REPORT OF EXAMINATION
OF THE

CNA CASUALTY OF CALIFORNIA

AS OF
DECEMBER 31, 2003

Participating State
and Zone:

California

Filed June 30, 2005

TABLE OF CONTENTS

Los Angeles, California
March 18, 2005

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable John Morrison
Secretary, Zone IV-Western
Commissioner of Insurance and Securities
Montana Department of Insurance
Helena, Montana

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman and Commissioners:

Pursuant to your instructions, an examination was made of the

CNA CASUALTY OF CALIFORNIA

(hereinafter also referred to as the Company) at its main administrative office located at CNA Plaza, Chicago, Illinois 60685.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 1998. This examination covers the period from January 1, 1999 through December 31, 2003. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2003, as deemed necessary under the circumstances.

The examination of the Company was made concurrently with the examinations of various other insurance subsidiaries of the CNA Financial Corporation (CNA) including Continental Reinsurance Corporation and Pacific Insurance Company which are both California domiciled entities.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

COMPANY HISTORY

The Company and certain of its U.S. affiliates were previously participants in an intercompany pooling arrangement (Pool) whereby each participating affiliate ceded 100% of its insurance business to Continental Casualty Company (CCC), which then retroceded the pooled businesses to each participating affiliate in accordance with the Pool participation percentages. During 2002, CNA initiated a project to consolidate its U.S. insurance entity structure to reduce complexity. Accordingly, during the fourth quarter of 2002, CCC was established as the primary risk bearer of the insurance risks currently retained in the group of companies formerly comprising the CCC Pool. This was accomplished through the execution of the following agreements: (1) a commutation of the CCC Pool agreement effective January 1, 2002, (2) a retroactive reinsurance quota-share agreement between CCC and each former Pool participant covering all in-force business, including outstanding loss reserves, as of December 31, 2001, and (3) a prospective 100% quota-share reinsurance agreement between CCC and each former Pool participant effective as of January 1, 2002.

As a result of this transaction, all balances previously assumed and ceded under the commuted CCC Pool agreement were reversed, and transactions reflecting the execution of the new quota-share agreements were recorded retroactive to January 1, 2002. Under the new quota-share agreements, the subsidiaries cede all in-force business, including outstanding loss reserves, and prospective underwriting activity to CCC. In conjunction with these changes, the aggregate capital of the members constituting the former Pool was reallocated to support the net risk retention of the new structure. Accordingly, the reallocation of capital was facilitated via a dividend payment of $68.4 million and a return of capital to CCC in the amount of $24 million.

The commuted CCC Pool agreement, the retroactive and prospective quota-share agreements, as well as the changes to the capital structure, were approved by the California Department of Insurance on November 15, 2002.

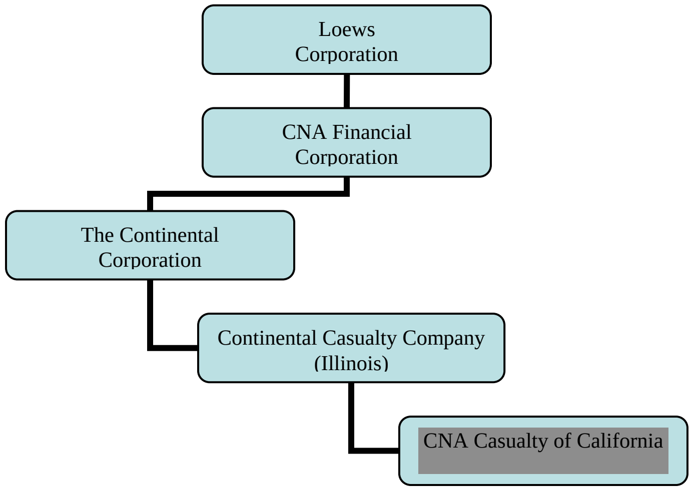
Management has represented that the Company is scheduled to be redomiciled by January 1, 2006.

MANAGEMENT AND CONTROL

CNA of California is a wholly-owned subsidiary of Continental Casualty Company (CCC), an insurance company domiciled in Illinois. CCC is wholly-owned by The Continental Corporation, which is wholly-owned by CNA Financial Corporation (CNAF). The Loews Corporation (Loews), the ultimate controlling entity, owns approximately 90% of the outstanding common stock of CNAF.

Members of the Tisch family which includes James S. Tisch, president and chief executive officer of Loews, are beneficial owners of approximately 31% of the outstanding stock of Loews. In addition to its involvement in the insurance business, Loews, through its subsidiaries, is active in the operation of hotels and resorts, production and sale of cigarettes, the operation of offshore oil drilling rigs, the distribution and marketing of watches and clocks, and the operation of a natural gas pipeline system.

The Company is a member of a holding company system. The following abbreviated organizational chart depicts the interrelationship of the members within the system as of December 31, 2003:



Management of the Company is vested in a six-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2003 follows:

Directors

Name and Residence	Principal Business Affiliation
Robert V. Deutsch* Farmington, Connecticut	Executive Vice President and Chief Financial Officer Continental Casualty Company
Jonathan D. Kantor Scarsdale, New York	Executive Vice President, Secretary and General Counsel Continental Casualty Company
Robert V. James** Galena, Illinois	Executive Vice President U.S. Insurance Operations Continental Casualty Company
James R. Lewis North Barrington, Illinois	President and Chief Executive Officer Property and Casualty Operations Continental Casualty Company
Stephen W. Lilienthal North Barrington, Illinois	Chairman, Chief Executive Officer and President Continental Casualty Company

Directors (cont.)

Robert L. McGinnis*** Highland Park, Illinois	President and Chief Executive Officer CNA Life and Group Operations Continental Casualty Company

*   resigned November 22, 2004
**   resigned January 4, 2004
*** resigned April 7, 2004

Principal Officers

Name	Title
Stephen W. Lilienthal	President
Dennis R. Hemme	Vice President and Treasurer
Jonathan D. Kantor	Executive Vice President, Secretary and General Counsel
Jeffery C. Alton	Vice President and Assistant Secretary
Martin T. Basich	Assistant Vice President and Assistant Secretary
Lawrence J. Boysen	Senior Vice President
Charles P. Colburn	Vice President
Robert V. Deutsch	Executive Vice President and Chief Financial Officer

Management Agreements

CNA Inter-Company Expense Agreement: The Company and its affiliates entered into an expense sharing agreement, which describes how the affiliates will determine, apportion, and settle certain inter-company expenses and allocations. Pursuant to the agreement, the costs of the following services are shared: marketing, human resources, contract administration, treasury and investment, financial reporting, information technology, systems planning and application, legal, underwriting, claims, administrative and other services and such expenses shall include: salaries; rent and facilities; utilities; equipment; legal; auditing; and other expenses related to the provision of services described above. Various allocation bases are employed, including written premiums, paid losses, and salaries, to distribute these expenses to a company level. Substantially all expenses paid by and allocated to the Company are subject to this agreement. The Company does not have employees of its own.

Federal Income Tax Allocation Agreement: The Company, along with all subsidiaries of The Continental Corporation are parties to the Federal Income Tax Allocation Agreement. This agreement provides that the ultimate parent shall file a consolidated federal income tax return for each taxable year the affiliate is required or permitted to file such return. The agreement also provides that the consolidated tax liability of the affiliates will be allocated to each member based on the percentage of the income tax liability of each member computed on a separate return basis.

TERRITORY AND PLAN OF OPERATION

The Company is licensed to transact multiple lines of business in the states of Arizona, California, Maryland and Nevada. In 2003, the Company wrote $28.1 million of direct premiums. Of the direct premiums written, the combination of other liability and medical malpractice coverages accounted for 83.8% of the total. Less than 2% of the direct premiums written pertained to California risks.

CNA's business is written through an extensive branch office and agency organization represented by approximately 5,000 independent agents and brokers.

REINSURANCE

Assumed

During 2003, the Company assumed a minimal amount of premiums which, as noted below, is retroceded to its parent.

Ceded

In conjunction with the previously referenced consolidation plan, the Company along with all other former members of the CCC Pool cede all in-force business, including outstanding loss reserves, and prospective underwriting activity to Continental Casualty Company. (see Company History)

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2003

Underwriting and Investment Exhibit for the Year Ended December 31, 2003

Reconciliation of Surplus as Regards Policyholders
from December 31, 1998 through December 31, 2003

Statement of Financial Condition
as of December 31, 2003

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$25,071,128	$	$25,071,128	
Cash and short-term investments	1,214,166		1,214,166	
Investment income due and accrued	177,789		177,789	
Net deferred tax asset	10,476,873	10,041,923	434,950	
Total assets	$36,939,956	$10,041,923	$26,898,033	
Liabilities, Surplus and Other Funds				
Losses and loss adjustment expenses			$ -0-	(1)
Current federal and foreign income taxes			175,845	
Remittances and items not allocated			(57,077)	
Payable to parent, subsidiaries and affiliates			1,415,074	
Total liabilities			1,533,842	
Common capital stock		$ 2,625,000		
Gross paid-in and contributed surplus		9,149,206		
Unassigned funds (surplus)		13,589,985		
Surplus as regards policyholders			25,364,191	
Total liabilities, surplus and other funds			$26,898,033	

Underwriting and Investment Exhibit for the Year Ended December 31, 2003

Statement of Income

Investment Income		
Net investment income earned	$ 970,800	
Net realized capital gains	338,024	
Net investment gain		1,308,824
Net income		$ 1,308,824

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2002		$ 23,839,497
Net income	$ 1,308,824	
Change in net unrealized capital gains	28,792	
Change in net unrealized foreign exchange capital loss	(263,375)	
Change in net deferred income tax	(7,906,504)	
Change in nonadmitted assets	8,356,957	
Change in surplus as regards policyholders		1,524,694
Surplus as regards policyholders, December 31, 2003		$ 25,364,191

Reconciliation of Surplus as Regards Policyholders
from December 31, 1998 through December 31, 2003

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 1998, per Examination			$ 65,956,669
Net income	$ 47,259,030	$	
Change in net unrealized capital gains	32,066		
Change in net unrealized foreign exchange capital loss		284,935	
Change in net deferred income tax		3,530,865	
Change in nonadmitted assets	7,338,492		
Cumulative effect of changes in accounting principles		1,611,906	
Capital changes: Paid-in	1,525,000		
Surplus adjustments: Paid-in		25,525,000	
Dividends to stockholders		68,400,000	
Aggregate write-ins for gains in surplus	2,605,640		
Totals	$ 58,760,228	$ 99,352,706	
Net decrease in surplus as regards policyholders			(40,592,478)
Surplus as regards policyholders, December 31, 2003, per Examination			$ 25,364,191

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

As referenced in the Company History section of this report, the Continental Casualty Company Pool (CCC Pool) was dissolved and replaced with separate 100% quota-share reinsurance agreements between Continental Casualty Company (CCC) and the former pool participants including the Company. In view of such, the Company does not have a reportable loss exposure per se. However, as noted in the 2003 Actuarial Opinion, "Contingent net liability exists with respect to ceded reinsurance which would become an actual liability in the event that the reinsurer would be unable to meet their obligations to the Company under existing reinsurance agreements."

The actuarial firm of Towers Perrin, Tillinghast (Tillinghast) was retained by the Illinois Department of Financial and Professional Regulation, Division of Insurance (Illinois Department) on behalf of all the applicable domiciliary states (including California) to assess the adequacy of the loss and loss adjustment expense (LAE) reserves of certain business written by the CNA Companies (CNA) as of December 31, 2003, net of reinsurance.

Subsequent to the completion of the actuarial reports, the Illinois Department requested and received from Tillinghast an opinion letter. The Tillinghast opinion concludes that "CNA's net loss and LAE reserves as of December 31, 2003, for the segments reviewed are below our point estimate in total, but fall within a range of reasonable estimates".

Actuarial Standard of Practice (ASOP) No. 36, Section 3.3 Significant Risks and Uncertainties requires that, when the actuary reasonably believes that there are significant risks and uncertainties that could result in material adverse deviation, the actuary should also include an explanatory paragraph in the statement of actuarial opinion…..the explanatory paragraph should contain the following:

(a) the amount of adverse deviation that the actuary judges to be material with respect to the statement of actuarial opinion; and

(b) a description of the major factors or particular conditions underlying risks and uncertainties that the actuary believes could result in material adverse deviation.

In compliance with the above referenced requirement, the Tillinghast opinion letter reflected the following disclosures:

- Additional risk factors include the position of the Company's carried asbestos, pollution, and other mass tort (APMT) reserves at the low end of our range of reasonable estimates, and the fact that reserves are significant in relation to surplus. Consequently, we believe that there are significant risks and uncertainties that could result in material adverse deviation from the held APMT loss and loss adjustment expense reserves;

- In consideration of the use of this opinion for purposes of solvency monitoring, we consider… (the amount) to be material for this review;

- The absence of other risk factors from this listing does not imply that additional factors will not be identified in the future as having been a significant influence on CNA's reserves.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None

Previous Report of Examination

Corporate Records (Page 6): It was recommended that the Company comply with CIC Section 735. The Company is not in compliance.

Accounts and Records (Page 9): It was recommended that the Company consider ways to better organize and retain its records. During the course of this examination, the organization and retention of records was not found to be problematic.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees of CNA Financial Corporation during the course of this examination are hereby acknowledged.

Respectfully submitted,

_____/S/_______________
David A. Fischman, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California