

Secretary of the State File Number

**6237**

Regulation of the  
**Department of Insurance**  
Concerning

**Annual Audited Financial Reports**

Regulations adopted after July 1, 2013, become effective upon posting to the Connecticut eRegulations System, or at a later date if specified within the regulation.

Posted to the Connecticut eRegulations System on **March 27, 2017**

EFFECTIVE DATE

**March 27, 2017**

Approved by the Attorney General on

**December 20, 2016**

Approved by the Legislation Regulation Review Committee on

**February 28, 2017**

Electronic copy with agency head certification statement electronically submitted to and received by the Office of the Secretary of the State on

**March 13, 2017**

The text of this approved regulation will be published in the Connecticut Law Journal

Form ICM-ECOPY (NEW 6/2015)  
State of Connecticut  
Secretary of the State



**IMPORTANT NOTICE FOR CONNECTICUT STATE AGENCIES**  
This form should be used only for regulations first noticed on and after March 23, 2015.

## Electronic Copy Certification Statement

*(Submitted in accordance with the provisions of section 4-172 of the Connecticut General Statutes)*

Regulation of the  
**Insurance Department**  
Concerning  
**Annual Audited Financial Reports**

Approved by the Legislative Regulation Review Committee: **February 28, 2017**  
eRegulations System Tracking Number: **PR-2016-071**

**I hereby certify** that the electronic copy of the above-referenced regulation submitted herewith to the Secretary of the State is a true and accurate copy of the regulation approved in accordance with sections 4-169 and 4-170 of the *Connecticut General Statutes*.

**And I further certify** that in accordance with the approval of Legislative Regulation Review Committee, all required technical corrections, page substitutions and deletions, if any, have been incorporated into said regulation.

**In testimony whereof**, I have hereunto  
set my hand on **March 13, 2017**.

---

Katharine L. Wade  
Commissioner  
Insurance Department



# STATE OF CONNECTICUT

## INSURANCE DEPARTMENT

March 13, 2017

**Via eRegulations system**

Ms. Kristin Karr, eRegulations Systems Manager  
Connecticut Secretary of the State  
30 Trinity Street  
Hartford, CT 06106

**RE: Annual Audited Financial Reports  
eRegulations System Tracking Number 2016-071**

Dear Ms. Karr:

In accordance with Conn. Gen. Stat § 4-172, the Connecticut Insurance Department (CID) is submitting the enclosed certified electronic copy of the above referenced regulation to the Secretary of the State. The Legislative Regulation Review Committee (LRRC) approved this regulation with technical corrections on February 28, 2017. At this time, all technical changes requested by the LRRC have been made except for the first part of #13, which states; “[o]n page 5, in line 2 of section 38a-54-11d(c), ‘organizationally independent. Specifically, the’ should be ‘organizationally independent from the insurer and, if applicable, the group of insurers. The’.” CID has discussed this matter with the Legislative Commissioners’ Office.

The subject regulation requires large insurers to implement an internal audit function to provide independent and objective assurance to the insurer’s audit committee and management regarding the insurer’s governance, risk management and internal controls. The relevant subsection states that in order to ensure that the internal auditors remain objective, the internal audit function shall be “organizationally independent.” This means, if you were to view an organizational chart of the insurer, the internal audit function would not fall under some other division or department but would be separate and have direct access to the board and the audit committee of the board (but still be within the insurer). The omitted technical correction noted above may lead to an interpretation that the internal audit function needs to be external to the insurer, which is exactly what it is not supposed to be.

The contact person at CID for this regulation is Jared Kosky, Counsel. He can be reached at 860-297-3998.

Sincerely,

A handwritten signature in blue ink that reads "Katharine L. Wade".

Katharine L. Wade  
Insurance Commissioner

**State of Connecticut  
Regulation of  
Insurance Department  
Concerning  
Annual Audited Financial Reports**

Section 1. Section 38a-54-2 of the Regulations of Connecticut State Agencies is amended to read as follows:

**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] who 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, the internal audit function of an insurer or group of insurers (if applicable), and external 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] to 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)] 38a-54-11a(g) of the Regulations of Connecticut State Agencies. If an audit committee is not designated by the insurer, the insurer’s entire board of directors shall constitute the audit committee.

(d) “Audited financial report” or “statutory financial statement” or “audited statutory financial statement” 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.

(f) “Commissioner” means the Insurance Commissioner of the State of Connecticut.

(g) “Department” or “Insurance Department” means the Insurance Department of the State of Connecticut.

(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.

(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] to 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 audit function” means a person or persons who provide independent, objective and reasonable assurance designed to add value and improve an organization’s operations and accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

[(l)](m) “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.

[(m)](n) “NAIC” means the National Association of Insurance Commissioners.

[(n)](o) “SEC” means the United States Securities and Exchange Commission.

[(o)](p) “Section 404” means Section 404 of the Sarbanes-Oxley Act of 2002 and the SEC’s rules and regulations promulgated thereunder.

[(p)](q) “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)](r) “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)](s) “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)](t) “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.

[(t)](u) “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. 2. Section 38a-54-11a of the Regulations of Connecticut State Agencies is amended to read as follows:

**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] Sections 38a-54-1 to 38a-54-13, inclusive, of the Regulations of Connecticut State Agencies. Each accountant shall report directly to the audit committee.

(c) Effective January 1, 2017, the audit committee of an insurer or group of insurers shall be responsible for overseeing the insurer's internal audit function and granting the internal audit function suitable authority and resources to fulfill the internal audit function's responsibilities required by Section 38a-54-11d of the Regulations of Connecticut State Agencies.

[(c)](d) 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)] (g) of this section and Section 38a-54-2(c) of the Regulations of Connecticut State Agencies.

[(d)](e) In order to be considered independent for purposes of this section, a member of the audit committee [may] shall 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)](f) 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)](g) 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)](h) (1) The audit committee shall require the accountant [that] who performs for an insurer any audit required by [this section] Sections 38a-54-1 to 38a-54-13, inclusive, of the Regulations of Connecticut State Agencies 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)](i) The proportion of independent audit committee members shall meet or exceed the following criteria[;]:

<b>Prior Calendar Year Direct Written and Assumed Premiums</b>		
<b>\$0 - \$300,000,000</b>	<b>Over \$300,000,000 - \$500,000,000</b>	<b>Over \$500,000,000</b>
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)](j) 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)](k) [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)] 38a-54-11a(i) 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.

Sec. 3. Subsection (a) of section 38a-54-11b of the Regulations of Connecticut State Agencies is amended to read as follows:

(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] Sections 38a-54-1 to 38a-54-13, inclusive, of the Regulations of Connecticut State Agencies; 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] Sections 38a-54-1 to 38a-54-13, inclusive, of the Regulations of Connecticut State Agencies.

Sec. 4. Subsection (b) of section 38a-54-11c of the Regulations of Connecticut State Agencies is amended to read as follows:

(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] 38a-8-104, 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.

Sec. 5. The Regulations of Connecticut State Agencies are amended by adding section 38a-54-11d as follows:

**(NEW) Sec. 38a-54-11d. Internal audit function requirements**

The requirements of this section shall be effective January 1, 2017.

(a) (1) **Exemption.** An insurer is exempt from the requirement of this section if:

(A) The insurer has annual direct written and unaffiliated assumed premium, including international direct and assumed premium but excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, of less than \$500,000,000; and

(B) If the insurer is a member of a group of insurers, the group has annual direct written and unaffiliated assumed premium, including international direct and assumed premium but excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, of less than \$1,000,000,000.

(2) If an insurer that is exempt from the requirements of this section no longer qualifies for such exemption, the insurer shall have one year following the year the threshold is exceeded to comply with the requirements of this section.

(b) **Function.** The insurer or group of insurers shall establish an internal audit function providing independent, objective and reasonable assurance to the audit committee and insurer management regarding the insurer's governance, risk management and internal controls. This assurance shall be provided by performing general and specific audits, reviews and tests and by employing other techniques deemed necessary to protect assets, evaluate control effectiveness and efficiency, and evaluate compliance with policies and regulations.

(c) **Independence.** In order to ensure that internal auditors remain objective, the internal audit function shall be organizationally independent. Specifically, the internal audit function shall not defer ultimate judgment on audit matters to others, and shall appoint a person to head the internal audit function who will have direct and unrestricted access to the board of directors. Organizational independence does not preclude dual-reporting relationships.

(d) **Reporting.** The head of the internal audit function shall report to the audit committee



regularly, but no less than annually, on the periodic audit plan, factors that may adversely impact the internal audit function's independence or effectiveness, material findings from completed audits and the appropriateness of corrective actions implemented by management as a result of audit findings.

(e) **Additional Requirements.** If an insurer is a member of an insurance holding company system or included in a group of insurers, the insurer may satisfy the internal audit function requirement set forth in this section at the ultimate controlling parent level, an intermediate holding company level or the individual legal entity level.

R-39 Rev. 02/2012

**Statement of Purpose**

To update the regulations concerning insurers' annual audited financial reports. These amendments change Connecticut's audit rule to adopt amendments to the Model Audit Rule of the National Association of Insurance Commissioners (NAIC), and to make other technical corrections. This regulation is used to improve the Insurance Department's surveillance of the financial condition of insurers. The revisions require large insurers to implement an internal audit function to provide independent and objective assurance to the insurer's audit committee and management regarding the insurer's governance, risk management and internal controls. The Insurance Department notes that these amendments are consistent with existing stock exchange requirements, international standards, and industry best practices observed by large insurers.

These revisions are required for the Insurance Department to maintain its accreditation by the NAIC. These amendments will not affect any other statutes or regulations.

**IMPORTANT NOTICE FOR CONNECTICUT STATE AGENCIES**

This form is to be used for proposed permanent and technical amendment regulations only and must be completed in full.

**AGENCY CERTIFICATION****Insurance Department**

Proposed Regulation Concerning

**Annual Audited Financial Reports**

eRegulations System Tracking Number PR2016-071

**I hereby certify the following:**

(1) The above-referenced **regulation** is proposed pursuant to the following statutory authority or authorities: **CGS Section 38a-54.**

*For technical amendment regulations proposed without a comment period, complete #2 below, then skip to #8.*

(2) As permitted by Section 4-168(h) of the *Connecticut General Statutes*, the agency elected to proceed without prior notice or hearing and posted the text of the proposed technical amendment regulation on eRegulations System website on \_\_\_\_\_.

*For all other non-emergency proposed regulations, complete #3 - #7 below, then complete #8)*

(3) The agency posted notice of intent with a specified comment period of not less than 30 days to the eRegulations System website on **October 18, 2016.**

(4) *(Complete one)*  No public hearing held or was required to be held. **OR**  One or more public hearings were held on: <<**select and enter dates**>>.

(5) The agency posted notice of decision to move forward with the proposed regulation to the eRegulations System website on **November 29, 2016.**

(6) *(Complete one)*  No comments were received. **OR**  Comments were received and the agency posted the statements specified in subdivisions (2) and (3) of CGS Section 4-168(e) to the eRegulations System website on <<**select and enter date**>>.

(7) The final wording of the proposed regulation was posted to the eRegulations System website on **October 18, 2016.**

(8) Subsequent to approval for legal sufficiency by the Attorney General and approval by the Legislative Regulation Review Committee, **the final regulation shall be effective**

*(Check one and complete as applicable)*

When posted to the eRegulations System website by the Secretary of the State.

**OR**  On \_\_\_\_\_

*(Date must be a specific calendar date not less than 11 days after submission to the Secretary of the State)*

*Katherine L. Wade*

**SIGNED**

*(Head of Board, Agency or Commission,  
or duly authorized deputy)*

*Commissioner*  
OFFICIAL TITLE

*11/29/16*  
DATE

**OFFICE OF THE ATTORNEY GENERAL  
REGULATION CERTIFICATION**

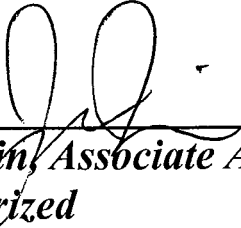
**Agency Department of Insurance**

***REGULATION NUMBER PR2016-071***

**This Regulation is hereby APPROVED by the Attorney General as to legal sufficiency in accordance with Connecticut General Statutes Section 4-169.**

**DATE: 12/20/2016**

**Signed:**

  
***Joseph Rubin, Associate Attorney General  
Duly Authorized***

# The Connecticut General Assembly

## Legislative Regulation Review Committee

Senator Paul Doyle  
Senate Chair



Representative Christie Carpino  
House Chair

### Official Record of Committee Action

February 28, 2017

Agency: Insurance Department  
Description: Annual Audited Financial Reports  
LRRC Regulation Number: 2016-033  
eRegulation Tracking Number: PR2016-071

The above-referenced regulation has been

### Approved with Technical Corrections

by the Legislative Regulation Review Committee in accordance  
with CGS Section 4-170.

Kirstin L. Breiner  
Committee Administrator



State of Connecticut  
Office of the Secretary of the State

## Confirmation of Electronic Submission

Re: Regulation of the Insurance Department concerning Annual Audited  
Financial Reports  
eRegulations System Tracking Number PR2016-071  
Legislative Regulation Review Committee Docket Number 2016-033

The above-referenced regulation was electronically submitted to the Office of the Secretary of the State in accordance with Connecticut General Statutes Section 4-172 on March 13, 2017.

Said regulation is assigned Secretary of the State File Number 6237.

The effective date of this regulation is March 27, 2017.

A handwritten signature in black ink that reads "Denise W. Merrill".

Denise W. Merrill  
Secretary of the State  
March 27, 2017

By:

/s/ Kristin M. Karr

Kristin M. Karr  
Administrative Law  
Information Systems Manager