INTERSTATE INSURANCE PRODUCT REGULATION COMMISSION (“ICC”)

GOVERNANCE ASSESSMENT REPORT

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ICC Governance Assessment Report

I. INTRODUCTION

In 2019, the Interstate Insurance Product Regulation Commission also known as the Insurance Compact Commission (the "ICC" or the "Compact") adopted a new strategic plan that called for, *inter alia*, a review of the ICC's governance practices and other related issues (the "Governance Review"). Following a competitive bidding process, in July 2020, the ICC engaged Squire Patton Boggs (US) LLP ("SPB") to conduct the Governance Review. The ICC Management Committee created a Governance Review Committee consisting of five management Committee members to manage and track the work. The ICC developed a narrative of issues to be addressed in this Governance Review and released it as a Scope of Work. The Scope of Work narrative is found in Appendix I. An Executive Summary of suggested courses of action for the ICC is below in Section III.

This Report describes the work SPB completed for the project and the SPB recommendations to ICC. This Report is organized into the following four sections:

A. Governance

B. Compact Law and Post-Wertz

C. Risk Mitigation Strategies

D. Tax Issues

In preparing these materials, we interviewed Commissioners and their staff, spoke with members of ICC's committees, reviewed numerous ICC documents, reviewed the governance documents of other interstate compacts, provided weekly status reports to the Governance Review Committee, and coordinated with the Rector and Associates firm that was simultaneously engaged to conduct a financial and operational review of the ICC. The Report includes a listing of the interviews at Appendix J, along with a list of the topics covered in most of the interviews. Attached to this Report are Appendices A through M which include summaries of the interviews, samples of various governance documents and other materials as referenced in this Report.

II. BACKGROUND AND DUE DILIGENCE

This Section of the Report provides foundational information for our observations, analysis and recommendations in the Report, along with an Executive Summary of our recommendations. This section provides background information on compacts and formation of the ICC, the ICC as a joint public agency and an instrumentality of the compacting states, and the tax status of the ICC. This Section will also provide a summary of the due diligence undertaken by the SPB team in preparation of this Report.

A. Compacts and State Authority

An interstate compact is a contract or agreement between states that allows states to cooperate on multi-state or national issues while retaining state control. Interstate compacts are created by authorization in the U.S. Constitution[1]. Although historically used most often to address border disputes and water rights, the use of interstate compacts has expanded significantly in recent decades to cover professional licensing, supervision of offenders, educational reform, adoption, drivers' licensing and vehicle registration, environmental issues, emergency management and other issues. Over 200 interstate compacts currently exist, and on average every state belongs to at least 25 compacts.

Compacts generally serve in one of three functions: (1) establish and clarify state boundaries, (2) facilitating multistate efforts to receive and develop policy, or (3) establishing joint legislative and regulatory policy.[2]Compacts are one of the oldest forms of formal interstate cooperation in the United States.[3] Compacts are not often encountered in the state-based system of insurance regulation or other forms of financial regulation.[4]

The United States Constitution includes a Compact Clause, which states "No State shall, without the consent of Congress…enter into any Agreement or Compact with another State…."[5] As described by one author:

> [C]ompacts represent the only mechanism in the Constitution by which the states themselves can alter the fundamental dynamics of their relationships without the intervention of the federal government, be they boundaries, substantive law, or even economic relationships. In short, compacts are the only constitutionally recognized mechanism by which states can reorder their organic relationships without running afoul of the authority of the federal government or reordering the federal structure of American government.[6]

However, our nation's long-held principles of federalism recognize that compacting authority is not bequeathed to the states through the United States Constitution. Instead, as the United States Supreme Court has recognized, states have the inherent authority to enter into compacts through their status as quasi-sovereigns.[7] As a result, compacts present state legislatures with a tool for

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[1] U.S. Constitution, Art. 1, Sec. 10.
[2] Interstate Compact Law and Use at 18.
[3] Buenger, et. al., *The Evolving Law and Use of Interstate Compacts (2nd. Ed.)*(2017)("Interstate Compact Law and Use") at 4.
[4] The ICC is the only insurance-based compact that has been successful to date. The Non-Admitted and Reinsurance Reform Act of 2010 authorized a surplus lines compact. The Surplus Lines Insurance Multi-state Compliance Compact (SLIMPACT) was not adopted by a sufficient number of states to become active. (Ballotpedia, https://ballotpedia.org/Surplus_Lines_Insurance_Multi-State_Compliance_Compact#:~:text=The%20Surplus%20Lines%20Insurance%20Multi,Rhode%20Island%2C%20Tennessee%20and%20Vermont). The Patient Protection and Affordable Care Act of 2010 authorized Interstate Health Exchanges, but none were proposed. In 1996, the Interstate Insurance Receivership Compact was proposed to address insurance company liquidations. Only three state legislatures – Illinois, Michigan and Nebraska – adopted the legislation so it did not become active. (Ballotpedia, https://ballotpedia.org/Interstate_Insurance_Receivership_Compact).
[5] U.S. Constitution, Art. 1, Sec. 10.
[6] Interstate Compact Law and Use at 3.
[7] *West Virginia ex. rel. Dyer v. Sims*, 341, U.S. 22. 31 (1951)("That a legislature may delegate to an administrative body the power to make rules and decide particular cases is one of the axioms of modern government…What is involved is a conventional grant of legislative power."); *see* Interstate Compact Law and Use at 17 ("The authority of

governance, with congressional involvement unnecessary in order for the compacting state legislatures to create a given compact.[8] The Compact Clause of the United States Constitution serves as a check on states when they are entering into compacts that encroach on federal authority.[9]

An interstate compact is like a treaty among the Compacting States, allowing them to cooperate on multi-state issues without federal intervention. United States Supreme Court Justice Louis Brandeis observed in *Hinderlinder v. La Plata River & Cherry Creek Ditch Co.* that "[t]he compact…adapts to our Union of sovereign States the age-old treaty-making power of independent sovereign nations."[10] In other words, compacts are negotiated agreements among states that have the status of both contract and statutory law.[11] Once enacted, the compacting states effectively "share sovereignty" with one another, acting jointly through formation of an interstate agency.[12]

B. Formation of the ICC and Compact Statute

In 2003, state insurance commissioners through efforts at the NAIC created Model 692 "Interstate Insurance Product Regulation Compact" (the Compact Statute") with the goal of creating an interstate agency which we now know as the ICC.[13] In 2004, Colorado and Utah became the first states to adopt the Compact Statute in its entirety, followed by Maine, New Hampshire, Virginia and West Virginia. From 2004 until 2006, 21 additional states adopted the Compact Statute in its entirety. Upon adoption of the Compact Statute by 26 states, Compact Statute Article 13(2) was triggered and the Compact Statute terms became effective on all enacting states. Today, 46 states and territories have enacted the Compact Statute (collectively the "Compacting States"). A list of these states and territories is attached at Appendix K.

The ICC was created by the state legislatures in the Compacting States to establish a "joint public agency".[14] The Compact Statute delegates to the Commission the authority to:

a. Develop product standards (defined in the statute as "Uniform Standards") for individual and group annuity, life insurance, disability income, and long-term care insurance products (the "Life and Life Related Products")[15];

states to enter into compacts is, in the words of James Madison, so clearly evident that no further discussion is needed." [citing Madison, Federalist 44 (1788)]).

[8] *See Virginia v. Tennessee*, 148 U.S. 503, 519 (1893); Interstate Compact Law and Use at 68.

[9] Interstate Compact Law and Use at 68.

[10] 304 U.S. 92, 104 (1938) (*cited by* Interstate Compact Law and Use at 3).

[11] Interstate Compact Law and Use at 3 (citing *Green v. Biddle*, 21 U.S. (8 Wheat), 1, 92 (1823)).

[12] Interstate Compact Law and Use at 51.

[13] Interstate Insurance Product Regulation Compact, NAIC Model 692 ("Compact Statute"). The NAIC is an organization of chief insurance regulators in the 50 states, the District of Columbia and the five U.S. territories. The Compact Statute was endorsed by the National Conference of State Legislatures ("NCSL") and the National Council of Insurance Legislators ("NCOIL").

[14] Compact Statute, Art. 3(1).

[15] Compact Statute, Art. IV.

b. Accept, review, and approve or disapprove product and product-related filings and, as applicable, rates related to Life and Life Related Products as submitted by insurance companies for use in Compacting States.[16]

c. Open an office, hire personnel and operate on behalf of the Compacting States.[17]

d. Establish a governing body, adopt governing bylaws, and elect governing officers.[18]

e. Bring legal actions, subpoena information, conduct hearings and issues advisory opinions.[19]

f. Maintain its own finances and be exempt from payment of any state taxes.[20]

A critical term in the Compact Statute, as enacted by the legislatures of all Compacting States, is Article IV(2), which describes the ICC's authority to adopt Uniform Standards for life insurance, annuity, disability and long term care insurance products, and the preemptive effect the ICC Uniform Standards have on the Compacting States. Article IV(2) provides:

> [t]o exercise its rule-making authority and establish reasonable Uniform Standards for Products covered under the Compact, and Advertisements related thereto, which shall have the force and effect of law and shall be binding in the Compacting States, but only for those Products filed with the Commission, provided, that a Compacting State shall have the right to opt out of such Uniform Standard pursuant to Article VII, to the extent and in the manner provided in this Compact.[21]

Article IV(2) allows the ICC to create Uniform Standards for filing and approval by insurance companies operating in any or all of the Compacting States, with the single and approved ICC filing.[22] Individual Compacting States are exempted from recognizing ICC approved products filings only if the Compacting State has "opted-out" of the ICC Uniform Standard through the "opt-out" process outlined in the Compact Statute.[23]

C. Governance Practices – Sources

As noted above, the Compact Statute, enacted by the Compacting States, forms a "joint public agency"[24]. This organization is an unincorporated public body governed by representatives appointed by each Compacting State. Typically, each state appoints as its member of the Commission the senior insurance regulatory executive in the state (the "Commissioner" or

[16] Compact Statute, Art. IV.
[17] Compact Statute, Art. IV(12).
[18] Compact Statute, Art. V(1).
[19] Compact Statute, Art. IV(7-8, 16).
[20] Compact Statute, Art. XII.
[21] Compact Statute, Art. IV(2).
[22] Below, we will review the decision in *Wertz v. Amica Life Insurance Company*, 462 P.3d 51 (Colo. 2020),and discuss the issues the Colorado Supreme Court raises regarding preemption, as well as risk mitigation efforts the ICC could take to address this decision and its potential implications.
[23] Compact Statute, Art. VII.
[24] Compact Statute, Art. I, III.

"Member").[25] The ICC, as a joint public agency, is authorized to adopt governing and operational rules, maintain staff, personnel, offices and its own finances, and authorized to act in a regulatory capacity by issuing subpoenas, conducting investigations, releasing advisory options and taking legal action within the terms of the Compact Statute and its enacted product and operating standards. The ICC is not formed or incorporated in any single state. Below, we will review Governance Practices and provide recommendations to improve on the rules and procedures utilized by the ICC.

D. The Compact Statute

The Compact Statute was proposed as a collaborative effort among insurance legislators, regulators and industry as a means of modernizing state insurance regulation, particularly reform of the state-based product filing and approval process for asset-based insurance products. Life insurance and life-related products are a national market – particularly for the types of insurance within the scope of the Compact Statute. Like other insurance products, life insurance and life-related products had historically been regulated exclusively by the states, in contrast to other regulated financial services. State insurance regulators recognized that there needed to be greater uniformity for the standards established by the various states that governed the terms of these filed insurance products. The legislators and regulators also recognized the need to have an entity serve as a central clearinghouse for prompt review and regulatory approval of insurance products based on the Uniform Standards on behalf of the participating states**.**

The Compact Statute authorizes the Commission to develop Uniform Standards and accept, review, and approve product filings for the following product lines: life insurance, annuities, disability income, and long-term care insurance – both individual and group (collectively, the "ICC Product Lines").

E. ICC and Tax Issues

As noted above, the ICC is an unincorporated entity. Currently, for federal income tax purposes, the ICC claims that it is an instrumentality of the states with its income exempt from federal income tax under section 115 of the Internal Revenue Code (the "Code").[26] The Internal Revenue Service ("IRS") has accepted all of the ICC's tax returns since 2008 without objection, and the IRS has conducted an examination of the ICC on this issue. In August 2017, the IRS issued "no change" letters for all of the ICC's federal tax returns from 2008, and 2011 to 2015. In 2015, the ICC sought a "private letter ruling" seeking IRS recognition of the ICC's tax exempt status under section 115 of the Internal Revenue Code but withdrew the application after the IRS indicated informally that the application would be likely be denied. Section D below discusses the ICCs current tax status and evaluates options for obtaining an IRS ruling in the future.

[25] Compact Statute, Art. V.1.a.

[26] The ICC is exempt from state taxes per the terms of the Compact Statute, as enacted by the legislatures of each Compacting State. Compact Statute, Art. XII.

F. *Wertz v. Colorado*

On April 27, 2020, the Colorado Supreme Court issued a decision in the case of *Amica Life Insurance Company v. Wertz*[27] ruling that a life insurance policy issued on a policy form approved by the ICC included a term that was in violation of Colorado law.[28] The *Wertz* decision presented a conflict between a Colorado statute and the Individual Term Life Insurance Policy Standards ("Standards") promulgated pursuant to the Compact.[29] The Colorado statute provides:

> The suicide of a policyholder after the first policy year of any life insurance policy issued by any life insurance company doing business in this state shall not be a defense against the payment of a life insurance policy….[30]

The Standards are more permissive in this regard, providing that "[t]he suicide exclusion period shall not exceed two years from the date of issue of the policy."[31] The policy at issue in *Wertz* was approved through the Compact and, as authorized by the Standards, contained a two-year suicide exclusion.[32] The policyholder committed suicide more than one year, but less than two years, after issuance of the policy. The carrier, Amica Life Insurance Company, sought a declaratory judgment that it was not obligated to pay the beneficiary of the policy, Mr. Wertz, because of the two-year suicide exclusion. Mr. Wertz argued that this exclusion was unenforceable by reason of the one-year exclusion in the Colorado statute. He further argued that the Colorado General Assembly was prohibited from delegating to the Commission the authority to enact a Standard inconsistent with a Colorado statute.[33]

The question ultimately reached the Colorado Supreme Court, on certification from the U.S. Court of Appeals for the Tenth Circuit.[34] The Colorado Supreme Court agreed with Mr. Wertz, holding that, "in the context of an interstate compact that has not been approved by Congress, the General Assembly may not delegate to an interstate administrative agency the authority to adopt regulations that effectively override Colorado statutory law."[35] Note, as will be discussed in detail below, that the *Wertz* holding is based directly from an assumption, reached in the absence of any briefing to the contrary, that the Compact lacks congressional consent. The state-law basis for the *Wertz* decision is the non-delegation doctrine under the Colorado Constitution, which holds that "the legislature may not delegate its legislative power to another agency or person."[36] Below, we will address a variety of issues that this decision creates for the ICC and provide recommendations on actions the ICC can take to preserve the intentions of its enacting legislatures.

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[27] *Amica Life Ins. Co. v. Wertz*, 462 P.3d 51 (Colo. 2020).
[28] A summary and analysis of the case is found in Section B below.
[29] *Amica Life Ins. Co. v. Wertz*, 462 P.3d 51, 52 (Colo. 2020).
[30] C.R.S. § 10-7-109.
[31] Individual Term Life Insurance Policy Standards, IIPRC-L-04-I (2016), § 3(Y)(3).
[32] *Wertz*, 462 P.3d at 52.
[33] *Id.*
[34] *Id.*
[35] *Id.* at 58.
[36] *Id.* at 54.

G. Summary of Actions Taken for this Report

Our work on the ICC Governance Assessment consisted of substantive review of the diligence materials, deep synthesis and detailed analysis, interviewing, collaboration, analysis and recommendations.

Governance. We reviewed the core Governance documents and the recent ICC strategic plan, along with state and federal law, and governing documents of other compacts. We also reviewed the governing documents of the National Insurance Producer Registry ("NIPR"), and numerous publications regarding governance best practices. We interviewed 12 current Commissioners and their key staff members regarding their thoughts and experiences with the ICC. We also interviewed three former Commissioners regarding the origins of the ICC and for background regarding the ICC's most recent strategic planning process. We met with the Legislative Committee, the Industry Advisory Committee and the Consumer Advisory Committee. We also observed meetings of various ICC committees, including the Governance Review Committee, the Product Standards Committee, and the Finance Committee. We also interviewed Richard Masters, the compact advisor for The Council of State Governments ("CSG").

Compact Law Issues. We reviewed the proceedings in the 10th Circuit to confirm that the Court took no adverse position on whether the Compact is entitled to the stature of federal law. We also analyzed the briefing before the Colorado Supreme Court to evaluate the arguments presented, with particular emphasis on the parties' stances concerning whether congressional consent, express or implied, for the Compact was required or had been obtained.[37] We assessed various procedural issues relevant to framing a collateral challenge to the Colorado Supreme Court's decision in federal court. We also evaluated these federal issues in relation to the Compact legislation and individual state constitutional issues that could arise in the absence of any federal ratification. We reviewed our analysis with SPB colleagues with expertise in U.S. constitutional law issues and with a compact specialist at the CSG. We also included questions regarding compact issues in our interviews with various stakeholders.

Federal Tax Status. We reviewed all materials prepared by or for the ICC regarding prior efforts to obtain tax exempt status, and materials generated in response to a 2017 inquiry by the IRS. We looked at public material (such as private letter rulings) on the tax status claimed by other compacts, discovering that there is little public information on how most compacts treat themselves for tax purposes. We also reviewed IRS rulings regarding other compacts, and met with the compact specialist at CSG who had done some significant analysis of the tax status of compacts and related matters.

H. Summary of Interviews

The consensus from our interviews is that the ICC is well regarded by regulators, legislators and stakeholders, and it is generally viewed as executing its primary operations well. The individuals we interviewed uniformly expressed positive opinions about the ICC, its progress since 2003, and the responsiveness of the ICC staff. All interviewees expressed appreciation for the ICC staff's professionalism and objectivity, and no stakeholder lodged any complaints regarding a lack of

[37] The Colorado Supreme Court made no reference to express or implied consent.

balance or expressions of favoritism for any stakeholders, including industry or specific filers. ICC should be proud of the favorable opinions we heard. The following summarizes common themes we heard expressed by multiple interviewees.

- ICC performs its basic functions of providing an effective single filing process for the products covered by ICC.
- ICC structure enables smaller states to discharge oversight functions that they would otherwise have difficulty performing.
- ICC structure enables effective involvement of technical expertise for the Compacting States.
- ICC supports insurance consumers by reducing industry costs and enabling product speed to market.
- ICC staff is responsive and knowledgeable.
- There is confusion about the roles of the different committees, and also about the roles of the full Commission and the Management Committee.
- There is confusion about the relationship between ICC and the NAIC, and a desire for more clarity about that relationship.
- Some ICC communications are extremely technical and therefore difficult for many Commission and committee members to understand.
- There is confusion about the roles of the Commission versus those of the Management Committee and other ICC Committees.
- Allowing key insurance department staff members to serve as a designee for the Commissioner ("Designee") is extremely important due to the time constraints of most Commissioners and the need for the states to bring the technical expertise of these Designees to ICC decisions.
- The ICC should operate as efficiently as possible.
- The ICC should be financially stable and sustainable independent of the NAIC.
- ICC should focus more on significant strategic issues and should be better at anticipating and preparing for emerging product trends policy issues.

See Appendix K for detailed interview list.

III. EXECUTIVE SUMMARY

This Report includes many suggestions and recommendations for the ICC to improve its governance practices and mitigate risk associated with governance matters. Each suggestion is based on legal or best practice analysis that includes evaluation of the law triggered by the action, the risks associated with the proposed action, and the time and resources the new action would take for busy Commissioners, as their respective state's ICC representative, and ICC staff. Our recommendations are summarized below, followed by several sections detailing our complete analysis on each topic.

Governance

1. The ICC should conduct annual Governance Effectiveness evaluations, prepare a calendar to reflect the various committee, Management Committee and plenary meetings necessary for the year, conduct governance and compact-related training, and take a variety of actions to improve the operation of the Management Committee and draft and annually update committee charters. Suggested issues of inquiry, a suggested calendar and related templates are included with the Report and its Appendices.

2. We found that Commissioners had numerous questions regarding functions and purpose of the ICC and its Management Committee. We suggest a variety of actions to respond to these questions and also to improve the efficiency of the Management Committee meetings. Our suggestions include maintaining a charter for the Management Committee, providing summary material with complex agenda items before the Management Committee, adopting a Consent Agenda and designating certain decisions that require full Commission approval. We also propose utilizing electronic meetings and providing a process for Actions Taken without /in Lieu of a Meeting to facilitate more efficient governance.

3. Each Commissioner, as their state's statutorily designated ICC representative, is a leader for the ICC. The Compact Statute identifies a variety of roles for certain representatives to assume various types of leadership within the ICC, including Management Committee and officer roles. We suggest developing written descriptions of these roles to clarify duties and responsibilities for each Commissioner. We also suggest maintaining state attendance statistics and publishing them in the ICC's annual report to ensure accountability to state legislators and the public.

4. Designees for Commissioners are authorized by each state insurance code and are key to operation of each state's involvement with the ICC. The Compact Statute is silent on the role of Designees, but references Commissioners in their individual capacity with no limitation on Designee involvement. The Report suggests that the ICC adopt written policies and procedures to address issues such as the role of Designees, conflict of interest and ethics matters, attendance and training options.

5. As ICC state representatives, Members serve in a governance role that varies significantly from their executive role with their respective insurance departments, and in their role with the NAIC. Therefore, in the Governance and Compact Law sections, we discuss some critical areas of understanding regarding the ICC that would benefit all Commissioners. We propose targeted orientation for new Commissioners and Designees to facilitate this understanding.

6. We reviewed various policies and procedures for the ICC, and provide suggestions on improvements to the ICC's Code of Ethics, Advisory Opinion process and process for dispute resolution among Compacting States.

7. We suggest preparing a written description of how the Compact Statute addresses immunity, and how the ICC will provide indemnification and legal defense to Members in the event of an action brought against them for issues associated with their service on behalf of the ICC.

8. We include a suggestion for a Table of Decision Authorities to provide Members with a clear understanding of the source of ICC actions.

9. We look at the "opt out" process, as outlined in the Compact Statute and operating procedures, and we provide guidance on its future use.

10. We address communications issues raised in our stakeholder interviews and provide suggestions for providing clarity to issues being discussed and proposals before the ICC.

11. We conducted a gap analysis on the ICC committee structure and identified several unaddressed areas now common for most governing bodies, including risk, technology and governance issues. We provide observations and suggestions on how ICC might address these identified gaps.

12. The ICC has an administrative service agreement with the NAIC and, as a result, it utilizes the same audit firm as the NAIC. We propose updates to the ICC Audit Committee Charter to update it for best practices such as audit partner rotation, auditor communication with the Audit Committee and periodic bidding of audit firms..

13. Our stakeholder interviews and review of materials identified confusion and concern regarding the relationship of the NAIC and the ICC. We provide suggestions as to how some of these issues might be clarified in the future.

14. As a result of our analysis of the Compact Statute, we identified two requirements in the Compact Statute – certain state filings and issues regarding the Administrative Procedures Act – that may require additional attention from the ICC.

15. We suggest analysis associated with the unique issues associated with 2020 and also provide a comparative analysis of other compacts and the ICC.

<u>Compact Law Issues and Governance</u>

16. The ICC is a joint public agency formed through unique and special action of the legislatures in each of the Compacting States. We provide background on compacts, their formation and their unique intersection between state and federal law. We discuss the methods that federal consent can be provided to state compacts, including implied and express consent, and also the law associated with compacts not obtaining federal consent. We analyze this law in the context of the Compact Statute and congressional action take regarding the ICC.

17. We opine that the ICC received implied congressional consent in 2006 when Congress approved the District of Columbia joining the ICC. We discuss the meaning of implied consent for the ICC, how the ICC might go about recognizing this implied consent, and we address the issues associated with acknowledging implied consent.

18. We discuss the implications of the *Amica v. Wertz*, the need for the ICC to embrace implied congressional consent in order to avoid erosion of the ICC's various Uniform Standards to be effective in all Compacting States in the future. We discuss strategies for the ICC to recognize its implied congressional consent. We also discuss the risks and benefits of seeking express congressional consent and the risks to the ICC of not acknowledging implied consent

<u>Tax Exempt Status</u>

19. We review the background of the ICC's tax exempt status and its prior efforts to obtain a private letter ruling from the IRS. We outline the ICC's options to maintain its tax exempt status and discuss the pros and cons of alternative options.

20. We suggest a strategy for the ICC to seek a private letter ruling from the IRS if it is inclined and provide cost estimates to inform the ICC's decision on whether to do so.

IV. ANALYSIS AND RECOMMENDATIONS

A. Corporate Governance

(i) Introduction

Corporate Governance has received intense and increasing attention in the U.S. in the last 30 years.

- The 1990s featured increased focus on financial fraud, financial reporting, and audit committees.

- By the early 2000s, spurred on by the Enron and Worldcom bankruptcies in 2001 and 2002, government regulators and capital markets articulated broader and more specific corporate governance expectations for governance structures and policies. In 2003, the SEC approved extensive additional NYSE and NASDAQ governance requirements for their listed companies.

- In 2008, the Financial Crisis renewed a focus on governance issues, resulting in passage of the Dodd Frank Wall Street Reform and Consumer Protection Act in 2010.

- In 2011, the National Association of Corporate Directors ("NACD") issued its statement on Key Agreed Principles to Strengthen Corporate Governance for Public Companies.

- In 2014, the NAIC adopted its Annual Corporate Governance Disclosure model act and regulation, and that annual governance filing requirement for insurance companies became a state insurance department accreditation requirement beginning in 2020. Similar evolution has taken place in Europe and elsewhere around the world.

Why does corporate governance matter, and what is "good corporate governance?" *Diligent Insights* observes that:

> *"Most examples of good corporate governance have something in common…they're built on a foundation of **transparency, accountability and trust**."*[38]

Deloitte describes the role of corporate governance as follows:

> *Why do boards and management teams need a governance framework to operate? A framework helps define the role of the board and management, delineates duties, and helps prevent duplicated efforts and the overlooking of critical issues. It can also assist with the execution of the board's core processes by providing structure to policies and tools (e.g., annual calendar, meeting agendas, committee charters, and guidelines). This allows the board to focus on the right issues and properly prioritize its limited time and resources. In addition, a framework provides the board with a structured way to collaborate with management on specific issues the company faces with minimal risk of confusion and loss of productivity. Lastly, a framework can help clarify each board committee's roles in fulfilling the board's objectives from a governance perspective*.[39]

Academic and professional governance literature often still reflects the early roots of corporate governance, by focusing on issues relevant to publicly traded, for profit organizations, such as those relating to financial performance and reporting, investor information flow, Director succession and recruitment, and effectively meeting the organization's regulatory requirements.

Why should ICC focus on governance practices that are based on corporate governance when it is an organization without investors or shareholders, and whose leadership is determined by legislative designation? Because as each state legislature has declared, the ICC is a joint public body that is responsive to each of the Compacting States. Strong governance practices have a profound impact on the performance and operations of any organization, whether investor capitalized or not, whether for profit or non-profit, and whether governed by shareholder elected leaders or leaders selected in other ways.[40] Strong governance practices help improve public accountability and transparency in any organization and are thus quite appropriate for ICC. One commentator captures the importance of strong governance across organizations in describing why it is important for non-profit entities.

> *The basic principles of governance work in the for-profit and nonprofit realms in quite similar ways. In general, governance is a structure that holds corporations accountable for responsible, ethical behavior….*

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[38] Diligent Insights, The Importance of Corporate Governance in an Organization, Nicholas J. Price, April 18, 2017 (emphasis added).
[39] Deloitte Hot Topics, Framing the Future of Corporate Governance, February 2013
[40] Harvard Law School Forum on Corporate Governance, *Nonprofit Corporate Governance: The Board's Role*. Lesley Rosenthal, April 15, 2012.

> *Nonprofit board members are responsible for the oversight and strategic planning of their organizations in a similar fashion to for-profit organizations. Nonprofit board members oversee matters that are critical to the health of the organization. Nonprofit board directors manage such fundamental matters as the viability of their organization's business model, the integrity of internal systems and controls, and the accuracy of financial statements.*[41]

No doubt, there are some elements of strong governance practices that are not applicable to the ICC, but there are many more common governance practices that can have a significant, direct impact on how efficiently ICC operates, how well it serves its stakeholders, and how effectively it evolves in response to the changing needs of insurance regulators and consumers.

The recommendations below are drawn from the broad literature and thinking about corporate governance in the United States. We have included recommendations that are akin to many of those applicable to all types of corporate entities, such as those calling for clear communication within and outside the organization, alignment of strategy and execution, supporting and strengthening governance leadership, understanding and planning for change, regular evaluation and improvement of governance effectiveness, and written articulation of important policies and procedures. Of course, we have omitted recommendations about issues that are not applicable to an interstate compact like the ICC – such as Director recruitment, activist shareholder proposals, Director compensation, and insider trading.

ICC's goal for improvements to its governance practices should be to institute a set of processes and structures that provide transparency and clarity, along with the flexibility to meet new challenges and innovations ahead. Strong corporate governance practices are iterative and not static or accomplished in a single step or action. Most importantly, the best practices in governance facilitate engagement among its leadership, and good communication and organizational development that improves with its functions and ability to serve.

(ii) ICC Governance Duties

ICC governance structures are defined by the Compact Statute enacted by each state, the ICC Bylaws, and the policies adopted by the ICC and Management Committee pursuant to those governance materials. The Compact Statute establishes the ICC as the senior governing body of the ICC, akin to a corporate board of directors.

The designated representative for each Compacting State are selected, respectively, by legislative designation when each state that enacts legislation authorizing its participation in the ICC. Individual representatives are each appointed by the state legislatures "pursuant to applicable law of the Compacting State."[42] Each state may decide whom to appoint as its representative on the Commission, when to withdraw that person's appointment, and whom to appoint to fill a vacancy in their ICC member seat.[43] When enacting the Compact Statute, the state typically appoint their

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[41] BoardEffect, *How Do Corporate Governance Structures Work in the Nonprofit Realm?* Nick Price, June 1, 2018.

[42] Compact Statute, Art V. 1.a

[43] *Id*.

Commissioner as their representative to the ICC.[44] None of the ICC governance documents or processes adopted pursuant to those governing documents distinguish between Commissioners who attain their positions in state government via appointment versus election.

The Commissioners serve in their ICC role in their capacity as a state executive branch appointee or employee of their respective state. Neither the Compact Statute nor the Bylaws states that Commissioners are relieved of any of the official duties or ethics obligations applicable to them under their respective state law. Indeed, the ICC Code of Ethics makes it clear that Commissioners are expected to comply with the obligations and conduct standards applicable to them in their state. The ICC governing documents also articulate specific standards of conduct for Commissioners are promulgated pursuant to the Compact Statute enacted by each of the Compacting States. Commissioners are expected to comply with both the standards in their states and the ICC standards.

State officials generally have duties mandated by their insurance codes or other state statutes, but none of those duties typically rise to the level of a “fiduciary standard.” In contrast, in corporate governance, directors have fiduciary obligations to their organizations because they are charged with protecting the organization. While the legal standard for execution of governance duties varies for public officials operating a joint public body such as the ICC, these key corporate fiduciary duties result in instructive best practices in organizational governance.

In the U.S., there are three primary articulations of the fiduciary duties owed by corporate directors to the organizations they lead. These typically include the Duty of Care, the Duty of Loyalty, and the Duty of Good Faith (collectively the “Director Duties”).

- The Duty of Care – This involves making a personal commitment to performing the functions of the role. It requires preparing for meetings, educating oneself about the business of the organization, and participating in discussion and decision making.

- The Duty of Loyalty – This involves acting in the best interest of the organization and putting the interests of the organization ahead of personal interest. A duty of acting in good faith is sometimes articulated as a corollary to this duty. Corporate Conflicts of Interest policies and disclosure requirements arise from this duty.

- The Duty of Good Faith/The Business Judgment Rule – The business judgment rule (BJR) is a presumption that protects the legitimate actions of corporate directors from challenge, typically in litigation. The presumption precludes plaintiffs and courts from second-guessing corporate actions if the Directors’ actions were: informed; taken in good faith; and taken in the honest belief that their actions were in the best interests of the corporation. Director duties to disclose potential conflicts of interest and not to participate in decisions in which their judgment may be impacted by personal interests also arise from the foundation of this business judgment rule.

These Director Duties are generally reflected in the statutes and common law in every state Corporation Code. More importantly, these duties provide the foundation for most governance

[44] Compact Statute, Art.V.1.a, drafting note.

models and descriptions of governance best practices. While no state law or ICC governance document expressly applies these Director Duties to each Compacting State's representative to the ICC, the language of the ICC governing documents and policies is clearly influenced by these Director Duties. Examples of the influence of the Director Duties on the ICC governing documents are as follows:

- General Authority. The Compact Statute gives the Commission the authority to perform functions "as may be necessary or appropriate to *achieve the purposes of [the] Compact consistent with state regulation of insurance*"[45] and to prescribe Bylaws "to govern its conduct as may be necessary or appropriate to carry out the purposes, and exercise the powers, of the Compact."[46]

- Avoiding Impropriety. The Compact Statute states that the Commission "shall at all times strive to avoid the appearance of impropriety."[47] .

- Conduct Standard for Indemnification. The Bylaws state that for a Compacting State Member to be considered for indemnification from the Commission, such representative must have "*acted in good faith and in a manner which the person reasonably believed to be in, or not opposed to, the best interests of the Commission, and with respect to any criminal proceeding, had no reasonable cause to believe that the conduct was unlawful.*[48]

This language draws on the typical duty of loyalty language one finds in corporate director standards of conduct.

- Code of Ethics. The Compact Statute gives the Commission the express authority to promulgate "*a code of ethics to address permissible and prohibited activities of commission members and employees."*[49] The ICC adopted the most recent version of that Code of Ethics in 2008. The Code of Ethics states that its purpose is, *inter alia*, to ensure that each Member conducts his or her official duties with the utmost integrity, and that the general rule of conduct is for each Member "to avoid, at all times and by all means, even the appearance of impropriety in any official action on behalf of the Commission."[50]

  The Code of Ethics also clarifies some of the interplay between Members' ongoing state law obligations and the standards of conduct expected for Members. It states that:

  > *This Code is intended to supplement and does not supersede or otherwise limit a Member's obligations under state ethics laws or rules. To the extent there is any inconsistency between the standards imposed by this code and*

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[45] Compact Statute, Art IV. 26.
[46] Compact Statute, Art. V, 1. C.
[47] Compact Statute, Art IV. 13.
[48] Compact Bylaws, Art. VI. 3.
[49] Compact Statute, Art. V. 1.b.vii.
[50] Compact Code of Ethics, I. A-B.

> *the standards imposed under state ethics laws or rules, the Members shall adhere to the stricter standard of conduct*.[51]

The Code of Ethics also expressly says that interactions between Members and state and local officials, such as lobbying and gift restrictions, are to be governed by state laws and rules, that Members must seek guidance about dealing with state and local officials, and that Members must exhibit heightened sensitivity to complying with relevant state and local rules and regulations.[52]

Members are required to comply with the enumerated standards in the 2008 Code of Ethics. These include obligations to maintain confidential information, to refrain from using his or her official position to secure unwarranted privileges or exemptions for himself or herself, to refrain from transactions in which direct or indirect financial interests may conflict with official ICC duties, to disclose and consider recusing oneself from decisions involving entities regulated by the Commission in which the Member has a permissible financial interest and other situations in which there may be substantial conflict between the Member's public interest and private interest, to disclose financial or personal interests in any business subject to the jurisdiction of the Commission, and to refrain from soliciting or receiving any gift intended to influence official action of the Commission.[53]

The governance recommendations in this Report reflects the view that strong governance practices are just as impactful and important for joint public agencies like the ICC as they are for more traditional corporate organizations.

(iii) Governance Improvement Options

For purposes of this Governance Review, we compared the current governance structures of the ICC to typical governance best practices in corporate, governmental, and other interstate compact entities. We also considered the elements of governance included in the NAIC Model Corporate Governance Annual Disclosure filing. Below we outline numerous options for governance improvement, all made in the context of (1) current, key ICC governance documents, and (2) the unique functions and regulatory structures of the ICC.

Our goal for this governance review was to provide the ICC with governance structure options that provide the ICC with increased clarity, transparency, and efficiency. These options can be revised over time to react to new challenges, new opportunities, and operational improvements. Most of these options could be implemented immediately by the ICC – the Commission, the Management Committee each standing committee, each advisory committee, and staff, if so desired. Due to the significant effort that would be required, we do not recommend actions that would entail every one of the 46 Compacting States reopening and passing changes to the existing Compact Statute.

We attach several samples and suggested documents for your review. Appendix A is a complete list of all Governance Attachments.

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[51] Compact Code of Ethics, II. B.
[52] Compact Code of Ethics, II. C.1-2.
[53] Compact Code of Ethics, III.C-D.

1. Annual Governance Effectiveness Discussion and Action Plan

We suggest that every element of the ICC – the Commission, the Management Committee each standing committee, each advisory committee, and staff - set aside time annually or biennially to discuss its governance effectiveness and to identify actions that could improve governance effectiveness ("Governance Effectiveness Discussions"). For best results, the topics to be discussed should be shared in advance of the discussion so that attendees have an opportunity to reflect and come prepared with comments and suggestions.

As a starting point, these Governance Effectiveness Discussions can be led by a Member, such as the board or committee chair, or by a member of the ICC staff. However, to encourage candor and full discussion, some organizations engage outside experts to facilitate Governance Effectiveness Discussions. Some organizations also periodically engage outside experts to confidentially interview participants, to review current governance structures and to make additional recommendations about governance effectiveness.

The following are topics for the Governance Effectiveness Discussions:

- Annual and regular meeting schedule. Is the regular meeting cycle for the year sufficient and reliably scheduled?
- Meeting agendas. Are the most important issues reflected on agenda? Is time appropriately allocated between significant issues and routine housekeeping issues?
- Meeting Length. Is there time for needed discussion during meetings?
- Adequacy of Discussion in Meetings. Do Members prepare adequately and participate actively? What can the organization do better to assist Members in their preparation?
- Timing and Content of Advance Materials. Are the materials useful, relevant, and available sufficiently in advance of meetings?
- Committee Membership Selection Process. Is there expertise or perspective that should be added to committee discussions?
- Relations between the Commission, or Committee, and ICC staff. Is communication effective and responsive? Is the information flow timely and understandable?
- Expert Advice. Is there sufficient opportunity to hear from outside experts and for training on new developments and emerging trends?
- Training. Is the training available to Members and their Designees sufficient? What issues do participants need to know more about? What emerging issues or trends should be explored?
- Improvements. What would make the discussions and decision process more effective?

- Other Thoughts. What other steps do Members suggest be taken to strengthen governance effectiveness?

Incorporating these topics into ongoing planning for annual ICC governance will lay a strong foundation for the ICC to add best practices to the ICC governance process.

2. Annual Governance Calendars

We suggest that the Commission and its committees each adopt an annual governance calendar that captures the critical actions and agenda items to be covered each year. The calendar is not an exhaustive list of every agenda item that will be covered during the year. Instead, it captures the important recurring or predictable actions that must be taken each year and enables tracking the completion of those items. A sample calendar for the Commission is attached as Appendix B. This sample is illustrative only, and would have to be built out for the Commission and each Committee based on actual meeting dates and regular agenda rhythms.

3. Training

Continuing education for governance leaders is considered a standard good governance practice. The general best practice standard is that governance leaders must stay current and continually (annually) refresh their understanding of business operations, risks, and trends. Many boards articulate regular training requirements their leaders must meet, and some adopt an annual Board training calendar. The status of directors' compliance with those requirements is tracked, just like attendance at Board and Committee meetings.

Due to their state insurance regulatory positions and their NAIC activities, Members may feel that they have ample opportunities outside ICC to be exposed to emerging issues and trends. However, this exposure is likely to be more focused on executive leadership than governance. Likewise, while some Members serve for many years, the stark reality is that turnover among Members occurs frequently, so many new personnel join the Member ranks annually. ICC is uniquely organized and there is regular turnover at the Commission.

For these reasons, we suggest that ICC include training in its annual governance calendar and in its annual governance effectiveness discussion. Possible training topics could include:

- New Member orientation as is already provided,
- Annual primers and refreshers on ICC organization structures and key issues,
- Updates on ICC operations, emerging issues related to Uniform Standards and related ICC reviews,
- Emerging innovations in technology that may present opportunities or challenges for ICC, and
- Education about the ICC Code of Ethics policy.

Members should identify training topics in their annual Governance Effectiveness/Discussion and whether ICC should partner with stakeholders, such as its advisory committees, to develop training. We also recommend that Designees be included in training sessions, whenever possible, as keeping these key staff members current on relevant topics can also improve their discharge of their ICC work.

4. Written Committee Charters

Every Committee should have a written charter describing its roles and responsibilities, and Committee members should review the charter at least every two years. Currently, only the ICC Audit Committee has a written charter. A proposed committee charter template that can be tailored for each Committee is attached as Appendix C. Also part of Appendix C is a draft Audit Committee charter using this template which incorporates into the template the responsibilities and authorities in the existing Audit Committee charter and the ICC governance documents.

5. Clarifying Commission and Management Committee Responsibilities

In recent years, the Management Committee and the Commission have met simultaneously. Many interviewees expressed confusion about what the respective role of each is, and some felt that there is no longer a need for the separate Management Committee. Conversely, there was little conceptual enthusiasm for adopting extensive limits on the topics coming before the Commission and moving responsibility for many topics solely to the Management Committee. Elimination of the Management Committee its membership and functions cannot be eliminated as they are mandated by the Compact Statute. For example, the Compact Statute states that the Management Committee is the primary governing body for the ICC and that it must approve Uniform Standards by a 2/3 vote prior to submission of Uniform Standards to the full Commission.

Despite the Compact Statute terms, there are several actions that the ICC can take to improve the effectiveness of the Management Committee. Below, we identify a number of alternatives to improve operation of the Management Committee so that Members fulfill their statutory authority, conduct governance operations efficiently and effectively and also better understand the distinction between the Management Committee and the full Commission and their distinct decision making processes. Our suggested Management Committee improvements are as follows:

a. Written Management Committee Charter

The written Management Committee Charter should adopt a charter that spells out some specific responsibilities of the Management Committee. These specific responsibilities could include some or all of the following:

- Address time sensitive and crisis situations in between Commission meetings
- Develop recommendations to the Commission on complex issues;
- Consider and recommend Bylaw changes for recommendation to the Commission;
- Consider and recommend annual operating plans to the Commission;
- Consider and recommend annual governance calendar to the Commission;

- Leading regular Commission governance effectiveness reviews;
- Consider and act on possible violations of the Code of Ethics policy by ICC staff, other than the Executive Director;
- Consider and act on ICC personnel and compensation decisions, other than for the Executive Director. These Management Committee duties and responsibilities should be outlined in training and in Governance Effectiveness Discussions; and
- These Management Committee duties and responsibilities should be outlined in training for the Management Committee and discussed in the Committee's Governance Effectiveness discussions.

The Management Committee Charter should be in the same format as the other committee charters.

b. Structuring Agendas and Minutes for Commission Meetings

Many interviewees noted that much of the ICC's business is technical and can, at times, be complex and tough to understand. We believe that the Agenda can be a strong tool to assist with Member communications and also improve discussions among Members. We acknowledge that the Agendas have been evolved to identify the actions required, the status of the item (new or amendment), the originating committee and similar critical items. Based on the comments from Members, we suggest attempting some additional amendments to the Agenda. For example, the Agenda could be reformatted so each agenda item has a summary description of the issue and a summary of the issuing committee's recommendations at the beginning of each item. The summary should describe issues such as:

- The nature of the action and whether it is pending with the Management Committee or full Commission:
- The source of the proposed revisions;
- A short description of the process for developing the revision;
- The goal(s) of the revisions; and
- Reference to any significant dissent or objection to the proposal.

This description should be prepared to generate questions and comments from Members and should be directed to assisting them with making an informed vote.

We received a number of comments regarding joint Commission and Management Committee meetings, with some suggesting that the Management Committee be eliminated and others advocating to make no change. We understand the concern regarding confusion and would like to propose a quick fix. Unfortunately, the Management Committee is required by the Compact Statute, so it cannot be eliminated. Our proposals for additions to the Agenda could also include additional guidance so meeting attendees understand who is serving on the Management Committee and they know when they need to case votes. Where actions will be discussed in full at the Management Committee meeting, and all Members are present, these actions could be slated for a consent agenda when considered by the full Commission to avoid unnecessary duplication of discussion. Additionally, as noted above, the availability of more electronic meetings may enable some Management Committee meetings to be held separately from the full Commission meetings.

c. Electronic Participation and Actions in Lieu of Meeting

The ICC Bylaws authorize both the Management Committee and the Commission to participate in meetings through telephonic or electronic platforms. The Bylaws specifically authorize the Commission and the Management Committee to act via telephone or telecommunication, as long as the discussion is "reasonably audible by all persons."[54] Any activity that can be addressed at an in person meeting can be addressed in a telephonic or telecommunications meeting as long as the discussion is reasonably audible as required. We suggest that the ICC take advantage of electronic meetings more frequently in the future so that ICC business is not overshadowed by busy schedules at the companion NAIC meetings.[55]

Actions without Meeting can be useful for any governing body, but are not usually efficient because they require a collection of signatures from each Management Committee or Commission Member. A clarifying issue that should be addressed is the need for an amendment to the Bylaws regarding actions without meeting.

Actions taken in lieu of a meeting are taken without discussion and based on written approval of the Members. Because the actions are taken without discussion, they must be approved unanimously by every voting Member. Typically, governing bodies use actions lieu of a meeting when all Members are present or easy to reach and to handle extremely time sensitive matters and matters on which little discussion is expected, or on which preliminary discussion has already occurred.

The Bylaws section describing actions in lieu of meetings for the Management Committee includes that unanimity requirement,[56] but it is missing from the Bylaws section authorizing actions in lieu of meetings for the Commission.[57] We recommend adding the unanimous written consent requirement to the provision of the Bylaws relating to Commission actions in lieu of a meeting.

[54] Compact Bylaws Art VII, Sec. 5.

[55] The COVID-19 pandemic that swept the globe in 2020 has resulted in significant changes in the way groups collaborate, communicate, and meet. While the ICC had historically held most meetings during the course of a year in solely teleconference format, both the NAIC and the ICC were forced to move to all teleconference, virtual meetings and communications in 2020. Many of these process changes may become permanent even after this pandemic is behind us. The proliferation of teleconference, virtual versus in-person meetings may present additional opportunities for ICC to rethink its annual Commission and Committee meeting calendars, its regular communications, its process for distributing materials, and its processes for receiving and reviewing industry filings. It also may enable some or all meetings to be scheduled separately from the NAIC annual calendar.

[56] Compact Bylaws Article III, Sec, 4(b).

[57] Compact Bylaws Article VII, Sec. 5.

d. Consent Agenda for Both Full Commission and Management Committee Agendas

We suggest reviewing actions to be taken at every Commission and Management Committee meeting to identify actions for which materials can be sent in advance and for which no detailed discussion is needed. Typically these items are routine housekeeping action items. Absent objection at the meeting, those actions can be listed as a single "Consent Agenda" action item on the agenda and taken as a single vote. This helps to free time for the discussion to focus on more complex, more significant issues.

e. Designating Decision Types Reserved Only to Full Commission

The Commission could adopt Resolutions or Bylaw changes that identify specific decisions and topics that are reserved to the full Commission. This list would not have to be exhaustive, but it would identify particular topics that must be considered and acted upon only by the Commission rather than the Management Committee, such as the following. Giving Members and Designees access to the list would support common understanding of the ICC's governance process:

- Authorization to participate in litigation
- Adoption of new or amended Uniform Standards
- Hiring of ICC Executive Director
- Adding new lines of business or services to states
- Financial Decisions above a specified value threshold
- Code of Ethics issues involving the Executive Director or a Member
- Adopting an annual fee or similar obligation for all Compacting States
- Other topics the Commission identifies as particularly sensitive or significant

6. Written Leadership Role Descriptions

We recommend written descriptions of the responsibilities and expectations of key ICC leaders, including Members, Management Committee members, officers, and Committee Chairs. Written role descriptions are helpful both to Members new to ICC and to existing leaders. Appendix D template that could be used as a basis to develop the leadership role descriptions. These descriptions should be reviewed and refreshed every 1 to 2 years. The following are some of the responsibilities that should be included in the role descriptions:

a. Commission Members

- Attend all Commission and committee meetings in person, through Designee or electronically absent a truly significant conflict;

- Inform the Commission of any Designee(s) as required under the Bylaws;
- Regularly communicate with Designee(s) to assure Member understanding of issues and to deliver clear policy direction to Designee;
- Actively prepare for Commission and Committee meetings; and
- Actively participate in Commission and Committee discussions.

b. Committee Chairs

- Work with ICC staff to prepare annual Committee calendar;
- Work with ICC staff to prepare agenda for each Committee meeting;
- Discuss with ICC staff any materials to be sent in advance of Committee meeting;
- Review minutes of each Committee meeting;
- Act as liaison with ICC staff about issues within purview of their Committee;
- Report to Management Committee and to Commission about Committee activity; and
- Lead Committee's annual governance effectiveness discussion.

c. Commission Officers

- Fulfill responsibilities identified in Bylaws and Compact Statute;
- Act as a liaison to ICC Committees on issues within the officer's responsibilities;
- Lead commission consideration of issues within the officer's responsibilities;
- Lead the external communications functions on ICC matters; and
- Fulfill other responsibilities specific to their respective roles as requested by the Commission or the Management Committee.

7. Designees

A uniform opinion among interviewees was that the ability of Commissioners to name Designees is critical to participation in the Compact. State insurance codes all provide for the Commissioner to work through deputies and other professional staff members. This authority is critical to the operation of all insurance departments so that the Commissioner can assure that their department has experienced staff dedicated to critical and often technical functions that are within the purview of the Commissioner's duties. The availability of Designees enables Commissioners to manage impossible demands on their time, and to involve appropriate expertise in their departments in issues when appropriate.

Our suggestions related to Designees are to adopt a written description of the Designee's role and include Designees in Code of Ethics and other written policies, as described below. An example description is included at Appendix E. We also suggest including Designees in all Member orientation and training programs, as described further below.

a. Written Role Description

There should be a written role description that spells out that the duties, obligations, and rights of Designees. A sample Designee role description is attached as Appendix D. The description should include the following:

- The role of the Designee is to represent their state and their Commissioner in the ICC activities for which they have been designated.

- The Designee is expected to attend (electronically or in person) ICC meetings related to the areas for which they have been designated.

- The Designee may exercise all of the roles of their Commissioner, including voting.

- All ICC policies, including Code of Ethics and Expense policies apply fully to Designees as they do to the Designee's Commissioner.

- Designees should regularly communicate with their Commissioner about developments and issues related to the ICC areas the Designee covers.

- Designees should verify with their Commissioner positions to take on important policy issues and votes.

- Designees should review any laws, regulations, or policies in their state that related to their service as a Designee and raise any questions they have with their Commissioner.

b. Participation in Code of Ethics and Other Policies

Designees should be subject to the same policies that Commissioners are subject to, including any obligation to regularly review, acknowledge and sign the policies.

i. Voting

The ICC allows Members to designate on an annual basis a proxy that can serve in place of the Member as the Designee with respect to Commission business.[58] This Designee can serve in the place of the Member with respect to commission business, attending meetings, service on committees. This Designee can also serve as a voting proxy, to cast one vote on behalf of the state he or she represents. Only Members and their proxy are entitled to vote, and this proxy cannot be

[58] Compact Bylaws, Article II.

given from Member to Member.[59] While Designees are permitted, the proxy process is not specified in the Bylaws or other ICC policy.

The ICC has an annual proxy designation process that is well documented with ICC staff. Additionally, Members will periodically utilize other Department staff who stand in and verbally announced a vote by proxy. The Bylaws are silent as to the form of proxy, thus providing flexibility that is demonstrated in the current process. We understand that flexibility is important. Likewise, we also understand that the recordkeeping associated with ad hoc proxy designations is difficult to staff and monitor. However, documented proxy designees are a better governance practice rather than ad hoc. In order to improve on proxy designations, we suggest that (i) the annual proxy designation list all department staff who are authorized to serve as proxies, (ii) if any staff members who are proxies change during the year, that the Members update the filed proxy, and (iii) annual Member training include proxy management as a topic.

The only cautionary comments we heard from interviewees about use of Designees is that occasionally they are not as aware as their Commissioner would be about larger policy issues particularly if the policy issue is a significant issue in their state. There are some topics about which only Commissioners should vote. The following are some of the possibilities to consider.

- Uniform Standards
- Personnel and staff compensation issues
- Member conflicts and Ethics issues
- Indemnification and defense expenses

8. Include Attendance Statistics in Annual Report

As a joint public agency, the ICC is a public body and has public accountability responsibilities. For example, the ICC's auditors are required to conduct a performance assessment of the ICC every one to three years.[60] Data regarding Member participation would be key to this assessment. Data can also assist Members and staff with identifying when to conduct Member outreach regarding technical or other support needs. We suggest that the ICC maintain statistics regarding Member attendance in Commission and Committee meetings and include these statistics in its Annual Report.

9. Phased Orientation of New Commission Members and Designees

Interviewees generally consider the current orientation program to be adequate. However, we heard several comments about the steep learning curve for new Commissioners, especially for those who do not have significant insurance background when they take office. We have two recommendations about the ICC orientation program.

[59] Compact Bylaws, Article VII, Sec. 5.
[60] Compact Statute, Art. XII, 6

a. Two Part Orientation

We recommend that orientation be in two phases. First, an initial orientation should be held soon after a Commissioner joins the Commission. Designees should also attend the orientation whether they are Department veterans or new in order to align future actions with their new Commissioner. This first session would include the current introductory materials and conversations. A second orientation should be scheduled within 12 months of the Commissioner joining the ICC to enable the Commissioners to ask questions about processes and issues they have encountered and to let the ICC staff know areas about which they have questions. This two-part process would enable Members to build an additional lawyer of understanding and to ask more informed questions relevant to their participation. Trainings could be done virtually and could be recorded for convenience of the Members and their Designees.

b. Designees Participate in Orientation

New Designees also should be required to participate in ICC orientation. To the extent a designee is designated only for certain specific topics or responsibilities, the Designee. Designees should have access to an orientation program focused on those responsibilities or topics. The ICC can make available pre-recorded orientation programs on the most commonly encountered topics, for on-demand viewing to facilitate the change of roles within state insurance departments.

10. Documentation of Policies and Processes

There are several policies and processes that we recommend documenting in writing. The documentation can be concise, but should be available to all Members and their Designees. The policies can be consolidated together in one place to enable easy access. We suggest that each policy be expressly assigned to a committee for oversight and periodic review. They should be reviewed and updated periodically. We also recommend Commissioners and Designees be required to review and acknowledge the policies in writing when they newly join ICC and annually or biennially thereafter.

The following is a list of some of the key policies we recommend including in the policy collection.

a. Code of Ethics Policy

This policy is an important underpinning of the duties and obligations of Members. It should be distributed to Members and their Designees regularly (typically annually) and acknowledged in writing.

i. Designees Included

Designees should have the same requirements for Code of Ethics review and acknowledgment as Members. This policy would be a good topic for periodic Member and Designee training.

ii. New Acknowledgement Form for Members and Designees

Although the ICC Code of Ethics applies to both Members and Employees, it currently includes a written acknowledgement form labelled for employees. We think it is important for Members and Designees also to acknowledge in writing that they have reviewed the Code of Ethics and commit to compliance with its requirements. Once designated, Designees assume all of the authority and obligations of their appointing Member,[61] so it is important for Designees also to acknowledge in writing that they have read and commit to the Code of Ethics. We recommend changing each reference to "Member" in the Code of Ethics to "member/designee." In addition, since the language applicable to Members or Designees is slightly different, Appendix F is separate Member/Designee Acknowledgement Form that can be used for Members and their Designees.

iii. Disclosure of Role as Member Appointed by State, District, or Territory

If the ICC was the elected Board of Directors of a corporate entity, it would be extremely important for each Director (Member) to disclose her dual roles as a Member of the Commission and as a state official of her appointing state. While a Corporate Board is not an exact analogy to the ICC, and the interests and duties of Members in their dual roles are often aligned, we believe it is advisable for Members and their Designees to expressly disclose their state regulatory or executive role. We suggest adding the language in the second paragraph of Appendix F to the Member or Designee acknowledgment and signature page of the Code of Ethics.

b. Advisory Opinions

The Commission has the authority under the Compact Statute, Art. XVI.2.c, to issue advisory opinions upon request. The ICC has an Operating Procedure describing the ICC procedures for issuing these opinions. We suggest that the Advisory Opinion Operating Procedure be included in the consolidated collection of procedures and made available to Members and Designees. We also suggest that responsibility for this process be expressly assigned to an ICC Committee.

c. Membership Dispute Resolution and Related Issues

Article IX of the Compact Statute states that upon the request of a Member, the Commission shall attempt to resolve disputes or other issues that arise among Compacting State on matters subject to the Compact. That provision also says that the Commission shall promulgate procedures for such dispute resolution. The ICC has an Operating Procedure outlining the process for handling disputes and related matters among Compacting States. We suggest this be included in the consolidated collection of procedures and made available to Members and Designees. We also suggest that responsibility for this process be expressly assigned to an ICC committee.

11. Project Assessment and Lessons Learned

Several interviewees commented that there should be more emphasis on evaluating projects after they are completed. Many organizations include a formal "lessons learned" debriefing and

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[61] Compact Bylaws Art II,

discussion at the conclusion of projects. We recommend building this step into large project work, as it enables improved outcomes in subsequent work and can avoid duplicating ineffective practices. Requiring a report on lessons learned from significant projects to the Management Committee, or other relevant standing committee, also emphasizes the importance of the discussion and lays the groundwork for continuous improvement.

12. Written Description of Immunity, Indemnification and Defense Expense Process

Article V. Sec 5 (a-c) of the Compact Statute makes three commitments to Members, officers, employees and agents. These are:

1. Immunity from suit and liability arising out of actual or alleged acts, errors, or omissions within the scope of their ICC duties and responsibilities ;
2. Payment of expenses in defending against civil claims arising out of actual or alleged acts, errors, or omissions within the scope of their ICC duties; and
3. Indemnification for any settlement or judgement arising out of actual or alleged acts, errors, or omissions within the scope of their ICC duties.

These commitments apply as long as the liability and expense were not caused by "intentional or willful, and wanton misconduct." Article VI. Sec. 3 of the ICC Bylaws further states that the indemnification commitment in the Compact Statute applies when the Member has

> *"acted in good faith and in a manner the person reasonably believes to be in, or not opposed to, the best interests of the Commission, and with respect to any criminal action or proceeding had no reasonable cause to believe the conduct was unlawful."*

The ICC immunity commitment appears to reflect the immunity typically applicable to state governments and granted to state official by state governments.[62] This immunity reflects both public policy and constitutional interests in insulating governmental entities and officials from challenge absent the government's express consent in limited circumstances. This language extends immunity to Members and staff in recognition that their ICC work is the work of state government regulatory bodies, and like the state employee regulators, they should be immune from claims challenging their work that is delivered in good faith.

The ICC indemnification commitment is like the indemnification commitments most corporate entities make to their leaders. Indemnification is a promise made to leaders who otherwise might be unwilling to put their personal assets at risk in the event of a legal challenge to their good faith discharge of their responsibilities to the organization. This commitment is a sort of "we've got your back" promise intended to assure capable individuals that the organization will stand behind

[62] See the following examples of state immunity statutes: West Virginia (W. Va. Code § 29-12A-5), Illinois (745 Ill. Comp. Stat. §§ 10/2-201 (immunity of public employees) through §§ 10/2-302 (indemnification of public employees)), and Ohio (Ohio Rev. Code Ann § 9.86).

their work on behalf of the organization. We understand that these indemnification and defense provisions have not ever been triggered.

The ICC Bylaws state that the Management Committee members who are not party to the proceeding in question shall determine whether indemnification is proper. They also specify who makes the determination if a majority of the Management Committee is not available to make the determination.[63] The Bylaws also allow the Commission to advance defense expenses before the final determination of whether indemnification is appropriate, if the individual makes a formal undertaking to repay the advance if indemnification is ultimately determined to be inappropriate.

We recommend committing the specifics of the indemnification and expense advancement process into a written policy. The document can spell out the process in more detail, including describing the timing and roles of each player in the process. Our experience is that it is better to develop these processes before an indemnification and advancement situation arises. The policy can include the draft resolution approving advancement of expenses, the language of the undertaking required, etc.

We also recommend that the ICC verify that the ICC D&O insurance policies that support indemnification provide coverage for indemnification and expense payments and appropriately reference Members and their Designees as covered under the policy.

13. Table of Decision Authorities

Some organizations use a Table of Decision Authorities as an internal control to track which decisions can be approved by their various governance functions. The table serves as a resource available to all involved about the process and authority required for different decisions. These tables show the ultimate decision-making authority in the organization by type of decision and sometimes by dollar threshold.

These tables often also show constituencies that may make recommendations, constituencies that must be consulted before a final decision is made, and constituencies that must be informed after the fact when certain decisions are made. A table like this could be used for some of the more complicated and important ICC processes, like adoption of Uniform Standards, decisions to initiate or participate in litigation, or authority to make financial commitments above a certain level. Appendix G is a sample Decision Authorities Table template.

14. Opt-Out Process

As background, the opt-out process is defined in the Article IV(2) of the Compact Statute as a limited right of Compacting States to not accept a Uniform Standard in their respective state. Article VII(4) allows states to opt-out of Uniform Standards either by legislation or regulation.

- The legislative option is expressly available when a state enacts the Compact Statute, including the ability to opt-out of any then-existing or prospective long-term care uniform

[63] Compact Statute Art. VI. Sec. 3-4. A-C.

standards, and is understood to be available at any time to opt out of adopted Uniform Standards.

- The regulation option is available if a state gives written notice of its intent to opt out to the Commission within 10 days after a Uniform Standard has been adopted.[64]

The Compact Statute provides a method to stay the effectiveness of a Uniform Standard while a state pursues its right to opt-out by regulation. A state can opt-in to a Uniform Standard later by legislation or regulation repealing or lifting all or a portion of its prior opt-out, if it chooses to do so at a later date. Since the ICC was formed, use of the opt-out process has been limited, although several states have opted out of certain long term care and disability Uniform Standards.

During our interviews with Commissioners, several commented on making changes to the ICC's opt-out process, including permitting only partial opt-out from a Uniform Standard. Likewise, in *Amica Life Insurance Co. v. Wertz*, the Colorado Supreme Court was critical of the limited time period that a Compacting State had to exercise its "opt-out" rights.[65] Based on the terms of the Compact Statute, this type of process change is not possible through a Bylaw or Commission rule amendment. Instead, such changes could only be made via legislative amendment to the Compact Statute by all Compacting States. As a result, a Compacting State can only opt-out of an entire Uniform Standard, not out of specific requirements within the adopted Uniform Standard - an "all or nothing" result.[66]

While not discussed in interviews or by the Colorado Supreme Court, Compacting States have an additional opportunity to opt-out of Uniform Standards beyond the date when the Uniform Standard is first adopted. Periodically, Uniform Standards are amended to address technical or other concerns. Likewise, Uniform Standards are reviewed once every five years and those reviews often result in amendments to the Uniform Standards. Compacting States can consider whether to opt-out of a Uniform Standard once the amending process is complete.

We suggest that the ICC release an Advisory Opinion and provide periodic training for members on the opt-out process, state opportunities for opt-out, and understanding the effect of an opt-out for a Compacting State's consumers and insurance market (the impact of a Uniform Standard not being available in a state). In Section B below, we discuss issues raised by *Amica Life Insurance Co. v. Wertz* regarding the Compact Statute and preemption of state insurance laws. This discussion also impacts Compacting State considerations regarding the opt-out process.

15. Communications and Materials

Effective, transparent communication is a critical element in developing trust, a positive reputation, and effective governance. We heard many favorable comments about ICC staff responsiveness and preparation of materials in advance of Committee and Commission meetings. It is important to regularly ask whether communication, both internal and external, is effective and

[64] Compact Statute, Art. 7(4).
[65] *Id.*
[66] Compact Statute, Art. 7. In the *Wertz* decision from the Colorado Supreme Court, the opt-out process was referenced, but in a manner that mischaracterized it as a process to create exceptions to portions to Uniform Standards. 462 P.3d at 56.

how it might be improved. This question should be part of the regular governance effectiveness discussions.

a. Clarity

The most significant concern we heard about communications was that recommendations from the Product Standards Committee are often described in extremely technical terms, making it difficult for participants who are not actuaries to follow the import of the recommendation. Some Commissioners even expressed frustration about this. When recommendations relate to extremely technical issues, we recommend adding and executive summary or overview that explains the key issues and implications of the technical recommendations.

b. Consumer Review of Industry Proposals

Sometimes proposals are advanced by the industry and discussed with Commissioners before consideration at the Product Standards Committee. Some consumer representatives feel that the result of this is that Commissioners have already considered proposals before there is any opportunity for consumer representatives to review or discuss. We suggest the ICC consider how to communicate with the consumer Advisory Committee earlier in the process regarding Product Standard amendments proposed by ICC staff, regulators or by the Industry Advisory Committee, or how to better clarify when a proposal is being authorized for full vetting and work as opposed to a completed recommendation. Many amendments and proposals are based on regulator experience, and describing these experiences in lay terms could help members of the Consumer Advisory Committee gain additional understanding so they can provide timely feedback. Perhaps this will involve including subject matter experts on Consumer Advisory Committee calls to provide background and respond to questions regarding a proposal.

c. Access to Information

It is important to ensure that Management Committee and Commission Members always have access to anything they need to consider in regard to a decision they are going to make. If there is ever a request for information that staff feels should not be granted, staff should refer the issue to the Management Committee for guidance about how to handle the situation.

16. Changes to ICC Committee Structures

ICC currently has a total of 10 committees. Some are required by the Compact Statute, some are specified in the Bylaws, and others are convened under the general authority given to the Commission and the Management Committee under the Compact Statute and the Bylaws. These committees can be grouped as follows:

- Four committees are specified in the Compact Statute (and also referenced in the Bylaws) – Management Committee, Legislative Committee, Consumer Advisory Committee, and the Industry Advisory Committee. The requirement to have these committees cannot be changed except by amendment to the Compact Statute.

- One Committee is specified in the Bylaws – the Audit Committee

- Five other Committees have been established pursuant to the general authority under the Compact Statute and Bylaws.[67] Rulemaking Committee, Finance Committee, Product Standards Committee, Regulatory Counsel Committee, and Actuarial Working Group.

While this is a robust committee structure, it does not meet several oversight functions that are common with governing boards today. Many governing boards include committees that address management of the organization's operational risks, technology and governance issues, all as further described below. We provide two alternatives for the ICC to add these committee functions to its governance structures.

a. Identify Additional Topics or Functions to be Addressed by Committees

ICC should consider important topics or functions, such as anticipating product filing trends, enterprise risk management, technology developments, and regular governance review, and decide whether those functions should be expressly addressed by a current committee or a new committee within the ICC Committee structure. The responsibilities should be included in the written charter for each committee. For example:

- The Audit Committee might more expressly consider risk and risk management
- The Product Standards Committee, in collaboration with the Actuarial Working Group, might expressly consider innovation and trend identification
- The Rulemaking Committee might expressly consider governance and Ethics issues
- Advisory Opinions and conflicts between Compacting States might be referred to the Officers, with assistance from the Regulatory Counsel Committee, to act as a special committee for such serious circumstances.

17. Auditors

a. Audit Committee Charter Amendments

As background, an organization's Audit Committee is a hub for oversight by any governing board, with its primary function to oversee the organization's external audit and auditors.[68] There are a number key governance best practices – auditor/audit committee communications, audit partner rotation, and audit bids – that are critical to all organizations. Three key best practices for any audit committee are (i) audit firm oversight and communications, (ii) audit partner rotation and (iii) periodically considering auditor replacement.[69]

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[67] Compact Statute, Art V. 3; Compact Bylaws Art VIII, sec. 4.A.

[68] In 2002, Congress recognized this by including numerous requirements for internal account testing and enterprise risk management in the Sarbanes-Oxley Act of 2002. Pub.L. 107-204. In 2003, the NAIC adopted amendments to the Annual Financial Reporting Model Regulation (NAIC MDL 205) to adopt the sections known as the Model Audit Rule, governing insurance company audit committee duties and financial testing requirements.

[69] A good source of guidance for Audit Committee best practices can be found in the NAIC Annual Financial Reporting Model Regulation (Model 205)(NAIC MDL 205), Section 14.

Audit oversight is a critical role for the Audit Committee. The Audit Committee should be well-informed about the external auditor's work, its ongoing observations of the committee and its final analysis.[70] The Audit Committee should be in regular contact with the external audit team, including the lead audit partner and any key audit personnel. Through the year, the Audit Committee and the external audit team should review the auditor's work plan, receive periodic status reports on the audit efforts and a thorough report on the auditor's final observations in its audit report and accompanying management letter. The Audit Committee should receive at least a portion of these reports in executive session so the external auditors can speak freely regarding any concerns or issues they may be experiencing with management.

The Audit Committee's role in ensuring auditor independence is an important best governance practice. The recognized tool for ensuring independence is to rotate the lead audit partner on a periodic basis.[71] The ICC has followed this practice for a number of years by coordinating its external audits with the NAIC based on their Service Agreement with the NAIC. Since 2007, the NAIC and the ICC have worked with two different audit firms, with the current auditor (RSM) being under retention since 2012. In 2017, the lead partner on the ICC audit was rotated. Throughout this entire time period, the ICC has participated in two different bid processes to identify a new auditor. The Audit Committee was involved in each of these processes.[72]

Another suggested practice is for the Audit Committee to periodically evaluate whether the audit should be bid out to another audit firm. Historically, the ICC has coordinated its external audits with the NAIC based on their Service Agreement with the NAIC. Since 2007, the NAIC and the ICC have worked with two different audit firms, with the current auditor (RSM) being under retention since 2012. In 2017, the lead partner on the ICC audit was rotated. Throughout this entire time period, the ICC has participated in two different bid processes to identify a new auditor. The Audit Committee was involved in each of these processes.

The ICC's Audit Committee Charter should be updated to address these practices. Attached at Appendix C is a suggested revision to the Audit Committee Charter.

b. Triennial Management Review

The Compact Statute requires that the Audit firm conduct a "management and performance audit" at least every three years.[73] We suggest that oversight of this function would be best housed with the Audit Committee, and the Audit Committee Charter should be amended to align it with this

[70] Annual Financial Reporting Model Regulation, NAIC MDL 205, Section 6(J).

[71] For example, in NAIC Model Law 205, audit partner rotation is required every five years, with the former audit partner prohibited from serving as on the audit again for five years. NAIC MDL 205, Section 7(D).

[72] Periodically changing audit firms is a standard issue for organizations to consider and is required for some companies. Rotation is intended to assure that relationships between the auditors and the entity do not become so cozy that the independence of the auditors and quality of the audit is not compromised. Changing audit firms is an expensive process. It usually takes a real investment of time for the audit firm to learn the entity's systems and processes, so changing firms can bring real additional cost. The ICC Audit Committee should periodically consider the possibility of rotating auditors and make a recommendation to the Commission about it. We suggest considering this issue every three to five years. We understand that the ICC has been informed by the NAIC Auditor Rotation Policy. We reviewed that policy and found it to provide solid guidance on rotation. The ICC should consider adopting its own Rotation Policy in a similar fashion.

[73] Compact Statute, Art. XII, 6.

Compact Statute requirement. From a functional perspective, this type of review can likely be addressed in the external auditor's management letter. We suggest talking with the current ICC audit firm to see whether they consider their annual management letter to meet this requirement and, if so, to ensure that the letter references this Compact Statute requirement.

18. NAIC Relationship

As described above, the ICC is a joint public agency created through legislative action in each Compacting State. The ICC operates similarly to an insurance department, but per the terms of the Compact Statute, the ICC is charged with fulfilling its duties in a manner that may vary from how individual Compacting States may operate. The ICC has statutorily defined duties and responsibilities that it must fulfill, and each Compacting State representative is charged with ensuring that these legislative mandates are fulfilled. Since its inception, the ICC has worked closely with the NAIC to begin operations and to use established processes and systems, and, as a matter of efficiency and convenience, it has coordinated its meetings and governance schedule with meetings of the NAIC.

Based on our interviews, many Commissioners see ICC as an arm of the NAIC, not as a separate organization both legally and operationally. Given that the ICC is a joint public agency and Commissioners, as representatives of their respective Compacting States, are responsible for discharging public duties when serving with the Commission, enhancing Member understanding of the ICC seems to be in order. As discussed above, in Member and Designee orientation and training, it will be important to include content to inform trainees about the distinction between the ICC, as a joint public agency formed by action of the Compacting State legislatures, as compared to the NAIC, a 501(c)(3) organization that solely supports state insurance departments.

The NAIC is certainly a key support organization for all state insurance departments, and its support of the ICC is certainly additional support for the Members, given the ICC's status as a joint public agency. ICC collaboration and communication with the NAIC is certainly important, economical and conducted well within the confines of a written service agreement, with no prohibitions in the Compact Statute or other law. The NAIC's involvement with the ICC since its inception has been to support state insurance regulators in fulfilling a key and unique set of statutory duties. We make the following suggestions for training curriculum:

- Include clear information about the nature of the ICC's status as a compact, and clarify its separate existence from the NAIC, and the NAIC's support role for the ICC in the ICC new Member orientation

- Consider whether the ICC can directly absorb operational expenses, or characterize NAIC support for these services in a manner that is similar to NAIC support provided to individual states.

- Include clear information about origins of the ICC as a joint public agency, and support that it pays for from the NAIC.

- Follow revised Audit Committee Charter actions to demonstrate independence in oversight of ICC operations and finances.

Members and Designees should have a clear understanding of the ICC, its role in state insurance regulation, its unique and sound legal background, and the role of their respective legislatures in creating the ICC.

19. Two Compact Statute Requirements

The Compact Statute outlines the duties and authority that the legislatures of the Compacting States provided to the ICC. As we reviewed the Compact Statute for this project and conducted a gap analysis with existing ICC governing documents, we identified two key issues that require further and immediate attention.

a. State Filings of Bylaw Amendments

Compact Statute Art. V.1.d. states that Bylaws and Bylaw amendments should be filed with "the appropriate agency or officer in each of the Compacting State." ICC should expressly articulate the position that providing notice and copies of amendments to the Member from each state meets this requirement.

b. Administrative Procedures Act

Compact Statute Art VII.2 specifies that the ICC rules and operating procedures shall be made pursuant to the Model State Administrative Procedures Act of 1981 as amended. We recommend that a review of these requirements be undertaken periodically. There have been several proposed and enacted administrative procedures acts put forth in recent years, so it is not clear if this requirement can even be met today. Research of this issue would go beyond the scope of this Review. We suggest that the ICC conduct this research in order to evaluate its current responsibilities under this portion of the Compact Statute.

20. Other Compacts

Attached as Appendix H is a chart comparing the approach of different Compacts on several key governance elements. Some of the elements compared are:

- Majority voting requirements for different issues,
- Whether compact proposals are advisory or binding on compacting states, whether Designees are permitted,
- Whether there is a process for states not to follow compact proposals,
- The commission's enforcement rights,
- What the flow of money is between states and the commission, and
- Membership types.

There are no other compacts exactly comparable to the ICC, but it is instructive to consider how other Compacts operate and how they handle these governance elements.

The most notable comparison to the ICC is the Interstate Commission for Adult Offender Supervision (the "Adult Offender Compact"), one of the oldest and largest interstate compacts. The Adult Offender Compact was first established in 1937 and substantially revised in 2002. Its member jurisdictions are all 50 states and three U.S. territories (D.C., U.S. Virgin Islands, and Puerto Rico). It supervises adult offenders who move across state lines and provides a single, uniform standard of supervision. Its rules are binding on its member states, except in two instances. First, if a majority of the states enact legislation expressly rejecting the Compact's rule, then the rule is not effective. Second, if a compact rule is challenged in court, a Compact Statute provision allows the court to set aside the rule if the court concludes the rule is not supported by substantial evidence in the rulemaking record.

The Interstate Tax Compact is an interesting compact because it has several categories of membership in addition to full compact members. The other categories have more limited voting and leadership participation rights, and may be charged fees different than fees charged to full compact members. It appears the different categories of membership enable non-compacting states to participate in issues of particular concern to them, and enables the Compact to collect additional revenue from non-compacting states. This compact is also interesting because its proposed rules are advisory only, and states are not required to adopt them. However, the compact has extensive enforcement capacities for its rules that a state has adopted. It also has express obligations relating to arbitrating disputes over the allocation of tax revenues between multiple states.

Finally, we included a description of how the NIPR and the NAIC address, or do not address, these governance elements. These are entities with which Members are familiar, and it is important to remember that neither of them is a compact, and they are subject to specific state laws applicable to their type of corporate entity.

21. Management Committee Membership Rotation and Officer Election

The current processes for selection of members of the Management Committee and the ICC Officers raise questions about whether additional flexibility in some of the processes might enable more effective Member participation in the Management Committee and enable more leadership continuity when the Commission feels that is needed.

The ICC Management Committee is comprised of 14 Member selected annually from three distinct groups of Compacting States. The three groups are specified in the Compact Statute and determined based on the premium volume in their respective states. Art.V.2.a.(i)-(iii). The ICC refers to the three groups as "Tiers I, II, and III."

The Compact Statute specifies slightly different processes for the selection of the Management Committee members from each of the three groups. A representative of each of the six states in Tier I serve on the Management Committee each year. Art.V.2.a.(i) The four Management Committee members from states in Tier II are to be selected "on a rotating basis as provided in the Bylaws." Art.V.2.a.(ii). The Members from the four states in Tier III must be selected based on one member each from each of the four NAIC zones, under a process "as provided in the Bylaws." Art.V.2.a.(iii).

The Commission's officers are elected annually from among the members of the Management Committee. Art.V.2.c. If the annual Management Committee selection process results in a Tier II or Tier III state not serving on the Management Committee in any given year, then the Commissioner from that state may not be elected as an officer in that year.

These selection processes for representatives of the states in Tiers II and III, combined with the annual officer election process, raise questions about (1) how a Member from Tiers II and III might choose not to serve on the Management Committee in any given year, and (2) how the Commission can enable officer continuity from year to year when that continuity is desirable.

The elements of these processes specified in the Compact Statute cannot be changed without reopening the Compact Statute in all the Compacting states. However, details of the processes stated in the Bylaws may be amended under the Commission's authority to amend the Bylaws, as long as the amendments do not conflict with the requirements in the Compact Statute. Bylaws, Art. XI.

Under the Bylaws, the four Tier III states are elected by vote of the Compacting States in each of the four NAIC regional zones. Art. III.1.A.(3). In 2020, there are 33 states in the Tier III, with at least five states in every NAIC zone. Because of the number of states in each zone from which that zone's Management Committee member may be elected, Members from the Tier III states effectively have the ability to choose or decline to stand for election in any given year. Those Members have the opportunity to shape their Management Committee service over time in the context of changing circumstances in their state, in their insurance department, and in their personal situation.

The rotation process the Bylaws specify for Management Committee members from Tier II states does not give Members from those Tier II states this same flexibility to shape their service on the Management Committee. That rotation process requires automatic rotation every year of the states from which Management Committee members are selected. The Bylaws expressly state that the process is designed to assure that each state in the Tier II group has the same opportunity to be represented on the Management Committee.

> *[E]ach compacting state in this category shall have an opportunity to be represented for the same number of annual terms on the Management Committee before any other compacting state in this same category is represented for an additional annual term . . .* Bylaws Art. III.1.A.(2)

Under the current premium volume of the Tier II states, this rotation process effectively results in one Tier II state rotating off the Management Committee each year and one other Tier II state rotating on to the Management Committee each year. While assuring that no one state has a disproportionate impact on the governance of ICC through membership on the Management Committee, this rigid rotation process does not offer any flexibility whatsoever for Members in Tier II states to decline Management Committee service from time to time in response to their particular professional or personal situation. The Bylaws do allow for Tier II state Members to resign after they are placed on the Management Committee, but there is no express provision enabling them to pass up placement on the committee <u>in advance</u> of the annual Management Committee composition process. Bylaws, Art. III. Sec. 2. C.

In addition, when the Tier II rotation process dictates that the state of a Commission Officer must rotate off the Management Committee, there is no express provision that would enable the rotation process to flex so that the Officer's state could remain on the Management Committee for an additional year and maintain officer continuity for an additional, consecutive year. While in many years, consecutive, repeat officer service may not be indicated, in some years there may be compelling reasons to enable a Tier II state to stay on the Management Committee and for the ICC officer from that state to be elected for a consecutive year(s) of service.

Appendix L shows amendments that could be made to the Commission's Bylaws to address both of these concerns and allow more flexibility in the Tier II Management Committee membership process. Suggested new language for the Bylaws is highlighted in yellow.

These amendments would:

- Retain the current Tier II rotation system as a default mechanism for selecting the Tier II states each year.
- Expressly authorize a state to pass up placement on the Management Committee from time to time.
- Expressly allow Tier II states to serve consecutive terms on the Management Committee if their Member is serving as an ICC Officer, if the Commission concludes that such consecutive years of service is desirable.

22. Compilation of Recommended Bylaw Changes

Appendix M lists all of the specific Bylaw changes recommended in the above analysis as well as the specific suggested language.

B. Compact Law Issues – Addressing Fundamental Governance Issues

(i) Introduction

Compacts are one of the oldest tools that states have used to exercise their sovereignty, originating before the United States Constitution was adopted. In order to explain and advise on issues related to the Compact Statute and next steps from *Amica Life Insurance Co. v. Wertz*, we first provide some background on Compact Law. We then discuss the *Amica Life Insurance Co. v. Wertz* decision and its possible impact on the ICC, the Compacting States, and filers. We follow with a discussion of congressional consent and the ICC, noting that the ICC has received implied congressional consent. We then discuss the tools and actions available to the ICC to improve the certainty of its filings and stability in its operations, to address the uncertainty and instability created by the *Amica Life Insurance Co. v. Wertz* decision and its troubling application to the Compact Statute saving clause and various Uniform Standards.

(ii) Sources of Law Regarding Compacts

Our nation's long-held principles of federalism recognize that compacting authority is not bequeathed to the states through the United States Constitution. Instead, as the United States

Supreme Court has recognized, states have the inherent authority to enter into compacts through their status as quasi-sovereigns.[74] As a result, compacts present state legislatures with a tool for governance, with congressional involvement unnecessary in order for the compacting state legislatures to create a given compact.[75] The Compact Clause of the United States Constitution serves as a check on states when they are entering into compacts to require congressional approval if the compact subject would encroach on federal authority.[76] The Compact Clause also serves as a source of authority for any compact with express or implied consent of Congress, providing as follows:

> ***No State shall, without the Consent of Congress,*** *lay any Duty of Tonnage, keep Troops, or Ships of War in time of Peace,* ***enter into any Agreement or Compact with another State****, or with a foreign Power, or engage in War, unless actually invaded, or in such imminent Danger as will not admit of delay.*[77]

Although this text may suggest that all interstate compacts must receive the express consent of Congress, the U.S. Supreme Court has ruled otherwise. In the seminal compact case *Virginia v. Tennessee*, the U.S. Supreme Court held that congressional consent is required only where the interstate agreement implicates the supremacy of the federal government:

> *Looking at the clause in which the terms "compact" or "agreement" appear, it is evident that the prohibition is directed to the formation of any combination tending to the increase of political power in the States, which may encroach upon or interfere with the just supremacy of the United States.*[78]

If an interstate compact facilitates only what states could accomplish unilaterally, it does not intrude on federal interests and requires no congressional consent in order to initiate its work.[79] Where congressional consent is required, desired or otherwise occurs, it can be obtained expressly through legislation or implicitly through congressional action that serves as an acknowledgement of the interstate compact.[80]

An interstate compact is like a treaty among the Compacting States, initiated by the states and allowing them to cooperate on multi-state issues that do not conflict with federal authority. United States Supreme Court Justice Louis Brandeis observed in *Hinderlinder v. La Plata River & Cherry*

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[74] *West Virginia ex. rel. Dyer v. Sims*, 341 U.S. 22, 31 (1951) ("That a legislature may delegate to an administrative body the power to make rules and decide particular cases is one of the axioms of modern government…What is involved is a conventional grant of legislative power."); *see* Interstate Compact Law and Use at 17 ("The authority of states to enter into compacts is, in the words of James Madison, so clearly evident that no further discussion is needed.") (citing Madison, Federalist 44 (1788)).
[75] *See Virginia v. Tennessee*, 148 U.S. 503, 519 (1893); Interstate Compact Law and Use at 68.
[76] Interstate Compact Law and Use at 68.
[77] U.S. Constitution, Section 10, Clause 3 (emphasis supplied).
[78] 148 U.S. 503, 519 (1893).
[79] *See United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 472-78 (1978).
[80] *See Virginia v. Tennessee*, 148 U.S. at 521–22 (providing that implied congressional assent arises when Congress acts in furtherance of a compact or acknowledges its effects without objection over a sustained period of time).

Creek Ditch Co. that "[t]he compact…adapts to our Union of sovereign States the age-old treaty-making power of independent sovereign nations."[81]

Compacts are negotiated agreements among states that have the status of both contract and statutory law.[82] Once enacted, the compacting states effectively "share sovereignty" with one another, acting jointly through formation of an interstate agency.[83] As described by one author:

> *[C]ompacts represent the only mechanism in the Constitution by which the states themselves can alter the fundamental dynamics of their relationships without the intervention of the federal government, be they boundaries, substantive law, or even economic relationships. In short, compacts are the only constitutionally recognized mechanism by which states can reorder their organic relationships without running afoul of the authority of the federal government or reordering the federal structure of American government.*[84]

Thus, states initiate compacts and share authority through compacts, and federal law touches all compacts in one way or another. Once enacted, compacts are binding on future state legislatures.[85] If there is a dispute among states, the United States Supreme Court has jurisdiction to hear the matter and to resolve it under federal common law.[86] As well, the Compacts Clause restricts compacts with the potential to alter the balance of power between the States and the federal government by requiring them to obtain express or implied congressional consent. Likewise, the Compacts Clause allows Congress to confer federal authority on a compact by its actions, express or implied. These issues will be discussed in more detail further below.

(iii) ***Amica Life Insurance Company v. Wertz***

In its decision in *Amica Life Insurance Company v. Wertz,* the Colorado Supreme Court held that, "in the context of an interstate compact that has not been approved by Congress, the General Assembly may not delegate to an interstate administrative agency the authority to adopt regulations that effectively override Colorado statutory law."[87] As a result, the Court ruled that the ICC-filed and approved life insurance policy form use by Amica and at issue in the case was not binding on Colorado-issued policies to the extent that the standard did not conform with Colorado insurance law. Specifically, the Court found that, in reviewing the claim made on the policy at issue, Amica must apply the one year suicide exclusion found in Colorado law rather than the two year suicide exclusion found in the applicable ICC life insurance Uniform Standards.[88]

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[81] 304 U.S. 92, 104 (1938) (cited in Interstate Compact Law and Use at 3).
[82] Interstate Compact Law and Use at 3 (citing *Green v. Biddle*, 21 U.S. 1, 92 (1823)).
[83] Interstate Compact Law and Use at 51.
[84] Interstate Compact Law and Use at 3.
[85] In *Virginia v. Tennessee*, Virginia claimed that a prior boundary settlement, approved by the legislatures of both states and subsequently honored by each for eighty-five years, was invalid because the original agreement had not received congressional approval. *Virginia v. Tennessee*, 148 U.S. at 503. The Court held that a prior enacted compact, with implied approval of congress, remained binding on both states. *Id.* at 525.
[86] *See, e.g.*, *Dyer*, 341 U.S. at 28.
[87] *Amica Life Insurance Co. v. Wertz*, 462 P.3d 51, 58 (2020).
[88] *Id.* at 52-53.

The Colorado Supreme Court's assumptions that the Compact is unable to preempt contrary Uniform Standards because it lacked congressional consent were made in the absence of any briefing or other information from any party or amicus.[89] The Court's state-law basis for the *Wertz* opinion is the non-delegation doctrine under the Colorado Constitution, which holds that "the legislature may not delegate its legislative power to another agency or person."[90] Despite our concerns regarding this ruling, we outline the non-delegation doctrine and various portions of the Compact Statute as they are of significant import to the analysis supporting our suggested actions for the ICC.

(iv) Non-Delegation Doctrine

In cases long preceding *Wertz*, the Colorado Supreme Court derived the non-delegation doctrine from multiple provisions of the Colorado Constitution, including its express requirement that "[t]he legislative power of the state shall be vested in the general assembly."[91] The constitutions of numerous other states contain language that has already been, or readily could be, judicially interpreted to impose a similar non-delegation doctrine.[92]

In its review of earlier Colorado precedents, the *Wertz* court opines that the non-delegation doctrine inferred from the Colorado Constitution forbids the legislature from delegating its "power to make law" without regard to whether or not that delegation is used to enact provisions inconsistent with existing statutes.[93] The *Wertz* court notes that, under Colorado constitutional law, the legislature may delegate only the "authority to execute a law," which means "the power to determine a state of facts upon which the law depends."[94] Further, even that limited delegation requires "sufficient statutory standards and safeguards and administrative standards and safeguards, in combination, to protect against unnecessary and uncontrolled exercise of discretionary power."[95] Specifically, the *Wertz* court notes that the Colorado courts have interpreted the state constitution to provide

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[89] *Id.* at 58. As detailed below, no party or amicus argued before the Colorado Supreme Court that the Compact had received implied congressional consent.
[90] *Id.* at 54.
[91] *Id.* at 54, citing Colo. Const. art. V, § 1(1).
[92] Such provisions are pervasive, but identification of them and analysis of their effects is beyond the scope of this report and would require detailed case law research in each compacting state. According to one source, the accuracy of which we have not confirmed, as many as ten compacting states have constitutional provisions that have been interpreted to impose a non-delegation doctrine of some kind. By way of example, the constitution of Pennsylvania, a compacting state, provides that "[t]he legislative power of this Commonwealth shall be vested in a General Assembly." Pa. Const. art. II, § 1. Based on this language, the Pennsylvania Supreme Court imposes a non-delegation doctrine: "[W]hen the General Assembly empowers some other branch or body to act, our jurisprudence requires that the basic policy choices involved in legislative power actually be made by the legislature as constitutionally mandated. This constraint serves two purposes. First, it ensures that duly authorized and politically responsible officials make all of the necessary policy decisions, as is their mandate per the electorate. And second, it seeks to protect against the arbitrary exercise of unnecessary and uncontrolled discretionary power." *Protz v. Workers' Comp. Appeal Bd.*, 639 Pa. 645, 655 (2017) (internal citations and quotations omitted). Applying this doctrine, the Court struck down the portion of a Pennsylvania workers' compensation statute that required physicians to assess the degree of a claimant's impairment by applying the methodology set forth in "the most recent edition" of a publication issued by the American Medical Association. *Id.* at 650.
[93] *Wertz*, 462 P.3d at 54. In other words, it is the delegation itself that is constitutionally impermissible, without regard to how the improperly delegated power is exercised.
[94] *Id.*
[95] *Id.*

that the legislature must "establish…a definite framework for the law's operation" before delegating "the details of rulemaking to an administrative agency to carry out that operation."[96]

(v) Compact Statute – Savings Clause

The Compact Statute includes a Savings Clause that addresses state constitutions inconsistent Compact Statute terms (the "ICC Savings Clause"). Specifically, the ICC Savings Clause provides:

> In the event any provision of this Compact exceeds the constitutional limits imposed on the legislature of any Compacting State, the obligations, duties, powers or jurisdiction sought to be conferred by that provision upon the Commission shall be ineffective as to that Compacting State, and those obligations, duties, powers or jurisdiction shall remain in the Compacting State and shall be exercised by the agency thereof to which those obligations, duties, powers or jurisdiction are delegated by law in effect at the time this Compact becomes effective.[97]

In the absence of congressional consent, the ICC Savings Clause effectively excuses a Compacting State whose state constitution includes a non-delegation doctrine from compliance with the ICC's rules or standards to the extent the legislature lacked constitutional authority to delegate the power to make the standard or rule.

As a practical matter, application of the non-delegation doctrine could manifest itself in one of two ways: negating a single Uniform Standard or negating all Uniform Standards. Both results are explored below. In our view, neither is in the best interests of the ICC.

First, a court may hold that ICC rules or Uniform Standards must yield to state statutes when and to the extent there is a conflict between them. This is the purported "narrow" holding in *Wertz*, which required application of the Colorado statutory standard for suicide exclusions but did not hold that *all* ICC rules or Uniform Standards were unenforceable in Colorado as the product of an impermissible delegation of legislative power.[98] This manifestation of the non-delegation doctrine is neither narrow nor positive for the ICC. Under this paradigm, state statutes must be given effect over contrary ICC rules or standards in all cases, without regard to which outcome is more beneficial to consumers. Granted, as *Wertz* demonstrates, litigation in this scenario is most likely when a state statute establishes a standard more favorable to the policyholder, and Wertz now creates a strong incentive to challenge the ICC rule or standard under the non-delegation doctrine.

Second, a court may hold that, because any delegation of legislative power to the ICC is unconstitutional, *all* ICC rules and standards that exceed what a state administrative agency could accomplish through regulation are unenforceable, irrespective of whether those rules and standards conflict with existing state statutes. Certainly, this scenario would be destructive to the ICC and would have an adverse impact on consumers holding ICC-filed products due to the uncertainly it would create in the Life and Life-related Insurance markets.

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[96] *Id.* at 55.
[97] C.R.S. § 24-60-3001, Article XVI(2)(d).
[98] Wertz, 462 P.3d at 52.

Whether courts in other non-delegation states follow the comparatively narrow approach of *Wertz* or issue broader rulings, in the absence of congressional consent, the ICC Savings Clause will excuse performance of any Compact obligation held to have been incurred in violation of the applicable non-delegation doctrine. Conversely, states that do not have constitutional restrictions on delegation would be bound by the terms of the ICC rules and standards by operation of law.[99] Given the terms of the Compact Statute supporting uniformity that were enacted by all Member legislatures, neither outcome seems to reflect the overall legislative intent of the Compact Statute.

In order to better understand how these various delegation doctrines impact the ICC, we next review the non-delegation doctrine in the context of the various forms of congressional consent – express congressional consent, implied congressional consent or no congressional consent. We then explore how the non-delegation doctrine would impact the ICC's Uniform Standards if each of the three forms of congressional consent is applied to the ICC, and suggestions on next steps for the ICC to protect its overall legislative purpose.

(vi) Congressional Consent and Interstate Compacts

Where interstate compacts work only in an administrative capacity for their member states, the issue of alignment with member state laws is not usually an issue. In comparison, when interstate compacts set policy or establish rules that may vary from the laws of their member states, then the certainty or consistency of such rules is sometimes called into question by member states, competing stakeholders, or other interests.

As noted above, interstate compacts do not always require congressional consent in order to be effective.[100] However, any compact that receives express or implied congressional consent automatically achieves the status of federal law.[101] As a result, while the status of congressional consent must be addressed in any analysis of an interstate compact, it can have particular import where a compact stands at odds with otherwise applicable state law, as the Supremacy Clause of

[99] For example, absent the non-delegation doctrine and issues of congressional consent, the *Wertz* case would present a more straightforward conflict between two Colorado statutes: the Compact as enacted by Colorado (C.R.S. § 24-60-3001) and the general prohibition against suicide exclusions of greater than one year (C.R.S. § 10-7-109). To resolve ordinary conflicts between two statutes, Colorado courts "apply interpretative rules of statutory construction so as to give effect to the [legislature's] intent." *Frazier v. People*, 90 P.3d 807, 811 (2004). In this process, a court will consider "factors such as legislative history, the consequences of a given construction and the goal of the statutory scheme." *Id.* In this regard, the Compact's recitation of its purposes to "develop uniform standards for insurance products covered under the Compact" and to "give appropriate regulatory approval to those product filings…satisfying the applicable uniform standard" provide a compelling demonstration of legislative intent that the Compact's product standards should displace any inconsistent provisions of state law in order to achieve uniformity. *See* C.R.S. § 24 60-3001, Article I(2), (4).

[100] Further, all valid interstate compacts are contracts among the compacting states: "Upon entering into an interstate compact, a state effectively surrenders a portion of its sovereignty; the compact governs the relations of the parties with respect to the subject matter of the agreement and is superior to both prior and subsequent law. Further, when enacted, a compact constitutes not only law, but a contract which may not be amended, modified, or otherwise altered without the consent of all parties. It, therefore, appears settled that one party may not enact legislation which would impose burdens upon the compact absent the concurrence of the other signatories." *C. T. Hellmuth & Assocs., Inc. v. Washington Metro. Area Transit Auth.*, 414 F. Supp. 408, 409 (D. Md. 1976). Unfortunately, this doctrine has limited potential to address the holding of *Wertz* because the ICC Savings Clause, which is part of the contractual agreement among the compacting states, excuses a compacting state's performance to the extent its legislature lacked constitutional authority to incur the obligation.

[101] *Cuyler v. Adams*, 449 U.S. 433, 440-41 (1981).

the U.S. Constitution requires giving priority to the terms of a compact to which Congress has provided express or implied consent.

1. Supremacy Clause

The Supremacy Clause of the U.S. Constitution provides:

> *This Constitution, and the laws of the United States which shall be made in pursuance thereof…, shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the Constitution or laws of any State to the contrary notwithstanding*.[102]

The U.S. Supreme Court holds that this clause "creates a rule of decision" whereby courts "must not give effect to state laws that conflict with federal laws."[103] Accordingly, any conflicting state law (including state constitutional law) must yield to the congressionally-approved compact. *Wertz* itself evidences this, inasmuch as it remarks that interstate compacts having congressional approval "override conflicting state law" based on "federal preemption or supremacy clause principles."[104]

2. Express Consent

Express consent for an interstate compact is typically conferred by a joint resolution of Congress. Congress may attach conditions to its consent. These may involve the duration of the agreement or require member states to act in a certain manner before activation of a compact.[105] The only limitation imposed on congressional conditions is that they must be constitutional.[106]

Conditions imposed by Congress also may be substantive, altering the purposes or procedures mandated by a compact. By way of example, House Joint Resolution 193 (Public Law 104-321) consented to the Emergency Management Assistance Compact in 1996. The joint resolution consists of three parts: (1) the grant of congressional consent; (2) the text of the compact as entered by the participating states; and (3) the conditions placed on Congress's consent, in the form of rules of construction. Where Congress attaches conditions to a compact, member states are deemed subject to them.[107] An interstate compact to which Congress has consented becomes, by virtue of that consent, federal law.[108]

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[102] U.S. Const. art. VI, cl. 2.
[103] *Armstrong v. Exceptional Child Ctr., Inc.*, 575 U.S. 320, 324 (2015).
[104] *Wertz*, 462 P.3d at 58.
[105] *See, e.g., Petty v. Tennessee-Missouri Bridge Comm'n*, 359 U.S. 275, 277-78 (1959) (mandated provisions regarding suability of bridge commission as binding on states because Congress possessed the authority to impose conditions as part of its consent, and the states accepted those conditions by enacting the compact).
[106] *New York v. United States*, 505 U.S. 144, 178 (1992).
[107] *Petty*, 359 U.S. at 281-82.
[108] *Cuyler*. 449 U.S. at 440.

3. Implied Consent

Establishing implied congressional consent, as described below, accomplishes the legal equivalent of express consent.[109] The benefit of implied consent, in some circumstances, is that the consent is provided without any additional conditions imposed by Congress. Implied consent is conferred by Congress through taking action that demonstrates its approval of an interstate compact.[110]

A fundamental case on implied consent, *Virginia v. Tennessee*, involved a claim by Virginia that a prior boundary settlement, approved by the legislatures of both states and subsequently honored by each for eighty-five years, was invalid because the original agreement had not received congressional approval.[111] The Court held that congressional acts subsequent to the boundary agreement, such as apportionment of congressional seats and division of federal judicial districts with reference to the boundary lines established in the agreement, constituted implied approval of the agreement:[112]

> *The Constitution does not state when the consent of Congress shall be given, whether it shall precede or may follow the compact made, or whether it shall be express or may be implied. In many cases the consent will usually precede the compact or agreement…. But where the agreement relates to a matter which could not well be considered until its nature is fully developed, it is not perceived why the consent may not be subsequently given.* ***[Justice] Story says that the consent may be implied, and is always to be implied when Congress adopts the particular act by sanctioning its objects and aiding in enforcing them; and observes that where a State is admitted into the Union, notoriously upon a compact made between it and the State of which it previously composed a part, there the act of Congress admitting such State into the Union, is an implied consent to the terms of the compact.*** *Knowledge by Congress of the boundaries of a State, and of its political subdivisions, may reasonably be presumed, as much of its legislation is affected by them….*[113]

The earlier case of *Green v. Biddle* succinctly articulated the standard for assessing the existence of implied congressional consent as follows:

> *Let it be observed, in the first place, that the constitution makes no provision respecting the mode or form in which the consent of Congress is to be signified, very properly leaving that matter to the wisdom of that body, to be decided upon according to the ordinary rules of law, and of right reason.* ***The only question in cases which involve that point is, has Congress, by some positive act, in relation to such agreement, signified the consent of that body to its validity?***[114]

[109] *Cuyler*, 449 U.S. at 438.
[110] *Virginia v. Tennessee*, 148 U.S. at 521–22; *Cuyler*, 449 U.S. at 441.
[111] *Virginia v. Tennessee*, 148 U.S. at 503.
[112] *Id.* at 525.
[113] *Id.* at 521 (emphasis supplied).
[114] 21 U.S. 1, 85-86 (1823).

Although the above-quoted U.S. Supreme Court cases establishing the doctrine of implied consent and setting forth its requirements are extremely old, they have not been overruled. To the contrary, as detailed in a later section, they have been cited with approval in modern decisions, including by the U.S. Supreme Court.[115]

Like express consent, implied consent confers the status of federal law upon an interstate compact.[116] "[W]here Congress has authorized the States to enter into a cooperative agreement, and where the subject matter of that agreement is an appropriate subject for congressional legislation, the consent of Congress transforms the States' agreement into federal law under the Compact Clause."[117] This transformation occurs automatically under federal law, and does not require any request by the compacting states or work any change to the existing language of the compact.[118]

4. No Consent

As previously discussed, an interstate compact may operate without congressional consent provided that it does not "tend…to the increase of political power in the States, which may encroach upon or interfere with the just supremacy of the United States."[119] Further, the U.S. Supreme Court has held that the participation of many states in a compact and a compact's establishment of an administrative body do not independently establish such an encroachment or interference.[120]

By way of example, the Interstate Compact for the Placement of Children has been held permissible despite its lack of congressional consent because, "[r]ather than altering the balance of power between the states and the federal government, [it] focuses wholly on adoption and foster care of children -- areas of jurisdiction historically retained by the states."[121]

Similarly, the Multistate Tax Compact, which did not receive congressional consent, has been reviewed in a series of state cases known as the *Gillette* line of cases after the compact was challenged in California.[122] In *Graphic Packaging Corporation v. Hegar*, the Texas Supreme Court recognizes that even compacts without congressional consent deserve constitutional protection under the Contracts Clause of the U.S. Constitution where the member states' contractual intent is unmistakable.[123]

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[115] *Cuyler*, 449 U.S. at 441 (citing *Virginia v. Tennessee* and *Green v. Biddle* in support of proposition that congressional consent to an interstate compact may be implied); *id.* at 441 n.9 (finding implied consent for a compact where Congress enacted legislation whereby the United States and the District of Columbia became members of the compact); *see also Star Scientific v. Beales*, 278 F.3d 339, 358 (4th Cir. 2002) (acknowledging the recognition of implied consent in *Cuyler*).
[116] *Cuyler*, 449 U.S. at 441.
[117] *Cuyler*, 449 U.S. at 440.
[118] *Cuyler*, 449 U.S. at 440.
[119] *U.S. Steel*, 434 U.S. at 471, quoting *Virginia v. Tennessee*, 148 U.S. at 519.
[120] *U.S. Steel*, 434 U.S. at 471-72.
[121] *McComb v. Wambaugh*, 934 F.2d 474, 479 (3d Cir. 1991).
[122] *Gillette*-style cases have taken place in at least California, Michigan, Minnesota, Oregon, and Texas.
[123] No. 15-0669, 2017 WL 6544951 (Tex. Dec. 22, 2017).

These compacts and rulings demonstrate that the Contracts Clause can provide a source of support for the enforceability of compacts that have not received any congressional consent, express or implied.[124]

(vii) ICC and Congressional Consent

Historically, the ICC has taken the position that it does not have any congressional consent. In our analysis below, we observe that the ICC has had well-supported implied congressional consent for a number of years. The ICC does not have express congressional consent, but it could advocate for it at any time. The *Wertz* decision has forced the ICC to reckon with these historic positions as they apply to the future of the ICC, especially as they apply to any applicable Compacting State's non-delegation doctrines.

Below, we will address each form of consent as they apply to the ICC. We analyze the ICC's implied congressional consent, whether express congressional consent is required and discuss the risks in continuing to assert that the ICC does not need congressional consent.

1. Implied Congressional Consent

a. Public Law 109-356 and Implied Congressional Consent

The ICC has a strong case to assert that implied consent to the ICC occurred, as a matter of law, through Congress's legislative authorization of the District of Columbia to enter into the Compact in 2006. Specifically, Congress enacted Public Law 109-356 (the "2006 DC ICC Approval"), which included the following provision:

> SEC. 104.
>
> AUTHORITY TO ENTER INTO INTERSTATE INSURANCE PRODUCT REGULATION COMPACT.
>
> (a) In General. The District of Columbia is authorized to enter into an interstate compact to establish a joint state commission as an instrumentality of the District of Columbia for the purpose of establishing uniform insurance product regulations among the participating States.
>
> (b) Delegation. Any insurance product regulation compact that the Council of the District of Columbia authorizes the Mayor to execute on behalf of the District may contain provisions that delegate the requisite power and authority to the joint State commission to achieve the purposes for which the interstate compact is established.

The 2006 DC ICC Approval meets the defined standards for implied consent established in *Green*, as discussed above, because it is very clearly a "positive act" of Congress "in relation to" the ICC. Further, the enactment provides textbook implied congressional consent in that it:

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[124] *Id*.

1. Necessarily acknowledges the ICC's "validity" and "signifie[s]…consent" as required by *Green*, because it would be nonsensical to claim that Congress authorized the District of Columbia to join a compact that Congress considered invalid or regarded as an impermissible incursion upon federal authority;"[125]

2. Specifically names the ICC and does not make its authorization contingent upon the then-existing text of the ICC (as demonstrated by the "[a]ny insurance product regulation compact" language): and

3. Expressly permits "delegat[ion of] the requisite power and authority" to achieve the ICC's purposes.

These actions directly facilitate the ICC (i.e., "sanction[] its objects and aid[] in enforcing them").[126]. Certainly these actions would support an assertion that Congress's authorization of the District of Columbia to enter the ICC constitutes implied congressional consent for the ICC.

The conclusion that congressional action created implied consent is supported by the U.S. Supreme Court's 1981 decision in *Cuyler v. Adams*, which cites *Virginia v. Tennessee* and *Green v. Biddle* with approval on the issue of implied consent.[127] At issue in *Cuyler* was the Interstate Agreement on Detainers ("Detainer Agreement"), an interstate compact that governs transfers of custody over prisoners.[128] Posed with the question of whether Congress had consented to the Detainer Agreement, the Court held that Congress had given both express and implied consent. Express consent arose from the federal Crime Control Consent Act of 1934, which provides blanket express consent for interstate compacts having a particular subject matter (namely, coordination of law enforcement).[129] Critically, the Court then also held that "Congress implicitly reaffirmed its consent" to the Detainer Agreement in 1970, when it enacted legislation (Pub. L. 91-538) providing for the United States and the District of Columbia to enter into the Detainer Agreement.[130] This demonstrates the continued vitality of the implied consent doctrine announced in *Virginia* and *Green*, as well as its modern application by the U.S. Supreme Court outside of the border-dispute context in which it was developed. Indeed, *Cuyler* provides a very direct and relatively recent example of the Court finding implied consent in an act of Congress authorizing participation in an interstate compact.[131]

A crucial point is that implied consent occurs automatically with Congressional action such as the 2006 DC ICC Approval and transforms a compact into federal law. This transformation is not

[125] *See Green*, 21 U.S. at 86.
[126] *See Virginia v. Tennessee*, 148 U.S. at 521.
[127] *Cuyler*, 449 U.S. at 441.
[128] *Cuyler*, 449 U.S. at 435 & n.1.
[129] *Cuyler*, 449 U.S. at 441 & n.9.
[130] *Cuyler*, 449 U.S. at 441 n.9.
[131] *Cuyler*, 449 U.S. at 441 n.9. Needless to say, Pub. L. 91-538 can be differentiated from the 2006 DC ICC Approval because the former involved the United States, in addition to the District of Columbia, becoming a member of the compact at issue. That said, *Cuyler* does not appear to emphasize United States membership as the basis for implied consent, but instead the fact that Congress enacted legislation acknowledging and facilitating the purpose of the Detainer Agreement. Indeed, *Cuyler* names the District of Columbia first when explaining that Congress, in Pub. L. 91-538, "adopt[ed] the Detainer Agreement on behalf of the District of Columbia and the United States." *Cuyler*, 449 U.S. at 441 n.9.

dependent upon a request from the compacting states or the presence of any particular language in the Compact.[132]

b. Implied Consent and *Wertz* Decision

The Colorado Supreme Court did not acknowledge that the ICC had implied congressional consent because, as noted above, neither the parties, nor amici, nor the certification order from the federal appellate court provided any indication that the Court should consider this possibility. The U.S. Tenth Circuit Court of Appeals likewise had no cause to suspect that the Compact had received implied congressional approval when it issued the certification order that initiated consideration of the case by the Colorado Supreme Court.[133] The Tenth Circuit issued its certification request to the Colorado Supreme Court on its own initiative (i.e., without request by either party) after the close of briefing.[134]

The briefing before the Colorado Supreme Court mirrored that before the Tenth Circuit on the issue of congressional approval for the Compact.[135] Accordingly, like the Tenth Circuit, the Colorado Supreme Court was not apprised of any argument that the Compact received congressional approval and, further, had no reason to question the parties' assertions that it had not. After the Colorado Supreme Court responded to the Tenth Circuit's certification request, the Tenth Circuit did not issue an opinion because Amica and Wertz settled on undisclosed terms and stipulated to dismissal of the appeal.[136] Thus, at no point did the Tenth Circuit take an express position on whether Congress approved the Compact, a circumstance that will considerably ease any litigation in federal court to establish implied consent. Likewise, these circumstances, combined with the fact that the question reached the Colorado Supreme Court through certification of a purported state-law issue, all but preordained the Court's assumption that the Compact lacked any type of congressional approval.

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[132] *See Cuyler*, 449 U.S. at 440-41.

[133] Amica, the party seeking to vindicate the Compact, expressly stated in its briefing that "[t]he Compact did not receive or require congressional consent." Appellee's Brief, *Amica Life Ins. Co. v. Wertz*, No. 18-1455 (10th Cir. Apr. 4, 2019), at 5 n.4. Wertz agreed, distinguishing the Compact from certain other interstate compacts on the basis that the Compact had not "received Congressional consent" and therefore did not "express…federal law." Appellant's Reply Brief, *Amica Life Ins. Co. v. Wertz*, No. 18-1455 (10th Cir. Apr. 25, 2019), at 24 n.9. The Commission was not a party in the case. The amicus brief filed by the NAIC and the Commission took no position on the matter, but underscored that the Compact did not require congressional approval, thereby likewise signaling the absence of any issue concerning whether the Compact had received implied approval from Congress. Brief of Amici Curiae, *Amica Life Ins. Co. v. Wertz*, No. 18-1455 (10th Cir. Apr. 10, 2019), at 10 n.2. Before the U.S. District Court, the NAIC did file an amicus brief that stated: "[W]ith knowledge of the Compact and its intended purposes, Congress has also consented to the District of Columbia's entrance into the Compact." Brief of Amici Curiae, *Amica Life Ins. Co. v. Wertz*, No. 1:15-cv-01161 (D. Colo. Oct. 27, 2017), at 12. This remark, which is the extent of the discussion, simply notes that Congress provided approval for the District of Columbia to enter the Compact. The brief does not take a position on whether that action constitutes implied congressional consent for the Compact as a whole under the Compact Clause. Indeed, the brief does not raise the possibility or provide the legal foundation for that argument. *Id.*

[134] No briefing or argument concerning the certification was requested or provided, and neither did the Tenth Circuit issue any opinion stating the reasons it certified a question.

[135] Wertz Opening Brief, *Amica Life Ins. Co. v. Wertz*, No. 2019SA143 (Colo. Sept. 18, 2019), at 21 n.5; *Amica Answer Brief, Amica Life Ins. Co. v. Wertz*, No. 2019SA143 (Colo. Sept. 18, 2019), at 2 n.4; *Brief of Amici Curiae, Amica Life Ins. Co. v. Wertz*, No. 2019SA143 (Colo. Sept. 18, 2019), at 7 n.2.

[136] Notice of Settlement and Stipulation for Dismissal of Appeal, *Amica Life Ins. Co. v. Wertz*, No. 18-1455 (10th Cir. May 14, 2020).

c. Implied Consent and the ICC Savings Clause

Where there is implied congressional consent, the ICC Savings Clause, as described above,[137] no longer excuses a compacting state from the obligation to recognize ICC standards or rules on grounds that the state's constitution forbids legislative delegation of the authority to establish those standards or rules. This result is an outgrowth of U.S. Supreme Court precedent holding that a compact with implied congressional consent is transformed into federal law.[138] Under the Supremacy Clause of the U.S. Constitution, federal law displaces inconsistent provisions of state law (even state constitutional law)[139]. Therefore, where the Compact is federal law, its provisions cannot be a violation of state constitutional law, and a violation of state constitutional law is a required condition for the ICC Savings Clause to apply. In short, the effect of implied congressional consent is that the non-delegation doctrine upon which the *Wertz* court bases its decision must yield to the ICC, which is federal law.

2. Express Congressional Consent

Successfully obtaining express congressional consent would confer the full weight of federal law upon the Compact. This would avoid the result in *Wertz*, which acknowledged that "federal preemption principles" empower congressionally approved compacts to "supersede conflicting state law."[140] The risks to the Compact in pursuing express congressional consent are:

- Invitation for federal interference with operation of the ICC or federal oversight of the products reviewed by ICC,
- Time or delay while Congress acts,
- Politicization of the Compact through advocacy for adding private rights of action or other demands outside the scope of the Compact Statute,
- Suggestion that implied congressional consent has not already been granted,
- A challenge brought based on facts that occurred prior to congressional consent might argue that the express consent demonstrates it had been lacking, and
- Implications of a denial of express consent.

None of these risk would serve as a bar to express congressional consent. However, if the ICC would pursue express consent, its legislative strategy would need to address each of these risks.

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[137] *See* pg. 45 of Report.
[138] *Cuyler*, 449 U.S. at 440-41.
[139] "Under the supremacy clause of the United States Constitution, a conflict between a constitutionally valid federal law and state law must be resolved in favor of the federal law. * * * For supremacy clause purposes, it makes no difference that [the conflicting] provision is found in the state constitution rather than in a state statute." *Gregory v. Ashcroft*, 898 F.2d 598, 600 (8th Cir. 1990).
[140] *Wertz*, 462 P.3d at 58.

3. No Consent - McCarran-Ferguson and the Saving Clause

As discussed above, many compacts do not require express or implied congressional consent because their subject matter is outside the enumerated powers of Congress to regulate (e.g., adoption). Many argue that the ICC does not require congressional consent due to the terms of the McCarran-Ferguson Act.[141] In our opinion, the McCarran-Ferguson Act does not provide comfort as to whether the Compact falls within a full exception to the need for congressional consent. Further, the ICC Savings Clause, as interpreted in connection with the non-delegation doctrine, could create significant risks for the ICC.

a. McCarran-Ferguson and No Consent

Certainly it is true that Congress, under the auspices of McCarran-Ferguson, has generally elected to reserve to the states the authority to regulate insurance. But McCarran-Ferguson is a direct response to *United States v. South-Eastern Underwriters Association*, in which the U.S. Supreme Court held that the Commerce Clause vests Congress with authority to regulate the business of insurance.[142] McCarran-Ferguson effectuates Congress's policy judgment that insurance generally ought to be regulated at the state level. Certainly, Congress has abdicated such authority for almost 80 years without significant amendment. However, due to the underlying Commerce Clause authority, there remains a potential argument that the ICC requires congressional consent.[143] This is particularly so because the ICC seeks to accomplish something that no state acting alone can: it authorizes a multistate administrative body to promulgate Uniform Standards that take precedence over inconsistent state statutes.[144]

There is significant risk to maintaining the position that the ICC has not received congressional consent because it is not necessary due to the enactment of McCarran-Ferguson. The former proposition leaves the Compact exposed to the reasoning in *Wertz* and the non-delegation doctrine, as discussed above. The latter proposition is subject to the counterarguments detailed above, which, if meritorious, expose the Compact to possible challenge under the Compacts Clause insofar as its aggregation of state regulatory authority can be viewed as strengthening the power of states in relation to the federal government.

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[141] Amica Answer Brief, *Amica Life Ins. Co. v. Wertz*, No. 2019SA143 (Colo. Sept. 18, 2019), at 2 n.4 ("Because insurance is within the sole province of the states pursuant to the McCarran-Ferguson Act, 15 U.S.C. § 1012(a)…, the Compact did not require or receive congressional approval.").

[142] 322 U.S. 533, 552-53 (1944).

[143] *U.S. Steel*, 434 U.S. at 472 (noting that "the pertinent inquiry is one of potential, rather than actual, impact upon federal supremacy").

[144] *U.S. Steel*, 434 U.S. at 473 (compact at issue does not encroach upon federal supremacy because it "does not purport to authorize the member states to exercise any powers they could not exercise in its absence"). There is cause to be leery of the argument that the Act supplies implicit consent for the Compact. First, the Act precedes the Compact by many decades, and therefore was not passed by Congress with reference to, in reliance upon, or in acknowledgment of the Compact. *See Green*, 21 U.S. at 85-86. Further, there is a meaningful difference between regulation of insurance by the individual states (which the Act preserves) and regulation of insurance by a group of states exercising power that none has individually (about which the Act is silent).

b. Savings Clause

In the absence of express congressional consent or recognized implied congressional consent, the ICC Savings Clause,[145] as described above, precludes any finding of a breach of the ICC by Colorado in connection with the Colorado Supreme Court's decision to apply Colorado law over the applicable ICC Uniform Standards maximum suicide exclusion period due to the non-delegation doctrine in the Colorado state constitution. *Wertz* holds that the Colorado legislature lacks constitutional authority to delegate power to ICC to promulgate Uniform Standards inconsistent with those set forth in a Colorado statute.[146] In sum, under the assumptions set forth in *Wertz*, standards promulgated under the Compact are unenforceable under Colorado law to the extent they conflict with a Colorado statute.

c. Risks Associated with No Consent Position

The uniform effect of the Uniform Standards could be severely diminished if the ICC does not begin to embrace its implied consent. As noted above, multiple Compacting States share Colorado's constitutional non-delegation doctrine. Further, as is true in Colorado but not presented by the facts of *Wertz*, in at least some of these jurisdictions the prohibition applies irrespective of whether any conflict is created with existing statutes.[147] The challenges posed by *Wertz* are therefore not confined to Colorado, though they are most acute there because of the *Wertz* decision.[148] As a result, state-specific insurance code variations could be asserted by individual insureds or beneficiaries on ICC-approved policy forms for many years to come. These assertions would create uncertainty and instability in certain insurance markets, with no consistency or warning. These risks are the exact concerns that the Commission was formed to avoid.

At this juncture, and in light of the circumstances, embracing implied consent would further the intent for uniformity that is paramount in the Compact Statute. State legislators indicated this paramount intent for uniformity by adding the following terms to the Compact Statute:

> *"[f]or any Product approved or certified to the Commission, the Rules, Uniform Standards and any other requirements of the Commission shall constitute the exclusive provisions applicable to the content, approval and certification of such Products."*[149]

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[145] Compact Statute, Article XVI(2)(d).

[146] *Wertz*, 462 P.3d at 58. Notably, a future Colorado decision could go even further, holding that the non-delegation doctrine precludes any Compact standard that lacks a "definite framework" set forth in a Colorado statute. That is because the non-delegation doctrine forbids **any** delegation of "the power to make law," without regard to consistency with existing statutes. *Id.* at 54-55.

[147] *See, e.g., Protz*, 639 Pa. at 655.

[148] An earlier case before the U.S. District Court for the District of Rhode Island also challenged the ICC's ability to displace inconsistent provisions of state law and resulted in a report and recommendation holding that interest due a life insurance policy beneficiary must be calculated at 9% pursuant to a Rhode Island statute (R.I.G.L. § 27-4-26) rather than at the dramatically lower rate authorized by the applicable ICC Uniform Standards. *N.Y. Life Ins. Co. v. Ortiz*, No. 14-74S, 2014 U.S. Dist. LEXIS 184801, *33-38 (D.R.I. Oct. 20, 2014). The district court judge neither accepted nor rejected the report and recommendation on this point and instead called for supplemental briefing. *N.Y. Life Ins. Co. v. Ortiz*, No. 14-74S, 2015 U.S. Dist. LEXIS 134097, *25-29 (D.R.I. Sept. 30, 2015). The case then settled on undisclosed terms and was dismissed without opinion.

[149] Compact Statute, Section 16(1)(b).

As noted above, implied congressional consent was not achieved by any state backing federal involvement in insurance regulation. Likewise, implied congressional consent is a direct recognition by Congress of the continuing and key role states play in insurance regulation. The ICC does not need to view the *Wertz* decision as controlling for its future. The ICC was not a party to the case and its precedent is questionable since its federal law elements were never confirmed by the District Court. In fact, if the ICC would treat *Wertz* alone as controlling, it would be ignoring the Compact Statute's express legislative intent for uniformity and longstanding legal precedent supporting the right of states to enter into compacts in the manner followed by all 46 Compacting States.

Some would argue that continuing to assert that, in light of *Wertz*, it would be acceptable for the ICC to become a "clearinghouse" for Uniform Standards. Certainly, the term "clearinghouse" is used in the Compact Statute's Purpose clause.[150] However, the term "clearinghouse" is specifically linked to the development and implementation of Uniform Standards, thus requiring the two concepts to be read together. The Compact Statute terms noted above do not support the position that enacting legislators intended for the ICC to serve as a mere clearinghouse for Uniform Standards that may not be applicable to all Compacting States.

If the ICC would not recognize implied consent, then the legislative intent for uniformity and continuity of the Uniform Standards among the Compacting States would be eroded. The potential speed of this erosion is uncertain, and could be accelerated by future litigation or industry action. We suggest that the principles of governing duties, including the duties of care, loyalty and good faith, be applied by the Compacting States as Members consider next steps with this analysis. The risks to the ICC and the Compacting States will have significant implications for many years to come.[151]

C. Risk Mitigation Recommendations

As noted above, the *Amica v. Wertz* decision exposed issues in the ICC structure and brings the ICC to a crossroads where it must decide whether it wishes to challenge the result in *Amica v. Wertz* or to accept its holding and work to understand and contain its effects. Below, we will describe options that range from taking no action to seeking express congressional consent. We provide these options to the ICC with a preface that the options are not ranked or prioritized. Our descriptions below are summaries due to the nature of this project.

(i) Recognize Implied Congressional Consent

The preceding section detailed the strong argument that Congress conferred implied consent for the Compact through its 2006 authorization of the District of Columbia to enter the Compact in Public Law 109-356 (the "2006 DC ICC Approval"). This legislation was unconditional and did not seek to influence the substantive provisions of the Compact.[152] To date, neither the ICC nor any court has acknowledged the 2006 DC ICC Approval as implied congressional consent, more likely due to lack of information than opposition as described above. Since the 2006 DC ICC

[150] Compact Statute, Section 1.
[151] See Section IV(A)(ii) above.
[152] In 2019, the District of Columbia acted on this congressional authorization by joining the Compact. D.C. Code §§ 31-1392.01 - 31-1392.02.

Approval provided implied congressional consent, the Compact has been automatically transformed into federal law at the time of such consent by operation of U.S. Supreme Court precedents that apply to all interstate compacts that have received express or implied congressional consent.[153] No prior action of the legislatures of the Compacting States, a court, or the ICC is necessary for this implied congressional consent to occur and to give the Compact the status of federal law.[154]

The advantage of the Compact having implied congressional consent is that, as even *Wertz* recognized, federal law prevails over inconsistent state law pursuant to the Supremacy Clause.[155] As such, all provisions of the Compact standards and rules would apply notwithstanding the contrary non-delegation doctrines in any Compacting States. We recommend that, using the methods suggested below, the ICC should communicate publicly with its Compacting States, its Legislative, Industry or Advisory Committees and other stakeholders that, based on this Governance Assessment, the ICC has learned that Congress conferred implied consent for the Compact through the 2006 DC ICC Approval. These communications can acknowledge that the Compact Uniform Standards apply notwithstanding any state non-delegation doctrines. These communications can certainly invite stakeholders to conduct their own legal review and open a dialogue on these issues. The ICC's primary goal at this point is to open lines of communication and develop additional confidence in its standards and rules.

1. Issue Advisory Opinion

The Compact authorizes the ICC, upon a majority vote of the participating states, to issue "advisory opinions" regarding "the meaning or interpretation of Commission actions."[156] We recommend that the ICC issue an Advisory Opinion to assert that implied congressional consent occurred through the 2006 DC ICC Approval and to explain the consequences of this consent. An ICC Advisory Opinion would be a public document and could be cited by litigants, scholars, and courts. While others might disagree with the ICC and its analysis, the published Advisory Opinion could serve as a vehicle for the ICC to assert congressional consent of its structure and efforts and to catalyze corroborating analyses from commentators and scholars that can be mobilized in any future litigation patterned after *Wertz*.

2. Product Filings in Response to *Wertz*

We understand from interviews with ICC stakeholders that some ICC filers are amending their life insurance product filings to alter the suicide exclusion period for Colorado policies to one year, This modification comports with the applicable ICC Uniform Standard, which simply provides that "[t]he suicide exclusion period shall not exceed two years from the date of issue of the policy."[157] As such, approval of these amended filings is proper. *Wertz* will remain precedent in Colorado, but that precedent does not require the ICC to act in any manner or to reinterpret its own

[153] *Cuyler*, 449 U.S. at 440 ("where Congress has authorized the States to enter into a cooperative agreement, and where the subject matter of that agreement is an appropriate subject for congressional legislation, the consent of Congress transforms the States' agreement into federal law under the Compact Clause").
[154] *Id.*
[155] *Wertz*, 462 P.3d at 58.
[156] Compact Statute, Article XVI(2)(c).
[157] Individual Term Life Insurance Policy Standards, IIPRC-L-04-I (2016), § 3(Y)(3).

Uniform Standards.[158] Filing companies can weigh their risks and options regarding Colorado claims, and will be aware if the ICC takes a public position regarding implied congressional consent. However, their ICC-filed products will be approved by the ICC within its current authority without any questions regarding approvals outside the terms of existing Uniform Standards.

3. Amend Uniform Standards for Notice

The *Wertz* case will not be the last time a private litigant challenges an ICC product standard. It is essential that the ICC obtains prompt notice of such challenges so that it can evaluate them and, where appropriate, submit amicus briefing or move to intervene as a party. Indeed, each future suit resembling *Wertz* filed in federal court provides a potential opportunity for the ICC to litigate its position on implied congressional consent and possibly obtain a judgment that will effectively moot the decision in *Wertz*. Even in state court cases, however, it is important that the ICC is aware of the arguments being made by private litigants so that it does not lose control of the development of the law concerning the applicability of the Compact and its standards. To this end, the ICC could amend each product standard (during its five year review process or otherwise) to add a requirement that, if a legal challenge is leveled against the enforceability of a Compact standard, the filing company must give the ICC prompt written notice of the suit.

We believe such a requirement is squarely within the ICC's authority under Article VII(1) of the Compact, which confers the power to "promulgate reasonable Rules, including Uniform Standards, and Operating Procedures in order to effectively and efficiently achieve the purposes of this Compact." Because maintenance of uniform standards is a paramount aim of the Compact, requiring carriers to provide prompt notice of any litigation seeking to undermine that uniformity is efficient and reasonable. The carriers will already be parties to the litigation, and thus the burden upon them minimal. By contrast, the ICC would have to expend great resources to monitor litigation nationwide for the assertion of such claims. Even exhaustive efforts would be incomplete and often would lead to discovery of pending matters only after they have significantly progressed, undermining the ability of the ICC to intervene and shape the course of the litigation when and if necessary.

4. Expand Communications

As noted above, the legal principles associated with interstate compacts are complex and, for those unfamiliar with them, seem to be at odds with state sovereignty. However, as discussed above, interstate compacts facilitate state sovereignty and the ICC is certainly a model for facilitating and encouraging state-based insurance regulation. The ICC, the Compacting States and stakeholders, including filing insurance companies, would benefit greatly from both simple and also scholarly explanations of interstate compacts as well as the historical background associated with adoption and implementation of the ICC. The ICC could pursue an ongoing effort for scholarly writings regarding these issues. The ICC could also incorporate this information in periodic trainings for Commissioners and Designees, and in periodic continuing legal education programs for insurance department legal staff who advise Members and Designees.

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[158] *See* Section B(7)(a)(iii) above.

(ii) Pursue Litigation

A federal court judgment recognizing Congress's implied consent to the Compact in 2006 would powerfully mitigate the effects of *Wertz* (and the many similar challenges that are virtually assured to follow). The litigation necessary to obtain such a judgment could be commenced in one of two principal ways. First, as alluded to above, the ICC could intervene as a party in an appropriate dispute between a carrier and a policyholder concerning whether Compact standards are enforceable notwithstanding alleged state constitutional constraints against delegation of legislative authority to the ICC. Second, the ICC could initiate an action for a declaratory judgment that indirectly attacks the result in *Wertz*.

(iii) Not Recognize Implied Congressional Consent

Another option is for the ICC to remain silent on implied congressional consent. If the ICC chooses this route, we suggest that it publicly acknowledge the existence of the non-delegation doctrine in Colorado (and in any other compacting state where future litigation yields appellate authority applying the doctrine to the Compact) and call for the ICC standards and rules to be recognized as binding to the extent that the ICC Savings Clause does not excuse performance. This position could be accomplished through issuance of an advisory opinion from the ICC and publication of clarifications of how the states would address state law variations impacted by the non-delegation doctrine. This approach entails many prominent risks. *First*, it will tend to undermine the ICC's future ability to make a persuasive case that implied congressional consent occurred in 2006, as it represents the ICC taking a position inconsistent with the existence of implied congressional consent. *Second*, it is likely to cause *Wertz*-like litigation to proliferate in Colorado and other compacting states with constitutional non-delegation doctrines. As the number of states and standards implicated by these challenges grows, it will become increasingly difficult for the ICC to maintain consistency of Uniform Standards, which may lead to a significant erosion of one of the Compact's principal aims. For these reasons, if the ICC does not wish to raise implied congressional consent as a shield against propagation of the result in *Wertz*, we advise that it work to obtain a clear understanding of which compacting states have constitutional non-delegation doctrines and to identify the variances between the laws of those jurisdictions and Compact standards.

We anticipate this would be an extremely complex undertaking, because statutes are not the only source of individual states' product standards. Product standards are also affected by regulations, other administrative guidance, and case law, among other potential sources. The inquiry should also extend to whether, in each compacting state with a non-delegation doctrine, the courts are likely to apply that doctrine only in the event of a conflict with an existing statute (which is the approach taken thus far in Colorado, as reflected in *Amica v. Wertz*), or whether past decisions make it more probable that the state's courts will forbid recognition of any Uniform Standard resulting from improperly delegated authority, without regard to whether a substantive conflict with state insurance law exists. Whether courts adopt a narrow or broad approach on that issue, it is important to remember that, where the non-delegation doctrine is held to apply, the effect will be to vindicate state law over the Uniform Standard at issue, regardless of which provides the rule more favorable to consumers.

(iv) Seek Express Congressional Consent

As described above, there is a legislative process for seeking congressional consent for the ICC. Obtaining express congressional consent would transform the Compact into federal law and thereby ensure that all Uniform Standards are binding when product approval is sought through the ICC, regardless of whether state constitutional doctrines restrict delegation of legislative authority. However, seeking express congressional consent carries many serious risks. A top risk is that Congress may exercise its power to place conditions on the ICC, which could include substantive changes to the ICC and/or imposition of binding interpretive guidance.

If the ICC seeks express consent, it could be construed as an admission that implicit consent is absent or uncertain or it could call the ICC standards or rules into question. Further, once in the congressional process, there is no certainty of timing or other political ramifications. For these reasons, we note that the ICC could look to seek express congressional consent, but should do so with extreme caution and only after exhausting reasonable efforts to obtain judicial acknowledgment that implied consent already exists.

D. Tax

(i) Introduction

In 2015, the Interstate Insurance Product Regulation Commission ("Commission") was unsuccessful at obtaining a ruling on its exempt status from the IRS. This memorandum reviews the Commission's prior effort to obtain a private letter ruling and its options for making another attempt to obtain a private letter ruling, incorporating as a tax-exempt entity and other approaches to maintain its tax-exempt status. It explains and outlines our recommended course of action for the Commission as testing the waters with an informal inquiry to the IRS regarding a potential ruling request based on a revised narrative and assessing options based on the feedback received if the Commission is inclined to pursue further efforts to obtain an IRS ruling. It also presents the implications of not taking any action or attempting to obtain tax exempt status under section 501(c)(3) of the Internal Revenue Code (the "Code").

(ii) Background and Private Letter Ruling

The Commission treats itself for federal income tax purposes as an instrumentality of the states with its income exempt from federal income tax under section 115 of the Code. It files corporate income tax returns, but it does not show income or expenses on the tax returns. Its annual tax returns note that the Commission claims that its income is exempt from tax under section 115.

The IRS examined the Commission's 2008 and 2011 through 2015 income tax returns, with each noting that the Commission claims that its income is exempt from tax under section 115. The IRS issued "no change" letters for each of these returns in August 2017.

On January 22, 2015, the Commission submitted to the IRS a request for a private letter ruling (the "2015 Ruling Request") that (i) the Commission was a wholly owned instrumentality of its Compacting States for purposes of section 3306(c)(7) of the Code; (ii) its gross income is derived from the exercise of an essential government function and is excludable from income under section 115(1) of the Code; and (iii) gifts and contributions to the Commission are deductible as charitable contributions. The IRS declined to rule. In explaining why the IRS would not rule, Sylvia Hunt, representing the IRS, identified several points of concern (as reflected in Karen Schutter's notes from a call with Ms. Hunt):

- The IRS officials found that insurance companies were paying the Commission for the privilege of using the Commission and no revenue was received from the states.
- The Commission was controlled by the insurance companies or the NAIC and not by the states. The IRS was concerned that the debt to NAIC and the fact that NAIC was holding off on repayment gave the NAIC substantial control of the Commission.
- Having Puerto Rico as a member was problematic.

Ms. Hunt advised that it was very unlikely that the IRS would ever question the Commission's tax-exempt status. She also advised that it is unlikely that the IRS would formally recognize the Commission as tax- exempt under section 501(c)(3).

(iii) Private Letter Ruling

1. Review of Private Letter Ruling

After reviewing the private letter ruling request and applicable authority, we conclude that the IRS should have been willing to provide a favorable ruling if the Commission was willing to make some tweaks to its organizational documents. However, that does not necessarily mean that the Commission should pursue another ruling request.

The IRS's decision to not rule must be put in perspective. The IRS did not tell the Commission that its income was *not* exempt from tax under section 115. An organization does not need a private letter ruling to claim an exemption under section 115.

Sometimes the IRS's decision not to rule is not based entirely on the merits of a particular ruling request. While private letter rulings apply only to the recipients of the rulings and are not supposed to have precedential value, they do have significant value to other persons. While not technically relying on private letter rulings as legal precedent, tax lawyers and accountants often give great weight to private letter rulings because they reflect the views of the IRS. Practitioners know that the IRS will have difficulty taking one position in one private letter ruling and a different position in another matter without an intervening change in law or new precedential guidance such as regulations or revenue rulings. The IRS is aware of the extent to which practitioners rely on private letter rulings and technical advice memoranda. Consequently, the IRS may be reluctant to rule on "edge of the law" matters or on matters on which the rulings may be used by others with different fact patterns.

The IRS may have chosen not to rule on the Commission's request because it did not want to issue a ruling that an organization could be a wholly owned instrumentality of Compacting States and its income could be exempt from tax under section 115 if the organization received virtually no funding from the states. By not ruling but suggesting that the Commission continue to behave as if it were exempt, the IRS was able to sidestep the issue. On the other hand, the IRS could have been concerned about benefits flowing to insurance companies or other matters.

2. What Can be done to Strengthen Ruling Request

If the Commission seeks a private letter ruling, it will need to make a stronger case for a ruling than was presented in the 2015 Ruling Request. Below, we discuss ways to strengthen the ruling request, including ways to address the concerns raised in response to the 2015 Ruling Request.

a. Change in Facts Requiring No Action

Changes in the relevant facts may make the case for a ruling stronger directly or by addressing some of the IRS concerns expressed with respect to the 2015 Ruling Request.

When the Commission filed the 2015 Ruling Request, it owed NAIC $1.1 million, the loan was nonperforming and it was not clear that the Commission could become self-funded. IRS officials were concerned that the debt gave NAIC implicit control over the Commission. In 2019, the Commission had sufficient revenue to cover its operating expenses and reduce its indebtedness. Under terms of loan agreement, its improved financial situation triggered repayment beginning December 31, 2019. At that time, the outstanding obligation (principal plus interest) was $3.45M.

Notably, 2019 was a unique year for revenues due to a change in mortality tables and other changes that caused an increase in filings. It is not clear that the increased revenue level will continue. The Commission is trying to renegotiate terms as it cannot repay loan and remain in the black. Consulting firm Rector & Associates is conducting a parallel "Business Assessment" on the ICC and will provide analysis of this debt.

Changes to the Commission's financial situation that make the Commission less dependent on NAIC would be helpful in a ruling request primarily because the Commission will be able to point out that it has eliminated one of the factors that the IRS had previously indicated was problematic. Nonetheless, we do not view the existence of the loan as a valid IRS basis for denying the Commission's request to be recognized as tax-exempt under section 501(c)(3) – particularly given that the IRS has recognized NAIC, the source of the loan, as a government unit. It is not appropriate for the IRS to assume that a loan inherently indicates control.

b. Change in Facts Requiring Action

The Commission can improve its ruling position by making certain changes in its governance documents or practices. Some of the changes may be relatively easy to make and some may be impractical or impossible. We have identified possible changes below.

i. Members that are not States

To qualify for favorable tax treatment, the Commission must be an instrumentality of the states and its income must inure to states. The Commission has Members that are not states, which is not unusual. However, the "inurement to states" requirement may be a source of concern to the IRS. We previously confronted this issue when we assisted the Southern Governors Association (the "SGA") in obtaining a favorable ruling that it was an instrumentality of the states and its income was exempt under section 115. The Governors of Puerto Rico and the Virgin Islands were dues paying members of the SGA. We wrote the liquidation provision of SGA's Articles of Incorporation so that the non-state members would not share in proceeds if the SGA was liquidated. That satisfied the IRS. The Commission could amend its governing documents in a similar manner to change the facts that raised IRS concern at the time of the 2015 Ruling Request.

In Rev. Rul. 57-128, the seminal ruling on instrumentalities of multiple states, the membership of the association (which happens to have been NAIC) included commissioners, directors, superintendents or other officials charged with supervising the insurance business within their respective states, territories, etc. The fact that territories and insular possessions were members did not prevent the IRS from issuing a favorable ruling. NAIC's current Certificate of Incorporation, as posted on its website, states that upon dissolution after satisfaction of liabilities, the Executive Committee shall dispose of all of the assets of NAIC "equitably to any state government which is represented as a member of NAIC" or to one or more exempt organizations.

While there is no guarantee that the Commission's adoption of a dissolution clause that excludes territories and possessions would address IRS concerns, we recommend an adjustment to the dissolution clause if the Commission seeks a private letter ruling. Such change would also be advisable if the Commission does not seek a private letter ruling but wants more comfort that its claimed exempt status is sustainable. We understand that such a change would require an amendment to the Commission's bylaws, but is unlikely to require legislative changes by Members.

ii. State Funding

Currently, the Commission collects directly from insurance companies both the Commission's fees as well as any fees that states charge insurers. The Commission then remits the state portion of the fee to the states. Since inception, the Commission has collected over $22 million in direct and retaliatory filing fees for many (but not all) of the Compacting States, and over $17 million in Commission fees. While we are not convinced that funding directly from the state is needed for the Commission to obtain a favorable ruling, the case for a ruling will be easier if the Commission receives some state funding. Several options for accomplishing this should be considered.

First, states could pay nominal dues to the Commission. In PLR 8544015, revenue from fishing licenses was the primary source of funding for a body corporate created pursuant to an interstate compact entered into by participating states to promulgate regulations governing fishing in a river flowing through the states. Each state made a $1,000 annual appropriation to support the activities of the body corporate. The IRS ruled that the income of body corporate was not includable in gross income under section 115. Charging Compacting States nominal dues could be a viable option for the Commission if Compacting States have sufficient discretionary funds that could be used to pay these nominal dues. This approach would be complicated for Compacting States that require state-law appropriations or changes to state law to pay dues. We understand that there likely are several states in this situation and that some (if not most) of these states may not obtain the necessary appropriations or state law changes for even a nominal payment of dues to the Commission.

Second, the Commission could demonstrate financial support from states by modifying the fee payment arrangement. States could collect fees from insurers and remit the Commission's share to the Commission – rather than the current arrangement where the Commission collects the fees and remits the state portion to the states. In PLR 85444015, the states collected the fishing license revenue and remitted all but 50 cents per license to the body corporate whose gross income was determined to be exempt from tax under section 115. It is our understanding that this type of change could likely be worked out without legislative action. We understand that not all states charge fees to insurers. If this approach is considered, the Commission would need to determine the number of states in this situation and whether these states have a mechanism to collect the Commission fees. Arguably, however, changing the payment process for a portion of the states, even if not all Compacting States, would demonstrate financial support from the states.

Third, if it is impractical or impossible to change the funding arrangement so that states collect fees from insurers and remit a portion to the Commission, the Commission should consider whether it would be possible to re-characterize what is happening from an accounting perspective, without any actual changes in the flow of funds. The Commission could be described as collecting the entire amount from insurers on behalf of the states and then paying itself from the states' shares of revenue. The concept here would be to treat the full amount as a payment to the states from the insurers so that the portion retained by the Commission could be treated as a fee paid by the states to the Commission for services provided on their behalf.

c. Change in Arguments

The 2015 Ruling Request was prepared without knowing what issues would trouble the IRS. With a new ruling request, the Commission would be able to strengthen some components of its rationale to respond to the concerns informally expressed by the IRS in 2015.

i. Control by and Relationship with NAIC

The IRS comments in response to the 2015 Ruling Request suggest that the IRS viewed NAIC as if it were a private sector trade association controlled by the insurance industry as opposed to an organization that is considered a governmental unit. NAIC, the subject of Rev. Rul. 57-128, is recognized by the IRS as a section 501(c)(3) public charity. In addition, in a December 20, 1999 letter, the IRS determined that NAIC is a "governmental unit" within the meaning of section 170(b)(1)(A)(v). As such, it is not required to file Forms 990 because it is an arm of a state or local government. If the Commission seeks a new ruling, we suggest including a description of NAIC, including how it is governed and how it raises funds. A ruling request also should clearly present NAIC as a nonprofit organization representing state officials and demonstrate that NAIC does not control state insurance laws on behalf of the insurance industry. This would enable the Commission to argue that even if NAIC is viewed as exerting control, there should be nothing wrong with a "governmental unit" having control. A comparable group of government officials controls NAIC.

As noted above, a new ruling request should build an argument that tax law does not usually look at lenders when determining who controls an organization. Nonetheless, the IRS claim that NAIC has too much control can be eliminated if the indebtedness is cancelled or substantially written down, and if some of the governance reforms referenced above are also addressed. It also is weakened if the Commission's debt to NAIC is restructured so that the Commission will not be in default and NAIC will not be able to call the debt or otherwise exercise default remedies for an extended period of time.

ii. Operated for the Benefit of the States

The 2015 Ruling Request includes a section on the Commission's success with respect to the increasing number of insurance companies registered and the number of filings between 2008 and 2014. This message should be reframed to highlight the ways in which the Commission's success has helped the states – rather than the insurance companies. A new ruling request should discuss the priorities of insurance commissioners within their states, including promoting consumer protections against bad actors in the insurance industry and protecting the insurance market in their states to ensure that residents have access to insurance products. Notably, the Commission helps states with respect to the latter. Further, the fact that insurance companies pay fees to the Commission is not inconsistent with the position that the Commission acts to benefit its Compacting States. It is typical for regulated entities to pay fees to their regulators – in practice and in IRS letter rulings.

iii. Need for State Funding

Rev. Rul. 57-128 sets forth six factors for determining whether an organization is an instrumentality of one or more states and political subdivisions. The IRS has used these six factors in many of its rulings on whether multi-state entities are instrumentalities of states. An entity does not have to meet all of the factors to be an instrumentality. The sixth factor is "the degree of financial autonomy and the source of its operating expenses." The factor indicates that the IRS should look at the source of an organization's operating expenses, but it does not say that source needs to in whole or part funds from the states. In Rev. Rul. 57-128, NAIC's income was "derived principally from amounts assessed against insurance companies by the insurance departments of the various states and by state contributions."

The IRS has generally held that where (i) the principal source of an organization's operating expenses is derived from state or local governments and (ii) the state and local governments have the ability to oversee use of these funds, the organization qualified as an instrumentality. This does not mean that both conditions need to be satisfied. The Service rejected instrumentality claims where an organization received no funding from state or local governments **and** no government had the ability to oversee the use of funds. See, e.g., Rev. Ruls. 69-453 and 65-26. A new ruling request also could suggest that because all fees are assessed pursuant to state legislative authority and at the direction of state officials, the correct focus is the state assessment authority rather than the source of funds. We believe that an argument can be built that the ability of governmental officials (in their official capacities) to oversee the assessment and use of the funds is sufficient.

PLR 8243165 involved an entity formed by a number of states pursuant to an interstate compact created by U.S. law to research and develop energy for regions comprised of Compacting States. The IRS concluded that the income of the entity was exempt from tax under section 115 even though the full cost of its operations and activities were to be paid from funds received pursuant to grants, contracts or other means from the Federal government. That entity apparently received no state funding.

A more thorough review of section 115 rulings may identify other compact entities that received favorable rulings without having any revenue from state contributions.

iv. Other Considerations

The possibility of a negative ruling from the IRS should weigh heavily on a decision as to whether to proceed with another ruling request. The Commission would need to disclose that it had previously sought a ruling request and the IRS chose not to rule.

Before submitting a ruling request, the Commission can do a pre-submission conference with the IRS. This generally requires the production of what we might call a mini-ruling request with arguments and analysis, but does not require the payment of a fee or, the preparation of a formal ruling request. If the IRS participants in the pre-submission call or meeting indicate that the IRS would be unlikely to rule or unlikely to rule favorably, the Commission would not need to move forward. There is still a risk that the IRS would view the Commission as a fee-for-service organization for the industry as opposed to an instrumentality of the states as described in the 2015 Ruling Request.

v. Cost of a New Ruling Request

The IRS charges a user fee for private letter ruling requests. The basic user fee for this type of request would be $30,000 under the IRS's current fee schedule.

The IRS has strict requirements for what must be included in a ruling request. In addition, as discussed above, some arguments would need to be carefully developed through additional research and analysis. A new request for a ruling would likely require lawyers with multiple areas of expertise and substantial back-and-forth between Commission staff and outside lawyers. Legal fees for preparing a ruling request could be in the range of $100,000 to $125,000, though the work could be done for considerably less than that if the goal is to produce a good rather than an outstanding ruling request. Approximately, half of these fees would be incurred through the time of the pre-submission conference. The remainder would be incurred for the preparation of the actual ruling request and conference with the IRS after submission. This is in addition to legal assistance with any changes to the operation of the Commission to increase the likelihood of a successful ruling.

Note that IRS lawyers will talk to parties that plan to submit ruling requests and often will give them some indication of the likelihood that the IRS will rule favorably without a formal pre-submission conference.

d. Section 501(c)(3) Organization

An organization of state officials can obtain recognition of tax-exempt status as a 501(c)(3) organization by reason of lessening the burden of governments. Examples include NAIC, National Lieutenant Governors Association, the Council of State Governments and the Education Commission of the States. With appropriate organizational changes, the Commission may be able to qualify as a section 501(c)(3) organization.

i. Exempt Purpose Issues

The 2015 Ruling Request makes a strong case that the Commission lessens the burdens of state governments by undertaking functions that state governments would otherwise undertake.

Nevertheless, IRS officials seemed concerned that the Commission's primary purpose was to lessen the burdens of insurance companies, rather than state governments. If the Commission were able to meet the organizational requirements for qualifying for section 501(c)(3) status described below, the principal issue relating to 501(c)(3) status would be whether the Commission is organized primarily to lessen the burdens of state governments, with any benefits to insurance companies being incidental.

The Commission lessens both the burdens of insurance companies and burdens of the states. Which purpose is primary may not be clear. The history of formation may be relevant but not conclusive. Even if the Commission was formed at the suggestion of the industry, governments frequently take action for the primary benefit of themselves or their constituents even though those who advocate for it stand to obtain incidental benefits. The IRS should not be challenging or questioning the motives of the 43 state legislatures (plus DC) that took action leading to the formation of the Commission or their inclusion in the compact. But that is exactly what the IRS did in deciding not to rule on the 2015 Ruling Request.

ii. Organizational Tests

To qualify for tax-exempt status under section 501(c)(3), an "organization must be a legal entity (corporation, trust or association) separate from its organizers and must have written articles of organization." IRS Publication 557 (January 2020) at page 24. Its articles of organization may be a corporate charter, such as filed articles of incorporation; a trust instrument; articles of association or any other written instrument by which the organization was created. Id.

To qualify for tax-exempt status under section 501(c)(3), an organization's articles of organization must limit the organization's purposes to one or more purposes for which section 501(c)(3) organizations can be formed. Usually this is done by tracking language from the Code. In this case, we would be looking for language similar to the following: "The Commission is formed exclusively for charitable purposes within the meaning of section 501(c)(3) of the Internal Revenue Code, including lessening the burdens of government." In addition, the articles of organization must not expressly empower an organization to engage, other than as an insubstantial part of its activities, in activities that do not further one or more exempt purposes. IRS Publication 557 (January 2020) at page 24. These requirements are not satisfied if the limitations and purposes are included only in bylaws or other rules and regulations.

Tax law also requires that a section 501(c)(3) organization's assets be permanently dedicated to exempt purposes. That means that should the organization dissolve, its assets must be distributed for an exempt purpose (such as to another section 501(c)(3) organization) or to the federal government or a state or local government for a public purpose.

The Commission does not have Articles of Incorporation or any equivalent organizing document. It was formed as the result of the legislative enactments by the Compacting States. To obtain tax-exempt status as a 501(c)(3) entity, the Commission will need a structure similar to a corporate structure with Articles of Incorporation or a charter, in addition to bylaws. Thus, the Commission would need to incorporate or develop a charter that binds Compacting States to qualify for exemption under section 501(c)(3). This would not be an easy task and is likely to require new legislation from the states, which, we understand, is probably not a viable option.[159]

An additional concern, emphasized in our discussion with an expert on interstate compact law described below, is that incorporating could be viewed as inconsistent with the Commission's status as a government instrumentality by making it look more like a private entity. Incorporation could also threaten the basis for the Commission's authority, which is delegated to it by state legislatures. The state legislatures are unlikely to be able to delegate regulatory authority to a private entity, such as a corporation. Notably, the interstate compacts that have incorporated and obtained tax-exempt status under section 501(c)(3) of the Code generally are not those that have rulemaking or regulatory authority.

iii. Procedure, Cost and Consequences

Once a state nonprofit entity is formed, it must file an application for recognition of its tax-exempt status with the IRS. The application also serves as a request for determination that contributions to the organization are deductible from tax.

The application is filed online using Form 1023. We can provide a pdf of the complete application, but the online version does not allow a user to scroll from one section to the next unless all questions are completed. In addition to identifying information, the application requires a detailed narrative discussing its past, present and future activities, when the activities were or are expected to be undertaken and how they will contribute to its exempt purpose. The organization will also need to provide detailed financial data covering the last four years.

It is difficult to predict how long the IRS will take to process an application for tax-exempt status. The IRS has indicated that it is taking about 6 months to respond, though recently received a positive response in less than 7 weeks, granted, this was a relatively noncontroversial application. If the application is selected for careful review, the IRS may take over ten months to process the application. The IRS may seek answers to additional questions or seek additional documents before issuing a determination letter.

The IRS charges a $600 fee for the application. There also will be legal fees related to the application process as well as the amendment or preparation of articles of incorporation, bylaws and other organizational documents. While formation of new charitable section 501(c)(3)

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[159] We reference for completeness an alternative path to qualify for exemption under section 501(c)(3), but we do not recommend the path. Under the path, the Commission would form a new nonprofit corporation under the laws of a state, draft articles of incorporation that will meet the organizational test, draft bylaws that will meet the organization's governance goals, and adopt policies that the IRS likes section 501(c)(3) organizations to adopt. The Commission would agree to transfer all of its assets (possibly subject to its liabilities) to the new nonprofit organization after the IRS recognizes the tax-exempt status of the new organization. If the IRS declines to issue a favorable ruling, the new organization would be dissolved. If successful, this path would provide more definitive answers as to potential liabilities of officers, directors and members. It also eliminates the risk that the Compact would lose its section 115 exemption without obtaining exempt status under section 501(c)(3).

This path raises significant material questions including whether forming a new corporation would violate the Compact by exceeding the authority granted to the Commission by the states. Another key concern is how the corporate form will affect the states, particularly whether states will need to re-ratify or approve legislation.

organization is not usually an expensive proposition, this project would have unusual complications. If the Commission determined that the project could be undertaken, we estimate that legal fees could exceed $100,000.

If the Commission files for tax-exempt status and the IRS recognized its tax-exempt status, the determination would be effective when the application was filed. If a new corporation is formed and the new corporation files for recognition of tax-exempt status within 27 months of formation, the determination would be retroactive to the date of formation.

A section 501(c)(3) organization generally must file annual information returns with the IRS on Form 990. The returns include information on corporate governance as well as financial information. However, if the organization is categorized as a governmental unit like NAIC, it should not have to file a Form 990.

e. Section 501(c)(4) Organization

Section 501(c)(4) of the Code provides an exemption for nonprofit organizations that promote social welfare. Technically, the Commission could seek recognition of tax-exempt status under section 501(c)(4). Section 501 (c)(4) organizations have the same exemption from income tax on their earnings as do section 501(c)(3) organizations. Similar to the 501(c)(3) organization option, we do not view a 501(c)(4) exemption as a viable option for the ICC.[160]

[160] Promoting social welfare is an expansive concept. Virtually all activity that qualifies for exemption under section 501(c)(3) promotes social welfare. Section 501(c)(4) organizations must operate primarily to further the common good and general welfare of the people of a community by bringing about civic betterment and social welfare. They are often formed to influence public policy by engaging in grassroots lobbying, direct lobbying and educating the general public and decision makers. They also can engage in a small amount of political activity (i.e., support of or opposition to a candidate for public office). In contrast, entities that are exempt from taxation under section 501(c)(3)) are prohibited from engaging in any political activity and may engage in only a small amount of lobbying or grassroots lobbying.

The primary reason for pursuing an exemption under section 501(c)(4) rather than 501(c)(3) in this case would be that the IRS is more forgiving and seems to pay less attention to 501(c)(4) organizations because less is at stake (no charitable deduction). In this case, however, the magnitude of the organization's revenue and expenses could draw additional attention and the organization would not receive recognition of tax-exempt status under section 501(c)(4).

Seeking tax-exempt status under section 501(c)(4) for the Commission in its current form could raise a number of technical issues. If the Commission claims to be exempt from taxation under 501(c)(4), it could be subject to penalties for not previously notifying the IRS of the claim and could be subject to penalties for not filing Form 990. The law is not clear on how an organization can make a prospective only claim for 501(c)(4) exempt status. These technical issues go away if a new corporation is formed, but the Commission would have to confront the issues discussed above in connection with a new corporation seeking recognition under section 501(c)(3).

(iv) Maintain Status Quo and Not Seek Recognition and Exemption

1. Reasons for Not Seeking Recognition of Exempt Status or Exempt Income

Several considerations point toward the Commission not applying for recognition of tax-exempt status or recognition that its income is exempt from tax under section 115.

- The Commission has received informal advice from the IRS that its current status will not be challenged. The fact that the Commission was audited and received a "no change" letter supports this informal feedback from the IRS. The analysis is this document indicates that the Commission's income should be exempt under section 115 (though it may be prudent to make some minor tweaks to strengthen the position).

- The majority of interstate compacts operate as tax-exempt entities without a ruling from the IRS. This fact reinforces the concept that most compacts are government instrumentalities by virtue of their basic functions and structures. Requesting a ruling from the IRS runs counter to this view – suggesting that they need IRS approval of their tax-exempt status.

- The outcome of a ruling request cannot be guaranteed. If the Commission legitimately fails to meet requirements for exemption, seeking a ruling will not help its situation (but see reasons for seeking a ruling).

- The application process and the other organizational actions required to improve the likelihood of success may be difficult to implement – and are costly.

- The consequences of becoming taxable may not be significant if the Commission is operating at a breakeven level before payment of principal on debt.

2. Risks of Not Taking Action

While the successful IRS audit may counter the legal uncertainty related to the IRS's previous refusal to issue a favorable ruling, the audit results should not be relied on too heavily. From the IRS perspective, there is little at stake when expenses exceed revenue and the denial of exempt status would not generate tax revenues. The IRS could take a different view if the Commission's financial position changed and the IRS could collect revenue by changing its position in a future audit, though is unlikely to do so retroactively. Thus, there is some risk of not taking action.

Generally, the statute of limitations on federal income tax liability is three years from the later of the due date for the return or the date on which the return is filed. In the case of fraud and certain substantial understatements, the IRS can reach back six years. In this case, where the IRS completed an audit and accepted returns as filed and in which the Commission continues to file corporate returns claiming the section 115 exemption, we find it highly unlikely that the IRS would seek to reach back six years if it changed its position. We would not even expect the IRS to reach back three years, other than as a tool to get the Commission to agree to pay taxes for the year under audit and future years. The tax picture would be affected, in part, by whether the Commission had income or losses for tax purposes. It is possible that the Commission would want to reach back to be able claim and carry over net operating losses.

Failure to have a definitive ruling on tax status could interfere with the Commission's ability to obtain third-party financing. Lenders often undertake careful due diligence and are concerned about possible liabilities.

Organizations sometimes seek greater tax certainty to avoid potentially adverse footnotes in audited financial statements. This may be important to investors (not applicable here), state auditors, or third parties that rely on the financial position of the organization. In this case, a potential tax liability to the IRS may be a greater concern to third parties than liabilities to the friendly NAIC. Nonetheless, given the fact that the majority of interstate compacts do not have rulings from the IRS on their tax-exempt status, state auditors should be accustomed to dealing with such compacts and the lack of a ruling should not interfere with the compact's ability to obtain a clean audit.

Not seeking a ruling could create a lost opportunity. If the Commission were to seek a ruling and the IRS were inclined to rule favorably, the IRS may require the Commission to take particular steps to obtain a favorable ruling. It would be hard to determine what those steps are without seeking a ruling. Continuing to operate without taking the steps, which may not be known unless a ruling is sought, could present risk.

Note that even if the IRS issues a favorable ruling, it can revoke the ruling prospectively. It is not a guarantee of favorable tax position forever. It is more a guarantee that any action that the IRS takes to impose tax on the Commission would be prospective.

3. Possible IRS Challenges

If the Commission's tax status is challenged in a future audit, we recommend that the Commission seek a technical advice memorandum. Such a request would likely be reviewed by the same team that would handle a private letter ruling request, but the IRS would need to make a decision. However, we have resolved matters with IRS in situations where we knew they did not want to have a published TAM.

4. Minor Changes to Protect Position

If the Commission chooses not to seek recognition of the tax-exempt status of the Commission or its income, it would continue to assert that its income is exempt under section 115. In such case, the Commission should consider making changes that would strengthen its tax position. Thus, the Commission should consider each of the changes suggested to improve its chances to obtain a favorable ruling and proceed with changes that can be made without legislative action or major inconvenience. In particular, it should consider modifying its dissolution clause to limit sharing of liquidation proceeds to states.

(v) Forgo the Section 115 Exemption

Occasionally organizations that could claim a tax-exemption choose not to claim one. Some reasons that organizations have chosen not to claim an exemption follow:

- The organization does not want to meet one or more requirements of obtaining the exemption even though the organization is capable of meeting the requirements.
- The organization does not expect to meet requirements for exemption in the future and wants to begin building net operating loss carryovers to years in which it will be taxable.
- The organization wants independence from the government. (A tax advocacy organization gave up its tax-exempt status because it saw a conflict between its advocacy and the IRS's ability to regulate its behavior through rules applicable to exempt organizations.)
- The exemption looks bad. Some of the sports leagues that held exemptions purportedly gave them up because they looked bad.

In this case, we could see the Commission ceasing to claim a section 115 exemption if it had serious doubts as to whether it qualified, expected the IRS to eventually determine that it did not qualify and wanted to begin building net operating loss carryovers for the time when it would be taxable. We do not think that the Commission should have serious doubts as to whether it qualifies for a section 115 exemption. The IRS has audited the Commission. Compacts frequently hold section 115 exemptions without receiving private letter rulings.

(vi) Insights from Rick Masters

As part of this review process, we discussed tax matters with Rick Masters, a compact law expert who serves as special counsel to the National Center for Interstate Compacts, affiliated with the Council of State Governments. His view is that most compacts are, by default, instrumentalities of government and are tax exempt on this basis. He strongly discourages compacts from incorporating – particularly, as with the ICC, where the compact serves a regulatory role. His position is based on a compact's authority being derived from a delegation of authority by state legislatures and that state legislatures are unlikely to have authority to delegate rulemaking and other regulatory actions to a private entity. Masters' view is that incorporating a compact makes the compact look more like a private entity than a governmental entity – undermining the position that compacts are instrumentalities of governments.

Masters indicated, based on his extensive research and work with compacts, that the majority of compacts are tax exempt based on their status as government instrumentalities under section 115 of the Code and that most of these compacts do not have IRS rulings on their status as government instrumentalities. Further, he does not believe that a ruling is necessary, as it should be sufficiently clear that these compacts are government instrumentalities. Research previously prepared for the Commission[161] that we have reviewed identifies only 10 compacts (out of around 180) with such rulings. While this research does not cover rulings published since 2015, Masters does not believe there have been many, if any.

[161] Memorandum from Rick Masters to Karen Schutter (July 23 2014); Memorandum from Allan J. Weiner (Kelly, Drye & Warren) to ICC Officer and Executive Director (October 16, 2008); and Memorandum from Douglas K. Anning (Polsinelli) to Karen Schutter (December 28, 2015).

Finally, Masters indicated that, generally, the compacts that incorporate and file for tax-exempt status under section 501(c)(3) of the Code are those that perform a primarily research or policy function, such as the Education Commission of the States.

(vii) Recommendation

We do not see a strong, significant or compelling need for the Commission to obtain a ruling from the IRS. However, if the Commission is inclined to "test the waters," we recommend beginning by seeking an informal conference with the IRS to assess the likelihood of a favorable ruling and the steps necessary to obtain one. The Commission can use this opportunity to clarify the facts and communicate a persuasive narrative of the Commission's function and relationship to NAIC. Before seeking the informal conference, the Commission should analyze the viability of the various options for changing the facts and addressing the concerns expressed by the IRS in response to the 2015 Ruling Request. Ideally, the Commission should make some changes, such as modifying the dissolution clause in the bylaws, before the conference. In addition, the Commission should determine whether other changes, such as Compacting States paying nominal dues, are viable so that those participating in the conference know what they can and cannot offer in response to IRS questions. In some cases, stating that the Commission cannot do what the IRS proposes may actually strengthen an argument that the Commission is an instrumentality of the states.

If informal outreach to the IRS results in a *strong* positive response without a need for material changes that the Commission would have difficulty making, the Commission should make the changes that it can reasonably make (and that counsel advises are likely needed to obtain a favorable ruling) and then seek a ruling. If the IRS seeks changes that are impractical to make (for example, because they require legislative action by states), we recommend not seeking a ruling. Similarly, we would not recommend seeking a ruling if the IRS does not provide a strong indication that it would likely rule favorably even if the IRS were to encourage the Commission to seek a ruling so that the IRS could look at all the facts in a more formal manner.

If the response from the IRS is not encouraging and the Commission decides not to seek a ruling, we suggest taking steps to try to improve the tax position in case of a challenge (such as fixing the dissolution provisions), but not to undertake steps that require state legislative action.

Most importantly, the Commission should avoid any actions that may create a trap without recourse, such as seeking ruling request without having high degree of certainty as to outcome or transferring assets to a possible new exempt organization without first receiving a favorable ruling for the new entity.

V. AUTHORS AND CONTACTS

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