REPORT OF EXAMINATION
OF THE

PACIFIC INSURANCE COMPANY

AS OF
DECEMBER 31, 2003

Participating State
and Zone:

California

Filed June 30, 2005

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Los Angeles, California
March 18, 2005

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition (EX4) 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

PACIFIC INSURANCE COMPANY

(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, 2001. This examination covers the period from January 1, 2002 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 including Continental Reinsurance Company and CNA Casualty of California 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 The Continental Insurance Company (CIC) intercompany pooling arrangement (Pool). Each participating affiliate in the CIC Pool had ceded 100% of its insurance business to CIC, which then retroceded the pooled insurance businesses, net of external reinsurance, 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. During the fourth quarter of 2003, the CIC Pool structure was commuted and replaced with separate 100% quota-share reinsurance agreements, effective January 1, 2003, between CIC and each of its Pool participants whereby CIC assumed the net underwriting activity in the former CIC Pool.

The following three reinsurance agreements were implemented in order to consolidate the net risks of the CIC Pool into CIC: (1) the commutation of the CIC Pool agreement effective January 1, 2003, (2) a 100% retroactive reinsurance agreement between CIC and each CIC Pool participant covering all direct in-force business as of December 31, 2002, and (3) a prospective 100% quota-share reinsurance agreement between CIC and each current CIC Pool participant effective January 1, 2003.

The final step in the reorganization plan encompassed a 100% quota-share reinsurance agreement between CIC and Continental Casualty Company (CCC), whereby the net underwriting risks residing in CIC are reinsured by CCC on a funds-held reinsurance basis effective January 1, 2003.

Approval to execute and implement the above referenced agreements was received from the California Department of Insurance on November 10, 2003.

As a result of this transaction, all balances currently assumed and ceded under the previously existing CIC Pool agreement were reversed, and transactions reflecting the execution of the new quota-share reinsurance agreements were recorded retroactive to January 1, 2003. Under the new quota-share reinsurance agreements, the former CIC Pool participants cede all in-force business, including outstanding loss reserves, and prospective underwriting activity to CIC, prior to external reinsurance.

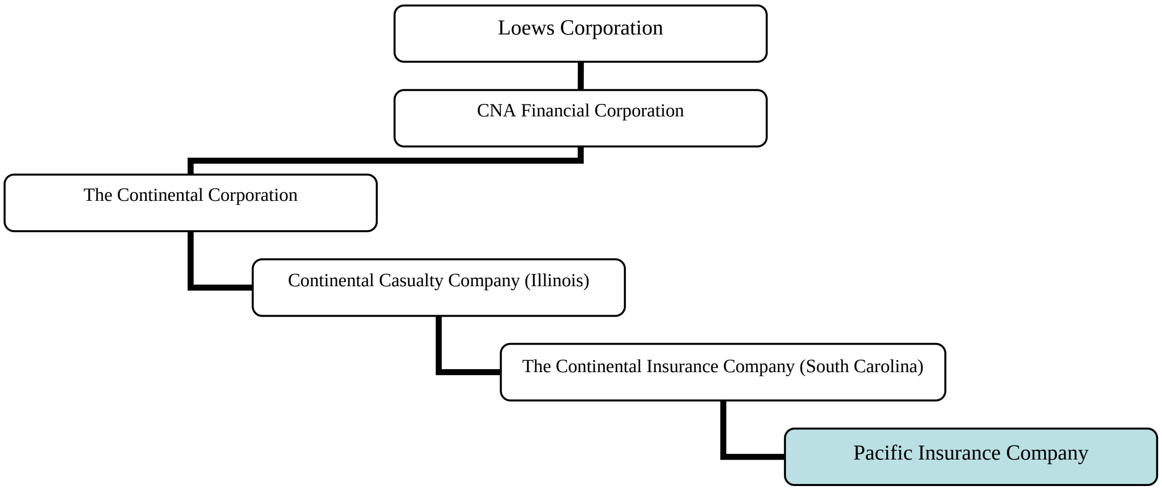
Effective January 1, 2005, the Company's state of domicile was changed from California to Illinois.

MANAGEMENT AND CONTROL

As of December 31, 2003, the Company was a wholly-owned subsidiary of Continental Casualty Company (CCC), an insurance company domiciled in Illinois. Effective June 30, 2004, CCC contributed to its directly owned subsidiary, The Continental Insurance Company (South Carolina), all outstanding Company shares. 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 June 30, 2004:



Management of the Company is vested in a five-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
Stephen W. Lilienthal North Barrington, Illinois	Chief Executive Officer and President Continental Casualty Company
Robert L. McGinnis** Highland Park, Illinois	President and Chief Executive Officer CNA Life and Group Operations Continental Casualty Company
Thomas Pontarelli Glenview, Illinois	Executive Vice President – Human Resources and Corporate Services Continental Casualty Company

Principal Officers

Name	Title
Stephen W. Lilienthal	Chief Executive Officer and President
Dennis R. Hemme	Vice President and Treasurer
Jonathan D. Kantor	Executive Vice President, Secretary and General Counsel
Robert V. Deutsch	Executive Vice President and Chief Financial Officer

* resigned 10/22/04
** resigned 04/07/04

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

As of December 31, 2001, the Company was licensed to transact multiple lines of business in the states of California and New York. It operates on a surplus lines or nonadmitted basis in the District of Columbia and all states except Alaska. Underwriting activities are limited to other liability and medical malpractice coverages. In 2003, the Company wrote $861,675 of direct premiums. None of the direct premiums pertained to California risks.

REINSURANCE

Assumed

The Company does not assume reinsurance.

Ceded

In conjunction with the previously referenced reorganization plan, the Company along with all other former members of the CIC Pool cede all in-force business, including outstanding loss reserves, and prospective underwriting activity to The Continental Insurance 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, 2001 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	$ 38,091,898	$	$ 38,091,898	
Cash and short-term investments	849,269		849,269	
Receivable for securities	3,398		3,398	
Interest income due and accrued	159,794		159,794	
Net deferred tax asset	29,403,580	28,834,524	569,056	
Receivable from parent, subsidiaries and affiliates	2,156,875		2,156,875	
Total assets	$ 70,664,814	$ 28,834,524	$ 41,830,290	
Liabilities, Surplus and Other Funds				
Losses and loss adjustment expenses			$ -0-	(1)
Remittances and items not allocated			(3,630)	
Payable to parent, subsidiaries and affiliates			9,331	
Aggregate write-ins for liabilities			95,587	
Total liabilities			101,288	
Common capital stock		$ 4,500,000		
Gross paid-in and contributed surplus		7,667,471		
Unassigned funds (surplus)		29,561,531		
Surplus as regards policyholders			41,729,002	
Total liabilities, surplus and other funds			$ 41,830,290	

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

Statement of Income

Investment Income

Net investment income earned	$ 3,095,575	
Net realized capital gains	3,649,358	
Net investment gain		6,744,933
Net income		$ 6,744,933

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2002		$ 32,690,566
Net income	$ 6,744,933	
Change in net unrealized capital losses	(728,433)	
Change in net unrealized foreign exchange capital losses	(535,923)	
Change in net deferred income tax	(2,058,349)	
Change in nonadmitted assets	2,487,648	
Change in provision for reinsurance	1,992,538	
Aggregate write-ins for gains in surplus	1,136,022	
Change in surplus as regards policyholders		9,038,436
Surplus as regards policyholders, December 31, 2003		$ 41,729,002

Reconciliation of Surplus as Regards Policyholders
from December 31, 2001 through December 31, 2003

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2001, per Examination			$ (853,174)
Net income	$ 31,110,404	$	
Net unrealized capital losses		902,774	
Change in net unrealized foreign exchange capital gain	278,747		
Change in net deferred income tax	20,263,959		
Change in nonadmitted assets		13,043,157	
Change in provision for reinsurance	3,674,816		
Aggregate write-ins for gains in surplus	1,200,180		
Totals	$ 56,528,106	$ 13,945,931	
Net increase in surplus as regards policyholders			42,582,175
Surplus as regards policyholders, December 31, 2003, per Examination			$ 41,729,001

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 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 results of which are described in detail below, 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 9): It was recommended that the Company implement procedures in its board meetings to ensure compliance with California Insurance Code (CIC) Section 735. The recommendation has been implemented.

Accounts and Records (Page 11): It was recommended that the Company maintain documentation to support all financial statement accounts. During the course of the current examination, the procurement of sufficient documentation to support account balances 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