REPORT OF EXAMINATION
OF THE
PACIFIC COMPENSATION INSURANCE COMPANY
AS OF
DECEMBER 31, 2012

Filed November 21, 2013

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Los Angeles, California
August 30, 2013

Honorable Dave Jones
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

PACIFIC COMPENSATION INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 30301 Agoura Road, Suite 100, Agoura Hills, California 91301.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was made as of December 31, 2008. This examination covers the period from January 1, 2009 through December 31, 2012. The examination was conducted in accordance with the National Association of Insurance Commissioners' Financial Condition Examiners' Handbook. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, to identify prospective risks, and to obtain information about the Company, including corporate governance, identification and assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, and management's compliance with Statutory Accounting Principles and Annual Statement instructions. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

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; pensions, stock ownership and insurance plans; growth of company; and accounts and records.

SUBSEQUENT EVENTS

Effective January 1, 2013, the Company entered into a Stop Loss Reinsurance Agreement with AIHL Re, LLC (AIHL Re), a Vermont captive insurer and affiliate. Under the terms of the agreement, AIHL Re provides the Company with non-cancelable reinsurance coverage with the following features: (1) coverage for adverse development on net losses and allocated loss adjustment expenses in excess of the Company's carried reserves at December 31, 2012, and (2) accident year stop loss coverage for any net losses and allocated loss adjustment expenses in excess of 75% of net earned premium for accident years 2013, 2014, and 2015. The agreement has an aggregate limit of $100 million, and was entered into by the Company as part of a plan to attain a rating of A- (Excellent) from rating agency A.M. Best, in order to better compete in the workers' compensation market. As a result of the aforementioned reinsurance agreement between the Company and AIHL Re, A.M. Best upgraded the Company's financial strength rating to A- (Excellent) from B++ (Good) during the second quarter of 2013. The California Department of Insurance consented to this agreement on April 26, 2013.

COMPANY HISTORY

The Company was incorporated in the state of California on January 1, 2002, received its Certificate of Authority on December 31, 2002, and commenced transacting property and casualty business on January 1, 2003.

The Company was a wholly-owned subsidiary of Employers Direct Corporation (EDC), a privately held corporation domiciled in Delaware. Effective July 18, 2007, Alleghany

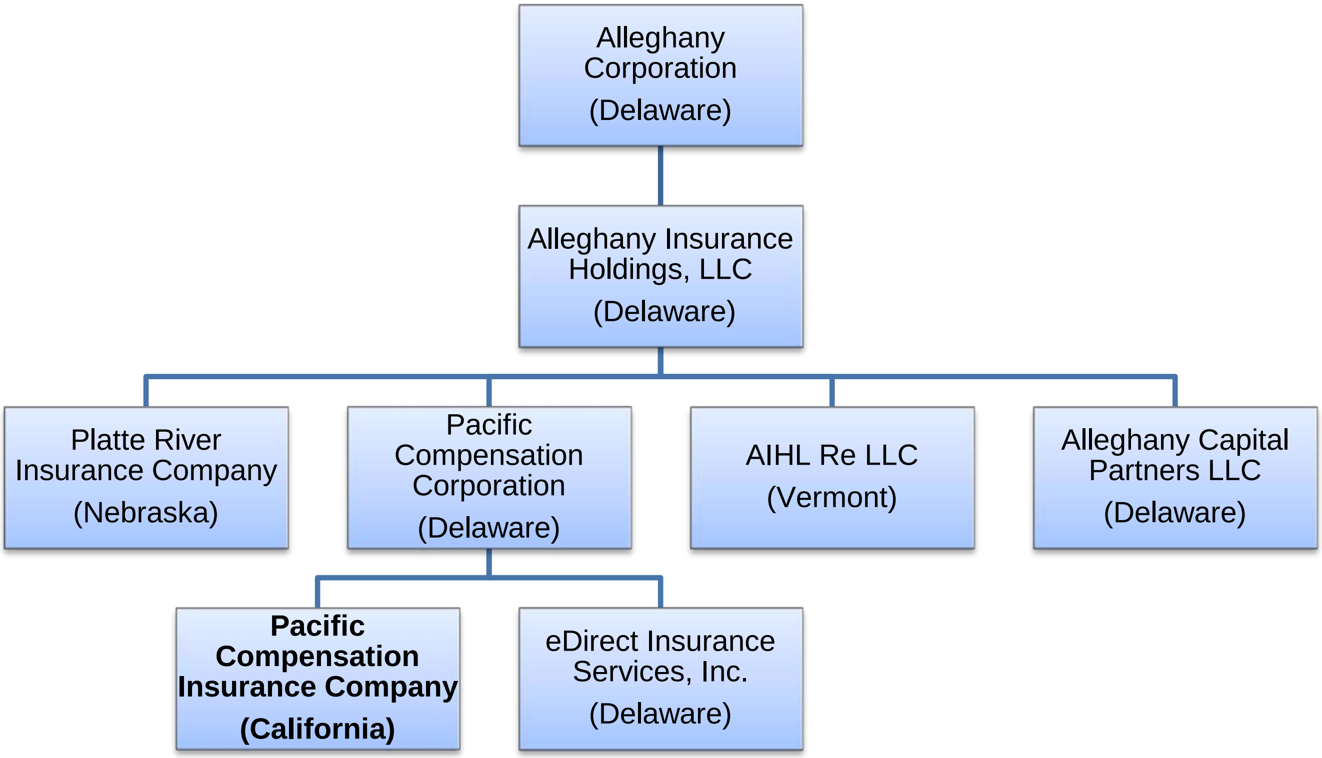
Insurance Holdings, LLC (AIHL), the insurance holding company subsidiary of the Alleghany Corporation, acquired approximately 98.4% of the common stock of EDC. The Alleghany Corporation, a Delaware domiciled publicly traded corporation, is engaged in the property and casualty insurance business through AIHL. Approval for the acquisition was granted by the California Department of Insurance on July 13, 2007. The remaining 1.6% of common stock owned by EDC senior management was acquired by AIHL during the first quarter of 2009.

Effective April 12, 2010, the name of the Company was changed from Employers Direct Insurance Company to Pacific Compensation Insurance Company. In addition, the name of the Company's direct parent was changed from Employers Direct Corporation to Pacific Compensation Corporation (PCC).

On September 27, 2010, AIHL transferred $40 million in cash to PCC. The proceeds were then transferred to the Company with $35 million recorded as a capital contribution and $5 million used to settle an intercompany receivable. On December 21, 2012, AIHL transferred $15 million in cash to PCC. The proceeds were then transferred to the Company as a capital contribution. As a result of the aforementioned transactions, the Company's gross paid-in and contributed surplus increased by $50 million during the examination period.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system. Ultimate control of the Company is maintained by Alleghany Corporation. The following abbreviated organizational chart depicts the Company's relationship within the holding company system (all ownership is 100%):



The four members of the board of directors, who are elected annually, manage the business and affairs of the Company. Following are members of the board and principal officers of the Company serving at December 31, 2012:

Directors

Name and Residence	Principal Business Affiliation
Joseph P. Brandon Fairfield, Connecticut	Executive Vice President Alleghany Corporation
Christopher K. Dalrymple Mount Kisco, New York	Senior Vice President, General Counsel, and Secretary Alleghany Corporation
Janet D. Frank [(a)] Calabasas, California	Chief Executive Officer and President Pacific Compensation Insurance Company

Name and Residence	Principal Business Affiliation
Roger B. Gorham [b] Hillsborough, New Jersey	Senior Vice President, Finance and Investment Alleghany Corporation

Principal Officers

Name	Title
Janet D. Frank [a]	Chief Executive Officer and President
Denise K. Richardson [c]	Vice President, Finance and Chief Financial Officer
June E. Duxler	Vice President, Human Resources and Administration
Roger B. Gorham	Vice President, Investments
Joyce S. Schulman	Vice President, Claims
Jon P. Siglar	Vice President, Chief Sales and Field Services Officer
Karen A. Sterner [d]	Vice President, Underwriting and Premium Audit
Mark E. Webb	Vice President, General Counsel

The following changes in directors and principal officers occurred during and subsequent to the examination date:

[a] Janet D. Frank was elected Director, Chief Executive Officer, and President, effective December 3, 2012. She was also appointed as Chairman of the Board on March 20, 2013. She replaced former Chairman, Chief Executive Officer, and President, James E. Little, effective December 3, 2012.

[b] Roger B. Gorham was replaced by John L. Sennott, Jr., Senior Vice President and Chief Financial Officer of Alleghany Corporation as a director, effective May 20, 2013. Mr. Sennott resides in Simsbury, Connecticut.

[c] Denise K. Richardson was named acting Chief Financial Officer, effective December 3, 2012. She was later elected Vice President, Finance and named Chief Financial Officer, effective March 20, 2013. She replaced former Chief Financial Officer, Ronald A. Groden, effective December 3, 2012.

[d] Karen A. Sterner, retired effective March 31, 2013. Christine E. Closser replaced Ms. Sterner as Vice President, Chief Underwriting and Premium Audit Officer, effective March 20, 2013.

Management Agreements

Administrative/Facilities Service Agreement: Effective June 14, 2007, the California Department of Insurance (CDI) approved an administrative/facilities service agreement between the Company and an affiliate, eDirect Insurance Services, Inc. (eDirect), a wholly-owned direct subsidiary of Pacific Compensation Corporation (PCC), the Company's parent. Under the terms of the agreement, the Company provided certain administrative support services and facilities to eDirect including, but not limited to, financial reporting, budget and cost accounting, personnel, legal, office services, policy records, information technology, computer, and communication services. Reimbursement for services provided was predicated on an actual cost basis. In the third quarter of 2009, after the sale of certain assets of eDirect, this agreement became inactive. During 2009, eDirect paid the Company a total of $338,279 for services received.

Tax Sharing Agreement: The Company entered into a tax sharing agreement with PCC on January 1, 2003. The agreement was approved by the CDI on August 1, 2003. Effective August 14, 2007, an amendment to this agreement to include eDirect, was approved by the CDI. Allocation of taxes is based on separate return calculations with current credit for net losses to the extent utilized by the consolidating entities. Intercompany tax balances are normally settled no later than thirty days following the filing of the consolidated tax return. The Company did not pay any federal income taxes during the examination period.

Investment Management Agreements: The Company's investment portfolio is managed by two individual management firms, one of which Alleghany Capital Partners, Inc. (ACP) is an affiliate. Each firm is responsible for managing a designated segment of the Company's investment portfolio. Within the confines of the Company's codified guidelines, each investment management firm has the authority to execute transactions without prior consultation with the Company's management. The agreements are summarized as follows:

- Effective August 1, 2007, an existing investment management agreement between General Re-New England Asset Management (GR-NEAM) and the Alleghany Corporation was amended to include the management of the Company's fixed income portfolio. Management fees for services provided under this agreement are calculated as follows: annual fee of 0.12% on the first $500 million of the market value of assets managed; 0.10% on the next $1 billion of the market value of assets managed; and 0.05% on the market value of the remaining assets under management. During the examination period, the Company paid GR-NEAM $286,214, $257,348, $257,466, and $211,862 in 2009, 2010, 2011, and 2012, respectively.

- On December 19, 2007, the CDI approved an investment management agreement between the Company and ACP, a subsidiary of Alleghany Corporation, the Company's ultimate parent. The agreement, which became effective January 1, 2008, provides for the management of the Company's equity account consisting of cash, equity securities, and other assets. Management fees for services provided are calculated as follows: annual fee of 1.0% on the first $200 million of the market value of assets managed; 0.5% on the next $200 million of the market value of assets managed; and 0.25% on the market value of the remaining assets under management. The Company did not own any equity securities during 2012. During the examination period, the Company paid ACP $188,387, $204,070, $34,222, and $0, for the years 2009, 2010, 2011, and 2012, respectively.

Term Loan Line of Credit Agreement: On March 23, 2007, the Company entered into a renewable term loan line of credit with its parent, PCC, providing for loans in an aggregate amount up to $5 million. Effective August 26, 2009, the borrowing limit was increased to $6 million. PCC utilized this line of credit during the examination period, however, as of year-end 2012 the outstanding principal balance owed to the Company was $0 and the term loan was inactive.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2012, the Company was licensed to write employers' liability and workers' compensation business in Arizona, California, Colorado, Idaho, Illinois, Nevada, Oregon, and Utah. During the period under review, writings were limited to workers' compensation coverage in Arizona, California, and Nevada.

Since its inception in 2002, the Company maintained the practice of selling workers' compensation policies primarily on a direct basis rather than through brokers. Effective August 1, 2009, the Company ceased soliciting new and renewal California business on a direct basis. Effective September 1, 2009, the renewal rights to its directly placed workers' compensation policies were sold to an independent brokerage firm.

The Company spent most of 2010 repositioning to distribute workers' compensation insurance in California through independent insurance brokers. This involved developing a brokerage marketing strategy, identifying appropriate brokers, designing a new broker contract, appointing key brokers, making investments in new systems, and adjusting rate filings where appropriate.

During 2011, the Company wrote a modest amount of new business, all of which was through brokers. During 2012, the Company wrote $19.4 million of direct premium. Of the premium written, all but $29,191 was written in California.

LOSS EXPERIENCE

A review of the Company's loss experience during the examination period disclosed a trend of net underwriting losses and net losses as follows:

Year	Net Underwriting Loss	Net Loss
2009	$70.0 million	$33.5 million
2010	$29.5 million	$ 6.8 million
2011	$51.4 million	$26.8 million
2012	$31.0 million	$16.9 million
2013*	$12.4 million	$ 6.3 million

*Through June 30, 2013

For the years 2009, 2010, 2011, and 2012, the Company reported unfavorable reserve developments of $27.1 million, $12.8 million, $28.3 million, and $5.4 million, respectively. Contributing to the above underwriting losses was the Company's decision to cease soliciting new and renewal business on a direct basis, effective August 1, 2009, which reduced the Company's ability to offset any underwriting losses with premiums earned. In addition, underwriting performance had been adversely affected by an increasingly competitive workers' compensation market.

As discussed within the "Subsequent Events" section of the report, the Company entered into a Stop Loss Reinsurance Agreement to mitigate future unfavorable reserve development trends. In addition, the Company has a current business plan which forecasts positive operating results in the near future.

CASH FLOW FROM OPERATIONS

A review of the Company's cash flow from operations during the examination period disclosed a trend of negative cash flows as follows:

Year	Net Cash from Operations
2009	$(31.1) million
2010	$(52.8) million
2011	$(53.5) million
2012	$(24.9) million
2013*	$(15.3) million

*Through June 30, 2013

The negative cash flow for the above listed periods is largely attributable to adverse development, plus a substantial reduction in premium collected since 2009 due to the competitive and soft workers' compensation market. The Company continues to make significant claim payments for policies with inception dates prior to 2009. Also contributing to the above negative operating cash flows are the Company's high ongoing operating fixed expenses in comparison to its low, but growing, premium volume. The Company has implemented a new business plan which forecasts a reverse of the negative cash flow trends in the future.

REINSURANCE

Assumed

With the exception of the Company's minor participation in the National Council on Compensation Insurance Pool, the Company did not assume reinsurance during the period under review.

Ceded

The Company's ceded reinsurance program provides protection for all business classified by the Company as workers' compensation and employers' liability. At year-end 2012, the Company maintained excess of loss reinsurance coverage for losses in excess of $5 million up to an aggregate amount of $20 million. The Company is solely responsible for any losses above $20 million. As of December 31, 2012, the Company maintained the following reinsurance arrangements:

Type of Contract	Reinsurer Name (authorized unless noted)	Company's Retention	Reinsurer Limit
First Excess of Loss	12.0% Atrium Syndicate 0609 9.5% Liberty Syndicate 4472 9.5% Chaucer Syndicate 1084 9.5% Brit Syndicate 2987 20.0% Faraday Syndicate 0435 9.5% Aspen Insurance UK Ltd 20.0% Hannover RK AG 10.0% Alterra Bermuda Limited (Unauthorized)	$5 million	$5 million each and every occurrence
Second Excess of Loss	12.0% Atrium Syndicate 0609 9.5% Liberty Syndicate 4472 9.5% Chaucer Syndicate 1084 9.5% Brit Syndicate 2987 10.0% Catlin U.S. (operating branch office Syndicate 2003) 9.5% Aspen Insurance UK Ltd 10.0% Endurance Specialty Ins LTD (Unauthorized) 10.0% Hannover RK AG 10.0% Odyssey Reinsurance Company 10.0% Alterra Bermuda Limited (Unauthorized)	$10 million	$10 million each and every occurrence

Facultative Reinsurance Agreement: The Company and Platte River Insurance Company (Platte River), a subsidiary of Alleghany Corporation, entered into a Facultative Reinsurance Agreement on December 1, 2012. The purpose of the agreement was to provide a facility whereby the Company would be able to take advantage of Platte River's A.M. Best "A" rating in the California marketplace. The agreement allowed the Company the use of a cut-through endorsement ("Endorsement") to provide workers' compensation insurance to certain insureds that required at least an "A" rating or better from A.M. Best. Under the terms of the agreement, Platte River would make payments on workers' compensation claims covered under policies bearing the Endorsement in the unlikely event the Company was financially unable to make such payments. Upon further review of the agreement, the Company concluded that the agreement should not be recorded as reinsurance or deposit accounting. Therefore, on December 27, 2012 it was determined that all consideration paid to Platte River should be expensed to other underwriting expenses when incurred. This agreement was subsequently terminated on July 18, 2013 due to the A.M. Best upgrade of the Company's financial strength rating to A- in the second quarter of 2013. During 2012, the Company paid Platte River $100,000.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2012

Underwriting and Investment Exhibit for the Year Ended December 31, 2012

Reconciliation of Surplus as Regards Policyholders from December 31, 2008 through December 31, 2012

Statement of Financial Condition
as of December 31, 2012

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 211,154,539	$	$ 211,154,539	(1)
Cash and short-term investments	21,595,196		21,595,196	
Investment income due and accrued	1,243,396		1,243,396	
Premiums and agents' balances in the course of collection	451,938	6,161	445,777	
Premiums, agents' balances and installments booked but deferred and not yet due (including $292,356 earned but unbilled premiums)	324,840	32,484	292,356	
Accrued retrospective premiums	199,100	75,773	123,327	
Current federal and foreign income tax recoverable and interest thereon	10,068,846		10,068,846	
Guaranty funds receivable or on deposit	3,065,028		3,065,028	
Electronic data processing equipment and software	2,516,803	2,516,803	0	
Furniture and equipment, including health care delivery assets	443,726	443,726	0	
Aggregate write-ins for other than invested assets	6,188,574	820,159	5,368,415	
Total assets	$ 257,251,986	$ 3,895,106	$ 253,356,880	

Liabilities, Surplus and Other Funds			
Losses and loss adjustment expenses		$ 128,395,172	(2)
Commissions payable, contingent commissions and other similar charges		308,842	
Other expenses		4,957,169	
Taxes, licenses and fees		447,352	
Unearned premiums		2,990,266	
Advance premium		114	
Funds held by company under reinsurance treaties		5,618,820	
Amounts withheld or retained by company for account of others		1,477,537	
Remittances and items not allocated		42,141	
Provision for reinsurance		14,005	
Payable to parent, subsidiaries and affiliates		2,417	
Aggregate write-ins for liabilities		182,279	
Total liabilities		144,436,114	
Common capital stock	$ 2,600,000		
Gross paid-in and contributed surplus	147,587,500		
Unassigned funds (surplus)	(41,266,734)		
Surplus as regards policyholders		108,920,766	
Total liabilities, surplus and other funds		$ 253,356,880	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2012

Statement of Income

Underwriting Income		
Premiums earned		$16,723,092
Deductions:		
Losses and loss expenses incurred	$ 19,822,673	
Other underwriting expenses incurred	27,865,181	
Total underwriting deductions		47,687,854
Net underwriting loss		(30,964,762)
Investment Income		
Net investment income earned	$ 3,769,971	
Net realized capital gain	267,273	
Net investment gain		4,037,244
Other Income		
Net loss from agents' or premium balances charged off	$ (55,833)	
Aggregate write-ins for miscellaneous income	(223,283)	
Total other losses		(279,116)
Net loss before federal income taxes		(27,206,634)
Federal income taxes		(10,277,254)
Net loss		$ (16,929,380)

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2011		$ 108,896,973
Net loss	$ (16,929,380)	
Change in nonadmitted assets	1,967,178	
Change in provision for reinsurance	(14,005)	
Surplus adjustments:		
Paid-in	15,000,000	
Change in surplus as regards policyholders for the year		23,793
Surplus as regards policyholders, December 31, 2012		$ 108,920,766

Reconciliation of Surplus as Regards Policyholders
from December 31, 2008 through December 31, 2012

Surplus as regards policyholders, December 31, 2008 per Examination			$ 75,197,386
	Gain in Surplus	Loss in Surplus	
Net loss	$	$ 31,163,092	
Net unrealized capital gains	1,278,760		
Change in net deferred income tax		20,539,033	
Change in nonadmitted assets	20,562,234		
Change in provision for reinsurance	13,584,511		
Surplus adjustments: Paid-in	50,000,000		
Total gains and losses	$ 85,425,505	$ 51,702,125	
Net increase in surplus as regards policyholders			33,723,380
Surplus as regards policyholders, December 31, 2012, per Examination			$ 108,920,766

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Workers' Compensation Deposit

California Insurance Code (CIC) Section 11691 states, in part, that an insurer writing workers' compensation business in the state of California must maintain a deposit with the State Treasurer to provide protection to the workers of the state in the event that it is unable to pay compensable workers' compensation claims when due.

During the review of the Company's loss and loss adjustment expense reserves as of December 31, 2012 performed by a California Department of Insurance (CDI) Actuary, it was determined that the Company had a $42 million gross reserve deficiency. With consideration given to this reserve deficiency, it is recommended that the Company recalculate its current workers' compensation deposit requirements.

(2) Losses and Loss Adjustment Expenses

Based on a review of the Company's loss and loss adjustment expense reserves by a Casualty Actuary from the CDI, the Company's reserves for loss and loss adjustment expenses were determined to be adequate by $5.3 million net of reinsurance; but deficient by $42 million gross of reinsurance as of December 31, 2012.

The net reserve redundancy as of December 31, 2012 consists of an estimated loss reserve redundancy of $5.2 million; an allocated loss adjustment expense reserve redundancy of $427,808; and an unallocated loss adjustment expense reserve deficiency of $369,632.

The gross reserve deficiency as of December 31, 2012 consists of an estimated loss reserve deficiency of $34.7 million; an allocated loss adjustment expenses reserve deficiency of $6.9 million; and an unallocated loss adjustment expense reserve deficiency of $369,632.

No examination adjustment was made to the Company's loss and loss adjustment expense reserves as of December 31, 2012.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Comments on Financial Statement Items – Workers' Compensation Deposit (Page 16): It is again recommended that the Company recalculate its workers' compensation deposit requirements.

Previous Report of Examination

Management and Control – Corporate Governance (Page 8): It was recommended that the board of directors implement revisions to any future performance driven plans to take into account the fact that it may take several years to determine ultimate losses for workers' compensation business in California. As such, it would be more prudent and reasonable to include provisions within such plans that a) require calculations of bonus payments on more developed estimates of losses and income, or b) allow the Company to recoup performance based incentive payments through some contractual mechanism (e.g., credits against future bonuses or "claw back") if it is later determined that the performance criteria were not achieved. It was also recommended that the incentive compensation calculation formula for the Company's actuary should be predicated upon the accuracy of reserves rather than underwriting results. The Company has complied with these recommendations.

Comments on Financial Statement Items – Workers' Compensation Deposit (Page 19): It was recommended that the Company recalculate its workers' compensation deposit requirements and fund any deficiencies. The Company complied with the previous examination recommendation; however, the workers' compensation deposit once again needs to be recalculated based on the current actuarial reserve review performed by the California Department of Insurance Actuary.

ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

________/S/________________
Sayaka T. Dillon, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California