

FIRST REGULAR SESSION

# SENATE BILL NO. 427

99TH GENERAL ASSEMBLY

INTRODUCED BY SENATOR WASSON.

Read 1st time February 15, 2017, and ordered printed.

ADRIANE D. CROUSE, Secretary.

1330S.02I

## AN ACT

To repeal sections 375.1025, 375.1052, 375.1053, and 375.1056, RSMo, and to enact in lieu thereof five new sections relating to internal audit requirements for insurers.

*Be it enacted by the General Assembly of the State of Missouri, as follows:*

Section A. Sections 375.1025, 375.1052, 375.1053, and 375.1056, RSMo, is repealed and five new sections enacted in lieu thereof, to be known as sections 375.1025, 375.1052, 375.1053, 375.1056, and 375.1058, to read as follows:

375.1025. As used in sections 375.1025 to 375.1062, the following terms shall mean:

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

(2) "Affiliate" or "affiliated", 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) "AICPA", the American Institute of Certified Public Accountants;

(4) "Audit committee", 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 any 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

**EXPLANATION—Matter enclosed in bold-faced brackets [thus] in this bill is not enacted and is intended to be omitted in the law.**

18 to be the audit committee for one or more of such controlled insurers solely for  
19 the purposes of sections 375.1025 to 375.1062 at the election of the controlling  
20 person. Such election shall be exercised under subsection [5] 6 of section  
21 375.1053. If an audit committee is not designated by the insurer, the insurer's  
22 entire board of directors shall constitute the audit committee;

23 (5) "Audited financial report", includes those items specified in section  
24 375.1032;

25 (6) "Department", the department of insurance, financial institutions and  
26 professional registration;

27 (7) "Director", the director of the department of insurance, financial  
28 institutions and professional registration;

29 (8) "Group of insurers", those licensed insurers included in the reporting  
30 requirements of sections 382.010 to 382.300, or a set of insurers as identified by  
31 management, for the purpose of assessing the effectiveness of internal control  
32 over financial reporting;

33 (9) "Indemnification", an agreement of indemnity or a release from  
34 liability where the intent or effect is to shift or limit in any manner the potential  
35 liability of the person or firm for failure to adhere to applicable auditing or  
36 professional standards, whether or not resulting in part from knowing of other  
37 misrepresentations made by the insurer or its representatives;

38 (10) "Independent board member", the same meaning as described in  
39 subsection [3] 4 of section 375.1053;

40 (11) **"Internal audit function", a person or persons that provide**  
41 **independent, objective, and reasonable assurance designed to add value**  
42 **and improve an organization's operations and accomplish its objectives**  
43 **by bringing a systematic, disciplined approach to evaluate and improve**  
44 **the effectiveness of risk management control and governance processes;**

45 (12) "Insurer", an insurer certified to do business in this state pursuant  
46 to section 375.161 or 375.831, and to companies authorized to transact business  
47 in this state pursuant to chapters 354, 376, 377, 378, 379 and 381;

48 [(12)] (13) "Internal control over financial reporting", a process effected  
49 by an entity's board of directors, management and other personnel designed to  
50 provide reasonable assurance regarding the reliability of the financial statements,  
51 i.e., those items specified in [subsections 2 to 7] **subdivisions (2) to (6) of**  
52 **subsection 2 and subsection 3** of section 375.1032 and includes those policies  
53 and procedures that:

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

56 (b) Provide reasonable assurance that transactions are recorded as  
57 necessary to permit preparation of financial statements, i.e., those items specified  
58 in [subsections 2 to 7] **subdivisions (2) to (6) of subsection 2 and**  
59 **subsection 3** of section 375.1032, and that receipts and expenditures are being  
60 made only in accordance with authorizations of management and directors; and

61 (c) Provide reasonable assurance regarding prevention or timely detection  
62 of unauthorized acquisition, use or disposition of assets that could have a  
63 material effect on the financial statements, i.e., those items specified in  
64 [subsections 2 to 7] **subdivisions (2) to (6) of subsection 2 and subsection**  
65 **3** of section 375.1032;

66 [(13)] **(14)** "NAIC", the National Association of Insurance Commissioners;

67 [(14)] **(15)** "SEC", the United States Securities and Exchange  
68 Commission;

69 [(15)] **(16)** "Section 404", Section 404 of the Sarbanes-Oxley Act of 2002,  
70 as amended, and the SEC's rules and regulations promulgated thereunder;

71 [(16)] **(17)** "Section 404 report", management's report on internal control  
72 over financial reporting, as defined by the SEC and the related attestation report  
73 of the independent certified public accountant as described in subsection 1 of  
74 section 375.1030;

75 [(17)] **(18)** "SOX compliant entity", an entity that either is required to be  
76 or voluntarily is compliant with all of the following provisions of the  
77 Sarbanes-Oxley Act of 2002, as amended:

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

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

82 (c) The internal control over financial reporting requirements of Section  
83 404.

375.1052. 1. Upon written application of any insurer, the director may  
2 grant a temporary exemption from compliance with sections 375.1025 to 375.1062  
3 if the director finds, upon review of the application, that compliance with sections  
4 375.1025 to 375.1062 would constitute a financial or organizational hardship  
5 upon the insurer. An exemption may be granted at any time and from time to  
6 time for a specified period or periods. Within ten days from a denial of an

7 insurer's written request for an exemption from sections 375.1025 to 375.1062,  
8 such insurer may request in writing a hearing on its application for an  
9 exemption. Such hearing shall be held in accordance with the provisions of  
10 chapter 536 pertaining to administrative hearing procedures and shall be a public  
11 meeting as provided by subdivision (3) of section 610.010.

12 2. Domestic insurers:

13 (1) Retaining a certified public accountant on August 28, 2009, who  
14 qualifies as independent shall comply with sections 375.1025 to 375.1062 for the  
15 year ending December 31, 2009, and each year thereafter unless the director  
16 permits otherwise;

17 (2) Not retaining a certified public accountant on [the effective date of this  
18 regulation] **August 28, 2009**, who qualifies as independent shall meet the  
19 following schedule for compliance with sections 375.1025 to 375.1062 unless the  
20 director permits otherwise:

21 (a) As of December 31, 2009, file with the director an audited financial  
22 report;

23 (b) For the year ending December 31, 2010, and each year thereafter, such  
24 insurers shall file with the director all reports and communications required by  
25 sections 375.1025 to 375.1062.

26 3. Foreign insurers shall comply with sections 375.1025 to 375.1062 for  
27 the year ending December 31, 1992, and each year thereafter, unless the director  
28 permits otherwise.

29 4. The requirements of subsection 3 of section 375.1037 shall be in effect  
30 for audits of the year beginning January 1, 2010, and thereafter.

31 5. The requirements of section 375.1053 are to be in effect January 1,  
32 2010. An insurer or group of insurers that is not required to have independent  
33 audit committee members or only a majority but not a supermajority of  
34 independent audit committee members, because the total written and assumed  
35 premium is below the threshold and subsequently becomes subject to one of the  
36 independence requirements due to changes in premium shall have one year  
37 following the year the threshold is exceeded, but not earlier than January 1,  
38 2010, to comply with the independence requirements. Likewise, an insurer that  
39 becomes subject to one of the independence requirements as a result of a business  
40 combination shall have one calendar year following the date of acquisition or  
41 combination to comply with the independence requirements.

42 6. The requirements of sections 375.1038, 375.1054, and 375.1056 are

43 effective beginning with the reporting period ending December 31, 2010, and each  
44 year thereafter. An insurer or group of insurers that is not required to file a  
45 report because the total written premium is below the threshold and subsequently  
46 becomes subject to the reporting requirements shall have two years following the  
47 year the threshold is exceeded to file a report. Likewise, an insurer acquired in  
48 a business combination shall have two calendar years following the date of  
49 acquisition or combination to comply with the reporting requirements.

50 **7. The requirements of section 375.1058 are effective beginning**  
51 **January 1, 2018. If an insurer or group of insurers that is exempt from**  
52 **section 375.1058 requirements no longer qualifies for that exemption,**  
53 **it shall have one year after the year the threshold is exceeded to**  
54 **comply with the requirements of section 375.1058.**

375.1053. 1. This section shall not apply to foreign or alien insurers  
2 licensed in this state or an insurer that is a SOX compliant entity or a direct or  
3 indirect wholly owned subsidiary of a SOX compliant entity.

4 2. The audit committee shall be directly responsible for the appointment,  
5 compensation, and oversight of the work of any accountant, including resolution  
6 of disagreements between management and the accountant regarding financial  
7 reporting, for the purpose of preparing or issuing the audited financial report or  
8 related work under sections 375.1025 to 375.1062. Each accountant shall report  
9 directly to the audit committee.

10 3. **The audit committee of an insurer or group of insurers shall**  
11 **be responsible for overseeing the insurer's internal audit function and**  
12 **granting the person or persons performing the internal audit function**  
13 **suitable authority and resources to fulfill their responsibilities if**  
14 **required by section 375.1058.**

15 4. Each member of the audit committee shall be a member of the board  
16 of directors of the insurer or a member of the board of directors of an entity  
17 elected under subsection [6] 7 of this section and subdivision [(6)] (4) of section  
18 375.1025.

19 [4.] 5. In order to be considered independent for purposes of this section,  
20 a member of the audit committee shall not, other than in his or her capacity as  
21 a member of the audit committee, the board of directors, or any other board  
22 committee, accept any consulting, advisory, or other compensatory fee from the  
23 entity or be an affiliated person of the entity or any subsidiary thereof. However,  
24 if law requires board participation by otherwise nonindependent members, such

25 law shall prevail and such members may participate in the audit committee and  
26 be designated as independent for audit committee purposes, unless they are an  
27 officer or employee of the insurer or one of its affiliates.

28 [5.] 6. If a member of the audit committee ceases to be independent for  
29 reasons outside the member's reasonable control, that person, with notice by the  
30 responsible entity to the state, may remain an audit committee member of the  
31 responsible entity until the earlier of the next annual meeting of the responsible  
32 entity or one year from the occurrence of the event that caused the member to be  
33 no longer independent.

34 [6.] 7. To exercise the election of the controlling person to designate the  
35 audit committee for purposes of sections 375.1025 to 375.1062, the ultimate  
36 controlling person shall provide written notice to the chief state insurance  
37 regulatory officials of the affected insurers. Notification shall be made timely  
38 prior to the issuance of the statutory audit report and include a description of the  
39 basis for the election. The election can be changed through notice to the director  
40 by the insurer, which shall include a description of the basis for the change. The  
41 election shall remain in effect for perpetuity, until rescinded.

42 [7.] 8. (1) The audit committee shall require the accountant that  
43 performs for an insurer any audit required by sections 375.1025 to 375.1062 to  
44 timely report to the audit committee in accordance with the requirements of the  
45 auditing profession, including:

46 (a) All significant accounting policies and material permitted practices;  
47 (b) All material alternative treatments of financial information within  
48 statutory accounting principles that have been discussed with management  
49 officials of the insurer, ramifications of the use of the alternative disclosures and  
50 treatments, and the treatment preferred by the accountant; and  
51 (c) Other material written communications between the accountant and  
52 the management of the insurer, such as any management letter or schedule of  
53 unadjusted differences.

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

59 [8.] 9. The proportion of independent audit committee members shall  
60 meet or exceed the following criteria:

61 (1) If the insurer wrote direct and assumed premiums of zero to three  
62 hundred million dollars during the prior calendar year, no minimum  
63 requirements are required regarding the number or proportion of audit committee  
64 members who shall be independent;

65 (2) If the insurer wrote direct and assumed premiums of three hundred  
66 million to five hundred million dollars during the prior calendar year, at least a  
67 majority of the members of the audit committee shall be independent; and

68 (3) If the insurer wrote direct and assumed premiums of five hundred  
69 million dollars or more during the prior calendar year, a supermajority of at least  
70 seventy-five percent of the members of the audit committee shall be independent.

71 [9.] 10. An insurer with direct written and assumed premium, excluding  
72 premiums reinsured with the Federal Crop Insurance Corporation and Federal  
73 Flood Program, less than five hundred million dollars may make application to  
74 the director for a waiver from the requirements of this section based upon  
75 hardship. The insurer shall file, with its annual statement filing, the approval  
76 for relief from this section with the states that it is licensed in or doing business  
77 in and the NAIC. If the nondomestic state accepts electronic filing with the  
78 NAIC, the insurer shall file the approval in an electronic format acceptable to the  
79 NAIC.

375.1056. 1. Every insurer required to file an audited financial report  
2 under sections 375.1025 to 375.1062 that has annual direct written and assumed  
3 premiums, excluding premiums reinsured with the Federal Crop Insurance  
4 Corporation and Federal Flood Program, of five hundred million dollars or more  
5 shall prepare a report of the insurer's or group of insurers' internal control over  
6 financial reporting, as such terms are defined in section 375.1025. The report  
7 shall be filed with the director along with the communication of internal  
8 control-related matters noted in an audit described under section  
9 375.1047. Management's report of internal control over financial reporting shall  
10 be as of December thirty-first immediately preceding.

11 2. Notwithstanding the premium threshold in subsection 1 of this section,  
12 the director may require an insurer to file management's report of internal  
13 control over financial reporting if the insurer is in any RBC level event, or meets  
14 any one or more of the standards of an insurer deemed to be in hazardous  
15 financial condition as defined in [rules adopted by the director] **section 375.539**.

16 3. An insurer or a group of insurers that is:

17 (1) Directly subject to Section 404;

18           (2) Part of a holding company system whose parent is directly subject to  
19 Section 404;

20           (3) Not directly subject to Section 404 but is a SOX compliant entity; or

21           (4) A member of a holding company system whose parent is not directly  
22 subject to Section 404 but is a SOX compliant entity;

23 may file its or its parent's Section 404 report and an addendum in satisfaction of  
24 the requirement of this section, provided that those internal controls of the  
25 insurer or group of insurers having a material impact on the preparation of the  
26 insurer's or group of insurers' audited statutory financial statements, namely  
27 those items included in subdivisions (2) to (6) of subsection 2 **and subsection**  
28 **3** of section 375.1032, were included in the scope of the Section 404 report. The  
29 addendum shall be a positive statement by management that there are no  
30 material processes with respect to the preparation of the insurer's or group of  
31 insurers' audited statutory financial statements excluded from the Section 404  
32 report. If there are internal controls of the insurer or group of insurers that have  
33 a material impact on the preparation of the insurer's or group of insurers' audited  
34 statutory financial statements and those internal controls were not included in  
35 the scope of the Section 404 report, the insurer or group of insurers may either  
36 file a report under this section, or the Section 404 report and a report under this  
37 section for those internal controls that have a material impact on the preparation  
38 of the insurer's or group of insurers' audited statutory financial statements not  
39 covered by the Section 404 report.

40           4. Management's report of internal control over financial reporting shall  
41 include:

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

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

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

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



54 (5) Disclosure of any unremediated material weaknesses in the internal  
55 control over financial reporting identified by management as of December  
56 thirty-first immediately preceding. Management is not permitted to conclude that  
57 the internal control over financial reporting is effective to provide reasonable  
58 assurance regarding the reliability of financial statements in accordance with  
59 statutory accounting principles if there is one or more unremediated material  
60 weaknesses in its internal control over financial reporting;

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

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

65 5. Management shall document and make available upon financial  
66 condition examination the basis upon which its assertions required in subsection  
67 4 of this section are made. Management may base its assertions, in part, upon  
68 its review, monitoring and testing of internal controls undertaken in the normal  
69 course of its activities. Management shall have discretion as to the nature of the  
70 internal control framework used, and the nature and extent of documentation, in  
71 order to make its assertion in a cost-effective manner and, as such, may include  
72 assembly of or reference to existing documentation. Management's report on  
73 internal control over financial reporting, required by subsection 1 of this section,  
74 and any documentation provided in support thereof during the course of a  
75 financial condition examination, shall be kept confidential by the department.

76 6. No officer responsible for financial reporting may be a member of the  
77 audit committee.

**375.1058. 1. An insurer is exempt from the requirements of this  
2 section if:**

3 **(1) The insurer has annual direct written and unaffiliated**  
4 **assumed premium, including international direct and assumed**  
5 **premium but excluding premiums reinsured with the Federal Crop**  
6 **Insurance Corporation and Federal Flood Program, totaling less than**  
7 **five hundred million dollars; and**

8 **(2) The insurer is a member of a group of insurers that has**  
9 **annual direct written and unaffiliated assumed premium, including**  
10 **international direct and assumed premium but excluding premiums**  
11 **reinsured with the Federal Crop Insurance Corporation and Federal**  
12 **Flood Program, totaling less than one billion dollars.**

13           2. The insurer or group of insurers shall establish an internal  
14 audit function providing independent, objective, and reasonable  
15 assurance to the audit committee and insurer management regarding  
16 the insurer's governance, risk management, and internal controls. This  
17 assurance shall be provided by performing general and specific audits,  
18 reviews, and tests and by employing other techniques deemed  
19 necessary to protect assets, evaluate control effectiveness and  
20 efficiency, and evaluate compliance with policies and regulations.

21           3. In order to ensure that internal auditors remain objective, the  
22 internal audit function must be organizationally  
23 independent. Specifically, the internal audit function shall not defer  
24 ultimate judgment on audit matters to others and shall appoint an  
25 individual to head the internal audit function who will have direct and  
26 unrestricted access to the board of directors. Organizational  
27 independence does not preclude dual-reporting relationships.

28           4. The head of the internal audit function shall report to the  
29 audit committee regularly, but no less than annually, on the periodic  
30 audit plan, factors that may adversely impact the internal audit  
31 function's independence or effectiveness, material findings from  
32 completed audits, and the appropriateness of corrective actions  
33 implemented by management as a result of audit findings.

34           5. If an insurer is a member of an insurance holding company  
35 system or included in a group of insurers, the insurer may satisfy the  
36 internal audit function requirements set forth in this section at the  
37 ultimate controlling parent level, an intermediate holding company  
38 level, or the individual legal entity level.

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