

Government of Puerto Rico
OFFICE OF THE COMMISSIONER OF INSURANCE
Guaynabo, Puerto Rico

[Stamped:
DEPARTMENT of STATE
Number: 7958
Date: December 16, 2010
Approved: Hon. Kenneth D.
McClintock
Secretary
By: (Signed)
Eduardo Arosemena-Muñoz
Assistant Secretary for
Services]

RULE NO. 14-A

FILING OF AUDITED FINANCIAL REPORTS BY LICENSEES

Government of Puerto Rico
OFFICE OF THE COMMISSIONER OF INSURANCE
Guaynabo, Puerto Rico

TABLE OF CONTENTS

RULE 14-A

FILING OF AUDITED FINANCIAL REPORTS BY LICENSEES

SECTION 1. - LEGAL BASIS.....	1
SECTION 2. - PURPOSE AND SCOPE.....	1
SECTION 3. - DEFINITIONS	2
SECTION 4. - GENERAL REQUIREMENTS RELATED TO FILING AND EXTENSIONS FOR FILING OF ANNUAL AUDITED FINANCIAL REPORTS AND AUDIT COMMITTEE APPOINTMENT.....	3
SECTION 5. - CONTENTS OF ANNUAL AUDITED FINANCIAL REPORTS	4
SECTION 6. - DESIGNATION OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT.....	4
SECTION 7 - QUALIFICATIONS OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS.....	5
SECTION 8 - CONSOLIDATED OR COMBINED FINANCIAL REPORTS	8
SECTION 9 - SCOPE OF AUDIT AND REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT	8
SECTION 10- NOTIFICATION OF ADVERSE FINANCIAL CONDITION	9
SECTION 11 - COMMUNICATION OF INTERNAL CONTROL RELATED MATTERS NOTED IN AN AUDIT.....	9
SECTION 12 - INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT'S LETTER OF QUALIFICATIONS	9
SECTION 13 - DEFINITION, AVAILABILITY AND MAINTENANCE OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT'S WORK PAPERS.....	10
SECTION 14 - REQUIREMENTS FOR AUDIT COMMITTEES	10
SECTION 15 - CONDUCT OF INSURER IN CONNECTION WITH THE PREPARATION OF REQUIRED REPORTS AND DOCUMENTS	12
SECTION 16 - MANagements REPORT OF INTERNAL CONTROLS FOR AUDITED FINANCIAL REPORTS	12

SECTION 17 - EXEMPTIONS AND EFFECTIVE DATES.....	14
SECTION 18 - CANADIAN AND BRITISH INSURERS	15
SECTION 19 - SEVERABILITY	17
SECTION 20 - EFFECT	17

Government of Puerto Rico
OFFICE OF THE COMMISSIONER OF INSURANCE
Guaynabo, Puerto Rico

RULE 14-A
FILING OF AUDITED FINANCIAL REPORTS BY LICENSEES

SECTION 1. LEGAL BASIS

The Office of the Commissioner of Insurance of Puerto Rico (OCI) hereby repeals Rule 14-A of the Regulations of the current Puerto Rico Insurance Code and adopts a new Rule 14-A, "Filing of Audited Financial Reports by Licensees," pursuant to the authority conferred on the Commissioner in the provisions of Section 2.030 of Public Law No. 77, enacted on June 19, 1957, as amended, known as the Puerto Rico Insurance Code, and the provisions of Public Law No. 170, enacted on August 12, 1988, as amended, known as the Puerto Rico Uniform Administrative Procedures Act..

This Rule is adopted according to model regulation #205, "Annual Financial Reporting Model Regulation," as recommended by the National Association of Insurance Commissioners (NAIC).

SECTION 2. PURPOSE AND SCOPE

The purpose of this Rule is to strengthen and complement the surveillance system of the operations and financial solvency of domestic authorized insurers by requiring (1) an annual audit of financial statements reporting the financial position and the results of operations of insurers by independent certified public accountants to be filed with the OCI, (2) Communication of Internal Control Related Matters Noted in an Audit, and (3) Management's Report of Internal Control Over Financial Reporting.

Each insurer, as defined in Section 3, shall be subject to the provisions of this Rule. Insurers having written less than one million dollars (\$1,000,000) in direct premiums during any calendar year and having fewer than one thousand (1,000) policyholders or certificateholders of written policies nationwide at the end of each calendar year, shall be exempt from this Rule for the current year, unless the Commissioner provides otherwise. Insurers having assumed premiums pursuant to reinsurance agreements or treaties of \$1,000,000 or more will not be exempt from the provisions of this Rule.

Foreign or alien insurers filing their audited financial reports in another State of the United States, pursuant to the filing requirements of that state, that the Commissioner finds are substantially similar to the requirements of this Rule, shall

be exempt from Sections 4 to 13 if:

- A. A copy of the Audited financial report, Communication of Internal Control Related Matters Noted in an Audit, and the Accountant's Letter of Qualifications that are filed with the other state are filed with the OCI in accordance with the filing dates specified in Sections 4, 11 and 12, respectively. Canadian insurers may submit accountants' reports as filed with the Office of the Superintendent of Financial Institutions Canada.
- B. A copy of any notification of adverse financial condition submitted in any other state is filed with the OCI within the period of time specified in Section 10 of this Rule.

Foreign or alien insurers required to file Management's Report of Internal Control over Financial Reporting in another state are exempt from filing the Report with the OCI, provided the Report filed in the other state includes similar requirements to those of Puerto Rico and the Report is filed with the Commissioner of the other state by the established deadline.

This Rule shall not prohibit, preclude or in any way limit the powers of the Commissioner of Insurance, set forth in Chapter 2 of the Puerto Rico Insurance Code, nor limit the practices and procedures established in the OCI pursuant to the Code.

SECTION 3. DEFINITIONS

The following terms shall have the meanings set forth below, except when another meaning may be inferred from the context or any other provision of this Rule:

- A. An "affiliate" of, or person "affiliated" with, a specific person, means 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.
- B. "Section 404" - Means Section 404 of the Sarbanes-Oxley Act of 2002 and the Securities Exchange Commission" (SEC) regulations promulgated thereunder.
- C. "Insurer" - Is a person who is engaged in transacting insurance as defined in Section 1.050 of the Insurance Code. Without limiting the general meaning of the above definition, reciprocal insurance association, mutual associations, health services organization or groups of any kind, whether for profit or not, engaged in the business of executing insurance contracts, are insurers.
- D. "Insurance Code" - Means Public Law No. 77, enacted on June 19, 1957, as amended, known as the Puerto Rico Insurance Code.
- E. "Audit Committee" - Means a committee (or equivalent group) established by the

board of directors of an entity for the purpose of overseeing the accounting and financial reporting processes of an insurer or group of insurers, and 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 designated as the audit committee for one or more of these insurers. Refer to Section 14E for exercising this election. If an audit committee is not designated by the insurer, the insurer's entire board of directors shall constitute the audit committee.

- F. "Adverse Financial Condition" - Means the provisions of Rule 94 defining the standards and authority of the Commissioner of Insurance with regard to insurers presenting an adverse financial condition.
- G. "Accountant" or "independent certified public accountant" - Means a certified public accountant or a firm of certified public accountants licensed to practice in the Commonwealth of Puerto Rico and who is a member of the Puerto Rico Certified Public Accountants Association.
- H. "Internal control over financial reporting" means the process effected by an entity's board of directors, management and other designated personnel to provide reasonable assurance regarding the reliability of the financial reports, i e , those items specified in Section 5B through 5G of this Rules and includes those policies and procedures that:
 - (a) Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets;
 - (b) Provide reasonable assurance that the recording of transactions will permit the preparation of the financial reports, i.e., those items specified in Section 5B through 5G of this Rule and that financial transactions have been made only in accordance with authorization of management and directors; and
 - (c) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial reports, i.e., those items specified in Section 5B through 5G of this Rule.
- I. "Sarbanes-Oxley Act (SOX) Compliant Entity" means an entity that either is required to be compliant with, or voluntarily is compliant with, the following provisions of the Sarbanes- Oxley Act of 2002:
 - (i) the preapproval requirements of Section 201 (Section 10A(i) of the Securities Exchange Act of 1934);
 - (ii) the Audit committee independence requirements of Section 301 (Section 10A(m)(3) of the Securities Exchange Act of 1934); and
 - (iii) the Internal control over financial reporting requirements of Section 404 (Item 308 of SEC Regulation S-K).

- J. "Insurer's management" - Means the group of highly qualified employees in charge of directing and managing an insurer's affairs.
- K. "Group of insurers" - Means authorized insurers, as identified by the management, for the purpose of evaluating the efficacy of internal controls on financial reporting.
- L. "Indemnification" means an agreement of indemnity or a release from liability for the purpose of modifying or limiting any kind of liability of a person or firm for failure to adhere to applicable auditing or professional standards, whether or not resulting from knowledge of misrepresentations made by the insurer or its representatives.
- M. "Section 404 Report" - Means management's report on internal control over financial reporting as defined by the SEC and the related audit report of the independent certified public accountant as described in Section 3G.
- N. "Audited financial reports" - Means and includes the definition stated in Section 5 of this Rule.
- O. "Independent member of the Board" - Means the definition stated in Section 14C.
- P. "NAIC" - Means the National Association of Insurance Commissioners.
- Q. "Receivership procedures" - Means any procedure established against an insurer for the purpose of liquidating, rehabilitating, reorganizing or conserving the insurer.
- R. "SEC" - Means the US Securities and Exchange Commission (SEC).

SECTION 4. GENERAL REQUIREMENTS RELATED TO FILING AND EXTENSIONS FOR FILING OF ANNUAL AUDITED FINANCIAL REPORT AND AUDIT COMMITTEE APPOINTMENT

- A. All authorized insurers shall have an annual audit by an independent certified public accountant and shall file an Audited financial report with the OCI on or before June 1 for the year of operations ended December 31 immediately preceding. The commissioner may require an insurer to file an audited financial report earlier than June 1, if notice is provided to the insurer ninety (90) days in advance.
- B. The Commissioner may grant extensions of time for the filing of audited financial reports for thirty (30) additional days, if the insurer and its independent certified public accountant show just cause. The request for extension must be submitted in writing not less than ten (10) days prior to the due date, with sufficient information to permit the commissioner to make an informed decision with respect to the requested extension.
- C. If an extension is granted in accordance with the provisions in Section B, a

similar extension of thirty (30) days is granted the insurer for the filing of Management's Report of Internal Control over Financial Reportings.

- D. Every insurer required to file annual audited financial reports as described in this Rule shall designate a group of individuals to constitute an audit committee, as defined in Section 3. The audit committee of an entity that controls an insurer may be appointed as the insurer's audit committee for purposes of this Rule, at the time the controlling person is elected.

SECTION 5. CONTENTS OF ANNUAL AUDITED FINANCIAL REPORTS

The annual Audited financial reports shall describe the financial condition of the insurer, the results of its operations, cash flows and changes in capital and surplus for the year then ended in conformity with statutory accounting practices prescribed, or otherwise permitted, by the OCI.

The audited financial reports shall include the following:

- A. Audit report of independent certified public accountant.
- B. Balance sheet reporting admitted assets, liabilities, capital and surplus.
- C. Statement of income.
- D. Statement of cash flow.
- E. Statement of changes in capital and surplus
- F. Notes to financial statements. These shall be those required by the appropriate NAIC Annual Statement Instructions and the NAIC Accounting Practices and Procedures Manual. The notes shall include a reconciliation of differences, if applicable, between the audited financial report and the annual report filed with the OCI with a written description of the nature of these differences.
- G. The audited financial reports shall be prepared in a form and substantially similar sections as the annual report of the insurer filed with the OCI. In addition, the financial reports shall be comparative with the previous year. If it is the first year in which an insurer is filing such reports, the comparative data should be omitted.

SECTION 6. DESIGNATION OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT

- A. All authorized insurers required to file an annual audited financial report, within sixty (60) days after becoming subject to this Rule, must register with the OCI in writing the name and address of the independent certified public accountant who will conduct the annual audit. Insurers who have not

- retained an independent certified public accountant by the effective date of this Rule shall register the name and address of their retained independent certified public accountant not less than six (6) months before the date when the first audited financial report is to be filed.
- B. The insurer shall obtain a letter from the independent certified public accountant, and file a copy with the commissioner, certifying that the accountant is aware of the provisions related to accounting and financial matters in the insurance code of the state of domicile. In addition, the account should state that her or she will express an opinion on the financial reports according to the statutory accounting practices prescribed or otherwise permitted by the OCI.
- C. If an accountant who prepared the preceding audited financial reports is dismissed or resigns, the insurer shall within five (5) business days notify the OCI of this event. The insurer shall also furnish the commissioner with a separate letter within ten (10) business days of the above five-day notification, stating whether in the twenty-four (24) months preceding such event there were any disagreements with the former accountant on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure; which disagreements, if not resolved to the satisfaction of the former accountant, would have caused him or her to make reference to the subject matter of the disagreement in connection with his or her opinion. The disagreements required to be reported include both those resolved to the former accountant's satisfaction and those not resolved to the former accountant's satisfaction. Disagreements contemplated by this section are those that occur at the decision-making level, i.e. , between personnel of the insurer responsible for presentation of its financial statements and personnel of the accounting firm responsible for rendering the opinion. In addition, the insurer shall request in writing that the former accountant furnish a letter addressed to the insurer stating whether the accountant agrees with the statements contained in the insurer's letter to the Commissioner, and, if not, stating the reasons for which he or she does not agree. The insurer shall furnish the former accountant's letter to the commissioner together with its own.

SECTION 7 - QUALIFICATIONS OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

- A. The Commissioner will not recognize an independent certified public accountant nor accept audited financial reports prepared either completely or partially by said accountant if the accountant:

- (1) Does not have a good reputation in the states where he or she is licensed to practice said profession; or
 - (2) Has executed, whether directly or indirectly, and indemnification agreement or release of liability with respect to the audit of the insurer.
 - (3) Has been convicted of fraud, bribery, a violation of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. Sections 1961 to 1968, or any dishonest conduct or practices under federal or state law;
 - (4) Has violated the Insurance Code or its Regulations with regard to a previous report filed under this Rule; or
 - (5) Has show a deficient pattern or practice in detecting or disclosing material information Regulations with regard to previous reports filed under this Rule.
- B. The commissioner shall recognize an independent certified public accountant as qualified as long as he or she conforms to the standards of his or her profession, as contained in the Code of Professional Ethics of the Puerto Rico Accounting Board and Rules and Regulations and the Puerto Rico Association of Certified Public Accountants.
- C. A qualified independent certified public accountant may enter into an agreement with an insurer to have disputes relating to an audit resolved by mediation or arbitration. However, in the event of a receivership proceeding commenced against the insurer under Chapter 40 of the Insurance Code, the mediation or arbitration provisions shall operate at the option of the receiver.
- D. The lead or coordinating audit partner having primary responsibility for the audit may not act in that capacity for more than five (5) consecutive years. The person shall be disqualified from acting in that or a similar capacity for the same company or its insurance subsidiaries or affiliates for a period of five (5) consecutive years. An insurer may make application to the commissioner for relief from the above requirement on the basis of unusual circumstances, whether existent or newly arisen. This application should be made at least thirty (30) days before the end of the calendar year. The commissioner may consider the following factors in determining if the relief should be granted:
- (a) Number of partners, expertise of the partners or the number of insurance clients in the currently registered firm;
 - (b) Premium volume of the insurer; or
 - (c) Number of jurisdictions in which the insurer transacts business.
- (2) The insurer shall file, with its financial statements, the approval for

relief from Subsection D (1) with the states that it is licensed in or doing business in and with the NAIC. If the state accepts electronic filing, the insurer shall file the approval in an electronic format acceptable to the NAIC

- E. (1) The Commissioner shall neither recognize as a qualified independent certified public accountant, nor accept an annual audited financial report, prepared in whole or in part by, a natural person accountant who contemporaneously provides the insurer with the following services unrelated to the audit:
- (a) Bookkeeping or other services related to the accounting records or financial statements of the insurer;
 - (b) Design and implementation of financial information systems;
 - (c) Appraisal or valuation services;
 - (d) The accountant may assist an insurer in understanding the methods, assumptions and inputs used in the determination of amounts recorded in the financial statement only if it is reasonable to conclude that the services provided will not be subject to audit procedures during an audit of the insurer's financial statements. An accountant's actuary may also issue an actuarial opinion or certification ("opinion") on an insurer's reserves if the following conditions have been met:
 - (i) Neither the accountant nor the accountant's actuary has performed any management functions or made any management decisions;
 - (ii) The insurer has competent personnel (or engages a third party actuary) to estimate the reserves for which management takes responsibility;
 - (iii) The accountant's actuary tests the reasonableness of the reserves after the insurer's management has determined the amount of the reserves;
 - (e) Outsourcing internal audit services;
 - (f) Management or human resources functions;
 - (g) Broker, investment adviser, or investment banking services;
 - (h) Legal services or expert services unrelated to the audit; o

- (i) Any other services that the commissioner determines, by regulation, are not permissible.
 - (2) In general, the principles of independence with respect to services provided by the qualified independent certified public accountant are predicated on three basic principles, violations of which would impair the accountant's independence. The principles are that the accountant cannot function in the role of management, cannot audit his or her own work, and cannot serve in an advocacy role for the insurer
- F. The Commissioner, pursuant to Section 2.190 of the Insurance Code, may hold administrative hearings to determine whether an independent certified public accountant is qualified and, considering the evidence submitted may determine whether or not the CPA is qualified to express an opinion with regard to the audited financial reports and require the insurer to replace the accountant with another whose relationship with the insurer is qualified under the provisions of this rule.
- G. Insurers having direct written and assumed premiums of less than \$100,000,000 in any calendar year may request an exemption from Subsection E (1). For this purpose, the insurer shall file with the commissioner a written report, establishing the reasons why the insurer should be exempt from these provisions. If the commissioner finds, upon review of this report, that compliance with this regulation would constitute a financial or organizational hardship upon the insurer, an exemption may be granted.
- H. An independent certified public accountant who performs an audit may engage in other non-audit services, including tax services, that are not described in Subsection E (1) or that do not conflict with Subsection E (2), only if the activity is approved in advance by the Audit committee, in accordance with Subsection I.
- I. All auditing services and other services provided to an insurer by the independent certified public accountant of the insurer shall be preapproved by the Audit committee. The preapproval requirement will not apply with respect to non-audit services if the insurer is a SOX Compliant Entity or a direct or indirect wholly-controlled subsidiary of a SOX Compliant Entity or:
- (1) The aggregate amount of all such non-audit services provided to the insurer constitutes not more than five percent (5%) of the total amount of fees paid by the insurer to its qualified independent certified public accountant during the fiscal year in which the non-audit services are provided;

- (2) The services were not recognized by the insurer at the time of the engagement to be non-audit services; and
 - (3) The services are promptly brought to the attention of the Audit committee and approved prior to the completion of the audit by the Audit committee or by one or more members of the Audit committee who are the members of the board of directors to whom authority to grant such approvals has been delegated by the Audit committee.
- J. The Audit committee may delegate to one or more designated members of the Audit committee the authority to grant the preapprovals required by Subsection I. The decisions of any member to whom this authority is delegated shall be presented to the full Audit committee at each of its scheduled meetings.
- K.
 - (1) The commissioner of insurance shall not recognize an independent certified public accountant as qualified for a particular insurer if a member of the board, president, chief executive officer, controller, chief financial officer, chief accounting officer, or any other person serving in an equivalent position for that insurer, was employed by the independent certified public accountant and participated in the audit of that insurer during the one (1) year period preceding the date that the most current opinion is due. This section shall only apply to partners and senior managers involved in the audit. An insurer may make application to the commissioner for relief from the above requirement on the basis of unusual circumstances.
 - (2) The insurer shall file, with its annual audited statements, the approval for relief from Subsection K (1) with the states that it is licensed in or doing business in and the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.

SECTION 8. CONSOLIDATED OR COMBINED FINANCIAL REPORTS

An insurer may make written application to the commissioner for approval to file audited consolidated or combined financial statements in lieu of separate annual audited financial statements if the insurer is part of a group of insurers that utilizes a pooling or 100 percent reinsurance agreement that affects the solvency and integrity of the insurer's reserves and the insurer cedes all of its direct and assumed business to the pool. In such cases, a columnar worksheet shall be filed as supplement to the consolidating or combining report, as follows:

- A. Amounts shown on the consolidated or combined Audited financial report shall be shown on the worksheet;
- B. Amounts for each insurer subject to this section shall be stated separately;
- C. Noninsurance operations may be shown on the worksheet on a combined or individual basis;
- D. Explanations of consolidating and eliminating entries shall be included; and
- E. A reconciliation shall be included of any differences between the amounts shown in the individual insurer columns of the worksheet and comparable amounts shown on the annual statements of the insurer.

SECTION 9. SCOPE OF AUDIT AND REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT

The audit of the insurer's financial statements shall be conducted in accordance with generally accepted auditing standards. In accordance with Section 319 of the Professional Standards of the AICPA, *Consideration of Internal Control in a Financial Statement Audit*, the independent certified public accountant should obtain an understanding of internal control sufficient to plan the audit. To the extent required by AU 319, for those insurers required to file a Management's Report of Internal Control over Financial Reporting, (taking into consideration the parameters established in Section 16 of this Rule), the independent certified public accountant should consider the most recent statements available in planning and performing the audit of the statutory financial statements. If the independent certified public accountant deems it necessary, consideration shall be given to the procedures illustrated in the *Financial Condition Examiners Handbook* promulgated by the NAIC.

SECTION 10. NOTIFICATION OF ADVERSE FINANCIAL CONDITION

- A. Insurers required to file audited financial reports with the OCI independent certified public accountant to report, in writing, within five (5) business days to the board of directors, its Audit committee and the OCI, any finding of material misstatements of the financial condition of the insurer or that the insurer failed to comply with the minimum capital and surplus requirements established in Section 3.090 of the Insurance Code.
- B. No independent certified public accountant shall be liable in any manner to any person for any statement made in connection with the above paragraph if the statement is made in good faith in compliance with Subsection A.

- C. If the accountant, subsequent to the date of the Audited financial report filed pursuant to this Rule, becomes aware of facts that might have materially affected his or her report, the accountant to take the necessary action to make corrections, as prescribed in the Professional Standards of the AICPA

SECTION 11. COMMUNICATION OF INTERNAL CONTROL RELATED MATTERS NOTED IN AN AUDIT

- A. Each insurer shall file written communication with the Commissioner describing material deficiencies found during the audit as of the preceding 31st of December in respect to internal controls. The communication shall be prepared by the accountant within sixty (60) days after filing of the audited financial reports. If there are no material weaknesses, the written communication shall so state.
- B. The insurer shall provide a description of remedial actions taken or proposed to correct unremediated deficiencies, if the actions are not described in the accountant's communication.

SECTION 12. INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT'S LETTER OF QUALIFICATIONS

The accountant shall furnish the insurer a letter stating the following:

- A. That the accountant is independent;
- B. The background and experience in general, and the experience in audits of insurers of the staff assigned to audit and whether each is independent in respect to the insurer;
- C. That the accountant understands the annual Audited financial report and his or her opinion thereon will be filed in compliance with this Rule and that the commissioner will be relying on this information in the monitoring and regulation of the financial position of insurer;
- D. That the accountant consents to the requirements of Section 13 of this Rule and that the accountant consents and agrees to make available for review by the commissioner, or the commissioner's designee, the audit work papers.
- E. That the accountant is duly authorized to practice the profession in Puerto Rico and that he or she is an accredited member of the Puerto Rico Association of Certified Public Accountants; and

- F. That the accountant has complied with the provisions of the Section 7.

SECTION 13. - DEFINITION, AVAILABILITY AND MAINTENANCE OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT'S WORK PAPERS

- A. Work papers are the records kept by the independent certified public accountant of the procedures followed, the tests performed, the information obtained, and the conclusions reached pertinent to the accountant's audit of the financial statements of an insurer. Work paper should include at least audit planning documentation, work programs, analyses, memoranda, letters of confirmation and representation, abstracts of company documents and schedules or commentaries prepared or obtained by the independent certified public accountant in the course of his or her audit of the financial statements of an insurer and which support the accountant's opinion.
- B. Every insurer shall require the accountant to make available for review by OCI examiners, all work papers prepared during the audit and any communications related to the audit between the accountant and the insurer, until the OCI has issued an examination report covering the period of the audit but no longer than seven (7) years from the date of the audit report
- C. If the OCI should perform review of the work papers, the OCI will retain photocopies of the documents. This review will be considered to be investigations and the work papers and communications obtained shall be treated with the same level of confidentiality as other documents examined by the OCS.

SECTION 14. REQUIREMENTS FOR AUDIT COMMITTEES

This Section shall not be applicable to foreign insurers authorized to transact insurance business in Puerto Rico or an insurer that is a SOX Compliant Entity or a direct or indirect wholly controlled subsidiary of a SOX Compliant Entity.

- A. The Audit committee shall be directly responsible for the appointment, compensation and oversight of the work of any accountant (including resolution of disagreements regarding the preparation of the audit financial reporting or any other work related to this Rule. Each accountant shall report directly to the Audit committee.
- B. Each member of the Audit committee shall be a member of the board of directors of the insurer or a member of the board of directors of an entity elected

pursuant to Subsection 3E.

- C. In order to be considered independent for purposes of this section, a member of the Audit committee may not, as member of the Audit committee, the board of directors, or any other board committee, accept any consulting, advisory or other compensatory fee from the insurer or be an affiliated person of the entity or any subsidiary thereof, or of the independent certified public accountant. However, if by law board participation by otherwise non-independent members is required, that law shall prevail and such members may participate in the Audit committee, unless they are officers or employees of the insurer or one of its affiliates.
- D. If a member of the Audit committee ceases to be independent for reasons outside the member's reasonable control, that person, with notice by the responsible entity to the OCI, may remain an Audit committee member of the entity until the earlier of the next annual meeting of the responsible entity or one (1) year from the occurrence of the event that caused the member to be no longer independent.
- E. To exercise the election of the controlling person to designate the Audit committee for purposes of this Rule, the controlling person shall notify the commissioners of the affected insurers in writing. Notification shall be made in a timely manner, prior to the issuance of the audited report and include a description of the basis for the election. The election can be changed through notice to the commissioner by the insurer, including a description of the basis for the change. The election shall remain in effect until rescinded.
- F.
 - (1) The Audit Committee shall require the independent certified public accountant to provide the Committee with a timely report of the following:
 - (a) All significant accounting policies and material permitted practices;
 - (b) All alternative applications of statutory accounting principles that have been discussed with management of the insurer, effects of the use of such principles and the required disclosure, and the treatment preferred by the accountant; and
 - (c) Other material written communications between the accountant and the management of the insurer, such as any management letter or schedule of unadjusted differences.
 - (2) If an insurer is a member of an insurance holding company system, the reports required by Subsection F1 may be provided to the Audit

committee on an aggregate basis for insurers in the holding company system, provided that any substantial differences among insurers in the system are identified to the Audit co.

- G. The proportion of independent Audit committee members shall meet or exceed the following criteria:

Prior Calendar Year Direct Written and Assumed Premiums		
\$0 - \$300,000,000	Over \$300,000,000 to \$500,000,000	Over \$500,000,000
No minimum requirements.	Majority (50% or more) of members shall be independent.	Super majority of members (75% or more) should be independents.

- H. An insurer with direct written and assumed premium, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, of less than \$500,000,000 may make application to the commissioner for a waiver from the Section 14 requirements based upon financial hardship. The insurer shall file, with its annual statement filing, the approval for relief from Section 14 with the states that it is licensed in or doing business in and the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.

SECTION 15. - CONDUCT OF INSURER IN CONNECTION WITH THE PREPARATION OF REQUIRED REPORTS AND DOCUMENTS

- A. No director or officer of an insurer shall, directly or indirectly:
- (1) Make or cause to be made a materially false or misleading statement to an accountant in connection with any audit, review or communication required under this Rule;
 - (2) Omit to state, or cause another person to omit to state, any material fact necessary in order to prepare the audited financial statements.
- B. No officer or director of an insurer, or any other person acting under the direction thereof, shall directly or indirectly take any action to coerce, manipulate, mislead or fraudulently influence an independent certified public accountant engaged in the performance of an audit if that person knew or should have known that the action, if successful, could result in rendering the insurer's financial statements materially misleading

- C. For purposes of Subsection B of this section, the actions describe below include, but are not limited to actions taken during the period of the audit to coerce, manipulate, mislead or intentionally influence an independent certified public accountant :
- (1) To issue or reissue a report on an insurer's financial statements that is not warranted in the circumstances, due to material violations of statutory accounting principles prescribed by the OCI, generally accepted auditing standards, or other professional or regulatory standards;
 - (2) Not to perform audit, review or other procedures required by generally accepted auditing standards or other professional standards;
 - (3) Unduly retain an issued report, if applicable; or
 - (4) Fail to communicate any mater to the Audit Committee.

SECTION 16. MANAGERMENTS REPORT OF INTERNAL CONTROLS FOR AUDITED FINANCIAL REPORTS

- A. Every insurer required to file an Audited financial report that has annual direct written and assumed premiums, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, of \$500,000,000 or more shall prepare a report of the insurer's or Group of insurers' Internal control over financial reporting, as defined in Section 3 of this Rule.. The report shall be filed with the OCI along with the Communication of Internal Control Related Matters Noted in an Audit described under Section 11 of this rule. The Management's Report of Internal Control over Financial Reporting shall be as of December 31 immediately preceding
- B. Notwithstanding the provisions of Subsection 16A of this Rule, the commissioner may require an insurer to file Management's Report of Internal Control over Financial Reporting if the insurer is in any RBC level event, or meets any one or more of the standards of an insurer deemed to be in hazardous financial condition as defined in Chapter 45 of the Insurance Code.
- C. An insurer or group of insurers that are SOX compliant, may file a report or a report of the parent company under Section 404 and an Addendum, to satisfy Section 16 of this Rule, provided that the internal controls of the insurer or group of insurers that have a material impact on the preparation of the audited financial reports of the insurer or group of insurers were included in the Section 404 report.

If the internal controls of the insurer or group of insurers have a material impact on the preparation of the financial statements, and said internal controls were not included in the Section 404 report, (i) a report should be filed containing the items stipulated in Section 16 or (ii) the Section 404 report and the Section 16 report with regard to the internal controls that are not covered by the Section 404 report.

D. The Management's Report of Internal Control over Financial Reporting shall 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 internal control over audited financial reports and an assertion, to the best of management's knowledge and belief, after diligent inquiry, as to whether its Internal control over financial reporting is effective to provide reasonable assurance regarding the reliability of financial statements in accordance with statutory accounting principles;
- (3) A statement that briefly describes the approach or processes by which management evaluated the effectiveness of its internal control over the audited financial report;
- (4) A statement that briefly describes the scope of work;
- (5) Disclosure of any unremediated material weaknesses. Management is not permitted to conclude that the internal control over audited financial report is effective if there is one or more unremediated material weaknesses;
- (6) A statement regarding the inherent limitations of internal control systems; and
- (7) Signatures of the chief executive officer and the chief financial officer (or equivalent position/title).

E. Management of the insurer shall document and make available for examination the basis upon which its assertions, required in Subsection 16D are made. Management may base its assertions, in part, upon its review, monitoring and testing of internal controls undertaken in the normal course of its activities.

- (1) Management of the insurer shall have discretion as to the nature of the internal control framework used, and the nature and extent of

documentation, to support its assertion in a cost effective manner. In addition, reference to existing documentation may be included.

- (2) The Management's Report on Internal Control over Financial Reporting, required in Subsection 16 A, and any documentation provided in support thereof during the course of a financial condition examination, shall be kept confidential by the OCI.

SECTION 17. EXEMPTIONS AND EFFECTIVE DATES

- A. Upon written application of any insurer, the commissioner may grant an exemption from compliance with any and all provisions of this Rule if the commissioner finds, upon review of the application, that compliance with this regulation would constitute a financial or organizational hardship upon the insurer. An exemption may be granted at any time and from time to time for a specified period or periods. Within ten (10) days from a denial of an insurer's written request for an exemption from this regulation, the insurer may request in writing a hearing on its application for an exemption. The hearing shall be held in accordance with Chapter 2 of the Insurance Code.
- B. Domestic and foreign insurers retaining an independent certified public accountant on the effective date of this Rule, shall comply with this regulation for the year ending December 31, 2011 and each year thereafter unless the commissioner permits otherwise.
- C. Requirements of Section 7D shall be effective for audits covering the period beginning on January 1, 2011.
- D. Requirements of Section 14 shall be effective January 1, 2011. 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 shall have one (1) year, following the year in which the threshold was exceeded to comply with the independent member requirements. Likewise, an insurer that becomes subject to one of the independence requirements as a result of a business combination shall have one (1) calendar year following the date of acquisition or combination to comply with the independence requirements.
- E. Requirements of Section 16 shall be effective at the beginning of the reporting period ending on December 31, 2011, and for all subsequent years. An insurer or Group of insurers that is not required to file a report because the total

written premium is below the threshold and subsequently becomes subject to the reporting requirements shall have two (2) years following the year the threshold is exceeded to file a report. Likewise, an insurer acquired in a business combination shall have two (2) calendar years following the date of acquisition or combination to comply with the reporting requirements.

SECTION 18. CANADIAN AND BRITISH INSURERS

- A. Canadian and British Insurers. In the case of Canadian and British insurers, the annual Audited financial report shall be defined as the annual statement of total business on the form filed by such companies audited by an independent chartered accountant

- B. For such insurers, the letter required in Section 6B shall state that the accountant is aware of the requirements relating to the annual Audited financial report filed with the commissioner pursuant to Section 4 and shall affirm that the opinion expressed is in conformity with those requirements.

SECTION 19. SEVERABILITY

If any word, sentence, paragraph, sub-paragraph, Section or part of this Rule were found to be null and void by a court of competent jurisdiction, the order of such court shall not affect or invalidate the remaining provisions of this Rule, and the effect of such order shall be limited to the word, sentence, paragraph, sub-paragraph, Section or part that has been found to be null and void.

SECTION 20. TRANSITION CLAUSE

The provisions of this Rule regarding the filing of audited financial reports by Licensees as of December 31, 2010, shall be effective beginning January 1, 2011.

SECTION 21. EFFECT

The provisions of this Rule shall enter into effect thirty (30) days after filing with the Department of State of Puerto Rico, under the provisions of the Public Law No. 170, *supra*.

(Signed)

RAMON L. CRUZ-COLON
COMMISSIONER OF INSURANCE

Date of approval: December 14, 2010

Date of Filing:

at the Department of State:

Date of Filing

at the Library of the Legislature: