

REVIEW

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NAIC MOVES FORWARD ON APPLYING SARBANES-OXLEY TO ALL INSURERS



By Chris Petersen

The NAIC/AICPA Working Group has agreed to a framework for applying Sarbanes-Oxley (“SOX”) requirements to insurance licensees including non-public insurance companies. As reported earlier, the NAIC is attempting to amend its Model Regulation Requiring Annual Audited Financial Regulations (“Model Regulation”) to apply SOX requirements regarding audit committees, independent auditors and financial controls to all insurers. To accomplish this task, the Working Group appointed three subgroups to examine applying SOX “Title II,” “Title III” and “Title IV” to insurance companies. The Title II subgroup examined issues regarding audit committees. The Title III subgroup studied independent auditors and the Title IV subgroup

was charged with reviewing internal management controls.

The Title II subgroup recommended, and the Working Group adopted, language mandating that all insurers establish audit committees. In addition, the required audit committees must be comprised of independent board members, i.e., audit committee members may not receive, other than in their capacity as board members, compensatory fees from the Plan. A provision, however, was added to the model that states that if domiciliary law requires board participation by otherwise non-independent board members such members may participate on the audit committee as independent members. The number of independent audit committee members varies based on the insurance-based revenue of the entity.

The Working Group also adopted the Title III subgroup’s recommendations regarding independent auditor provisions. The proposal contains additional new standards for qualified independent certified public accountants (“QICPA”). Under the proposal, a Plan’s QICPA may not provide insurers with non-audit services such as book keeping, consulting, financial information system design, etc. Under limited circumstances, the audit committee may grant approval for the QICPA to provide certain non-audit related services, but even the use of these limited services is capped. Insurers having direct written and assumed premiums of less than \$100,000,000 in any calendar year may request an exemption from the Department of Insurance.

Finally, the Title IV subgroup adopted some significant amendments to its section of the Model Audit rule relating to internal management controls. Insurers will be required to file a “Management Report of Internal Control over Financial Reporting.” This report must include 1) a statement that management is responsible for establishing and maintaining adequate internal control over financial reporting, 2) a statement that management has established effective internal control over financial reporting that provide reasonable assurance regarding the reliability of financial statements, 3) a statement that briefly describes the approach or processes by which management evaluated the effectiveness of its internal controls and 4) disclosures of any unremediated material weakness in the internal control over financial reporting.

The Working Group also adopted some important amendments to these requirements. First, companies with less than \$500,000,000 in annual premiums are excluded from the Title IV requirements. The Working Group also agreed to eliminate the requirement of for external, independent attestation of an insurer’s internal controls thus eliminating the additional costs associated with the independent review. Also adopted were provisions that make it clear that management has the discretion to report either at the enterprise level or at any other level within the holding company framework. Finally the model now includes a more flexible reporting framework and less onerous documentation requirements.

Although approved by the Working Group, the model still must go through several other hurdles at the NAIC. These hurdles combined with the delayed implementation timeframes in model means that it is highly unlikely that compliance will occur before 2009. □

Chris Petersen is a partner in the firm’s insurance group. He concentrates in legal and compliance services relating to the Health Insurance Portability and Accountability Act (HIPAA), privacy, state small-group and individual insurance reform regulation and the interaction between state and federal law. Chris received his bachelor’s degree from Washington University (St. Louis, Mo.) and his law degree from Georgetown University.