

EY regulatory reporting brief

EY's regulatory reporting brief explores the Federal Reserve regulatory reporting, highlighting report requirements, recent news and updates, and identifying common reporting challenges.

In focus:

- The Federal Reserve Bank (FRB) recently developed and published for comments the Federal Register Notice (FRN) relating to the Consolidated Financial Statements for Insurance Nonbank Financial Companies (FR 2085). The FR 2085 report is currently open for comments through June 24, 2016. The report is expected to be filed quarterly, beginning with the reporting period that ends on June 30, 2017.
- The FR 2085 report collects financial data from insurance nonbank financial companies on a consolidated basis in the form of a balance sheet, an income statement and detailed supporting schedules, including a schedule of off-balance sheet items.
- The Federal Reserve Bank's tighter regulations are putting the industry on notice, as firms must prepare for changes to processes, organization, technology and data.
- As such, now is the time for these companies to consider the risks linked to regulatory reporting mandates by building sustainable, scalable reporting in tandem with their initiatives.

Filing criteria

- Insurance companies subject to enhanced prudential standards by the Federal Reserve and having 40% of total consolidated assets related to insurance activities
- Anticipated initial filers: AIG, Prudential and potentially other large insurance companies

Filing frequency

- The FR 2085 forms are to be filed quarterly, as of the last calendar day of the quarter. The quarterly filings are due to the FRB 45 calendar days after the "as of" date.

Spotlight on FR 2085:

Stronger spotlight on insurance financial companies

Report summary

What is the FR 2085?

Companies that the Financial Stability Oversight Council (FSOC) has identified (i) for supervision by the Board of Governors of the Federal Reserve System (Board) and subject to enhanced prudential standards per the Dodd-Frank Act and (ii) with at least 40% of total consolidated assets related to insurance activities as of the end of either of the two most recently completed fiscal years will be required to submit the "Consolidated Financial Statements for Insurance Nonbank Financial Companies" (FR 2085) on a quarterly basis, as of the last calendar day of the quarter with the FRB.

The FR 2085 reports financial information in the form of financial statements, including a consolidated balance sheet, a consolidated statement of income, changes in equity capital and detailed supporting schedules, including asset-related schedules and schedules for insurance-related underwriting activities.



Building a better working world



History

The severity of the 2008 global financial crisis highlighted the interconnected nature of financial institutions, as well as the risks they pose to the financial system when they are in distress. Insurance markets have become increasingly global and interconnected, and business activities they engage in have become increasingly tied to the financial markets. As such, the Financial Stability Board (FSB) asked the Insurance Association of Insurance Supervisors (IAIS) to set up a process to assess insurers' systemic riskiness and to recommend policy measures designed to prevent catastrophic failure in the sector. In July 2013, the FSB identified a list of nine multinational insurance groups it considers to be global systemically important insurers (G-SII), including three based in the US.

In the US, the FSOC, established under the federal Dodd-Frank Wall Street Reform and Consumer Protection Act, was authorized to address systemic risk and now has its own process for evaluating and designating domestic systemically important insurers.

Overall, the systemically important financial institution (SIFI) designation as well as heightened awareness on the interconnectedness of financial institutions will subject insurance nonbank firms to Federal Reserve oversight generally reserved for large banks and bank holding companies. The firms will also be subject to consolidated supervision by the Federal Reserve and enhanced prudential standards. SIFI designated companies continue to challenge the FSOC's SIFI decision and have embarked on a journey to:

- Determine and implement new reporting requirements (such as the FR 2085 report, which is being introduced by the FRB for insurance nonbank companies)
- Review finance operating model to meet regulatory requirements
- Develop a road map for a strategic reporting solution
- Initiate data governance efforts for finance, regulatory, capital and risk

Report overview

The FR 2085 is intended to provide a similar level of insight into insurance companies that the FR Y-9C report does for banks. The report consists of 12 primary schedules and 2 Notes schedules, and is to be prepared in accordance with US generally accepted accounting principles (GAAP) and the report instructions.

FR 2085 schedule listing

1. Schedule IRI – Consolidated Statement of Income
 - a. Schedule IRI-A – Changes in Equity Capital
 - b. Schedule IRI-B – Charge-Offs and Recoveries on Loans and Leases and Changes in Allowance for Loan and Lease Losses
 - c. Schedule IRI-C – Property and Casualty Insurance Underwriting Results by Line of Business and calculated ratios
2. Schedule IRC – Consolidated Balance Sheet
 - a. Schedule IRC-B – Securities and Other Invested Assets
 - b. Schedule IRC-C – Loans and Lease Financing Receivables
 - c. Schedule IRC-D – Trading Assets and Liabilities
 - d. Schedule IRC-I – Insurance-Related Underwriting Activities (including Reinsurance)
 - e. Schedule IRC-L – Derivatives and Off-Balance Sheet Items
 - f. Schedule IRC-M – Memoranda
 - g. Schedule IRC-V – Variable Interest Entities
3. Notes to the Income Statement
4. Notes to the Balance Sheet

FR 2085 – Consolidated Financial Statements for Insurance Nonbank Financial Companies (see Appendix for overview of information required by schedule)

Report overview

The 12 primary schedules are categorized into 3 header schedules for the Consolidated Report of Income (Schedule IRI), Consolidated Balance Sheet (Schedule IRC) and Changes in Equity Capital (Schedule IRI-A) as well as detailed supporting schedules.

The supporting schedules IRI-C and IRC-I are specific to insurance and are used to provide detail on insurance-related underwriting activities by Line of Business (LOB), such as Property & Casualty (P&C), Life, Accident & Health, Annuities, Closed Block and Reinsurance.

The FR 2085 report is tailored for insurance companies and includes specific line items for insurance premiums, policyholder charges and fees, Loss and Loss Adjustment Expenses (LAE), future policy benefits, dividends to policyholders and amortization of deferred policy acquisition costs. Detailed schedules exist to report rollforward of policyholder account balances, future policyholder benefits, loss adjustment expenses and deferred acquisition costs. These items introduce a new level of granular FRB reporting for insurance companies (see Appendix for an overview of information required by schedule).

The report also includes two Notes schedules to highlight items that should be reported as footnotes to the report as well as transactions that are separately disclosed in the reporter's quarterly reports to its shareholders, in its press releases or on its quarterly reports to the U.S. Securities and Exchange Commission (SEC).

The current version of the report does not include any schedule for reporting capital-related information, similar to Schedule HC-R in FR Y-9C. The industry recognizes that the final published version of the report may include additional updates.

EY perspectives on regulation reporting for insurers – overview of common challenges

Starting in 2017, certain insurers would have to prepare, on a quarterly basis, a new set of reports that comply with FRB regulations (such as FR 2085). The purpose of these insurance-specific reports is to illustrate key financial and risk performance measures for insurance companies similar to the various capital metrics for banks. The FRB reports are based on the US GAAP basis for insurance accounting but utilize granularity similar to statutory accounting. Key differences between US GAAP reporting and the new FRB reports include additional granularity of financial metrics for assets and liabilities in the FRB report (such as detailed liability reserve and deferred acquisition cost rollforwards by line of business in accordance with categories defined by the FRB, variable annuity disclosures and detailed information on P&C reserves). Obtaining and reporting this information on a quarterly basis will be an onerous exercise for reporters.

These increased reporting requirements will challenge the finance and actuarial organizations, requiring sign-off on balances from administrative and valuation systems, which would then need to be reconciled with the books and records to ultimately produce reports at the level of granularity demanded by the FRB. CFOs will eventually be required to implement an attestation framework and to sign off on regulatory filings that are largely based on legacy administrative or valuation systems and spreadsheets. In addition, further complexities may arise due to lack of automation and historical underinvestment in fully integrating acquisitions. As a result, companies will need to invest in their overall finance regulatory operating model, including processes, governance, technology and data, in order to prepare and submit reports to the FRB in an accurate, timely and controlled manner. Below are a number of common challenges filers may experience when preparing the FR 2085.

Technology and data

The FR 2085 contains summary schedules and edit checks for reconciliation with supporting detail schedules. In order to seamlessly produce and reconcile these balances, filers will need to focus on overall data governance and technology enablement. Data quality standards and controls will have to be enhanced or implemented within the finance, risk, actuarial and IT organizations.

The FR 2085 also requires the reporting of consolidated financial results on a variety of investments and insurance items often found in disparate sources or spreadsheets. Sourcing and aggregation of data, as well as reconciliation with finance systems in order to meet detailed, granular reporting by the FRB, will be a challenge. Lack of strong data management and data governance processes may not support traceability of reported data back to the authoritative systems. Sample key data attributes that will need to be accurately sourced, classified and reconciled include:

- ▶ Detailed investments information, including collateral, counterparties and investment type
- ▶ Insurance information related to future policy benefits (FPBs), policyholder account balances (PABs), variable annuities and deferred acquisition costs (DACs)

Other technology- and data-related challenges that may potentially surface include:

- ▶ Insurance information is required by line of business and is often not aligned with the FRB definitions nor at the required level of granularity.
- ▶ Metrics commonly reported to management (such as policyholder liability and DAC rollforwards) may not be consistent with the FRB presentation format. In some cases, data granularity may be missing by particular lines of businesses or regions.
- ▶ The global nature of insurance companies will increase the challenge of obtaining granular information. Non-US businesses may often be tracked in disparate systems, and multiyear efforts may be required to consolidate information in a FRB-defined line of business format.

Governance and accountability

The FRB requires insurance companies to maintain a reliable regulatory reporting process with a strong governance and policy framework. Common governance challenges faced by insurance organizations include:

- ▶ Need for in-depth analysis and reconciliations to properly consolidate, convert or classify balances
- ▶ Identification of required topside adjustments in a controlled manner
- ▶ Validation of assumptions and estimates made by actuaries in calculation and attribution of liabilities and variable annuity guarantees
- ▶ Reconciliation of actuarial reserve information with corresponding beginning and ending balances in the ledger
- ▶ Nonstandard chart of accounts across the consolidated organization
- ▶ No clear controls on reporting spreadsheets and source systems
- ▶ Unclear ownership of aforementioned processes



Process and controls

Organizations often face process and control-related challenges in the sourcing and classification of certain key data elements.

Common process and control challenges faced by insurance organizations include:

- ▶ Initially, data may only be available on a lag due to the business process, technology or geographical constraints within the finance and reporting processes. A remediation plan to address obtaining data on a timely basis will be required, and assumptions or adjustments to address the lag in the interim will need to be addressed.
- ▶ Typical insurance systems and processes have been designed to meet deadlines for quarterly and annual SEC reporting (i.e., quarterly 45 days, annual 60 days). Based on guidelines issued by the FRB, the FR 2085 is to be filed on a quarterly basis, 45 calendar days after quarter-end. These requirements are more stringent than SEC deadlines and may pose challenges for the regulatory reporting team.
- ▶ High-cost and multiyear effort to provide the FR 2085 in its current format. The preparation time needed to build out reporting processes to enable the completion of this report in its current format may be quite significant.
- ▶ Design and implementation of controls to enable reconciliation of balances between:
 - ▶ Administrative or valuation systems and ledger
 - ▶ Reporting or consolidation systems to FR 2085 report
 - ▶ Detail and summary schedules of FR 2085
 - ▶ FR 2085 report and other SEC 10-K/10-Q, supplemental financial information provided to shareholders (usually on a quarterly basis) and regulatory reports

People and organizational structure

Companies will be challenged to find resources with the necessary skills to prepare the FR 2085. Furthermore, companies will need to add resources to extract information from multiple systems, compile the information with the required granularity and reconcile the reports to other publicly reported information. Finally, the FRB expects institutions to have a robust quality assurance process to support the production of reliable information. This will be exacerbated by an overlap between the FRB and SEC reporting timelines. Hence, regulatory reporting resources will need to coordinate across multiple data domains requiring project management and coordination skills as well as change management capabilities.

How we see it

Insurance companies required to submit FR 2085 should consider the development of a multi-year implementation road map, including the design of a target state reporting framework, to address governance, data and resource challenges. The road map should include the tactical, interim solution while implementing the longer-term automated, strategic solution.

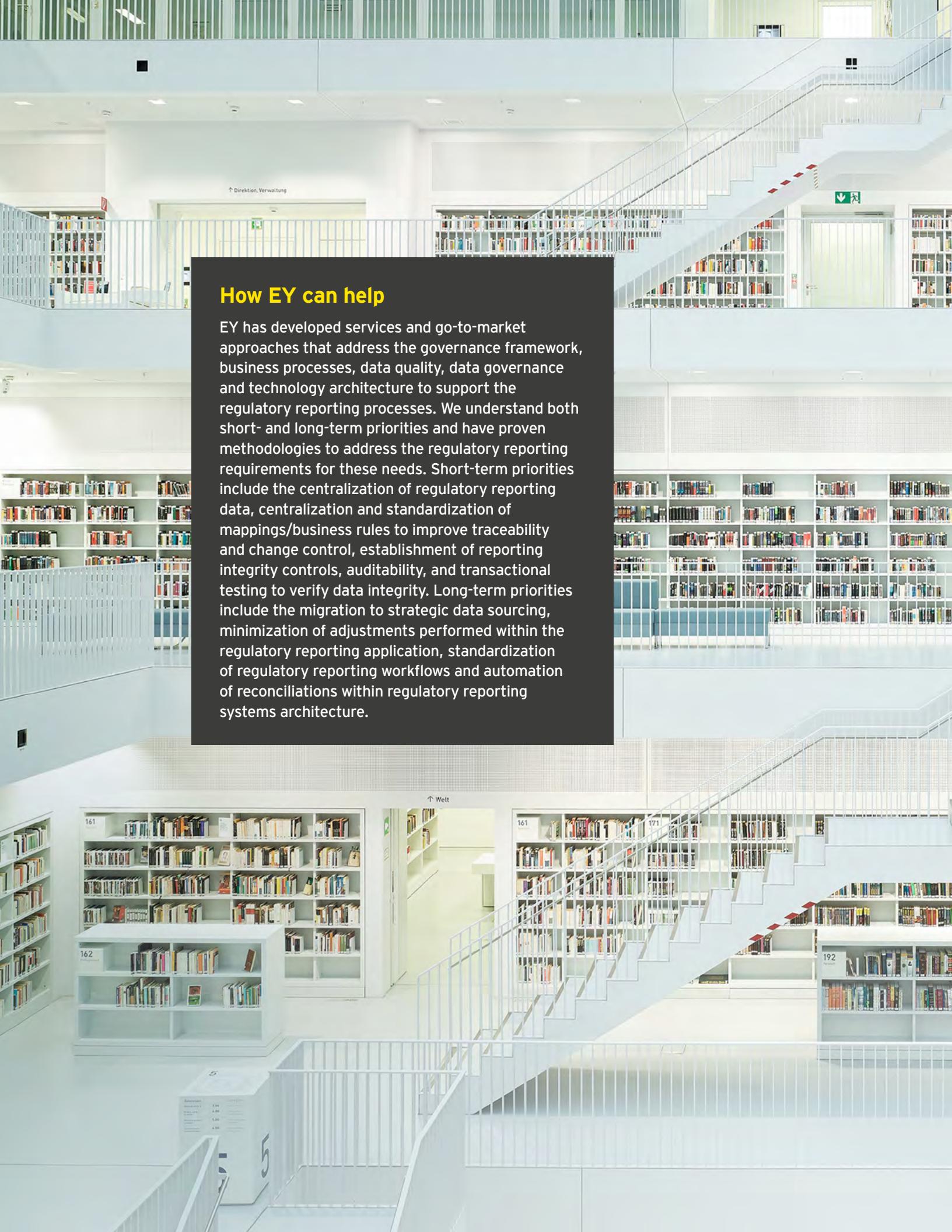
Implementation considerations in the road map should include technology (data sourcing and systems architecture), reporting processes (including reconciliations, controls and sign-offs on balances) and a regulatory reporting function. The road map should also include the creation of a strong governance framework to drive accountability in the regulatory reporting process; the framework should include well-documented controls, policies and procedures to establish well-defined roles and responsibilities for regulatory reporting.

Additionally, organizations should consider establishing governing bodies with cross-functional representation to drive implementations across reporting regimes and the organization. A strong governance process is essential given the depth and reach of regulatory reporting.

What's next?

- ▶ The FRB will accept comments on the FR 2085 report until June 24, 2016.
- ▶ Organizations will need to design and implement a road map for reporting processes and ways to support meeting new requirements.





How EY can help

EY has developed services and go-to-market approaches that address the governance framework, business processes, data quality, data governance and technology architecture to support the regulatory reporting processes. We understand both short- and long-term priorities and have proven methodologies to address the regulatory reporting requirements for these needs. Short-term priorities include the centralization of regulatory reporting data, centralization and standardization of mappings/business rules to improve traceability and change control, establishment of reporting integrity controls, auditability, and transactional testing to verify data integrity. Long-term priorities include the migration to strategic data sourcing, minimization of adjustments performed within the regulatory reporting application, standardization of regulatory reporting workflows and automation of reconciliations within regulatory reporting systems architecture.

Appendix

Report detail

This section includes a high-level summary of each schedule in the FR 2085 report.

Schedules
1. Schedule IRI – Consolidated Statement of Income
a. Schedule IRI-A – Changes in Equity Capital
b. Schedule IRI-B – Charge-Offs and Recoveries on Loans and Leases and Changes in Allowance for Loan and Lease Losses
c. Schedule IRI-C – Property and Casualty Insurance Underwriting Results by Line of Business and calculated ratios
2. Schedule IRC – Consolidated Balance Sheet
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1. Schedule IRI – Consolidated Statement of Income

Schedule IRI reports on items of income and expense for the calendar year-to-date reporting period, including adjustments of accruals and other accounting estimates made shortly after the end of the reporting period. This schedule is tailored for insurance companies and includes specific revenue line items for insurance premiums and policyholder charges and fees. Insurance-specific expense line items include loss and loss adjustment expenses (LAE), losses for future policy benefits, dividends to policyholders and amortization of deferred policy acquisition costs. Interest income and interest expense line items are not over-emphasized here, as in the FR Y-9C; this schedule focuses more on financial metrics for insurers. Schedule IRI has three sub-schedules to provide additional substantiation on revenues, expenses and equity capital:

- Schedule IRI-A** reports on total equity capital, including perpetual preferred stock, common stock, capital surplus, retained earnings, accumulated other comprehensive income and other equity capital components, such as treasury stock and unearned employee stock ownership plan shares (no differences from the FR Y-9C report).
- Schedule IRI-B** has two parts.
 - IRI-B Part A reports on loans and leases charged off and recovered during the current calendar year-to-date period.
 - Part B reports the reconciliation of the allowance for loan and lease losses on a calendar year-to-date basis. The reconciliation also includes activity in the allocated transfer risk reserve that relates to loans and leases (during the reporting period). IRI-B is similar to FR Y-9C HI-B; however, IRI-B has less granularity for construction and consumer loans.
- Schedule IRI-C** is for P&C reserves reporting and provides a breakdown of financial metrics (premiums, loss and loss adjustment expenses, other expenses) by P&C LOBs. These line items are reported separately for US domestic and international LOB on both a gross basis (direct and assumed amounts) and net basis (gross amounts less reinsurance ceded amounts). Incurred loss and loss adjustment expenses (LAE) are reported by current accident year, catastrophes and prior accident year development. Other expenses that are reported in these schedules include acquisition and other direct expenses for each line of business. These premium and expense numbers are subsequently used as inputs to calculate loss ratio, expense ratio and combined ratio. IRI-C is a new schedule introduced for reporting P&C reserves and metrics and has no matching schedule in the FR Y-9C report.

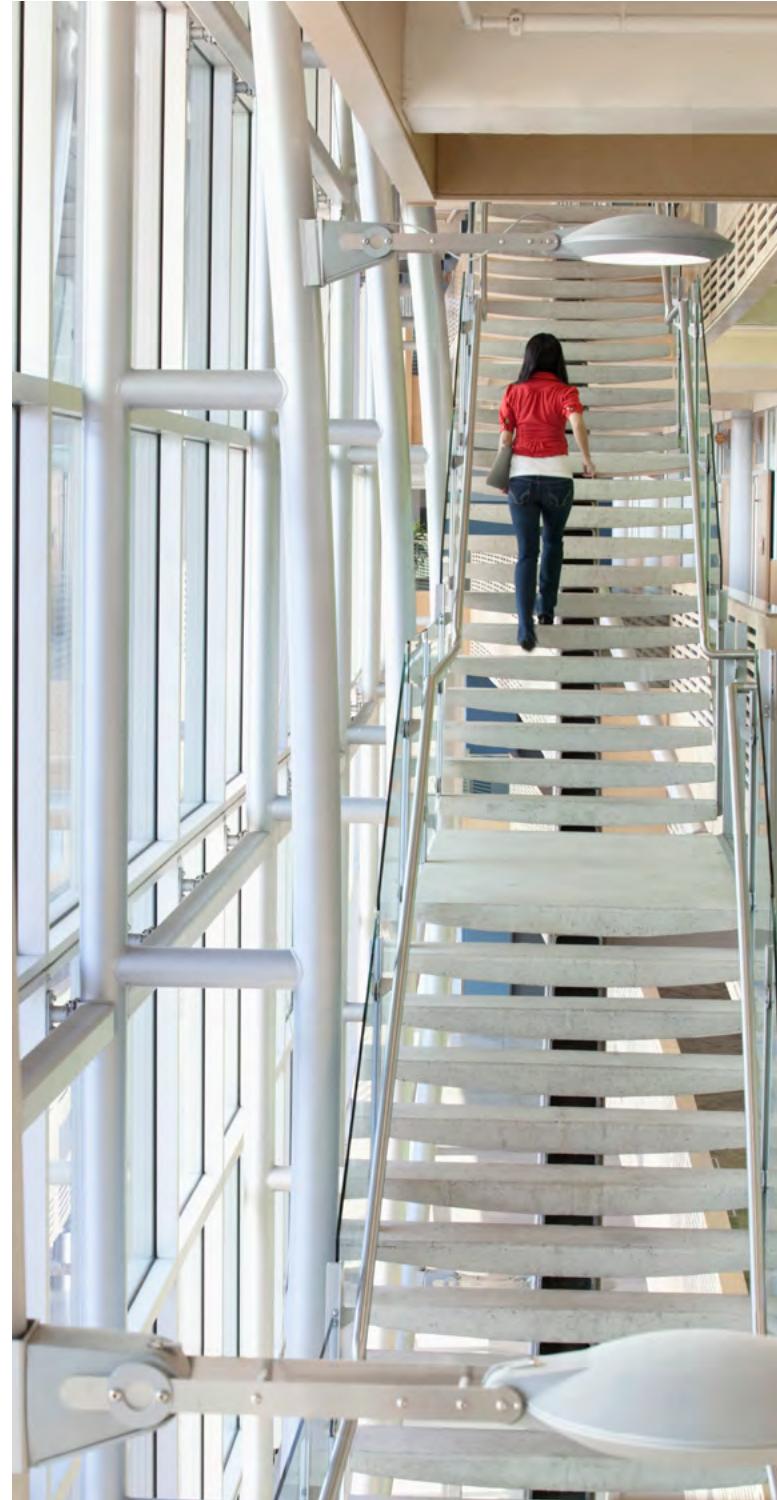
2. Schedule IRC – Consolidated Balance Sheet

Schedule IRC collects information on the reporter's assets and liabilities for the calendar year-to-date reporting period. Schedule IRC line items for assets include investment assets by category. For fixed maturity securities, the report is split between held-to-maturity securities, available-for-sale and fair value option. For equity securities, the report is split between available-for-sale and fair value option. In addition, there is a separate category for trading assets, loans and leases, short-term investments and other invested assets. Other insurance-specific asset line items are policy loans, deferred policy acquisition costs and value of business acquired, reinsurance assets, separate account assets, premiums and other receivables. Schedule IRC line items for liabilities include loss and LAE reserves, unearned premiums, policyholder liabilities (future policy benefits and policyholder account balance), other policyholder funds and policyholders' dividends.

While Schedule IRC includes most of the granularity of Schedule HC (FR Y-9C), it does not include detail for deposit liabilities that are typical of banks. Schedule IRC has seven sub-schedules to provide additional substantiation on assets and liabilities:

a. Schedule IRC-B has three parts.

- IRC-B Part A reports fixed maturity and equity securities (including held-to-maturity (HTM), available-for-sale (AFS) and fair value option (FVO) reporting) by investment type.
- Part B includes information on other invested assets, such as real estate held for investment/sale, loans and leases held for sale, third-party managed funds and investment partnerships.
- Part C includes credit quality of securities (both investment grade and sub-investment grade).
- IRC-B mimics FR Y-9C schedule HC-B for the most part and has variances around credit quality and remaining maturity of debt securities.



Appendix

b. **Schedule IRC-C** has three parts.

- ▶ IRC-C Part A reports all loans and leases that the reporter has the intent and ability to hold for the foreseeable future or until maturity or payoff (financing receivables).
- ▶ IRC-C Part B reports all loans, including loans and leases held for sale, leases, debt securities and other assets that are past due or are in nonaccrual status, regardless of whether such credits are guaranteed or secured or by the US Government or by others.
- ▶ IRC-C Part C includes information on the credit quality of loans secured by real estate.
- ▶ IRC-C is largely similar to HC-C; it additionally includes a deep dive on credit quality of loans secured by real estate (based on loan-to-value ratio).

c. **Schedule IRC-D** reports assets, liabilities, and other financial instruments classified as trading. This schedule mimics HC-D in FR Y-9C, but has much lower granularity.

d. **Schedule IRC-I** has three sections.

- ▶ IRC-I Section I Part A reports P&C Loss and loss adjustment expense (LAE) reserves by P&C domestic and International LOB on both a discounted and undiscounted basis. IRC-I Section I Part B reports P&C Loss and loss adjustment expense (LAE) reserve rollforwards for the reporter on a consolidated basis.
- ▶ IRC-I Section II includes substantiation for reporters engaged in life, health and/or annuities underwriting activities. A summary schedule is included up front to capture reserves for future policy benefits, policyholder account balances, DAC and VOBA for all life, accident and health, annuities and closed block operations. Detail substantiation of each of these liabilities by LOB is included in subsequent schedules.
- ▶ IRC-I Section II Part A reports future policy benefits roll forward by domestic individual products (Part A-1), domestic group products (Part A-2), international products (Part A-3).
- ▶ IRC-I Section II Part B reports policyholder account balances roll forward by domestic individual products (Part B-1), domestic group products (Part B-2), international products (Part B-3).

- ▶ IRC-I Section II Part C reports variable annuities and guarantees associated with them, including guarantee reserves.
- ▶ IRC-I Section II Part D reports assets and liabilities associated with insurance closed block.
- ▶ IRC-I Section II Part E reports deferred policy acquisition costs and value of business acquired roll forward by domestic (Part E-1) and international (Part E-2) line of business.
- ▶ IRC-I Section III reports information on assets related to reinsurance contracts on both a consolidated and individual reinsurer counterparty basis.
- ▶ Schedule IRC-I is much more granular than HC-I and includes a deep dive of financial metrics for life, accident and health, annuities LOBs (including reinsurance). The purpose of Schedule IRC-I is to report assets and liabilities for insurance companies by line of business. This level of data granularity and specificity to insurance was not required in any prior FRB report. The loss, expense and reserves metrics may be used by the FRB as an indicator of risk.

e. **Schedule IRC-L** reports selected freestanding and embedded derivatives, commitments, contingencies and other off-balance sheet items. It is largely similar to HC-L in the FR Y-9C but lacks granularity on commitments and standby letters of credit. IRC-L also includes specifics on embedded derivatives with guarantees within asset and liability host insurance contracts.

f. **Schedule IRC-M** includes memoranda items for Schedule IRC including deferred tax assets, reporting of deferred policy acquisition costs, deferred sales inducements, value of business acquired, goodwill and intangibles. It is similar to Schedule HC-M in FR Y-9C, although the Y-9C schedule has additional report items.

g. **Schedule IRC-V** collects information on variable interest entities (VIEs) that have been consolidated by the reporter because the reporter or a consolidated subsidiary is the primary beneficiary of the VIE. This schedule is aligned to Schedule HC-V in FR Y-9C.



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To learn more about how the changing regulatory reporting environment might affect your organization and how EY can help, please contact one of our professionals.



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