

1-1 By: Eiland (Senate Sponsor - Averitt) H.B. No. 2752
1-2 (In the Senate - Received from the House April 14, 2009;
1-3 April 27, 2009, read first time and referred to Committee on
1-4 Business and Commerce; May 19, 2009, reported adversely, with
1-5 favorable Committee Substitute by the following vote: Yeas 7, Nays
1-6 0; May 19, 2009, sent to printer.)

1-7 COMMITTEE SUBSTITUTE FOR H.B. No. 2752 By: Estes

1-8 A BILL TO BE ENTITLED
1-9 AN ACT

1-10 relating to independent audits of insurer financial statements and
1-11 insurer internal controls.

1-12 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:

1-13 SECTION 1. Section 401.001, Insurance Code, is amended by
1-14 adding Subdivisions (2-a), (2-b), (4-a), (4-b), (6), (7), (8), and
1-15 (9) and amending Subdivision (4) to read as follows:

1-16 (2-a) "Audit committee" means a committee established
1-17 by the board of directors of an entity for the purpose of overseeing
1-18 the accounting and financial reporting processes of an insurer or
1-19 group of insurers and audits of financial statements of the insurer
1-20 or group of insurers. At the election of the controlling person,
1-21 the audit committee of an entity that controls a group of insurers
1-22 may be the audit committee for one or more of the controlled
1-23 insurers solely for the purposes of this subchapter. If an audit
1-24 committee is not designated by the insurer, the insurer's entire
1-25 board of directors constitutes the audit committee.

1-26 (2-b) "Group of insurers" means those authorized
1-27 insurers included in the reporting requirements of Chapter 823, or
1-28 a set of insurers as identified by management, for the purpose of
1-29 assessing the effectiveness of internal control over financial
1-30 reporting.

1-31 (4) "Insurer" means an insurer authorized to engage in
1-32 business in this state, including:

- 1-33 (A) a life, health, or accident insurance
1-34 company;
1-35 (B) a fire and marine insurance company;
1-36 (C) a general casualty company;
1-37 (D) a title insurance company;
1-38 (E) a fraternal benefit society;
1-39 (F) a mutual life insurance company;
1-40 (G) a local mutual aid association;
1-41 (H) a statewide mutual assessment company;
1-42 (I) a mutual insurance company other than a
1-43 mutual life insurance company;
1-44 (J) a farm mutual insurance company;
1-45 (K) a county mutual insurance company;
1-46 (L) a Lloyd's plan;
1-47 (M) a reciprocal or interinsurance exchange;
1-48 (N) a group hospital service corporation;
1-49 (O) a stipulated premium company; ~~and~~
1-50 (P) a nonprofit legal services corporation; and
1-51 (Q) a health maintenance organization.

1-52 (4-a) "Internal control over financial reporting"
1-53 means a process implemented by an entity's board of directors,
1-54 management, and other personnel designed to provide reasonable
1-55 assurance regarding the reliability of the entity's financial
1-56 statements. The term includes policies and procedures that:

1-57 (A) relate to the maintenance of records that, in
1-58 reasonable detail, accurately and fairly reflect the transactions
1-59 and dispositions of assets;

1-60 (B) provide reasonable assurance that:

1-61 (i) transactions are recorded as necessary
1-62 to permit preparation of the financial statements; and

1-63 (ii) receipts and expenditures are made

2-1 only in accordance with authorizations of management and directors;
2-2 and
2-3 (C) provide reasonable assurance regarding
2-4 prevention or timely detection of unauthorized acquisition, use, or
2-5 disposition of assets that could have a material effect on the
2-6 financial statements.
2-7 (4-b) "Management" means the management of an insurer
2-8 or group of insurers subject to this subchapter.
2-9 (6) "SEC" means the United States Securities and
2-10 Exchange Commission.
2-11 (7) "Section 404" means Section 404, Sarbanes-Oxley
2-12 Act of 2002 (15 U.S.C. Section 7262), and rules adopted under that
2-13 section.
2-14 (8) "Section 404 report" means management's report on
2-15 internal control over financial reporting as determined by the SEC
2-16 and the related attestation report of an accountant.
2-17 (9) "SOX-compliant entity" means an entity that is
2-18 required to comply with or voluntarily complies with:
2-19 (A) the preapproval requirements provided by 15
2-20 U.S.C. Section 78j-1(i);
2-21 (B) the audit committee independence
2-22 requirements provided by 15 U.S.C. Section 78j-1(m)(3); and
2-23 (C) the internal control over financial
2-24 reporting requirements provided by 15 U.S.C. Section 7262(b) and
2-25 Item 308, SEC Regulation S-K.
2-26 SECTION 2. Sections 401.002, 401.003, and 401.004,
2-27 Insurance Code, are amended to read as follows:
2-28 Sec. 401.002. PURPOSE OF SUBCHAPTER. The purpose of this
2-29 subchapter is to:
2-30 (1) require an annual audit by an independent
2-31 certified public accountant of the financial statements reporting
2-32 the financial condition and the results of operations of each
2-33 insurer;
2-34 (2) require communication of internal control related
2-35 matters noted in an audit; and
2-36 (3) require management to report on internal control
2-37 over financial reporting [~~or health maintenance organization~~].
2-38 Sec. 401.003. EFFECT OF SUBCHAPTER ON AUTHORITY TO EXAMINE.
2-39 This subchapter does not limit the commissioner's authority to
2-40 order or the department's authority to conduct an examination of an
2-41 insurer [~~or health maintenance organization~~] under this code or the
2-42 commissioner's rules.
2-43 Sec. 401.004. FILING AND EXTENSIONS FOR FILING OF AUDITED
2-44 FINANCIAL REPORT. (a) Unless exempt under Section 401.006,
2-45 401.007, or 401.008 and except as otherwise provided by Sections
2-46 401.005 and 401.016, an insurer [~~or health maintenance~~
2-47 ~~organization~~] shall:
2-48 (1) have an annual audit performed by an accountant;
2-49 and
2-50 (2) file with the commissioner on or before June 1 [~~30~~]
2-51 an audited financial report for the preceding calendar year.
2-52 (b) The commissioner may require an insurer [~~or health~~
2-53 ~~maintenance organization~~] to file an audited financial report on a
2-54 date that precedes June 1 [~~30~~]. The commissioner must notify the
2-55 insurer [~~or health maintenance organization~~] of the filing date not
2-56 later than the 90th day before that date.
2-57 (c) An insurer [~~or health maintenance organization~~] may
2-58 request an extension of the filing date by submitting the request in
2-59 writing before the 10th day preceding the filing date. The request
2-60 must include sufficient detail for the commissioner to make an
2-61 informed decision on the requested extension. The commissioner may
2-62 extend the filing date for one or more 30-day periods if the
2-63 commissioner determines that there is good cause for the extension
2-64 based on a showing by the insurer [~~or health maintenance~~
2-65 ~~organization~~] and the [~~insurer's or health maintenance~~
2-66 ~~organization's~~] accountant of the reasons for requesting the
2-67 extension. An extension granted under this subsection also applies
2-68 to the filing of management's report on internal control over
2-69 financial reporting.

3-1 (d) An insurer required to file an annual audited financial
 3-2 report under this subchapter shall designate a group of individuals
 3-3 to serve as its audit committee. The audit committee of an entity
 3-4 that controls an insurer may, at the election of the controlling
 3-5 person, be the insurer's audit committee for purposes of this
 3-6 subchapter.

3-7 SECTION 3. The heading to Section 401.005, Insurance Code,
 3-8 is amended to read as follows:

3-9 Sec. 401.005. ALTERNATIVE FILING FOR CANADIAN OR BRITISH
 3-10 INSURERS [~~OR HEALTH MAINTENANCE ORGANIZATIONS~~].

3-11 SECTION 4. Section 401.005(a), Insurance Code, is amended
 3-12 to read as follows:

3-13 (a) Instead of the audited financial report required by
 3-14 Section 401.004, an insurer [~~or health maintenance organization~~]
 3-15 domiciled in Canada or the United Kingdom may file the insurer's [~~or~~
 3-16 ~~health maintenance organization's~~] annual statement of total
 3-17 business on the form filed by the insurer [~~or health maintenance~~
 3-18 ~~organization~~] with the appropriate regulatory authority in the
 3-19 country of domicile. The statement must be audited by an
 3-20 independent accountant chartered in the country of domicile.

3-21 SECTION 5. Section 401.006, Insurance Code, is amended to
 3-22 read as follows:

3-23 Sec. 401.006. EXEMPTION FOR CERTAIN SMALL INSURERS [~~AND~~
 3-24 ~~HEALTH MAINTENANCE ORGANIZATIONS~~]. (a) An insurer [~~or health~~
 3-25 ~~maintenance organization~~] that has less than \$1 million in direct
 3-26 premiums written in this state during a calendar year and fewer than
 3-27 1,000 policyholders or certificate holders of direct written
 3-28 premiums nationwide at the end of the calendar year is exempt from
 3-29 the requirement to file an audited financial report if the insurer
 3-30 [~~or health maintenance organization~~] submits an affidavit, made
 3-31 under oath by one of the insurer's [~~or health maintenance~~
 3-32 ~~organization's~~] officers, that specifies the amount of direct
 3-33 premiums written in this state during that period and the number of
 3-34 policyholders or certificate holders of direct written premiums
 3-35 nationwide at the end of the calendar year.

3-36 (b) Notwithstanding Subsection (a), the commissioner may
 3-37 require an insurer [~~or health maintenance organization~~], other than
 3-38 a fraternal benefit society that does not have any direct premiums
 3-39 written in this state for accident and health insurance during a
 3-40 calendar year, to comply with this subchapter if the commissioner
 3-41 finds that the insurer's [~~or health maintenance organization's~~]
 3-42 compliance is necessary for the commissioner to fulfill the
 3-43 commissioner's statutory responsibilities.

3-44 (c) An insurer [~~or health maintenance organization~~] that
 3-45 has assumed premiums of at least \$1 million under reinsurance
 3-46 agreements is not exempt under Subsection (a).

3-47 SECTION 6. The heading to Section 401.007, Insurance Code,
 3-48 is amended to read as follows:

3-49 Sec. 401.007. EXEMPTION FOR CERTAIN FOREIGN OR ALIEN
 3-50 INSURERS [~~OR HEALTH MAINTENANCE ORGANIZATIONS~~].

3-51 SECTION 7. Section 401.007, Insurance Code, is amended by
 3-52 amending Subsections (a) and (b) and adding Subsection (c) to read
 3-53 as follows:

3-54 (a) A foreign or alien insurer [~~or health maintenance~~
 3-55 ~~organization~~] that files an audited financial report in another
 3-56 state in accordance with that state's requirements for audited
 3-57 financial reports may be exempt from filing a report under this
 3-58 subchapter if the commissioner finds that the other state's
 3-59 requirements are substantially similar to the requirements
 3-60 prescribed by this subchapter.

3-61 (b) An insurer [~~or health maintenance organization~~] exempt
 3-62 under this section shall file with the commissioner a copy of:

3-63 (1) the audited financial report, the communication of
 3-64 internal control-related matters noted in the audit [~~report on~~
 3-65 ~~significant deficiencies in internal controls~~], and the
 3-66 accountant's letter of qualifications filed with the other state;
 3-67 and

3-68 (2) any notification of adverse financial conditions
 3-69 report filed with the other state.

4-1 (c) A foreign or alien insurer required to file management's
 4-2 report of internal control over financial reporting in another
 4-3 state is exempt from filing the report in this state if the other
 4-4 state has substantially similar reporting requirements and the
 4-5 report is filed with the commissioner in that state in the time
 4-6 specified.

4-7 SECTION 8. Section 401.008, Insurance Code, is amended to
 4-8 read as follows:

4-9 Sec. 401.008. HARSHIP EXEMPTION. (a) An insurer [~~or~~
 4-10 ~~health maintenance organization~~] that is not eligible for an
 4-11 exemption under Section 401.006 or 401.007 may apply to the
 4-12 commissioner for a hardship exemption.

4-13 (b) Subject to Subsection (c), the commissioner may grant an
 4-14 exemption under this section if the commissioner finds, after
 4-15 reviewing the application, that compliance with this subchapter
 4-16 would constitute a severe financial or organizational hardship for
 4-17 the insurer [~~or health maintenance organization~~]. The commissioner
 4-18 may grant the exemption at any time for one or more specified
 4-19 periods.

4-20 (c) The commissioner may not grant an exemption under this
 4-21 section if:

4-22 (1) the exemption would diminish the department's
 4-23 ability to monitor the financial condition of the insurer [~~or~~
 4-24 ~~health maintenance organization~~]; or

4-25 (2) the insurer [~~or health maintenance organization~~]:

4-26 (A) during the five-year period preceding the
 4-27 date the application for the exemption is made:

4-28 (i) has been placed under supervision,
 4-29 conservatorship, or receivership;

4-30 (ii) has undergone a change in control, as
 4-31 described by Section 823.005; or

4-32 (iii) has been subject to a significant
 4-33 number of complaints, as determined by the commissioner;

4-34 (B) has been identified by the department as
 4-35 troubled;

4-36 (C) has been or is the subject of a disciplinary
 4-37 action by the department; or

4-38 (D) is not complying with the law or with a rule
 4-39 adopted by the commissioner.

4-40 SECTION 9. Sections 401.009(a), (b), and (c), Insurance
 4-41 Code, are amended to read as follows:

4-42 (a) An audited financial report required under Section
 4-43 401.004 must:

4-44 (1) describe the financial condition of the insurer
 4-45 [~~or health maintenance organization~~] as of the end of the most
 4-46 recent calendar year and the results of the insurer's [~~or health~~
 4-47 ~~maintenance organization's~~] operations, changes in financial
 4-48 position, and changes in capital and surplus for that year;

4-49 (2) conform to the statutory accounting practices
 4-50 prescribed or otherwise permitted by the insurance regulator in the
 4-51 insurer's [~~or health maintenance organization's~~] state of domicile;
 4-52 and

4-53 (3) include:

4-54 (A) the report of an accountant;

4-55 (B) a balance sheet that reports admitted assets,
 4-56 liabilities, capital, and surplus;

4-57 (C) a statement of gain or loss from operations;

4-58 (D) a statement of cash flows;

4-59 (E) a statement of changes in capital and
 4-60 surplus;

4-61 (F) any notes to financial statements;

4-62 (G) supplementary data and information,
 4-63 including any additional data or information required by the
 4-64 commissioner; and

4-65 (H) information required by the department to
 4-66 conduct the insurer's [~~or health maintenance organization's~~]
 4-67 examination under Subchapter B.

4-68 (b) The notes to financial statements required by
 4-69 Subsection (a)(3)(F) must include:

5-1 (1) a reconciliation of any differences between the
 5-2 audited statutory financial statements and the annual statements
 5-3 filed under this code, with a written description of the nature of
 5-4 those differences;

5-5 (2) any notes required by the appropriate National
 5-6 Association of Insurance Commissioners annual statement
 5-7 instructions [~~or by generally accepted accounting principles~~]; and

5-8 (3) a summary of the ownership of the insurer [~~or~~
 5-9 ~~health maintenance organization~~] and that entity's relationship to
 5-10 any affiliated company.

5-11 (c) The financial statements included in the audited
 5-12 financial report must be prepared in a form and use language and
 5-13 groupings substantially the same as the relevant sections of the
 5-14 annual statement of the insurer filed with the commissioner. The
 5-15 financial statements must be comparative, including amounts on
 5-16 December 31 of the current year and amounts as of the immediately
 5-17 preceding December 31, except for the first year in which an insurer
 5-18 is required to file the report. [An insurer or health maintenance
 5-19 organization required under Section 401.004 to file an audited
 5-20 financial report that does not retain an independent certified
 5-21 public accountant to perform an annual audit for the previous year
 5-22 may not be required to include in the report audited statements of
 5-23 operations, cash flows, or changes in capital and surplus for the
 5-24 first year. The insurer or health maintenance organization must
 5-25 include those statements in the first-year report and label the
 5-26 statements as unaudited. The insurer or health maintenance
 5-27 organization must include in the first-year report all other
 5-28 reports described by Section 401.004.]

5-29 SECTION 10. Section 401.010, Insurance Code, is amended to
 5-30 read as follows:

5-31 Sec. 401.010. REQUIREMENTS FOR FINANCIAL STATEMENTS IN
 5-32 AUDITED FINANCIAL REPORT. (a) An accountant must audit the
 5-33 financial reports provided by an insurer [~~or health maintenance~~
 5-34 ~~organization~~] for purposes of an audit under this subchapter. The
 5-35 accountant who audits the reports must conduct the audit in
 5-36 accordance with generally accepted auditing standards or with
 5-37 standards adopted by the Public Company Accounting Oversight Board,
 5-38 as applicable, and must consider the standards specified in the
 5-39 Financial Condition Examiner's Handbook adopted by the National
 5-40 Association of Insurance Commissioners or other analogous
 5-41 nationally recognized standards adopted by commissioner rule.

5-42 (a-1) In accordance with "Consideration of Internal Control
 5-43 in a Financial Statement Audit," AU Section 319, Professional
 5-44 Standards of the American Institute of Certified Public
 5-45 Accountants, the accountant shall obtain an understanding of
 5-46 internal control sufficient to plan the audit. To the extent
 5-47 required by AU Section 319, for those insurers required to file a
 5-48 management's report of internal control over financial reporting
 5-49 under Section 401.024, the accountant shall consider the most
 5-50 recently available report in planning and performing the audit of
 5-51 the statutory financial statements. In this subsection, "consider"
 5-52 has the meaning assigned by Statement on Auditing Standards No.
 5-53 102, "Defining Professional Requirements in Statements on Auditing
 5-54 Standards," or a successor document.

5-55 (b) The financial statements included in the audited
 5-56 financial report must be prepared in a form and using language and
 5-57 groupings substantially the same as those of the relevant sections
 5-58 of the insurer's [~~or health maintenance organization's~~] annual
 5-59 statement filed with the commissioner. Beginning in the second
 5-60 year in which an insurer [~~or health maintenance organization~~] is
 5-61 required to file an audited financial report, the financial
 5-62 statements must also be comparative, presenting the amounts as of
 5-63 December 31 of the reported year and the amounts as of December 31
 5-64 of the preceding year.

5-65 SECTION 11. Section 401.011, Insurance Code, is amended by
 5-66 amending Subsections (a), (b), and (c) and adding Subsections
 5-67 (c-1), (e), (f), (g), (h), (i), (j), (k), (l), and (m) to read as
 5-68 follows:

5-69 (a) Except as provided by Subsections (c), ~~and~~ (d), (e),

6-1 (f), (g), and (l), the commissioner shall accept an audited
 6-2 financial report from an independent certified public accountant or
 6-3 accounting firm that:

6-4 (1) is a member in good standing of the American
 6-5 Institute of Certified Public Accountants and is in good standing
 6-6 with all states in which the accountant or firm is licensed to
 6-7 practice, as applicable; and

6-8 (2) conforms to the American Institute of Certified
 6-9 Public Accountants Code of Professional Conduct and to the rules of
 6-10 professional conduct and other rules of the Texas State Board of
 6-11 Public Accountancy or a similar code.

6-12 (b) If the insurer [~~or health maintenance organization~~] is
 6-13 domiciled in Canada, the commissioner shall accept an audited
 6-14 financial report from an accountant chartered in Canada. If the
 6-15 insurer [~~or health maintenance organization~~] is domiciled in Great
 6-16 Britain, the commissioner shall accept an audited financial report
 6-17 from an accountant chartered in Great Britain.

6-18 (c) A lead partner or other person responsible for rendering
 6-19 a report for an insurer may not act in that capacity [~~or health~~
 6-20 ~~maintenance organization~~] for more than five [~~seven~~
 6-21 years and may not, during the five-year [~~two-year~~] period after
 6-22 that fifth [~~seventh~~] year, render a report for the insurer [~~or~~
 6-23 ~~health maintenance organization~~] or for a subsidiary or affiliate
 6-24 of the insurer [~~or health maintenance organization~~] that is engaged
 6-25 in the business of insurance. On application made at least 30 days
 6-26 before the end of the calendar year, the [~~The~~] commissioner may
 6-27 determine that the limitation provided by this subsection does not
 6-28 apply to an accountant for a particular insurer [~~or health~~
 6-29 ~~maintenance organization~~] if the insurer [~~or health maintenance~~
 6-30 ~~organization~~] demonstrates to the satisfaction of the commissioner
 6-31 that the limitation's application to the insurer [~~or health~~
 6-32 ~~maintenance organization~~] would be unfair because of unusual
 6-33 circumstances. In making the determination, the commissioner may
 6-34 consider:

6-35 (1) the number of partners or individuals the
 6-36 accountant employs, the expertise of the partners or individuals
 6-37 the accountant employs, or the number of the accountant's insurance
 6-38 clients;

6-39 (2) the premium volume of the insurer [~~or health~~
 6-40 ~~maintenance organization~~]; and

6-41 (3) the number of jurisdictions in which the insurer
 6-42 [~~or health maintenance organization~~] engages in business.

6-43 (c-1) On filing its annual statement, an insurer for which
 6-44 the commissioner has approved an exception under Subsection (c)
 6-45 shall file the approval with the states in which it is doing or is
 6-46 authorized to do business and with the National Association of
 6-47 Insurance Commissioners. If a state other than this state accepts
 6-48 electronic filing with the National Association of Insurance
 6-49 Commissioners, the insurer shall file the approval in an electronic
 6-50 format acceptable to the National Association of Insurance
 6-51 Commissioners.

6-52 (e) In providing services, the accountant shall not:

6-53 (1) function in the role of management, audit the
 6-54 accountant's own work, or serve in an advocacy role for the insurer;
 6-55 or

6-56 (2) directly or indirectly enter into an agreement of
 6-57 indemnity or release from liability regarding the audit of the
 6-58 insurer.

6-59 (f) The commissioner may not recognize as qualified an
 6-60 accountant, or accept an annual audited financial report that was
 6-61 prepared wholly or partly by an accountant, who provides an insurer
 6-62 at the time of the audit:

6-63 (1) bookkeeping or other services related to the
 6-64 accounting records or financial statements of the insurer;

6-65 (2) services related to financial information systems
 6-66 design and implementation;

6-67 (3) appraisal or valuation services, fairness
 6-68 opinions, or contribution-in-kind reports;

6-69 (4) actuarially oriented advisory services involving

7-1 the determination of amounts recorded in the financial statements;
7-2 (5) internal audit outsourcing services;
7-3 (6) management or human resources services;
7-4 (7) broker or dealer, investment adviser, or
7-5 investment banking services;
7-6 (8) legal services or other expert services unrelated
7-7 to the audit; or
7-8 (9) any other service that the commissioner determines
7-9 to be inappropriate.

7-10 (g) Notwithstanding Subsection (f)(4), an accountant may
7-11 assist an insurer in understanding the methods, assumptions, and
7-12 inputs used in the determination of amounts recorded in the
7-13 financial statement if it is reasonable to believe that the
7-14 advisory service will not be the subject of audit procedures during
7-15 an audit of the insurer's financial statements. An accountant's
7-16 actuary may also issue an actuarial opinion or certification on an
7-17 insurer's reserves if:

7-18 (1) the accountant or the accountant's actuary has not
7-19 performed management functions or made any management decisions;
7-20 (2) the insurer has competent personnel, or engages a
7-21 third-party actuary, to estimate the reserves for which management
7-22 takes responsibility; and
7-23 (3) the accountant's actuary tests the reasonableness
7-24 of the reserves after the insurer's management has determined the
7-25 amount of the reserves.

7-26 (h) An insurer that has direct written and assumed premiums
7-27 of less than \$100 million in any calendar year may request an
7-28 exemption from the requirements of Subsection (f) by filing with
7-29 the commissioner a written statement explaining why the insurer
7-30 should be exempt. The commissioner may grant the exemption if the
7-31 commissioner finds that compliance with Subsection (f) would impose
7-32 an undue financial or organizational hardship on the insurer.

7-33 (i) An accountant who performs an audit may perform nonaudit
7-34 services, including tax services, that are not described in
7-35 Subsection (f) or that do not conflict with Subsection (e), only if
7-36 the activity is approved in advance by the audit committee in
7-37 accordance with Subsection (j).

7-38 (j) The audit committee must approve in advance all auditing
7-39 services and nonaudit services that an accountant provides to the
7-40 insurer. The prior approval requirement is waived with respect to
7-41 nonaudit services if the insurer is a SOX-compliant entity or a
7-42 direct or indirect wholly owned subsidiary of a SOX-compliant
7-43 entity or:

7-44 (1) the aggregate amount of all nonaudit services
7-45 provided to the insurer is not more than five percent of the total
7-46 amount of fees paid by the insurer to its accountant during the
7-47 fiscal year in which the nonaudit services are provided;
7-48 (2) the services were not recognized by the insurer at
7-49 the time of the engagement to be nonaudit services; and
7-50 (3) the services are promptly brought to the attention
7-51 of the audit committee and approved before the completion of the
7-52 audit by the audit committee or by one or more members of the audit
7-53 committee who are the members of the board of directors to whom the
7-54 audit committee has delegated authority to grant approvals.

7-55 (k) The audit committee may delegate to one or more
7-56 designated members of the audit committee the authority to grant
7-57 the prior approval required by Subsection (i). The decisions of any
7-58 member to whom this authority is delegated shall be presented to the
7-59 full audit committee at each of its scheduled meetings.

7-60 (l) The commissioner may not recognize an accountant as
7-61 qualified for a particular insurer if a member of the board, the
7-62 president, chief executive officer, controller, chief financial
7-63 officer, chief accounting officer, or any person serving in an
7-64 equivalent position for the insurer, was employed by the accountant
7-65 and participated in the audit of that insurer during the one-year
7-66 period preceding the date on which the most current statutory
7-67 opinion is due. This subsection applies only to partners and senior
7-68 managers involved in the audit. An insurer may apply to the
7-69 commissioner for an exemption from the requirements of this

8-1 subsection on the basis of unusual circumstances.
8-2 (m) The insurer shall file, with its annual statement
8-3 filing, the approval of an exemption granted under Subsection (h)
8-4 or (l) with the states in which it does or is authorized to do
8-5 business and with the National Association of Insurance
8-6 Commissioners. If a state, other than this state, in which the
8-7 insurer does or is authorized to do business accepts electronic
8-8 filing, the insurer shall file the approval in an electronic format
8-9 acceptable to the National Association of Insurance Commissioners.

8-10 SECTION 12. Section 401.012, Insurance Code, is amended to
8-11 read as follows:

8-12 Sec. 401.012. HEARING ON ACCOUNTANT QUALIFICATIONS;
8-13 REPLACEMENT OF ACCOUNTANT. The commissioner may hold a hearing to
8-14 determine if an accountant is qualified and independent. If, after
8-15 considering the evidence presented, the commissioner determines
8-16 that an accountant is not qualified and independent for purposes of
8-17 expressing an opinion on the financial statements in an audited
8-18 financial report filed under this subchapter, the commissioner
8-19 shall issue an order directing the insurer [~~or health maintenance~~
8-20 ~~organization~~] to replace the accountant with a qualified and
8-21 independent accountant.

8-22 SECTION 13. Section 401.013(a), Insurance Code, is amended
8-23 to read as follows:

8-24 (a) The audited financial report required under Section
8-25 401.004 must be accompanied by a letter provided by the accountant
8-26 who performed the audit stating:

8-27 (1) the accountant's general background and
8-28 experience;

8-29 (2) the experience of each individual assigned to
8-30 prepare the audit in auditing insurers [~~or health maintenance~~
8-31 ~~organizations~~] and whether the individual is an independent
8-32 certified public accountant; and

8-33 (3) that the accountant:

8-34 (A) is properly licensed by an appropriate state
8-35 licensing authority, is a member in good standing of the American
8-36 Institute of Certified Public Accountants, and is otherwise
8-37 qualified under Section 401.011;

8-38 (B) is independent from the insurer [~~or health~~
8-39 ~~maintenance organization~~] and conforms to the standards of the
8-40 profession contained in the American Institute of Certified Public
8-41 Accountants Code of Professional Conduct, the statements of that
8-42 institute, and the rules of professional conduct adopted by the
8-43 Texas State Board of Public Accountancy, or a similar code;

8-44 (C) understands that:

8-45 (i) the audited financial report and the
8-46 accountant's opinion on the report will be filed in compliance with
8-47 this subchapter; and

8-48 (ii) the commissioner will rely on the
8-49 report and opinion in monitoring and regulating the insurer's [~~or~~
8-50 ~~health maintenance organization's~~] financial position; and

8-51 (D) consents to the requirements of Section
8-52 401.020 and agrees to make the accountant's work papers available
8-53 for review by the department or the department's designee.

8-54 SECTION 14. Sections 401.014(a) and (b), Insurance Code,
8-55 are amended to read as follows:

8-56 (a) Not later than December 31 of the calendar year to be
8-57 covered by an audited financial report required by this subchapter,
8-58 an insurer [~~or health maintenance organization~~] must register in
8-59 writing with the commissioner the name and address of the
8-60 accountant retained to prepare the report.

8-61 (b) The insurer [~~or health maintenance organization~~] must
8-62 include with the registration a statement signed by the accountant:

8-63 (1) indicating that the accountant is aware of the
8-64 requirements of this subchapter and of the rules of the insurance
8-65 department of the insurer's [~~or health maintenance organization's~~]
8-66 state of domicile that relate to accounting and financial matters;
8-67 and

8-68 (2) affirming that the accountant will express the
8-69 accountant's opinion on the financial statements in terms of the

9-1 statements' conformity to the statutory accounting practices
 9-2 prescribed or otherwise permitted by the insurance department
 9-3 described by Subdivision (1) and specifying any exceptions the
 9-4 accountant believes are appropriate.

9-5 SECTION 15. Sections 401.015(a), (b), and (d), Insurance
 9-6 Code, are amended to read as follows:

9-7 (a) If an accountant who signed an audited financial report
 9-8 for an insurer [~~or health maintenance organization~~] resigns as
 9-9 accountant for the insurer [~~or health maintenance organization~~] or
 9-10 is dismissed by the insurer [~~or health maintenance organization~~]
 9-11 after the report is filed, the insurer [~~or health maintenance~~
 9-12 ~~organization~~] shall notify the department not later than the fifth
 9-13 business day after the date of the resignation or dismissal.

9-14 (b) Not later than the 10th business day after the date the
 9-15 insurer [~~or health maintenance organization~~] notifies the
 9-16 department under Subsection (a), the insurer [~~or health maintenance~~
 9-17 ~~organization~~] shall file a written statement with the commissioner
 9-18 advising the commissioner of any disagreements between the
 9-19 accountant and the insurer's [~~or health maintenance organization's~~]
 9-20 personnel responsible for presenting the insurer's [~~or health~~
 9-21 ~~maintenance organization's~~] financial statements that:

9-22 (1) relate to accounting principles or practices,
 9-23 financial statement disclosure, or auditing scope or procedures;

9-24 (2) occurred during the 24 months preceding the date
 9-25 of the resignation or dismissal; and

9-26 (3) would have caused the accountant to note the
 9-27 disagreement in connection with the audited financial report if the
 9-28 disagreement were not resolved to the satisfaction of the
 9-29 accountant.

9-30 (d) The insurer [~~or health maintenance organization~~] shall
 9-31 file with the statement required by Subsection (b) a letter signed
 9-32 by the accountant stating whether the accountant agrees with the
 9-33 insurer's [~~or health maintenance organization's~~] statement and, if
 9-34 not, the reasons why the accountant does not agree. If the
 9-35 accountant fails to provide the letter, the insurer [~~or health~~
 9-36 ~~maintenance organization~~] shall file with the commissioner a copy
 9-37 of a written request to the accountant for the letter.

9-38 SECTION 16. Sections 401.016 and 401.017, Insurance Code,
 9-39 are amended to read as follows:

9-40 Sec. 401.016. AUDITED COMBINED OR CONSOLIDATED FINANCIAL
 9-41 STATEMENTS. (a) An insurer [~~or health maintenance organization~~]
 9-42 described by Section 401.001 [~~401.001(3) or (4)~~] that is required
 9-43 to file an audited financial report under this subchapter may apply
 9-44 in writing to the commissioner for approval to file audited
 9-45 combined or consolidated financial statements instead of separate
 9-46 audited financial reports if the insurer [~~or health maintenance~~
 9-47 ~~organization~~]:

9-48 (1) is part of a group of insurers [~~or health~~
 9-49 ~~maintenance organizations~~] that uses a pooling arrangement or 100
 9-50 percent reinsurance agreement that affects the solvency and
 9-51 integrity of the insurer's [~~or health maintenance organization's~~]
 9-52 reserves; and

9-53 (2) cedes all of the insurer's [~~or health maintenance~~
 9-54 ~~organization's~~] direct and assumed business to the pool.

9-55 (b) An insurer [~~or health maintenance organization~~] must
 9-56 file an application under Subsection (a) not later than December 31
 9-57 of the calendar year for which the audited combined or consolidated
 9-58 financial statements are to be filed.

9-59 (c) An insurer [~~or health maintenance organization~~] that
 9-60 receives approval from the commissioner under this section shall
 9-61 file a columnar combining or consolidating worksheet for the
 9-62 audited combined or consolidated financial statements that
 9-63 includes:

9-64 (1) the amounts shown on the audited combined or
 9-65 consolidated financial statements;

9-66 (2) the amounts for each insurer [~~or health~~
 9-67 ~~maintenance organization~~] stated separately;

9-68 (3) the noninsurance operations shown on a combined or
 9-69 individual basis;

10-1 (4) explanations of consolidating and eliminating
10-2 entries; and

10-3 (5) a reconciliation of any differences between the
10-4 amounts shown in the individual insurer [~~or health maintenance~~
10-5 ~~organization~~] columns of the worksheet and comparable amounts shown
10-6 on the insurer's [~~or health maintenance organization's~~] annual
10-7 statements.

10-8 (d) An insurer [~~or health maintenance organization~~] that
10-9 does not receive approval from the commissioner to file audited
10-10 combined or consolidated financial statements for the insurer [~~or~~
10-11 ~~health maintenance organization~~] and any of the insurer's [~~or~~
10-12 ~~health maintenance organization's~~] subsidiaries or affiliates
10-13 shall file a separate audited financial report.

10-14 Sec. 401.017. NOTICE OF ADVERSE FINANCIAL CONDITION OR
10-15 MISSTATEMENT OF FINANCIAL CONDITION. (a) An insurer [~~or health~~
10-16 ~~maintenance organization~~] required to file an audited financial
10-17 report under this subchapter shall require the [~~insurer's or health~~
10-18 ~~maintenance organization's~~] accountant to immediately notify the
10-19 board of directors of the insurer [~~or health maintenance~~
10-20 ~~organization~~] or the insurer's [~~or health maintenance~~
10-21 ~~organization's~~] audit committee in writing of any determination by
10-22 that accountant that:

10-23 (1) the insurer [~~or health maintenance organization~~]
10-24 has materially misstated the insurer's [~~or health maintenance~~
10-25 ~~organization's~~] financial condition as reported to the
10-26 commissioner as of the balance sheet date being audited; or

10-27 (2) the insurer [~~or health maintenance organization~~]
10-28 does not meet the minimum capital and surplus requirements
10-29 prescribed by this code for the insurer [~~or health maintenance~~
10-30 ~~organization~~] as of that date.

10-31 (b) An insurer [~~or health maintenance organization~~] that
10-32 receives a notice described by Subsection (a) shall:

10-33 (1) provide to the commissioner a copy of the notice
10-34 not later than the fifth business day after the date the insurer [~~or~~
10-35 ~~health maintenance organization~~] receives the notice; and

10-36 (2) provide to the accountant evidence that the notice
10-37 was provided to the commissioner.

10-38 (c) If the accountant does not receive the evidence required
10-39 by Subsection (b)(2) on or before the fifth business day after the
10-40 date the accountant notified the insurer [~~or health maintenance~~
10-41 ~~organization~~] under Subsection (a), the accountant shall file with
10-42 the commissioner a copy of the accountant's written notice not
10-43 later than the 10th business day after the date the accountant
10-44 notified the insurer [~~or health maintenance organization~~].

10-45 (d) An accountant is not liable to an insurer [~~or health~~
10-46 ~~maintenance organization~~] or the insurer's [~~or health maintenance~~
10-47 ~~organization's~~] policyholders, shareholders, officers, employees,
10-48 directors, creditors, or affiliates for a statement made under this
10-49 section if the statement was made in good faith to comply with this
10-50 section.

10-51 SECTION 17. Section 401.019, Insurance Code, is amended to
10-52 read as follows:

10-53 Sec. 401.019. COMMUNICATION OF [REPORT ON SIGNIFICANT
10-54 DEFICIENCIES IN] INTERNAL CONTROL MATTERS NOTED IN AUDIT. (a) In
10-55 addition to the audited financial report required by this
10-56 subchapter, each insurer [~~or health maintenance organization~~]
10-57 shall provide to the commissioner a written communication prepared
10-58 by an accountant in accordance [report of significant deficiencies
10-59 required and prepared by an accountant in accordance] with the
10-60 Professional Standards of the American Institute of Certified
10-61 Public Accountants that describes any unremediated material
10-62 weaknesses in its internal controls over financial reporting noted
10-63 during the audit.

10-64 (b) The insurer [~~or health maintenance organization~~] shall
10-65 annually file with the commissioner the communication [report]
10-66 required by this section not later than the 60th day after the date
10-67 the audited financial report is filed. The communication must
10-68 contain a description of any unremediated material weaknesses, as
10-69 defined by Statement on Auditing Standards No. 112, "Communicating

11-1 Internal Control Related Matters Identified in an Audit," or a
 11-2 successor document, as of the immediately preceding December 31, in
 11-3 the insurer's internal control over financial reporting that was
 11-4 noted by the accountant during the course of the audit of the
 11-5 financial statements. The communication must affirmatively state
 11-6 if unremediated material weaknesses were not noted by the
 11-7 accountant.

11-8 (c) The insurer [or health maintenance organization] shall
 11-9 also provide a description of remedial actions taken or proposed to
 11-10 be taken to correct unremediated material weaknesses [significant
 11-11 deficiencies], if the actions are not described in the accountant's
 11-12 communication [report].

11-13 [~~(c) The report must follow generally the form for~~
 11-14 ~~communication of internal control structure matters noted in an~~
 11-15 ~~audit described in Statement on Auditing Standard (SAS) No. 60, AU~~
 11-16 ~~Section 325, Professional Standards of the American Institute of~~
 11-17 ~~Certified Public Accountants.]~~

11-18 SECTION 18. Sections 401.020(a) and (b), Insurance Code,
 11-19 are amended to read as follows:

11-20 (a) In this section, "work papers" means the records kept by
 11-21 an accountant of the procedures followed, the tests performed, the
 11-22 information obtained, and the conclusions reached that are
 11-23 pertinent to the accountant's audit of an insurer's [or health
 11-24 maintenance organization's] financial statements. The term
 11-25 includes work programs, analyses, memoranda, letters of
 11-26 confirmation and representation, abstracts of company documents
 11-27 and schedules, and commentaries prepared or obtained by the
 11-28 accountant in the course of auditing the financial statements that
 11-29 support the accountant's opinion.

11-30 (b) An insurer [or health maintenance organization]
 11-31 required to file an audited financial report under this subchapter
 11-32 shall require the [insurer's or health maintenance organization's]
 11-33 accountant to make available for review by the department's
 11-34 examiners the work papers and any record of communications between
 11-35 the accountant and the insurer [or health maintenance organization]
 11-36 relating to the accountant's audit that were prepared in conducting
 11-37 the audit. The insurer [or health maintenance organization] shall
 11-38 require that the accountant retain the work papers and records of
 11-39 communications until the earlier of:

11-40 (1) the date the department files a report on the
 11-41 examination covering the audit period; or

11-42 (2) the seventh anniversary of the date of the last day
 11-43 of the audit period.

11-44 SECTION 19. The heading to Section 401.021, Insurance Code,
 11-45 is amended to read as follows:

11-46 Sec. 401.021. COMMISSIONER-ORDERED AUDIT [PENALTY FOR
 11-47 FAILURE TO COMPLY].

11-48 SECTION 20. Sections 401.021(a), (b), and (c), Insurance
 11-49 Code, are amended to read as follows:

11-50 (a) If an insurer [or health maintenance organization]
 11-51 fails to comply with this subchapter, the commissioner shall order
 11-52 that the insurer's [or health maintenance organization's] annual
 11-53 audit be performed by a qualified independent certified public
 11-54 accountant.

11-55 (b) The commissioner shall assess against the insurer [or
 11-56 health maintenance organization] the cost of auditing the insurer's
 11-57 [or health maintenance organization's] financial statement under
 11-58 this section.

11-59 (c) The insurer [or health maintenance organization] shall
 11-60 pay to the commissioner the amount of the assessment not later than
 11-61 the 30th day after the date the commissioner issues the notice of
 11-62 assessment to the insurer [or health maintenance organization].

11-63 SECTION 21. Subchapter A, Chapter 401, Insurance Code, is
 11-64 amended by adding Sections 401.022, 401.023, 401.024, and 401.025
 11-65 to read as follows:

11-66 Sec. 401.022. REQUIREMENTS FOR AUDIT COMMITTEES. (a) This
 11-67 section does not apply to foreign or alien insurers authorized in
 11-68 this state or to an insurer that is a SOX-compliant entity or a
 11-69 direct or indirect wholly owned subsidiary of a SOX-compliant

12-1 entity.

12-2 (b) An insurer to which this subchapter applies shall
 12-3 establish an audit committee conforming to the following criteria:

12-4 (1) an insurer with over \$500 million in direct
 12-5 written and assumed premiums for the preceding calendar year shall
 12-6 establish an audit committee with an independent membership of at
 12-7 least 75 percent; and

12-8 (2) an insurer with \$300 million to \$500 million in
 12-9 direct written and assumed premiums for the preceding calendar year
 12-10 shall establish an audit committee with an independent membership
 12-11 of at least 50 percent.

12-12 (c) The commissioner may require the insurer's board to
 12-13 enact improvements to the independence of the audit committee
 12-14 membership if the insurer:

12-15 (1) is in a risk-based capital action level event;

12-16 (2) meets one or more of the standards of an insurer
 12-17 considered to be in hazardous financial condition; or

12-18 (3) otherwise exhibits qualities of a troubled
 12-19 insurer.

12-20 (d) An insurer with direct written and assumed premiums,
 12-21 excluding premiums reinsured with the Federal Crop Insurance
 12-22 Corporation and the National Flood Insurance Program, of less than
 12-23 \$500 million may apply to the commissioner for a waiver from the
 12-24 requirements of this section based on hardship. The insurer shall
 12-25 file, with its annual statement filing, the approval of a waiver
 12-26 under this subsection with the states in which it does or is
 12-27 authorized to do business and with the National Association of
 12-28 Insurance Commissioners. If a state other than this state accepts
 12-29 electronic filing, the insurer shall file the approval in an
 12-30 electronic format acceptable to the National Association of
 12-31 Insurance Commissioners.

12-32 (e) In this section, premiums that are assumed from
 12-33 affiliates in the same group of insurers are excluded in
 12-34 determining whether an insurer has less than \$500 million in direct
 12-35 written premiums and assumed premiums.

12-36 (f) The audit committee is directly responsible for the
 12-37 appointment, compensation, and oversight of the work of any
 12-38 accountant, including the resolution of disagreements between the
 12-39 management of the insurer and the accountant regarding financial
 12-40 reporting, for the purpose of preparing or issuing the audited
 12-41 financial report or related work under this subchapter. Each
 12-42 accountant shall report directly to the audit committee.

12-43 (g) Each member of the audit committee must be a member of
 12-44 the board of directors of the insurer or a member of the board of
 12-45 directors of an entity elected under Subsection (j) and described
 12-46 under Section 401.001(2-a).

12-47 (h) To be independent for purposes of this section, a member
 12-48 of the audit committee may not, other than in the person's capacity
 12-49 as a member of the audit committee, the board of directors, or any
 12-50 other board committee, accept any consulting, advisory, or other
 12-51 compensatory fee from the entity or be an affiliated person of the
 12-52 entity or any subsidiary of the entity. To the extent of any
 12-53 conflict with another statute requiring an otherwise
 12-54 nonindependent board member to participate in the audit committee,
 12-55 the other statute prevails and controls, and the member may
 12-56 participate in the audit committee unless the member is an officer
 12-57 or employee of the insurer or an affiliate of the insurer.

12-58 (i) If a member of the audit committee ceases to be
 12-59 independent for reasons outside the member's reasonable control,
 12-60 the member may remain an audit committee member of the responsible
 12-61 entity, if the responsible entity gives notice to the commissioner,
 12-62 until the earlier of:

12-63 (1) the next annual meeting of the responsible entity;

12-64 or

12-65 (2) the first anniversary of the occurrence of the
 12-66 event that caused the member to be no longer independent.

12-67 (j) To exercise the election of the controlling person to
 12-68 designate the audit committee under this subchapter, the ultimate
 12-69 controlling person must provide written notice of the affected

13-1 insurers to the commissioner. Notice must be made before the
 13-2 issuance of the statutory audit report and must include a
 13-3 description of the basis for the election. The election may be
 13-4 changed through a notice to the commissioner by the insurer, which
 13-5 must include a description of the basis for the change. An election
 13-6 remains in effect until changed by later election.

13-7 (k) The audit committee shall require the accountant who
 13-8 performs an audit required by this subchapter to report to the audit
 13-9 committee in accordance with the requirements of Statement on
 13-10 Auditing Standards No. 114, "The Auditor's Communication With Those
 13-11 Charged With Governance," or a successor document, including:

13-12 (1) all significant accounting policies and material
 13-13 permitted practices;

13-14 (2) all material alternative treatments of financial
 13-15 information in statutory accounting principles that have been
 13-16 discussed with the insurer's management officials;

13-17 (3) ramifications of the use of the alternative
 13-18 disclosures and treatments, if applicable, and the treatment
 13-19 preferred by the accountant; and

13-20 (4) other material written communications between the
 13-21 accountant and the management of the insurer, such as any
 13-22 management letter or schedule of unadjusted differences.

13-23 (l) If an insurer is a member of an insurance holding
 13-24 company system, the report required by Subsection (k) may be
 13-25 provided to the audit committee on an aggregate basis for insurers
 13-26 in the holding company system if any substantial differences among
 13-27 insurers in the system are identified to the audit committee.

13-28 Sec. 401.023. PROHIBITED CONDUCT IN CONNECTION WITH
 13-29 PREPARATION OF REQUIRED REPORTS AND DOCUMENTS. (a) A director or
 13-30 officer of an insurer may not, directly or indirectly:

13-31 (1) make or cause to be made a materially false or
 13-32 misleading statement to an accountant in connection with an audit,
 13-33 review, or communication required by this subchapter; or

13-34 (2) omit to state, or cause another person to omit to
 13-35 state, any material fact necessary in order to make statements
 13-36 made, in light of the circumstances under which the statements were
 13-37 made, not misleading to an accountant in connection with any audit,
 13-38 review, or communication required under this subchapter.

13-39 (b) An officer or director of an insurer, or another person
 13-40 acting under the direction of an officer or director of an insurer,
 13-41 may not directly or indirectly coerce, manipulate, mislead, or
 13-42 fraudulently influence an accountant performing an audit under this
 13-43 subchapter if that person knew or should have known that the action,
 13-44 if successful, could result in rendering the insurer's financial
 13-45 statements materially misleading.

13-46 (c) For purposes of Subsection (b), actions that could
 13-47 result in rendering the insurer's financial statements materially
 13-48 misleading include actions taken at any time with respect to the
 13-49 professional engagement period to coerce, manipulate, mislead, or
 13-50 fraudulently influence an accountant:

13-51 (1) to issue or reissue a report on an insurer's
 13-52 financial statements that is not warranted and would result in
 13-53 material violations of statutory accounting principles prescribed
 13-54 by the commissioner, generally accepted auditing standards, or
 13-55 other professional or regulatory standards;

13-56 (2) not to perform an audit, review, or other
 13-57 procedure required by generally accepted auditing standards or
 13-58 other professional standards;

13-59 (3) not to withdraw an issued report; or

13-60 (4) not to communicate matters to an insurer's audit
 13-61 committee.

13-62 Sec. 401.024. MANAGEMENT'S REPORT OF INTERNAL CONTROL OVER
 13-63 FINANCIAL REPORTING. (a) Each insurer required to file an audited
 13-64 financial report under this subchapter that has annual direct
 13-65 written and assumed premiums, excluding premiums reinsured with the
 13-66 Federal Crop Insurance Corporation and the National Flood Insurance
 13-67 Program, of \$500 million or more shall prepare a report of the
 13-68 insurer's or group of insurers' internal control over financial
 13-69 reporting. The report must be filed with the commissioner with the

14-1 communication described by Section 401.019. The report of internal
 14-2 control over financial reporting shall be as of the immediately
 14-3 preceding December 31.

14-4 (b) Notwithstanding the premium threshold under Subsection
 14-5 (a), the commissioner may require an insurer to file the
 14-6 management's report of internal control over financial reporting if
 14-7 the insurer is in any risk-based capital level event or meets one or
 14-8 more of the standards of an insurer considered to be in hazardous
 14-9 financial condition as described by Chapter 404.

14-10 (c) An insurer or a group of insurers may file the insurer's
 14-11 or the insurer's parent's Section 404 report and an addendum if the
 14-12 insurer or group of insurers is:

14-13 (1) directly subject to Section 404;
 14-14 (2) part of a holding company system whose parent is
 14-15 directly subject to Section 404;

14-16 (3) not directly subject to Section 404 but is a
 14-17 SOX-compliant entity; or

14-18 (4) a member of a holding company system whose parent
 14-19 is not directly subject to Section 404 but is a SOX-compliant
 14-20 entity.

14-21 (d) A Section 404 report described by Subsection (c) must
 14-22 include those internal controls of the insurer or group of insurers
 14-23 that have a material impact on the preparation of the insurer's or
 14-24 group of insurers' audited statutory financial statements,
 14-25 including those items listed in Sections 401.009(a)(3)(B)-(H) and
 14-26 (b). The addendum must be a positive statement by management that
 14-27 there are no material processes with respect to the preparation of
 14-28 the insurer's or group of insurers' audited statutory financial
 14-29 statements, including those items listed in Sections
 14-30 401.009(a)(3)(B)-(H) and (b), excluded from the Section 404 report.
 14-31 If there are internal controls of the insurer or group of insurers
 14-32 that have a material impact on the preparation of the insurer's or
 14-33 group of insurers' audited statutory financial statements and those
 14-34 internal controls are not included in the Section 404 report, the
 14-35 insurer or group of insurers may either file:

14-36 (1) a report under this section; or
 14-37 (2) the Section 404 report and a report under this
 14-38 section for those internal controls that have a material impact on
 14-39 the preparation of the insurer's or group of insurers' audited
 14-40 statutory financial statements not covered by the Section 404
 14-41 report.

14-42 (e) The insurer's management report of internal control
 14-43 over financial reporting must include:

14-44 (1) a statement that management is responsible for
 14-45 establishing and maintaining adequate internal control over
 14-46 financial reporting;

14-47 (2) a statement that management has established
 14-48 internal control over financial reporting and an opinion concerning
 14-49 whether, to the best of management's knowledge and belief, after
 14-50 diligent inquiry, its internal control over financial reporting is
 14-51 effective to provide reasonable assurance regarding the
 14-52 reliability of financial statements in accordance with statutory
 14-53 accounting principles;

14-54 (3) a statement that briefly describes the approach or
 14-55 processes by which management evaluates the effectiveness of its
 14-56 internal control over financial reporting;

14-57 (4) a statement that briefly describes the scope of
 14-58 work that is included and whether any internal controls were
 14-59 excluded;

14-60 (5) disclosure of any unremediated material
 14-61 weaknesses in the internal control over financial reporting
 14-62 identified by management as of the immediately preceding December
 14-63 31;

14-64 (6) a statement regarding the inherent limitations of
 14-65 internal control systems; and

14-66 (7) signatures of the chief executive officer and the
 14-67 chief financial officer or an equivalent position or title.

14-68 (f) For purposes of Subsection (e)(5), an insurer's
 14-69 management may not conclude that the internal control over

15-1 financial reporting is effective to provide reasonable assurance
15-2 regarding the reliability of financial statements in accordance
15-3 with statutory accounting principles if there is one or more
15-4 unremediated material weaknesses in its internal control over
15-5 financial reporting.

15-6 (g) Management shall document, and make available on
15-7 financial condition examination, the basis of the opinions required
15-8 by Subsection (e). Management may base opinions, in part, on its
15-9 review, monitoring, and testing of internal controls undertaken in
15-10 the normal course of its activities.

15-11 (h) Management has discretion as to the nature of the
15-12 internal control framework used, and the nature and extent of
15-13 documentation, in order to form its opinion in a cost-effective
15-14 manner and may include an assembly of or reference to existing
15-15 documentation.

15-16 (i) The department shall maintain the confidentiality of
15-17 the management's report of internal control over financial
15-18 reporting required by this section and any supporting documentation
15-19 provided in the course of a financial condition examination.

15-20 Sec. 401.025. TRANSITION DATES. (a) An insurer or group of
15-21 insurers whose audit committee as of January 1, 2010, is not subject
15-22 to the independence requirements of Section 401.022 because the
15-23 total written and assumed premium is below the threshold under that
15-24 section, and that later becomes subject to one of the independence
15-25 requirements because of changes in the amount of written and
15-26 assumed premium, has one year following the year in which the
15-27 written and assumed premium exceeds the threshold amount to comply
15-28 with the independence requirements. An insurer that becomes
15-29 subject to one of the independence requirements as a result of a
15-30 business combination must comply with the independence
15-31 requirements not later than the first anniversary of the date of the
15-32 acquisition or combination.

15-33 (b) An insurer or group of insurers that is not required by
15-34 Section 401.024 to file a report beginning with the reporting
15-35 period ending December 31, 2010, because the total written premium
15-36 is below the threshold amount, and that later becomes subject to the
15-37 reporting requirements, has two years after the year in which the
15-38 written premium exceeds the threshold amount to file a report. An
15-39 insurer acquired in a business combination must comply with the
15-40 reporting requirements not later than the second anniversary of the
15-41 date of the acquisition or combination.

15-42 SECTION 22. Section 401.001(3), Insurance Code, is
15-43 repealed.

15-44 SECTION 23. (a) Section 401.011(c), Insurance Code, as
15-45 amended by this Act, takes effect January 1, 2010.

15-46 (b) Section 401.022, Insurance Code, as added by this Act,
15-47 takes effect January 1, 2010.

15-48 (c) Except as provided by Subsections (a) and (b) of this
15-49 section, Chapter 401, Insurance Code, as amended by this Act, takes
15-50 effect beginning with the reporting period ending December 31,
15-51 2010.

15-52 SECTION 24. Except as otherwise provided by this Act, this
15-53 Act takes effect September 1, 2009.

15-54 * * * * *