



PROPOSED RULE MAKING

CR-102 (October 2017)
(Implements RCW 34.05.320)
Do NOT use for expedited rule making

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STATE OF WASHINGTON
FILED

DATE: September 04, 2019

TIME: 10:08 AM

WSR 19-18-090

Agency: Office of the Insurance Commissioner

- Original Notice
- Supplemental Notice to WSR _____
- Continuance of WSR _____

- Preproposal Statement of Inquiry was filed as WSR 19-12-060 ; or
- Expedited Rule Making--Proposed notice was filed as WSR _____; or
- Proposal is exempt under RCW 34.05.310(4) or 34.05.330(1); or
- Proposal is exempt under RCW _____.

Title of rule and other identifying information: (describe subject) Internal Audit Requirements for Insurance Companies

Insurance Commissioner Matter R 2019-02

Hearing location(s):

Date:	Time:	Location: (be specific)	Comment:
October 8, 2019	10:00AM	Office of the Insurance Commissioner 302 Sid Snyder Avenue SW, Suite 200 Olympia, WA 98501	

Date of intended adoption: October 10, 2019_ (Note: This is NOT the effective date)

Submit written comments to:

Name: Scott Bird
Address: PO Box 40260, Olympia, WA 98504-0260
Email: rulescoordinator@oic.wa.gov
Fax: 360-586-3109
Other:
By (date)

Assistance for persons with disabilities:

Contact Melanie Watness
Phone: 360-725-701
Fax: 360-586-2023
TTY: 360-586-0241
Email: MelanieW@oic.wa.gov
Other:
By (date)

Purpose of the proposal and its anticipated effects, including any changes in existing rules: To incorporate an internal audit function requirement for large insurers writing more than \$500 million, or insurance groups writing more than \$1 billion in annual premium. These insurers must maintain 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.

Reasons supporting proposal: Needed for NAIC Accreditation

Statutory authority for adoption: RCW 48.02.060, RCW 48.44.050, and RCW 48.46.200.

Statute being implemented:

Is rule necessary because of a:

Federal Law?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Federal Court Decision?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
State Court Decision?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No

If yes, CITATION:

Agency comments or recommendations, if any, as to statutory language, implementation, enforcement, and fiscal matters: None

Name of proponent: (person or organization) Mike Kreidler, Insurance Commissioner

<input type="checkbox"/> Private
<input type="checkbox"/> Public
<input checked="" type="checkbox"/> Governmental

Name of agency personnel responsible for:

	Name	Office Location	Phone
Drafting:	Jim Tompkins	PO Box 40260, Olympia, WA 98504-0260	(360) 725-7036

Implementation:

Enforcement:

Is a school district fiscal impact statement required under RCW 28A.305.135? Yes No

If yes, insert statement here:

The public may obtain a copy of the school district fiscal impact statement by contacting:

Name:
Address:
Phone:
Fax:
TTY:
Email:
Other:

Is a cost-benefit analysis required under RCW 34.05.328?

Yes: A preliminary cost-benefit analysis may be obtained by contacting:

Name: Tabba Alam
Address: PO Box 40260, Olympia, WA 98504-0260
Phone: (360) 725-7170
Fax: (360) 586-3109
TTY: (360) 586-0241
Email: tabbaa@oic.wa.gov
Other:

No: Please explain:

Regulatory Fairness Act Cost Considerations for a Small Business Economic Impact Statement:

This rule proposal, or portions of the proposal, **may be exempt** from requirements of the Regulatory Fairness Act (see chapter 19.85 RCW). Please check the box for any applicable exemption(s):

This rule proposal, or portions of the proposal, is exempt under RCW 19.85.061 because this rule making is being adopted solely to conform and/or comply with federal statute or regulations. Please cite the specific federal statute or regulation this rule is being adopted to conform or comply with, and describe the consequences to the state if the rule is not adopted.

Citation and description:

This rule proposal, or portions of the proposal, is exempt because the agency has completed the pilot rule process defined by RCW 34.05.313 before filing the notice of this proposed rule.

This rule proposal, or portions of the proposal, is exempt under the provisions of RCW 15.65.570(2) because it was adopted by a referendum.

This rule proposal, or portions of the proposal, is exempt under RCW 19.85.025(3). Check all that apply:

- | | |
|---|--|
| <input type="checkbox"/> RCW 34.05.310 (4)(b)
(Internal government operations) | <input type="checkbox"/> RCW 34.05.310 (4)(e)
(Dictated by statute) |
| <input type="checkbox"/> RCW 34.05.310 (4)(c)
(Incorporation by reference) | <input type="checkbox"/> RCW 34.05.310 (4)(f)
(Set or adjust fees) |
| <input type="checkbox"/> RCW 34.05.310 (4)(d)
(Correct or clarify language) | <input type="checkbox"/> RCW 34.05.310 (4)(g)
((i) Relating to agency hearings; or (ii) process requirements for applying to an agency for a license or permit) |

This rule proposal, or portions of the proposal, is exempt under RCW RCW 19.85.025.

Explanation of exemptions, if necessary: The domestic insurers that are affected by this rule are not small businesses as defined in RCW 19.85.020(3)..

COMPLETE THIS SECTION ONLY IF NO EXEMPTION APPLIES

If the proposed rule is **not exempt**, does it impose more-than-minor costs (as defined by RCW 19.85.020(2)) on businesses?

- No Briefly summarize the agency's analysis showing how costs were calculated. _____
- Yes Calculations show the rule proposal likely imposes more-than-minor cost to businesses, and a small business economic impact statement is required. Insert statement here:

The public may obtain a copy of the small business economic impact statement or the detailed cost calculations by contacting:

Name:
Address:
Phone:
Fax:
TTY:
Email:
Other:

Date: September 3, 2019

Name: Mike Kreidler

Title: Insurance Commissioner

Signature:



AMENDATORY SECTION (Amending WSR 15-22-062, filed 10/30/15, effective 1/1/16)

WAC 284-07-110 Definitions. For the purposes of WAC 284-07-100 through 284-07-230 the following definitions shall apply:

(1) "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, the terms mean a Canadian-chartered or British-chartered accountant.

(2) 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.

(3) "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))~~ the internal audit functions 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 WAC 284-07-100 through 284-07-230 at the election of the controlling person. Refer to WAC 284-07-213(5) for exercising this election. If an audit committee is not designated by the insurer, the insurer's entire board of directors ~~((shall))~~ constitutes the audit committee.

(4) "Audited financial report" means and includes those items specified in WAC 284-07-130.

(5) "Group of insurers" means those licensed insurers included in the reporting requirements of chapter 48.31B RCW, or a set of insurers as identified by management, for the purpose of assessing the effectiveness of internal control over financial reporting.

(6) "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 knowing of other misrepresentations made by the insurer or its representatives.

(7) "Independent board member" has the same meaning as described in WAC 284-07-213(3).

(8) "Insurer" has the same meaning as set forth in RCW 48.01.050. It also includes health care service contractors registered under chapter 48.44 RCW, health maintenance organizations registered under chapter 48.46 RCW, fraternal benefit societies registered under chapter 48.36A RCW, and self-funded multiple employer welfare arrangements authorized under chapter 48.125 RCW.

(9) "Internal audit function" means a person or persons that 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.

(10) "Internal control over financial reporting" means a process effected by an entity's board of directors, management and other per-

sonnel designed to provide reasonable assurance regarding the reliability of the financial statements, i.e., those items specified in WAC 284-07-130 (2)(b) through (g) and includes those policies and procedures that:

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

(b) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements, i.e., those items specified in WAC 284-07-130 (2)(b) through (g) and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and

(c) 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 statements, i.e., those items specified in WAC 284-07-130 (2)(b) through (g).

~~((10))~~ (11) "NAIC" means the National Association of Insurance Commissioners.

~~((11))~~ (12) "Policy holder" ~~((shall))~~ also means subscriber.

~~((12))~~ (13) "SEC" means the United States Securities and Exchange Commission.

~~((13))~~ (14) "Section 404" means Section 404 of the Sarbanes-Oxley Act of 2002 and the SEC's rules and regulations promulgated thereunder.

~~((14))~~ (15) "Section 404 report" means management's report on internal control over financial reporting as defined by the SEC and the related attestation report of the independent certified public accountant described in WAC 284-07-110(1).

~~((15))~~ (16) "SOX compliant entity" means an entity that either is required to be compliant with, or voluntarily is compliant with, all of the following provisions of the Sarbanes-Oxley Act of 2002:

(a) The preapproval requirements of Section 201 (Section 10A(i) of the Securities and Exchange Act of 1934);

(b) The audit committee independence requirements of Section 301 (Section 10A (m) (3) of the Securities and Exchange Act of 1934); and

(c) The internal control of financial reporting requirements of Section 404 (Item 308 of SEC Regulations S-K).

AMENDATORY SECTION (Amending WSR 09-20-069, filed 10/5/09, effective 11/5/09)

WAC 284-07-213 Requirements for audit committees. This section ~~((shall))~~ does 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.

(1) The audit committee ~~((shall be))~~ is 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 WAC 284-07-100 through 284-07-230. Each accountant ~~((shall))~~ must report directly to the audit committee.

(2) The audit committee of an insurer or group of insurers is responsible for overseeing the insurer's internal audit function and

granting the person or persons performing the function suitable authority and resources to fulfill their responsibilities if required by WAC 284-07-214.

(3) Each member of the audit committee (~~shall~~) must 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 (~~(4)~~) (6) of this section and WAC 284-07-110(3).

(~~(3)~~) (4) 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 nonindependent members, that law shall prevail and the 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.

(~~(4)~~) (5) If a member of the audit committee ceases to be independent for reasons outside the member's reasonable control, that person, with notice by the responsible entity to the state, may remain an audit committee member for 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.

(~~(5)~~) (6) To exercise the election of the controlling person to designate the audit committee for purposes of WAC 284-07-100 through 284-07-230, the ultimate controlling person (~~shall~~) must provide written notice to the commissioners of the affected insurers. Notification (~~shall~~) must be made timely prior to the issuance of the statutory audit report and include a description of the basis for the election. The election can be changed through notice to the commissioner by the insurer, which (~~shall~~) must include a description of the basis for the change. The election (~~shall~~) remains in effect for perpetuity, until rescinded.

(~~(6)~~) (7) (a) The audit committee (~~shall~~) must require the accountant that performs for an insurer any audit required by WAC 284-07-100 through 284-07-230 to timely report to the audit committee in accordance with the requirements of SAS 61, *Communication with Audit Committees*, or its replacement, including:

(i) All significant accounting policies and material permitted practices;

(ii) 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

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

(b) If an insurer is a member of an insurance or health carrier holding company system, the reports required by (a) 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.

~~((7))~~ (8) The proportion of independent audit committee members ~~((shall))~~ must 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 and B.	Majority (50% or more) of members shall be independent. See also Note A and B.	Supermajority of members (75% or more) shall be independent. See also Note A.

Note A: The commissioner has authority by state law to require the entity's board to enact improvements to the independence of the audit committee membership if the insurer is in a RBC 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 five hundred million dollars 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 nonaffiliates for the reporting entities.

~~((8))~~ (9) An insurer with direct written and assumed premiums, excluding premiums reinsured with the Federal Crop Insurance Corporation and federal flood program, less than five hundred million dollars may make application to the commissioner for a waiver from this section's requirements based upon hardship. The insurer ~~((shall))~~ must file, with its annual statement filing, the approval for relief from this section with the states that it is licensed in or doing business in and the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer ~~((shall))~~ must file the approval in an electronic format acceptable to the NAIC.

NEW SECTION

WAC 284-07-214 Internal audit function requirements. (1) An insurer is exempt from the requirements 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 Insurance Program, less than five hundred million dollars; and

(b) If the insurer is a member of a group of insurers, the group has annual direct written and unaffiliated assumed premium including direct and assumed premium, but excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Insurance Program, less than one billion dollars.

(2) An insurer or group of insurers exempt from the requirements of this section is encouraged, but not required, to conduct a review of the insurer business type, sources of capital, and other risk factors to determine whether an internal audit function is warranted. The potential benefits of an internal audit function should be assessed and compared against the estimated costs.

(3) The insurer or group of insurers must establish an internal audit function providing independent, objective and reasonable assur-

ance to the audit committee and insurer management regarding the insurer's governance, risk management and internal controls. This assurance must 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.

(4) In order to ensure that internal auditors remain objective, the internal audit function must be organizationally independent. Specifically, the internal audit function will not defer ultimate judgment on audit matters to others, and must appoint an individual 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.

(5) The head of the internal audit function must 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.

(6) 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.

AMENDATORY SECTION (Amending WSR 09-20-069, filed 10/5/09, effective 11/5/09)

WAC 284-07-220 Exemptions and effective dates. (1) Upon written application of any insurer, the commissioner may grant an exemption from compliance with any and all provisions of WAC 284-07-100 through 284-07-230 if the commissioner finds, upon review of the application, that compliance with WAC 284-07-100 through 284-07-230 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 days from a denial of an insurer's written request for an exemption from WAC 284-07-100 through 284-07-230, the insurer may request in writing a hearing on its application for an exemption. The hearing shall be held in accordance with the rules and procedures pertaining to administrative hearings.

(2) Domestic insurers retaining a certified public accountant on the effective date of WAC 284-07-100 through 284-07-230 who qualify as independent (~~shall~~) must comply with WAC 284-07-100 through 284-07-230 for the year ending December 31, 1992, and each year thereafter unless the commissioner permits otherwise.

(3) Domestic insurers not retaining a certified public accountant on the effective date of WAC 284-07-100 through 284-07-230 who qualify as independent may meet the following schedule for compliance unless the commissioner permits otherwise.

(a) As of December 31, 1992, file with the commissioner an audited financial report.

(b) For the year ending December 31, 1992, and each year thereafter, the insurers (~~shall~~) must file with the commissioner all re-

ports and communications required by WAC 284-07-100 through 284-07-210.

(4) Foreign insurers (~~shall~~) must comply with WAC 284-07-100 through 284-07-230 for the year ending December 31, 1992, and each year thereafter, unless the commissioner permits otherwise.

(5) The requirements of WAC 284-07-150(4) shall be in effect for audits of the year beginning January 1, 2010 and thereafter.

(6) The requirements of WAC 284-07-213 are to be in effect 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 premium and assumed premium is below the threshold and subsequently becomes subject to one of the independence requirements due to change in premiums (~~shall have~~) has one year following the year the threshold is exceeded (but not later 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 business combination (~~shall have~~) has one calendar year following the date of acquisition or combination to comply with the independence requirements.

(7) The requirements of WAC 284-07-150 (7) through (12), 284-07-190, 284-07-215, and 284-07-217 are 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 and subsequently becomes subject to the reporting requirements (~~shall have~~) has 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~~) has two calendar years following the date of acquisition or combination to comply with the reporting requirements.

(8) The requirements of WAC 284-07-214 are to be in effect on January 1, 2020. If an insurer or group of insurers that is exempt from WAC 284-07-214 requirements no longer qualifies for that exemption, it has one year after the year the threshold is exceeded to comply with the requirements of WAC 284-07-214.