REPORT OF EXAMINATION
OF THE

SUPERIOR PACIFIC CASUALTY COMPANY

AS OF
DECEMBER 31, 1999

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Los Angeles, California
March 1, 2000

Honorable Alfred W. Gross
Chair, Financial Condition (EX4)
Subcommittee
Commissioner of Insurance
Virginia Department of Insurance
Richmond, Virginia

Honorable Chuck Quackenbush
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chair and Commissioner:

Pursuant to your instructions, an examination was made of the

SUPERIOR PACIFIC CASUALTY COMPANY

at its home office located at 26541 Agoura Road, Calabasas, California 91302.

SCOPE OF EXAMINATION

This was a limited scope examination as of December 31, 1999. The only financial numbers analyzed were losses and loss adjustment expenses. Based on a loss and loss adjustment expense reserve analysis conducted by Ernst & Young LLP (E&Y), the Company's independent consulting actuary, the loss and loss adjustment expense reserves used for this Report of Examination were those amounts representing E&Y's selected ultimates. This examination also included a review of the status of the reinsurance ceded contract with United States Life Insurance Company, a review of the purchase of the Business Insurance Group made by Superior National Insurance Group, Inc. in 1998, a review of principal directors and officers, and a review of jurisdictions in which the Company is licensed.

INSOLVENCY

This examination determined that the surplus as regards policyholders of the Company as of December 31, 1999 is a negative $58,501,000 as a result of examination adjustments to the loss and loss adjustment expense reserves. This financial condition meets the definition of insolvency per California Insurance Code Section 985.

COMPANY HISTORY

Acquisition of Pac Rim Holding Corporation

In April 1997, Superior National Insurance Group (SNIG) acquired Pac Rim Holding Corporation (Pac Rim), the parent company of Pacific Rim Assurance Company, subsequently renamed Superior Pacific Casualty Company (SPCC). The acquisition was delayed in December 1996 when Pac Rim revealed its reserves were being challenged by the California Department of Insurance. In February 1997, the purchase price was renegotiated down from a range of $3.00 - $3.10 per share to $2.105 per share. The net effect of this adjustment was to reduce Pac Rim equity from approximately $26 million to $19 million. This represents a purchase price of 1.6 times the equity of Pac Rim.

SNIG paid $42 million for all of the outstanding stock of Pac Rim. It consisted of $20 million in cash to Pac Rim common stockholders, $20 million in convertible debentures, and $2 million to warrant and option holders. SNIG issued $105 million of Trust Issued Preferred Equity Securities (TIPES). The proceeds were used to prepay the $41 million unamortized Pac Rim acquisition bank debt and the $28 million preferred stock outstanding with Centre Re. There were $4 million in transaction fees and SNIG contributed $15,000,000 to the Company. This transaction was approved by the California Department of Insurance in 1997.

In connection with the acquisition of SPCC, SNIG agreed with the California Department of Insurance that SPCC would operate in “runoff” and that all new or renewal business would be written in Superior National Insurance Company.

Acquisition of Business Insurance Group, Inc. by Superior National Insurance Group, Inc.

Superior National Insurance Group, Inc. (SNIG) entered into a Purchase Agreement dated May 5, 1998 with Foundation Health Corporation (FHC) under which SNIG would purchase from FHC all of the shares of Business Insurance Group, Inc.(BIG), and by that means, the ownership of its insurance subsidiaries, Business Insurance Company (BICO), Combined Benefits Insurance Company (CBIC), Commercial Compensation Insurance Company (CCIC), and California Compensation Insurance Company (CalComp).

Prior to the closing, FHC agreed to cause the seller subsidiaries (BIG, BICO, CBIC, CCIC and CalComp) to purchase $150,000,000 of adverse development protections on loss and allocated loss adjustment expense reserves for claims occurring on or before December 31, 1997. Within 60 days of the date of the agreement, SNIG may request, in writing, and, if requested, FHC agreed to cause the seller subsidiaries to increase the amount of reinsurance cover by $25,000,000 for losses occurring on or prior to that portion of the 1998 accident year commencing January 1, 1998 and including June 30, 1998, in exchange for a $5,000,000 increase in the purchase price. The option was exercised by SNIG. The sale was contingent on the purchase of the aggregate excess of loss agreement with Inter-Ocean Reinsurance Company, Ltd.

Prior to the closing, Business Insurance Group, Inc. dividended or caused to be distributed, all of the capital stock of Foundation Health Resource Management (d.b.a. Reviewco), Foundation Integrated Risk Management Solutions, Incorporated (d.b.a. FIRM Solutions), and Axis Integrated Resources, Inc.

As part of the closing, SNIG and BIG agreed to enter into a long-term service agreement for medical bill review, PPO utilization and certain managed care services. They also agreed to enter into a long-term service agreement with FIRM Solutions for claim negotiation and review services. In addition, they agreed to enter into a long-term service agreement with Axis Integrated Resources, Inc. for recruitment of employees and placement of temporary workers services. SNIG and BIG agreed to enter into an agreement with Foundation Health Systems, Inc. (FHS) setting forth the terms of the transitional services.

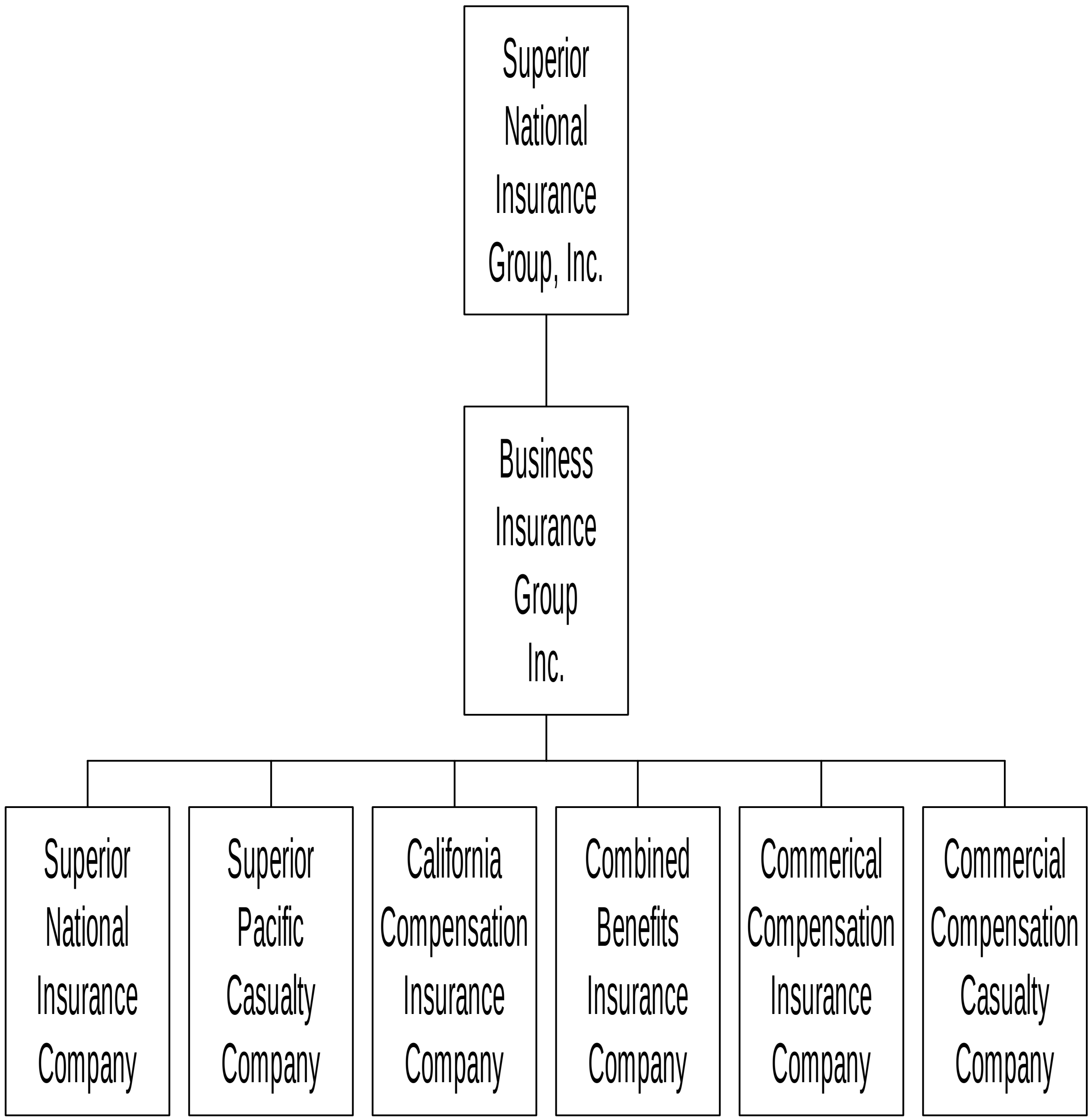
Upon execution of this purchase agreement, FHC agreed that SNIG may place certain senior executives (Interim Consulting Team) in interim consulting positions at BIG and its insurance subsidiaries. FHC agreed to cause BIG and its insurance subsidiaries to take, or not take, such actions as the Interim Consulting Team may reasonably direct with respect to (1) the strategy and execution of the insurance subsidiaries' underwriting, reinsurance, claims handling and other operational functions and (2) the restructuring of certain asset positions.

The purchase price was $285,000,000 less the cost of the reinsurance agreement described above.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which Superior National Insurance Group, Inc. is the ultimate parent. The immediate parent of the Company is Business Insurance Group, Inc. which is a wholly owned subsidiary of Superior National Insurance Group, Inc. The following abridged organization chart shows the relationships between the Company and its insurance company affiliates under the holding company system:

Superior National Insurance Group Insurance Company Subsidiaries



The following are the principal directors and officers of the Company:

Directors

Name and Residence	Principal Business Affiliation
Bradley E. Cooper New York, New York	Senior Vice President of Capital Z Management, Inc. and Partner of Insurance Partners, Inc.
William L. Gentz Encino, California	Chairman of the Board Superior National Insurance Group, Inc.
Steven D. Germain New York, New York	Director Zurich Centre Group, LLC
Roger W. Gilbert Newport Beach, California	Managing Partner of Insurance Partners Advisors, L. P.
Steven B. Gruber Scarsdale, New York	Insurance Partners, LP
Arnold J. Senter Bell Canyon, California	Executive Vice President Superior National Insurance Group, Inc.
Gordon E. Noble Tiburon, California	Chairman and Chief Executive Officer Noble & Associates
Charles L. Pecchenino (1) Gig Harbor, Washington	Former Chairman of the Board Superior National Insurance Group, Inc.
Craig F. Schwarberg Mission Hills, Kansas	Retired
J. Chris Seaman Oak Park, California	President Superior National Insurance Group, Inc.
Robert A. Spass Westfield, New Jersey	Deputy Chairman of the Board of Capital Z Management, Inc. and Capital Z Partners, Ltd., Managing Partner of Insurance Partners Advisors, L.P.

(1) resigned December 1999; not replaced to date

Officers

Name	Title
William L. Gentz	Chairman of the Board
J. Chris Seaman	President and Chief Executive Officer
Arnold J. Senter	Executive Vice President, Chief Operating Officer
Thomas I. Boggs, Jr.	Senior Vice President, Chief Underwriting Officer
James L. Cinney	Senior Vice President, Administration
R. Scott Holman	Senior Vice President, Regional Manager – Woodland Hills
Karl O. Johnson	Senior Vice President, Regional Manager - Fresno
Robert E. Nagle	Senior Vice President, General Counsel, and Secretary
Robert J. Nieber	Senior Vice President, Regional Manager, Pleasanton
Douglas R. Roche	Senior Vice President, Management Information Systems
Theresa A. Sealy	Senior Vice President, California Operations Officer
Edward C. Shoop	Senior Vice President, Chief Actuary
Ronald J. Tonani	Senior Vice President, Marketing
Stephen J. Weiss	Senior Vice President, National Operations Officer
Doris K. Lai	Vice President, Finance and Treasurer

TERRITORY AND PLAN OF OPERATION

The Company is licensed as a multiple lines insurer in Alabama, Arizona, California, Georgia, South Dakota, and Texas. Direct business is only written in Arizona.

REINSURANCE

Intercompany Pooling Agreement Effective December 31, 1998:

Effective December 31, 1998, California Compensation Insurance Company (CalComp), Combined Benefits Insurance Company (CBIC), Commercial Compensation Insurance Company (CCIC), Superior National Insurance Company (SNIC), and Superior Pacific Casualty Company (SPCC) entered into a Restated and Amended Intercompany Pooling Agreement. The lines of business covered under this pooling agreement include all workers' compensation insurance policies, certificates, insurance contracts and reinsurance issued, written or assumed (other than reinsurance under this agreement, reinsurance of any accident and health/disability insurance policies, or any Arizona business ceded to SNIC by Business Insurance Company), by the parties thereto, for occurrences taking place January 1, 1995 and subsequent. Occurrences prior to January 1, 1995 are not included as insurance, and remain on the books of the respective company.

The effective percentages as of December 31, 1998 are shown as follows:

Company	Percent
California Compensation Insurance Company	62.0
Combined Benefits Insurance Company	2.0
Commercial Compensation Insurance Company	2.0
Superior National Insurance Company	22.0
Superior Pacific Casualty Company	12.0
Total	100.0

At December 31, 1999, the pooling participation percentages had been changed to the following:

Company	Percent
California Compensation Insurance Company	63.9
Combined Benefits Insurance Company	1.2
Commercial Compensation Insurance Company	0.9
Superior National Insurance Company	22.0
Superior Pacific Casualty Company	12.0
Total	100.0

The applicable percentage for CalComp is defined in the agreement as 100% less the designated percentages of CBIC, CCIC, SNIC, and SPCC. The agreement allows the applicable percentages to be recomputed and revised at the discretion of CalComp, except that a change of 5% or more for CCIC can not be effective without the prior written approval of the New York Department of Insurance. At CalComp's discretion, any revision of the applicable percentages may be effective as of December 31 of the preceding year.

Under the agreement, CBIC, CCIC, SNIC, and SPCC cede to CalComp all losses and expenses incurred under all policies to which this agreement applies, and CalComp retrocedes to CBIC, CCIC, SNIC, and SPCC their applicable percentage of the pooled business.

With respect to the liability balance as of December 31, 1998, consisting of unearned premium reserve, general and other acquisition underwriting reserves, and the loss and loss adjustment expense reserves for claims with an accident date of January 1, 1995 and subsequent, the agreement provides for a portfolio transfer by CBIC, CCIC, SNIC, and SPCC, and recorded by CalComp.

This contract was submitted to the California Department of Insurance pursuant to California Insurance Code Section 1215.5.

Quota Share Treaty with United States Life Insurance Company (New York):

The SNIG and BIG companies entered into a multi-year quota share treaty with United States Life Insurance Company (US Life) to be effective May 1, 1998. The treaty was executed on November 13, 1998. For the purposes of the above quota share treaty, the Superior National Insurance Group (SNIG) collectively refers to Superior National Insurance Company (SNIC) and Superior Pacific Casualty Company (SPCC). Similarly, the Business Insurance Group (BIG) collectively refers to California Compensation Insurance Company (Calcomp), Combined Benefits Insurance Company (CBIC), Commercial Compensation Insurance Company (CCIC) and Business Insurance Company (since renamed Centre Insurance Company).

The class of business reinsured was workers' compensation insurance and subject business is further defined as "large account business". The term large account business for the purposes of this treaty shall mean:

(1) Ceded policies of BIG generating an estimated annualized premium volume of $25,000 or greater;

(2) Ceded policies of SNIG during the period May 1, 1998, through February 1, 1999, generating an estimated annualized premium volume of $25,000 or greater but not exceeding $100,000; and

(3) Ceded policies of SNIG issued or renewed on or after February 1, 1999 and generating an estimated annualized premium volume of $25,000 or greater.

The term of the treaty covers five contract years and shall remain in force until January 1, 2003, however, at the sole option of US Life the treaty may be terminated at January 1, 2001 or January 1, 2002 (i.e., three years fixed with a two-year option). Also, at the sole option of US Life, the term of the contract may be extended for an additional two years (resulting in seven contract years in total). If the treaty is terminated, a runoff of policies inforce and claims obligations is applicable. WEB Management LLC acted as the broker on behalf of US Life and E.W. Blanch Co. is named as intermediary.

As respects business subject to this treaty, SNIG and BIG shall retain and be liable for a percentage of their net liability as set forth below:

Contract Year	Cession	Retention
First contract year	100%	0%
Second contract year	93%	7%
Third contract year	87%	13%
Fourth contract year	0% to 80%	20% to 100%
Fifth contract year	0% to 73%	27% to 100%

Article V, Section F of the treaty specifies SNIG and BIG shall purchase or be deemed to have purchased inuring reinsurance to limit its loss subject hereto from any one occurrence to $500,000. Our examination indicated that SNIG and BIG were party to a per occurrence excess of loss treaty effective May 1, 1998 with Trustmark Life Insurance Company (Illinois) ceding $4.5 million in excess of $500,000. However, Trustmark subsequently has disputed this treaty, desires to rescind or commute and has requested arbitration.

The following schedule depicts the Group's stated reinsurance premiums ceded to US Life via this treaty (inception through December 31, 1999):

		Ceded premiums
SNIG		$127,815,329
BIG		$538,009,502
	Total	$665,824,831

Material Contingency:

On November 24, 1999, US Life refused to recognize or receive payment of reinsurance premiums for this treaty from SNIG and BIG.

On November 29, 1999, SNIG and BIG were notified in writing that US Life demands arbitration against them on the above quota share treaty. US Life in arbitration will seek relief including, but not limited to, rescission or reformation of the treaty and damages.

The outcome of the arbitration of this quota share treaty with US Life is material to SNIG and BIG. Because of the adverse loss experience that has occurred on the subject business, a rescission or a retroactive termination of this treaty will cause a material additional reduction in SNIG's and BIG's policyholders surplus. It is anticipated that the arbitration process may well exceed one year.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 1999;

Underwriting and Investment Exhibit for the Year Ended December 31, 1999;

Reconciliation of Examination Changes as of December 31, 1999.

Statement of Financial Condition
as of December 31, 1999
(Amounts in Thousands)

Assets		Net Admitted Assets	Notes
Bonds		$ 55,833	
Stocks		(273)	
Cash and short-term investments		1,227	
Agents' balances or uncollected premiums		3,325	
Funds held by or deposited with reinsured companies		16,008	
Reinsurance recoverables on loss and loss adjustment expense payments		1,104	
Interest, dividends and real estate income due and accrued		492	
Receivable from parent, subsidiaries and affiliates		4,192	
Aggregate write-ins for other than invested assets		-0-	
Total assets		$ 81,908	

Liabilities, Surplus and Other Funds			
Losses and loss adjustment expenses		$ 72,151	(1)
Contingent commissions and other similar charges		138	
Other expenses		6,031	
Taxes, licenses and fees		348	
Unearned premiums		3,932	
Dividends to policyholders declared and unpaid		27	
Funds held by company under reinsurance treaties		96	
Amounts withheld or retained by company for account of others		132	
Payable to parent, subsidiaries and affiliates		57,513	
Aggregate write-ins for liabilities		41	
Total liabilities		140,409	
Common capital stock	$ 3,100		
Gross paid-in and contributed surplus	23,552		
Unassigned funds (surplus)	(85,153)		
Surplus as regards policyholders		(58,501)	
Total liabilities, surplus and other funds		$ 81,908	

Underwriting and Investment Exhibit
for the Year Ended December 31, 1999
(Amounts in Thousands)

Statement of Income

Underwriting Income

Premiums earned		$ 28,280
Deductions:		
Losses incurred and loss expenses incurred	$105,782	
Other underwriting expenses incurred	2,515	
Total underwriting deductions		108,297
Net underwriting (loss)		(80,017)

Investment Income

Net investment income earned	$ 4,235	
Net realized capital gains	(251)	
Net investment gain		3,984

Other Income

Net loss from agents' or other premium balances charged off	$ (4,588)	
Total other income		(4,588)
Net income loss before dividends to policyholders and federal income taxes		(80,621)
Federal income taxes incurred		1,300
Net loss		$(81,921)

Reconciliation of Examination Changes
as of December 31, 1999
(Thousands of Dollars)

	Per Company	Per Examination	Surplus Increase (Decrease)	Notes
Losses and Loss Adjustment Expenses	$20,331	$72,151	$(51,820)	(1)
Increase (Decrease) in surplus as regards policyholders			(51,820)	
Surplus as regards policyholders, Per Company			(6,681)	
Surplus as regards policyholders, Per Examination			$(58,501)	

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

This examination increased the Company's reserve for losses and loss adjustment expenses by $51,820,000. The examination conclusion is based on a loss and loss adjustment expense reserve analysis performed by Ernst & Young LLP, the Company's consulting actuary, and further supported by a separate loss and loss adjustment expense reserve analysis performed by the California Department of Insurance.

The Company pools its loss and loss adjustment expenses with its affiliated companies, Combined Benefits Insurance Company, Commercial Compensation Insurance Company, Superior National Insurance Company and California Compensation Insurance Company. The pooling percentages as of December 31, 1999 are shown as follows:

Company	Percent	Examination Loss and Loss Adjustment Expense Reserve Increase (Thousands)
California Compensation Insurance Company	63.9	$230,804
Combined Benefits Insurance Company	1.2	3,909
Commercial Compensation Insurance Company	0.9	3,305
Superior National Insurance Company	22.0	121,426
Superior Pacific Casualty Company	12.0	51,820
Total	100.0	$411,264

Actuarial analysis was made for the entire pool as a whole, and applicable participation percentages were allocated to each company.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Insolvency (Page 1): This examination determined that the surplus as regards policyholders of the Company as of December 31, 1999 (after adjustment of losses and loss adjustment expenses is a negative $58,501,000. This financial condition meets the definition of insolvency shown in California Insurance Code Section 985.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the officers and employees of the Company during the course of this examination is acknowledged.

Sincerely,

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Ronald M. Redholtz, CFE
Examiner-in-Charge
Senior Insurance Examiner
Department of Insurance
State of California