

**PROPOSED REGULATION OF THE
COMMISSIONER OF INSURANCE**

LCB File No. R108-16

June 23, 2016

EXPLANATION – Matter in *italics* is new; matter in brackets ~~omitted material~~ is material to be omitted.

AUTHORITY: NRS 679B.130, 680A.120

A REGULATION relating to insurance; amending the requirements for the internal audit function as part of the CPA Report requirements.

Section 1. Chapter 680A of NAC is hereby amended by adding thereto the provisions set forth as sections 2 to 4, inclusive, of this regulation:

Sec. 2. *“Internal audit function” is a process that provides 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 process.*

Sec. 3. 1. Exemption – 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 Program, less than \$500,000,000; and

(b) 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, less than \$1,000,000,000.

Sec. 4. 1. 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.

2. Independence – 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 shall 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.

3. 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.

4. 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 requirements set forth in this section at the ultimate controlling parent

level, an intermediate holding company level or the individual legal entity level.

Sec. 5. NAC 680A.005 is hereby amended to read as follows:

“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.

Sec. 6. NAC 680A.199 is hereby amended to read as follows:

1. The provisions of this section do not apply to a foreign or alien insurer 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.
2. The audit committee shall be directly responsible for the appointment, compensation and oversight of the work of any accountant for the purpose of preparing or issuing the Audited Financial Report or related work pursuant to NAC 680A.173 to 680A.211, inclusive. Any dispute between the management of the insurer and the accountant during the course of the audit regarding the financial reporting for the preparation or issuance of the annual Audited Financial Report of the insurer must be resolved by the audit committee. Each accountant shall report directly to the audit committee.
3. *The audit committee of an insurer or group of insurers shall be 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 NAC 680A.201.*

~~3~~4. Each member of the audit committee must be a member of the board of directors of the insurer or a member of the board of directors of an entity that controls a group of insurers. If an

audit committee is not designated by the insurer, the insurer's entire board of directors shall constitute the audit committee.

~~4~~5. Except as otherwise provided in this subsection, to be considered independent for the 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 or committee, accept any consulting, advisory or other compensatory fee from the entity or be an affiliated person of the entity or any subsidiary thereof. If, by law, participation on the board of directors by otherwise non-independent members is required, 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. 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 NAC 680A.173 to 680A.211, inclusive, at the election of the controlling person.

~~5~~6. If a member of the audit committee ceases to be independent for reasons outside the member's reasonable control, the insurer shall provide notice to the Commissioner, and the member may remain an audit committee member of the insurer until the earlier of the next annual meeting of the insurer or 1 year after the occurrence of the event that caused the member to be no longer independent.

~~6~~7. To exercise the election of the controlling person to designate the audit committee for purposes of NAC 680A.173 to 680A.211, inclusive, the ultimate controlling person shall provide written notice to the insurance regulatory authority of other affected states. Notification must be made timely before the issuance of the Audited Financial Report and include a description of the basis for the election. The election may be changed through notice to the Commissioner by the

insurer, which must include a description of the basis for the change. The election remains in effect for perpetuity or until rescinded.

~~7~~8. The audit committee shall require the independent certified public accountant that performs any audit for an insurer as required by NAC 680A.173 to 680A.211, inclusive, to timely report to the audit committee in accordance with the requirements of Statements of Auditing Standards No. 61, Communication with Audit Committees, included in the *AICPA Professional Standards*, as adopted by reference in NAC 680A.189, including, without limitation:

- (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 the management of the insurer, ramifications of the use of the alternative disclosures and treatments, and the treatment preferred by the accountant; and
- (c) Any other material written communications between the independent certified public accountant and the management of the insurer, including any management letter or schedule of unadjusted differences.

~~8~~9. If an insurer is a member of an insurance holding company system, the reports required by subsection 7 may be provided to the audit committee on an aggregate basis for the insurers in the holding company system if the independent certified accountant identifies to the audit committee any substantial differences among insurers in the system.

~~9~~10. The proportion of independent audit committee members must meet or exceed the following criteria:

Previous Calendar Year Direct Written and Assumed Premiums		
\$0 – 300,000,000	\$300,000,001 – 500,000,000	Over \$500,000,000
No minimum requirements.	Majority (50 percent or more) of members shall be independent.	Supermajority (75 percent or more) of members shall be independent.

~~110~~11. The Commissioner may require the board of directors of an insurer or a group of insurers to enact improvements to the independence of the audit committee membership, if:

(a) The insurer is subject to filing the Risk-Based Capital (RBC) Report and the insurer has identified a risk-based capital action level event pursuant to the provisions of NAC 681B.400 to 681B.595, inclusive;

(b) The insurer meets one or more of the standards of an insurer deemed to be in hazardous financial condition identified pursuant to NRS 680A.205 and NAC 680A.220 to 680A.226, inclusive; or

(c) The insurer otherwise exhibits qualities of a troubled insurer.

~~111~~12. All insurers with less than \$500 million in direct written and assumed premiums for the previous calendar year are encouraged to structure their audit committees with at least a supermajority of independent audit committee members.

~~112~~13. An insurer with direct written and assumed premiums, excluding premiums reinsured with the Federal Crop Insurance Corporation and the National Flood Insurance Program, of less than \$500 million may apply in writing to the Commissioner for a waiver from the requirements of this section based on hardship. If the waiver is granted, the insurer shall file, with its annual statement filing, the approval for the waiver with the states in which it is licensed or doing business and with the National Association of Insurance Commissioners. If the nondomestic

state accepts electronic filing with the National Association of Insurance Commissioners, the insurer shall file the approval in an electronic format acceptable to the National Association of Insurance Commissioners.

~~13~~14. The requirements of this section become effective on January 1, 2010, except that:

(a) 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 because the total written and assumed premium is below the threshold and subsequently becomes subject to one of the independence requirements due to changes in premiums must comply with the independence requirements within 1 year after the year the threshold is exceeded; and

(b) An insurer that becomes subject to one of the independence requirements because of a business combination must comply with the independence requirements within 1 calendar year after the date of acquisition or combination.

Sec. 7. NAC 680A.207 is hereby amended to read as follows:

1. Domestic insurers retaining a qualified independent certified public accountant on December 31, 2009, shall comply with the provisions of NAC 680A.173 to 680A.211, inclusive, for the year ending December 31, 2009, and each year thereafter unless the Commissioner permits otherwise.

2. Domestic insurers not retaining a qualified independent certified public accountant on December 31, 2009, shall meet the following schedule for compliance unless the Commissioner permits otherwise:

(a) As of December 31, 2009, file with the Commissioner an Audited Financial Report; and

(b) For the year ending December 31, 2010, and each year thereafter, file with the Commissioner all reports and communication required by NAC 680A.173 to 680A.211, inclusive.

3. Foreign and alien insurers shall comply with the provisions of NAC 680A.173 to 680A.211, inclusive, for the year ending December 31, 2010, and each year thereafter, unless the Commissioner permits otherwise.

4. The requirement of subsection 3 of this section is to be in effect January 1, 2017. If an insurer or group of insurers that is exempt from the requirement no longer qualifies for that exemption, it shall have one year after the year the threshold is exceeded to comply with the requirements of this section.