and any other subsidiaries of the holding company. See Section 332.3(a), Section 332.3(d), and Section 332.3(g).

The privacy rule does not impose limitations on information sharing with affiliates. It does, however, require disclosure of such information sharing policies and practices. (Note: The rules governing the sharing of information between a bank and its affiliates are set forth in the Fair Credit Reporting Act.)

Although the privacy rule most commonly uses the term "nonaffiliated third parties," there are some instances in which a distinction is made between nonaffiliated financial institutions and all other nonaffiliated third parties. Readers should pay particular attention to these distinctions. See Section 332.13.

Other Resources

A variety of resources are available to help banks understand the privacy rule and related issues. Some of the most significant are listed below. All FDIC material can be found at www.fdic.gov.

FDIC Financial Institution Letter titled ***Final Rule on the Privacy of Consumers' Financial Information***, (FIL-34-2000 dated June 5, 2000).

FDIC Financial Institution Letter titled ***Proposed Regulations Implementing the Fair Credit Reporting Act***, (FIL-71-2000 dated October 26, 2000).

FDIC Financial Institution Letter titled ***Proposed Security Standards for Customer Information***, (FIL-43-2000 dated July 6, 2000).

FDIC Financial Institution Letter titled ***Internet Web Site Privacy Survey Report***, (FIL-113-99 dated December 27, 1999).

FDIC Financial Institution Letter titled ***Online Privacy of Consumer Financial Information***, (FIL-86-98 dated August 17, 1998).

Transcript of ***"Is It Any of Your Business? Consumer Information, Privacy, and the Financial Services Industry,"*** an interagency public forum hosted by the FDIC, March 23, 2000.

Office of the Comptroller of the Currency's Bulletin titled ***Privacy Laws and Regulations***, (September 8, 2000) available at www.occ.treas.gov.

Office of Thrift Supervision's Memorandum to Chief Executive Officers titled ***Privacy Preparedness Check-up***, (September 29, 2000) available at www.ots.treas.gov.

I. Background and Summary

The Fair Credit Reporting Act (FCRA) [15 USC 1681-1681u] became effective on April 25, 1971. The FCRA is part of a group of acts contained in the Federal Consumer Credit Protection Act [5 USC 1601 *et seq.*], such as the Truth in Lending Act and the Fair Debt Collection Practices Act. Congress subsequently passed the Consumer Credit Reporting Reform Act of 1996 (Reform Act), which substantially revised the FCRA. These revisions generally became effective on September 30, 1997. Minor amendments to the FCRA were made in 1997 and 1998. The Gramm-Leach-Bliley Act of 1999 made additional changes, including provisions permitting regulations to be adopted to implement the requirements of the FCRA.

The purposes of the FCRA, as amended, include the following:

- to regulate aspects of the consumer reporting industry;
- to place disclosure obligations on users of consumer reports;
- to establish requirements applicable to the furnishing of information to consumer reporting agencies; and
- to require timely responses to consumer inquiries regarding information maintained by consumer reporting agencies.

The FCRA places restrictions on the use of consumer reports and, in certain instances, requires the deletion of information from them.

Financial institutions may be subject to the FCRA as:

- procurers and users of information (for example, as credit grantors, purchasers of dealer paper, or when opening deposit accounts);
- furnishers and transmitters of information (by reporting information to consumer reporting agencies or other third parties, or to affiliates);
- marketers of credit or insurance products; or
- employers.

Generally, financial institutions will not be considered to be consumer reporting agencies; however, it is possible for them to become consumer reporting agencies. Therefore, financial institutions should exercise careful scrutiny of their operations to ensure that they comply with the requirements of the FCRA as applicable.

II. Relation to State Laws and Administrative Enforcement

Section 624 [15 USC 1681t] preempts certain state law requirements while generally preserving the rights of states to legislate on matters covered by the FCRA (but only to the extent that state laws are *not inconsistent* with the FCRA). Areas where state requirements/prohibitions are entirely preempted include:

- furnishing and using consumer reports in connection with any credit or insurance transaction that is not initiated by the consumer; and
- the duties of a person taking adverse action with respect to a consumer under sections 615 (a) and (b).

In general, state requirements/prohibitions are preempted with respect to the exchange of information among affiliates. In addition, certain other areas of state laws are preempted as provided by section 624.

Section 621 [15 USC 1681s] establishes responsibilities for administrative enforcement of the FCRA. The Federal Trade Commission (FTC) is authorized to enforce the requirements for certain persons other than banks, savings associations, and credit unions. The banking and thrift super-

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visory agencies are authorized to enforce the FCRA with respect to their supervised institutions. State law enforcement officials also may enforce the FCRA through court actions. Federal regulators, however, have a right to intervene in any action brought by a state.

III. Important Definitions

There are a number of definitions used throughout the FCRA. The more important definitions that financial institutions and examination staff should be aware of include the following:

Consumer

A "consumer" is defined as an individual.

Consumer Report

A "consumer report" is any written, oral, or other communication of any information by a consumer reporting agency that bears on a consumer's creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for:

- credit or insurance to be used primarily for personal, family, or household purposes;
- employment purposes; or
- any other purpose authorized under section 604 [15 USC 1681b]. (Refer to section IV, "Requirements on Consumer Reporting Agencies.")

The term "consumer report" does not include:

- any report containing information solely about transactions or experiences between the consumer and the institution making the report;
- any communication of that transaction or experience information among entities related by common ownership or affiliated by corporate control (for example, different banks that are members of the same holding company, or subsidiary companies of a bank);
- communication of other information among persons related by common ownership or affiliated by corporate control if
  - — it is clearly and conspicuously disclosed to the consumer that the information may be communicated among such persons; and
  - — the consumer is given the opportunity, before the time that the information is communicated, to direct that the information not be communicated among such persons.
- any authorization or approval of a specific extension of credit directly or indirectly by the issuer of a credit card or similar device;
- any report in which a person who has been requested by a third party to make a specific extension of credit directly or indirectly to a consumer, such as a lender who has received a request from a broker conveys his or her decision with respect to such request, if the third party advises the consumer of the name and address of the person to whom the request was made, and such person makes the disclosures to the consumer required under section 615 [15 USC 1681m]; or
- a communication described in section 603(o) [15 USC 1681a(o)] (which relates to certain reports to prospective employers).

Person

A "person" means any individual, partnership, corporation, trust, estate, cooperative, association, government or governmental subdivision or agency, or other entity.

Investigative Consumer Report

An "investigative consumer report" means a consumer report or portion thereof in which information on a consumer's character, general reputation, personal characteristics, or mode of living is obtained through personal interviews with neighbors, friends, or associates of the consumer re-

ported on or with others with whom he is acquainted or who may have knowledge concerning any such items of information. However, such information does not include specific factual information on a consumer's credit record obtained directly from a creditor of the consumer or from a consumer reporting agency when such information was obtained directly from a creditor of the consumer or from the consumer.

Adverse Action

The term "adverse action" has the same meaning as used in section 701(d)(6) [15 USC 1691(d)(6)] of the Equal Credit Opportunity Act (ECOA). Under the ECOA, it means a denial or revocation of credit, a change in the terms of an existing credit arrangement, or a refusal to grant credit in substantially the amount or on substantially the terms requested. Under the ECOA, the term does not include a refusal to extend additional credit under an existing credit arrangement where the applicant is delinquent or otherwise in default, or where such additional credit would exceed a previously established credit limit. The term has the following additional meanings for purposes of the FCRA:

- a denial or cancellation of, an increase in any charge for, or a reduction or other adverse or unfavorable change in the terms of coverage or amount of, any insurance, existing or applied for, in connection with the underwriting of insurance;
- a denial of employment or any other decision for employment purposes that adversely affects any current or prospective employee;
- a denial or cancellation of, an increase in any charge for, or any other adverse or unfavorable change in the terms of, any license or benefit described in section 604(a)(3)(D) [15 USC 1681b(a)(3)(D)]. (Refer to section IV. A., "Permissible Purposes for Furnishing or Using Consumer Reports"); and
- an action taken or determination that is (a) made in connection with an application made by, or transaction initiated by, any consumer, or in connection with a review of an account to determine whether the consumer continues to meet the terms of the account, and (b) adverse to the interests of the consumer.

Employment Purposes

The term "employment purposes" when used in connection with a consumer report means a report used for the purpose of evaluating a consumer for employment, promotion, reassignment or retention as an employee.

Consumer Reporting Agency

The term "consumer reporting agency" means any person which, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties, and which uses any means or facility of interstate commerce for the purpose of preparing or furnishing consumer reports.

IV. Requirements on Consumer Reporting Agencies

Consumer reporting agencies have substantial obligations placed upon them by the FCRA. These obligations are summarized below. Financial institutions and other persons that are users or furnishers of information from or to consumer reporting agencies should also be aware of the obligations of the consumer reporting agencies since certain requirements on the agencies will affect requirements on users or furnishers of information.

A. Permissible Purposes for Furnishing or Using Consumer Reports

Section 604 [15 USC 1681b] prohibits a consumer reporting agency from furnishing a consumer report, except for the following purposes.

In addition to furnishing consumer reports in connection with credit or insurance pre-screens, a consumer reporting agency may furnish a consumer report:

- when the consumer has authorized the release in writing;
- pursuant to a court order or subpoena issued by a federal grand jury;
- to an agency administering a state plan under section 454 of the Social Security Act [42 USC 654] to establish or modify child support awards;
- in response to a request by a state or local child support enforcement agency, if proper certification is provided; or
- to a person the consumer reporting agency has reason to believe
  - — intends to use the information in connection with a credit transaction involving the consumer on whom the information is to be furnished and involving the extension of credit to, or review or collection of an account of, the consumer;
  - — intends to use the information for employment purposes;
  - — intends to use the information for underwriting insurance involving the consumer;
  - — intends to use the information for determining the consumer's eligibility for a license or other benefit granted by a government instrumentality that is required by law to consider an applicant's financial responsibility or status;
  - — intends to use the information, as a potential investor or servicer, or current insurer, in connection with a valuation of, or an assessment of the credit or prepayment risks associated with, an existing credit obligation; or
  - — otherwise has a legitimate business need for the information, either in connection with a business transaction initiated by the consumer, or to review an account to determine whether the consumer continues to meet the terms of the account.

This last provision permits an institution to obtain consumer reports, for example, for deposit services, such as a consumer opening a transaction account. Consumers who are turned down when attempting to open an account because of information contained in a consumer report must be provided an adverse action notification. (Refer to section V, "Requirements on Users of Consumer Reports.")

Disclosures containing medical information. A consumer reporting agency cannot furnish a consumer report containing medical information about a consumer without the consumer's consent in the following circumstances:

- for employment purposes; or
- in connection with a credit or insurance transaction.

Disclosures to government agencies. Consumer reporting agencies, under section 608 [15 USC 1681f], may furnish to government agencies (federal, state, or local) identifying information on any consumer that is limited to the consumer's name, address, former addresses, places of employment, or former places of employment. This is a specific exemption from the general requirements of section 604 of the FCRA. Special rules under section 604 apply when a U.S. government agency head makes a written finding that a consumer report is relevant to a national security investigation being carried on by the agency.

Disclosures to the Federal Bureau of Investigation (FBI). Consumer reporting agencies are required to furnish information to the FBI when it requests the information pursuant to an authorized foreign counterintelligence investigation. Section 625 [15 USC 1681u] provides specific requirements on how the FBI and the consumer reporting agency must comply with the provisions of the FCRA in this area.

B. Information Contained in Consumer Reports

Section 605 [15 USC 1681c] contains limitations on the type of information contained in consumer reports and the length of time it may be reported by a consumer reporting agency. Examples of information that must be excluded from a consumer report are as follows:

- bankruptcy cases that antedate the report by more than ten years measured from the date of entry of the order for relief or the date of adjudication;
- civil suits, civil judgments and records of arrest that, from date of entry, antedate the report by more than seven years or until the governing statute of limitations has expired, whichever is the longer period;
- paid tax liens which, from date of payment, antedate the report by more than seven years;
- accounts placed for collection or charged off which antedate the report by more than seven years. (The reporting periods have been lengthened for certain adverse information pertaining to U.S. Government-insured or -guaranteed student loans, or pertaining to national direct student loans. Refer to sections 430A(f) and 463(c)(3) of the Higher Education Act of 1965 [20 USC 1080a(f) and 20 USC 1087cc(c)(3)], respectively);
- any other adverse information, other than records of convictions of crimes, which antedates the report by more than seven years.

These time restrictions do not apply in the case of a consumer report to be used in connection with

- a credit transaction involving, or which may reasonably be expected to involve, a principal amount of $150,000 or more;
- the underwriting of life insurance involving, or which may reasonably be expected to involve, a face value of $150,000 or more; or
- the employment of any individual at an annual salary that equals, or which may reasonably be expected to equal, $75,000 or more.

Indication of closure of account by consumer. If a consumer reporting agency is notified pursuant to section 623(a)(4) [15 USC 1681s-2(a)(4)] that a credit account of a consumer was voluntarily closed by the consumer, the agency is to indicate that fact in any consumer report that includes information related to the account.

Indication of dispute by consumer. If a consumer reporting agency is notified pursuant to section 623(a)(3) [15 USC 1681s-2(a)(3)] that information regarding a consumer which was furnished to the agency is disputed by the consumer, the agency is to indicate that fact in each consumer report that includes the disputed information.

Information on overdue child support obligations. In contrast to prohibitions on reporting certain information, section 622 [15 USC 1681s-1] requires a consumer reporting agency to include, in any consumer report furnished by the agency, information on the failure of the consumer to pay overdue support where the information (a) is provided or verified by a specified government agency and (b) antedates the report by seven years or less.

C. Investigative Consumer Reports

According to section 606 [15 USC 1681d], an investigative consumer report may not be procured or caused to be prepared unless the consumer has been provided a clear and accurate disclosure by the person requesting the report that an investigative consumer report may be obtained. This disclosure must contain a statement in writing of the consumer's right to request additional disclosures about the report, and a summary of the consumer's rights under the FCRA, mailed or otherwise delivered to the consumer not later than three days after the date on which the report was first requested. The person procuring the report from the consumer reporting agency (or causing it to be prepared) must certify to the consumer reporting agency that the person has complied with these disclosure requirements and will comply in the event the consumer exercises his or her right to request additional disclosures.

D. Compliance Procedures

Section 607 [15 USC 1681e] requires consumer reporting agencies to maintain reasonable procedures to avoid violations of section 605 and limit distribution of consumer reports only to persons with a permissible purpose under section 604. Section 607 requires consumer reporting agencies to follow reasonable procedures in preparing consumer reports to assure maximum possible accu-

racy of the information that they report on consumers.

Section 607 also establishes rules for persons who obtain consumer reports for resale to other parties. Information generally must be provided back to the consumer reporting agency as to the identity of the end user of the report and each permissible purpose for which it was furnished to the end user.

Consumer reporting agencies may not prohibit the disclosure of the contents of a consumer report to the consumer by the user of the report, if adverse action has been taken by the user based in whole or in part on the report.

E. Disclosures to Consumers

Under sections 609 and 610 [15 USC 1681g and 1681h], a consumer reporting agency, upon request from a consumer, must clearly and accurately disclose the following information to the consumer in writing (unless the consumer has authorized another form of disclosure, including electronic means, if available from the agency) when it is provided proper identification:

- all information in the consumer's file at the time of the request (except that information about credit scores or other risk scores or predictors relating to the consumer need not be disclosed).
- the sources of the information (except that sources of information acquired solely for use in preparing an investigative consumer report and actually used for no other purpose need not be disclosed, provided that in the event an action is brought, such sources would be available to the plaintiff under appropriate discovery procedures).
- in general, the identity of each person that procured a consumer report
  - — for employment purposes, during the two years preceding the request, or
  - — for any other purpose, during the one year preceding the request.

Identification must include the name of the person or, if applicable, the trade name under which such person conducts business, and upon the consumer's request, the address and telephone number of the person.

- dates, original payees, and amounts of any checks upon which is based any adverse characterization of the consumer, included in the file at the time of the disclosure; and
- a record of all inquiries received during the one-year period preceding the request that identified the consumer in connection with a credit or insurance transaction not initiated by the consumer.

The consumer reporting agency shall provide, with each written disclosure made pursuant to the above requirements, a written summary of the consumer's rights in a form prescribed by the FTC. Consumer reporting agencies that maintain consumer files on a nationwide basis (refer to section 603(p) [15 USC 1681a (p)] must include a toll-free telephone number.

F. Procedures in Case of Disputed Accuracy

Under section 611 [15 USC 1681i], if the consumer disputes the completeness or accuracy of any information contained in a consumer file, and the consumer notifies the agency directly, the consumer reporting agency must:

- reinvestigate, at no charge, and record the current status of the disputed information, or delete the item from the file, generally within 30 days of receiving notice from the consumer; and
- provide notification of the dispute to any person that provided any item of the information in dispute, within five business days from the agency's receipt of notice of the dispute.

The 30-day time period above may be extended up to an additional 15 days if the consumer submits additional relevant information during the 30-day period, but no such extension may be made if the information that is the subject of the reinvestigation is found during the 30-day period to be inaccurate or incomplete or the consumer

reporting agency determines that the information cannot be verified.

A consumer reporting agency may terminate a reinvestigation of a consumer dispute if it makes a reasonable determination that the dispute is frivolous or irrelevant. If it makes such a determination, it must notify the consumer within five business days. The notice must include the reasons for the determination and identify any information required to investigate the disputed information.

If, after any reinvestigation of any information disputed by a consumer, an item of information is found to be inaccurate or incomplete or cannot be verified, the consumer reporting agency must promptly delete or modify the information, as appropriate. The information cannot be reinserted into the file unless the person who furnishes the information certifies that the information is complete and accurate. If the information is reinserted, the consumer reporting agency must notify the consumer of the reinsertion in writing within five business days. The notice must include (a) the business name and address of any furnisher contacted and the telephone number of such furnisher, if reasonably available, or of any furnisher that contacted the consumer reporting agency, in connection with the reinsertion, and (b) a notice of the consumer's right to add a statement to the file disputing the accuracy or completeness of the information.

A consumer reporting agency must maintain reasonable procedures to prevent the reappearance in a consumer's file, and in consumer reports on the consumer, of information that is deleted, other than information that has been properly reinserted. Consumer reporting agencies that maintain consumer files on a nationwide basis must have an automated system through which a furnisher of information may report the results of a reinvestigation that finds incomplete or inaccurate information in a consumer's file to other such consumer reporting agencies.

Within five business days after completion of a reinvestigation, a consumer reporting agency must notify the consumer of the results of the investigation by mail or other means authorized by the consumer and available to the agency. If the reinvestigation does not resolve the dispute, the consumer may file a brief statement setting forth the nature of the dispute. The statement, or a clear and accurate summary thereof, must be put in any subsequent consumer report containing the disputed information, unless there are reasonable grounds to believe that the dispute is frivolous or irrelevant.

G. Permissible Charges for Disclosures

Section 612 [15 USC 1681j] provides that a consumer reporting agency may not impose any charge on a consumer for providing any notification or disclosure required by the FCRA, except for those authorized under this section. A consumer reporting agency may impose a reasonable charge on a consumer when it:

- makes a disclosure to the consumer pursuant to section 609 [15 USC 1681g]. That charge must not exceed $8.50 for the year 2000 (the amount is to be adjusted annually by the FTC, based on changes in the consumer price index) and must be indicated before the consumer reporting agency provides the disclosure; and
- provides the notification pursuant to section 611(d) [15 USC 1681i(d)] at any time after the 30-day period beginning on the date of the notice of the results of the reinvestigation. That charge may not exceed the amount the agency would impose on each recipient of the notification for a consumer report, and must be indicated before furnishing the information.

According to section 611(d) [15 USC 1681i(d)], following any deletion of information which is found to be inaccurate or whose accuracy can no longer be verified or any notation as to disputed information, the consumer reporting agency must, at the request of the consumer, furnish notification that the item has been deleted, or the statement or summary of dispute referred to above, to any person specifically designated by the consumer who has within two years prior thereto received a consumer report for employment purposes, or within six months prior thereto received

a consumer report for any other purpose, which contained the deleted or disputed information.

A consumer reporting agency that maintains a file on a consumer must make all disclosures required by section 609 [15 USC 1681g] at no charge if the consumer has requested them under section 609 within 60 days after receiving:

- a notice of adverse action pursuant to section 615 [15 USC 1681m]; or
- notification from a debt collection agency affiliated with the consumer reporting agency stating that the consumer's credit rating has been or may be adversely affected.

The consumer reporting agency also must make the disclosures required by section 609 [15 USC 1681g] at no charge, once in any 12-month period, if the consumer requests them and certifies in writing that he or she:

- is unemployed and intends to apply for employment in the 60-day period beginning on the date on which the certification is made;
- is a recipient of public welfare assistance; or
- has reason to believe that the file on the consumer at the agency contains inaccurate information due to fraud.

H. Public Record Information for Employment Purposes

Under section 613 [15 USC 1681k], a consumer reporting agency that furnishes a consumer report for employment purposes and for that purpose compiles and reports public record information that is likely to have an adverse effect upon a consumer's ability to obtain employment generally must:

- at the time the public record information is reported to the user of the report, notify the consumer that public record information is being reported, together with the name and address of the person to whom the information is being reported; or
- maintain strict procedures to ensure that such public record information is complete and up to date.

I. Restrictions on Investigative Consumer Reports

Section 614 [15 USC 1681l] provides that when a consumer reporting agency prepares an investigative consumer report, no adverse information in the consumer report (other than public record information) may be included in a subsequent consumer report, unless the information:

- has been verified in the process of making the subsequent report; or
- was received within the three-month period preceding the date the subsequent report is furnished.

V. Requirements on Users of Consumer Reports

A. Information Obtained from a Consumer Report

Section 615(a) [15 USC 1681m(a)] requires that if any person takes any adverse action with respect to any consumer that is based in whole or in part on any information contained in a consumer report, the person must:

- provide oral, written, or electronic notice of the adverse action to the consumer;
- provide to the consumer orally, in writing, or electronically, the name, address, and telephone number of the consumer reporting agency from which it received the information (including a toll-free telephone number established by the agency, if the consumer reporting agency maintains files on a nationwide basis); and a statement that the consumer reporting agency did not make the decision to take the adverse action and is unable to provide the consumer the specific reasons why the adverse action was taken; and
- provide the consumer an oral, written, or electronic notice of the consumer's right to

obtain a free copy of the consumer report within 60 days of receiving notice of the adverse action, and the consumer's right to dispute the accuracy or completeness of any information in the consumer report with the consumer reporting agency.

B. Information Obtained from a Source Other Than a Consumer Report

Section 615(b)(1) [15 USC 1681m(b)(1)] provides that if consumer credit is denied or the charge for such credit is increased, partially or wholly on the basis of information obtained from a person other than a consumer reporting agency bearing upon the consumer's creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living, the user:

- must clearly and accurately disclose the consumer's right to file a written request for the reasons for the adverse action; and
- if it receives such a request within 60 days after the consumer learns of the adverse action, must, within a reasonable period of time, disclose the nature of the adverse information.

C. Information Obtained from an Affiliate

Section 615(b)(2) [15 USC 1681m(b)(2)] provides that if a user takes an adverse action involving credit (taken in connection with a transaction initiated by a consumer), insurance or employment, it must notify the consumer of the adverse action, if it took the action based in whole or part on information provided by an affiliate that:

- bears upon the consumer's creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living; and
- is not information solely as to the transactions or experiences with the consumer on the part of the person furnishing the information, or information in a consumer report.

The notification must inform the consumer that the consumer may obtain a disclosure of the nature of the information relied upon by making a written request within 60 days of transmittal of the adverse action notice. If the consumer makes such a request, the user must disclose the nature of the information not later than 30 days after receiving the request.

D. Using Consumer Reports for Employment Purposes

Section 604(b)(2) [15 USC 1681b(b)(2)] generally requires the written permission of the consumer to procure a consumer report for "employment purposes." Moreover, a clear and conspicuous disclosure that a consumer report may be obtained for employment purposes generally must be provided in writing to the consumer prior to procuring a report.

Prior to taking any adverse action as to employment based in whole or in part on the consumer report, the user must generally provide to the consumer:

- a copy of the report; and
- the FTC notice described within section 609(c)(3) [15 USC 1681g].

At the time a user of the report takes adverse action in an employment situation, an adverse action notice, as required by section 615, also must be provided to the consumer.

VI. Responsibilities Placed on Furnishers of Information

Section 623 [15 USC 1681s-2] contains a number of new requirements for persons furnishing information to consumer reporting agencies.

Duties of furnishers to provide accurate information. A person may, but need not, specify an address for receipt of notices from consumers concerning inaccurate information. If the person specifies such an address, then the person may not furnish information relating to a consumer to any consumer reporting agency if (a) the person has been notified by the consumer, at the specified

address, that the information is inaccurate, and (b) the information is in fact inaccurate. If the person does not specify an address, then the person may not furnish any information relating to a consumer to any consumer reporting agency, if the person knows or consciously avoids knowing that the information is inaccurate.

When a person, who regularly and in the ordinary course of business furnishes information to one or more consumer reporting agencies about the person's transactions or experiences with any consumer, determines that any such information is not complete or accurate, the person must promptly notify the consumer reporting agency of that determination. The person also must provide to the agency any corrections to that information, or any additional information, necessary to make the information provided by the person to the agency complete and accurate and must not thereafter furnish to the agency any of the information that remains incomplete or inaccurate.

If the completeness or accuracy of any information furnished by a person to a consumer reporting agency is disputed to such person by a consumer, that person may not furnish the information to any consumer reporting agency without notice that the information is disputed by the consumer.

Voluntary closures of accounts. Any person, who regularly and in the ordinary course of business furnishes information to a consumer reporting agency regarding a consumer who has a credit account with that person, must notify the agency of the voluntary closure of the account by the consumer in information regularly furnished for the period in which the account is closed.

Notice involving delinquent accounts. A person who furnishes information to a consumer reporting agency about a delinquent account being placed for collection, charged off, or subjected to any similar action must, not later than 90 days after furnishing the information to the consumer reporting agency, notify the agency of the month and year of the commencement of the delinquency that immediately preceded the action.

Duties upon notice of dispute. Whenever a person receives a notice of dispute from a consumer reporting agency regarding the accuracy or completeness of any information provided by the person pursuant to section 611, that person must:

- conduct an investigation regarding the disputed information;
- review all relevant information provided by the consumer reporting agency along with the notice;
- report the results of the investigation to the consumer reporting agency; and
- if the information is found to be incomplete or inaccurate, report those results to all nationwide consumer reporting agencies to which the person previously provided the information.

The investigations, reviews, and reports required to be made must be completed within 30 days. The time period may be extended for 15 days if a consumer reporting agency receives additional relevant information.

Enforcement of the responsibilities of furnishers of information under section 623 (except those described under "Duties Upon Notice of Dispute") is reserved exclusively for the federal and state agencies and officials, including the financial institution regulatory agencies, identified under section 621 [15 USC 1681s]. (Refer to section II, "Relation to State Laws and Administrative Enforcement.")

VII. Pre-Screening Requirements

The practice of using consumer reports for the purpose of selecting pools of individuals for solicitation of financial or other products has expanded substantially since the 1970s. Guidance on these issues is discussed in this section.

A. Firm Offer of Credit or Insurance

The term "firm offer of credit or insurance" means any offer of credit or insurance to a consumer that will be honored if the consumer is determined, based on information in a consumer

report on the consumer, to meet the specific criteria used to select the consumer for the offer, except that the offer may be further conditioned on one or more of the following:

- the consumer being determined, based on information in the consumer's application for the credit or insurance, to meet specific criteria bearing on creditworthiness or insurability, as applicable, that are established
  - — before selection of the consumer for the offer; and
  - — for the purpose of determining whether to extend credit or insurance pursuant to the offer.
- verification
  - — that the consumer continues to meet the specific criteria used to select the consumer for the offer, by using information in a consumer report on the consumer, information in the consumer's application for the credit or insurance, or other information bearing on the creditworthiness or insurability of the consumer; or
  - — of the information in the consumer's application for the credit or insurance, to determine that the consumer meets the specific criteria bearing on creditworthiness or insurability.
- the consumer furnishing any collateral that is a requirement for the extension of the credit or insurance that was
  - — established before selection of the consumer for the offer of credit or insurance; and
  - — disclosed to the consumer in the offer of credit or insurance.

B. Credit or Insurance Transaction Not Initiated by the Consumer

The term "credit or insurance transaction that is not initiated by the consumer" is a new term defined in section 603(m) [15 USC 1681a(m)] for use in dealing with pre-screening issues. The term does not include the use of a consumer report by a person with whom the consumer has an account or insurance policy for the following purposes:

- reviewing the account or insurance policy; or
- collecting the account.

C. Furnishing Reports in Connection with Credit Transactions not Initiated by the Consumer

Section 604(c) [15 USC 1681b(c)] establishes requirements for consumer reporting agencies when furnishing consumer reports for use in connection with pre-screens. A consumer reporting agency may only furnish a person with a consumer report for pre-screening purposes if:

- the consumer authorizes the agency to provide such report to such person, or
- the transaction consists of a firm offer of credit or insurance and
  - — the consumer reporting agency has established the required procedures to permit consumers to elect to be excluded from pre-screened lists; and
  - — no such election is in effect as to the consumer.

A person receiving a pre-screened list from a consumer reporting agency may, for each consumer on the list, receive only the following information:

- the name and address of the consumer;
- an identifier that is not unique to the consumer and that is used by the person solely for the purpose of verifying the identity of the consumer; and
- other information about the consumer that does not identify the relationship or experience of the consumer with a particular creditor or other entity.

As indicated above, a consumer reporting agency must establish procedures that allow a consumer

to notify the agency that the consumer elects to be excluded from pre-screen lists furnished by the agency. Notifications can be made through a notification system maintained by the agency or by submitting a signed notice of election form issued by the agency. Exclusion requests made through the notification system expire two years following notification unless earlier withdrawn. If the request is made on the election form, it never expires, although it may be withdrawn.

D. Duties of Users Making Written Solicitations on the Basis of Information from Consumer Files

Under section 615(d) [15 USC 1681m(d)], any person who uses a consumer report on any consumer in connection with any credit or insurance transaction that is not initiated by the consumer and that is provided to that person in accordance with paragraph C. above must provide with each written solicitation, a clear and conspicuous statement that:

- information contained in a consumer's consumer report was used in connection with the offer;
- the consumer received the offer because he or she satisfied the criteria for creditworthiness or insurability used to screen for the offer;
- if applicable, the credit or insurance may not be extended if, after the consumer responds, it is determined that the consumer does not meet the criteria used for screening or any applicable criteria bearing on creditworthiness or insurability, or the consumer does not furnish required collateral; and
- consumers have the right to prohibit use of information in their consumer file in connection with future pre-screened offers of credit or insurance by contacting a notification system established under section 604(e)(5) by the consumer reporting agency that provided the report. The address and toll-free telephone number of the appropriate notification system must be provided.

Record Retention Requirements. Section 615(d)(3) requires a person who makes an offer of credit or insurance to a consumer in a transaction not initiated by the consumer to maintain on file the criteria used to select the consumer to receive the offer, all criteria bearing on creditworthiness or insurability, as applicable, that are the basis for determining whether or not to extend credit or insurance pursuant to the offer, and any requirement for the furnishing of collateral as a condition of the extension of credit or insurance, until the expiration of the three-year period beginning on the date on which the offer is made to the consumer.

VIII. Civil Liability, Limitation of Actions, and Unauthorized Disclosure

Sections 616 and 617 [15 USC 1681n and 1681o] establish the circumstances under which persons violating the FCRA may be liable for willful or negligent noncompliance. Civil liability awards for violations may include actual damages, court costs, attorneys' fees and, for willful noncompliance, punitive damages.

Section 618 [15 USC 1681p] establishes a statute of limitations for bringing actions under the FCRA. The time period is generally two years from the date the liability arises; however, it can be extended for certain willful and material misrepresentations to a date two years after the individual discovers the misrepresentation.

Sections 619 and 620 [15 USC 1681q and 1681r] make it a crime for any person to knowingly and willfully obtain information on a consumer from a consumer reporting agency under false pretenses, and for any officer or employee of a consumer reporting agency to knowingly and willfully provide information concerning an individual to a person not authorized to receive it. The penalty for violation is a fine, imprisonment for up to two years, or both.

Examination Objectives

1. To determine the financial institution's compliance with the FCRA.

Relating to HB106 From Thyes

- Quick Map -

The Devastating Effect of Opt-In Restrictions

Customers expect financial institutions to use their personal information responsibly. They also expect high quality, convenient, and affordable financial services. Balancing these expectations has yielded exceptional benefits for consumers and contributed to the longest sustained economic growth in modern history. Opt-in restrictions - which require customer consent before any sharing of information occurs - threaten to destroy that balance, and significantly reduce the benefits of fair information use.

1. Opt-in restrictions raise the price of goods and services

Financial institutions rely on integrated information systems to operate more efficiently, thereby avoiding the costs of acquiring and maintaining duplicate systems. Requiring customers to opt-in to information sharing decreases the speed, lowers the efficiency, and raises the cost of information. This means that customers will end up paying higher prices for goods and services.

For example, U.S. mortgage markets are highly efficient because of the ability to share information. With opt-in, a financial institution would be forced to begin from scratch the process of collecting and verifying information about a customer who has applied for a mortgage. This process would take much longer than it does today, create delays in mortgage closings, and raise the interest rate on mortgage loans. The same would be true - including higher interest rates - for other credit products, such as credit cards and automobile loans.

Opt-in restrictions unnecessarily inconveniences consumers

Information sharing among affiliates allows customers to receive consolidated statements, avoid making multiple telephone calls or deal with each account separately within the same institutional family. Opt-in restrictions would make impossible these important customer conveniences. Because it would be so prohibitively expensive to offer some customers consolidated statements, but not others, the financial institution would likely not provide consolidated services to anyone. Thus, even though most customers prefer this service, the opt-in restrictions would ruin it for everyone.

Opt-in restrictions hinder or stop consumer transactions

Debit and credit card and check-cashing networks depend upon the instantaneous availability of standardized, reliable databases of historical personal financial information. Because opt-in requires customer consent before information is shared, it hinders the development of these databases. This means that some transactions would be delayed - or not even take place - because of a lack of needed information. This clearly would impose great inconveniences on customers.

Opt-in restrictions limit consumers' choice of goods and services

By making information sharing close to impossible, opt-in restrictions severely limit a financial institution's ability to recognize and respond to individual customer needs. The result: customers would have fewer options available to them.

Opt-in restrictions make it more difficult for small businesses to compete

Smaller financial institutions often depend on outsourcing and other joint ventures to provide a wide range of products and services efficiently and at the lowest possible prices. Outsourcing requires that information be shared. Information sharing thus enables institutions to offer products and services that they simply would not have been able to provide. This helps promote competition and drive down prices.

By severely limiting the available information, opt-in hurts **all** businesses, and imposes an especially heavy burden on small institutions that rely on outsourcing or joint ventures.

Opt-in restrictions are impractical and costly to administer

Individual consent required with opt-in is often impractical to obtain and, thus, significantly more expensive to administer. For instance, obtaining opt-in approval for information sharing can cost almost $30 per customer. In one case, getting permission to use information required almost five calls to each household. In one-third of households called, the company never reached the customer. These added costs will ultimately be paid by all consumers whether they wanted their information shared or not.

Opt-in restrictions make fraud more difficult to detect

Information sharing helps identify unauthorized account activity and other fraudulent schemes so that financial institutions can better protect their customers. Opt-in restrictions would dramatically limit the information necessary to protect customers' accounts.

2. **Opt-in restrictions limit e-commerce and innovation**

Information sharing allows financial institutions to rapidly develop and test market new and innovative products and services. If opt-in restrictions were imposed, every idea for new services would require the institution to contact each of its customers to seek permission to use their information. This raises the cost of research and development, delays the time to market, and thus stifles innovation.

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Page prepared by Ayca Ergeneman

Thursday, March 15, 2001

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- Quick Map -

Existing Privacy Laws Already Regulate Information Sharing

Some 20 different federal laws already regulate information sharing and provide consumers with a plethora of privacy protections. Five, in particular, play principal roles in regulating information sharing by financial institutions.

1. Gramm-Leach-Bliley Act of 1999

Title V of the Gramm-Leach-Bliley Act of 1999 established a set of comprehensive privacy laws at the federal level applicable to any firm that provides financial services. The new law established four new requirements regarding the nonpublic personal information of a consumer:

- ***Annual Disclosure of Privacy Policy:*** A financial institution must annually disclose to consumers its policy and practice regarding the protection and disclosure of nonpublic personal information to affiliates and nonaffiliated third-parties.

- ***Customer "Opt-Out" of Disclosures to Third-Parties:*** Consumers have the right to prevent the disclosure of nonpublic personal information to a nonaffiliated third-party - commonly referred to as the right to "opt-out." Third-parties may not re-disclose that information.

  There are important exceptions designed to resolve the practical problems with an opt-out provision. For example, opt-out does not apply in cases where information sharing is necessary to produce a consolidated customer statement, complete a transaction, or service the customer's account. It also does not apply to information disclosed to market the financial institution's own products or services offered through joint agreements with another financial institution.

- ***Prohibition on Disclosure of Account Information:*** A financial institution may not disclose account numbers to any nonaffiliated third-party for use in telemarketing, direct mail marketing, or other marketing through electronic mail to the consumer.

- ***Regulatory Standards to Protect Security and Confidentiality:*** Financial institution regulators are to establish "standards" (related to the physical security and integrity of customer records) that would (1) ensure the security and confidentiality of customer records; (2) protect against any anticipated threats to the security of such records; and (3) to protect against unauthorized access to such records that could result in substantial harm or inconvenience to the customer.

The law also established rulemaking and enforcement authority for federal banking agencies, the National Credit Union Administration, the Securities Exchange Commission (SEC), the Treasury Department, and the Federal Trade Commission (FTC) each to prescribe implementing regulations for their respective institutions.

The law also makes it a federal crime to fraudulently obtain or cause to disclose customer information from a financial institution. This provision is aimed at the abusive practice of "pretext calling," in which someone misrepresents the identity of the person requesting the information or otherwise misleads an institution or customer into making an unwitting disclosure of customer information.

2. The Fair Credit Reporting Act

The Fair Credit Reporting Act (FCRA) contains many important privacy safeguards. It gives consumers the ability to stop the sharing of their credit application information or other personal information (obtained from third-parties, such as credit bureaus) with affiliated companies. The law permits sharing of information with affiliates regarding the consumer's performance on the loan or other "experience" resulting from the relationship between the consumer and the financial institution.

Moreover, it is important to note that the FCRA allows only ***affiliated*** companies to share such application or credit bureau information after provision to the customer of notice and an opportunity to opt-out. If a financial institution were to share such information with an unaffiliated third-party, it could become a consumer reporting agency subject to burdensome, complex and onerous requirements of the existing FCRA.

The FCRA also mandates that other notices be provided to consumers in connection with the sharing of information. For example, financial institutions are required to notify consumers when adverse action is taken in connection with credit, insurance, or employment based on information obtained from an affiliate. This notice must inform the consumer that he or she also may obtain the information that led to the adverse action simply by requesting it in writing.

The FCRA also gives consumers the power to stop unwanted credit solicitations by blocking the use of their information from pre-screening by consumer reporting agencies. Pre-screening is the process in which a consumer reporting agency prepares a list of consumers who, based on the agency's review of its files, meet certain criteria specified by a creditor who has requested the prescreening. The FCRA also mandates that providers of credit include disclosures with every solicitation explaining that the offer results from a pre-screening and that the consumer has the right to be excluded from future pre-screenings by notifying the consumer reporting agency.

3. The Electronic Fund Transfer Act

The Electronic Fund Transfer Act and its implementing regulation require that consumers be informed about a financial institution's information-sharing practices with regard to all accounts that may incur electronic fund transfers. This would include virtually all checking, savings and other deposit accounts.

Financial institutions are required to provide consumers with extensive disclosures at the beginning of the consumer's relationship with the institution. As part of these initial disclosures, each financial institution must state the circumstances under which it (in the ordinary course of business) will disclose information concerning a consumer's deposit account to third-parties. For purposes of this requirement, the term "third-parties" also includes other subsidiaries of a financial institution's parent holding company.

4. The Right to Financial Privacy Act

Historically, the most significant privacy concern of consumers relates to ***government*** access to their financial records. The purpose of the Financial Privacy Act is to protect consumer records maintained by financial institutions from improper disclosure to federal government officials or agencies.

Specifically, the Act currently prohibits disclosure to the federal government of records held by certain financial institutions without providing notification to the consumer whose records are sought and the expiration of a "waiting period," during which the consumer may challenge and prevent disclosure through legal action.

5. The Telephone Consumer Protection Act

The Telephone Consumer Protection Act (TCPA) gives consumers the right under federal law to stop telemarketing calls from a particular company.

Under TCPA, companies can make telemarketing calls to residential telephones only if:

- the call occurs between 8 a.m. and 9 p.m. (local time at the called party's location);
- the caller provides certain identifying information to the consumer; and
- the company maintains a company-specific "do-not-call" list of persons who do not wish to receive telephone solicitations made by or on behalf of the company.

If a consumer wishes to opt-out of future telemarketing calls from a particular company, the

consumer only need indicate that he or she does not wish to be called again. The company then must add the consumer's name to the company's "do-not-call" list.

In addition, TCPA protects consumers by restricting the use of automatic telephone dialing devices and prerecorded or artificial telephone messages.

The Direct Marketing Association (DMA) also maintains "customer exclusion files" so that individuals may remove their names from lists compiled or maintained by the agencies and companies that are members of DMA. Names remain in the exclusion file for five years.

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Tony Knowles, Governor

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February 9, 2001

The Honorable Representative Murkowski
Chairman, House Labor & Commerce Committee
Alaska State Legislature
State Capitol Room 408
Juneau, AK 99801-1182

Dear Representative Murkowski:

RE: HB 106 (An Act relating to the authorizations for state financial institutions; relating to confidential financial records of depositors and customers of certain financial institutions; relating to the Alaska Banking Code, Mutual Savings Bank Act, Alaska Small Loans Act, and Alaska Credit Union Act; and providing for an effective date.)

On February 5, 2001, HB 106 (Companion Bill SB 66) was introduced at the request of Governor Knowles, and has been referred to your committee with a zero fiscal note.

One of the most important goals of this bill is to amend the Alaska Banking Code (AS 06.05) to comply with significant changes to federal banking law made by the Gramm-Leach-Bliley Act (GLBA) enacted on November 12, 1999. GLBA increases the ability of banks, insurance companies, and securities firms to combine. It also creates a new entity called Financial Holding Companies (FHCs) that can engage in businesses previously prohibited or limited. HB 106 provides for FHCs, eliminates conflicting restrictions on Alaska banks, and seeks to provide parity between our state-chartered banks and national banks.

In addition to addressing parity concerns, the bill also addresses some industry concerns and provides some regulatory simplifications. For example, the bill:

- Allows state banks to utilize the Internet for reporting quarterly financial condition;
- Eliminates the requirement for department approval to establish Automated Teller Machines (ATMs) and for national banks to establish branches;

- Reduces unnecessary restrictions on bank directors and treats directors of a mutual bank similar to directors of a commercial bank;
- Clarifies the institutions available for regulatory staff to bank with without a conflict of interest;
- Eliminates the cap on credit card charges thus allowing Alaska banks to compete with national banks in all interest rate environments; and
- Moves the current section on privacy of depositor and customer records from AS 06.05 to AS 06.01, thus providing the same privacy protection now enjoyed by bank customers to customers of other institutions regulated under Title 6.

We respectfully request you to schedule HB 106 for hearing in your committee, and we urge favorable action on this bill. We will be happy to meet with you and other members of the committee to brief you on the bill, and to provide any other information you may require. Thank you for considering our request.

Yours truly,

Deborah B. Sedwick

Deborah B. Sedwick
Commissioner

DENALI STATE BANK

"Your Community Bank" Member FDIC

February 12, 2001

RECEIVED
FEB 15 2001

Terry Lutz
Financial Institutions Examiner IV
Sate Division of Banking
PO Box 110807
Juneau, AK 99811-0807

REF: HB 106

Dear Terry,

I have had the opportunity to review the text on the above-mentioned bill. It appears that there are numerous changes that would benefit the state chartered banks and place us in the same level playing field as the out-of-state national banks. With the provisions included in the bill, small independent banks like Denali State Bank and others would be able to be competitive with our large national counterparts.

Thanks for all your work. We are in support of the House Bill 106.

Sincerely,

Jo Heckman
Senior Vice President &
Chief Operating Officer

February 16, 2001

RECEIVED
FEB 22 2001

CREDIT UNION

Terry Lutz
Chief Financial Institutions Examiner
Division of Banking & Economic Development
P.O. Box 110807
Juneau, AK 99801-0807

VIA Facsimile 907 465-2549

Dear Terry:

Attached is a copy of a letter I sent to Senator Phillips regarding SB66, which is scheduled for a hearing on Tuesday, February 20.

Please note my request for two amendments, neither of which appears to be controversial from our viewpoint. Other than those two items, Credit Union 1 is in complete support of both SB 66 and the companion bill, HB 106.

I really appreciate your efforts on this bill and companion bill HB 106. Hopefully, we can get it passed in the first year of this legislative session.

Thanks also for submitting many of our requests to the administration so they could be included in these bills.

If you have any questions or comments, please feel free to contact me.

Sincerely,

Leslie Ellis
President

LE:de
C: Terry Elder, Division of Banking, Securities & Corporations, Director

3500 Eide Street
Anchorage, Alaska 9
Phone: 907-786-2222
Toll Free: 800-478-22
Fax: 907-562-5184
Online: http: www.c

February 16, 2001

CREDIT UNION

Senator Randy Phillips
Labor & Commerce Committee Chair
State Capitol, Room 103
Juneau, AK 99801-1182

VIA Facsimile 907-465-4979

RE: SB66

Dear Senator:

This letter is in support of SB66 "An act relating to the authorizations for state financial institutions....." which is scheduled for a committee hearing on Tuesday, February 20.

Credit Union 1 (Alaska State charter #1) is in support of SB66, and had in fact, requested many of the changes related to AS 6.45, and is pleased that they are being included in the bill.

Regarding the bill, we have two proposed amendments.

Sec. 3 AS 06.01.028 **Depositor and Customer Records Confidential.**

We respectfully request an amendment that allows financial institutions to share depositor and [member] customer records with "affiliated third parties."

This will allow financial institutions to share their records with reputable companies vendors that the financial institution has a relationship with for purposes of selling financial services such as insurance products (e.g. credit life and disability insurance on loans)

Sec. 50 AS06.45.060 (5)(iv)

We also respectfully request that this section of the bill be amended to raise the aggregate of loans to a director or member of the supervisory committee or credit committee of the credit union making the loan to $20,000, (plus pledged shares) from the existing $5,000, for purposes of Board of Director approval.

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Anchorage, Alaska 99
Phone: 907-786-2222
Toll Free: 800-478-222
Fax: 907-562-5184
Online: http: www.cu

This will achieve parity with federally chartered credit unions, and will allow credit unions more flexibility in granting loans to officials, as well as afford officials more privacy in their loan transactions.

Thank you for scheduling a hearing on this bill and for considering our requests. If you or your staff would like to discuss this bill or the proposed amendments in detail, please contact me at 786-2294 or e-mail at ellisl@cul.org.

Sincerely,

Leslie Ellis

Leslie Ellis
President

C: Terry Elder, Division of Banking, Securities & Corporations, Director
Terry Lutz, Chief Financial Institutions Examiner
Senator Dave Donley, Co-Chairman, Senate Finance Committee
Senator Robin Taylor, Chairman, Judiciary Committee
Representative Lisa Murkowski, Chair, Labor & Commerce

Mt. McKinley Bank
MEMBER FDIC

530 Fourth Avenue • P. O. Box 73880 • Fairbanks, Alaska 99707 • (907) 452-1751 • FAX (907) 456-5982
1380 University Avenue • Fairbanks, Alaska 99709 • (907) 474-1770 • FAX (907) 474-1771
www.mtmckinleybank.com

March 19, 2001

Representative Lisa Murkowski
House Labor & Commerce Committee
State Capitol
Juneau, Alaska 99801-1182

Re: HB 106

Dear Representative Murkowski:

Mt. McKinley Bank supports an amendment to HB 106 that would align our state bank examination schedule with current federal examination requirements. Specifically, well-capitalized and good performing banks would see the examination cycle move from once a year to every 18-months. Hopefully, the state examination could be coordinated with the federal examination so that the business disruption associated with the exam could be kept to a minimum.

Of course, state bank examiners could return to a bank more often than every 18-months if conditions warrant closer supervision. But for those banks that have a strong performance record and solid capital base, it would be appropriate to reduce the examination cycle from once a year to twice every three years. Last fall, Mt. McKinley Bank underwent a joint examination by both state and federal bank examiners and was pleased with the coordinated effort of that approach. A coordinated examination enabled us to prepare required documentation through a single effort and save valuable staff time in the process. This fact alone justifies our support of the proposed amendment to HB 106.

Sincerely,

Craig Ingham
President &
Chief Executive Officer

Northrim Bank

Customer First Service

FAX TRANSMITTAL COVER SHEET

DATE: Tuesday, March 27, 2001 **TIME:** 3:30 PM

TO: Honorable Lisa Murkowski, Chairperson House Labor & Commerce

COMPANY: **FAX:** (907) 465-2293

FROM: Julie Bailey **TELEPHONE:** (907) 261-3534 **FAX:** (907) 261-3349

MESSAGE: Please see attached letter regarding House Bill 106

THIS TRANSMITTAL TOTALS 3 PAGES (INCLUDING COVER SHEET)
If copies are not clear, or if you did not receive all of the pages, please call:

Julie Bailey at (907) 261-3534

This fax, and any attachments, are CONFIDENTIAL and are intended solely for the recipient noted on this cover sheet. If you have received this fax in error, please notify the sender as soon as possible, or if no contact information is available, call Northrim Bank's Customer Service Department at 907-261-3345, and destroy the fax you received.

Thank you

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Midtown Financial Center
3111 C Street, Anchorage, Alaska 99503

Northrim Bank
Customer First Service

March 27, 2001

Honorable Lisa A. Murkowski
Chairperson
House Labor & Commerce Committee
State Capitol, Room 408
Juneau, Alaska 99801-1182

Re: HB 106

Dear Chairperson Murkowski:

We would like to add our comments regarding House Bill 106 to those you have received from several other banks. We appreciate the fact that HB 106 was introduced to "ensure there are no conflicts in the state banking code with GLBA" (Gramm-Leach-Bliley Act.) A second reason for the bill is listed as, "to ensure that state banks are given comparable powers to the powers granted national banks as a result of the implementation of GLBA."

We are concerned that the contents of one section, proposed section 06.01.028 "Depositor and customer records confidential," do pose conflicts between the state banking code and GLBA, and do not grant us comparable powers to national banks. This essentially establishes two standards of privacy – one for state banks and one for national banks.

The privacy and confidentiality of our customers' personal information has always been of great concern to us at Northrim and to all Alaskan banks. Not only do we have strict federal laws and regulations already in place to regulate privacy, but we also recognize that keeping our customers' information confidential provides them with the great "Customer First Service" that they expect from us. The Federal Regulations already in place, which affect privacy in various ways, are Bank Secrecy Act, Children's Online Privacy Protection Act, Electronic Funds Transfer Act, Fair Credit Reporting Act, Right to Financial Privacy Act, Telemarketing and Consumer Fraud and Abuse Prevention Act of 1991, Telephone Consumer Protection Act of 1991, and Gramm-Leach-Bliley Act. In addition, the bank regulators have issued final guidelines regarding Customer Data Security Standards, and we must be in compliance with these by 7/1/2001. It becomes difficult and complicated when our state laws are not consistent with the federal laws with which we are already required to comply. It is also inefficient and burdensome to maintain bank policies and procedures for the state that conflict with the standards set by the federal regulators.

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Anchorage, Alaska 99524-1489
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FAX: 907/562-1758

Lastly, we are glad to learn that the proposed insurance law changes set forth in SB 138 conform to the privacy standards set forth in GLBA. However, in this case, the state is again establishing a dual standard for privacy – one for state regulated financial institutions and another for insurance companies.

We hope that you will take all of these things into consideration when reviewing the Alaska Bankers' amendment to this section of HB 106, which attempts to align state law with the requirements of GLBA. We feel that the standards set forth in GLBA are beneficial to financial institutions and consumers alike because they provide the financial industry with the flexibility to provide customers with additional beneficial information without added, costly regulations.

Sincerely,

Marc Langland
President and CEO

Tony Knowles, Governor

Alaska Department of Community and Economic Development

Division of Banking, Securities, and Corporations
P.O. Box 110807, Juneau, AK 99811-0807
Telephone: (907) 465-2521 • Fax: (907) 465-2549 • TDD: (907) 465-5437
Email: dbsc@dced.state.ak.us • Website: www.dced.state.ak.us/bsc/bsc.htm

March 29, 2001

The Honorable Lisa A. Murkowski
Chair, House Labor and Commerce Committee
Alaska House of Representatives
State Capitol Room 408
Juneau, AK 99801-1182

Dear Chairperson Murkowski:

RE: Amended Comments on Privacy Policy Reflected in SB 66 and HB 106

We previously provided you a copy of correspondence between the division and the Senate Labor and Commerce Committee on the issue of privacy in SB 66. We also provided you this morning with a memorandum to us from the department of law that has required us to change our comments regarding information sharing with affiliated firms. We have, therefore, amended the Comments on the Privacy Policy Reflected in SB 66, dated March 25, 2001, and have enclosed the amended comments dated March 29, 2001. These amended comments have been provided to Sen. Phillips, and we provide them to you so that you will have the latest version.

We hope the amended comments will be helpful to the committee. We reviewed the March 25, 2001, document containing our comments on the bankers association's amendment, and do not believe that needs to be amended to reflect our current position on the FCRA.

We will be happy to discuss these with the committee at your pleasure.

Yours truly,

Franklin T. Elder
Director

Enclosure (1)

Comments on the Privacy Policy Reflected in SB 66

While it is possible to be verbose and philosophical in describing something called a Privacy Policy, it is also possible to state it simply. **In SB 66, we have proposed AS 06.01.028 (as amended) to maintain the current right of depositors and customers of financial institutions in Alaska to determine affirmatively whether nonpublic personal information about them, residing in the records of the financial institutions, will be shared by the institutions with others.**[1] This is the same protection and right these depositors and customers of banks have had for over 30 years in Alaska. Under the Gramm-Leach-Bliley Act (GLBA), that removed the depression-era prohibitions of affiliations of banks, insurance companies, and securities firms, financial institutions must provide customers with the ability to opt-out of sharing information with nonaffiliated third parties. We believe the opt-out provision is not sufficient consumer protection, and the opt-in provision, that has been part of the Alaska Banking Code for decades, is important to ensure the protection of the privacy of the Alaskans who are customers of these institutions.

While we agree with the industry that these records are records of the financial institutions, we believe Alaskans reserve the right to determine how and if the content of those records will be shared with nonaffiliated third parties. We also believe the Alaska Constitution (at section 1.22) requires it. By affirmatively determine its use, we mean that the institutions must continue to obtain specific prior approval to share information from the customer, unless it is a type of information or for a purpose that is provided for in federal or state law. For example, public information about a customer is not confidential. This type of information might be published in a phone book. Also, information for credit reporting agencies, responses to court and administrative orders, and verification of sufficient funds will not require a customer's approval. But sharing of nonpublic, personal information not covered by exceptions should be approved by the customer. For the last 30 years, Alaska law has provided this protection.

In the jargon of the discussion on privacy, this is called opt-in. In an opt-in system, the institutions must obtain the affirmative authorization of customers to share nonpublic information. The GLBA provides no limitations on sharing information among affiliates and only requires an opt-out system for sharing nonpublic information with nonaffiliated third parties. Under an opt-out system, the institutions must provide reasonable opportunity to customers to say no to sharing, but, if they do not respond, then the institutions are free to share. With opt-in, customers are out unless they ask to be in. With opt-out, customers are in unless they ask to be out. Since many people do not respond to requests from institutions, these people would be in under the opt-out system, which is exactly why institutions prefer this system.

Fortunately, section 524 of the GLBA provides states the right to adopt more restrictive privacy provisions than those in the GLBA. The Federal Trade Commission (FTC) can determine whether a state has done that, or gone too far. It is important, however, to remember that opt-in

---

[1] Based on a recommendation of the department of law, we take the position at this time that the Fair Credit Reporting Act (FCRA) preempts state restrictions on information sharing among affiliates. Until and unless the issue is addressed more clearly at the federal level, we take it to mean that the opt-in requirement in AS 06.01.028(a)(3) does not apply to information sharing with affiliates, but does apply to information sharing with nonaffiliated third parties. We do not believe an amendment to the provision is needed since SB 66, like current law, does not specifically refer to affiliated and nonaffiliated third parties.

and opt-out are only mechanisms by which customers ultimately end up on a list of customers that the institutions can share information about or on a list of customers they cannot share information about. This is not a restriction on sharing, but on the appropriate way to determine whose information is shared.

Some simply might say this is the way Alaskans have had it for over 30 years, and there is no reason to change that now. In fact, with increased concern about information about all citizens so easily obtained by others, there is probably more reason to be concerned now than there was 30 years ago. But, let us also remember what information we are talking about protecting. It is nonpublic personal information. This is personally identifiable financial information that the customer has provided the institution in order to obtain certain financial products or services. For example, this information includes a credit application for a home, car, home improvement, or credit card; account balances; payment and overdraft history; purchases on credit cards and debit cards; information obtained from an Internet collection device called a "cookie," or from a consumer report. It is very easy to see that financial institutions have a large amount of detail about customers because customers use services of these institutions. Indeed, the vast majority of citizens use at least one service of financial institutions.

The privacy provision in SB 66 reflects the policy, however, that because customers use financial institutions to open checking or share accounts, to obtain loans, or to purchase certificates of deposit, does not mean the customers want their nonpublic personal information shared for other totally unrelated purposes. The financial institutions require customers to provide certain information for certain services, and customers provide this information specifically because they desire those services. It is another matter entirely when the institutions propose to use that information for marketing services not directly related to, or required for, the purpose for which the information is obtained.

And, with whom would financial institutions share the information? There are two types, affiliated and nonaffiliated third parties. Affiliated third parties are entities under some common ownership and control of the financial institution. Under the GLBA, this now might be an insurance company or a securities firm. In fact, in a financial holding company, it may be almost any kind of company. These may be referred to as the "family of firms." Nonaffiliated third parties are everyone else in the world.

Since under current federal law it appears the Fair Credit Reporting Act (FCRA) preempts state restrictions on sharing information with affiliates, this policy provides customers the right to affirmatively determine if nonpublic information about them is shared with everyone else in the world (nonaffiliated third parties). We suspect most Alaskans will be very reluctant to agree to have their nonpublic information potentially shared with everyone, especially if it were explained in plain language what was being shared and with whom.

Whether the mechanism used is opt-in or opt-out does make a big difference. Experience so far suggests that the opt-out system comes with privacy policy statements and opt-out forms in small print brochures included as statement stuffers with no return envelope or postage. At times, opt-out forms are not provided, but a toll-free number is included for people to call to opt-out. These are not conducive to generating a response, which, under the opt-out system, means the customer will be counted in. We cannot know, but we suspect, that an opt-in system would come with

privacy policy statements and opt-in forms in large, colorful brochures explaining the benefits and providing a self-addressed, stamped envelope. Admittedly, this would be more expensive and less attractive for the financial institutions. But, a privacy policy is supposed to protect the people.

The American Bankers Association (ABA) website contains a policy statement entitled "The Devastating Effect of Opt-in Restrictions." Let us take a look at a few of the claims. The ABA claims opt-in will raise the price of goods and services. We agree that opt-in costs the institutions more to put a person on the "okay to share" list. We are not convinced that the overall cost to society is higher, however, when we consider factors such as increased fraud resulting from easier access to very nonpublic information.

The ABA statement suggests that "integrated" systems will keep a person from having to "start from scratch" in applying for loans. Evidently, the statement's writer has never applied to refinance a mortgage at the same institution.

The ABA statement says that opt-in will prevent people from getting services like consolidated statements. But, institutions now can outsource printing of statements to a third party without sending them the customers' credit files. Also, if this product really requires sharing nonpublic personal information not covered by the exceptions in state or federal law, and this service is important to customers, they will opt in.

The ABA statement suggests that opt-in will stop consumer transactions, as debit card, credit card, and check-cashing networks would not be able to be developed to supply the needed historical information. This ignores the fact Alaska's law allows verification of sufficient funds. These kinds of networks have been in place for years, and do not depend on sharing nonpublic personal information about customers.

The ABA statement suggests that financial institutions will not be able to recognize and respond to customers needs in an opt-in system. They must be assuming most people would not opt in. If they do not opt in, it is true that nonaffiliated third parties would have difficulty in doing targeted solicitations of financial institutions' customers, but the financial institutions themselves should be able to respond to the financial needs of their customers under either system.

Finally, the ABA statement claims that opt-in is impractical and costly to administer. The statement said in one case the institution had to make five calls to the customer before obtaining permission to share. By describing how difficult it is to obtain affirmative approval of their customers, however, the ABA statement calls into question whether this is being driven by customer demand or by desires of the financial institutions to use the information in different ways. We believe financial institutions would be able to obtain permission from a certain percentage of their customers by creative and attractive brochures that explain in plain language the benefits to the customers of this sharing. We also believe that people who do not respond to these overtures should not end up on the "okay to share" list by default.

Certainly, it is understood that the GLBA and other laws such as the Fair Credit Reporting Act (FCRA) place some limitations on any statement on privacy reflected in SB 66. For example, under the GLBA, states may not have insurance laws that prevent or significantly interfere with

bank insurance sales, marketing or cross-marketing activities. Under the FCRA, financial institutions may share information with affiliates, and it provides for an opt-out system. States may enact stricter privacy provisions after January 1, 2004 under the FCRA.

We suggest, however, that the opt-in provision in SB 66 does not create a conflict with other provisions of law. Indeed, under the FCRA, this provision currently appears to be not applicable with respect to affiliates. We continue to believe, however, that financial institutions that desire to cross-market their products can do so without sharing all of the nonpublic personal information about their customers with each other and with everyone else. There must be some subset of information that financial institutions really, really need for this purpose. However, currently, financial institutions may share this information with affiliates and provide an opt-out option to customers.

One additional question must be asked, however. Do opt-out provisions for affiliate sharing and opt-in provisions for nonaffiliated third party sharing seriously damage the competitive position of smaller institutions to compete with larger institutions that have more affiliated firms? This is a matter of size, not type of charter. Nationwide, some of the largest financial institutions are state-chartered. In Alaska, however, state-chartered institutions tend to be smaller than national and federal chartered institutions. We believe the answer to this question is, no. Even if there is some competitive effect, we believe customer privacy is important enough not to be sacrificed on that basis alone.

We take this position because the opt-in provision would apply to institutions of all sizes. Further, it is not a restriction on the sharing of information, but only on the mechanism used to place people in the "okay to share" or the "not okay to share" list. Under either system, institutions will have to maintain and implement these separate lists. We do not argue that there is no effect on competitive position, and we recognize that opt-in is probably more expensive. Perhaps the current federal law will provide incentives for financial institutions of all sizes to increase their affiliations. But, we do not believe that that this issue raises sufficient concern to eliminate the protection that Alaska customers of financial institutions have had for over 30 years.

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Tony Knowles, Governor

Alaska Department of Community and Economic Development

Division of Banking, Securities, and Corporations
P.O. Box 110807, Juneau, AK 99811-0807
Telephone: (907) 465-2521 • Fax: (907) 465-2549 • TDD: (907) 465-5437
Email: dbsc@dced.state.ak.us • Website: www.dced.state.ak.us/bsc/bsc.htm

March 29, 2001

The Honorable Lisa A. Murkowski
Chair, House Labor and Commerce Committee
Alaska House of Representatives
State Capitol Room 408
Juneau, AK 99801-1182

Dear Chairperson Murkowski:

RE: Follow-up on FCRA and Privacy in HB 106

In our letter dated March 27, 2001, we informed you that we had asked the department of law to advise us regarding the applicability of the Fair Credit Reporting Act (FCRA) on privacy provisions in HB 106. They reviewed the FCRA and spoke with legal counsel at the Federal Deposit Insurance Corporation (FDIC). Dan Robinson, Assistant Attorney General, provided us with a memorandum summarizing his review, and it is attached to this letter for your information.

As you can see, Dan discovered that it is most likely that the FCRA preempts state restrictions on information sharing among affiliates. States may pass restrictions after January 1, 2004. While his discussions with the FDIC suggested that privacy is a hot topic in Washington, and specifically with the relationship of the FCRA and the Gramm-Leach-Bliley Act (GLBA), it is our opinion that a challenge of that preemption has little likelihood of success.

Therefore, as we mentioned in our previous letter, this means the opt-in provision in HB 106 applies to information sharing with nonaffiliated third parties only. The FCRA requires financial institutions to provide customers an opt-out opportunity for sharing with affiliates in order to avoid certain reporting requirements of the FCRA. Under current federal law, it is our position that the FCRA preempts applying the opt-in provision to information sharing with affiliates. We continue to believe, as the memorandum states, that no amendment to SB 66 is required because of this issue.

We have been informed that the bankers association continues to desire an opt-out provision for sharing with nonaffiliated third parties. It continues to be our position that consumer protection and the Alaska Constitution call for a continuation of the opt-in requirement for sharing with nonaffiliated third parties that has been in the Alaska Banking Code for over thirty years.

We will be happy to discuss these with the committee at your pleasure.

Yours truly,

Franklin T. Elder
Director

Enclosure (1)

HB 113

Alaska State Legislature

Representative Joe Green

SPONSOR STATEMENT

HOUSE BILL 113

"An Act relating to health care insurance payments for hospital or medical services; and providing for an effective date."

House Bill 113 builds upon a national trend to develop fair payment provisions that enable health insurance companies to make sound business decisions while ensuring that patients receive benefit payments in an appropriate time frame. This concept of "prompt pay" legislation has been successfully adopted and implemented by 39 states.

House Bill 113 requires health insurers to pay benefits within twenty working days of receiving a "clean claim" if the claim is submitted in a traditional paper method or ten working days if made electronically. If a payment is not made on time the insurer is charged interest on the outstanding claim. HB 113 also establishes a definition for "clean claim" that recognizes an insurance company's need to make payment decisions based upon complete and accurate information.

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM February 23, 2001

SUBJECT: Sectional Summary of HB 113

TO: Representative Joe Green
Attn: Kevin

FROM: Michael F. Ford
Legislative Counsel

You have requested a sectional summary of the above-described bill.

As a preliminary matter, note that a sectional summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents. If you would like an interpretation of the bill as it may apply to a particular set of circumstances, please advise.

Section 1. Requires a health care insurer to pay group health care benefits within certain time limits. Requires notice for late payments, adds a penalty for failure to make required payments, and provides for direct payment of benefits to a health care provider. Provides for transfer of the right to request direct payment of benefits by a qualified domestic relations order. Requires a health care insurer to file certain reports with the Division of Insurance.

Section 2. Technical amendment.

Section 3. Technical amendment.

Section 4. Effective date.

MFF:lmb:glc
01-061.lmb

PROMPT PAYMENT LAWS

* = contained in state Unfair Business Practice Act

State	Prompt Pay Law	"Clean Claim" Defined	Uniform Claim Form	Timeframe: Non-Electronic	Timeframe: Electronic	Notice/Timeframe for Incomplete/ Contested Claim	Interest Incurred	Enforcement and Penalties	Other
Alabama	Yes Code of Ala. §27-1-19	No	No	25 working days after receipt	Same	Insurer must: 1) Notify within 2 weeks of receipt; 2) specify which items are in dispute; 3) pay undisputed portion within 30 days of receipt of claim	1.5% per month	--	Permits assignability of benefits
Alaska	No	--	--	--	--	--	--	--	--
Arizona	Yes A.R.S. § 20-3101	Yes	No	30 days after receipt, or as specified in contract	Same	Insurer must: 1) Send written request for additional information within 30 days of receipt; 2) specify reasons for delay in processing; 3) approve/deny claim within 30 days after receipt of additional info., or as specified in contract.	Legal rate	Insurers must provide semi-annually to director report of grievance resolutions. Director may examine insurers with significant numbers of unresolved grievances.	Specifically applies to third party intermediaries
Arkansas	No	--	--	--	--	--	--	--	--
California	Yes Cal Health & Saf Code § 1371	No	No	30 working days after receipt (45 days for HMOs)	Same	Plan must: 1) Notify within 30 days of receipt if contested/denied (45 days for HMOs); 2) pay undisputed portion of the claim; 3) identify portion of claim that is contested and reasons for contesting/denying; 4) pay within 30 days (45 for HMOs) after receipt of necessary info.	10% per annum	--	Defines a "reasonably contested" claim

State	Prompt Pay Law	"Clean Claim" Defined	Uniform Claim Form	Timeframe: Non-Electronic	Timeframe: Electronic	Notice/Timeframe for Incomplete/ Contested Claim	Interest Incurred	Enforcement and Penalties	Other
Colorado	Yes CRS § 10-16-106.5	Yes	Yes	45 calendar days after receipt	30 calendar days after receipt	Carrier must: 1) Notify within 30 calendar days of receipt; 2) explain what info. is needed; 3) dispense of claim within 90 calendar days of initial receipt	10% per annum	3% of total claim if originally contestested/ incomplete claim not paid within 90 days of receipt; Ins. Commis-sioner may assess additional penalties	Retroactive denials allowed in certain cases; carrier may deny claim if info. requested is not received within 30 days of request
Connecticut *	Yes Conn. Gen. Stat. § 38a-816	No	No	45 days, or as stipulated by contract, after receipt	Same	--	15% per annum	Penalties assessed pursuant to Unfair Business Practice Act	--
Delaware *	Yes 18 Del. C. § 2304 et seq.	No	No	45 days after receipt	Same	Insurer must notify within 30 days of receipt if claim is denied	Maximum allowed by law	Insurance Commissioner may assess penalties under Unfair Business Practice Act	--
District of Columbia	No	--	--	--	--	--	--	--	--
Florida	Yes Fla. Stat. § 627.613	No	No	45 days after receipt	Same	Insurer must: 1) Notify within 45 days of receipt; 2) pay within 60 days of receipt of necessary information; 3) pay/deny all claims within 120 days of receipt	10% per annum	--	Permits retroactive denials if insurer finds that provider improperly billed patient

State	Prompt Pay Law	"Clean Claim" Defined	Uniform Claim Form	Timeframe: Non-Electronic	Timeframe: Electronic	Notice/Timeframe for Incomplete/ Contested Claim	Interest Incurred	Enforcement and Penalties	Other
Georgia	Yes O.C.G.A. §§ 33-20A-6; 33-24-59.5	No	No	15 working days of receipt	Same	Insurer must: 1) Notify within 15 days of receipt; 2) state reasons for failure to pay; 3) itemize documents needed to process; 4) pay undisputed part of claim; 5) pay/deny claim within 15 working days of receiving necessary info.	18% per annum	Penalties may be assessed under general insurance laws	Insurance Commissioner requires all insurers to file data on the speed of claims handling with their quarterly reports
Hawaii	Yes HRS § § 431:13-108; 431:13-201	No	No	30 days after receipt	15 days after receipt	Insurer must: 1) Notify within 15 days (7 days for electronic); 2) identify contested portion and reason for contesting/ denying claim and may request additional information; 3) pay within 30 days (7 days for electronic) after receiving information	15% per annum; may be suspended by Insurance Commis-sioner in certain cases	In determining gravity of penalty, Insurance Commissioner may consider relevant factors bearing upon violation.	--
Idaho	No	--	--	--	--	--	--	--	--
Illinois	Yes 215 ILCS 5/356y	No	No	30 days after receipt	Same	Insurer must notify of any known failure to provide sufficient documentation within 30 days after receipt	9% per year; must be paid within 30 days of the claim payment	Insurance Dept. may enforce the act pursuant to its general enforcement powers	--
Indiana	No	--	--	--	--	--	--	--	--
Iowa	No	--	--	--	--	--	--	--	--
Kansas	No	--	--	--	--	--	--	--	--
Kentucky	No	--	--	--	--	--	--	--	--

State	Prompt Pay Law	"Clean Claim" Defined	Uniform Claim Form	Timeframe: Non-Electronic	Timeframe: Electronic	Notice/Timeframe for Incomplete/ Contested Claim	Interest Incurred	Enforcement and Penalties	Other
Louisiana	Yes R.S. 22:250:31 et seq.	No	Yes	45 days after receipt, if submitted within 45 days of the date of service; 60 days after receipt if submitted after 45 days	25 days after a correctly completed uniform claim form is transmitted	Non-electronic: Insurer must review claim within a reasonable time of receipt; if incomplete, notice must be given within 3 business days (2 business days for electronically submitted claims) of review	12% per annum	Monetary penalties, suspension/ revocation of cert. of authority	--
Maine	Yes 24-A M.R.S. § 2436	No	No	30 days after receipt and ascertainment of the loss is made	Same	Insurer must: 1) Notify claimant within 30 days of receipt that additional info. is required; 2) pay within 30 days of receipt of such information	18% per annum	Reasonable attorney fees paid by insurer if overdue benefits are recovered in an action against insurer or if overdue benefits are paid after receipt of notice of the attorney's representation	--
Maryland	Yes Md. Ins. Code § 15-1005; Md. Health Code § 15-102.3	No	No	30 days after receipt	Same	Insurer must: 1) Send notice of refusal to reimburse within 2 weeks of receipt; 2) include reason for refusal/ what info. is necessary; 3) reimburse within 30 days after receipt of necessary documentation	1.5% for 31st through 60th day; 2% from 61st through 120th day; 2.5% after 120th day	--	Insurer may retroactively deny reimbursement up to 6 months after claim payment is made
Massachusetts	No	--	--	--	--	--	--	--	--

State	Prompt Pay Law	"Clean Claim" Defined	Uniform Claim Form	Timeframe: Non-Electronic	Timeframe: Electronic	Notice/Timeframe for Incomplete/ Contested Claim	Interest Incurred	Enforcement and Penalties	Other
Michigan	Yes MSA § 24.12006	No	No	30 days after receipt	Same	Insurer must: 1) Specify materials constituting satisfactory proof of loss within 30 days after receipt; 2) pay supported portion of claim within 60 days after receipt; 3) pay remainder of claim within 60 days of receipt of information	12% per annum	--	--
Minnesota	Yes 2000 SB 2767 (eff. 1/1/01)	Yes	No	30 days after receipt	Same	--	1.5% per month	Commissioner may not assess a financial administrative penalty against a plan for violation of the law	Plan must itemize interest payments made separately from other payments; plan may require provider to bill plan or TPA for interest
Mississippi	Yes Miss. Code Ann. § 83-9-5	No	No	45 days after receipt	Same	Payment is overdue if not made within 45 days after necessary information is received; if necessary information is not supplied for the entire claim, the amount supported by reasonable proof is overdue if not paid within 45 days of receipt of such proof	18% per annum	Person entitled to benefits may bring action to recover benefits, interest and any other damages allowable by law	--
Missouri	Yes § 376.383 R.S. Mo	No	No	45 days after receipt	Same	Insurer must: 1) Send notice of refusal to pay and include reason for refusal or state that more info. is necessary; 2) pay or deny within 10 days after additional info. is received	12% per annum	--	--

State	Prompt Pay Law	"Clean Claim" Defined	Uniform Claim Form	Timeframe: Non-Electronic	Timeframe: Electronic	Notice/Timeframe for Incomplete/ Contested Claim	Interest Incurred	Enforcement and Penalties	Other
Montana *	Yes Mont. Code Anno. § 33-18-232	No	No	30 days after receipt of a proof of loss	Same	Insurer must pay or notify the insured or assignee of the reasons for failure to pay in full and/or request additional information within 30 days. If the insurer fails to do this, the insured/assignee may report the delay to the Commissioner of Insurance. The Commissioner may investigate to determine if the insurer has failed to pay without good reason, and whether the delay is a general course of business practice.	Upon a determination that a delay is a general course of business practice and for a year thereafter, claims not paid within 30 days without good reason will incur interest at 18% per annum	--	--
Nebraska	No	--	--	--	--	--	--	--	--
Nevada	Yes NRS 683A	No	No	30 days of approval of claim (must be approved within 30 days of receipt)	Same	If additional info. is needed, insurer must notify within 20 days; approve/deny within 30 days after receiving additional info.	Rate of interest established pursuant to law	--	--
New Hampshire	No	--	--	--	--	--	--	--	--
New Jersey	Yes N.J. Stat. § 17B:27-44.2	No	Yes	40 calendar days after receipt	30 calendar days after receipt or time allowed under medicare, whichever is shorter	Insurer must: 1) Notify within 30 days of reason for denial, what info. is needed to process; 2) pay undisputed portion of claim; 3) pay within 40 days (30 for electronic) of receipt of necessary info.	10% per annum	TPA must demonstrate that it will comply with the law, as condition of continued authorization to do business	Payers must maintain claims information that is audited and submit annually to Commissioner, Governor and Legislature; Commissioner may act further if info. warrants

State	Prompt Pay Law	"Clean Claim" Defined	Uniform Claim Form	Timeframe: Non-Electronic	Timeframe: Electronic	Notice/Timeframe for Incomplete/ Contested Claim	Interest Incurred	Enforcement and Penalties	Other
New Mexico	Yes SB 164 (2000)	Yes	Yes	45 days after receipt	30 days after receipt	If plan is unable to determine liability for or refuses to pay a claim within specified timeframes, the plan must make a good faith effort to notify the participating provider within 30 days (45 for manual submission) of reasons for denial or specific information required to determine liability	18% per annum	--	Prohibits contractual hold harmless agreements
New York	Yes	No	Yes	45 days after receipt	Same	--	12% per annum or the rate set by the tax commissioner for corporate taxes	--	--
North Carolina	Yes N.C. Gen. Stat. § 58-3-100	No	No	30 days to acknowledge claim, but only if it contains sufficient info. for the insurer to identify the specific coverage involved	--	--	--	Commissioner may invoke civil penalty for violation	--
North Dakota	No	--	--	--	--	--	--	--	--

State	Prompt Pay Law	"Clean Claim" Defined	Uniform Claim Form	Timeframe: Non-Electronic	Timeframe: Electronic	Notice/Timeframe for Incomplete/ Contested Claim	Interest Incurred	Enforcement and Penalties	Other
Ohio	Yes ORC Ann § 3901.38	No	No	24 days of a completed claim form, or as specified in contract	Same	--	As agreed to by the parties, or as specified in statute	Aggrieved party may file written complaint; Superintendent may issue cease and desist order and may require penalties as specified by law	--
Oklahoma *	Yes 36 Okl. St. § 1219	No	No	30 days after receipt to notify policyholder of the cause for delay in payment; 60 days to pay before interest is incurred	Same	--	T-Bill rate plus 2%	--	--
Oregon	No	--	--	--	--	--	--	--	--
Pennsylvania	Yes 40 P.S. §§ 991.2101, 991.2166	Yes	No	45 days after receipt	Same	--	10% per annum	--	--
Rhode Island	No	--	--	--	--	--	--	--	--
South Carolina	No	--	--	--	--	--	--	--	--
South Dakota	No	--	--	--	--	--	--	--	--

State	Prompt Pay Law	"Clean Claim" Defined	Uniform Claim Form	Timeframe: Non-Electronic	Timeframe: Electronic	Notice/Timeframe for Incomplete/ Contested Claim	Interest Incurred	Enforcement and Penalties	Other
Tennessee	Yes (TennCare HMOs) Tenn. Code Ann. § 56-32-226	No	No	90% of claims must be paid within 30 days of receipt; 99.5% must be processed within 60 days of receipt	Same	HMO must notify provider that claim has been denied and specify reasons; provider has 60 days to request reconsideration and must submit additional documentation, if necessary, within 60 days; if HMO doesn't respond within 60 days, provider may request that denial be independently reviewed	--	Provider may pursue contractual and legal action if he does not request independent review	--
Texas	Yes Tex. Stat. Ann. Art. 20A.18B	Yes	No	45 days after receipt	Same (21 days for submission of prescription benefit claim)	Insurer must: 1) pay the total amount of the claim; 2) pay the portion of the claim not in dispute and notify the physician why the remaining portion is in dispute; or 3) notify the physician why the claim will not be paid., within 45 days of receipt	18% per annum	Penalties of up to $1000 per day	Attorney's fees may be recovered
Utah *	Yes R590-89-7	No	No	30 days after receipt	Same	--	--	Penalties may be imposed under general unfair business practices act	--
Vermont	Yes 18 VSA § 9418	No	No	45 days after receipt	Same	Insurer must: 1) Notify claimant that claim is contested or denied; 2) include specific reasons and describe information necessary to process; 3) pay within 45 days after receipt of information	12% per annum (may be suspended by Commissioner in certain cases)	Commissioner may impose penalty, not to exceed $500 per violation, if a pattern of denial is established	--

Virginia	Yes Va. Code Ann. § 38.2-3407.15	Yes	No	40 days after receipt	Same	Carrier has 30 days after receipt to request info. and documentation necessary to process or determine if claim is clean	As established by law	Penalties under unfair trade practice law	Retroactive denials permitted, with restrictions

State	Prompt Pay Law	"Clean Claim" Defined	Uniform Claim Form	Timeframe: Non-Electronic	Timeframe: Electronic	Notice/Timeframe for Incomplete/ Contested Claim	Interest Incurred	Enforcement and Penalties	Other
Washington	Yes (reg.) WAC § 284-43-321	Yes	No	95% of the monthly volume of clean claims must be paid within 30 days of receipt; 95% of the monthly volume of all claims must be paid or denied within 60 days of receipt	Same	Denial must include specific reason why the claim was denied. In cases of denials based on medical necessity, the carrier must disclose the basis for the decision.	12% per annum; interest must be added to the amount of the unpaid claim	--	-- --
West Virginia	No	--	--	--	--	--	--	--	--
Wisconsin	Yes Wis. Stat. § 628.46	No	No	30 days after receipt	Same	Insurer must pay any partial amount supported by written notice of claim	12% per annum	--	--
Wyoming	Yes Wyo. Stat. § 26-15-124	No	No	45 days after receipt of proof of loss and supporting evidence	Same	Exceptions to the 45 day rule shall be made if there is any question as to the validity or amount of the claim.	10 % per year	Attorney fees may be awarded	--

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FISCAL NOTE

STATE OF ALASKA
2001 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: HB 113
() Publish Date:

Revision Date/Time (Note if correction): 02/23/2001 5:05p.m.
Dept. Affected: DCED
Title: Health Care Insurance Payments
BRU: Insurance Operations
Component: Insurance Operations
Sponsor: Representative Green
Requester: House Labor & Commerce
Component Number: 354

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )	0.0	0.0	0.0	0.0	0.0	0.0

FUND SOURCE (Thousands of Dollars)						
1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2001) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2002 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*
The bill has no fiscal impact on this component

Prepared by: Robert A. Lohr, Director — Phone 907-269-7900
Division: Insurance — Date/Time 02/23/2001 5:05p.m.
Approved by: Commissioner Deborah B. Sedwick — Date 2/23/2001
Agency: Department of Community & Economic Development

For distribution information, call the Governor's Legislative Office

(Rev 2/7/2001 OMB)

HB 119

Alaska State Legislature

Representative Peggy Wilson
Putting Alaska's Families First

SPONSOR STATEMENT HB 119

Last spring, the Legislature passed truly historic legislation creating the Power Cost Equalization Endowment and authorizing the sale of the Four Dam Pool Projects to the local utilities and communities. The PCE Endowment was funded by an appropriation from the Constitutional Budget Reserve and from proceeds from the sale of the Four Dam Pool projects. These bills (HB 446 & HB 447) were signed into law by Governor Knowles last May.

The Four Dam Pool Utilities and the State have been diligently working to complete this complex transaction by December 31, 2001. At closing, the proceeds from this sale will be deposited into the Power Cost Equalization Endowment.

The Four Dam Pool communities and utilities have created a Joint Action Agency (JAA), which will become the owners of the Four Dam Pool Projects. However, during the legal review of this new organization, a variety of technical issues were raised concerning the tax and regulatory status of the JAA, the powers of the JAA, and the relationship between the JAA and its member utilities.

HB 119 will resolve these issues so that the sale of the Four Dam Pool projects can be completed as envisioned and the Power Cost Equalization Endowment can be fully funded.

More specifically HB 119 addresses the following four issues.

1. Federal Tax Status of Joint Action Agency

Although the Joint Action Agency was formed by specific authorizing legislation, because its members are both municipal and cooperative utilities its characterization for federal tax purposes is uncertain. Obtaining favorable federal tax status as a "government entity" is essential for the Joint Action Agency to operate on a tax-exempt basis and have the ability to issue tax-exempt bonds and to provide maximum flexibility to allow local ownership of the individual projects in the future. A key factor relied on by the Internal

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Representative_Peggy_Wilson@Legis.state.ak.us • http://www.akrepublicans.org • 1-800-686-3824

Revenue Service in determining whether an entity has governmental status is the nature and scope of the entity's condemnation or eminent domain powers. Currently the Joint Action Agency legislation is silent as to the Joint Action Agency's condemnation powers. To achieve the necessary federal tax treatment for the Joint Action Agency, Section 6 of HB119 amends AS 42.45.310 to specifically grant to the Joint Action Agency the eminent domain powers granted to the State and municipalities in order to carry out the Joint Action Agency's authorized purposes. This expanded condemnation power may be exercised, however, only within the boundaries of the power projects the Joint Action Agency purchases from the State.

2. State Tax Status of Joint Action Agency

The Joint Action Agency's tax status under Alaska law is a central factor to determining the federal tax status of the Joint Action Agency. State law currently provides that the Joint action Agency is "subject to state and local taxes to the extent any of the public utilities forming the agency is subject to that particular tax." The impact of this provision and the tax status of the Joint Action Agency under Alaska law are not clear, as the JAA is comprised of both cooperative member utilities and municipal member utilities. Section 9 of HB119 amends AS 42.45.310 to exempt the Joint action Agency from all forms of state and local taxation, other than amounts that are payable under the electric cooperative tax as a result of retail power sales by the Joint Action Agency.

3. Potential Liability of Member Utilities for Claims against the JAA

State law currently provides that the Joint Action Agency will have "a separate and distinct legal existence from the public utilities" that form the Joint Action Agency. However neither AS 42.45.300 or AS 42.45.310 includes language that specifically insulates the public utilities that form the JAA from liability for claims against the Joint Action Agency. Given reported Alaska case law on shareholder liability and the absence of specific protections in the Joint Action Agency statute, there is some risk that claims against the JAA might also be asserted against the member utilities. To ensure that the Joint Action Agency is treated for all purposes as a separate and distinct legal entity from its member utilities, Section 6 of HB 119 amends AS 42.45.310 to include provisions similar to those contained in other Alaska statutes to expressly protect the member utilities from any liabilities of the Joint Action Agency. Section 13 of HB 119 also adds a new section AS 42.45.320 to the JAA statute to limit the individual liability of directors and officers of the Joint Action Agency, consistent with other Alaska statutory provisions.

4. Exemption from Regulatory Commission of Alaska Regulation

Because the JAA is granted the powers of a "public utility" under AS 42.05, it is not entirely clear whether the JAA is fully or only partially exempt from regulation by the RCA under AS 42.05. To create consistency within AS 42.05 with respect to the regulation of the Joint Action Agency, Sections 1, 2, 3, and 4 of HB 119 make conforming amendments to existing statutory provisions and add a new subsection (o) to

AS 42.05.711 to provide that the Joint Action Agency is exempt from all RCA regulation with respect to its ownership and operation of and the power sales from the existing Four Dam Pool projects. This general regulatory exemption is, however, limited in duration and stays in place only until such time as the indebtedness incurred by the Joint Action Agency to the State in connection with the acquisition of the projects is retired.

FISCAL NOTE

STATE OF ALASKA
2001 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: HB119
() Publish Date:

Revision Date/Time (Note if correction): 02/14/2001 10:35A.M.
Dept. Affected: DCED
Title: Public Utility Joint Action Agencies
BRU: AIDEA
Component: AEA O & M
Sponsor: Representative Wilson
Requester: House Labor & Commerce
Component Number: 1948

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2001) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2002 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

The bill provides amendments to 2000 legislation that authorized the sale of the Four Dam Pool projects. In its current form, the bill attempts to provide that a joint action agency formed under AS 42.45.310 will be both a political subdivision and an entity whose liability is limited to the assets and revenues of a joint action agency. AEA is working to finalize the sale of the Four Dam Pool projects to the operating utilities and communities. AEA is concerned that in its current form the legislation is too far reaching and may create uncertainty and potential problems and conflicts related to financial responsibilities, duties of a public/private entity and delegation of unlimited municipal powers.

Prepared by: Robert Poe, Jr. Phone 907-269-3000
Division: Executive Director, AIDEA & AEA Date/Time 02/14/2001 10:30A.M.
Approved by: Commissioner Deborah B. Sedwick Date 2/14/2001
Agency: Department of Community & Economic Development

For distribution information, call the Governor's Legislative Office

(Rev 2/7/2001 OMB)

FISCAL NOTE

STATE OF ALASKA
2001 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: HB119
() Publish Date:

Revision Date/Time (Note if correction): 02/13/2001 1:50p.m.
Dept. Affected: DCED
Title: Public Utility Joint Action
BRU: RCA
Component: RCA
Sponsor: Representative Wilson
Requester: DCED
Component Number: 2417

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2001) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2002 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This proposed legislation will not cause any increase to the agency's budget.

Prepared by: G. Nanette Thompson
Phone (907) 269-6222
Division Chair, RCA
Date/Time 02/13/2001 1:50p.m.
Approved by: Commissioner Deborah B. Sedwick
Date 2/13/2001
Agency Department of Community & Economic Development

For distribution information, call the Governor's Legislative Office

(Rev 2/7/2001 OMB)

Alaska State Legislature

Representative Peggy Wilson
Putting Alaska's Families First

Date: February 7, 2001

To: Representative Lisa Murkowski
Chairman House Labor & Commerce Committee

From: Representative Peggy Wilson PW

Re: "An Act exempting joint action agencies from regulation by the state or municipalities; relating to the relationship between a joint action agency and the public utilities that form the joint action agency; relating to powers a immunities of a joint action agency; requiring filing of the joint action agency agreement; relating to the financial affairs of a joint action agency; declaring certain joint action agencies to be political subdivision for certain purposes; relating to liability and indemnification of officers, employees, and agents of joint action agencies; and defining 'agency agreement' as used with reference to joint action agencies."

As envisioned in HB446, which the legislature passed and the Governor signed in May of 2000, the Four Dam Pool communities and utilities have created a Joint Action Agency (JAA), which will become the owners of the Four Dam Pool Projects. However, during the legal review of this new organization, a variety of technical issues were raised concerning the legal status of the JAA, the powers of the JAA, and the relationship between the JAA and its member utilities.

This bill will resolve these issues so that the sale of the Four Dam Pool projects can be completed as envisioned and the Power Cost Equalization Endowment can be fully funded.

I am prime sponsor of this bill. Cosponsors at this time are Representatives Davies, Harris, Joule, Lancaster, Morgan, Stevens and Williams.

The bill referenced above will be introduced on Friday, February 9th. I am writing you in advance in hopes that you will schedule the legislation next week pending referral to your committee.

If you have any questions please don't hesitate to contact me.

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Alaska State Legislature

Representative Peggy Wilson
Putting Alaska's Families First

February 9, 2001

To: Rep. Lisa Murkowski

From: Rep. Peggy Wilson PW

Thank you for scheduling my bill for this Monday, February 12th before Labor and Commerce. This legislation will resolve a variety of technical issues that have been raised during the legal review of the newly created Joint Action Agency.

The following people will appear before your committee on Monday to testify to this legislation and answer any questions you or other members of the committee may have.

Mike Schraeder
Legal Counsel for the Four Dam Pool
AterWynne
Portland, Oregon

David Carlson
Divestiture Project Coordinator
For the Four Dam Pool
Petersburg

Tom Friesen
Ketchikan Representative
To the Four Dam Pool

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BACKGROUND AND SUMMARY RELATED TO HOUSE BILL 119 AND SENATE BILL 84 CONCERNING FOUR DAM POOL POWER AGENCY

Background

Alaska House Bill 446, signed in to law by Governor Knowles in May, 2000 (ch 60, SLA 2000, effective July 1, 2000), created the Power Cost Endowment and authorized the sale of the Four Dam Pool projects to a joint action agency ("JAA") to be formed by the utilities that purchase power from the projects (the "Member Utilities"). Upon enactment of House Bill 446, the representatives to the Four Dam Pool's Project Management Committee ("PMC"), Ater Wynne LLP as counsel to PMC, counsel to the individual utilities and other professional advisors to the PMC commenced work on a number of fronts and began working with representatives of the Alaska Energy Authority and others on behalf of the State of Alaska to complete the sale and transfer of the Four Dam Pool Projects and the funding of the PCE endowment by the December 31, 2001 closing date.

House Bill 446 included provisions which created a new section AS 42.45.310 in Article 6, Chapter 45 of Title 42 of the Alaska Statutes. This new section supplemented an existing section AS 42.45.300 (which allowed public utilities to form joint action agencies) to allow the Four Dam Pool purchasing utilities to form a JAA to acquire, own, operate and manage the Four Dam Pool projects. The five Member Utilities have, pursuant to these statutory provisions, now entered into a JAA Agreement creating the "Four Dam Pool Power Agency." During the negotiation of the terms of the JAA Agreement among the Member Utilities a variety of issues were raised concerning the legal and tax status of the JAA, the powers of the JAA and the relationship between the JAA and its Member Utilities. While most of these issues were addressed by specific provisions in the JAA Agreement, others resulted from the absence of specific legal authority or general uncertainty under Alaska or federal law and, therefore, could not be resolved by agreement among the Member Utilities. These remaining legal issues are addressed by the provisions contained in House Bill 119 and Senate Bill 84 (collectively referred to herein as the "JAA Bill").

The House Labor and Commerce Committee held an initial hearing on the JAA Bill on Monday, February 12th. A number of issues were raised and concerns were expressed regarding certain provisions of the JAA Bill at the hearing, including the absence of testimony in support of the JAA Bill by the AEA or the Regulatory Commission of Alaska ("RCA"). Following the February 12th Committee hearing, members of the Labor and Commerce Committee, representatives of the PMC, the AEA, the RCA, the Attorney General's Office and Legislative Counsel have worked together to address and resolve issues raised by the initial form of the JAA Bill, resulting in a revised JAA Bill in the form of the attached Committee Substitute. It is the understanding of the PMC and its representatives that this revised JAA Bill is supported by the AEA, the RCA and the Attorney General's Office.

The corrections and additions to existing law contained in the JAA Bill are intended to clarify the federal and state tax status of the JAA, ensure that the JAA is a limited liability entity and confirm the nature

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HOUSE BILL ____

Background

Alaska House Bill 446, signed in to law by Governor Knowles in May, 2000 (ch 60, SLA 2000, effective July 1, 2000), created the PCE endowment and authorized the sale of the Four Dam Pool projects to a joint action agency ("JAA") to be formed by the utilities that purchase power from the projects. Upon enactment of House Bill 446, the representatives to the Four Dam Pool's Project Management Committee, the PMC's counsel and other counsel and professional advisors to the PMC have worked on a number of fronts to complete the sale and transfer of the Four Dam Pool Projects and the funding of the PCE endowment by the December 31, 2001 closing date.

House Bill 446 included provisions which created a new section AS 42.45.310 in Article 6, Chapter 45 of Title 42 of the Alaska Statutes. This new section supplemented an existing section AS 42.45.300 (which allowed public utilities to form JAAs) to allow the Four Dam Pool purchasing utilities to form a JAA to acquire, own, operate and manage the Four Dam Pool projects. The five purchasing utilities have, pursuant to these statutory provisions, now entered into a JAA agreement creating the "Four Dam Pool Power Agency." During the negotiation of the terms of the JAA Agreement among the purchasing utilities a variety of issues were raised concerning the legal status of the JAA, the powers of the JAA and the relationship between the JAA and its member utilities. While most of these issues were addressed by specific provisions in the JAA agreement, others resulted from the absence of specific legal authority or general uncertainty under Alaska or federal law and, therefore, could not be resolved by agreement among the member utilities. These remaining legal issues are resolved by the technical corrections contained in House Bill ____.

Summary

The technical corrections contained in House Bill ____ are intended to clarify the federal and state tax status of the JAA, ensure that the JAA is a limited liability entity and confirm that the JAA is not subject to regulation by the RCA. A brief explanation of these technical corrections follows:

Federal Tax Status of JAA

Although the JAA has been formed pursuant to specific authorizing legislation, because its members are both municipal and cooperative utilities its characterization for federal tax purposes is uncertain. Obtaining favorable federal tax status as a "governmental entity" is essential for the JAA to operate on a tax-exempt basis and to provide maximum flexibility to allow local ownership of the individual projects in the future. A key factor relied on by the IRS in determining whether an entity has governmental status is the nature and scope of the entity's condemnation or eminent domain powers. Currently the JAA legislation is silent as to the JAA's condemnation powers. To achieve the necessary federal tax treatment for the JAA, Section 7 of House Bill ___ amends AS

and extent of the RCA's authority to regulate the JAA. A detailed explanation of these corrections, additions and issues follows:

Federal Tax Status of JAA

Although the JAA has been formed pursuant to specific authorizing legislation, because the Member Utilities are both municipal and cooperative utilities its characterization for federal tax purposes is uncertain. Obtaining favorable federal tax status as a "governmental entity" is essential for the JAA to operate on a tax-exempt basis and to provide maximum flexibility to allow local ownership of the individual projects in the future.

A review of the business objectives of the Member Utilities is important to understanding why the JAA's attainment of governmental status is important. The business objectives of the Member Utilities are as follows:

1. Avoidance of a JAA level tax on income of the JAA derived from operation of the Four Dam Pool projects.

2. Avoidance of a JAA level tax on income of the JAA derived from sale of any of the Four Dam Pool facilities.

3. Avoidance of any pass-through of income of the JAA to the cooperative Member Utilities.

4. Avoidance of any restrictions on the terms and price of a sale of any of the Four Dam Pool facilities to any of the Member Utilities.

5. Avoidance of any restrictions on the ability of the JAA to distribute its assets to the Member Utilities on dissolution in a manner that would be decided by the Member Utilities at a subsequent date.

Treasury Regulations define a "political subdivision" as "any division of any State or local government unit which is a municipal corporation or which has been delegated the right to exercise part of the sovereign power of the units." Regulations Section 1.103-1(b). By ruling, the Service has held that limited amounts of a sovereign power are insufficient to confer governmental status; the Service has refused to view entities as governmental that possess the limited eminent domain powers frequently conferred on investor-owned utilities and certain quasi-public universities, particularly if there are any private interests involved, as is the case with the JAA because of the cooperative Member Utilities. The private letter ruling in which the Service's position was most clearly articulated specifically held that the private involvement of members in the actions of an exempt electric cooperative precluded the coop from being treated as a governmental agency, despite the possession of certain powers of eminent domain. *See* Private Letter Ruling 9149007. The Service has been more inclined to conclude that eminent domain powers are substantial if title to the property passes on commencement of the action (as it does under Alaska's declaration of taking proceeding) than when it passes only at the conclusion of the legal proceeding. *Compare* PLR 9725038 with *Philadelphia National Bank v. United States*, 666 F.2d 834 (3rd Cir. 1981), *cert den.* 457 U.S. 1105. Given that the Service more closely scrutinizes entities in which private interests are involved, it is particularly important that the JAA have full eminent domain powers. *See* PLR 9725038.

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42.45.310 to specifically grant to the JAA the eminent domain powers granted to the State and municipalities by AS 09.55.240 to 09.55.460 to carry out the JAA's authorized purposes.

State Tax Status of JAA

Paragraph (f) of AS 42.45.310 currently provides that the JAA is "subject to state and local ad valorem, income, or excise taxes that may be assessed or levied against property, assets, income, and receipts . . . [and] the electric cooperative tax" only to the extent "any of the public utilities forming the agency is subject to the particular tax." This provision was intended to maintain the *status quo* with respect to the tax treatment of the JAA and its member utilities, given the different tax treatment under Alaska law of the cooperative member utilities and the municipal member utilities. The impact of this provision and the tax status of the JAA under Alaska law, however, is not clear. The JAA's tax status under Alaska law is also central in determining the federal tax status of the JAA. Section 10 of House Bill ____ amends AS 42.45.310 to exempt the JAA from all forms of state and local taxation.

Potential Liability of Member Utilities for Claims Against JAA

Paragraph (c) of AS 42.45.310 currently provides that the JAA will have "a separate and distinct legal existence from the public utilities" that form the JAA. Unlike other Alaska statutes that provide for the formation of corporations and other limited liability entities, however, neither AS 42.45.300 or AS 42.45.310 includes language that specifically insulates the public utilities that form the JAA from liability for claims against the JAA. Given reported Alaska case law on shareholder liability and the absence of specific protections in the JAA statute, there is some risk that claims against the JAA might also be asserted against the member utilities. To ensure that the JAA is treated for all purposes as a separate and distinct legal entity from its member utilities, Section 7 of House Bill ____ amends AS 42.45.310 to include provisions similar to those contained in other Alaska statutes to expressly protect the member utilities from any liabilities of the JAA. Section 14 of House Bill ___ also adds a new section AS 42.45.320 to the JAA statute to limit the individual liability of directors and officers of the JAA, consistent with other Alaska statutory provisions.

Exemption from RCA Regulation

Because the JAA is granted the powers of a "public utility" under AS 42.05 (see AS 42.45.310(c), as amended by Section 7 of House Bill ___), it is not entirely clear that the JAA is exempt from regulation by the RCA under AS 42.05. Because of the relationship of the JAA to its member utilities and the fact that the member utilities themselves are either regulated (Kodiak Electric Association, Inc.) or exempt from regulation (Copper Valley Electric Association, Inc., and Cities of Ketchikan, Petersburg and Wrangell), Section 7 of House Bill ___ confirms that the JAA is not subject to RCA regulation under AS 42.05 and is not required to obtain a certificate of need and convenience under AS 42.05.221. Sections 1, 2, 3 and 4 of House Bill ___ make conforming amendments to existing statutory provisions to confirm the JAA's exemption.

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Under AS 42.45.300, a joint action agency, such as the JAA, is granted the powers of a public utility under AS 42.05, which include a limited power of eminent domain under AS 42.05.631 but not the full powers of eminent domain possessed by the state and by municipalities under AS 09.55.240 through 09.55.460 (which include the authority to file a declaration of taking under AS 09.55.420). Both AS 42.45.300 and AS 42.45.310 are silent as to the Agency's eminent domain powers. AS 42.45.310(d) does authorize the members forming the JAA to define its powers, and there is some possibility that this provision would allow the members to delegate their powers of eminent domain to the JAA, but it is unclear, under Alaska law and local law, whether the city Member Utilities have the power to make such a delegation. As a result, the JAA arguably possesses only the eminent domain powers of public utilities. In a request to the Service asking it to rule that the JAA is governmental, there is significant risk that it might refuse to do so because the facts presented would be extremely close to those analyzed in Private Letter Ruling 9149007.

If, however, it were possible to obtain, by statute, full eminent domain power, either by an express grant of such power by the Legislature or by delegation of such powers to the JAA from the city Member Utilities, then the JAA would have a much better chance of obtaining a favorable private letter ruling from the Service. A change in AS 42.45.310 would present a stronger case than a delegation of eminent domain power by the city Member Utilities, because even if it can be concluded (i) that current AS 42.45.310 implicitly authorizes the cities to delegate their powers of eminent domain to the JAA, and (ii) that such powers can permissibly be delegated under state and local law, these powers, by statute, may only be exercised within the boundaries of the cities themselves (AS 29.35.030), and the Service could view these limitations as precluding governmental status, given the location of the generating facilities and the expected scope of operations of the JAA.

If the JAA is, by statute, given the same powers of eminent domain that are possessed by political subdivisions of the State of Alaska, the JAA has an excellent chance of receiving a private letter ruling from the Internal Revenue Service that the JAA will be treated as a governmental unit for federal tax purposes and federal tax law should not interfere with the accomplishment of any of the business goals. To enhance the ability of the JAA to achieve the necessary federal tax treatment, Section 6 of the JAA Bill amends AS 42.45.310 to specifically grant to the JAA the eminent domain powers granted to the State and municipalities by AS 09.55.240 to 09.55.460.

Proposed JAA Eminent Domain Powers

As noted above, under AS 42.45.300, a joint action agency, such as the JAA, is granted the powers of a public utility under AS 42.05. These powers include the limited power of eminent domain under AS 42.05.631, but not the full powers of eminent domain possessed by the state and by municipalities under AS 09.55.240 through 09.55.460. The difference in the eminent domain powers granted to public utilities and those granted to the state and municipalities is procedural in nature *i.e.*, the state and municipalities can exercise their condemnation powers through the filing of a declaration of taking under AS 09.55.420. To address concerns regarding the scope of the JAA condemnation powers, in granting state and municipal eminent domain powers to the JAA, Section 6 of the JAA Bill limits the exercise of those powers to the acquisition of land and materials necessary "carry out the authorized purposes of the joint action agency within the boundaries of the power project purchased by the agency from the Alaska Energy Authority."

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State Tax Status of JAA

Paragraph (f) of AS 42.45.310 currently provides that the JAA is "subject to state and local ad valorem, income, or excise taxes that may be assessed or levied against property, assets, income, and receipts . . . [and] the electric cooperative tax" only to the extent "any of the public utilities forming the agency is subject to the particular tax." This provision was intended to maintain the *status quo* with respect to the tax treatment of the JAA and its Member Utilities, given the different tax treatment under Alaska law of the cooperative Member Utilities and the municipal Member Utilities. The impact of this provision and the tax status of the JAA under Alaska law, however, is not clear. The JAA's tax status under Alaska law is also a central factor in determining the federal tax status of the JAA.

Section 9 of the JAA Bill amends AS 42.45.310 to exempt the JAA from all forms of state and local taxation, other than the electric cooperative tax. It is the understanding of the PMC that the Member Utilities are currently exempt from state and local taxation, other than the electric cooperative tax, in the case of the cooperative Member Utilities. Under Section 9 of the JAA Bill, only JAA revenues derived from the retail sale of electric power would be subject to the electric cooperative tax contained in AS 10.25.540 to 10.25.570.. The exempt status of the JAA is consistent with the tax treatment of Alaska port authorities under AS 29.35.670.

Potential Liability of Member Utilities for Claims Against JAA

Paragraph (c) of AS 42.45.310 currently provides that the JAA will have "a separate and distinct legal existence from the public utilities" that form the JAA. Unlike other Alaska statutes that provide for the formation of corporations and other limited liability entities, however, neither AS 42.45.300 or AS 42.45.310 includes language that specifically insulates the public utilities that form the JAA from liability for claims against the JAA. Given reported Alaska case law on shareholder liability and the absence of specific protections in the JAA statute, there is some risk that claims against the JAA might also be asserted against the Member Utilities. To ensure that the JAA is treated for all purposes as a separate and distinct legal entity from its Member Utilities, Section 6 of the JAA Bill amends AS 42.45.310 to include provisions similar to those contained in other Alaska statutes to expressly protect the Member Utilities from any liabilities of the JAA. The language contained in Section 6 of the JAA Bill is similar to that contained in AS 29.35.605(c) and AS 29.35.650 relating to port authorities. *See also, e.g.*, AS 42.40.690(a)(providing that the debts and liabilities of the Alaska Railroad Corporation are to be paid from ARC assets and are not obligations of the State).

Section 14 of the JAA Bill also adds a new section AS 42.45.320 to the JAA statute to limit the individual liability of directors and officers of the JAA. The language of Section 14 is consistent with other Alaska statutory provisions and, specifically, is based on AS 10.25.145 defining the liability of officers and directors of electric and telephone cooperatives.

Tax-Exempt Bonding Authority

If the JAA is classified as a "governmental entity" for federal tax purposes, the JAA would have the ability to issue tax-exempt bonds if the bonds satisfied each of the many requirements imposed by the Internal Revenue Code of 1986 (the "Code"). The enabling legislation does not give the JAA any priority rights, over other Alaska entities, to issue tax-exempt debt.

The Code generally permits the issuance of two distinct types of tax-exempt bonds to finance power generation, transmission, and distribution assets: (1) governmental bonds, which may finance facilities that are owned by governmental entities and may provide power or transmission services only to governmental entities and the general public, and (2) local furnishing bonds, which may finance facilities that are owned either by governmental or non-governmental entities and may provide power and transmission services to private entities, such as for-profit corporations and non-profit cooperatives.

Governmental bonds do not require an allocation of bond volume cap and are not limited by federal tax law as to the amount that can be issued, either on a state-by-state or on a national basis.

Local furnishing bonds do, however, require an allocation of volume cap. If the JAA were to conclude in the future that the Code permits it to issue local furnishing bonds for certain purposes and desires to issue tax-exempt bonds for those purposes, it would be able to do so only if it applied for, and received, an allocation of bond volume cap from the State's private activity bond allocating committee. The JAA enabling legislation does not give the JAA any preferential rights to a volume cap allocation. The JAA would be required to stand in line with other Alaska issuers and be subject to the same standards as other issuers and projects for a volume cap allocation.

Exemption from RCA Regulation

Because the JAA is granted the powers of a "public utility" under AS 42.05, it is not entirely clear whether the JAA is fully or only partially exempt from regulation by the RCA under AS 42.05. Under the Alaska Public Utilities Regulatory Act, AS 42.05, the RCA is granted broad powers to regulate public utilities engaging or proposing to engage in a utility business in the State of Alaska. This regulatory authority is not unlimited, however, and the AEA and certain utilities are, or may elect to become, exempt from regulation by the RCA.

Pursuant to the Regulatory Act's exemption provisions, four of the five Member Utilities are currently exempt from most types of regulation by the RCA. AS 42.05.711(b) & (g). The Regulatory Act also exempts the Long-Term Power Sales Agreement between the State and the Member Utilities ("PSA") and any amendments thereto from review and approval by the RCA. This PSA exemption, as provided for in last year's enabling legislation, stays in place until such time as all indebtedness incurred by the JAA in connection with the acquisition of the Four Dam Pool projects is retired. AS 42.05.431(c).

To create consistency within the Regulatory Act with respect to the regulation of the JAA, Sections 1, 2, 3 and 4 of the JAA Bill make conforming amendments to existing statutory provisions and add a new subsection (o) to AS 42.05.711 to provide that the JAA is exempt from all RCA regulation with respect to its ownership and operation of and the power sales from the existing Four Dam Pool projects. This general regulatory exemption is, however, like the PSA exemption from RCA review and approval, limited in duration and stays in place only until such time as the indebtedness incurred by the JAA to the State in connection with the acquisition of the projects is retired. Upon final payment of the JAA indebtedness, the JAA will be required to obtain a certificate of public convenience and necessity and amendments to the PSA will be subject to RCA review and approval.

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SUMMARY OF TAX ANALYSIS RELATED TO STATUS OF FOUR DAM POOL POWER AGENCY

Introduction

The five power purchasers (the "Purchasers" or the "Members") under the Long Term Power Sales Agreement between the Purchasers and the Alaska Power Authority (the "PPA") have created a joint action agency (the "Agency"), pursuant to AS 42.45.310 (the "Authorizing Legislation"), that will purchase and operate the Four Dam Pool projects, subject to the terms of the PPA. The following summarizes our analysis as to why changes in the Authorizing Legislation are necessary if the Agency is to have a reasonable chance of receiving a private letter ruling from the Internal Revenue Service that it is a governmental agency for federal income tax purposes. For purposes of this memorandum, Kodiak Electric Association, Inc. ("Kodiak") and Copper Valley Electric Association, Inc. ("Copper Valley") will be referred to as the "Coops," and the Cities of Ketchikan, Petersburg and Wrangell will be referred to as the "Cities."

Business Objectives

A review of the business objectives of the Members is important to understanding why the Agency's attainment of governmental status is important. The business objectives of the Members are as follows:

1. Avoidance of an Agency level tax on income of the Agency derived from operation of the Four Dam Pool projects.

2. Avoidance of an Agency level tax on income of the Agency derived from sale of any of the Four Dam Pool facilities.

3. Avoidance of any pass-through of income of the Agency to the Coops.

4. Avoidance of any continuing oversight and control of the Agency by the State of Alaska.

5. Avoidance of any restrictions on the terms and price of a sale of any of the Four Dam Pool facilities to the Purchasers.

6. Avoidance of any restrictions on the ability of the Agency to distribute its assets to the Purchasers on dissolution in a manner that would be decided by the Purchasers at a subsequent date.

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Avoidance of an Agency level tax on income is important, because the Agency will regularly generate income. The amount of income generated in any year will be equal to (a) the sum of (i) the gross deposits into the insurance and R&R reserve funds made during the year, (ii) the amount of current revenues used to pay or fund payment of principal of outstanding debt, and (iii) the interest earnings on funds on hand, less (b) the sum of (i) current year's depreciation and (ii) losses not covered by insurance. No taxable income would be produced by revenues used to pay current O&M and interest expense.

Summary Conclusions

If the Agency is, by statute, given the same powers of eminent domain that are possessed by political subdivisions of the State of Alaska, the Agency has an excellent chance of receiving a private letter ruling from the Internal Revenue Service that the Agency will be treated as a governmental unit for federal tax purposes and federal tax law should not interfere with the accomplishment of any of the business goals.

Governmental Agency Status

Treasury Regulations define a "political subdivision" as "any division of any State or local government unit which is a municipal corporation or which has been delegated the right to exercise part of the sovereign power of the units." Regulations Section 1.103-1(b). By ruling, the Service has held that limited amounts of a sovereign power are insufficient to confer governmental status; the Service has refused to view entities as governmental that possess the limited eminent domain powers frequently conferred on investor-owned utilities and certain quasi-public universities, particularly if there are any private interests involved, as is the case with the Agency because of the Coop members. The private letter ruling in which the Service's position was most clearly articulated specifically held that the private involvement of members in the actions of an exempt electric cooperative precluded the coop from being treated as a governmental agency, despite the possession of certain powers of eminent domain. *See* Private Letter Ruling 9149007. The Service has been more inclined to conclude that eminent domain powers are substantial if title to the property passes on commencement of the action (as it does under Alaska's declaration of taking proceeding) than when it passes only at the conclusion of the legal proceeding. *Compare* PLR 9725038 with Philadelphia National Bank v. United States, 666 F.2d 834 (3rd Cir. 1981), *cert den.* 457 U.S. 1105. Given that the Service more closely scrutinizes entities in which private interests are involved, it is particularly important that the Agency have full eminent domain powers. *See* PLR 9725038.

Under AS 42.45.300, a joint action agency, such as the Agency, is granted the powers of a public utility under AS 42.05, which include a limited power of eminent domain under AS 42.05.631

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and not the full powers of eminent domain possessed by the state and by municipalities under AS 09.55.240 through 09.55.460 (which include the authority to file a declaration of taking under AS 09.55.420). The Authorizing Legislation itself is silent as to the Agency's eminent domain powers. AS 42.45.310(d) does authorize the members forming the Agency to define its powers, and there is some possibility that this provision would allow the members to delegate their powers of eminent domain to the Agency, but it is unclear, under Alaska law and local law, whether the Cities have the power to make such a delegation. As a result, the Agency arguably possesses only the eminent domain powers of public utilities. In a request to the Service asking it rule that the Agency is governmental, there is significant risk that it might refuse to do so because the facts presented would be extremely close to those analyzed in Private Letter Ruling 9149007.

If, however, it were possible to obtain, by statute, full eminent domain power, either by a change in the Authorizing Legislation or by delegation of such powers to the Agency from the Cities, then the Agency would have a much better chance of obtaining a favorable private letter ruling from the Service. A change in the Authorizing Legislation would present a stronger case than a delegation of eminent domain power by the Cities, because even if we could conclude (i) that the current Authorizing Legislation implicitly authorizes the Cities to delegate their powers of eminent domain to the Agency, and (ii) that such powers can permissibly be delegated under state and local law, these powers, by statute, may only be exercised within the boundaries of the Cities themselves (AS 29.35.030), and the Service could view these limitations as precluding governmental status, given the location of the generating facilities and the expected scope of operations of the Agency.

SES:MES:ddp

CITY OF CRAIG
RESOLUTION NO. 01-04

THAT THE REGULATORY COMMISSION OF ALASKA ENSURES THAT THE SALE OF THE FOUR DAM POOL INITIAL PROJECT IS SUCCESSFUL AND ENSURES THAT THE POWER COST EQUALIZATION PROGRAM IS FULLY FUNDED AS INTENDED

WHEREAS, the City of Craig, Alaska, is concerned about the cost of electric power faced by its citizens;

WHEREAS, the cost to generate electric power for the citizens of the City of Craig is three to five times greater than the cost in urban communities of Alaska;

WHEREAS, the State of Alaska has provided financial assistance to rural Alaskan communities such as the City of Craig to cope with the substantially higher cost of electric power, to encourage Alaska's economic growth and to bring a modern standard of living to all Alaskans beginning with the enactment in 1980 of the Power Production Cost Assistance Program;

WHEREAS, the citizens of the City of Craig benefit from the financial assistance from the State of Alaska provided to offset the higher cost of electric power;

WHEREAS, the financial assistance from the State of Alaska is presently provided through a Power Cost Equalization (PCE) Program;

WHEREAS, the PCE Program does not have a permanent source of funds;

WHEREAS, the Alaska Legislature has enacted House Bill 446 and Governor Knowles has signed House Bill 446 which authorizes the Alaska Energy Authority to sell the Four Dam Pool Initial Project and which authorizes the establishment of a Trust Fund that will provide a permanent source of funds for the PCE Program;

WHEREAS, the Alaska Legislature has enacted House Bill 447 and Governor Knowles has signed House Bill 447 which appropriates the funds from the sale of the Four Dam Pool Initial Project to the Trust Fund;

WHEREAS, the municipalities of Ketchikan, Wrangell and Petersburg and the cooperatives of Kodiak Electric Association, Inc., and Copper Valley Electric Association, Inc., have informed the Regulatory Commission of Alaska (RCA) that the sale of the Four Dam Pool Initial Project and the permanent funding for the PCE Program may be in jeopardy if the RCA does not take immediate action on behalf of Kodiak Electric Association, Inc.; and

WHEREAS, the RCA has opened docket number U-01-6 to consider what actions it should take on behalf of Kodiak Electric Association, Inc., with respect to the sale of the Four Dam Pool Initial Project;

NOW, THEREFORE, THE COUNCIL FOR THE CITY OF CRAIG FINDS:

1. That if the PCE Program does not have a permanent source of funds, financial assistance from the State of Alaska is not assured;

2. That if the Trust Fund is provided with adequate principal, the PCE Program will have a permanent source of funds which will better ensure that the citizens of the City of Craig continue to receive assistance to offset the higher cost of electric power; and

3. That the Trust Fund requires the proceeds from the sale of the Four Dam Pool Initial Project to ensure that the Trust Fund has adequate principal to provide the PCE Program with a permanent source of funds;

NOW, THEREFORE, THE COUNCIL FOR THE CITY OF CRAIG HEREBY RESOLVES:

1. That the Regulatory Commission of Alaska should take all action necessary in its docket number U-01-6 to ensure that the sale of the Four Dam Pool Initial Project is successful and to ensure that the PCE Program is fully funded as Governor Knowles and the Alaska Legislature have intended.

APPROVED _____

_____ ATTEST _____

ACTING MAYOR, GREG HEAD VICKI HAMILTON, CITY CLERK