

Regulatory Analysis Form		This space for use by IIRC RECEIVED
(1) Agency Insurance Department		2000 SEP 21 AM 10:19 REGULATORY REVIEW COMMISSION
(2) I.D. Number (Governor's Office Use) 11-203		IRRC Number: #2150
(3) Short Title Miscellaneous Provisions		
(4) PA Code Cite 31 Pa. Code, Chapter 147	(5) Agency Contacts & Telephone Numbers Primary Contact: Peter J. Salvatore, Regulatory Coordinator, 1326 Strawberry Square, Harrisburg, PA 17120, (717) 787-4429 Secondary Contact: Elaine Leitzel, (717) 787-8840	
(6) Type of Rulemaking (check one) <input checked="" type="checkbox"/> Proposed Rulemaking <input type="checkbox"/> Final Order Adopting Regulation <input type="checkbox"/> Final Order, Proposed Rulemaking Omitted		(7) Is a 120-Day Emergency Certification Attached? <input checked="" type="checkbox"/> No <input type="checkbox"/> Yes: By the Attorney General <input type="checkbox"/> Yes: By the Governor
(8) Briefly explain the regulation in clear and nontechnical language. The purpose of this rulemaking is to update Chapter 147, commonly referred to as the CPA Audit Rule, to reflect current statutory accounting practices and procedures adopted by the National Association of Insurance Commissioners (NAIC). The regulations prescribe requirements for annual audits of financial statements filed by insurers with the Department. The regulations were adopted in 1979 and last amended November 11, 1995. The regulations are based on a model regulation adopted by the NAIC and are included in the NAIC's state accreditation standards for regulation of the financial solvency of the insurance industry. Pennsylvania is currently accredited by the NAIC for compliance with the financial regulation standards. In 1998 the NAIC revised the model regulation to make it consistent with the NAIC's codified <i>Accounting Practices and Procedures Manual</i> (manual) that will be effective January 1, 2001. Insurers subject to these regulations have been advised by Insurance Department Notice Nos. 1998-04 and 2000-02 that they will be required to adhere to the manual in preparing financial statements to be filed with the Department. This rulemaking will update the regulations to be consistent with the manual and the 1998 revisions to the NAIC model regulation.		
(9) State the statutory authority for the regulation and any relevant state or federal court decisions. The rulemaking is proposed under the authority of sections 206, 506, 1501 and 1502 of The Administrative Code of 1929 (71 P.S. §§ 66, 186, 411 and 412) relating to the general rulemaking authority of the Department; section 320 of The Insurance Company Law of 1921 relating to the authority of the Commissioner to require insurers to file statements concerning their affairs and financial condition; and section 1605(a)(3)(ii) of The Insurance Company Law of 1921 (40 P.S. §1605(a)(3)(ii)); sections 205 and 206 of The Pennsylvania Fair Plan Act (40 P.S. §§ 1600.205 and 1600.206); 40 Pa.C.S. §§ 6125, 6331 and 6701; sections 11 and 14 of the Health Maintenance Organization Act (40 P.S. §§ 1561 and 1564); section 630 of the act of May 17, 1921 (P.L. 682, No. 284) (40 P.S. § 764a); sections 7 and 25 of the Continuing Care Provider Registration and Disclosure Act (40 P.S. §§ 3207 and 3225); and section 602 of the Fraternal Benefit Societies Code (40 P.S. § 1142.602) which, respectively, relate to the specific regulatory and rulemaking authority of the Department regarding financial reporting by surplus lines insurers, the Pennsylvania Fair Plan, hospital plan corporations, health services plan corporations, health maintenance organizations, preferred provider organizations; continuing care providers and fraternal benefit societies.		

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(10) Is the regulation mandated by any federal or state law or court order, or federal regulation? If yes, cite the specific law, case or regulation, and any deadlines for action. No.

(11) Explain the compelling public interest that justifies the regulation. What is the problem it addresses?

This rulemaking amends § 147.4 (relating to contents of annual audited financial report) to address technical issues involving disclosures required in audit reports to be filed under the requirements of the manual. Section 147.4(2) currently requires the notes to financial statements in annual audited financial reports to include notes required by generally accepted accounting principles (GAAP). Because the Statements of Statutory Accounting Principles (SSAPs) contained in the manual now address all types of required disclosures, the reference to GAAP is no longer needed and has been replaced with a reference to the manual. Section 147.4(2)(i) has been further amended to clarify that the notes shall include a reconciliation of any differences between the audited financial statement and the annual financial statement that the insurer has filed with the Department. In addition, the reference to section 320 of The Insurance Company Law of 1921 (40 P.S. § 443) has been expanded to refer to other laws and regulations that may apply to financial statements filed by the various types of insurers under the scope of the regulations. Finally, § 147.4(2)(ii) has been deleted because a summary of the ownership and relationships of the insurer and all affiliated companies is required under SSAP No. 1 (relating to disclosure of accounting policies, risks and uncertainties, and other disclosures) in the manual. These amendments will eliminate potentially confusing inconsistencies between the regulations and the manual.

(12) State the public health, safety, environmental or general welfare risks associated with nonregulation.

There are no public health, safety, environmental or general welfare risks associated with the updates to the regulations.

(13) Describe who will benefit from the regulation. (Quantify the benefits as completely as possible and approximate the number of people who will benefit.)

Affected insurers will benefit by the elimination of inconsistencies between the Department's regulations, the manual and the NAIC model, thereby reducing time spent by insurers to resolve the inconsistencies.

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(14) Describe who will be adversely affected by the regulation. (Quantify the adverse effects as completely as possible and approximate the number of people who will be adversely affected.)

No persons, groups or entities will be adversely affected by the updates to the regulations.

(15) List the persons, groups or entities that will be required to comply with the regulation. (Approximate the number of people who will be required to comply.)

All types of insurance companies and continuing care providers licensed to transact business in this Commonwealth and the independent certified public accountants retained by the insurers to conduct annual audits will be required to comply with the updated regulations.

(16) Describe the communications with and input from the public in the development and drafting of the regulation. List the persons and/or groups who were involved, if applicable.

The Department received comments from a group of "Insurance Trade Associations in Support of NAIC Codification" encouraging the Department to adopt the 1998 technical changes to the NAIC model regulation. The group includes the Alliance of American Insurers, American Association of Health Plans, American Council of Life Insurance, American Insurance Association, Blue Cross/Blue Shield Association, Health Insurance Association of America, National Association of Independent Insurers, National Association of Mutual Insurance Companies and Reinsurance Association of America. Drafts of the proposed rulemaking to update the regulations were provided to The Insurance Federation of Pennsylvania, Inc., the Pennsylvania Association of Mutual Insurance Companies and counsel for the Pennsylvania Fraternal Congress for review and comment. The Department received no comments or objections to the proposed updates to the regulations from these trade associations.

(17) Provide a specific estimate of the costs and/or savings to the regulated community associated with compliance, including any legal, accounting or consulting procedures which may be required.

The updates to the regulations would impose no additional costs on affected insurers.

Regulatory Analysis Form

(18) Provide a specific estimate of the costs and/or savings to local governments associated with compliance, including any legal, accounting or consulting procedures which may be required.

There is no fiscal impact on local governments associated with the updates to the regulations.

(19) Provide a specific estimate of the costs and/or savings to state government associated with the implementation of the regulation, including any legal, accounting, or consulting procedures which may be required.

There is no fiscal impact to state government associated with the updates to the regulations.

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(20) In the table below, provide an estimate of the fiscal savings and costs associated with implementation and compliance for the regulated community, local government, and state government for the current year and five subsequent years. N/A

	Current FY Year	FY +1 Year	FY +2 Year	FY +3 Year	FY +4 Year	FY +5 Year
SAVINGS:	\$	\$	\$	\$	\$	\$
Regulated Community						
Local Government						
State Government						
Total Savings						
COSTS:						
Regulated Community						
Local Government						
State Government						
Total Costs						
REVENUE LOSSES:						
Regulated Community						
Local Government						
State Government						
Total Revenue Losses						

(20a) Explain how the cost estimates listed above were derived.

N/A

Regulatory Analysis Form

(20b) Provide the past three year expenditure history for programs affected by the regulation.

N/A

Program	FY -3	FY -2	FY -1	Current FY

(21) Using the cost-benefit information provided above, explain how the benefits of the regulation outweigh the adverse effects and costs.

N/A

(22) Describe the nonregulatory alternatives considered and the costs associated with those alternatives. Provide the reasons for their dismissal.

The regulations are based on a model regulation adopted by the NAIC and are included in the NAIC's state accreditation standards for regulation of the financial solvency of the insurance industry. Pennsylvania is currently accredited by the NAIC for compliance with the financial regulation standards. This rulemaking is the most efficient, effective way to prescribe requirements for annual audits consistent with NAIC requirements.

(23) Describe alternative regulatory schemes considered and the costs associated with those schemes. Provide the reasons for their dismissal.

The rulemaking updates existing regulations.

Regulatory Analysis Form

(24) Are there any provisions that are more stringent than federal standards? If yes, identify the specific provisions and the compelling Pennsylvania interest that demands stronger regulation.

No federal standards are applicable to the updates to the regulations.

(25) How does this regulation compare with those of other states? Will the regulation put Pennsylvania at a competitive disadvantage with other states?

The updates to the regulations will make the regulations consistent with national codified accounting principles for insurance companies prescribed by the NAIC. Pennsylvania is one of 47 states currently accredited by the NAIC for compliance with minimum standards for effective financial solvency regulation. Because the updates to the regulations will make Pennsylvania requirements consistent with NAIC requirements and the requirements in most other states, the regulations will not put Pennsylvania at a competitive disadvantage with other states.

(26) Will the regulation affect existing or proposed regulations of the promulgating agency or other state agencies? If yes, explain and provide specific citations.

No.

(27) Will any public hearings or informational meetings be scheduled? Please provide the dates, times, and locations, if available.

No public hearings or informational meetings have been scheduled on the updates to the regulations.

Regulatory Analysis Form

(28) Will the regulation change existing reporting, record keeping, or other paperwork requirements? Describe the changes and attach copies of forms or reports which will be required as a result of implementation, if available.

No.

(29) Please list any special provisions which have been developed to meet the particular needs of affected groups or persons including, but not limited to, minorities, elderly, small businesses, and farmers.

None.

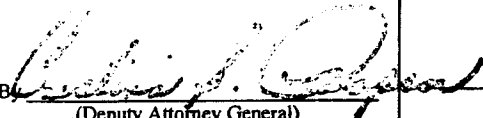
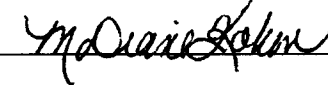
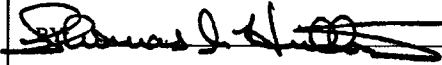
(30) What is the anticipated effective date of the regulation; the date by which compliance with the regulation will be required; and the date by which any required permits, licenses or other approvals must be obtained?

The updates to the regulations will take effect after a 30-day public comment period; final review and approval by the legislative standing committees, the Independent Regulatory Review Commission and the Office of Attorney General; and upon final publication in the *Pennsylvania Bulletin*.

(31) Provide the schedule for continual review of the regulation.

The Department reviews regulations on a triennial basis.

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CDL-1 FACE SHEET FOR FILING DOCUMENTS WITH THE LEGISLATIVE REFERENCE BUREAU (Pursuant to Commonwealth Documents Law)		RECEIVED 2000 SEP 21 AM 10:19 INDEPENDENT REGULATORY REVIEW COMMISSION
# 2150		DO NOT WRITE IN THIS SPACE
Copy below is hereby approved as to form and legality. Attorney General  (Deputy Attorney General) <u>SEP 15 2000</u> Date of Approval Q Check if applicable. Copy not approved. Objections attached.	Copy below is hereby certified to be a true and correct copy of a document issued, prescribed or promulgated by: Insurance Department (AGENCY) DOCUMENT/FISCAL NOTE NO. <u>11-203</u> DATE OF ADOPTION: _____ BY:  M. Diane Koken TITLE: Insurance Commissioner	Copy below is hereby approved as to form and legality. Executive or Independent Agencies  <u>9/5/00</u> DATE OF APPROVAL (DEPUTY GENERAL COUNSEL) (CHIEF COUNSEL, INDEPENDENT AGENCY) (STRIKE INAPPLICABLE TITLE) Q Check if applicable. No Attorney General approval or objection within 30 days after submission.

NOTICE OF PROPOSED RULEMAKING

INSURANCE DEPARTMENT

31 Pa. Code, Chapter 147

ANNUAL AUDITED INSURERS' FINANCIAL REPORT REQUIRED

PREAMBLE

The Insurance Department (Department) proposes to amend Chapter 147, Annual Audited Insurers' Financial Report Required, as set forth in Annex A. The rulemaking is proposed under the authority of sections 206, 506, 1501 and 1502 of The Administrative Code of 1929 (71 P.S. §§ 66, 186, 411 and 412) relating to the general rulemaking authority of the Department; section 320 of The Insurance Company Law of 1921 relating to the authority of the Commissioner to require insurers to file statements concerning their affairs and financial condition; and section 1605(a)(3)(ii) of The Insurance Company Law of 1921 (40 P.S. §1605(a)(3)(ii)); sections 205 and 206 of The Pennsylvania Fair Plan Act (40 P.S. §§ 1600.205 and 1600.206); 40 Pa.C.S. §§ 6125, 6331 and 6701; sections 11 and 14 of the Health Maintenance Organization Act (40 P.S. §§ 1561 and 1564); section 630 of the act of May 17, 1921 (P.L. 682, No. 284) (40 P.S. § 764a); sections 7 and 25 of the Continuing Care Provider Registration and Disclosure Act (40 P.S. §§ 3207 and 3225); and section 602 of the Fraternal Benefit Societies Code (40 P.S. § 1142.602) which, respectively, relate to the specific regulatory and rulemaking authority of the Department regarding financial reporting by surplus lines insurers, the Pennsylvania Fair Plan, hospital plan corporations, health services plan corporations, health maintenance organizations, preferred provider organizations; continuing care providers and fraternal benefit societies. The regulations require insurers to have annual audits of their year-end financial statements conducted by independent certified public accountants.

Purpose

The purpose of this rulemaking is to update Chapter 147, commonly referred to as the CPA Audit Rule, to reflect current statutory accounting practices and procedures adopted by the National Association of Insurance Commissioners (NAIC). The regulations prescribe requirements for annual audits of financial statements filed by insurers with the Department. The regulations were adopted in 1979 and last amended November 11, 1995. The regulations are based on a model regulation adopted by the NAIC and are included in the NAIC's state accreditation standards for regulation of the financial solvency of the insurance industry. Pennsylvania is currently accredited by the NAIC for compliance with the financial regulation standards. In 1998, the NAIC revised the model regulation to make it consistent with the NAIC's codified *Accounting Practices and Procedures Manual* (manual) that will be effective January 1, 2001. Insurers subject to these regulations have been advised by Insurance Department Notice Nos. 1998-04 and 2000-02 that they will be required to adhere to the manual in preparing financial statements to be filed with the Department. This rulemaking will update the regulations to be consistent with the manual and the 1998 revisions to the NAIC model regulation.

Explanation of Regulatory Requirements

This rulemaking proposes to amend § 147.4 (relating to contents of annual audited financial report) to address technical issues involving disclosures required in audit reports to be filed under the requirements of the manual.

Section 147.4(2) currently requires the notes to financial statements in annual audited financial reports to include notes required by generally accepted accounting principles (GAAP). Because the Statements of Statutory Accounting Principles (SSAPs) contained in the manual now address all types of required disclosures, the reference to GAAP is no longer needed and has been replaced with a reference to the manual. Section 147.4(2)(i) has been further amended to clarify that the notes shall include a reconciliation of any differences between the audited financial statement and the annual financial statement that the insurer has filed with the Department. In addition, the reference to section 320 of The Insurance Company Law of 1921 (40 P.S. § 443) has been expanded to refer to other laws and regulations that may apply to financial statements filed by the various types of insurers under the scope of the regulations. Finally, section 147.4(2)(ii) has been deleted because a summary of the ownership and relationships of the insurer and all affiliated companies is required under SSAP No. 1 (relating to disclosure of accounting policies, risks and uncertainties, and other disclosures) in the manual. These amendments will eliminate potentially confusing inconsistencies between the regulations and the manual.

External Comments

The Department received comments from a group of “Insurance Trade Associations in Support of NAIC Codification” encouraging the Department to adopt the 1998 technical changes to the NAIC model regulation. The group includes the Alliance of American Insurers, American Association of Health Plans, American Council of Life Insurance, American Insurance Association, Blue Cross/Blue Shield Association, Health Insurance Association of America, National Association of Independent Insurers, National Association of Mutual Insurance Companies and Reinsurance Association of America. The Department also requested comments from The Insurance Federation of Pennsylvania, Inc., the Pennsylvania Association of Mutual Insurance Companies, and the Pennsylvania Fraternal Congress in the development of this rulemaking. The Department received no objections to the amendments in this rulemaking.

Fiscal Impact

The proposed rulemaking has no fiscal impact.

Paperwork

The proposed rulemaking would impose no additional paperwork requirements on the Department or affected insurers.

Persons Regulated

This proposed rulemaking applies to insurance companies, other insurer entities and continuing care providers licensed to transact business in this Commonwealth and the independent certified public accountants retained by those insurers to conduct annual audits.

Contact Person

Questions or comments regarding the proposed rulemaking may be addressed in writing to Peter J. Salvatore, Regulatory Coordinator, Pennsylvania Insurance Department, 1326 Strawberry Square, Harrisburg, Pennsylvania 17120, within 30 days following the publication of this notice in the Pennsylvania Bulletin. Questions and comments may also be e-mailed to psalvato@ins.state.pa.us or faxed to (717) 772-1969.

Regulatory Review

Under section 5(a) of the Regulatory Review Act (71 P.S. §745.5(a)) the Department submitted a copy of this regulation on September 21, 2000 to the Independent Regulatory Review Commission (IRRC) and to the Chairpersons of the Senate Banking and Insurance Committee and the House Committee on Insurance. In addition to submitting this proposed rulemaking, the Department has provided IRRC and the Committees with a copy of a detailed Regulatory Analysis Form prepared by the agency in compliance with Executive Order 1996-1, "Regulatory Review and Promulgation." A copy of this material is available to the public upon request.

Under section 5(g) of the Regulatory Review Act, if IRRC has objections to any portion of the proposed amendments, it will notify the Department within 10 days of the close of the Committees' review period. The notification shall specify the regulatory review criteria that have not been met by that portion. The Regulatory Review Act specifies detailed procedures for review, prior to final publication of the regulations by the Department, the General Assembly and the Governor of objections raised.

M. Diane Koken
Insurance Commissioner

CONTINUATION SHEET FOR FILING DOCUMENTS
WITH THE LEGISLATIVE REFERENCE BUREAU
Pursuant to Commonwealth Documents Law

Annex A

**TITLE 31. INSURANCE. PART VIII. -- MISCELLANEOUS PROVISIONS.
CHAPTER 147. ANNUAL AUDITED INSURERS' FINANCIAL REPORT
REQUIRED**

§ 147.4. Contents of annual audited financial report.

(a) The annual audited financial report shall reflect the financial condition of the insurer as of the end of the most recent calendar year and 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 Department. Statutory accounting practices are those practices and procedures prescribed by the Accounting Practices and Procedures Manuals published by the National Association of Insurance Commissioners, or as otherwise prescribed or provided by specific statutes, regulations, orders or rulings of the Commonwealth or the Department.

(b) The annual audited financial report shall, at a minimum, include the following:

(1) Financial statements that present in a comparable manner, as of the end of the current and the preceding calendar year, the financial condition of the insurer, including the following:

- (i) Balance sheet reporting admitted assets, liabilities, capital and surplus.
- (ii) Statement of operations.
- (iii) Statement of cash flows.
- (iv) Statement of changes in capital and surplus.

(2) Notes to financial statements. These notes shall be those required by the appropriate National Association of Insurance Commissioners Annual Statement Instructions and [other notes required by generally accepted accounting principles and shall also include the following:

- (i) **A] Accounting Practices and Procedures Manual. The notes shall include a reconciliation of differences, if any, between the audited statutory financial statements and the annual statements filed with the Department under**

section 320 of The Insurance Company Law of 1921 (40 P. S. § 443) **and other applicable laws and regulations**, with a written description of the nature of these differences, particularly with respect to surplus or stockholder equity and the results of operations. The insurer shall file an amendment to its annual statement with the Department, the National Association of Insurance Commissioners and other states in which the insurer is licensed, to reflect differences between the audited statutory financial statement and the annual statement filed with the Department within 60 days of the filing date of the audited financial report. The Commissioner may require amendments to financial statements to be filed with the Department and the National Association of Insurance Commissioners on diskettes or other electronic information storage devices acceptable to the Commissioner.

[(ii) A summary of ownership and relationships of the insurer and affiliated companies.]

(3) The report of an independent certified public accountant prepared in compliance with this chapter, including notification of adverse financial condition, report on significant deficiencies in internal controls and letter of qualifications of the independent certified public accountant.

(c) The financial statements included in the audited financial report shall be prepared in a form and using language and groupings substantially the same as the relevant sections of the annual statement of the insurer filed with the Department, and the financial statements shall be comparative, presenting the amounts as of December 31 of the current year and the amounts as of the immediately preceding December 31. In the first year in which an insurer is required to file an audited financial report, the comparative data may be omitted if sufficient detail is made available to the Department upon request. An account which represents less than 5% of the insurer's admitted assets may be aggregated for reporting purposes, except that all invested asset accounts shall be separately reported.

(d) If an error is discovered after a report is filed, the accountant shall withdraw the report and issue a corrected report within 30 days of discovery of the error. To the extent

that the error requires an amendment to the insurer's annual financial statement filed with the Department, the insurer shall file an amendment under subsection (b)(2)(i).



**COMMONWEALTH OF PENNSYLVANIA
INSURANCE DEPARTMENT**

OFFICE OF SPECIAL PROJECTS
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Harrisburg, PA 17120

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E-mail: psalvato@ins.state.pa.us

September 21, 2000

Mr. Robert Nyce
Executive Director
Independent Regulatory Review Comm.
333 Market Street
Harrisburg, PA 17101

Re: Insurance Department Proposed
Regulation No. 11-203, Annual
Audited Insurers' Financial Report
Required

Dear Mr. Nyce:

Pursuant to Section 5(a) of the Regulatory Review Act, enclosed for your information and review is proposed regulation 31 Pa. Code, Chapter 147, Annual Audited Insurers' Financial Report Required.

The purpose of this rulemaking is to reflect current statutory accounting practices and procedures adopted by the National Association of Insurance Commissioners (NAIC). The regulation prescribes requirements for annual audits of financial statements filed by insurers with the Department. The regulation was adopted in 1979 and last amended November 11, 1995. The regulation is based on a model regulation adopted by the NAIC and are included in the NAIC's state accreditation standards for regulation of the financial solvency of the insurance industry. Pennsylvania is currently accredited by the NAIC for compliance with the financial regulation standards. In 1998, the NAIC revised the model regulation to make it consistent with the NAIC's codified *Accounting Practices and Procedures Manual* (manual) that will be effective January 1, 2001. Insurers subject to this regulation have been advised by Insurance Department Notice Nos. 1998-04 and 2000-02 that they will be required to adhere to the manual in preparing financial statements to be filed with the Department. This rulemaking will update the regulation to be consistent with the manual and the 1998 revisions to the NAIC model regulation.

If you have any questions regarding this matter, please contact me at (717) 787-4429.

Sincerely yours,

A handwritten signature in cursive script that reads "Peter J. Salvatore".

Peter J. Salvatore
Regulatory Coordinator

TRANSMITTAL SHEET FOR REGULATIONS SUBJECT TO THE
REGULATORY REVIEW ACT

I.D. NUMBER: 11-203
SUBJECT: Annual Audited Insurers' Financial Report Required
AGENCY: DEPARTMENT OF INSURANCE #2150

RECEIVED
2000 SEP 21 AM 10:19
INDEPENDENT REGULATORY
REVIEW COMMISSION

TYPE OF REGULATION

- X Proposed Regulation
Final Regulation
Final Regulation with Notice of Proposed Rulemaking Omitted
120-day Emergency Certification of the Attorney General
120-day Emergency Certification of the Governor
Delivery of Tolled Regulation
a. With Revisions b. Without Revisions

FILING OF REGULATION

DATE	SIGNATURE	DESIGNATION
9-21-00	Sheila Eckhart	HOUSE COMMITTEE ON INSURANCE
9/21/00	Verise Fallon	SENATE COMMITTEE ON BANKING & INSURANCE
9/21/00	Tina Eckert	INDEPENDENT REGULATORY REVIEW COMMISSION
		ATTORNEY GENERAL
9/21/00	Col. Brown	LEGISLATIVE REFERENCE BUREAU

September 19, 2000