I. THE SYSTEM

Introduction

The NAIC Insurance Regulatory Information System (IRIS) is a collection of analytical solvency tools and databases designed to provide state insurance departments with an integrated approach to screening and analyzing the financial condition of insurers operating within their respective states. IRIS, developed by state insurance regulators participating in NAIC committees, is intended to assist state insurance departments in targeting resources to those insurers in greatest need of regulatory attention. IRIS is not intended to replace each state insurance department's own in-depth solvency monitoring efforts, such as financial analyses or examinations. This manual is designed to assist state insurance departments and the public in understanding two of the key tools within IRIS – the IRIS Ratios and the Analyst Team System.

One of the most difficult tasks facing insurance regulators is to make effective use of limited resources. All insurers are required to file financial statements with all states in which they are licensed to operate. No state is able to thoroughly review the financial condition of all licensed insurers immediately upon receipt of the financial statements. IRIS helps by providing solvency tools and databases that highlight those insurers that merit the highest priority in the allocation of the regulators' resources, thus directing those resources to the best possible use.

IRIS Ratio Application

The IRIS Ratio Application generates key financial ratio results based on financial information obtained from insurers' statutory annual financial statements. The ratios' results are used in determining the level of regulatory attention required. The NAIC Insurance Analysis and Information Services Department, under the direction of the Financial Analysis Research and Development Working Group, conducts annual reviews of the ratios to ensure that each ratio is current and continues to be relevant to solvency monitoring.

Reports are made available for the IRIS Ratio results to regulators and interested parties. The reports list insurers alphabetically by type of insurer and include ratio results, usual ranges, and identification of unusual values.

A ratio that falls outside the usual range is not necessarily considered adverse. For example, an increase larger than "usual" in policyholders' surplus is not necessarily an unfavorable result. Furthermore, in some years it may not be unusual for financially stable insurers to have several ratios with results outside the usual range. For example, a rise or decline in the equity markets may result in a significant change in policyholders' surplus. Since surplus is used as the divisor in many of the ratio formulas, certain ratios may fall outside their usual range.

The ratios and trends are valuable in identifying insurers likely to experience financial difficulties. They are not, in themselves, indicative of adverse financial conditions. The ratios and range comparisons are automatically generated upon data submission, if all data elements are present in the submission. If data elements are submitted with data validation failures or material accounting errors, these failures/errors will be reflected in the results. If amended data is received after the results have been generated, the ratio results will be recalculated.

Analyst Team System

The Analyst Team, a group of financial examiners and analysts representing all zones of the NAIC, conducts the analytical phase. The Analyst Team meets annually at the NAIC Central Office to review the annual financial statement and results of the IRIS Ratio tool and other solvency tools (e.g., risk-based capital). The NAIC Analyst Team Oversight Working Group determines the criteria to be used in selecting which insurers' annual financial statements are to be reviewed by the Analyst Team.

The primary goal of the Analyst Team is to identify insurers that appear to require immediate regulatory attention. Based on a review of the insurer's financial results, the Analyst Team will recommend the level of regulatory attention required by designating an insurer "Level A," "Level B," or "Reviewed, no level." These designations are intended to assist states in prioritizing their workload so that potential problem insurers are focused on first in the regulatory review process. An insurer's designation is identified in the Analyst Team System reports available to state insurance regulators.

A "Level A" insurer designation means that the state regulator should give that insurer the highest priority in the review process. A "Level A" designation does not necessarily indicate that an insurer is facing financial adversity. The regulator should perform a comprehensive analytical review of the insurer's financial condition to determine the factors affecting the financial ratio results to confirm whether closer regulatory attention is required. While insurers designated as "Level B" may also have adverse results, these insurers do not require the immediate attention recommended with "Level A" insurers.

Following the Analyst Team's review, the information is available to state insurance regulators through the NAIC I-SITE application. The information reported includes the Analyst Team Validated Level, basic financial information, and analyst comments supporting the conclusion. The information distributed is not intended to be a complete analysis, nor is it an expression of an opinion about an insurer.

Limitations

The IRIS Ratios and the Analyst Team Reports depend on the accuracy and standardization of the annual financial statements or Internet filings of insurers. The tools cannot identify a misstatement of financial condition or a financial statement not prepared in the proper or complete format. Also, there exists the possibility of data-processing errors.

The IRIS Ratios and Analyst Team System have been reasonably effective in distinguishing between troubled and financially stable insurers. As previously stated, the results are not in themselves determinative of the financial condition of an insurer. The results are subject to individual insurer circumstances. The following caveats apply:

1. No state can rely on the tools' results as the state's only form of surveillance.

2. Important decisions, such as licensing, should not be based on the tools' results without further analysis or examination of the insurer.

3. Valid interpretation of the tools' results depends, to a considerable extent, on the judgment of financial analysts and examiners. An insurer's ratios may be outside the usual range because of unusual accounting methods, changes in corporate structure, restatements of prior periods, correction of errors in prior periods, or other circumstances.

4. The Analyst Team System reports are intended only for analysis by state regulators and are **confidential**. If areas of concern are identified, the state insurance department may review an insurer's annual financial statement and other relevant information and direct inquiries to the insurer to determine whether a department on-site examination is required.

5. The criteria for determining usual range values and the usefulness of the IRIS Ratios, although based on the recent experience of insurers becoming insolvent, may not be valid for future experience in different economic periods. For this reason, the components of the ratios are reviewed annually.

6. While the information contained in the IRIS reports is compiled in a manner and from sources believed to be reliable, its accuracy is not guaranteed.

7. **For Life Insurers Only:** It should be noted that the data used in calculating the ratio results of insurers domiciled in Canada or having a Canadian base of operations that now file on the regular life blank are provided through a supplementary filing. The supplementary filing is not subject to the crosschecks applied to annual financial statement data.

For Life Insurers and Fraternal Societies Only: The IRIS Ratios do not include tests of reserve adequacy or strength; however, they do include a test of reserve consistency. The test of consistency may identify insurers that have problems with reserve calculation. However, the determination of reserve adequacy is one of the primary purposes of an on-site examination.

Merged Insurers

The IRIS Ratio results of insurers that have entered into mergers during the previous year could be distorted. The distortion occurs if the prior year data used to calculate the ratios is obtained on a single-insurer basis. The ratios are calculated using prior year data obtained on the merged entity, if the merged data is provided by the insurer. Merged prior year data is obtained from insurers on a voluntary basis and is not subject to NAIC data-validation procedures or independent audit requirements.