Legislative Regulation Review Committee

2008-020b

Insurance Department

ANNUAL AUDITED FINANCIAL REPORTS

IMPORTANT: Read Instructions on bottom of Certification Page before completing this Form. Failure to comply with instructions may cause disapproval of proposed Regulations.

STATE OF CONNECTICUT

REGULATION

OF

NAME OF AGENCY
INSURANCE DEPARTMENT

Concerning

SUBJECT MATTER OF REGULATION

Annual Audited Financial Reports

SECTION 1

Sections 38a-54-1 to 38a-54-14, inclusive, of the Regulations of Connecticut State Agencies are amended to read as follows:

Sec. 38a-54-1. Purpose and scope

(a) Sections 38a-54-1 to 38a-54-14, inclusive, of the Regulations of Connecticut State Agencies are intended to improve the Insurance Department's surveillance of the financial condition of insurance companies, health care centers and fraternal benefit societies doing business in the State of Connecticut by requiring (1) an annual [examination] audit of financial statements reporting the financial position and the results of operations of insurers by independent certified public accountants [of the financial statements reporting the financial position and the results of operations of insurers], (2) a Communication of Internal Control Related Matters Noted in an Audit, and (3) a Management's Report of Internal Control Over Financial Reporting.

(b)(1) Every insurer as defined in Section 38a-54-2 of the Regulations of Connecticut State Agencies shall be subject to the requirements of Sections 38a-54-1 to 38a-54-14, inclusive, of the Regulations of Connecticut State Agencies. Insurers having direct premiums written in this state of less than $1,000,000 in any year and having less than 1,000 policyholders or certificateholders of directly written policies nationwide at the end of any year are exempt from Sections 38a-54-1 to 38a-54-14, inclusive, of the Regulations of Connecticut State Agencies for such year, unless the Commissioner makes a specific finding that compliance is necessary for the Commissioner to carry out statutory responsibilities, except that insurers having assumed premiums pursuant to contracts and/or treaties of reinsurance of $1,000,000 or more shall not be so exempt.

(2) Foreign and alien insurers filing the audited financial reports in another state, pursuant to [such other] that state's requirement for filing of audited financial reports which has been found by the Commissioner to be substantially similar to the requirements herein, are exempt from Sections 38a-54-1 to 38a-54-14, inclusive, of the Regulations of Connecticut State Agencies if:

(A) a copy of the [Audited] audited [Financial Report] financial report, Communication of Internal Control Related Matters Noted in an Audit, [Report on Significant Deficiencies in Internal Controls,] and the Accountant's Letter of Qualifications, which are filed with such other state, are filed with the Commissioner in accordance with the filing dates specified in Sections 38a-54-3, 38a-54-9a and 38a-54-10, of the Regulations of Connecticut State Agencies respectively, (Canadian insurers may submit [independent auditors'] accountants' reports as filed with the [Canadian Dominion Department of Insurance] Office of the Superintendent of Financial Institutions, Canada); and

(B) a copy of any [notification of adverse financial condition report] Notification of Adverse Financial Condition Report filed with such other state is filed with the Commissioner within the time specified in Section 38a-54-9 of the Regulations of Connecticut State Agencies.

(C) Foreign or alien insurers required to file a Management's Report of Internal Control Over Financial Reporting in another state are exempt from filing such Report in this state provided the other state has substantially similar reporting requirements and the report is filed with the Commissioner of the other state within the time specified by the other state.

(c) Sections 38a-54-1 to 38a-54-14, inclusive, of the Regulations of Connecticut State Agencies shall not prohibit, preclude or in any way limit the Insurance Commissioner from ordering and/or conducting and/or performing examinations of insurers under the General Statutes, Regulations and procedures of the Connecticut Insurance Department.

Sec. 38a-54-2. Definitions

As used in Sections 38a-54-1 to 38a-54-13, inclusive of the Regulations of Connecticut State Agencies:

(a) "Accountant" or "independent certified public accountant" means an independent certified public accountant or accounting firm in good standing with the American Institute of Certified Public Accountants (AICPA) and in all states in which he or she is licensed to practice; for Canadian and British companies, it means a Canadian-chartered or British-chartered accountant.

(b) An "affiliate" of, or person "affiliated" with, a specific person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.

(c) "Audit committee" means a committee (or equivalent body) established by the board of directors of an entity for the purpose of overseeing the accounting and financial reporting processes of an insurer or group of insurers, and audits of financial statements of the insurer or group of insurers. The audit committee of any entity that controls a group of insurers may be deemed to be the audit committee for one or more of these controlled insurers solely for the purposes of Sections 38a-54-1 through 38a-54-14, inclusive, of the Regulations of the Connecticut State Agencies at the election of the controlling person in accordance with the provisions of Section 38a-54-11a(e). If an audit committee is not designated by the insurer, the insurer's entire board of directors shall constitute the audit committee.

[(b)](d) "Audited financial report" or "statutory financial statement" or "audited statutory financial statement" [means and includes]mean and include those items specified in Section 38a-54-4 of the Regulations of Connecticut State Agencies.

(e) "Business combination" means the consolidation, for accounting purposes, of a corporation and one or more incorporated or unincorporated businesses. In a business combination, the multiple entities are considered as one entity for accounting purposes.

[(c)] (f) "Commissioner" means the Insurance Commissioner of the State of Connecticut.

[(d)] (g) "Department" or "Insurance Department" means the Insurance Department of the State of Connecticut.

[(e)] (h) "Indemnification" means an agreement of indemnity or a release from liability where the intent or effect is to shift or limit in any manner the potential liability of the person or firm for failure to adhere to applicable auditing or professional standards, whether or not resulting in part from other misrepresentations made knowingly or otherwise by the insurer or its representatives.

(i) "Independent board member" has the same meaning as described in Section 38a-54-11a of the Regulations of Connecticut State Agencies.

[(f)](j) "Insurer" or "Insurance Company" means an insurance company, health care center or fraternal benefit society licensed by the Commissioner to do business in this State.

(k) "Group of insurers" means those licensed insurers included in the reporting requirements of Sections 38a-129 through 38a-142, inclusive, of the Connecticut General Statutes, or a set of such insurers as identified by management, for the purpose of assessing the effectiveness of internal controls over financial reporting.

(l) "Internal control over financial reporting" means a process effected by an entity's board of directors, management and other personnel designed to provide reasonable assurance regarding the reliability of financial statements such as those items specified in Section 38a-54-4 of the Regulations of Connecticut State Agencies and including those policies and procedures that:

(1) Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets;

(2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and

(3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statement.

[(g)](m) "NAIC" means the National Association of Insurance Commissioners.

(n) "SEC" means the United States Securities and Exchange Commission.

(o) "Section 404" means Section 404 of the Sarbanes-Oxley Act of 2002 and the SEC's rules and regulations promulgated thereunder.

(p) "Section 404 Report" means a management's report on "internal control over financial reporting" as defined by the SEC and the Communication of Internal Control Related Matters Noted in an Audit.

(q) "SOX compliant entity" means an entity that either is required to be compliant with, or voluntarily is compliant with, the following provisions of the Sarbanes-Oxley Act of 2002: (1) the preapproval requirements of Section 201 (Section 10A(i) of the Securities Exchange Act of 1934); (2) the audit committee independence requirements of Section 301 (Section 10A(m)(3) of the Securities Exchange Act of 1934); and (3) the internal control over financial reporting requirements of Section 404 (Item 308 of SEC Regulation S-K).

(r) "Statutory audit" means the inspection of the accounting records and procedures of a business, government unit, or other reporting entity by an accountant for the purpose of verifying the accuracy and completeness of the records.

(s) "Statutory audit opinion" means the written conclusion based upon the statutory audit which indicates whether in the opinion of the accountant, the admitted assets, liabilities and surplus are represented fairly in all material respects.

[(h)](t) "Workpapers" means the records kept by the independent certified public accountant of the procedures followed, the tests performed, the information obtained, and the conclusions reached pertinent to his or her examination of the financial statements of an insurer. Workpapers, accordingly, may include audit planning documentation, summary of unadjusted differences, audit completion memorandum, work programs, analyses, memoranda, letters of confirmation and representation, abstracts of company documents and schedules or commentaries prepared or obtained by the independent certified public accountant in the course of his or her examination of the financial statements of an insurer and which support his or her opinion thereof.

Sec. 38a-54-3. General requirements related to [Filing] filing and extension for filing of annual audited financial reports and [Audit Committee Appointment]audit committee appointment

(a) All insurers shall have an annual audit by an independent certified public accountant and shall file an audited financial report with the Commissioner on or before June 1 for the year ended December 31 immediately preceding. The Commissioner may require an insurer to file an audited financial report earlier than June 1 with ninety (90) days advance notice to the insurer.

(b) Extensions of the June 1 filing date may be granted by the Commissioner for thirty (30) day periods upon showing by the insurer and its independent certified public accountant the reasons for requesting such extension and determination by the Commissioner of good cause for an extension. The request for extension shall be received in writing not less than ten (10) days prior to the due date in sufficient detail to permit the Commissioner to make an informed decision with respect to the requested extension.

(c) If an extension is granted in accordance with the provisions of this section, a similar extension of thirty (30) days shall be granted for the filing of the Management's Report of Internal Control Over Financial Reporting.

(d) Each insurer required to file an annual audited financial report pursuant to Sections 38a-54-1 through 38a-54-14, inclusive, of the Regulations of the Connecticut State Agencies shall designate a group of individuals as constituting its audit committee, as defined in Section 38a-54-2. The audit committee of an entity that controls an insurer may be deemed to be the insurer's audit committee for purposes of Sections 38a-54-1 through 38a-54-14, inclusive, of the Regulations of the Connecticut State Agencies at the election of the controlling person.

Sec. 38a-54-4. Contents of annual audited financial report

(a) The annual audited financial report shall report the financial position of the insurer as of the end of the most recent calendar year and the results of its operations, cash flows and changes in capital and surplus for the year then ended in conformity with statutory accounting practices prescribed, or otherwise permitted, by the department of insurance of the state of domicile.

(b) The annual audited financial report shall include the following:

(1) report of independent certified public accountant;

(2) balance sheet reporting admitted assets, liabilities, capital and surplus;

(3) statement of operations;

(4) statement of changes in capital and surplus;

(5) statement of cash flows;

(6) notes to financial statements. These notes shall be those required by the appropriate NAIC Annual Statement Instructions and the NAIC Accounting Practices and Procedures Manual. The notes shall include a reconciliation of differences, if any, between the audited statutory financial statements and the annual statement filed pursuant to Section 38a-53 of the Connecticut General Statutes with a written description of the nature of these differences.

(c) The financial statements included in the Audited [Financial Report] financial report shall be prepared in a form and using language and groupings substantially the same as the relevant sections of the annual statement of the insurer filed with the Commissioner; the financial statements shall be comparative, presenting the amounts for the years ended December 31 of the current and immediately preceding year. However, in the first year in which an insurer is required to file an audited financial report, the comparative data may be omitted.

Sec. 38a-54-5. Designation of independent certified public accountant

(a) Each insurer required to file an annual audited financial report pursuant to Section 38a-54-3 of the Regulations of Connecticut State Agencies shall within sixty (60) days after becoming subject to such requirement, register with the Commissioner in writing the name and address of the independent certified public accountant or accounting firm [(generally referred to in Sections 38a-54-1 to 38a-54-14, of the Regulations of Connecticut State Agencies inclusive, as the "accountant")] retained to conduct the annual audit required by Section 38a-54-3 of the Regulations of Connecticut State Agencies. Insurers not retaining an independent certified public accountant on the effective date of Section 38a-54-3 of the Regulations of Connecticut State Agencies shall register the name and address of their retained independent certified public accountant not less than six (6) months before the date when the first audited financial report is to be filed.

(b) The insurer shall obtain a letter from the accountant, and file a copy with the Commissioner stating that the accountant is aware of the provisions of the insurance code and the rules and Regulations of the insurance department of its state of domicile that relate to accounting and financial matters and affirming that he or she will express his or her opinion on the financial statements in terms of their conformity to the statutory accounting practices prescribed or otherwise permitted by such department, specifying such exceptions as he or she may believe appropriate. If an accountant who was the accountant for the immediately preceding filed audited financial report is dismissed or resigns, the insurer shall notify the Connecticut Insurance Department within five (5) business days of this event. The insurer shall also furnish the Commissioner with a separate letter within ten (10) business days of the above notification stating whether in the twenty-four (24) months preceding such event there were any disagreements with the former accountant on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of the former accountant, would have caused him or her to make reference to the subject matter of the disagreement in connection with his or her opinion. The disagreements required to be reported in response to this section include both those resolved to the former accountant's satisfaction and those not resolved to the former independent accountant's satisfaction. Disagreements contemplated by this section are those that occur at the decision-making level, that is, between personnel of the insurer responsible for presentation of its financial statements and personnel of the accounting firm responsible for rendering its report. The insurer shall also in writing request such former accountant to furnish a letter addressed to the insurer stating whether the accountant agrees with the statements contained in the insurer's letter and, if not, stating the reasons for which he or she does not agree; and the insurer shall furnish such responsive letter from the former accountant to the Commissioner together with its own.

Sec. 38a-54-6. Qualifications of independent certified public accountant

(a) The Commissioner shall not recognize any person or firm as a qualified independent certified public accountant if the person or firm: (1) is not in good standing with the [American Institute of Certified Public Accountants] AICPA and in all states in which the accountant is licensed to practice, or, for a Canadian or British company, that is not a chartered accountant; or

(2) has either directly or indirectly entered into an agreement of indemnity or release from liability (collectively referred to as "indemnification") with respect to the audit of the insurer.

(b) Except as otherwise provided herein, the Commissioner shall recognize an independent certified public accountant as qualified in accordance with Sections 38a-54-1 to 38a-54-14, inclusive, of the Regulations of Connecticut State Agencies as long as he or she conforms to the standards of his or her profession, as contained in the Code of Professional Ethics of the [American Institute of Certified Public Accountants] AICPA and Rules and Regulations and Code of Ethics and Rules of Professional Conduct of the Connecticut [Board of Public] State Board of Accountancy, or similar code.

(c) A qualified independent certified public accountant may enter into an agreement with an insurer to have disputes relating to an audit resolved by mediation or arbitration. However, in the event of a [deliquency] delinquency proceeding commenced against the insurer under Chapter 704c of the Connecticut General Statutes, the mediation or arbitration provisions shall operate at the option of the statutory successor.

(d) [No partner or other persons responsible for rendering an independent audit report] The lead or coordinating audit partner having primary responsibility for the audit may not act in that capacity for more than [seven (7)] five (5) consecutive years. [Following any period of service such] The person shall be disqualified from acting in that or a similar capacity for the same company or its insurance subsidiaries or affiliates for a period of [two (2)] five (5) consecutive years. An insurer may make application to the Commissioner for relief from the above rotation requirement on the basis of unusual circumstances. This application shall be made at least thirty (30) days before the end of the calendar year. The Commissioner may consider the following factors in determining if the relief sought should be granted:

(1) number of partners, expertise of the partners or the number of insurance clients in the currently registered firm;

(2) premium volume of the insurer; or

(3) number of jurisdictions in which the insurer transacts business.

The requirements of this subsection shall become effective on July 29, 1996.

(e) An insurer shall file, with its annual statement filing, the approval for relief as provided in subsection (d) of this section with the states that it is licensed in or doing business in and with the NAIC. If the non-domestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.

(f) The Commissioner shall [not] neither recognize as a qualified independent certified public accountant, nor accept any annual audited financial report prepared in whole or in part by, any person who:

(1) has been convicted of fraud, bribery, a violation of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. Sections 1961- 1968, or any dishonest conduct or practices under federal or state law;

(2) has been found to have violated the insurance laws of this State with respect to any previous reports submitted under Sections 38a-54-1 to 38a-54-14, inclusive, of the Regulations of Connecticut State Agencies; or

(3) has demonstrated a pattern or practice of failing to detect or disclose material information in previous reports filed under the provisions of Sections 38a-54-1 to 38a-54-14, inclusive, of the Regulations of Connecticut State Agencies.

[(f)] (g) The Insurance Commissioner may, as provided in Section 38a-16 of the Connecticut General Statutes and the Rules of Practice of the Insurance Department, hold a hearing to determine whether [a] an independent certified public accountant is qualified and, considering the evidence presented, may rule that the accountant is not qualified for purposes of expressing his or her opinion on the financial statements in the annual audited financial report made pursuant to Section 38a-54-3 of the Regulations of Connecticut State Agencies and require the insurer to replace the accountant with another whose relationship with the insurer is qualified within the meaning of this section.

(h) (1) The Commissioner shall not recognize an independent certified public accountant as qualified, nor accept an annual audited financial report prepared in whole or in part by an accountant who provides to an insurer, contemporaneously with the audit, the following non-audit services:

(A) Bookkeeping or other services related to the accounting records or financial statements of the insurer;

(B) Financial information systems design and implementation;

(C) Appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

(D) Actuarially-oriented advisory services involving the determination of amounts recorded in the financial statements. The accountant may assist an insurer in understanding the methods, assumptions and inputs used in the determination of amounts recorded in the financial statement only if it is reasonable to conclude that the services provided will not be subject to audit procedures during an audit of the insurer's financial statements. An accountant's actuary may also issue an actuarial opinion or certification on an insurer's reserves if the following conditions have been met:

(i) Neither the accountant nor the accountant's actuary has performed any management functions or made any management decisions;

(ii) The insurer has competent personnel, or engages a third party actuary, to estimate the reserves for which management takes responsibility; and

(iii) The accountant's actuary tests the reasonableness of the reserves after the insurer's management has determined the amount of the reserves;

(E) Internal audit outsourcing services;

(F) Management functions or human resources;

(G) Broker or dealer, investment advisor, or investment banking services;

(H) Legal services or expert services unrelated to the audit; or

(I) Any other services that the Commissioner determines, by regulation, are impermissible.

(2) To be considered independent with respect to services provided by the qualified independent certified public accountant, the accountant shall not function in the role of management, audit his own work, or serve in an advocacy role for the insurer.

(i) Insurers having direct written and assumed premiums of less that $100,000,000 in any calendar year may request an exemption from subsection (h)(1) of this section. The insurer shall file with the Commissioner a written statement discussing the reasons why the insurer should be exempt from these provisions. If the Commissioner finds, upon review of this statement, that compliance with said subsection would constitute a financial or organizational hardship upon the insurer, an exemption may be granted.

(j) A qualified independent certified public accountant who performs the audit may engage in other non-audit services, including tax services, that are not described in subsection (h)(1) of this section or that do not conflict with subsection (h)(2) of this section, only if the activity is approved in advance by the audit committee, in accordance with subsection (k) of this section.

(k) All auditing services and non-audit services provided to an insurer by the qualified independent certified public accountant of the insurer shall be preapproved by the audit committee. The preapproval requirement is waived with respect to non-audit services if the insurer is a SOX compliant entity or a direct or indirect wholly-owned subsidiary of a SOX compliant entity or:

(1) The aggregate amount of all such non-audit services provided to the insurer constitutes not more than five percent (5%) of the total amount of fees paid by the insurer to its qualified independent certified public accountant during the fiscal year in which the non-audit services are provided;

(2) The services were not recognized by the insurer at the time of the engagement to be non-audit services; and

(3) The services are promptly brought to the attention of the audit committee and approved prior to the completion of the audit by the audit committee or by one or more members of the audit committee who are members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee pursuant to subsection (l) of this section.

(l) The audit committee may delegate to one or more designated members of the audit committee who are members of the board of directors the authority to grant pre-approvals required by subsection (k) of this section. The decisions of any members to whom this authority is delegated shall be presented to the full audit committee at each of its scheduled meetings.

(m) (1) The Commissioner shall not recognize an independent certified public accountant as qualified for a particular insurer if a member of the board, president, chief executive officer, comptroller, chief financial officer, chief accounting officer, or any person serving in an equivalent position for that insurer, was employed by the independent certified public accountant and participated in the audit of that insurer during the one-year period preceding the date that the most current statutory audit opinion is due. This subsection shall only apply to partners and

senior managers involved in the audit. An insurer may make written application to the Commissioner for relief from this subsection on the basis of unusual circumstances.

(2) The insurer shall file, with its annual statement filing, the approval for relief from subsection (m)(1) of this section with the states that it is licensed in or doing business in and the NAIC. If the non-domestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.

(n) The requirements of this section shall be effective for audits in the year beginning January 1, 2010.

Sec. 38a-54-7. Consolidated or combined audits

An insurance company may make written application to the Commissioner for approval to file audited consolidated or combined financial statements in lieu of separate annual audited financial statements if the insurer is part of a group of insurance companies which utilizes a pooling or one hundred percent reinsurance agreement that affects the solvency and integrity of the insurer's reserves and such insurer cedes all of its direct and assumed business to the pool. In such cases, a columnar consolidating or combining worksheet shall be filed with the report, as follows:

[(a)] (1) Amounts shown on the consolidated or combined audited financial report shall be shown on the worksheet.

[(b)] (2) Amount for each insurer subject to this section shall be stated separately.

[(c)] (3) Noninsurance operations may be shown on the worksheet on a combined or individual basis.

[(d)] (4) Explanations of consolidating and eliminating entries shall be included.

[(e)] (5) A reconciliation shall be included of any differences between the amounts shown in the individual insurer columns of the worksheet and comparable amounts shown on the annual statements of the insurers.

Sec. 38a-54-8. Scope of [examination] audit and report of independent certified public accountant

Financial statements furnished pursuant to Section 38a-54-4 of the Regulations of Connecticut State Agencies shall be examined by [an] the independent certified public accountant. The [examination] audit of the insurance company's financial statements shall be conducted in accordance with generally accepted auditing standards. In accordance with AU Section 319 of the Professional Standards of the AICPA, Consideration of Internal Control in a Financial Statement Audit, the independent certified public accountant shall obtain an understanding of internal control sufficient to plan the audit. To the extent required by AU 319, for those insurers required to file a Management's Report of Internal Control Over Financial Reporting pursuant to Section 38a-54-11c of the Regulations of Connecticut State Agencies, the independent certified public accountant shall consider, as that term is defined in Statement on Auditing Standards 102, Defining Professional Requirements in Statements on Auditing Standards or its replacement, the most recently available report in planning and performing the audit of the statutory financial statements. [and consideration]Consideration [should] shall be given to [such other] the procedures illustrated in the Financial Condition Examiner's Handbook promulgated by the National Association of Insurance Commissioners as the independent certified public accountant deems necessary.

Sec. 38a-54-9. Notification of adverse financial condition

(a) The insurer required to furnish the annual audited financial report shall require the independent certified public accountant to notify in writing within five (5) business days the board of directors or its audit committee any determination by [that] the independent certified public accountant that the insurer has materially misstated its financial condition as reported to the Commissioner as of the balance sheet date currently under [examination]audit or that the insurer does not meet the minimum capital and surplus requirement of Section 38a-72 of the Connecticut General Statutes, as amended, as of that date. The insurer shall furnish such notification to the Commissioner within five (5) business days of receipt thereof and shall provide the independent certified public accountant making the report with evidence of the report

being furnished to the Commissioner. If the independent certified public accountant fails to receive such evidence within the required five (5) business day period, the independent certified public accountant shall furnish to the Commissioner a copy of its report within the next five (5) business days.

(b) No independent certified public accountant shall be liable in any manner to any person for any statement made in connection with this section if such statement is made in good faith compliance with this section.

(c) If the accountant, subsequent to the date of the audited financial report filed pursuant to Section 38a-54-3 of the Regulations of Connecticut State Agencies, becomes aware of facts which might have affected his or her report, the accountant shall fulfill his or her obligation to take such action as prescribed in Volume 1, Section AU 561 of the Professional Standards of the [American Institute of Certified Public Accountants]AICPA.

Sec. 38a-54-9a. [Report on significant deficiencies in internal controls] Communication of Internal Control Related Matters Noted in an Audit

(a) In addition to the annual audited financial [statements] report, each insurer shall furnish the Commissioner with a written [report] communication as to any unremediated material weaknesses in its internal controls over financial reporting noted during the audit. Such communication shall be prepared by the accountant [describing significant deficiencies in the insurer's internal control structure noted by the accountant during the audit] within sixty (60) days after the filing of the annual audited financial report, and shall contain: a description of any unremediated material weakness, as the term "material weakness" is defined in Statement on Auditing Standards 60 [SAS No. 60], Communication of Internal Control [Structure] Related Matters Noted in an Audit, [(AU Section 325 of the Professional Standards of the American Institute of Certified Public Accountants)] or its replacement as of December 31 immediately preceding, so as to coincide with the audited financial report set forth in Section 38a-54-3 in the insurer's internal control over financial reporting noted by the accountant during the course of the audit. [requires an accountant to communicate significant deficiencies (known as "reportable conditions") noted during a financial statement audit to the appropriate parties within an entity. No report should be issued if the accountant does not identify significant deficiencies. If significant deficiencies are noted, the written report shall be filed annually by the insurer with the Department within sixty (60) days after the filing of the annual audited financial statements. The insurer is required to provide a description of remedial actions taken or proposed to correct significant deficiencies, if such actions are not described in the accountant's report.]

(b) The insurer is required to provide a description of remedial actions taken or proposed to correct unremediated material weaknesses, if the actions are not described in the accountant's communications.

(c) If no unremediated material weaknesses were noted, the communication should so state in written notification to the Commissioner by June 1 as part of the annual audited financial report filing.

Sec. 38a-54-10. Accountant's letter of qualifications

The accountant shall furnish the insurer in connection with, and for inclusion in, the filing of the annual audited financial report, a letter [stating]which states all of the following:

(1) That the accountant is independent with respect to the insurer and conforms to the standards or his or her profession as contained in the Code of Professional Ethics and [Pronouncements] pronouncements of the [American Institute of Certified Public Accountants] AICPA and the Rules of Professional Conduct of the Connecticut [Board of Public] State Board of Accountancy, or similar code.

(2) With respect to the staff assigned to the engagement, their background and experience in general, their experience in audits of insurers, and whether each is an independent certified public accountant. Nothing within Sections 38a-54-1 to 38a-54-14, inclusive, of the Regulations of Connecticut State Agencies shall be construed as prohibiting the accountant from utilizing such staff as he or she deems appropriate where use is consistent with the standards prescribed by generally accepted auditing standards.

(3) That the accountant understands the annual audited financial report and his or her opinion thereon will be filed in compliance with Sections 38a-54-1 to 38a-54-14, inclusive, of

the Regulations of Connecticut State Agencies and that the Commissioner will be relying on this information in the monitoring and regulation of the financial position of insurers.

(4) That the accountant consents to the requirements of Section 38a-54-11 of the Regulations of Connecticut State Agencies and that the accountant consents and agrees to make available for review by the Commissioner, his designee or his appointed agent, the workpapers, as defined in Section 38a-54-2 of the Regulations of Connecticut State Agencies.

(5) A representation that the accountant is properly licensed by an appropriate state licensing authority and is a member in good standing in the [American Institute of Certified Public Accountants] AICPA.

(6) A representation that the accountant is in compliance with the requirements of Section 38a-54-6 of the Regulations of Connecticut State Agencies.

Sec. 38a-54-11. Availability and maintenance of independent CPA workpapers

(a) Every insurer required to file an audited financial report pursuant to Section 38a-54-3, shall require the accountant to make available for review by Insurance Department examiners, all workpapers prepared in the conduct of his or her [examination] audit and any communications related to the audit between the accountant and the insurer, at the offices of the insurer, at the Insurance Department or at any other reasonable place designated by the Commissioner. The insurer shall require that the accountant retain the audit workpapers and communications until the Insurance Department has filed a report of examination covering the period of the audit but no longer than seven (7) years from the date of the audit report.

(b) In the conduct of the aforementioned periodic review by the Department examiners, it shall be agreed that photocopies of pertinent audit workpapers may be made and retained by the Department. Such reviews by the Department examiners shall be considered investigations and all working papers and communications obtained during the course of such investigations shall be afforded the same confidentiality as other examination workpapers generated by the Department.

(NEW) Sec. 38a-54-11a. Requirements for audit committees

(a) This section shall not apply to foreign or alien insurers licensed in this state or an insurer that is a SOX compliant entity or a direct or indirect wholly-owned subsidiary of a SOX compliant entity.

(b) The audit committee shall be directly responsible for the appointment, compensation and oversight of the work of any accountant (including resolution of disagreements between management and the accountant regarding financial reporting) for the purpose of preparing or issuing the audited financial report or related work pursuant to this section. Each accountant shall report directly to the audit committee.

(c) Each member of the audit committee shall be a member of the board of directors of the insurer or a member of the board of directors of an entity elected pursuant to subsection (e) of this section and Section 38a-54-2(c) of the Regulations of Connecticut State Agencies.

(d) In order to be considered independent for purposes of this section, a member of the audit committee may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee, accept any consulting, advisory or other compensatory fee from the entity or be an affiliated person of the entity or any subsidiary thereof. However, if law requires board participation by otherwise non-independent members, that law shall prevail and such members may participate in the audit committee and be designated as independent for audit committee purposes, unless they are an officer or employee of the insurer or one of its affiliates.

(e) If a member of the audit committee ceases to be independent for reasons outside the member's reasonable control, such member, with notice by the responsible entity to the Commissioner, may remain an audit committee member of the responsible entity until the earlier of the next annual meeting of the responsible entity or one year from the occurrence of the event that caused the member to be no longer independent.

(f) To exercise the election of the controlling person to designate the audit committee for purposes of this section, the ultimate controlling person shall provide written notice to the commissioners of the states in which the affected insurers are licensed in or do business in.

Timely notification shall be made prior to the issuance of the report of the statutory audit opinion and include a description of the basis for the election. The election may be changed through notice to the Commissioner by the insurer, which shall include a description of the basis for the change. The election shall remain in effect, until rescinded.

(g)(1) The audit committee shall require the accountant that performs for an insurer any audit required by this section to timely report to the audit committee in accordance with the requirements of Statement on Auditing Standards 61, Communication with Audit Committees, or its replacement, including:

(A) all significant accounting policies and material permitted practices;

(B) all material alternative treatments of financial information within statutory accounting principles that have been discussed with management officials of the insurer, ramifications of the use of the alternative disclosures and treatments, and the treatment preferred by the accountant; and

(C) other material written communications between the accountant and the management of the insurer, such as any management letter or schedule of unadjusted differences.

(2) If an insurer is a member of an insurance holding company system, the reports required by subdivision (1) of this subsection may be provided to the audit committee on an aggregate basis for insurers in the holding company system, provided that any substantial differences among insurers in the system are identified to the audit committee.

(h) The proportion of independent audit committee members shall meet or exceed the following criteria:

Prior Calendar Year Direct Written and Assumed Premiums		
$0 - $300,000,000	**Over $300,000,000 - $500,000,000**	**Over $500,000,000**
No minimum requirements. See also Note A, B and C.	Majority (50% or more) of members shall be independent. See also Note A, B and C.	Supermajority of members (75% or more) shall be independent. See also Note A and C.

Note A: As provided in Sections 38a-8 and 38a-72 of the Connecticut General Statutes, the Commissioner shall require the entity's board to enact improvements to the independence of the audit committee membership if the insurer is in a risk-based capital action level event, meets one or more of the standards of an insurer deemed to be in hazardous financial condition, or otherwise exhibits qualities of a troubled insurer.

Note B: All insurers with less than $500,000,000 in prior year direct written and assumed premiums are encouraged to structure their audit committees with at least a supermajority of independent audit committee members.

Note C: Prior calendar year direct written and assumed premiums shall be the combined total of direct premiums and assumed premiums from non-affiliates for the reporting entities.

(i) An insurer with direct written and assumed premiums, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, of less than $500,000,000 may make written application to the Commissioner for a waiver from the requirements of this section based upon hardship. The insurer shall file, with its annual statement filing, any approval for relief granted by the Commissioner from this section with the states that it is licensed in or doing business in and the NAIC. If the non-domestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.

(j) The requirements of this section shall be effective January 1, 2010. An insurer or group of insurers that is not required to have independent audit committee members or only a majority of independent audit committee members, as opposed to a supermajority, because the total written and assumed premium is below the threshold that subsequently becomes subject to one of the independence requirements as provided in Section 38a-54-11a(h) of the Regulations of Connecticut State Agencies due to changes in premium shall have one year following the year

the threshold is exceeded, but not earlier than January 1, 2010, to comply with the independence requirements. Likewise, an insurer that becomes subject to one of the independence requirements as a result of a business combination shall have one calendar year following the date of acquisition or business combination to comply with the independence requirements.

(NEW) **Sec. 38a-54-11b. Conduct of insurer in connection with the preparation of required reports and documents**

(a) No director or officer of an insurer shall, directly or indirectly: (1) Make or cause to be made a materially false or misleading statement to an accountant in connection with any audit, review or communication required under this section; or (2) make, or cause another person to make, a misleading statement by omitting a material statement to an accountant in connection with any audit, review or communication required under this section.

(b) No officer or director of an insurer, or any other person acting under the direction therof, shall directly or indirectly take any action to coerce, manipulate, mislead or fraudulently influence any accountant engaged in the performance of an audit pursuant to Sections 38a-54-1 through 38a-54-14, inclusive, of the Regulations of the Connecticut State Agencies if such director, officer or person knew or should have known that the action, if successful, could result in rendering the insurer's financial statements materially misleading.

(c) For purposes of subsection (b) of this section, actions that if successful, could result in rendering the insurer's financial statements materially misleading include, but are not limited to, actions taken at any time with respect to the professional engagement period to coerce, manipulate, mislead or fraudulently influence an accountant:

(1) To issue or reissue a report on an insurer's financial statements that is not warranted in the circumstances (due to material violations of statutory accounting principles prescribed by the Commissioner, generally accepted auditing standards, or other professional or regulatory standards);

(2) Not to perform audit, review or other procedures required by generally accepted auditing standards or other professional standards;

(3) Not to withdraw an issued report; or

(4) Not to communicate matters to an insurer's audit committee.

(d) The requirements of this section shall be effective beginning with the reporting period ending December 31, 2010 and each year thereafter. An insurer or group of insurers that is not required to file a report because the total written premium is below the threshold that subsequently becomes subject to the reporting requirements shall have two years following the year the threshold is exceeded, but not earlier than December 31, 2010 to file a report. Likewise, an insurer acquired in a business combination shall have two calendar years following the date of acquisition or business combination to comply with the reporting requirements.

(NEW) **Sec. 38a-54-11c. Management's Report of Internal Control Over Financial Reporting**

(a) Each insurer required to file an audited financial report pursuant to Sections 38a-54-1 through 38a-54-14, inclusive, of the Regulations of the Connecticut State Agencies that has annual direct written and assumed premiums, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, of $500,000,000 or more shall prepare a report of the insurer's or group of insurers' internal control over financial reporting, as these terms are defined in Section 38a-54-2. The report shall be filed with the Commissioner along with the Communication of Internal Control Related Matters Noted in an Audit described under Section 38a-54-9a of the Regulations of Connecticut State Agencies. The Management's Report of Internal Control Over Financial Reporting shall be as of December 31 immediately preceding.

(b) Notwithstanding the premium threshold in subsection (a) of this section, the Commissioner may require an insurer to file a Management's Report of Internal Control over Financial Reporting if the insurer is in a risk-based capital level event, or meets any one or more of the standards of an insurer deemed to be in hazardous financial condition as defined in Sections 38a-8-101 to 38a-104, inclusive, 38a-72-1 to 38a-72-13, inclusive, and 38a-193-1 to 38a-193-13, inclusive, of the Regulations of the Connecticut State Agencies.

(c) An insurer or a group of insurers that is (1) directly subject to Section 404; (2) part of a holding company system whose parent is directly subject to Section 404; (3) not directly subject to Section 404 but is a SOX compliant entity; or (4) a member of a holding

company system whose parent is not directly subject to Section 404 but is a SOX compliant entity, may file its or its parent's Section 404 Report and an addendum in satisfaction of this section's requirement, provided that the internal controls of the insurer or group of insurers having a material impact on the preparation of the insurer's or group of insurers' audited statutory financial statements (those items included in Section 38a-54-4 of the Regulations of Connecticut State Agencies) were included in the scope of Section 404 Reports. The addendum shall be a positive statement by management that there are no material processes with respect to the preparation of the insurer's or group of insurers' audited statutory financial statements (those items included in Section 38a-54-4 of the Regulations of Connecticut State Agencies) excluded from the Section 404 Report. If there are internal controls of the insurer or group of insurers or that have a material impact on the preparation of the insurer's or group of insurers' audited statutory financial statements and those internal controls were not included in the scope of the Section 404 Report, the insurer or group of insurers may either file a report pursuant to this section or a Section 404 Report and a report pursuant to this section for those internal controls that have a material impact on the preparation of the insurer's or group of insurers' audited statutory financial statements not covered by the Section 404 Report.

(d) The Management's Report of Internal Control Over Financial Reporting shall include:

(1) A statement that management is responsible for establishing and maintaining adequate internal controls over financial reporting;

(2) A statement that management has established internal controls over financial reporting and an assertion, to the best of management's knowledge and belief, after diligent inquiry, as to whether its internal controls over financial reporting is effective to provide reasonable assurance regarding the reliability of financial statements in accordance with statutory accounting principles;

(3) A statement that briefly describes the approach or processes by which management evaluated the effectiveness of its internal controls over financial reporting;

(4) A statement that briefly describes the scope of work that is included and whether any internal controls were excluded;

(5) Disclosure of any unremediated material weaknesses in the internal controls over financial reporting identified by management as of December 31 immediately preceding. Management shall not conclude that the internal controls over financial reporting is effective to provide reasonable assurance regarding the reliability of financial statements in accordance with statutory accounting principles if there is one or more unremediated material weaknesses in its Internal controls over financial reporting;

(6) A statement regarding the inherent limitations of internal control systems; and

(7) Signatures of the chief executive officer and the chief financial officer or equivalent position or title.

(e)(1) Management shall document and make available upon financial condition examination the basis upon which its assertions, required in subsection (d) of this section are made. Management may base its assertions, in part, upon its review, monitoring and testing of internal controls undertaken in the normal course of its activities.

(2) Management shall have discretion as to the nature of the internal control framework used, and the nature and extent of documentation, in order to make its assertion in a cost effective manner, and as such, may include assembly of or reference to existing documentation.

(3) Management's Report on Internal Control Over Financial Reporting, required by subsection (a) of this section, and any documentation provided in support thereof during the course of a financial condition examination, shall be kept confidential by the insurance department.

(f) The requirements of this section shall be effective beginning with the reporting period ending December 31, 2010 and each year thereafter. An insurer or group of insurers that is not required to file a report because the total written premium is below the threshold that subsequently becomes subject to the reporting requirements shall have two years following the year the threshold is exceeded, but not earlier than December 31, 2010 to file a report. Likewise, an insurer acquired in a business combination shall have two calendar years following the date of acquisition or business combination to comply with the reporting requirements.

Sec. 38a-54-12. **Exemptions and compliance dates**

(a) Upon written application of any insurer, the Commissioner may grant an exemption from compliance with Sections 38a-54-1 to 38a-54-14, inclusive, of the Regulations of Connecticut State Agencies if the Commissioner finds, upon review of the application, that compliance would constitute a financial or organizational hardship upon the insurer. An exemption may be granted at any time and from time to time for a specified period or periods. Within ten (10) days from a denial of an insurer's written request for an exemption, such insurer may request in writing a hearing on its application for an exemption. Such hearing shall be held in accordance with the rules of practice of the Insurance Department, Sections 38a-8-7 to 38a-8-75, inclusive, of the Regulations of Connecticut State Agencies. A request for exemption must be made for each calendar year for which such exemption is sought. Application for exemption must be received on or before December 31 of the year for which such exemption is sought.

(b) Domestic insurers retaining a certified public accountant on the effective date of Sections 38a-54-1 to 38a-54-14, inclusive, who qualify as independent in accordance with AICPA standards, shall comply with Sections 38a-54-1 to 38a-54-14, inclusive, of the Regulations of Connecticut State Agencies for the year ending December 31, 2008 and each year thereafter unless the Commissioner permits otherwise.

(c) Domestic insurers not retaining a certified public accountant on the effective date of Sections 38a-54-1 to 38a-54-14, inclusive, of the Regulations of Connecticut State Agencies who qualifies as independent in accordance with AICPA standards, shall meet the following schedule for compliance unless the Commissioner permits otherwise:

(1) As of December 31, 2008, file with the Commissioner an audited financial report;

(2) For the year ending December 31, 2008, and each year thereafter, file with the Commissioner all reports and communication required by Sections 38a-54-1 to 38a-54-14, inclusive, of the Regulations of Connecticut State Agencies.

(d) Foreign insurers shall comply with Sections 38a-54-1 to 38a-54-14, inclusive, of the Regulations of Connecticut State Agencies for the year ending December 31, 2008 and each year thereafter, unless the Commissioner permits otherwise.

Sec. 38a-54-13. Canadian and British companies

(a) In the case of Canadian and British insurers, the annual audited financial report shall be defined as the annual statement of total business on the form filed by such companies with their [domiciliary] supervision authority duly audited by an independent chartered accountant.

(b) For such insurers, the letter required in Section 38a-54-5 of the Regulations of Connecticut State Agencies shall state that the accountant is aware of the requirements relating to the annual audited [statement] financial report filed with the Commissioner pursuant to Section 38a-54-3 and shall affirm that the opinion expressed is in conformity with such requirements.

Sec. 38a-54-14. Severability

If any provision of Sections 38a-54-1 to 38a-54-13, inclusive, of the Regulations of Connecticut State Agencies or the applicability thereof to any person or circumstance is held to be invalid, the remainder of said sections or the applicability of such provision to other persons or circumstances shall not be affected thereby.

Statement of Purpose: To update the provisions of regulations concerning annual audited financial reports.

A. The problems, issues or circumstances that the regulation proposes to address.

The revisions amend the regulation to recognize changes resulting from Sarbanes-Oxley and to improve the Insurance Department's surveillance of the financial conditions of insurers. These revisions are required for the Insurance Department to maintain accreditation by the National Association of Insurance Commissioners (NAIC).

The Insurance Department proposes to adopt the NAIC Model Audit Act in full. Because of Sarbanes-Oxley, most insurers were required to enhance internal controls around all functions of operations. (Section 404 of the Sarbanes-Oxley Act of 2002 reporting requirements). A NAIC working group, made up of regulators around the country, has determined what necessary elements of the Section 404 reporting should be documented and reported on to state insurance regulators. If unduly burdensome to exempt SEC filers, there is a provision within the statute in which the Commissioner may grant an exemption.

B. A summary of the main provisions of the regulation.

The proposed regulations' predominate theme is centered around management accountability of internal control, independent auditors qualifications and duties, and letters to state regulators of notification of internal control weaknesses.

C. The legal effects of the regulation, including all ways that the regulation would change existing regulations or other laws.

No other laws or regulations will be affected.

CERTIFICATION

R-39 REV. 1/77

Be it known that the foregoing: Page 1 of 1 pages

☒ Regulations ☐ Emergency Regulations

Are:

☐ Adopted ☒ Amended as hereinabove stated ☐ Repealed

By the aforesaid agency pursuant to:

☐ Sections ~~38a-8 and 38a-54~~ of the General Statutes.

☐ Section _____ of the General Statutes, as amended by Public Act No._____ of the _____ Public Acts.

☐ Public Act No. _____of the Public Acts.

After publication in the Connecticut Law Journal on ~~March 4, 2008~~ _____ and of the notice of the proposal to:

☐ Adopt ☒ Amend ☐ Repeal such regulations

(If applicable): ☐ And the holding of an advertised public hearing on _____day of _____20 ___

WHEREFORE, the foregoing regulations are hereby:

☐ Adopted ☐ Amended as hereinabove stated ☐ Repealed

Effective:

☐ When filed with the Secretary of the State.

(OR)

☐ The _____ day of _____.

In Witness Whereof:	DATE 11/6/08	SIGNED (*Head of Board, Agency or Commission*)	OFFICIAL TITLE, DULY AUTHORIZED INSURANCE COMMISSIONER
Approved by the Attorney General as to legal sufficiency In accordance with Sec. 4-169, as amended, C. G. S. :		SIGNED 11/25/08	OFFICIAL TITLE, DULY AUTHORIZED ASSOC. ATT. GENERAL

☐ Approved

☐ Disapproved

☐ Disapproved in part, (Indicate Section Numbers disapproved only)

☐ Rejected without prejudice.

By the Legislative Regulation Review Committee in accordance With Sec. 4-170, as amended, of the General Statutes.	DATE	SIGNED (*Clerk of the Legislative Regulation Review Committee*)

Two certified copies received and filed, and one such copy forwarded to the Commission on Official Legal Publications In accordance with Section 4-172, as amended, of the General Statutes.

DATE	SIGNED (*Secretary of the State.*)	BY

INSTRUCTION

1. One copy of all regulations for adoption, amendment or repeal, except emergency regulations, must be presented to the Attorney General for his determination of legal sufficiency. Section 4-169 of the General Statutes.

2. Seventeen copies of all regulations for adoption, amendment or repeal, except emergency regulations, must be presented to the standing Legislative Regulation Review Committee for its approval. Section 4-170 of the General Statutes.

3. Each regulation must be in the form intended for publication and must include the appropriate regulation section number and section heading. Section 4-172 of the General Statutes.

4. Indicate by "(NEW)" in heading if new regulation. Amended regulations must contain new language in capitol letters and deleted language in brackets. Section 4-170 of the General Statutes.