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IS U.S. INSURANCE REGULATION UNCONSTITUTIONAL?

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Abstract: Insurance regulation is ostensibly the primary domain of the states. In practice, however, the most important and powerful entity in insurance regulation is not a state at all, but a non-profit corporation known as the National Association of Insurance Commissioners, or NAIC. Much of the NAIC's power lies in its production of various "handbooks" and "manuals" that have the force of law because they are incorporated by reference in state insurance codes. Under this statutory scheme, when the NAIC updates or changes its various manuals, handbooks, or accounting forms, it also changes state insurance regulation. Because the NAIC is a private entity, it produces these various materials that have the force of law without being bound by any safeguards that ordinarily accompany the production of regulation, whether at the state or federal level. Moreover, the NAIC uses its unique accreditation program to directly pressure state legislatures to delegate this authority to it. This Article argues that this scheme violates basic separation of powers and non-delegation principles embedded in every state Constitution. Under any reasonable version of these principles, the delegation of state regulatory authority to a private entity that directly pressures legislatures to make this delegation and whose actions are not reviewable through any formal judicial or administrative process is unconstitutional. Recognizing this conclusion has the potential to improve state insurance regulation by increasing the accountability of state regulators and the NAIC. But it also carries the risk of undermining state insurance regulation by frustrating efforts to promote uniform national standards. However, this Article suggests that state legislatures can enact reforms that simultaneously remedy the unconstitutional structure of state insurance regulation while preserving the many practical benefits that flow from delegating production of regulatory standards to a single, national entity like the NAIC. In particular, they can establish an entity through an interstate compact that is truly independent from state insurance regulators and that is empowered to review the NAIC's production of regulatory materials that have the force of law.

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INTRODUCTION

Insurance regulation is ostensibly the primary domain of the states.[1] In practice, however, the most important and powerful entity in insurance regulation is, without question, not a state at all. Nor is it even a government entity. Instead, it is a private, non-profit corporation known as the National Association of Insurance Commissioners, or NAIC.[2]

In many contexts, the NAIC's role in state insurance regulation is uncontroversial. For instance, the NAIC produces model insurance statutes and regulations. Much like any other model law project,[3] states sometimes adopt these models wholesale, sometimes choose not to adopt them, and sometimes adopt them with significant changes.[4] The NAIC also affords state insurance regulators an opportunity to collaborate with one another, provides both regulators and consumers with an array of services, and conducts various public information campaigns.[5]

But the NAIC's true power lies in its direct production of insurance regulatory materials that have the force of law, a category that includes over a dozen "handbooks" and "manuals."[6] These materials dictate (among many

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[1] McCarran-Ferguson Act, ch. 20, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§ 1011–1015 (2012)).

[2] *See generally* KENNETH ABRAHAM & DANIEL SCHWARCZ, INSURANCE LAW AND REGULATION (6th ed. 2015); Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 FLA. ST. U. L. REV. 625 (1999).

[3] *See, e.g.*, RESTATEMENT OF LIAB. INS. (AM. LAW INST., Proposed Final Draft No. 2, 2018).

[4] All model laws and regulations are available at *NAIC Model Laws, Regulations, and Guidelines*, NAT'L ASS'N INS. COMMISSIONERS, http://www.naic.org/store_model_laws.htm (last visited Aug. 18, 2018). For each model, the NAIC maintains an up-to-date list indicating which jurisdictions have enacted that model or a substantially similar version.

[5] ABRAHAM & SCHWARCZ, *supra* note 2, at 111-13.

[6] Examples include the (1) Accounting Practices and Procedures Manual, (2) Annual Statement Blank, (3) Annual Statement Instructions, (4) Financial Analysis Handbook, (5) Financial Condition Examiner's Handbook, (6) Insurance Regulatory Information System Ratio Manual, (7) NAIC Uniform Life, Accident and Health, Annuity and Credit Product Coding Matrix, (8) Own Risk and Solvency Assessment Guidance Manual,

other things) the information that insurers and other regulated entities must regularly report to regulators, the methodologies they must use to determine their capital levels, and the accounting standards that they must employ to calculate their assets and liabilities. They also constrain the work of regulators, in addition to regulated entities, dictating the methodologies they must use when conducting financial and market conduct exams.[7]

These documents have the force of law because virtually every state's insurance laws say they do.[8] More specifically, the insurance codes of virtually every state requires insurers and state regulators to adhere to the rules that are detailed in the most recent versions of these NAIC materials.[9] As a result, when the NAIC updates or changes any of its various manuals, handbooks, or accounting forms, it also changes state insurance regulation—without further action by the democratically accountable representatives of the states. This practice is one particularly troubling type of a more general statutory drafting practice known as dynamic incorporation by reference.[10]

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(9) Purposes and Procedures Manual of the NAIC Investment Analysis Office, (10) Risk Based Capital Forecasting and Instructions, and (11) Securities Valuation Manual. *See* S. 341, 120th Gen. Assemb., 2d Reg. Sess. (Ind. 2018), 2018 Ind. Acts 1167, http://iga.in.gov/static-documents/2/3/f/b/23fbf999/SB0341.04.ENRH.pdf (compiling these).

[7] Examples of such manuals include: NAT'L ASS'N OF INS. COMM'RS, FINANCIAL CONDITION EXAMINERS HANDBOOK, and NAT'L ASS'N OF INS. COMM'RS, MARKET REGULATION HANDBOOK EXAMINATION STANDARDS.

[8] One partial exception is Indiana. *See id.* Indiana's Senate Enrolled Act No. 341 changes all statutory references to NAIC materials so that they refer to the 2017 edition of those materials. At the same time, however, the legislation specifies that the "commissioner may implement" materials updated by the NAIC "in the regulation of the business of insurance" so long as the commissioner reports the amendment to the legislative council and standing committees. *See id.* ch. 1.5, § 1(c).

[9] *See, e.g.*, 40 PA. STAT. AND CONS. STAT. ANN. § 991.2602 (West 2018). Some state statutes do not explicitly reference the most recent versions of NAIC documents. But even in these cases, regulators require insurers to comply with the most recent versions of NAIC materials.

[10] *See* Jim Rossi, *Dynamic Incorporation of Federal Law*, 77 OHIO ST. L.J. 457 (2016). *See also* John Mark Keyes, *Incorporation by Reference in Legislation*, 25 STATUTE L. REV. 180 (2004) (distinguishing among four different types of text that can be incorporated by reference, as well as

Because the NAIC is a private entity, it produces these various materials that have the force of law without being bound by any of the procedural safeguards that ordinarily accompany the production of regulation, whether at the state or federal level.[11] For instance, the NAIC is not required by any law to provide the public with notice and an opportunity to comment on these materials before they are adopted, though it generally does so voluntarily. It also need not disclose information that would be publicly-accessible if held by a public entity. And nothing that the NAIC produces is subject to judicial review or routine oversight by an administrative body.[12]

Even more gallingly, while the NAIC's power to directly set many of the details of state insurance regulation is itself a function of state law, in many cases state lawmakers are effectively compelled by the NAIC itself to delegate this authority to the private entity. The NAIC manages this staggering feat through its Financial Standards and Accreditation Program. Under this program, states can only be accredited if they adopt a set of NAIC model laws, or their substantial equivalent.[13] And it is those very laws that incorporate by reference NAIC manuals and handbooks.

Although the NAIC cannot mandate that states participate in its accreditation program, it has cleverly designed the program so that states effectively have no choice on the matter. That is why every single state is accredited. The NAIC accomplishes this by including a seemingly innocuous provision in the model laws that states must adopt to be accredited: accredited state insurance departments are only permitted to defer to the solvency regulation of an insurer's home state (i.e. its state of domestication)

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between incorporations by reference that are "static" (fixed in time) and "ambulatory" (linked to the most recent versions of the incorporated text)).

11 State administrative law is variable. However, it generally follows many of the basic principles of federal administrative law with respect to the availability of judicial review and the requirements for agencies to provide the public with notice and an opportunity to comment on a range of administrative actions.

12 State administrative law is variable. However, it generally follows many of the basic principles of federal administrative law with respect to the availability of judicial review and the requirements for agencies to provide the public with notice and an opportunity to comment on a range of administrative actions.

13 *See infra* Section I.B.

if the home state is itself accredited.[14] As a result, any insurer domesticated in a state that lost its accreditation would quickly "redomesticate" to another state.[15] Failing to do so would subject it to financial scrutiny in every state where it sold coverage. Such redomestication requires moving the insurer's principal place of business, as well as the taxes and jobs that come along with it.[16] In a real sense, then, the NAIC – a private entity subject to none of the normal safeguards that ordinarily constrain the administrative state – has developed a complex system that effectively compels states to delegate to it the authority to produce many of the key details of state insurance regulation as it sees fit.

This scheme, I argue, violates basic separation of powers and non-delegation principles embedded in every state constitution. Although state constitutions vary, they all vest in a legislative branch the power to make laws, and they all are understood to limit the legislature's power to delegate this authority elsewhere.[17] Under any reasonable version of this principle, I argue, the delegation of state regulatory authority to a private entity that directly pressures legislatures to make this delegation and whose actions are not reviewable through any formal judicial or administrative process is unconstitutional. The Article is the first in-depth analysis of these

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[14] *See* MODEL LAW ON EXAMINATIONS § 3(C) (NAT'L ASS'N OF INS. COMM'RS 1999) ("In lieu of an examination under this Act of a foreign or alien insurer licensed in this state, the commissioner may accept an examination report on the company as prepared by the insurance department for the company's state of domicile…only if…the insurance department was at the time of the examination accredited under the NAIC's Financial Regulation Standards and Accreditation Program….").

[15] *See infra* Section I.B.

[16] *See* REDOMESTICATION MODEL BILL § 1 (NAT'L ASS'N OF INS. COMM'RS 2006) ("An insurer that is organized under the laws of any other state and is admitted to do business in this state for the purpose of writing insurance may become a domestic insurer by…and by designating its principal place of business at a place in this state."); MODEL LAW ON EXAMINATIONS (NAT'L ASS'N OF INS. COMM'RS 1999) (noting that virtually every single state has adopted the NAIC Redomestication Model Law, and the small handful that have not have "related activity".).

[17] *See* ROBERT F. WILLIAMS, THE LAW OF AMERICAN STATE CONSTITUTIONS (2009).

constitutional issues, notwithstanding the fact that several prominent former and current officials have alluded to this issue for decades.[18]

The Article's argument unfolds in four Parts. Part I begins by briefly introducing the NAIC's governance structure, funding model, and

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[18] Dating as far back as 1991, Roy Woodall – the former independent member of the Financial Stability Oversight Counsel with Insurance Expertise – warned that "national regulation of insurance is the culmination of a state supported regulatory scheme whereby a select few insurance regulators are able to engineer methods by which the NAIC can usurp legislative and judicial powers of the states by expending existing NAIC regulatory vehicles to impose illegal and unconstitutional regulatory jurisdiction and requirements upon the insurance industry in all fifty states – without the benefits of any state or federal oversight or legislative action." S. Roy Woodall, Jr., *The NAIC and "National Regulation,*" Editorial, National Association of Life Companies Newsletter (1991). More recently, Congressman Ed Royce has suggested during oral comments in several congressional hearings that the NAIC has usurped state authority by making regulatory policy without any effective oversight by the states or other public actors. *See* Allison Bell, *Republican Questions Constitutionality of Insurance Regulatory System*, THINKADVISOR (Oct. 25, 2017, 06:29 AM), https://www.thinkadvisor.com/2017/10/25/republican-questions-constitutionality-of-insuranc/?slreturn=20190009212135. Yet a third example of prominent former or current officials questioning the constitutionality of the NAIC's authority comes from former Illinois Insurance Commissioner Nat Shapo. In oral testimony before a committee of Indiana lawmakers, Shapo argued that "Dynamic incorporation by reference—implementing material added to [incorporated by referenced] work product after State's adoption of work product through [Incorporation by Reference]—[is] not allowed" under "state constitutional law" and the non-delegation doctrine. *See* Testimony of Nat Shapo, Katten Muchin Rosenman LLP, before August 16, 2017: Interim Study Committee on Financial Institutions and Insurance. This issue has also been a frequent topic of conversation at meetings of the National Conference of Insurance Legislatures. *See* Ian Adams, *At NCOIL, State Lawmakers Look to Claw Back Power from NAIC*, INS. J., (March 6, 2017), https://www.insurancejournal.com/blogs/right-street/2017/03/06/443636.htm; Ian Adams, *NCOIL, NAIC on Collision Course over Delegation Authority*, INS. J., (July 15, 2017), https://www.insurancejournal.com/blogs/right-street/2017/07/15/457728.htm).

accreditation program. It then explores how states delegate power to the NAIC by incorporating-by-reference the most recent versions of the NAIC's materials. It focuses attention on three notable examples of such dynamic incorporation by reference. The first concerns life insurers' calculation and reporting of their reserves, which determine the capital they must set aside to pay future policyholder claims. Second, Part I describes how the NAIC directs insurers' methods and documentation of their corporate risk management practices. Third, Part I explores how states delegate to the NAIC the power to set the accounting rules that govern insurers' copious financial reporting obligations.

Part II lays the Article's legal foundation by describing state law regarding legislative delegations of power to private entities. Although this law varies across jurisdictions, virtually every state tolerates legislative delegation of power to private parties only in limited circumstances. States generally avoid any bright-line rules on this issue, instead utilizing a variety of overlapping multi-factor tests. Relevant factors include the public or private character of the delegate, the extent to which the delegate's authority is subject to judicial or administrative oversight, and whether the delegate's exercise of authority has significance independent of the delegating statute. Part II explores how these factors play out in two situations that closely parallel states' delegation of power to the NAIC: dynamic incorporation by reference of the American Medical Association's impairment standards in state workers' compensation laws, and state and federal delegations of authority to the Financial Accounting Standards Board (FASB) to set Generally Accepted Accounting Principles (GAAP).

Drawing on Parts I and II, Part III explains why states' delegation of power to the NAIC violates essential separation of powers and due process principles embedded in every state constitution. First, Part III argues that the NAIC is a private entity for purposes of states' non-delegation doctrines. Under the formalistic approach to this issue that some courts employ, this conclusion flows naturally from the fact that the NAIC is chartered as a Delaware corporation founded by state regulators, rather than state legislatures.[19] But even under the functional approach embraced by other courts, the NAIC is a private delegate. This is because state legislatures have limited and fragmented control over the NAIC, a reality that is perhaps best illustrated by the inability of states legislatures to date to successfully reclaim their constitutional authority from the NAIC.

The NAIC's law-making authority is constitutionally problematic for a second set of reasons as well: it is exempt from dedicated and

[19] *See infra* Section III.

independent oversight by state judges or administrate bodies. In fact, none of the NAIC's alterations to its dynamically-incorporated manuals are routinely reviewed by any state court or administrative agency.[20] State insurance regulators' direct participation in the NAIC's internal processes is no substitute for such independent oversight. To the contrary, state insurance regulators operating under the auspices of the NAIC may have substantial interests in using the NAIC's delegated authority in ways that promote their own biased interests. For instance, state insurance regulators may use the NAIC's authority to inflate the scope and complexity of the special accounting principles that U.S. insurers are required to use.[21] Doing so can increase the value of regulators' specialized insurance expertise, limit the risk of perceived encroachment on their turf by federal officials, and improve the NAIC's capacity to fund its operations by selling new publications or services. Alternatively, state regulators can, and do, use the NAIC to raise, pursue, and implement difficult policies in a private forum, away from democratic accountability.[22]

To be sure, state statutes do contain provisions allowing state regulators to depart from dynamically incorporated materials, the most important factor suggesting that the NAIC's scheme may be constitutional. But such departures are not routinely or formally considered by state insurance departments. Nor could they be, given the relative scope of the NAIC's power and the limited resources of most state insurance departments. Even in the rare instances when an individual state insurance department departs from a specific NAIC-produced standard, it is in no position to use this action to influence the NAIC's operations more broadly.[23]

The final, and perhaps most important, reason that states' delegations of powers to the NAIC are generally unconstitutional is that the NAIC's exercise of its delegated authority is practically immune from implicit oversight by state legislatures. This is a result of the NAIC's unique Financial Standards and Accreditation Program, which deprives state lawmakers of any realistic capacity to claw-back their delegations of power to the NAIC by amending state law.[24] As a practical matter, the NAIC uses the threat of doom of a state's domestic insurance industry to compel states

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[20] *See infra* Section I.
[21] *See infra* Section III.
[22] *See infra* Section III.
[23] *See infra* Section III.
[24] *See infra* Section I.

to delegate to it immense power over both the details of insurance regulation and the larger framework within which those details are generated.

Part IV of the Article considers the implications of the conclusion that much of state insurance regulation rests on an unconstitutional foundation. It first explores both the positive and negative impacts of simply eliminating state delegations of power to the NAIC. Although this approach would increase accountability and decrease bias in the production of state insurance regulation, it would also undermine the uniformity and agility of such regulation. For this reason, Part IV concludes by suggesting that states can constitutionally preserve their delegations of power to the NAIC by creating, through an interstate compact, an independent entity responsible for reviewing the production of new NAIC materials that have the force of law.

I. STATE DELEGATION OF POWER TO THE NAIC

The NAIC is, in many ways, a unique entity in the American regulatory landscape. To be sure, as a private organization of public officials, it resembles any number of other groups, such as the Association of State and Territorial Health Officials or the Association of State Criminal Investigative Agencies.[25] But unlike any other private association of public officials, the NAIC is directly responsible for producing many of the essential details of state regulation. Section A of this Part briefly describes the NAIC's history and structure. Section B then describes the NAIC's unusual "accreditation" program, which is directly responsible for the organization's unique regulatory authority under state law. Section C then explores three notable state delegations of authority to the NAIC, involving life insurers' calculation and reporting of their reserves, insurers' corporate risk management practices and reporting, and insurers' accounting rules.

A. OVERVIEW OF THE NAIC

The NAIC describes itself as "the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S.

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[25] *About,* ASS'N OF STATE AND TERRITORIAL HEALTH OFFICIALS, http://www.astho.org/About/ (last visited Nov. 19, 2018); *About*, ASS'N OF STATE CRIMINAL INVESTIGATIVE AGENCIES, https://www.ascia.org/about.php (last visited Nov. 19, 2018).

territories."[26] A group of state insurance commissioners created the organization in 1871 as an unincorporated association.[27] At the time, the NAIC was focused on facilitating states' efforts to regulate multistate insurers by developing a uniform system of financial reporting for these companies.[28] But throughout the twentieth century, the NAIC's importance in state insurance regulation gradually increased, with the organization taking on an increasingly prominent role in crafting model laws and regulations for states to implement and operating as a forum for dialogue among state regulators and the insurance industry.[29]

As the NAIC's role increased, so did its staff and budget. Run on a shoestring with a small staff as recently as the 1980s, today the NAIC has approximately 500 employees spread out over offices in Washington, D.C., New York, and Kansas City.[30] This staff is supported by a budget of over $100 million as well as a reserve of an additional $100 million.[31]

The NAIC sets its own budget without any external oversight. Much of the NAIC's revenue comes from its sale of data, reports, and publications

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[26] *About the NAIC,* NAT'L ASS'N INS. COMMISSIONERS, https://www.naic.org/index_about.htm (last visited Aug. 25, 2018).

[27] This was shortly after the Supreme Court held in *Paul v. Virginia* that Congress's power to regulate interstate commerce did not extend to the business of insurance. 75 U.S. 168 (1868).

[28] KENNETH MEIER, THE POLITICAL ECONOMY OF REGULATION: THE CASE OF INSURANCE 54 (1988).

[29] *See* Randall, *supra* note 2, at 648. One watershed moment in the NAIC's evolution was its rile in coordinating states' response to *United States v. S.-E. Underwriters Ass'n,* which overruled *Paul v Virginia* by holding that the deferral government could indeed regulate the business of insurance under its Commerce Clause power. 322 U.S. 533 (1994). The case generated substantial concern among states worried about federal encroachment on the regulation and taxation of insurance as well as among insurers concerns about a new source of federal scrutiny. The NAIC ultimately played a major role in proposing the McCarran-Ferguson Act, which cemented the states' authority to regulate the business of insurance and remains the central law in U.S. regulations.

[30] *See* NAT'L ASS'N OF INS. COMM'RS, 2018 NAIC BUDGET 25 (2018), https://www.naic.org/documents/about_budget_2018_budget.pdf?13; *About the NAIC*, *supra* note 15.

[31] *See supra* note 19.

to the insurance industry. For instance, the NAIC's leading source of revenue is its provision of valuation services, which instruct insurers how to value their investments for regulatory reporting purposes.[32] Other major contributors to the NAIC's budget include the sale of publications and insurance data products, transaction filing fees, and its administrative services and license fees, all of which ultimately come out of the pocket of insurance industry members.[33] Although state insurance regulators cannot compel insurers to pay these NAIC fees, they can informally pressure carriers to do so by threatening negative treatment of noncompliant carriers. Among the publications that the NAIC sells to the industry are the very manuals that are dynamically incorporated by reference into state law.[34]

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[32] The NAIC charges the largest subset of individual carriers $36,000 annually for full access to this database, and ultimately earns approximately $26 million annually in connection with this service. The NAIC earns a roughly similar amount annually from the fees that it charges to insurers for filing their required quarterly and annual statements with the NAIC's central data collection system. This includes NAIC designation and review date, pricing, SIC code, SVO group code, and market indicator. NAT'L ASS'N OF INS. COMM'RS, *Supra* note 19, at 2.

[33] *Id.* Although the NAIC does charge its individual members – who consist of the fifty-six state insurance commissioners – an assessment fee, total revenue from this source only comes in at about 2% of the NAIC's annual budget. *See id.*

[34] *See* Lawrence A. Cunningham, *Private Standard in Public Law: Copyright, Lawmaking, and the Case of Accounting*, 104 MICH. L. REV. 291 (2005) (considering whether such materials are entitled to copyright). The NAIC also derives approximately a quarter of its budget from various vendor service units. Both directly and through its controlled corporate affiliate NIPR, the NAIC collects over $25 million annually from its business units which sell their services to the public offices of the same insurance commissioners who are its members and who are the beneficiaries of significant largesse from the NAIC's expenditure of its $100 million budget. This includes annual commissioner-only junkets to resorts in tropical locations like the Virgin Islands every February, and prime domestic locations like Laguna Beach and Coeur d'Alene every July. The NAIC, capitalizing on state budget crunches in the last 20 years, has formed several vendors that serve as a portal for almost all agent and broker licensing transactions, most rate and form filings, billions in premium tax payments, and various other regulatory functions. The NAIC explicitly competes with

Since 1999, the NAIC has been organized as a non-profit corporation that is governed by an Executive Committee consisting of seventeen state insurance commissioners. This Executive Committee is elected by the NAIC's membership, which consists of the chief state government official in charge of regulating the business of insurance in each state, as well as six additional U.S. jurisdictions.[35] The NAIC's day-to-day operations are directed by its Chief Executive Officer and senior management, who are hired and overseen by the Executive Committee.

As a private non-profit corporation, the NAIC is not subject to any state or federal government accountability laws, such as Freedom of Information Acts, Sunshine Acts, Inspectors General requirements, or state Conflict of Interest rules.[36] However, the NAIC does maintain a number of self-imposed policies and practices that overlap with the typical content of these laws. For instance, all NAIC members are required to sign a conflict-

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private vendors for the no-bid contracts that it receives from its members, and in fact was forced to pay a $1.5 million settlement to a vendor which accused it of predatory behavior, including price fixing. Trade press and a key Congressman have argued that these activities violate a host of state ethics laws, but without a day-to-day supervisor and without any investigative reporters assigned to the NAIC beat, no efforts at accountability have been made.

[35] *See* NAT'L ASS'N OF INS. COMM'RS, BYLAWS OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (2015).

[36] For one example of how this plays out, consider the industry-aggregate data that the NAIC's Auto Insurance Study Group recently collected in connection with its charge to study auto insurance affordability and availability. The NAIC has refused to make this data publicly available, even though it is similar to data reported by the statistical agents to state insurance regulators, which is publicly available. *See* Comments of CFA and CEJ to Auto Insurance Working Group Regarding the August 10, 2018 Draft "Report" Outline (Sept. 1, 2018)(on file with the CEJ) ("By providing the data to the NAIC instead of the states, somehow clearly public information has, inappropriately, become confidential information because the NAIC – despite its quasi-governmental role – is not subject to any state or federal public information law. The NAIC's refusal to make public the data submitted by industry adds fuel to the complaint that the NAIC is unaccountable to legislators and consumers who are impacted by NAIC actions.").

of-interest policy that requires them to "avoid any activity or situation where their personal interest could conflict, or give the appearance of a conflict, with the business operations or regulatory support activities of the NAIC."[37]

The NAIC organizes much of its activity through an elaborate series of committees and sub-committees. These committees are typically staffed by a group of volunteer state insurance regulators, who are heavily supported by NAIC staff.[38] All changes to model laws and regulations are conducted through this committee structure.[39] Changes to the statutorily-referenced materials, such as handbooks and guides, are also conducted through the NAIC's committee structure, with different committees being charged with maintaining and updating different documents.[40]

Industry has substantial sway over the NAIC's operations and practices, a fact that is most obviously visible at the organization's three annual meetings. Under the NAIC's open meeting policy, almost all of the organization's meetings – both in person and via teleconference – are open

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[37] Although the policy extends to promised offers of future employment, it is commonplace for NAIC members to take high-profile industry lobbying positions shortly after being members of NAIC leadership. In at least some of these cases, individuals have represented the industry in front of the same committees that they chaired as an NAIC officer only months earlier. *See, e.g.*, *Csiszar Named President of PCI; Resigns as S.C. Insurance Regulator, President of NAIC*, INS. J. (Aug. 18, 2004), https://www.insurancejournal.com/news/national/2004/08/18/45061.htm.

[38] *See* Daniel Schwarcz, *Preventing Capture Through Consumer Empowerment Programs*, *in* PREVENTING REGULATORY CAPTURE: SPECIAL INTEREST INFLUENCE AND HOW TO LIMIT IT 365, 365-96 (David A Moss & Daniel Carpenter eds., 2013).

[39] In 2007, the NAIC adopted an internal procedure for model law development, which requires that a parent committee and the NAIC's Executive Committee approve development of the model, as well as the final version of the model, by two-thirds majority vote. *See* PROCEDURES FOR MODEL LAW DEV. (NAT'L ASS'N OF INS. COMM'RS 2013). (2007), https://www.naic.org/documents/committees_models_procedures.pdf.

[40] *See*, *e.g.*, *Statutory Accounting Principles (E) Working Group*, NAT'L ASS'N INS. COMM'RS, https://www.naic.org/cmte_e_app_sapwg.htm (last visited Jan. 6, 2019) ("The Statutory Accounting Principles (E) Working Group is responsible for developing and adopting substantive, nonsubstantive and interpretation revisions to the NAIC *Accounting Practices and Procedures Manual* (AP&P Manual")) (emphasis in original).

to the industry and other members of the public.[41] A typical in-person committee meeting might consist of around 20 committee members seated at the front of the room, with approximately 200 spectators in the audience, almost all of whom are representing the industry in some fashion. The NAIC derives meaningful revenue from industry participation in its annual meetings, amounting to approximately $3 million annually.[42] Private parties routinely participate actively in committee meetings through the submission of oral and written comments and reports as well as through formal presentations. To help offset this industry influence, the NAIC operates a formal consumer participation program, which facilitates participation in its activities by approximately twenty designated consumer liaisons.[43]

B. THE NAIC'S FINANCIAL STANDARDS AND ACCREDITATION PROGRAM

Individual states need not adopt the NAIC's model laws, and they often choose not to do so when it comes to NAIC models having nothing to do with financial regulation. However, states do indeed uniformly enact the subset of NAIC model laws that are required under the NAIC's Financial Standards and Accreditation Program.[44] This program certifies that individual state departments' solvency regulation meets minimum standards, which requires the department to have "adequate statutory and administrative authority."[45] For an insurance department to be deemed to have adequate legal authority under the program, its state must adopt the subset of NAIC model laws that are accreditation standards, or else they must adopt laws with "substantially similar provisions."[46]

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41 NAT'L ASS'N OF INS. COMMISSIONERS, NAIC POLICY STATEMENT ON OPEN MEETINGS (2014), https://www.naic.org/documents/meetings_naic_policy_mtg_801.pdf. However, the NAIC reserves the right to hold closed meetings on a regulator-to-regulator basis for a broad variety of reasons. *Id.*

42 See NAT'L ASS'N OF INS. COMM'RS, *supra* note 30.

43 *See* Schwarcz, *supra* note 38.

44 ABRAHAM & SCHWARCZ, *supra* note 2.

45 NAT'L ASS'N OF INS. COMM'RS, FINANCIAL REGULATION STANDARDS AND ACCREDITATION PROGRAM 1, 1–17 (2018), https://www.naic.org/documents/cmte_f_frsa_pamphlet.pdf [hereinafter "NAIC Accreditation Standards"].

46 *Id.* at 9.

States face little practical choice but to adopt the NAIC accreditation standards because failing to do so would result in a substantial reduction in their tax revenue and jobs. Within the various model laws that states must adopt under the accreditation program are provisions allowing state insurance departments to defer to the solvency regulation of an insurer's state of domestication,[47] but only if that state's insurance department is accredited. As a result, insurers operating in multiple states will predictably shift their state of domestication out of a state that lost its NAIC accreditation, because failing to do so would result in it being subject to solvency-oriented scrutiny in every state where it sold coverage. To accomplish such a redomestication, insurers must generally re-designate their "principal place of business" to the new state of domestication.[48] Consequently, a state that lost its NAIC accreditation would also lose the jobs and tax revenue associated with its domesticated insurers. State legislatures, of course, have strong reasons to avoid this outcome.

One recent presentation to New Mexico's Legislative Council by the Chief General Counsel of the New Mexico insurance department is illustrative of the pressure the NAIC accreditation program places on state legislatures. In explaining why, the New Mexico legislature needed to promptly adopt the NAIC's ORSA Model Law – a new accreditation standard – the presentation observes:

The NAIC requires enactment of this bill in order for OSI [the Office of Superintendent of Insurance in New Mexico] to maintain its accreditation with the NAIC: If OSI loses its accreditation, New Mexico insurers that write in other states would have to undergo costly and disruptive examinations by the insurance departments of each state in which they write. This could cause insurers to leave New Mexico and to domicile in another state, resulting in the loss of jobs and tax revenues. Since all 50 states are currently accredited, New Mexico's loss of accreditation would be a national embarrassment and would lend support to efforts to shift insurance regulation to the federal government with a resulting loss in state control and revenues.[49]

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[47] Technically this is referred to as the insurer's state of domicile, and it is analogous to a corporation's state of incorporation.

[48] See NAIC, Redomestication Model Bill, Model 350.

[49] Vicente Vargas & Margaret Moquin, *Presentation to the New Mexico Legislative Council Service: Own Risk and Solvency Assessment* (Sept. 12, 2017), https://www.nmlegis.gov/handouts/CCJ%20091217%20Item%204%20Own%20Risk%20and%20Solvency%20Assesment,%20Office%20of%20Superintendent%20of%20Insurance.pdf.

The immense pressure that the NAIC's accreditation program places on states is intentional. In the late 1980s and early 1990s, state solvency regulation was subject to blistering criticism at the federal level due to several high-profile insurance insolvencies. A series of federal reports concluded that state insurance solvency regulation was "seriously deficient"[50] and that the NAIC could not compel states to enact needed reforms.[51] The NAIC's accreditation program was directly designed to overcome these problems. It did so, of course, by effectively threatening to regulate into oblivion the insurers of any state that chose not to adhere to the NAIC's new program.

C. STATE DELEGATIONS TO THE NAIC

States delegate a tremendous amount of authority over insurance regulation to the NAIC due to their insurance codes' incorporation by reference of the latest versions of NAIC materials. One recent count identified seventeen such NAIC-produced documents that were dynamically incorporated by reference in Indiana's statutes.[52] A substantial majority of these documents are required by the NAIC's accreditation standards, meaning that they are dynamically incorporated by reference under the laws of every U.S. jurisdiction.[53] Although the scope and significance of these NAIC-produced documents varies considerably, many are hundreds of pages long and control central elements of state insurance regulation. By way of example, this Section reviews three significant state delegations of authority to the NAIC, which govern insurers' calculation and reporting of their

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[50] COMM. ON ENERGY AND COMMERCE, 101ST CONG., REP ON INSURANCE COMPANY INSOLVENCIES (Comm. Print 1990).

[51] GAO REPORT, INSURANCE REGULATION: ASSESSMENT OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (1991) ("For several reasons, GAO questions whether NAIC's accreditation program can achieve its goal…. NAIC does not have the authority necessary to fulfill its assumed role as a national regulator. As a result, NAIC is unlikely to achieve its stated goal of establishing a national insurance regulatory system. It can neither compel state actions necessary for effective regulation nor, in the long run, can it sustain its reforms.").

[52] *See* note 5, *supra*.

[53] *See* NAIC ACCREDITATION STANDARDS, *supra* note 30.

reserves, methods and documentation of corporate risk management, and accounting rules.

1. Dynamic Incorporation by Reference of the NAIC's Valuation Manual

Perhaps the most significant state delegation of power to the NAIC stems from states' dynamic incorporation-by-reference of the NAIC's Valuation Manual. With a small handful of exceptions, the law of every state in the country includes language identical or substantially similar to the NAIC's 2009 Model Standard Valuation Law (SVL), which dynamically incorporates by reference the NAIC's Valuation Manual.[54] The Valuation Manual, in turn, governs every facet of life insurers' calculation and reporting of their "reserves."[55]

Rules governing life insurers' reserve calculations are among the most important elements of state solvency regulation. Reserves correspond to the amount that insurers must "set aside" on their balance sheet in anticipation of future payouts to insurance policyholders.[56] They operate as the foundation for many other core regulatory tools, the most important of which are capital requirements.[57] Reserve calculations are particularly important for long-tail lines of coverage like life insurance, where there is typically a substantial time gap between when a policyholder pays premiums and when they potentially receive payment on their claims.[58] If insurers are not forced to properly account for their obligations in the distant future, then they may well not be able to pay for those claims when they come due.

The SVL model and the state statutes emulating it do contain some principles regarding the scope of the Valuation Manual and the process that the NAIC must follow to amend the manual. For instance, they indicate that the Valuation Manual should specify the format of reports, information, and data that insurers must submit to state regulators; the assumptions that insurers must use in their reserve modeling; and the procedures that insurers must maintain for corporate governance and oversight of the actuaries who

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[54] NAT'L ASS'N OF INS. COMM'RS, STANDARD VALUATION LAW § 11 (2010).

[55] *Id.*

[56] *See* ABRAHAM & SCHWARCZ, *supra* note 2, at 121-22.

[57] *Id.*

[58] *Id.* at 292.

develop the reserve models.[59] Additionally, state laws based on the NAIC model SVL provide that individual state commissioners can implement regulations requiring insurers to use procedures that depart from those contained in the model.[60] They also provide that the NAIC can only amend the model via a super-majority vote of its fifty-six voting members.[61]

The latest version of the NAIC's Valuation Manual – last amended in August of 2017 – clocks in at 295 pages and includes detailed and extensive provisions on virtually every element of insurers' reserve calculation. It is organized into five sections. The primary section details how insurers must calculate their reserves using projected asset and liability cash flows across a range of economic scenarios.[62] These projections must incorporate insurers' assumptions about factors such as policyholder mortality, policyholder behavior, and expenses. Insurers are also required by the Valuation Manual to calculate a minimum reserve amount, which is intended to prevent excessively low reserves. The other four sections of the Valuation Manual govern procedural and reporting requirements for insurers. For instance, they require insurers to submit to regulators actuarial opinions regarding the adequacy of reserves as well as reams of data regarding the carriers' mortality, morbidity, policyholder behavior, and expense experience.[63]

Almost every state passed the NAIC's updated SVL model well before the NAIC published this latest version of its Valuation Manual, meaning that these states delegated authority to the NAIC which it actually

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[59] Standard Valuation Law § 11 (NAT'L ASS'N OF INS. COMM'RS 2010). In addition to life insurance contracts, the SVL also applies to annuity and pure endowment contracts, accident and health contracts, and deposit contracts issued on or after the operative date of the Valuation Manual.

[60] *Id.* The Commissioner is also authorized to require a company to change an assumption or method if the Commissioner determines it is not in compliance with the Act or the Valuation Manual.

[61] Memorandum from the Life Actuarial (A) Task Force, Nat'l Ass'n of Ins. Comm'rs, to the Fin. Regulation Standards and Accreditation (F) Comm., Nat'l Ass'n of Ins. Comm'rs (Nov. 3, 2016), https://www.naic.org/documents/cmte_f_pbr_referal_2009_revisions_standard_valuation_law_820.pdf [hereinafter Task Force Memorandum].

[62] NAT'L ASS'N OF INS. COMM'RS, VALUATION MANUAL (2018).

[63] *Id.* Under the Valuation Manual, the NAIC itself is the experience data collection agent.

used. In fact, many states passed the NAIC's model SVL law between 2009, when it was finalized, and late 2012, when the NAIC published the first version of the Valuation Manual.[64] States that passed the NAIC's SVL model after the NAIC first published the Valuation Manual in 2012 but before the NAIC's latest update of the manual in August 2017 – a category which includes almost all of the states that did not pass the model before late 2012[65] – also delegated authority to the NAIC that it used extensively. Between 2015 and 2017, the NAIC has adopted over fifty different amendments to the valuation manual at five different times.[66]

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[64] The NAIC model and corresponding state statutes allowed states to incorporate a then-undrafted Valuation Manual by providing that insurers' reserve calculations would only be governed by the manual when two conditions were met. First, the NAIC model and the statutes on which it is based required a super-majority of the NAIC's fifty-six voting members to approve the Valuation Manual. Second, it required a supermajority of U.S. insurance jurisdictions to adopt legislation implementing the SVL revisions. In June 2016, the NAIC certified that these conditions had been met. First, between 2009 and 2016, forty-five states, representing 79.5% of U.S. premium volume, had adopted the 2009 NAIC model revisions to their SVLs or legislation with substantially similar terms and provisions. Second, the NAIC formally adopted the first version of the Valuation Manual in December 2012, and subsequently adopted over fifty different amendments to the Valuation Manual at five different times between 2015 and 2017. As a result of these conditions being met, the Valuation Manual is now law in almost every U.S. state. Starting in 2017, a three-year trial phase of PBR – during which the Valuation Manual is optional for insurers – went into effect in all states that had passed the model legislation. The trial phase for implementation was established in the manual itself, rather than in the SVL revisions. At the start of 2020, PBR will become fully effective and the Valuation Manual will dictate insurers' reserve practices in all states that have passed the model law. *See* Task Force Memorandum, *supra* note 42.

[65] Meanwhile, forty-five of the fifty-one jurisdictions that have adopted the NAIC's SVL did so by the end of 2016, before the latest round of NAIC revisions to the Valuation Manual. *Id.*

[66] *See* NAT'L ASS'N OF INS. COMM'RS, VALUATION MANUAL at i (2018), https://www.naic.org/documents/prod_serv_2018_valuation_manual.pdf (listing amendments through 2016: "The National Association of Insurance Commissioners (NAIC) initially adopted the *Valuation Manual* on Dec. 2,

States have almost uniformly passed the NAIC's model SVL law notwithstanding that the Valuation Manual that it incorporates into state law represents a fundamental change in the character of state solvency regulation. Historically, states required life insurers to use mechanical and relatively simple formulas to calculate their reserves. This approach, however, created a variety of complications due to the increasing heterogeneity and complexity of life insurers' products.[67] Starting shortly before the 2008 financial crisis, state regulators organizing through the NAIC responded to these concerns by launching a Principles-Based Reserving (PBR) initiative.[68] The core idea of PBR was to replace the mechanical rules governing insurers' reserve calculations with a system that allowed insurers to calculate their future obligations to policyholders based on internal, company-specific models. Rather than checking the accuracy of insurers' mechanical calculations, state regulators in this regime would ensure that firms' internal models complied with a range of broad principles, technical specifications, and procedural requirements. The SVL model and Valuation Manual implement this new PBR regime.

States' uniform passage of the NAIC SVL model is largely attributable to NAIC pressure via the accreditation program. Starting in early 2010, an NAIC committee recommended including the 2009 revisions to the NAIC's SVL model in the NAIC's accreditation standards.[69] After years of delay and debate, the NAIC ultimately adopted this suggestion in 2016, but delayed its implementation until January 2020.[70] At present only five jurisdictions have not passed the latest version of the SVL law, and it is

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2012, with subsequent adoptions of amendments on June 18, 2015; Nov. 22, 1015 [sic]; April 6, 2016; Aug. 29, 2016; and Aug. 9, 2017.").

[67] Robert F. Weber, *Combating the Teleological Drift of Life Insurance Solvency Regulation: The Case for a Meta-Risk Management Approach to Principles-Based Reserving*, 8 BERKLEY BUS. L.J. 35, 105-15 (2011).

[68] This timing is notable. A similar principles-based approach to calculating capital requirements proved disastrous in the crisis, but by the time this became clear, the PBR initiative was already quite far along. *See* Daniel Schwarcz & Steven L. Schwarcz, *Regulating Systemic Risk in Insurance*, 81 U. CHI. L. REV. 1569 (2014).

[69] *See* Task Force Memorandum, *supra* note 61.

[70] *The National System of State Regulation and Principle-Based Reserving*, NAT'L ASS'N OF INS. COMMISSIONERS (July 12, 2018), https://www.naic.org/cipr_topics/principle_based_reserving_pbr.htm.

widely expected that these holdouts will succumb to NAIC pressure by 2020.[71]

NAIC staff have played a central role in the implementation of PBR and will continue to do so for the foreseeable future. For instance, the NAIC maintains substantial actuarial staff to assist state regulators in reviewing individual companies' reserve calculations and documentation. It created a standing Valuation Analysis (E) Working Group to serve as a "confidential forum regarding questions and issues arising during the course of annual principle-based reserving (PBR) reviews or PBR examination" and to refer issues that may require "consideration of changes/interpretations to be provided in the *Valuation Manual*."[72]

2. Dynamic Incorporation by Reference of the Own Risk and Solvency Assessment Manual

State statutory references to the NAIC's "Own Risk and Solvency Assessment Manual" ("ORSA Manual") constitute a second type of state delegation of power to the NAIC. These statutory cross-references derive from the NAIC's Risk Management and Own Risk Solvency Assessment Model Act ("ORSA Model Act"), which the NAIC formally adopted in 2012.[73] The Act specifies that changes made by the NAIC to the ORSA Manual are effective starting in the calendar year after adoption.[74] Since the NAIC designated the Model Act as an accreditation standard, every single state (except one) has adopted the model or a statute with substantially similar language as of March 2018.[75]

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[71] As of today, fifty-one U.S. jurisdictions have passed these revisions; The five that have not are New York, Alaska, Massachusetts, the District of Columbia, and Puerto Rico. *See* Task Force Memorandum*, supra* note 61.

[72] *Valuation Analysis (E) Working Group*, *2018 Charges*, NAT'L ASS'N INS. COMM'RS, https://www.naic.org/cmte_e_valuation_analysis_wg.htm (last visited Aug. 26, 2018).

[73] RISK MGMT. & OWN RISK & SOLVENCY ASSESSMENT MODEL ACT (NAT'L ASS'N OF INS. COMM'RS 2012).

[74] *Id.* § 2.

[75] *See* NAT'L ASS'N OF INS. COMM'RS, STATE LEGISLATIVE BRIEF: THE RISK MANAGEMENT AND OWN RISK SOLVENCY ASSESSMENT MODEL ACT (2018), https://www.naic.org/documents/cmte_legislative_liaison_brief_orsa.pdf.

The ORSA Model Act requires large insurers to maintain an enterprise risk management framework based on the latest version of the NAIC's ORSA Manual. Carriers subject to the Act must regularly assess their risk management framework "consistent with a process comparable to" the NAIC's ORSA Manual.[76] To document their compliance with the risk management processes outlined in the ORSA Manual, insurers covered by the Act are required to annually produce an ORSA summary report. The Act provides that this ORSA summary report – like the ORSA itself and the other required documentation – "shall be prepared consistent with the ORSA Guidance Manual."[77]

The ORSA Model Act does not provide the NAIC with any direction about the process or substance of the ORSA Manual. For instance, it does not contain any substantive guidance on how the NAIC should craft the standards within the ORSA Manual, aside from the implicit suggestion that the manual should cover appropriate risk management practices for insurers. Nor does the Model Act specify any procedure for the NAIC to follow in adopting or revising the manual.

The NAIC adopted the latest version of its ORSA Manual in late 2017.[78] The manual contains a variety of directions to insurers regarding the content, procedures, and documentation of their required risk management practices. For instance, it specifies that insurers must assess and document their Risk Culture and Governance, Risk Identification and Prioritization, Risk Appetite, Tolerances and Limits, Risk Management and Controls, and Risk Reporting and Communication.[79]

One of the most important elements of the manual requires insurers to report a "group risk capital assessment" in their ORSA summary report.[80]

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[76] Risk Management and Own Risk and Solvency Assessment Model Act § 4 (NAT'L ASS'N OF INS. COMM'RS 2012).

[77] *Id.* § 7(A). In addition, "[d]ocumentation and supporting information shall be maintained" and shall be made available to the commissioner upon the commissioner's request. *Id.*

[78] *See* NAT'L ASS'N OF INS. COMM'RS, NAIC OWN RISK AND SOLVENCY ASSESSMENT (ORSA) GUIDANCE MANUAL, at iii (2017).

[79] *Id.* at 8.

[80] *Id.* at 10–11 ("The analysis of an insurer's group assessment of risk capital requirements and associated capital adequacy description should be accompanied by a description of the approach used in conducting the analysis. This should include key methodologies, assumptions and considerations used in quantifying available capital and risk capital.").

In contrast to the ordinary capital rules that states apply to individual insurance entities, the ORSA Manual's direction for group capital calculations provide insurers with substantial latitude in their calculations. Under the manual, insurers are allowed to select their own methodologies and assumptions for calculating their group capital, so long as they describe and explain their approach.

The ORSA Manual's latitude in specifying how insurers should calculate their group capital may change soon. Many foreign regulators have expressed concern about state insurance regulators' lack of a standardized group capital requirement, and states have responded by developing a variety of much more specific principles for group capital calculations. State regulators have emphasized, however, that they do not plan to implement this new group capital methodology as an independent quantitative requirement, but instead intend to use it solely as an "additional regulatory assessment tool."[81] This strongly suggests that state regulators may implement their new group capital methodology simply by amending the ORSA Manual rather than by establishing a new group capital model law or regulation.

New changes to the ORSA Manual's group capital rules would not be the first NAIC update of the manual. While the NAIC first adopted the ORSA Manual in 2014, it subsequently amended the manual in 2017. The most important changes to the manual created a process for the NAIC to update the manual in the future. Those procedures designated a specific NAIC group as being responsible for updating the manual and contained no requirement that NAIC members as a whole approve changes to the document.

3. Dynamic Incorporation by Reference of the Accounting Practices and Procedures Manual

A third example of state delegation to the NAIC via dynamic incorporation by reference concerns insurers' accounting practices. Every state requires by statute that insurers report their financial information to insurance regulators using a unique set of insurance-specific accounting

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[81] *See*, *e.g.*, David Altmaier, *Group Capital Calculation*, NAIC (2018), https://www.naic.org/insurance_summit/documents/insurance_summit_2018_FR_22.pdf.

rules known as Statutory Accounting Principles ("SAP").[82] Although these accounting rules are termed "statutory," they are not, in fact, contained in any state statute. Instead, they are detailed in the voluminous, multi-volume, NAIC Accounting Practices and Procedures Manual (AP&P Manual), the latest version of which state laws incorporate by reference. As with the Valuation Manual and ORSA Manual, the NAIC's accreditation program requires this delegation of authority to the NAIC as a condition for states to maintain their financial accreditation.[83] This, of course, explains why states

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[82] The history of the AP&P Manual demonstrates the NAIC's intentional use of the incorporation by reference process to establish itself as a body with pseudo-Congressional power to pass laws for the entire country. Before 2000, the NAIC published a series of Accounting Practices and Procedures Manuals, slim volumes for each different line of insurance, housed in loose leaf binders which allowed for updating. The title of these manuals was incorporated by reference in state statutes, mandating the use of the statutory accounting regime they established. During the 1990s, NAIC members concluded that a full, comprehensive rewrite of the accounting manual was necessary to establish a uniform national regulatory requirement for accounting practices. The new work product was massive. Including subsequent amendments, this amounted to over 1,000 pages of new material. *See* NAT'L ASS'N OF INS. COMM'RS, CODIFICATION OF STATUTORY ACCOUNTING PRINCIPLES STATE IMPLEMENTATION (2000). The NAIC intentionally gave the new manual the same name as the already incorporated by reference accounting manuals, so that, it asserted, the new AP&P Manual would automatically become the law upon NAIC adoption. NAIC members faithfully followed this guidance, sending out bulletins to regulated entities, explaining that a sea change was being made to their accounting requirements, not by lawmaking in their states, but by the decree of the NAIC through the incorporation by reference mechanism; and further explaining that NAIC intended to make changes every year to the Manual which would also automatically become new law in each state. *See id.*

[83] Unlike the valuation and ORSA documents, the NAIC does not maintain a model law or regulation that broadly requires this delegation, though several model laws do indeed dynamically incorporate by reference the AP&P Manual in a narrower context. *See, e.g.*, INVS. OF INSURERS MODEL ACT § 7 (NAT'L ASS'N OF INS. COMM'RS 2017). Instead, the NAIC's Accreditation program directly requires that states mandate companies follow the AP&P Manual, without specifying how exactly they must

have so uniformly delegated to the NAIC the power to set the accounting rules that bind insurers through the AP&P Manual.

The AP&P Manual is voluminous, but – unlike the NAIC's Valuation or ORSA manuals – it is not freely available to the public. Instead, each user must pay approximately $500 to access the manual.[84] The manual covers an immense range of insurance-specific accounting and reporting rules, as suggested by the fact that its table of contents alone is fifteen pages long. Examples of topics covered include the subset of assets that insurers can include on their balance sheets, the proper accounting treatment of anticipated premiums tax benefits, and the accounting treatment of reinsurance transactions.

The special accounting rules detailed in the AP&P Manual are ostensibly intended to better reflect the capacity of insurers to pay their commitments to policyholders if they had to be liquidated, in contrast to GAAP's focus on facilitating outsiders' assessments of a firm's market value.[85] Reflecting SAP's conservatism relative to GAAP, the AP&P manual is often substantially more prescriptive than GAAP. For instance, SAP requires property/casualty insurers to value high-quality bonds at amortized cost rather than market value, whereas GAAP allows insurers to select between these two approaches depending on their anticipated plans for the bonds.[86] Similarly, SAP only allows insurers to include on their balance sheets admitted assets, which can be readily converted to cash.[87]

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accomplish this result. *See* NAIC ACCREDITATION STANDARDS, *supra* note 45, at 9 ("The department should require that all companies reporting to the department file the appropriate NAIC annual statement blank, which should be prepared in accordance with the NAIC's instructions handbook and follow those accounting procedures and practices prescribed by the NAIC's *Accounting Practices and Procedures Manual*, utilizing the version effective January 1, 2001 and all subsequent revisions adopted by the Financial Regulation Standards and Accreditation (F) Committee.").

[84] *See* Cunningham, *supra* note 34, at 292-93 (considering when private publications that operate as law should be made freely available to the public).

[85] *See* Weber, *supra* note 67, at 53–63.

[86] *See Background on: Insurance Accounting*, INS. INFO. INST. (Mar. 3, 2014), https://www.iii.org/article/background-on-insurance-accounting.

[87] *Id.*

The manual is routinely updated by the NAIC's Statutory Accounting Principles (E) Working Group.[88] The Working Group considers whether each new GAAP item should be adopted or adjusted for insurance in the AP&P Manual.[89] It also maintains a public tool for anyone to propose items to be updated in the manual.[90] By way of illustration, the working group recently considered twenty-seven different proposed revisions to the AP&P Manual and it regularly adopts dozens of revisions to the manual each year.

Notwithstanding state mandates that carriers comply with the latest version of the AP&P Manual, individual states have the authority to depart from the AP&P Manual in two scenarios. First, states can adopt via statute or regulation "Prescribed Accounting Practices" that alter SAP rules for all insurers domiciled in the state. Second, the manual also authorizes state regulators to allow "Permitted Accounting Practices" for individual insurers who request approval for departures from SAP.[91] In either case, insurers must disclose their reliance on these exceptions from SAP in their financial statements.

II. THE LAW GOVERNING STATE LEGISLATIVE DELEGATION OF POWERS TO PRIVATE ACTORS

Just like the federal constitution, every state constitution vests an independent branch of state government with the legislative power. And just like the federal constitution, a corollary of this principle is that the legislature has limited authority to delegate this power elsewhere. Legislative delegations of power to a private actor, as opposed to a government agency, are particularly troubling, as they implicate not just separation of powers principles, but also more fundamental due process concerns.

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[88] For instance, the initial Codification of SAP in 2001 imposed an initial 73 Statements of Statutory Accounting Principles upon regulated companies. As of today, the number of SSAPs has grown to 10,757.

[89] *See* Deborah L. Lindberg & Deborah L. Seifert, *A New Paradigm of Reporting on the Horizon*, 29 J. INS. REG. 229, 242 (2010).

[90] *Statutory Accounting Principles* € Working Group, NAT'L ASS'N INS. COMM'RS, https://naic.org/cmte_e_app_sapwg.htm (last visited Aug. 26, 2018).

[91] *Statutory Accounting Principles (SAP)*, NAT'L ASS'N INS. COMM'RS, https://www.naic.org/cipr_topics/topic_statutory_accounting_principles.htm (last visited Jan. 6, 2019).

For these reasons, state courts from across the country have invalidated a broad range of legislative delegations to private parties. In doing so, they generally employ what amounts to a multi-factor balancing test that considers (i) the public or private status of the delegate, (ii) oversight of the delegate by public bodies such as the judiciary or a public agency, and (iii) the delegate's independence from the lawmaking function.

This Part overviews this caselaw, abstracting away from the law of any individual state to derive and illustrate the general principles that influence state court scrutiny of legislative delegations to private actors. After briefly reviewing states' generalized non-delegation doctrines in Section A, Section B explores why state delegations to private parties raise distinctive issues. Section C then distills the relevant factors that state courts consider in assessing the constitutionality of delegations to private actors. Finally, Section D illustrates the application of these principles in two contexts that resemble the states' delegation of power to the NAIC: state incorporation of American Medical Association standards in workers' compensation statutes, and state and federal delegations of authority to the Financial Accounting Standards Board to set accounting rules for private entitles.

A. STATES' NON-DELEGATION DOCTRINES

The non-delegation doctrine limits legislatures' constitutional authority to delegate their powers to third parties.[92] It is typically rooted in separation of powers principles.[93] Consistent with this foundation, the vast majority of non-delegation cases concern legislative delegations to executive agencies, courts, or other governmental entities.[94]

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[92] *See* Gary Lawson, *Delegation and Original Meaning*, 88 VA. L. REV. 327, 335–43 (2002).

[93] *See* Jim Rossi, *Institutional Design and the Lingering Legacy of Antifederalist Separation of Powers Ideals in the States*, 52 VAND. L. REV. 1167, 1190 (1999). *Contra* Joseph Postell, *"The People Surrender Nothing": Social Compact Theory, Republicanism, and the Modern Administrative State*, 81 MO. L. REV. 1003, 1003 (2016) ("[T]he true foundation of the nondelegation principle is the idea of the social compact and the related theory of republican government.").

[94] Jason Iuliano & Keith E. Whittington, *The Nondelegation Doctrine: Alive and Well*, 93 NOTRE DAME L. REV. 619, 641 (2017).

Although the non-delegation doctrine is virtually a dead letter in federal jurisprudence,[95] it is quite robust in state courts.[96] Indeed, between 1940 and 2015, 85% of all non-delegation cases were decided by state, rather than federal, courts.[97] Parties seeking to invalidate a statutory delegation of power in these cases enjoyed a 16% success rate, which stands in stark contrast to the 3% success rate that their counterparts experienced in federal courts over the same time period.[98]

Unlike the federal constitution – which is silent on the topic of non-delegation – most state constitutions directly limit legislatures' powers to delegate their law-making authority.[99] These constitutional provisions come in three basic varieties. Some expressly prohibit any branch of government from exercising another's powers.[100] Other state constitutions prohibit the legislature from "making the passage of any law contingent upon any event or outside authority."[101] A third type of constitutional provision "explicitly

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[95] *See* Rossi, *supra* note 93, at 1178; Miriam Seifter, *States, Agencies, and Legitimacy*, 67 VAND. L. REV. 443, 452 (2014) (calling the federal non-delegation doctrine "toothless").

[96] *See generally* Rossi, *supra* note 93, at 1187–1201 (surveying state nondelegation doctrine and classifying states' approaches as "weak," "strong," or "moderate"); Iuliano & Whittington, *supra* note 94, at 620 ("[D]espite the doctrine's disappearance at the federal level, it has become an increasingly important part of state constitutional law.").

[97] Iuliano & Whittington, *supra* note 94, at 636. This survey examined a sample of 1,075 non-delegation cases decided between 1940 and 2015.

[98] *Id.*

[99] Keith E. Whittington & Jason Iuliano, *The Myth of the Nondelegation Doctrine*, 165 U. PA. L. REV. 379, 416 (2017).

[100] *Id.* at 416. Whittington and Iuliano cite the Texas constitution as representative: "The powers of the Government of the State of Texas shall be divided into three distinct departments…and no person, or collection of persons, being of one of these departments, shall exercise any powers properly attached to either of the others." TEX. CONST. art. II, § 1.

[101] Whittington & Iuliano, *supra* note 99, at 416. The authors cite Indiana's constitution as an example: "No law shall be passed, the taking effect of which shall be made to depend upon any authority, except as provided in this Constitution," IND. CONST. art. I, § 25.

forbids the legislature from delegating any of its powers" to a variety of actors, including private entities.[102]

Given this variation in constitutional text, it is no surprise that state caselaw on the non-delegation doctrine also varies significantly. One extensive survey grouped states' approaches to the doctrine into three categories, though they do not correspond neatly to the three types of state constitutional provisions on the issue.[103] First, some states uphold legislative delegations when the delegated power is subject to adequate procedural safeguards.[104] Second, a larger group of states requires state legislatures to articulate substantive standards that constrain the exercise of delegated power and guide judicial review of the delegate's actions.[105] Finally, a third group of states employ a balancing test that considers both substantive and procedural restrictions on delegated power in light of various additional factors, such as the subject matter of the underlying statute.[106]

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[102] Whittington & Iuliano, *supra* note 99, at 416. The authors cite Colorado's constitution as representative: "The general assembly shall not delegate to any special commission, private corporation or association, any power to make, supervise or interfere with any municipal improvement, money, property, or effects, whether held in trust or otherwise, or to levy taxes or perform any municipal function whatever," COLO. CONST. art. V, § 35.

[103] Rossi, *supra* note 93, at 1187-1201. Rossi's survey "updated and refined" an earlier survey by Gary Greco. I*d.* at 1191 n.108 (citing Gary J. Greco, *Standards or Safeguards: A Survey of the Delegation Doctrine in the States*, 8 ADMIN. L.J. AM. U. 567 (1994)).

[104] Rossi, *supra* note 93, at 1191-93; *see e.g.*, Warren v. Marion Cty., 353 P.2d 257, 261 (Or. 1960) (in banc) ("[T]he important consideration is not whether the statute delegating the power expresses *standards*, but whether the procedure established for the exercise of the power furnishes adequate *safeguards* to those who are affected by the administrative action.").

[105] Rossi, *supra* note 93, at 1193-97; *see*, *e.g.*, *Newport Int'l Univ., Inc. v. Dep't of Educ.*, 186 P.3d 382, 390 (Wyo. 2008) ("The crucial test in determining whether there is an unlawful delegation is whether the statute contains sufficient standards to enable the agency to act and the courts to determine whether the agency is carrying out the legislature's intent.").

[106] Rossi, *supra* note 93, at 1198-1200; *see e.g.*, Cottrell v. Denver, 636 P.2d 703, 709 (Colo. 1981) (en banc) ("[T]he test is not simply whether the

B. THE UNIQUE CASE OF LEGISLATIVE DELEGATIONS TO PRIVATE PARTIES

Courts at both the federal and state levels have long recognized that laws delegating legislative authority to private, rather than public, actors raise unique concerns.[107] Perhaps the most well-known articulation of this view is from the 1936 Supreme Court case *Carter v. Carter Coal Co.*, which involved a federal law authorizing private coal producers and miners to set binding wage and hour restrictions.[108] In finding the law unconstitutional, the Court emphasized that it conferred power onto "private persons" rather than "an official or an official body," and thus constituted "legislative delegation in its most obnoxious form."[109] Although federal caselaw building on this principle is limited, numerous state court decisions have similarly concluded that many, if not most, "private delegations are unconstitutional under the relevant state constitutions."[110]

State courts' skepticism toward legislative delegation to private parties is generally driven just as much by due process and rule of law concerns as by separation of powers principles.[111] Unlike public entities authorized to exercise legislative powers, like executive agencies or courts, "private delegates may not be subject to direct political controls nor to due process, administrative procedure laws, freedom of information laws, or judicial review."[112] Private entities may also labor under conflicts of interest that harm their competitors or other private actors.[113]

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delegation is guided by standards, but whether there are sufficient statutory standards and safeguards and administrative standards and safeguards, in combination, to protect against unnecessary and uncontrolled exercise of discretionary power.").

[107] *E.g.*, Protz v. Workers' Comp. Appeal Bd., 161 A.3d 827, 837 (Pa. 2017).

[108] Carter v. Carter Coal Co., 298 U.S. 238 (1936).

[109] *Id*. at 311.

[110] Calvin R. Massey, *The Non-Delegation Doctrine and Private Parties*, 17 GREEN BAG 2D 157, 171 (2014).

[111] *Id.* at 167–68.

[112] MICHAEL ASIMOW & RONALD M. LEVIN, STATE AND FEDERAL ADMINISTRATIVE LAW 395 (3d. ed. 2009).

[113] *See Carter Coal*, 298 U.S. at 311.

Despite these concerns, delegation of authority to private entities is sometimes both necessary and beneficial. State governments lacking resources or expertise may look to private organizations for regulatory guidance.[114] In some contexts, a need for uniformity across states may drive legislatures to adopt a national organization's standards.[115] And legislatures may decide it would be expedient to delegate a degree of regulatory power to the private parties subject to regulation.[116]

One of the most common ways in which state legislatures delegate authority to private actors is by incorporating privately-produced rules or standards into statutes. Not all statutory references to private entities' materials implicate the non-delegation doctrine. Statutes that incorporate *pre-existing* sources are perfectly innocuous. In such cases, the legislature has had an opportunity to review and affirmatively adopt the incorporated standards and the reference operates as a mere legislative short-hand.[117] However, when a statute cross-references not just existing materials, but also *prospectively* adopts – sight unseen – future changes made by private actors to incorporated materials, the statute transfers to those actors the capacity to change the law.[118] This is just as much a delegation of legislative power to private actors as more explicit delegation of the type at issue in *Carter Coal*.

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[114] *See In re* Hansen, 275 N.W.2d 790, 796–97 (Minn. 1978).

[115] *See* Lucas v. Me. Comm'n of Pharmacy, 472 A.2d 904, 911 (Me. 1984) (noting a need for uniform education standards for pharmacists and health professionals).

[116] *See* Tex. Boll Weevil Eradication Found., Inc. v. Lewellen, 952 S.W.2d 454 (Tex. 1997), *as supplemented on denial of reh'g* (Oct. 9, 1997) (invalidating a statute designed to give farmers control over an agricultural pest eradication program).

[117] *See* Bd. of Trs. v. Mayor of Balt., 562 A.2d 720, 731 (Md. 1989). However, some early non-delegation cases suggested that statutes incorporating another jurisdiction's laws, even without dynamic incorporation of changes, were invalid because the practice sidestepped important legislative processes. *See* F. Scott Boyd, *Looking Glass Law: Legislation by Reference in the States*, 68 LA. L. REV. 1201, 1211–12, 1254–55 (2008).

[118] *See Bd. of Trs.*, 562 A.2d at 731; Boyd, *supra* note 117, at 1254–57.

C. KEY FACTORS IN ASSESSING THE CONSTITUTIONALITY OF LEGISLATIVE DELEGATIONS TO PRIVATE ACTORS

Although state legislatures commonly delegate authority to private organizations, the non-delegation doctrine places limits on the practice.[119] State courts have found that a wide variety of delegations to private actors exceed these limits.[120] Just like the state caselaw addressing non-delegation principles generally,[121] the subset of this caselaw focused on delegations to private parties is varied, both within and across states. State courts have developed varying and overlapping multi-factor tests for assessing when legislative delegations of power to private actors are constitutionally permissible,[122] and some have even suggested that all delegations of power to private entities are unconstitutional.[123] This subsection distills from this caselaw several of the most important factors[124] that influence state courts'

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[119] *See generally* Boyd, *supra* note 117, at 1251–60 (discussing the non-delegation doctrine as a constraint on incorporation by reference); *Tex. Boll Weevil*, 952 S.W.2d at 465–69, 471–72.

[120] *See, e.g.*, Gumbhir v. Kan. State Bd. of Pharmacy, 618 P.2d 837 (Kan. 1980) (university accreditation); Hillman v. N. Wasco Cty. People's Util. Dist., 323 P.2d 664, 670 (Or. 1958) (state electrical code), *overruled on other grounds by* Maulding v. Clackamas Cty., 563 P.2d 731 (Or. 1977); Protz v. Workers' Comp. Appeal Bd., 161 A.3d 827 (Pa. 2017) (workers' compensation); *Tex. Boll Weevil*, 952 S.W.2d 454 (pest-control program).

[121] *See supra* Section II.A.

[122] *Tex. Boll Weevil*, 952 S.W.2d at 470 (recognizing that non-delegation cases "do not yet, when taken together, evince a coherent constitutional standard").

[123] For instance, the intermediate appellate court in Protz v. W.C.A.B. (Derry Area Sch. Dist.), 124 A.3d 406, 412 (Pa. Cmwlth. 2015), held that all delegations of authority to private entities violate the Pennsylvania Constitution. The Pennsylvania Supreme Court ultimately did not reach this issue, though, concluding that the state's incorporation by reference of the AMA's impairment standards could not withstand constitutional scrutiny even if the AMA were a governmental entity. *See Protz v. Workers' Comp. Appeal Bd.*, 161 A.3d at 837.

[124] The list is not intended to be exhaustive, but instead to focus on those factors that are most significant in the caselaw and relevant to states' delegation of power to the NAIC. For instance, in addition to the factors

analysis of legislative delegation to private actors: (1) whether the delegate is a public or private entity; (2) whether the delegate's exercise of authority is directly policed by public officials, including courts or regulators; and (3) the extent to which the delegate is independent from the lawmaking process and exercising objective expertise rather than making policy.

1. Is the Delegate a Private or Public Entity?

For reasons described above, courts universally recognize that legislative delegations of power to private actors raise more significant constitutional concerns than delegations of power to government entities.[125] Application of this principle is straight-forward in most cases, even though

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discussed in this Section, legislatures may not delegate "inherent government functions" to non-government entities. ASIMOW & LEVIN, *supra* note 112, at 396; *see, e.g.*, State v. Curley-Egan, 910 A.2d 200 (Vt. 2006) (police power); Christ v. Md. Dep't of Nat. Res., 644 A.2d 34, 42 (Md. 1994) (dicta); Paul R. Verkuil, *Public Law Limitations on Privatization of Government Functions,* 84 N.C. L. REV. 397, 424–26 (2006) (discussing non-delegable government functions at the federal level). As a corollary, courts are reluctant to allow delegations to private entities when the delegated power involves criminal penalties. *See, e.g.*, B.H. v. State, 645 So.2d 987, 993 (Fla. 1994); *Texas Boll Weevil*, 952 S.W.2d at 472. Courts may also consider whether a delegation vests both rulemaking and adjudicatory power in the same entity. *Id*. Finally, so long as the legislature "determines the rights, duties, and liabilities of persons and corporations under certain conditions of fact," it may delegate (even to private parties) "the duty of ascertaining when the facts exist which call into activity certain provisions of the law." State v. Gee, 236 P.2d 1029, 1032 (Ariz. 1951) (quoting Borgnis v. Falk Co., 133 N.W. 209, 219 (Wis. 1911)); *accord State v. Wakeen*, 57 N.W.2d 364, 367 (Wis. 1953).

[125] *See* Carter v. Carter Coal Co., 298 U.S. 238, 311 (1936) (labeling delegation to private parties, "legislative delegation in its most obnoxious form"); Bd. of Trs. v. Mayor of Balt., 562 A.2d 720, 730 (Md. 1989) ("[D]elegations of legislative authority to private entities are strictly scrutinized because, unlike governmental officials or agencies, private persons will often be wholly unaccountable to the general public."); *Tex. Boll Weevil*, 952 S.W.2d at 470.

the public/private distinction is itself often hazy.[126] For instance, corporations and professional associations are generally private, whereas entities that are formed by statute, constitution, or regulation are typically public.

But this distinction is less clear when legislatures create ostensibly private entities and grant them legal or regulatory authority. In such cases, courts typically resist formalistic analysis that gives definitive weight to the delegate's charter type. Instead, they typically weigh the relative role of private citizens and government actors in controlling the delegate's decision-making, operations, and objectives to determine whether the delegation is public or private.

This focus on who controls a delegate's operations is illustrated by a Texas Supreme Court case invalidating a statute that created a foundation and delegated to it control over an agricultural pest eradication program. Despite the legislature's creation of the foundation and specification of its objectives, the court deemed the foundation to be private for purposes of the non-delegation doctrine because its board was composed solely of farmers with a direct private interest in the program's implementation.[127] Farmers' control over the foundation rendered the delegation private because "courts have universally treated a delegation as private where 'interested groups have been given authoritative powers of determination.'"[128]

Courts' focus on who controls hybrid public/private entities that are delegated authority is also illustrated by a recent U.S. Supreme Court case applying the federal non-delegation doctrine. In *Department of Transportation v. Association of American Railroads*, the Court rejected a non-delegation challenge to a statute empowering Amtrak to help develop performance and service quality metrics for the broader industry.[129] This result followed from the Court's conclusion that Amtrak was a public, rather than a private, entity for purposes of the non-delegation doctrine, notwithstanding its status as a for-profit corporation.[130] Amtrak, the Court emphasized, was not only created by federal law, but was controlled by

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[126] *See* Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543, 547 (2000); Gillian E. Metzger, *Privatization as Delegation*, 103 COLUM. L. REV. 1367, 1369 (2003).

[127] *Tex. Boll Weevil*, 952 S.W.2d at 471.

[128] *Id.* at 470–71.

[129] Dept. of Transp. v. Ass'n of Am. R.R., 135 S. Ct. 1225 (2015).

[130] *Id.* at 1232–33.

federal officials who played a major role in directing its objectives and operations.[131] For instance, Amtrak's board is largely appointed by the President, confirmed by the Senate, subject to removal at-will.[132] Moreover, the federal government owns nearly all of Amtrak's stock.[133] Amtrak is also subject to various traditional government oversight tools: the Freedom of Information Act applies to it, and it is required to maintain an inspector general.

In addition to these formal government controls over Amtrak's operations, the Court emphasized that the federal government also holds extensive practical control over the rail company. For instance, Amtrak is required to submit annual reports to Congress, which frequently holds hearings scrutinizing the company's budget, routes, and service. Congress also exercises extensive informal control over Amtrak by subsidizing the company's operations to a tune of $40 billion over the course of approximately four decades. The federal government, the Court concluded, "extensively supervise[s] and substantially fund[s]" Amtrak's "priorities, operations, and decisions."[134] In sum, the federal government's control over Amtrak rendered it a public entity for purposes of the non-delegation doctrine, meaning that Congress's delegation of power to the railroad raised limited issues under the federal constitution.

2. Is the Private Delegate's Exercise of Authority Adequately Policed by Judges or Administrative Bodies?

To the extent that a legislature has indeed delegated authority to a private rather than a public actor, a second key consideration under states' non-delegation doctrines is whether the private delegate's power is adequately policed by judges or administrative bodies. Both state and federal courts have generally tolerated legislative delegations to private entities when public officials exercise sufficient oversight over the private delegate's decision-making.[135] Such oversight can come in varying forms, ranging from

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[131] *Id.* at 1232 ("[Amtrak] was created by the Government, is controlled by the Government, and operates for the Government's benefit.").

[132] *Id.* at 1231-32.

[133] *Id.*

[134] *Id.* at 1232.

[135] *See* Madrid v. St. Joseph Hosp., 928 P.2d 250, 258 (N.M. 1996); *cf.* Sunshine Anthracite Co. v. Adkins, 310 U.S. 381, 399 (1940) (holding

judicial review of the entity's compliance with substantive or procedural requirements, to direct oversight of the delegate's actions by a government agency.[136]

For instance, courts generally permit delegations to private parties when the delegating statute articulates substantive standards to guide the delegate's exercise of discretion, and compliance with these standards is judicially reviewable.[137] This approach, of course, parallels the rules that govern delegations to public entities, such as agencies.[138] It is therefore hardly surprising that courts often conflate the rules governing these two types of delegations.[139] But consistent with the unique concerns implicated by delegations to private entities, courts sometimes suggest that the substantive constraints on private delegations must be more specific than

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Congress may give private entities a role in rulemaking so long as the private entity functions subordinately to the government); Pittston Co. v. United States, 368 F.3d 385, 395 (4th Cir. 2004) ("[C]ongress may employ private entities for ministerial or advisory roles, but it may not give these entities governmental power over others."). *See generally* Donna M. Nagy, *Playing Peekaboo with Constitutional Law: The PCAOB and Its Public/Private Status*, 80 NOTRE DAME L. REV. 975, 1059 (2005) ("But court decisions, including by the Supreme Court, demonstrate that governmental oversight of private decision making will generally insulate Congress's private delegations from constitutional challenge.").

[136] *Compare* United Chiropractors of Wash., Inc. v. State, 578 P.2d 38, 39–40 (Wash. 1978) (emphasizing the legislature's obligation to establish standards, guidelines, and procedural safeguards), *with* Tex. Boll Weevil Eradication Found., Inc. v. Lewellen, 952 S.W.2d 454, 473 (Tex. 1997), *as supplemented on denial of reh'g* (Oct. 9, 1997) (analyzing Commissioner of Agriculture's direct oversight over private foundation, among several other factors).

[137] *See, e.g.*, Newport Int'l Univ., Inc. v. Dep't of Educ., 186 P.3d 382, 390 (Wyo. 2008); Proctor v. Andrews, 972 S.W.2d 729, 735–36, 737–38 (Tex. 1998).

[138] *See supra* Section II.A.

[139] *E.g.*, Colo. Polytechnic Coll. v. State Bd. for Cmty. Colls. & Occupational Educ., 476 P.2d 38, 42 (Colo. 1970). *But cf.* Texas Boll Weevil, 952 S.W.2d at 472–73 (establishing separate non-delegation test for delegations to private entities).

those on delegations to public actors.[140] For instance, at least one court has suggested that private delegations should be "narrow in duration, extent, and subject matter."[141]

A second way that public oversight may allow private delegations to pass constitutional scrutiny is if the delegate's authority must be exercised in accordance with judicially-enforceable procedural restrictions.[142] Here too, the caselaw parallels precedent governing delegations to public agencies, though comparison is slightly muddied because private entities are not subject to procedural rules such as state administrative procedure acts and sunshine laws. Procedural restrictions on private delegates' capacity to exercise delegated authority must consequently be contained within the delegating statute. Such judicially-enforceable procedural restrictions on delegations can help prevent arbitrary or self-interested decision-making by the delegate.[143] Because private delegations raise particularly salient concerns of bias, courts reviewing challenges to such delegations often emphasize whether parties affected by the delegate's exercise of authority are involved in the decision-making process, such as through a notice and comment process.[144]

Procedural and substantive restrictions on a private delegate's power are only relevant for purposes of constitutional analysis if they are legally

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[140] Bd. of Trs. v. Mayor of Balt., 562 A.2d 720, 730 (Md. 1989) ("[D]elegations of legislative authority to private entities are strictly scrutinized. . . ."); *accord* Tex. Boll Weevil, 952 S.W.2d at 469 ("[W]e believe it axiomatic that courts should subject private delegations to a more searching scrutiny than their public counterparts.").

[141] *See Tex. Boll Weevil*, 952 S.W.2d at 472.

[142] *See supra* Section II.A. As with the ordinary non-delegation doctrine, some courts require a combination of procedural and substantive restrictions. *See, e.g.*, United Chiropractors of Wash., Inc. v. State, 578 P.2d 38, 39–41 (Wash. 1978).

[143] *See* Protz v. Workers' Comp. Appeal Bd., 161 A.3d 827, 834 (Pa. 2017).

[144] *See Texas Boll Weevil*, 952 S.W.2d at 472–74 (analyzing statutory requirement that private delegate's board be elected by affected parties); Indep. Electricians & Elec. Contractors' Ass'n v. N.J. Bd. of Examiners of Elec. Contractors, 256 A.2d 33, 42 (N.J. 1969) (noting that private delegate's procedures in adopting and revising its standards reflect the national consensus of interested parties).

mandated and judicially reviewable, rather than voluntarily adopted.[145] This is because the non-delegation doctrine restricts legislatures' ability to delegate power "regardless of the manner in which the recipient wields it."[146] Thus, the fact that a delegate "has opted to use its powers for good," such as by self-imposing procedural restraints, "is no antidote" to a lack of constitutional power.[147]

Judicial review of a delegate's compliance with procedural or substantive restrictions is not the only way that public oversight can legitimize delegations of power to private actors. Direct oversight of a private delegate's decision-making by an administrative agency can also curb arbitrary or self-interested actions sufficiently to avoid the constitutional problems that undergird the non-delegation doctrine.[148] This strategy of administrative oversight of private delegates is central to insulating from challenge a number of federal delegations of power to private entities. For instance, the key private bodies that play a role in securities regulation – including the Financial Standards Accounting Board (FASB), the Public Company Accounting Oversight Board (PCAOB), the New York Stock Exchange (NYSE), and the National Association of Securities Dealers (NASD) – are all directly overseen by the SEC.[149] In each case, federal courts have rejected federal non-delegation challenges to these entities on the basis of such direct oversight by the SEC.[150]

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[145] Although courts are not always explicit about the assumption that procedural or substantive restrictions must be judicially reviewable, they reliable operate on this assumption. *See, e.g.*, *Protz*, 161 A.3d at 834, 836; *Texas Boll Weevil*, 952 S.W.2d at 472–74. As one court has stated in the context of a public non-delegation case, "a corollary of the doctrine of unlawful delegation is the availability of judicial review." Askew v. Cross Key Waterways, 372 So. 2d 913, 918 (Fla. 1978).

[146] *Protz*, 161 A.3d at 835 n.4.

[147] *Id.*; *cf.* Carter v. Carter Coal Co., 298 U.S. 238, 291 (1936) ("[B]eneficent aims, however great or well directed, can never serve in lieu of constitutional power.").

[148] *See Tex. Boll Weevil*, 952 S.W.2d at 472–73 (describing agency oversight of private delegate as "uneven and incomplete").

[149] Nagy, *supra* note 13535, at 1022, 1057–61.

[150] *See, e.g.*, Todd & Co. Inc. v. Sec. & Exch. Comm'n., 557 F.2d 1008, 1012–14 (3d Cir. 1977); R.H. Johnson & Co. v. Sec. & Exch. Comm'n., 198

Judicial or administrative oversight of a delegate may be constitutionally sufficient when a public official retains discretion in adopting or applying the standards.[151] For instance, if enforcement of a private delegate's standards requires agency officials or judges to exercise their discretion in applying the standard, or to use it as only one factor in their decision-making, then there may be no impermissible delegation of legislative power.[152] In such cases, a government official maintains control over the legal effects of a delegate's decisions, meaning that the delegate does not have unconstrained "power to determine what the law will be."[153] Other courts have suggested that delegations of power to private institutions are more likely to be constitutionally permissible if impacted parties can seek review from public officials of any adverse decision by the delegate.[154]

At least some commentators have suggested that, in addition to judicial or administrative oversight, legislative oversight of a private delegate is sufficient under the non-delegation doctrine.[155] Under this view, the key consideration for assessing the constitutionality of a private delegation is "the ease with which Congress [or state legislatures] could reclaim or amend its delegation."[156] Because legislatures generally do not

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F.2d 690, 695 (2d Cir. 1952); Arthur Andersen & Co. v. Sec. & Exch. Comm'n., No. 76C-2832, 1978 WL 1073, at *3 (N.D. Ill. Mar. 1978).

[151] *See* Madrid v. St. Joseph Hosp., 928 P.2d 250, 257 (N.M. 1996); Bd. of Tr. of the Emp. Retirement Sys. v. Mayor & City Council of Balt. v. Mayor & City Council of Balt., 562 A.2d 720, 732 (Md. 1989).

[152] *See, e.g.*, *Madrid*, 928 P.2d at 258 ("Where evidence is conflicting, the ultimate decision concerning the degree of a worker's impairment and disability rests with the workers' compensation judge."); *Bd. of Tr. of the Emp. Retirement Sys.*, 562 A.2d at 732 (Md. 1989).

[153] *Madrid*, 928 P.2d at 256.

[154] *See* In re Hansen, 275 N.W.2d 790, 796-797 (Minn. 1978); Newport Int'l Univ., Inc. v. Dep't of Educ., 186 P.3d 382, 390 (Wyo. 2008).

[155] *See* Vikram David Amar, *Indirect Effects of Direct Election: A Structural Examination of the Seventeenth Amendment*, 49 VAND. L. REV. 1347, 1360-84 (1996).

[156] Brian Galle, *Designing Interstate Institutions: The Example of the Streamlined Sales and Use Tax Agreement ("SSUTA"),* 40 U.C. DAVIS L. REV. 1381, 1428 n.240 (2007).

face constraints in clawing back power from private delegates, most such delegations to private actors are unproblematic on this view.[157]

3. Does the Delegate's Exercise of Authority Have Significance Independent of the Incorporating Statute?

Another relevant factor to state constitutional analysis of private delegations is whether the delegate's actions have any significance independent of the statute that delegated authority to it. To the extent that a delegate's exercise of authority is "guided by objectives unrelated to the statute in which [the material] function[s]," then it is less plausible to "construe [it] as a deliberate law-making act" of the type that would potentially violate the non-delegation doctrine.[158] This factor is most clearly applicable to dynamic incorporations by reference, where a statute gives legal effect to both existing and future versions of referenced material.[159] However, courts have also considered a private delegate's independent purpose in cases where the delegate receives a more direct delegation of authority from the legislature.[160]

A private delegate's actions are likely to have significance independent of a legislative delegation when they are motivated by concerns that are not principally legal or regulatory. For example, when a private entity updates standards that are dynamically incorporated by reference in a statute to reflect scientific advances – rather than to influence the way the statute operates – its actions have independent significance.[161] This, of course, is most likely to occur when the putative delegate has expertise that

[157] *See id*.

[158] *Madrid*, 928 P.2d at 257; *accord* Lucas v. Me. Comm'n of Pharmacy, 472 A.2d 904, 909 (Me. 1984).

[159] *See* Boyd, *supra* note 117, at 1255–57.

[160] *See* Tex. Boll Weevil Eradication Found., Inc. v. Lewellen v. Abbott, 952 S.W.2d 454, 474–75 (Tex. 1997), *as supplemented on denial of reh'g* (Oct. 9, 1997).

[161] *See, e.g.*, State v. Wakeen, 57 N.W.2d 364, 369 (Wis. 1953) (upholding dynamic incorporation by reference of the United States Pharmacopeia's definition of drug); *Madrid*, 928 P.2d at 259 (upholding incorporation of American Medical Association's physical impairment guidelines).

is tied to a non-regulatory domain, such as science or education.[162] The same conclusion may follow when a private delegate's standards are used in a broad set of materials beyond the challenged statutory regime.[163]

By contrast, private entities that exercise delegated authority for the sole or express purpose of influencing legal or regulatory standards are more likely to face successful non-delegation challenges. Delegates may be so influenced for a variety of reasons, including the prospect that they can reap pecuniary benefits by influencing the law.[164] For this reason, courts are often particularly skeptical of delegations to private entities that hold the prospect of substantially benefiting those parties' finances.[165]

One alternative explanation for courts' consideration of a private delegate's independence from the incorporating statute involves the practical ability of legislatures to claw back power from the private delegate.[166] Independent expert bodies that produce standards that happen to be dynamically incorporated into state law are unlikely to directly pressure state legislatures to retain their delegated authority. This means that the legislature has no practical restrictions on its ability to claw back authority from the delegate. By contrast, when private entities exercise delegated authority for the sole purpose of influencing legal or regulatory standards, they are likely to guard that authority jealously and employ various means to thwart the legislature's practical ability to claw back that authority.

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[162] *See, e.g.*, Colo. Polytechnic Coll. v. State Bd. for Cmty. Coll. & Occupation Educ., 476 P.2d at 42 (Colo. 1970) (expertise in post-secondary education); *Lucas*, 472 A.2d at 909–11 (pharmaceutical education); *Hansen*, 275 N.W.2d at 796–97 (legal education); *Wakeen*, 57 N.W.2d at 369 (pharmaceuticals).

[163] *See Lucas*, 472 A.2d at 909–11 (listing several uses for American Council on Pharmaceutical Education accreditation standards independent of their use in Maine's pharmaceutical licensure statute).

[164] *See Texas Boll Weevil*, 952 S.W.2d at 472; *cf.* Alexander Volokh, *The New Private- Regulation Skepticism: Due Process, Non-Delegation, and Antitrust Challenges*, 37 HARV. J.L. & PUB. POL'Y 931, 941–42 (2014) ("[D]elegation of power plus pecuniary bias is a due process faux-pas, and it is easy to imagine (or presume) that such bias will be more likely if the delegate is private.").

[165] *See* Carter v. Carter Coal Co., 298 U.S. 238, 311 (1936); *Texas Boll Weevil*, 952 S.W.2d at 472.

[166] *See supra* Section II.C.2.

D. APPLICATION OF PRIVATE NON-DELEGATION FACTORS IN WORKERS' COMPENSATION AND ACCOUNTING DELEGATIONS

State courts have applied the considerations detailed above to countless different legislative delegations of power to private entities, ranging from organizations devoted to accrediting educational institutions to bodies developing standards to protect individuals' privacy. This subsection focuses on caselaw analyzing delegations to private actors in two settings that closely parallel state delegation of insurance regulatory authority to the NAIC. The first involves state workers' compensation statutes that rely on materials produced by the American Medical Association to help assess a worker's physical impairment. The second focuses on delegations by both federal and state actors to the Financial Accounting Standards Board to set Generally Accepted Accounting Principles.

1. Workers' Compensation Statutes and the American Medical Association's Impairment Guides

State workers' compensation statutes frequently rely on the American Medical Association's (AMA) Impairment Guides to help ascertain the severity of workers' physical disabilities and ultimately their compensation.[167] When these statutes attempt to incorporate future versions of the Guides as promulgated by the AMA, they raise a non-delegation problem.[168] However, courts applying the non-delegation factors above have reached mixed conclusions regarding such statutes' constitutionality.

For instance, in a 2017 case, the Pennsylvania Supreme Court struck down the state's dynamic incorporation by reference of the AMA's

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[167] *See* Protz v. Workers' Comp. Appeal Bd., 161 A.3d 827, 835–36 (Pa. 2017) ("[T]he General Assembly gave the AMA de facto, unfettered control over a formula that ultimately will determine whether a claimant's partial-disability benefits will cease after 500 weeks."); McCabe v. North Dakota Workers Comp. Bureau, 567 N.W.2d 201, 205 (N.D. 1997).

[168] In *McCabe v. North Dakota Workers Compensation Bureau*, the court avoided the constitutional problems presented by dynamic incorporation by holding that the statute's language does not incorporate future changes to the Guides. As such, the statute did not impermissibly delegate power to the AMA. *McCabe*, 567 N.W.2d 201.

impairment guidelines as an impermissible delegation.[169] This scheme, the court held, violated the Pennsylvania Constitution's vesting of legislative power in the legislature because it did nothing to limit the AMA's arbitrary and capricious exercise of this delegated power, effectively giving it "de facto, unfettered control over a formula" that determines a claimant's recovery.[170] In reaching this conclusion, the court emphasized that the statute failed to declare any policy regarding the Guides' methods for evaluating physical impairment or to prescribe any standards to guide the AMA in creating its methodology.[171] The court also noted a conspicuous lack of procedural safeguards binding the AMA's drafting process, such as notice and comment procedures and judicial review.[172] These factors ultimately led the court to conclude that the state's delegation of power to the AMA would violate the State's constitution even if the AMA were a governmental entity.[173] But the court expressly declined to reject either the intermediate appellate court's conclusion that all delegations of power to private entities violate the Pennsylvania Constitution or the more moderate view that private delegations require "a more exacting form of judicial scrutiny" than delegations to public actors.[174]

By contrast, the Supreme Court of New Mexico upheld the state's dynamic incorporation of the Guides.[175] In *Madrid v. St. Joseph Hospital*, the court stressed that the AMA is a body with medical expertise that produces the Guides based on scientific objectives, rather than solely for use in New Mexico's statute.[176] It also emphasized that the statute made the Guides only one factor in determining a worker's right to compensation, leaving the ultimate decision with the workers' compensation judge.[177] Thus, public officials retained some discretion in applying the Guides, supporting the delegation.

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[169] *Protz*, 161 A.3d at 841.
[170] *Id.* at 836.
[171] *Id.* at 835–36.
[172] *Id.* at 836.
[173] *Id*. at 838.
[174] *Id*.
[175] Madrid v. St. Joseph Hosp., 928 P.2d 250 (N.M. 1996).
[176] *Id.* at 257–58.
[177] *Id.* at 258; *cf.* McCabe v. N.D. Workers Comp. Bureau, 567 N.W.2d 201, 205 (N.D. 1997).

2. Delegation to FASB to Develop Generally Accepted Accounting Principles

Both federal and state authorities delegate power to the Financial Standards Accounting Board (FASB) to update GAAP. FASB's authority over GAAP stems from the Securities Exchange Act of 1934, which authorized the Securities and Exchange Commission (SEC) to establish a common system of accounting.[178] The SEC initially sub-delegated this authority to the primary trade association of the accounting profession,[179] and later shifted this delegation to FASB, a private, non-profit corporation whose Board is selected by a panel of accounting professionals.[180] FASB Board members are full-time employees of FASB who are drawn from the accounting profession. Although the SEC does not play any direct role within FASB's institutional structure, it devotes extensive resources to monitoring the organization's agenda and operations, through a dedicated SEC Office of the Chief Accountant.[181] Although the SEC has direct authority to overrule FASB, it generally influences FASB decision making more subtly by using suggestions and the implicit threat of a veto.[182]

Because the SEC's delegation of power to FASB is a matter of federal law, there is limited state case law on point. One exception is an intermediate appellate case from Texas, which addressed a non-delegation challenge to a Texas statute that required companies to compute their tax obligations using "generally accepted accounting principles."[183] The Texas Comptroller interpreted this provision to refer to GAAP, as promulgated by FASB. In rejecting the argument that this interpretation amounted to an

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[178] Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78qq (2012).

[179] *See* Nagy, *supra* note 135, at 985.

[180] William W. Bratton, *Private Standards, Public Governance: A New Look at the Financial Accounting Standards Board*, 48 B.C. L. REV. 5 (2007).

[181] *Id.* at 36.

[182] *Id. See also* Nahum D. Melumad & Toshiyuki Shibano, *The Securities and Exchange Commission and the Financial Accounting Standards Board: Regulation Through Veto-Based Delegation*, 32 J. ACCT. RES. 1, 2, 7–14 (1994); D. Paul Newman, *The SEC's Influence on Accounting Standards: The Power of the Veto*, 19 J. ACCT. RES. 134, 143 (1981).

[183] Cent. Power & Light Co. v. Sharp, 919 S.W.2d 485, 492 (Tex. App.–Austin 1996).

unconstitutional delegation of power to a private entity, the Texas court emphasized that FASB "operates without reference to any legislative purpose, and it does not make its pronouncements in order to fulfill or effectuate any statute."[184] The Court also noted that the Comptroller's rules specifically did not make GAAP unconditionally binding on companies, but instead instructed companies to depart from GAAP when "the context clearly requires" doing so to avoid a misleading financial statement.[185] Finally, the court reasoned that aggrieved taxpayers could go before the Comptroller to contest their tax liability. All this, the court held, demonstrated that "the Comptroller, not FASB, holds and exercises the properly delegated power to interpret and apply tax laws."[186]

Federal caselaw also makes clear that the SEC's sub-delegation of authority to FASB is constitutional. Although no federal case explicitly reaches this conclusion, federal courts have routinely rejected nondelegation challenges to the SEC's delegation of power to other private entities, such as the National Association of Securities Dealers (NASD). In doing so, they generally emphasize that NASD's decisions are "subject to full review by the S.E.C., a wholly public body, which must base its decision on its own findings."[187] This logic, of course, is equally applicable to FASB. The constitutionality of the SEC's delegation to FASB is only enhanced by the fact that Congress, in the Sarbanes-Oxley Act of 2002, conditioned FASB's authority on it meeting five conditions.[188] These conditions required the organization to be entirely private, maintain procedures ensuring prompt consideration of emerging accounting issues, and to be deemed by the SEC to be capable of improving the accuracy and effectiveness of financial reporting and investor protection.[189] These restrictions on FASB's composition and procedures, as well as the direct role for the SEC in

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[184] *Id.*

[185] *Id.*

[186] *Id.*

[187] Todd & Co. v. Inc. SEC, 557 F.2d 1008, 1012–14 (3d Cir. 1977). S*ee also* R.H. Johnson & Co. v. SEC, 198 F.2d 690, 695 (2d Cir. 1952). For an argument that the SEC's delegation of power to FASB is indeed unconstitutional. *See* Bruce Edward Committe, *The Delegation and Privatization of Financial Accounting Rulemaking Authority in the United States of America*, 1 CRITICAL PERSP. ACCT. 145 (1990).

[188] Sarbanes-Oxley Act of 2002,15 U.S.C. § 7219(b), (e) (2012).

[189] *Id.*

assessing FASB's competence, render the constitutionality of the SEC's delegation to FASB clear.

III. THE UNCONSTITUTIONALITY OF THE U.S. STATE INSURANCE REGULATORY REGIME

Each state has its own precedents regarding the constitutionality of attempts by its legislature to delegate authority to private actors.[190] Moreover, even within a single state, different legislative delegations of authority to the NAIC pose distinct legal issues, as they vary with respect to relevant factors such as the substantive and procedural guidance that accompanies these delegations as well as state regulators' discretion to depart from dynamically-incorporated NAIC manuals.[191] For these reasons, it is impossible to conclusively assess the constitutionality of all state delegations of authority to the NAIC in every jurisdiction.

Nonetheless, this Section argues that most state delegations of authority to the NAIC raise major constitutional problems under the non-delegation principles of most states. The analysis below explains this conclusion by focusing on the three factors that state courts have generally found to be influential in assessing the constitutionality of legislative delegations to private parties.[192] First, Section A explains that the NAIC is a private entity for purposes of the non-delegation doctrine. Second, Section B shows that the NAIC's exercise of its delegated authority is not subject to any meaningful oversight by the judiciary or individual state insurance departments. Finally, Section C argues that the NAIC's production of dynamically-incorporated materials do not have significance independent of legislative delegations to the organization. The fact that the NAIC actively pressures state legislatures to delegate authority to it through its accreditation program strongly supports this conclusion.

A. THE NAIC IS A PRIVATE ACTOR FOR PURPOSES OF THE NON-DELEGATION DOCTRINE

As a private, non-profit corporation founded and controlled by state insurance commissioners, the NAIC is in some ways at the border of the

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[190] *See supra* Section II.C.
[191] *See supra* Section I.C.
[192] *See supra* Section II.C.

public/private divide. But when it comes to states' non-delegation doctrines, the NAIC's status as a private entity is relatively clear. From a formalistic perspective, this conclusion follows from the fact that the NAIC is registered as a 501(c)(3) non-profit corporation in the state of Delaware.[193] As a Delaware corporation, the NAIC is not subject to any of the safeguards that ordinarily apply to government bodies, such as state Freedom of Information Acts or Sunshine Laws.[194]

Although some courts confronting non-delegation claims have resisted formalistic categorization of entities that are formed or controlled by legislatures, these cases do not apply to the NAIC. Unlike these cases – which are exemplified by Amtrak and the Texas Agricultural Pest Eradication Foundation[195] – state insurance regulators, rather than state legislatures, founded the NAIC and control its operations.[196] And they

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[193] *See* NAT'L ASS'N INS. COMM'RS, ARTICLES OF INCORPORATION (Adopted Oct. 1999), https://www.naic.org/documents/about_certificate_of_incorporation.pdf. The fact that the NAIC is a registered non-profit corporation, as compared to Amtrak's status as a for profit corporation, may arguably weigh in favor of its status as a public rather than private entity. Indeed, the D.C. Circuit decision finding Amtrak to be a private entity emphasized its status as a for profit corporation, noting that this mission was at odds with the traditional mission of public entities to advance the common good. *See* Ass'n of Am. Railroads v. U.S. Dep't of Transp., 721 F.3d 666, 677 (D.C. Cir. 2013), *vacated and remanded sub nom*. Dep't of Transp. v. Ass'n of Am. Railroads, 135 S. Ct. 1225, 191 L. Ed. 2d 153 (2015). By contrast, the NAIC's mission is expressly to "serv[e] the public interest" and promote "fundamental insurance regulatory goals" by assisting "state insurance regulators, individually and collectively." *See Mission,* NAT'L ASS'N INS. COMM'RS, https://www.naic.org/index_about.htm (last visited Oct. 4, 2018). As a charitable nonprofit, the NAIC also faces constraints on its expenditure of funds and must disclose information that private entities do not. But unlike virtually any other non-profit, the NAIC does not file Form 990 annual disclosures about its budget and activities, relying on an IRS private letter exempting it from this requirement. *See* Letter from Kevin M. McCarthy, NAIC President, to Edward R. Royce, U.S. House of Representatives (Mar. 20, 2012), https://www.naic.org/documents/committees_ex_grlc_120320_royce_letter.pdf.

[194] These laws only apply to government entities.

[195] *See supra* Section II.C.1.

[196] *See supra* Section I.A.

formed it not to serve some independent public purpose, but instead to operate as an association that could assist them in performing their professional responsibilities.[197] No court has ever held that a private corporation founded by non-legislative officials to operate as a professional association is a public entity for purposes of the non-delegation doctrine.

Even for courts inclined to embrace a less formalistic approach to the public/private distinction, the NAIC's private status for purposes of the non-delegation doctrine is clear. Recall that courts employing such a functional approach typically focus on the government's control of the delegate's decision-making, operations and objectives.[198] Because it is state legislatures to whom state Constitutions delegate the legislative power, it is the legislature's control over a delegate that is the focus of this inquiry.[199] Thus, Amtrak was a public entity because Congress played a central role in its operations and delegated to the President authority to appoint its Board.[200]

Under this type of functional approach to the public/private divide, the NAIC is almost certainly a private entity because no state legislature exercises direct control over it. This conclusion follows from three considerations. First, any control that state legislatures have over the NAIC is fragmented among 56 jurisdictions.[201] This is significant, as individual states' non-delegation doctrines are rooted in their individual constitutions.[202] Thus, the relevant question for any individual state is not whether states in the aggregate exercise sufficient control over the NAIC to render it a public entity. Instead, the relevant question is whether the government of the specific state where a case is filed sufficiently controls the NAIC. Fragmentation of state control over the NAIC means that the answer to this question must be "no." To analogize, if the Minnesota legislature were to delegate authority to an Iowa agency, this delegation would best be understood as private rather than public under the Minnesota Constitution, because an Iowa agency is not democratically accountable to the people of Minnesota.

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[197] *Id.*

[198] *See supra* Section II.C.1.

[199] *See id.*

[200] *See id.*

[201] As discussed in Section I, the NAIC's voting membership consists of the fifty states plus six additional jurisdictions. *See supra* Section I.A.

[202] *See supra* Section II.A.

Fragmented control of the NAIC by fifty-six different state insurance commissioners also undermines the organization's accountability to any individual state legislature. State legislatures have limited incentives to directly monitor and attempt to exert control over national organizations like the NAIC, even if they might plausibly be able to do so through their influence over state insurance departments.[203] This is but one example of a familiar tragedy of the commons problem: the costs of any such oversight would be borne entirely by the state, but the benefits would be diffused nationally.[204] By contrast, the federal government's control over Amtrak, for instance, allowed it to pursue a unified objective with respect to the railroad.[205]

A second reason that the NAIC is a private entity even under a functional approach to the non-delegation doctrine is that, unlike other hybrid public-private entities, the NAIC is not subject to any supplemental laws that imbue it with public features. Cases that have found ostensibly private corporations like Amtrak to be public entities have highlighted the unique constraints that legislatures imposed on these entities.[206] To illustrate, Amtrak was required by statute to comply with the Freedom of Information Act, to maintain an Inspector General, and to regularly submit formal reports to Congress.[207] Even the Texas Boll Weavel foundation – which the court ultimately deemed private – was subject to public safeguards, such as a

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[203] *See* Daniel Schwarcz, *A Critical Take on Group Regulation of Insurers in the United States,* 5 U.C. IRVINE L. REV. 537, 550 (2015) (noting limited incentives of states insurance regulators to devote sufficient attention to matters of national or international concern, like systemic risk).

[204] Although state legislatures try to overcome these coordination problems through organizations like the National Conference of Insurance Legislatures (NCOIL), these efforts only prove the larger point: NCOIL is universally understood to be a less prominent and important organization than the NAIC, a telling fact given that state legislatures are generally supposed to have oversight responsibilities over state regulators.

[205] *See supra* Section II.C.1.

[206] *See id.*

[207] *See* Dep't of Transp. v. Ass'n of Am. R.Rs., 135 S. Ct. 1225, 1232 (2015).

requirement that it publish its rules and the prospect of dissolution by a public official.[208] No such requirements apply to the NAIC.

Finally, unlike the cases finding privately-chartered corporations to be public for purposes of the non-delegation doctrine, states do not play a meaningful role in funding the NAIC. To the contrary, state funds ultimately contribute a tiny fraction to the NAIC's budget.[209] The vast majority of the NAIC's revenue instead stems from its sale of services and publications to the insurance industry.[210] This is significant, as it means that states have limited informal control over the NAIC's actions flowing from their financial backing of the organization.[211]

The NAIC, in sum, is a private entity for purposes of states' non-delegation doctrines. Under a formalistic analysis, this conclusion flows naturally from the fact that the NAIC is chartered as a Delaware corporation founded by state regulators, rather than state legislatures. From a more functional perspective, states' fragmented control over the organization means that it is not controlled by or accountable to any individual state. State legislatures also lack any indirect authority over the NAIC as it is not subject to any supplemental public safeguards and it is funded almost entirely by its sale of services and publications to the insurance industry.

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[208] *See* Tex. Boll Weevil Eradication Found., Inc. v. Lewellen, 952 S.W.2d 454, 470-471 (Tex. 1997), *as supplemented on denial of reh'g* (Oct. 9, 1997).

[209] *See supra* Section I.A.

[210] *See supra* Section I.A.

[211] Although the insurance industry clearly exercises much less control over the NAIC's operations than did the private farmers in the *Boll Weavel* case, their influence on the NAIC is different in kind than ordinary industry influence on state agencies. The NAIC's open meeting policy has no parallel for government agencies, where the default assumption is that meetings among staff will be "closed" to the industry. This practice – coupled with the fact that so much of the NAIC's work takes place through meetings conducted within the committee structure – ensures that the industry has a major voice in virtually every facet of the NAIC's operations. So too does the fact that the NAIC's conflict of interest policy is much weaker than almost any individual states, allowing in the most extreme cases for NAIC officers to switch within months from chairing an NAIC committee to representing industry interests before that committee.

B. THE NAIC'S EXERCISE OF DELEGATED AUTHORITY IS NOT SUBJECT TO MEANINGFUL PUBLIC OVERSIGHT

Unlike other private entities that are permissibly delegated legal authority by state legislatures, the NAIC's exercise of delegated authority is not subject to meaningful oversight by either state judiciaries or administrative agencies.[212] This point is straight-forward with respect to judicial oversight, as the NAIC's decision-making is not judicially reviewable.[213] But the lack of NAIC oversight by state insurance departments requires more explanation given the dominant role of state regulators in directing the organization and producing its work product.[214] Subsection One first explains why state regulators' direct role in producing the NAIC's dynamically-incorporated materials does not constitute public oversight of the type that is relevant for purposes of states' non-delegation doctrines. Subsection Two then suggests that individual state regulators' capacity to depart from NAIC-drafted materials in specified circumstances also does not result in sufficient public oversight of the NAIC under non-delegation caselaw.

1. State Regulators' Direct Role in Developing NAIC Materials Does Not Constitute Public Oversight

When legislatures delegate lawmaking authority to private organizations, they often task state agencies with monitoring and overseeing this exercise of authority.[215] Public officials in these schemes do not directly control the private delegate's decision making. Instead, they maintain their independence from the delegate to ensure that it is exercising its legislatively-delegated authority effectively, fairly, and efficiently. To illustrate, Congress authorized the SEC to sub-delegate authority over accounting rules to FASB.[216] But FASB itself is comprised entirely of private individuals with accounting expertise, rather than any SEC officials.[217] The role of the SEC in this scheme is to actively monitor how FASB exercises its delegated authority to ensure that its deliberations and determinations are not

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[212] *See supra* Section II.C.2.
[213] *See supra* Introduction.
[214] *See supra* Section I.C.
[215] *See supra* Section II.C.2.
[216] *See supra* Section II.D.2.
[217] *See supra* Section II.D.2.

unfairly biased or inadequately sensitive to relevant public policy concerns.[218]

The NAIC turns this structure on its head. State insurance regulators do not independently oversee the NAIC's exercise of authority. Instead, they directly exercise this authority through their participation in the NAIC's internal processes.[219] Thus, state insurance regulators acting under the auspices of the NAIC set the terms of the Valuation, AP&P, and ORSA manuals, relying only on private parties, like NAIC staff and industry, to advise them in this process rather than to exercise this authority directly.[220] By directly exercising the authority delegated to the NAIC, public officials produce rules with the force of law while avoiding any independent oversight whatsoever. State regulators' exercise of the NAIC's delegated authority is also exempt from any of the other constraints that ordinarily accompany officials' public actions, such as laws governing conflicts of interest and transparency.[221]

This lack of independent oversight undermines the due process values that are at the heart of courts' skepticism of private delegations.[222] Independent oversight of private delegates' exercise of authority promotes due process for a variety of reasons. Perhaps most importantly, it limits the risk of biased decision-making by private delegates, a concern that courts repeatedly emphasize in the caselaw examining the enhanced constitutional concerns associated with private delegations.[223]

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[218] *See supra* Section II.D.2. Similarly, the American Medical Association's impairment standards ultimately are applied by state actors–Workers' Compensation Administrative Law Judges–who are not themselves AMA members. *See also supra* Section II.D.1.

[219] *See supra* Section I.

[220] *See supra* Section I.

[221] *See supra* Section I.

[222] *See supra* Section II.B.

[223] *See supra* Section II.B. Of course, other Due Process values are also served by independent oversight of a private delegate's exercise of power. For instance, independent oversight helps ensure that rules with the force of law are evaluated from two independent perspectives, thus reducing the potential influence of group think or hidden biases. Just like a student cannot reliably grade her own work, state regulators cannot meaningfully oversee the production of materials that they themselves produce.

The risk that the NAIC will exhibit bias in exercising its delegated power is notable. State insurance regulators operating under the auspices of the NAIC may have substantial interests in using their delegated authority to expand the NAIC's power and improve its finances. For instance, state insurance regulators may use the NAIC's authority to inflate the scope and complexity of statutory accounting principles.[224] Doing so can increase the value of regulators' specialized insurance expertise, limit the risk of perceived encroachment on their turf by federal officials,[225] and improve the NAIC's capacity to fund its operations by selling updates AP&P manuals.[226]

State regulators' exercise of authority through the NAIC may be biased in other ways as well. For instance, state regulators can, and do, increasingly use the NAIC to raise, pursue, and implement difficult policies in a private forum, away from democratic accountability. By increasing the scope of issues that are regulated through NAIC manuals, rather than via ordinary administrative actions within individual insurance departments, state regulators can avoid the ordinary costs and difficulties associated with

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[224] There are good reasons to be skeptical that effective insurance regulation truly requires unique accounting principles as detailed and extensive as those found within statutory accounting. For an overview of how statutory accounting differs from GAAP, *see Background on: Insurance Accounting*, INS. INFO. INST., https://www.iii.org/publications/insurance-handbook/regulatory-and-financial-environment/background-on-insurance-accounting (last visited, Oct. 8, 2018).

[225] For instance, insurance companies that are not publicly held only report their financial status using statutory accounting. However, many of the regulatory tools used by federal regulators are specifically designed for GAAP reporting. This fact has substantially complicated the Federal Reserve's ability to regulate insurance-focused savings and loan holding companies. *See generally Legislative Review of H.R. 5059, The State Insurance Regulation Preservation Act Before the U.S. H. of Reps. Comm. on Financial Servs. and the Subcomm. on Hous. & Ins*., Insurance Summit (2018) (testimony of Daniel Schwarcz, Professor of Law, University of Minnesota Law School).

[226] As discussed above, the NAIC sells access to the AP&P manual to help fund its operations. *See supra* Section I. There is a good argument that the AP&P manual should not be protected by intellectual property laws given its status as state law. *See* Cunningham, *supra* note 34.

complying with their individual states' administrative laws.[227] For instance, rather than promulgating new regulations regarding group capital requirements – a controversial and complex topic[228] – states can simply avoid any legal process by inserting new rules on this topic into the ORSA guidance manual.[229]

Even if state regulators' participation in the NAIC were somehow construed to constitute public oversight of the organization, this would still likely not satisfy state constitutional requirements. This is because, as noted above, the relevant perspective for purposes of evaluating non-delegation principles is that of an individual state, not states collectively.[230] And from the perspective of any individual state, its public officials will generally play a minimal or non-existent role in exercising the NAIC's authority. The NAIC's individual committees are comprised of regulators from a variety of different states.[231] As such, when those committees approve of changes to materials that are dynamically incorporated by reference, public officials from any single state will, at most, play only a limited role in producing or reviewing these materials.

While laudable, the NAIC's efforts to promote involvement of various stakeholders in its deliberations does not alter this analysis. Recall that the NAIC actively encourages industry and consumer stakeholder participation in its operations, both by maintaining a robust open meetings policy and by covering the costs of consumer-representatives to participate in its deliberations.[232] But none of these efforts come close to constituting the type of oversight that constitutional principles generally demand for

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[227] Robert Williams coined the term "substance creep" to describe this phenomenon in a talk describing some of the potential risks associated with states' dynamic incorporation-by-reference of NAIC materials.

[228] *See* Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance, Sept. 22, 2017, E.U.-U.S., T.I.A.S. 18-404 [hereinafter Covered Agreement]. *See generally* Schwarcz, *supra* note 203. Recently, the United States agreed in a "covered agreement" with the E.U. The agreement creates an expectation that state insurance regulators will develop and implement a group capital "requirement or assessment."

[229] *See supra* Section I.C.2.

[230] *See supra* Section III.A.

[231] *See supra* Section I.

[232] *See supra* Section I.A.

private delegations. The reason is simple: stakeholders who participate in the NAIC's deliberations have no formal authority to vote on or otherwise directly influence the organization's work product. Indeed, NAIC consumer representatives have complained public and privately for years that the NAIC merely pays lip service to consumer interests while generally doing little to promote real change.[233] As such, their participation in the NAIC's operations cannot coherently be considered oversight.

Also, praiseworthy but irrelevant for purposes of constitutional analysis are the NAIC's various internal procedures for publicly exposing working drafts and voting on changes to these materials. As discussed above, a private delegate's voluntarily-adopted procedures for exercising its authority have nothing to do with the power that the legislature has delegated to that entity.[234] Because compliance with these standards is not legally mandated, the NAIC can always change, or simply ignore, these internal rules with no consequence.

2. State Insurance Departments' Capacity to Depart from NAIC Manuals Does not Result in Meaningful Oversight of the NAIC

The only plausible way that individual state insurance departments can be understood to exercise public oversight over the NAIC is through their authority to depart from dynamically-incorporated NAIC materials in specified circumstances. State insurance departments' capacity to authorize such departures varies by topic and state. However, a common structure –

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[233] *See, e.g.*, Comments of CFA and CEJ to Auto Insurance Working Group Regarding the August 10, 2018 Draft "Report" Outline, CONSUMER FED'N OF AM. (Sept. 1, 2018), https://consumerfed.org/wp-content/uploads/2018/09/cfa-cej-comments-naicautowg.pdf. One notable exception is that the NAIC consumer liaison program seemingly had a large impact on the organization's implementation of the Affordable Care Act. *See* Timothy Jost, *Reflections on The National Association of Insurance Commissioners and Implementation of the Patient Protection and Affordable Care Act*, 159 U. PA. L. REV. 2043 (2011).

[234] Consumer Federation of America, *supra* note 204; Jost, *supra* note 204; *cf.* Carter v. Carter Coal Co., 298 U.S. 238, 291 (1936) ("[B]eneficent aims, however great or well directed, can never serve in lieu of constitutional power.").

reflected in both the Valuation and AP&P Manuals[235] – is that individual state insurance departments can either promulgate regulations authorizing departures from specific provisions within dynamically-incorporated NAIC manuals for all insurers, or else they can permit such departures for individual insurers who apply for exemptions.[236]

State Departments' limited authority to depart from NAIC manuals is in some ways comparable to other types of public oversight of private delegations that Courts have found significant. For instance, as described earlier, one court tolerated a state's prospective incorporation by reference of GAAP in part because aggrieved taxpayers could contest their tax liability before the state Comptroller.[237] And a key element of the SEC's oversight over FASB and other private delegates is its capacity to veto individual rules,[238] an authority that is comparable to individual insurance departments' authority to depart from portions of dynamically incorporated NAIC manuals.

Notwithstanding these similarities, individual states' capacity to depart from NAIC-produced material should not be deemed sufficient public oversight of the NAIC to stave off a non-delegation challenge. This is for two fundamental reasons. First, state insurance departments' actual capacity to depart from NAIC materials is extremely limited as a practical matter. Second, individual states' authority to depart from NAIC materials does not empower them to more broadly influence the NAIC's exercise of its delegated authority.

Consider first the practical limits on states' capacity to depart from NAIC materials that are dynamically incorporated by reference into state law. Unlike other public overseers of private delegates, individual state insurance departments must promulgate regulations to reject rules contained within dynamically-incorporated NAIC materials.[239] Doing so, of course, is time consuming, costly, and itself subject to judicial challenge. By contrast, states need merely do nothing to accept the NAIC's exercise of delegated authority. This scheme inhibits state insurance departments' oversight of the

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[235] *See supra* Section I.C.

[236] In the statutory accounting context, the former are referred to as prescribed practices, whereas the latter are referred to as permitted practices.

[237] *See supra* Section II.D.2 (describing Cent. Power & Light Co. v. Sharp, 919 S.W.2d 485 (Tex. App. 1996)).

[238] *See supra* Section II.D.2.

[239] *See supra* Section I.C.

NAIC by making it both costly and difficult. Consistent with this fact, state insurance departments almost never promulgate rules departing from dynamically incorporated NAIC materials.

To be sure, states are empowered to authorize specific departures from NAIC rules for individual insurers without promulgating regulations.[240] But this power to grant individual exemptions to insurers cannot be understood to constitute oversight of the NAIC's delegated power. Instead, it simply allows insurance departments to recognize individual instances where the NAIC's rules may not be appropriate.[241] Moreover, this type of individualized exercise of discretion requires insurers to affirmatively request an exemption; it is not a necessary incident of the NAIC's exercise of delegated power. By contrast, courts that have authorized workers' compensation statues that dynamically incorporate AMA impairment standards have emphasized that administrative law judges must apply these standards using their discretion in order for them to have the force of law.[242]

States' capacity to meaningfully exercise their authority to depart from dynamically incorporated NAIC materials is also limited by the sheer scope of these materials. As described above, states delegate an immense array of different authorities to the NAIC, encompassing not just the rules governing accounting, reserving, and corporate governance, but also a wide range of additional topics.[243] In many ways, the NAIC essentially controls all aspects of financial regulation of U.S. insurers: The entire accounting system comes from NAIC in the AP&P Manual, and the entire method of analyzing and examining insurers' finances and governance is found in the Financial Condition Examiners Handbook and Financial Analysis Handbook.[244] States simply do not have the practical bandwidth to

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[240] *See supra* Section I.C.

[241] *See supra* Section I.C.

[242] *See supra* Section II.D.1.

[243] *See supra* Section I.

[244] There is nothing discrete about NAIC's involvement in setting regulatory policy. Instead, by design, the NAIC has since 1990 attempted to "establish a national system of uniform insurance regulation" with itself at the center. Today, that goal is described in the current "About the NAIC" tagline used in all its official statements, which concludes with the description that "NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S." *See*, *About the NAIC*, *supra* note 15.

meaningfully monitor the NAIC's actions across all of these domains.[245] Perhaps reflecting this difficulty of effectively monitoring expansive delegations of power to private actors, at least one court has suggested that the scope of a state's delegation of power to a private entity is itself relevant to whether it is constitutionally permissible.[246]

Apart from these practical limits on state insurance departments' capacity to depart from dynamically incorporated NAIC materials, any such departures do not, in fact, operate as a form of oversight over the NAIC. The mere fact that one or even several states exercise their authority to depart from NAIC-produced materials does not empower those states to influence the NAIC more broadly. Even in such cases, the NAIC's manuals have the force of law in the vast majority of U.S. jurisdictions. The upshot of this reality is that, unlike other public watchdogs of private parties who are delegated authority, states have limited capacity to transform their veto authority into soft power that can influence the NAIC's actions. Compare, for instance, the power that an individual state wields vis a vis the NAIC relative to the SEC's veto power over FASB. As noted above, the SEC doesn't need to use its veto authority in order for it to dramatically influence FASB's decision-making, because the veto threat is typically enough.[247] No individual state can similarly transform whatever veto authority it has into a broader capacity to oversee the NAIC's operations.

C. THE NAIC'S EXERCISE OF DELEGATED AUTHORITY IS NOT INDEPENDENT FROM THE DELEGATING STATUE

Even state statutes that dynamically incorporate by reference materials that are produced by private organizations without any meaningful public oversight may not violate Constitutional non-delegation principles. At least some courts have approved of such legislative delegations when the

245 *See Improving U.S. Insurance Regulation*, BIPARTISAN POLICY CTR. 26, 28 (Apr. 2017), https://bipartisanpolicy.org/wp-content/uploads/2017/04/Improving-U.S.-Insurance-Regulation.pdf (noting that many state insurance departments have too few resources to effectively regulate their markets).

246 *See* Tex. Boll Weevil Eradication Found., Inc. v. Lewellen, 952 S.W.2d 454 (Tex. 1997), *as supplemented on denial of reh'g* (Oct. 9, 1997).

247 *See supra* Section II.D.1; William W. Bratton, *Private Standards, Public Governance: A New Look at the Financial Accounting Standards Board*, 48 B.C. L. REV. 5 (2007).

private organization is an independent, expert body, as illustrated by the conflicting caselaw on workers' compensation statutes that dynamically incorporate by reference impairment standards produced by the American Medical Association.[248] At first blush, states' prospective incorporation-by-reference of the NAIC's materials may seem defensible under this precedent; the NAIC undoubtedly possesses a massive amount of insurance expertise, both among its direct employees and as a result of its network of state insurance regulators.[249]

But unlike any of these cases where courts have approved of prospective statutory incorporation by reference of a private expert body's standards, the NAIC's production of these standards is not independent of the law-making process. To the contrary, the entire purpose of the NAIC's production of dynamically-incorporated materials is to set the terms by which state insurance regulation operates. Unlike, for instance, the AMA's impairment standards – which can help medical professionals perform their professional obligations for reasons having nothing to do with workers' compensation – the materials contained in the various dynamically-incorporated NAIC materials have no independent purpose aside from state insurance regulation. To illustrate, statutory accounting principles require different accounting standards than GAAP ostensibly to facilitate regulators' capacity to assess whether an insurer will be able to pay its future claims.[250] Similarly, the NAIC's valuation manual exist solely to ensure that carriers meet regulatory expectations in setting aside appropriate funds to pay future claims.[251]

Not only are the NAIC's dynamically incorporated materials created for the express purpose of binding insurers and insurance regulators, but the NAIC actively pressures states to adopt these standards through its accreditation program. The pressure that the NAIC's accreditation program places on states to delegate authority to the NAIC is described in detail in Part I.[252] The key point here, though, is that this type of pressure directly undermines any plausible claim that the NAIC's dynamically-incorporated materials are produced from some reason independent of their legal authority. It is one thing for a private organization to exercise delegated authority for the sole purpose of influencing legal rules. But independence is

[248] *See supra* Section II.D.1.
[249] *See supra* Section I.
[250] *See supra* Section I.B.
[251] *See supra* Section I.B.
[252] *See supra* Section I.

even more lacking when an organization like the NAIC exercises this power only after actively pressuring states to delegate this authority to them.

In fact, the NAIC's accreditation program strikes at the heart of the constitutional concerns that motivate states' non-delegation doctrines by undermining state legislatures' practical ability to claw back power from the NAIC.[253] Simply put, the NAIC faces no practical risk that state legislatures will limit its authority when it uses that authority to further inflate its prominence in state insurance regulation, enhance its revenue, and allow state regulators to fundamentally alter state insurance law without any legally-mediated public accountability. At the end of the day, no state can make a realistic threat that it will reverse its delegation of authority to the NAIC, because doing so would trigger significant tax and employment repercussions for the state. Rather than legislatures delegating authority to the NAIC, the NAIC has – in a quite real sense – successfully constructed a scheme where it delegates to itself the authority to shape insurance regulation as it sees fit, with no public accountability or legally-mandated process.

Ultimately, a substantial portion of U.S. insurance regulation rests on a constitutionally-shaky foundation. As a private entity that is not controlled by state legislatures and unaccountable to any independent public authority, the NAIC's direct exercise of delegated power violates core principles of every states' constitutions. The question, of course, becomes what should states do about this problem.

IV. IMPLICATIONS OF AND SOLUTIONS FOR THE UNCONSTITUTIONAL STRUCTURE OF U.S. INSURANCE REGULATION

Recognizing the unconstitutional foundations of U.S. insurance regulation would complicate the capacity of states to effectively regulate insurers. But it would not undermine states' insurance regulation writ large. This Part explains that conclusion. First, Part A briefly considers both the positive and negative impacts of simply eliminating state delegations of power to the NAIC. Although this approach would increase accountability and decrease bias in the production of state insurance regulation, it would also undermine the uniformity and agility of such regulation. For this reason, Part B suggests one approach to preserving states' reliance on the NAIC while instituting safeguards that would ensure constitutional protections: creating an interstate insurance compact that would be staffed by

[253] *See supra* Section II.C.

independent experts in insurance regulation and responsible for reviewing the production of new NAIC materials that have the force of law.

A. THE CONSEQUENCES OF ELIMINATING STATES' DYNAMIC CROSS REFERENCES TO NAIC MATERIALS

The unconstitutional structure of state insurance regulation is easily remediable. State insurance laws could simply be revised – either directly by state legislatures, or judicially, by courts severing the unconstitutional portions of these laws – so that they only cross-referenced versions of NAIC materials that were finalized before those state laws were enacted.[254] This would mean that NAIC changes to statutorily cross-referenced materials would only have the force of law to the extent that state legislators, after having a chance to review these changes, approved of these materials.[255] State legislatures wishing to delegate this review process to their state insurance departments could easily do so by directly empowering them to adopt via regulation updated versions of cross-referenced NAIC materials.

These reforms would increase the NAIC's accountability and transfer power back to states, where it rightly resides under the current US insurance regulatory framework. In doing so, these reforms could have a substantial impact on the substance of the materials the NAIC adopted in its various manuals. Controversial changes would likely prompt much closer legislative or regulatory scrutiny which, in turn, would have a disciplining effect on what the NAIC chose to include in these materials, leading it to shy away from shoe-horning controversial or substantive provisions into its manuals and guides. This reform would also assure impacted parties of the opportunity to challenge any elements of the NAIC-produced materials that they objected to through the ordinary safeguards built into state legislative or regulatory processes.

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254 *See supra* section II.B (discussing the fact that non-prospective cross-references are not delegations of power, but simply legislative short-hand).

255 In most cases, states could presumably will to do this through omnibus legislation that would be adopted without serious controversy or debate. For this approach to work, the NAIC would be forced to revise its accreditation program standards to clarify that updated NAIC-produced manuals, guides, and the like need only be adopted by states after a reasonable period of time for review and evaluation of those materials by state legislators.

At the same time, this approach could have significant drawbacks by undermining the uniformity and agility of state insurance regulation. A substantial benefit of the NAIC's dynamic incorporation by reference approach is that it allows state insurance regulation to quickly and uniformly respond to emerging regulatory issues. Moreover, states' lack of uniform insurance regulation has proven to be a substantial problem in a variety of settings. Such inconsistencies increase the costs of compliance for insurers,[256] create the prospect of regulatory arbitrage,[257] and potentially undermine the effectiveness of state insurance regulation.[258] For these reasons, it is worthwhile to consider whether reforms to the structure of state insurance law and regulation could simultaneously preserve the NAIC's role in drafting dynamically-incorporated materials for state law while limiting the constitutional infirmities of this approach.

B. A Proposed Interstate Compact to establish Independent Review of the NAIC's Exercise of Delegated Authority

Eliminating state delegations of power to the NAIC would clearly have both costs and benefits. But there is a potential way for state legislatures to avoid this tradeoff by constitutionally delegating power to the NAIC. In particular, they could create, through an interstate compact, an independent public entity that would be tasked with reviewing the NAIC's exercise of delegated authority.

As discussed above, state delegations of power to private entities are generally constitutionally permissible if they are subject to independent oversight by state courts or agencies.[259] But simply applying this approach to the NAIC could create substantial practical problems if the NAIC's revisions of dynamically incorporated materials were independently reviewed in each state, then many of the benefits of consolidating the

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[256] *See* MARTIN F. GRACE & ROBERT W. KLEIN, THE FUTURE OF INSURANCE REGULATION IN THE UNITED STATES 13–51, 117–43 (Brookings Inst. & Geor. State Univ. eds., 2009).

[257] *See* FEDERAL INSURANCE OFFICE, HOW TO MODERNIZE AND IMPROVE THE SYSTEM OF INSURANCE REGULATION IN THE UNITED STATES (2013).

[258] *Id.*

[259] *See supra* Section II.C.

production of these standards at the NAIC might be lost. The rules of state insurance regulation contained in dynamically incorporated materials could be rejected or revised by individual states, potentially leading to the same patchwork of rules that motivated creation of the NAIC accreditation program in the first place.[260]

An interstate compact could allow states to avoid these practical problems while simultaneously assuring that their delegations of power to the NAIC are constitutionally compliant. In particular, states could use an interstate compact to create a new multistate public entity whose sole responsibility would be to independently review the NAIC's exercise of delegated authority. In this sense, the new entity's role would resemble the SEC's oversight of FASB or even state courts' oversight of state agencies under basic administrative law principles. Thus, the new entity created by interstate compact could focus on assessing whether the NAIC's production of materials that have the force of law adhered to various procedural and substantive constraints. Such review, as in both ordinary administrative law and the SEC's oversight of FASB, would presumably be deferential in recognition of the NAIC's expertise.[261] Subjecting the NAIC's exercise of delegated authority to review by an independent, multistate entity created by interstate compact would almost certainly solve the constitutional problems embedded within the current U.S. insurance regulatory framework. As discussed at length above, oversight by an independent, public entity is usually sufficient to insulate delegations of power to a private entity from constitutional scrutiny.[262] Meanwhile, there is little doubt that state legislatures could constitutionally delegate oversight of the NAIC to a new multistate entity that they created by interstate compact, rather than to their own state courts or agencies. It is well established that state legislatures can, via interstate compact, constitutionally create a multistate public agency to formulate regulatory standards.[263] It seemingly follows that states could also constitutionally empower such a multistate entity with responsibility for scrutinizing a private delegate's development of regulatory standards.[264]

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[260] *See supra* Section I.B.

[261] *See supra* Section II.D.1.

[262] *See supra* Section II.C (explaining that delegations to private actors are generally constitutionally if the private actor's exercise of authority is subject to independent, public scrutiny).

[263] *See* Amica v. Wertz, Civil Action No. 15-cv-1161-WJM-CBS (2018).

[264] To be sure, this proposal is still subject to the concern – invoked above with respect to the NAIC – that public officials from one state are not

This proposed approach would not only meet state constitutional requirements, but it would preserve the practical benefits associated with consolidating the production of financial regulatory standards within the NAIC. The NAIC would continue to be in charge of updating materials that are dynamically incorporated by reference in state law, thus avoiding any substantial disruption in the mechanics of state insurance regulation. For similar reasons, the proposed approach would also continue to take advantage of the NAIC's expertise and knowledge in producing the detailed rules of insurance regulation.

Using an interstate compact to create a new multistate entity with a role in insurance regulation is not without precedent. To the contrary, in 2004 participating states created an Interstate Insurance Product Regulation Commission (IIPRC) as "a joint public agency." The IIPRC began operating in 2006 and, as of September 2014, 44 states had enacted legislation agreeing to the Compact, representing over 70% of national premium volume.[265] Consistent with its public status, the IIPRC is legally required to adhere to a number of procedural requirements. For instance, it must follow "a rulemaking process that conforms to the Model State Administrative Procedure Act of 1981" and provide advance written notice of its intent to adopt new standards.[266] Similarly, any standards it promulgates can be judicially challenged in much the same manner as ordinary regulations.[267]

The key difference between the proposal here and the IIPRC is that the new multistate public entity proposed here would be responsible for overseeing the NAIC's production of regulatory rules with the force of law, rather than creating those rules itself. As such, it would need to be structured

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politically accountable to the populations of other states. But this criticism would be muted in the context of a public entity that was affirmatively created by state legislatures to ensure that the NAIC's exercise of delegated authority was itself reasonable.

[265] The IIPRC reviews policy forms based on uniform rules that it promulgates in coordination with the NAIC. IIPRC product rules are initially devised by NAIC and IIPRC committees and subjected to a sixty-day public comment period. To be adopted, they must be approved by 2/3 of the IIPRC management committee, made up of 15 member states representing a cross-section of states, and then 2/3 of all member states. *See* ABRAHAM & SCHWARCZ, *supra* note 2; Elizabeth F. Brown, *Will the Federal Insurance Office Improve Insurance Regulation?*, 81 U. CIN. L. REV. 551, 563 (2012).

[266] Amica v. Wertz, Civil Action No. 15-cv-1161-WJM-CBS.

[267] *Id.*

differently from the IIPRC. Perhaps most importantly, unlike the IIPRC, the proposed multistate entity would need to be independent of the NAIC and state insurance regulators. Consistent with the entity's adjudicative role, this could be accomplished by staffing it with a rotating panel of state appellate judges.

An alternative approach to remedying the unconstitutional structure of state insurance regulation would be to entirely relocate the production of materials that have the force of law from the NAIC to the newly-created multistate entity. This proposal – which would hew closely to the IIPRC approach – would more directly solve the constitutional infirmities of the present state insurance regulatory system by shifting states' delegations of power to a public multistate entity, rather than by subjecting the NAIC's exercise of delegated authority to oversight by that entity. As such, its structure could directly mirror the IIPRC, both with respect to applicable procedural requirements and membership. The most significant drawback of this approach is that it could substantially disrupt the current processes for producing materials that are dynamically incorporated by reference in state law.

But whatever the details, creating a new single, publicly-accountable, entity to play a role in overseeing or producing uniform regulatory standards represents one promising approach to addressing the unconstitutionality of the present state-based regulatory scheme while preserving most of its benefits.

CONCLUSION

Despite ubiquitous rhetoric emphasizing the primacy of states in insurance regulation, the NAIC in many ways operates as a national regulator of the business of insurance. But unlike any other regulator, the NAIC is completely unaccountable to legislatures or judicial officers, either at the state or federal level. The NAIC's accreditation program further undermines its accountability, allowing it to effectively compel states to preserve and expand its delegated authority. This unconstitutional structure has allowed the NAIC to broaden its power, size, and reach, in ways that often have dubious social value. It is now time for states to take back their power from rogue state insurance regulators by holding the NAIC accountable. Doing so need not undermine the structure of state insurance regulation. By using the interstate compact process to create a public entity that would review the NAIC's actions that have the force of law, states can reign in the NAIC's excessive power while preserving the capacity of state insurance regulation to produce uniform and agile standards.