

REPORT ON EXAMINATION  
OF THE  
TRANSCONTINENTAL INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2003

DATE OF REPORT

DECEMBER 21, 2005

EXAMINER

PATRICK WHITE

## TABLE OF CONTENTS

| <u>ITEM</u>                                    | <u>PAGE NO.</u> |
|--|-----------------|
| 1. Scope of examination                        | 2               |
| 2. Description of Company                      | 3               |
| A. Management                                  | 3               |
| B. Territory and plan of operation             | 5               |
| C. Reinsurance                                 | 8               |
| D. Holding company system                      | 10              |
| E. Significant operating ratios                | 13              |
| F. Abandoned property law                      | 14              |
| G. Accounts and records                        | 14              |
| 3. Financial statements                        | 20              |
| A. Balance Sheet                               | 20              |
| B. Underwriting and investment exhibit         | 22              |
| C. Capital and surplus account                 | 23              |
| 4. Losses and loss adjustment expenses         | 24              |
| 5. Market conduct activities                   | 26              |
| 6. Compliance with prior report on examination | 28              |
| 7. Summary of comments and recommendations     | 33              |
| Appendix A                                     |                 |



STATE OF NEW YORK  
INSURANCE DEPARTMENT  
25 BEAVER STREET  
NEW YORK, NEW YORK 10004

December 21, 2005

Honorable Howard Mills  
Superintendent of Insurance  
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 22346 dated March 10, 2005, attached hereto, I have made an examination into the condition and affairs of the Transcontinental Insurance Company as of December 31, 2003, and submit the following report thereon.

Wherever the designations "the Company" or "TIC" appear herein without qualification, they should be understood to indicate the Transcontinental Insurance Company.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York Insurance Department.

The examination was conducted at the Company's administrative offices located at CNA Plaza, Chicago, Illinois, 60685.

## **1. SCOPE OF EXAMINATION**

The previous examination was conducted as of December 31, 1998. This examination covered the five-year period from January 1, 1999 through December 31, 2003. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination comprised a complete verification of assets and liabilities as of December 31, 2003. The examination included a review of income, disbursements and company records deemed necessary to accomplish such analysis or verification and utilized, to the extent considered appropriate, work performed by the Company's independent certified public accountants. A review or audit was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners ("NAIC"):

- History of Company
- Management and control
- Corporate records
- Fidelity bonds and other insurance
- Territory and plan of operation
- Growth of company
- Business in force by states
- Reinsurance accounts and records
- Financial statements
- Market conduct activities

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

This report on examination is confined to financial statements and comments on those matters which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

## 2. DESCRIPTION OF COMPANY

The Company was incorporated on August 21, 1925 under the laws of New York. It commenced business on November 1, 1925. Franklin National Insurance Company of New York and United National Indemnity Company were merged with and into the Transcontinental Insurance Company as of the close of business December 31, 1955. On March 8, 1994, Transcontinental increased its paid in capital from \$3,000,000, consisting of 300,000 shares at \$10 par value per share, to \$4,200,000, consisting of 420,000 shares at \$10 par value per share.

### A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than thirteen members. As of the examination date, the board of directors was comprised of twelve members and one director resigning on December 31, 2003. It is noted that the Company filled the vacancy on the board before the next quarterly statement date. The board met four times during each calendar year for the period under examination.

The directors as of December 31, 2003, were as follows:

| <u>Name and Residence</u>         | <u>Principal Business Affiliation</u>                                      |
|-----------------------------------|--|
| Heather E. Davis<br>Flossmoor, IL | Vice President, Government Relations,<br>CNA Insurance Companies           |
| Michael Fusco<br>Woodbury, NY     | Executive Vice President, Chief Actuary,<br>CNA Insurance Companies        |
| Michael T. Gengler<br>Chicago, IL | Senior Vice President & Deputy General Counsel,<br>CNA Insurance Companies |
| Lynne Gugenheim<br>Chicago, IL    | Senior Vice President & Deputy General Counsel,<br>CNA Insurance Companies |

| <u>Name and Residence</u>                 | <u>Principal Business Affiliation</u>   |
|---|---|
| Richard A. Kaminsky<br>Evanston, IL       | Vice President & Associate General Counsel,<br>CNA Insurance Companies                      |
| Jonathan D. Kantor<br>Scarsdale, NY       | Executive Vice President, General Counsel<br>& Secretary,<br>CNA Financial Corporation      |
| Robert M. Mann<br>Highland Park, IL       | Senior Vice President,<br>CNA Financial Corporation   |
| James J. Morris<br>Wilmette, IL           | Vice President, Assistant Secretary &<br>Assoc. General Counsel,<br>CNA Insurance Companies |
| Mary A. Ribikawskis<br>Bartlett, IL       | Assistant Vice President & Assistant<br>Corporate Secretary,<br>CNA Insurance Companies     |
| Daniel F. Schmitt<br>Rockville Center, NY | Vice President, Underwriting,<br>CNA Insurance Companies                                    |
| Michael J. Sehr<br>Evanston, IL           | Senior Vice President & Deputy General<br>Counsel,<br>CNA Insurance Companies               |
| Thomas P. Stillman<br>Chicago, IL         | Senior Vice President & Deputy General<br>Counsel,<br>CNA Insurance Companies               |

The minutes of all of the board of directors' meetings held during the examination period were reviewed. The boards of directors' meetings were generally well attended.

At December 31, 2003, the principal officers of the Company were:

| <u>Officer</u>        | <u>Title</u>   |
|-----------------------|--|
| Jonathan D. Kantor    | Chairman of the Board, Secretary and General Counsel President |
| Dennis R. Hemme       | Vice President and Treasurer                                   |
| Mary A. Ribikawskis   | Assistant Vice President and Secretary                         |
| Robert V. Deutsch     | Executive Vice President, Chief Financial Officer              |
| Michael Fusco         | Executive Vice President                                       |
| John P. Golden        | Executive Vice President, Chief Information Officer            |
| Dean K. Harring       | Executive Vice President, Claims                               |
| Robert V. James       | Executive Vice President, U.S. Insurance Operations            |
| James R. Lewis        | President and CEO, Property & Casualty Operations              |
| Stephen W. Lilienthal | Executive Vice President, Chief Operating Officer              |
| Robert L. McGinnis    | President and CEO, CNA Life & Group Operations                 |
| Thomas Pontarelli     | Executive Vice President, Human Resources & Corp. Services     |
| Peter W. Wilson       | Executive Vice President, Global Specialty Operations          |

#### B. Territory and Plan of Operation

As of December 31, 2003, the Company was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

| <u>Paragraph</u> | <u>Kind of Insurance</u>                       |
|------------------|--|
| 3                | Accident and health                            |
| 4                | Fire   |
| 5                | Miscellaneous property damage                  |
| 6                | Water damage                                   |
| 7                | Burglary and theft                             |
| 8                | Glass  |
| 9                | Boiler and machinery                           |
| 10               | Elevator                                       |
| 11               | Animal   |
| 12               | Collision                                      |
| 13               | Personal injury liability                      |
| 14               | Property damage liability                      |
| 15               | Workers' compensation and employers' liability |
| 16               | Fidelity and surety                            |
| 17               | Credit   |
| 19               | Motor vehicle and aircraft physical damage     |
| 20               | Marine and inland marine                       |
| 21               | Marine protection and indemnity                |
| 22               | Residual value                                 |

The Company was also licensed as of December 31, 2003, to transact such workers' compensation insurance as may be incidental to coverages contemplated under paragraphs 20 and 21 of Section 1113(a) New York Insurance Law, including insurances described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69<sup>th</sup> Congress, as amended; 33 USC Section 901 et seq. as amended).

Based upon the lines of business for which the Company is licensed, and the Company's current capital structure, and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$4,200,000.

The Company is licensed in the District of Columbia, Puerto Rico, and all fifty states. The following schedule compares direct premiums written during the examination period in New York State with the total direct premiums written in the United States, including Puerto Rico:

| Calendar<br>Year | <u>DIRECT PREMIUMS WRITTEN (000's)</u> |                            |  |
|------------------|--|----------------------------|--|
|                  | <u>New York State</u>                  | <u>Total United States</u> | <u>Premiums Written in NY<br/>State as a percentage of<br/>Total US Premiums</u> |
| 1999             | \$206,747                              | \$1,280,346                | 16.1%  |
| 2000             | \$161,801                              | \$1,056,653                | 15.3%  |
| 2001             | \$97,156                               | \$970,286                  | 10.0%  |
| 2002             | \$55,673                               | \$679,296                  | 8.1%   |
| 2003             | \$53,169                               | \$549,552                  | 9.6%   |

The Company's predominant lines of business were commercial multiple peril and workers' compensation, which accounted for 44.32% and 23.58%, respectively of the Company's 2003 direct written business. Business is produced by independent agents and agents with delegated underwriting authority.

During 2002, CNA Insurance Group ("CNA") began the process of streamlining its United States property and casualty insurance entity structure. CNA has been conducting research and investigating ways to

create a simpler, more efficient organization. By the end of 2004, CNA currently plans to complete the process of re-evaluating its business needs to determine an optimum insurance company count. Over the next few years, CNA plans to continue the process of re-domesticating its core U.S. property and casualty insurance companies into a total of three states (down from fourteen) and to prepare for the merger of redundant companies.

Also, during 2002, and in conjunction with the execution of this plan, CNA restructured the Continental Casualty Company group of companies by establishing Continental Casualty Company as the net risk bearer for the group. This was accomplished through the commutation of the former inter-company reinsurance pool agreement and the establishment of individual reinsurance contracts and quota share treaties between Continental Casualty Company and each of the former inter-company reinsurance pool members.

CNA also accomplished the same type of restructuring for the Continental Insurance Company group of companies. CNA commuted the restated inter-company pooling agreement, effective January 1, 2001, replacing it with individual reinsurance contracts and quota share treaties between the Continental Insurance Company and each of the current inter-company reinsurance pool members. These agreements are very similar to the ones used to restructure the former Continental Casualty Company inter-company reinsurance pool, as well as the agreements used in 2001 to de-pool the former members of the Continental Insurance Company inter-company reinsurance pool.

CNA has put in place a reinsurance contract between the Continental Insurance Company and Continental Casualty Company, through which Continental Casualty Company reinsures 100% of the business of the Continental Insurance Company. These actions establish Continental Casualty Company as the net risk bearer of nearly the entire U.S. property and casualty insurance operations of CNA.

### C. Reinsurance

#### (i) Inter-Company Reinsurance Pooling Agreement

Prior to January 1, 2002, the Company was a party to an inter-company reinsurance pooling agreement with Continental Casualty Company (“CCC”), an affiliate, and other property and casualty companies in the CNA Insurance Group. The agreement provided for the companies to cede 100% of its gross premiums written, gross losses paid, expenses paid (other than investment expenses, corporate expenses and federal or foreign income taxes), retrospective payments and underwriting assets and liabilities to CCC. CCC obtained the external reinsurance and distributed the net retained liability and net underwriting assets and liabilities to the companies of the CCC Pool based upon their participation percentages.

Effective January 1, 2002, the Company entered into a new inter-company reinsurance pooling agreement with CCC. Under the terms of the agreement all new business written on or after January 1, 2002, by the members of the CCC Pool will be ceded 100% to the CCC Pool. The old business written and in force on or prior to December 31, 2001, along with the underlying reserves, was commuted and the obligations were reinsured 100% by CCC. Transcontinental Insurance Company has obtained the necessary regulatory approval to participate in the CNA reinsurance pooling agreement.

#### (ii) Finite Reinsurance

From 1999-2002, CCC, on behalf of the pool, purchased thirty-five finite reinsurance contracts. The contracts all include a funds held provision where the fund balance is usually the ceded premiums plus interest less loss payments, less the experience (margin) account. Interest is explicit in the pricing of the contract. The funds held provide the funding for losses incurred on the contracts. The CCC’s two largest finite reinsurance contracts representing 58% of the unpaid ceded loss reserves and 56% of the funds withheld balances at December 31, 2003, were reviewed and were found to transfer risk after extensive analysis by the Illinois

Division of Insurance's consultant actuary, a nationally recognized actuarial consulting firm and the Casualty Actuarial Section of the Illinois Division of Insurance.

Pursuant to the above, CNA reported the following in its Security Exchange Commission ("SEC") 10-K filing for the year ended December 31, 2004:

"The amount subject to interest crediting on these funds withheld contracts will vary over time based on a number of factors, including the timing of loss payments and ultimate gross losses incurred. The Company expects that it will continue to incur significant interest costs on these contracts for several years".

In addition the Company reported the following comment regarding interest charges on its finite reinsurance treaties in its SEC 10-K filing for the year ended December 31, 2004:

"...Interest cost on funds withheld and other deposits is credited during all periods in which a funds withheld liability exists. Pretax interest cost, which is included in net investment income, was \$267 million, \$344 million and \$239 million in 2004, 2003 and 2002. The amount subject to interest crediting rates on such contracts was \$2,570 million and \$2,789 million at December 31, 2004 and 2003".

CCC had previously indicated that the ultimate interest charges for these reinsurance contracts could be approximately \$900,000,000, on a pre-tax basis for the period of 2004-2009. However, the actual interest to be paid is variable and subject to the amount and timing of losses paid out of the funds withheld balance.

The funds withheld balances for the period 2001-2004 were as follows:

|      | <u>Funds Withheld</u><br><u>Balance</u> |
|------|---|
| 2001 | \$2,979,815,000                         |
| 2002 | \$2,910,625,000                         |
| 2003 | \$2,854,729,000                         |
| 2004 | \$2,570,000,000                         |

The Illinois Division of Insurance reviewed the Company's finite reinsurance program and the associated interest charges incurred, funds held balances, and ceded losses. It was concluded that the Company has accounted for these contracts in accordance with statutory accounting guidelines.

(iii) Reinsurance Transactions

Many of the transactions with affiliates are related to quota share reinsurance agreements. It is the Company's policy to include "quota share" transactions within the inter-company accounts. This handling prevents the appropriate tracking of reinsurance amounts and therefore, prevents proper presentation of the annual statement, Schedule F concerning reinsurance transactions conducted with affiliated entities.

The NAIC Accounting Practices and Procedures Manual, Statements of Statutory Accounting Principles ("SSAP") No. 62, paragraph 26 and the NAIC Annual Statement Instructions for Property and Casualty Insurance Companies instruct companies to report reinsurance related receivable and payable amounts on the annual statement line items specifically for reinsurance. The New York Insurance Law requires companies to prepare their annual statements in accordance with NAIC Annual Statement Instructions.

Therefore, it is recommended that the Company comply with the NAIC Accounting Practices and Procedures Manual, SSAP No. 62, paragraph 26, and the Annual Statement Instructions.

D. Holding Company System

The Company is a wholly-owned subsidiary of National Fire Insurance Company of Hartford, a Connecticut insurer, whose outstanding stock is in turn, owned by Continental Casualty Company. Continental Casualty Company is wholly-owned by CNA Financial Corporation. The Company's ultimate parent is Loews Corporation, which as of December 31, 2003 owned 90% of the voting stock of CNA Financial Corporation.

In CNA's current organizational structure, the Continental Casualty Company group of insurers and the Continental Insurance Company group of insurers are under common ownership by Continental Casualty Company and its upstream parents, the Continental Corporation and CNA Financial Corporation, and the ultimate parent of both groups of companies is Loews Corporation.

(i) Holding Company Agreements

The Company was a party to the following holding company agreements as of December 31, 2003: CNA Reinsurance Pooling Agreement, CNA Inter-Company Expense Agreement and Federal Income Tax Allocation Agreement.

See Section 2(C) "Reinsurance" of this report for a description of the CNA Reinsurance Pooling Agreement. The other agreements are described below:

a) CNA Inter-Company Expense Agreement

The CNA inter-company expense agreement became effective January 1, 1977 and remains in effect until canceled. The agreement provides for the sharing of expenses among various CNA companies. Several endorsements over the years added and deleted various companies as parties to the agreement.

b) Federal Income Tax Allocation Agreement

The federal income tax allocation agreement became effective January 1, 1980. It shall continue in effect until termination or cancelled as provided for in the agreement. The participating parties to the agreement are National Fire Insurance Company of Hartford ("Parent") and Transcontinental Insurance Company ("Subsidiary"). The non-participating parties to the agreement are Loews Corporation, CNA Financial Corporation and Continental Casualty Company, due to their direct and indirect ownership of Parent and Subsidiary.

The agreement provides for TIC to calculate its tax liability under the method put forth at Section 3 (A) of Department Circular Letter No. 33 (1979). Section 3 (A) states that:

“The tax charge or tax refund to the domestic insurer under the agreement shall be the amount that the domestic insurer would have paid or received if it had filed on a separate return basis with the Internal Revenue Service”.

The agreement was approved by the Department as meeting the requirements of Department Circular Letter No. 33 (1979).

(ii) Section 1221 of the New York Insurance Law

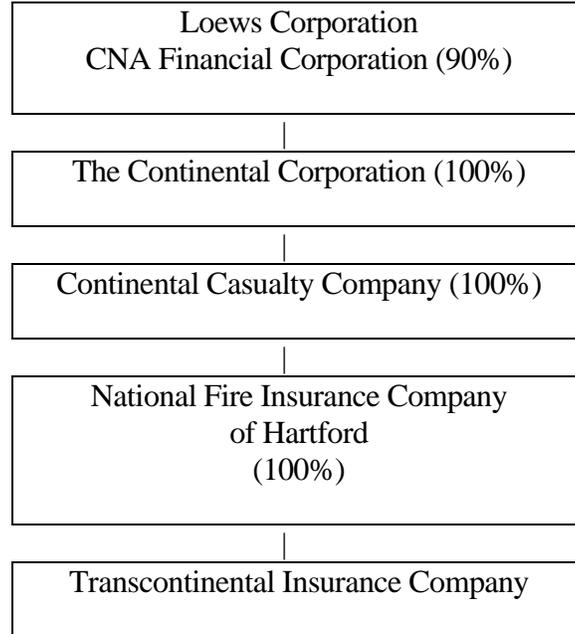
Section 1221(a)(1) of the New York Insurance Law states that:

“Every person who directly or indirectly owns beneficially more than ten percent of any class of shares of a domestic insurer or is a director or officer thereof shall file in the office of the superintendent: within ten days after he becomes such owner, director or officer a statement, in form prescribed by the superintendent, of the amount of all such shares of which he is the beneficial owner”.

During the course of this examination it was found that the directors and officers were not making the filings required by Section 1221 of the New York Insurance Law. This recommendation was made in the prior report on examination.

Therefore, it is recommended that the Company ensure that all of its directors and officers make the required filings under Section 1221 of the New York Insurance Law, henceforth.

The following is an abbreviated organization chart of the members of the holding company system:



See Appendix A of the report for the whole CNA Financial Corporation holding company chart.

#### E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2003, based upon the results of this examination:

|  |       |
|--|-------|
| Liabilities to liquid assets (cash and invested assets less investments in affiliates) | 2.00% |
| Change in surplus  | 8.00% |
| * Investment Yield   | 2.80% |

The above ratio denoted with an asterisk fall outside the benchmark ranges set forth in the Insurance Regulatory Information Systems of the National Association of Insurance Commissioners.

#### F. Abandoned Property Law

The Company's abandoned property filings for the period under examination were reviewed. Based upon the review it appears that the Company was filing the required detailed report pursuant to Section 1315 of the New York Abandoned Property Law. The reports filed along with the Section 1315 verification and checklist also contained the required preliminary detailed information pursuant to Section 1316 of the New York Abandoned Property Law. The Company has procedures in place for the handling of unclaimed funds to ensure that outstanding checks are subject to follow-up procedures on a periodic basis.

#### G. Accounts and Records

The Company does not maintain adequate books and records necessary to complete the examination of its financial statements, in violation of the requirements of Department Regulation 172. Further details of non-compliance are provided below in the relevant sections to which the various issues were noted.

The internal auditors perform regular reviews of accounts and records of the Company and may recommend changes in the Company's procedures. An independent certified public accounting firm conducts an ongoing audit of operations with interim recommendations to management and an annual certified report to the board of directors.

The Company utilizes automated systems to maintain and account for most transactions. The PeopleSoft General Ledger ("GL"), Query and Archive Warehouse constitute CNA's official book of record for financial reporting. The GL consists of various ledgers that contain specific types of information required to support GAAP, STAT, SEC and Internal Management Reporting. Within the PeopleSoft GL, all financial data is stored in what PeopleSoft calls "tables." Data in the tables can be reviewed using the PeopleSoft Query tool

or reported using tools such as Crystal Reports, or Essbase cubes. To roll up data in PeopleSoft for reporting purposes, trees are used to aggregate data for GAAP, STAT, SEC, and other reporting needs.

(i) Certified Public Accountants (“CPA”) Contract

The examination obtained and reviewed a copy of the engagement agreement between its independent certified accountants and the CNA Financial Corporation. The agreement did not meet the requirements established by Department Regulation 118. This recommendation was included in the prior report on examination.

Therefore, it is recommended that the Company comply with the Department's Regulation No. 118 as follows:

“Such contract must specify that:

- (a) The CPA provide an audited financial statement on or before May 31st together with an opinion on the financial statements and an evaluation of the insurer's accounting procedures and internal control systems as are necessary to the furnishing of the opinion;
- (b) The CPA should report to the Department in writing if the CPA has determined that the insurer has materially misstated its financial condition or that the insurer does not meet minimum capital or surplus to policyholder requirements set forth in the Insurance Law”.

(ii) Allocation of Expenses

Sections 1505(a)(1), (2), (3) of the New York Insurance Law state that:

“(a) Transactions within a holding company system to which a controlled insurer is a party shall be subject to the following: (1) the terms shall be fair and equitable; (2) charges or fees for services performed shall be reasonable; and (3) expenses incurred and payments received shall be allocated to the insurer on an equitable basis in conformity with customary insurance accounting practices consistently applied.” Section 1505(b) of the New York Insurance Law states that:

“The books, accounts and records of each party to all such transactions shall be so maintained as to clearly and accurately disclose the nature and details of the transactions including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties”.

Based on this review of the CNA inter-company expense agreement, it was determined that the agreement does not serve as an adequate guideline for the allocation of expenses among the companies nor is it a useful tool for regulators in understanding the allocations made by the companies and determining the fairness of its terms.

Therefore, it is recommended that the expense agreement be rewritten to more clearly define the specific services provided, the specific providers of the identified services, the specific recipients of the services, and reimbursement/payment terms under the agreement to meet the provisions set forth under New York Insurance Law. It is further recommended that the Company file such amended agreement in accordance with Section 1505(d) of the New Insurance Law.

(iii) Premium Taxes on High Deductible Workers' Compensation Policies

Section 3443 of the New York Insurance Law permits the issuance of workers' compensation and employers' liability insurance policies containing deductibles. Pursuant to this section of law, the insurer pays from the first dollar on a compensable claim and is then reimbursed by the policyholder for the applicable deductible. It is the position of both the Department and the New York Department of Taxation and Finance that premium taxes must be collected and paid on these policies. The amount of the deductible paid by the policyholder to the insurer should be treated as premium paid to the insurer for the purpose of Section 1510 of the New York Tax Law.

The Department issued Circular Letter No. 10 (2001) dated April 13, 2001 to once again alert all insurers of their duty to pay premium taxes as required. The Company failed to include deductible

reimbursements when computing the taxes imposed by Section 1510 of the New York Tax Law. This recommendation was included in the prior report on examination.

In view of the above, it is recommended that the Company pay its premium taxes in accordance with Section 1510 of the New York Tax Law as reinforced by Department Circular Letter No. 10 (2001). In addition, the Company is directed to remit the taxes owed on the reimbursement of deductibles that it has received on high deductible workers' compensation policies from insureds, retroactive to the inception date of the Company's high deductible workers' compensation policy program.

(iv) Continental Casualty Company Agents' Balances or Uncollected Premiums

During the coordinated multi-state examination, the following issues were noted associated with the examination of Agents' balances or uncollected premiums and are hereby incorporated into this report on a summary basis:

- The Company did not provide adequate documentation supporting the contractual obligations of any third parties related to the reported receivable.
- The Company's documentation shows receivable amounts greater than ninety days old and such amounts were treated as admitted assets.
- The Company could not provide documentation showing that the ceding entities were in good standing.

Based on the foregoing, the Company is not in compliance with the following regulatory provisions:

- SSAP No. 62-Assumed Reinsurance: Receivables greater than ninety days are to be non-admitted.
- SSAP No. 6-Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers: Receivables greater than ninety days are to be non-admitted.

- Annual statement should be prepared in accordance with the annual statement instructions as adopted by the NAIC.

TCI cedes 100% of its agents' balances and uncollected premium amounts to the CCC Pool, and therefore, the above issues do not have a direct financial impact upon the Company. However, the prior report on examination indicated similar concerns and disclosure of the ongoing problems were deemed appropriate.

(v) Custodial Agreement

The custodial agreement with JP Morgan Chase Bank was examined for compliance with criteria set forth in the NAIC Financial Condition Examiners Handbook, Part 1, Section IV. Based upon this review, it was determined that the agreement did not contain the following provisions 2(e) and 2(f), which state:

“2(e). If custodian gains entry in a clearing corporation through an agent, there should be a written agreement between the custodian and the agent that the agent shall be subjected to the same liability for loss of securities as the custodian.

2(f). That if the custodial agreement has been terminated or if 100% of the account assets in any one custody account have been withdrawn, the custodian shall provide written notification, within three business days of termination of withdrawal, to the insurer's domiciliary commissioner.

Therefore, it is recommended that the Company revise the custodial agreement to comply with the requirements of the NAIC Financial Condition Examiners Handbook.

(vi) Federal and Foreign Income Taxes (Excluding Deferred Taxes)

CNA agreed with the IRS regarding changes to the Company's taxable net income for the 1995-1997 audit cycle on September 2, 2002. The changes increased the Company's tax liability by \$3,612,196. As of October 1, 2004, the Company had not settled this liability with its parent, National Fire Insurance Company of Hartford. The federal tax allocation agreement requires that any balances due to or from the parent be settled within 15 days of filing the consolidated income tax return.

There was no change made to the balance sheet, since the amount was minimal. However, it is recommended that the Company settle inter-company tax liabilities in a timely manner as required by the federal tax allocation agreement and the NAIC Accounting Practices and Procedures Manual, SSAP No. 10.

### 3. FINANCIAL STATEMENTS

#### A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as determined by this examination as of December 31, 2003 and as reported by the Company.

| <u>Assets</u>   | <u>Assets</u>       | <u>Assets Not<br/>Admitted</u> | <u>Examination<br/>Net Admitted<br/>Assets</u> |
|---|---------------------|--------------------------------|--|
| Bonds   | \$70,132,846        | \$0                            | \$70,132,846                                   |
| Cash, cash equivalents and short-<br>term investments   | 16,075,683          | 1,899                          | 16,073,784                                     |
| Investment income due and accrued                       | 960,344             | 0                              | 960,344  |
| Net deferred tax asset                                  | 907,779             | 491,783                        | 415,996  |
| Receivables from parent,<br>subsidiaries and affiliates | 40,752              | 0                              | 40,752   |
| Total assets  | <u>\$88,117,404</u> | <u>\$493,682</u>               | <u>\$87,623,722</u>                            |

Liabilities, Surplus And Other FundsLiabilities

|  |  |              |
|--|--|--------------|
| Current federal and foreign income taxes       |  | \$351,690    |
| Payable to parent, subsidiaries and affiliates |  | 1,504,766    |
| Payable for securities                         |  | 5            |
| Aggregate write-ins for liabilities            |  | <u>1,897</u> |
| Total liabilities                              |  | \$1,858,358  |

Surplus and Other Funds

|   |                   |                     |
|---|-------------------|---------------------|
| Common capital stock                        | \$4,200,000       |                     |
| Gross paid in and contributed surplus       | 19,318,263        |                     |
| Unassigned funds (surplus)                  | <u>62,247,101</u> |                     |
| Surplus as regards policyholders            |                   | <u>85,765,364</u>   |
| Total, liabilities, surplus and other funds |                   | <u>\$87,623,722</u> |

NOTE: The Internal Revenue Service has completed its audits of the Company's consolidated Federal Income Tax returns through tax year 1997 which resulted in agreed upon changes increasing taxable income of the Company by \$10,502,994. Audits covering tax years 1998 through 2001 are currently in progress. The examiner is unaware of any potential exposure of the Company to any unasserted tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders decreased by \$167,078,105 during the five-year examination period, January 1, 1999 to December 31, 2003, detailed as follows:

Statement of Income

Underwriting Income

Premiums earned \$498,085,001

Deductions:

|   |               |
|---|---------------|
| Losses incurred                                 | \$412,433,131 |
| Loss adjustment expenses incurred               | 80,387,929    |
| Other underwriting expenses incurred            | 181,403,623   |
| Aggregate write-ins for underwriting deductions | <u>1,899</u>  |

Total underwriting deductions 674,226,582

Net underwriting gain or (loss) \$(176,141,581)

Investment Income

|                              |                   |
|------------------------------|-------------------|
| Net investment income earned | \$173,067,169     |
| Net realized capital gain    | <u>57,614,662</u> |

Net investment gain or (loss) 230,681,831

Other Income

|   |                |
|---|----------------|
| Net gain or (loss) from agents' or premium balances charged off | \$(791,015)    |
| Finance and service charges not included in premiums            | 257,844        |
| Aggregate write-ins for miscellaneous income                    | <u>956,272</u> |

Total other income 423,101

Net income before dividends to policyholders and before federal and foreign income taxes \$54,963,351

Dividends to policyholders 7,226,722

Net income after dividends to policyholders but before federal and foreign income taxes \$47,736,629

Federal and foreign income taxes incurred (18,937,304)

Net Income \$66,673,933

Capital and Surplus Account

|  |                     |                      |                      |
|--|---------------------|----------------------|----------------------|
| Surplus as regards policyholders per report on examination as of December 31, 1998 |                     |                      | \$252,843,469        |
|  | <u>Gains in</u>     | <u>Losses in</u>     |                      |
|  | <u>Surplus</u>      | <u>Surplus</u>       |                      |
| Net income   | \$66,673,932        |                      |                      |
| Net unrealized capital gains or (losses)   | 500,713             |                      |                      |
| Change in net unrealized foreign exchange capital gain (loss)                      |                     | \$563,447            |                      |
| Change in net deferred income tax  | 1,138,522           |                      |                      |
| Change in non-admitted assets  |                     | 4,633,209            |                      |
| Change in surplus notes  |                     | 6,425                |                      |
| Cumulative effect of changes in accounting Principles                              |                     | 10,175,765           |                      |
| Surplus adjustments paid in  |                     | 30,000,000           |                      |
| Dividends to stockholders  |                     | 194,900,000          |                      |
| Aggregate write-ins for gains and losses in surplus                                | <u>4,887,574</u>    |                      |                      |
| Total gains and losses   | <u>\$73,200,741</u> | <u>\$240,278,846</u> |                      |
| Net increase (decrease) in surplus   |                     |                      | <u>(167,078,105)</u> |
| Surplus as regards policyholders per report on examination as of December 31, 2003 |                     |                      | <u>\$85,765,364</u>  |

#### **4. LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES**

The Company reported no liability as of the examination date. The Company cedes 100% of its losses to the CCC pool and has no net exposure. Contingent net liability would have been existed with respect to ceded reinsurance which would become an actual liability in the event that the reinsurers would be unable to meet their obligations to the Company under the existing reinsurance agreements. If CCC, for any reason were to become unable to honor the 100% quota share reinsurance agreement with the Company, all ceded risk would be returned to TIC. The CCC Pool was reviewed by the Illinois Insurance Department and the following is the results of the actuarial review.

The adequacy of the carried reserves for losses and loss adjustment expenses was determined based on an extensive actuarial review. This review was conducted primarily by a nationally recognized actuarial consulting firm, and supplemented by analyses performed by examination staff and work of the Casualty Actuarial Section of the Illinois Division of Insurance. Procedures included an independent review of Company data, as well as review of portions of the companies' appointed actuaries' workpapers, Statements of Actuarial Opinion, and Schedule P.

In developing the loss reserve estimates for the core lines of business analyzed, paid and incurred losses were projected to estimate ultimate values using several actuarial methods. An ultimate value was then selected by reviewing the various ultimate estimates and applying actuarial judgment to achieve a reasonable estimate for the ultimate liability. The indicated reserves were determined as the difference between the selected ultimate loss and the paid loss. The following actuarial methods were utilized in projecting net ultimate losses and loss adjustment expenses for the core lines of business:

- Reported loss development method,
- Paid loss development method,
- Expected loss method,
- Reported Bornhuetter-Ferguson method,
- Paid Bornhuetter-Ferguson method,
- Adjusted reported method,
- Adjusted paid method,
- Frequency/severity method,
- Paid allocated loss adjustment expense (“ALAE”) development method,
- Paid to paid ALAE method and
- Paid ALAE Bornhuetter Ferguson method.

An independent ground up actuarial analysis was performed on the Company’s asbestos, pollution and other mass torts (“APMT”) liabilities. Since traditional actuarial methods do not adequately consider factors inherent in the development of losses for APMT exposures, non-traditional approaches were used to estimate the Company’s ultimate APMT liabilities. The review of the Company’s APMT exposures included:

- Exposure-based analysis, which included the utilization of proprietary simulation models supplemented by incurred but not reported (“IBNR”) development factors,
- Aggregate loss development factor projections,
- Paid loss market share technique,
- Judgmentally selected survival ratios.

The methods used depended on the type of exposure being analyzed and on the amount of information and experience available in reference to that category.

The point estimate by a nationally recognized independent actuarial firm for the relevant business exceeds CNA’s carried reserve as of December 31, 2003 by \$1,090 million, or approximately 18% of CNA’s consolidated policyholders’ surplus. However, the results of this analysis indicate that the reserves held by the Company are within a range of reasonable reserve estimates for the unpaid loss and loss adjustment expenses of the Company.

During the period covered by this examination, the Company has taken significant steps to maintain adequate reserves. The Illinois Division of Insurance, therefore, recognized those actions in this report. In the years subsequent to the last examination, the Company has strengthened reserves in excess of \$5 billion in the aggregate.

Based upon the results of all analyses performed, the Illinois Division of Insurance, Casualty Actuarial Section determined that the Company's net loss and loss adjustment expense reserves make a reasonable provision for the unpaid loss and loss adjustment expense obligations of the Company as of December 31, 2003.

The projected ultimate liabilities and associated reserves for loss and loss adjustment expenses are estimates. As estimates, these values are subject to variability. The possibility of this variability arises from the fact that all factors affecting the ultimate liability for losses and loss adjustment expenses have not taken place and cannot be evaluated with absolute certainty. This is especially true with respect to estimations of APMT reserves due to the volatility of a variety of risk factors unique to this business, such as whether coverage exists, determination of ultimate damages and allocation of such damages to responsible parties.

## **5. MARKET CONDUCT ACTIVITIES**

In the course of this examination, a review was made of the manner in which the Company conducts its business practices and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the generally more precise scope of a market conduct investigation, which is the responsibility of the Market Conduct Unit of the Property Bureau of this Department.

The general review was directed at practices of the Company in the following areas:

- A. Sales and advertising
- B. Underwriting
- C. Treatment of policyholders and claimants

i. Mortgagee Clause and Department Circular Letter No. 17 (1976)

A sample of commercial multiple peril policy cancellations was reviewed. The review found that the Company was not providing the required notice to the mortgagee when policies were cancelled at the insureds request as required by the New York Standard Mortgagee Clause and Department Circular Letter No. 17 (1976). The Company acknowledged that during the exam some polices were identified as having been cancelled at the request of the insured and no notification was provided to the mortgagee. This recommendation was included in the prior report on examination.

In view of the above, it is recommended that the Company comply with the provisions of the New York Standard Mortgagee Clause and Department Circular Letter No. 17 (1976).

ii. Agents

The Company provided a listing of agents that it terminated during the period of examination. The Company did not provide copies of the notices of termination issued to terminated agents. As a result, there was no way of verifying that the notices of termination were issued in compliance with Department Regulation 90.

Therefore, it is recommended that the Company maintain and produce for examination the notices of termination of agent contracts to determine compliance with Department Regulation 90.

## **6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION**

The prior report contained comments and recommendations as follows: (page numbers refer to the prior report on examination):

| <u>ITEM</u>  | <u>PAGE NO.</u>             |
|--|-----------------------------|
| <p>A.     <u>Management</u></p> <p>It is recommended that Director David A. Bierschied, Sr., either improve his attendance at board meetings or that the stockholders replace him with an individual who will be more active in the affairs of the Company.</p> <p>The Company has complied with this recommendation.</p>  | <p>5</p>                    |
| <p>B.     <u>Territory and Plan of Operation</u></p> <p>i.     It is recommended that the Company take the steps necessary to conform its licenses outside this state to its New York license and immediately cease the doing of any kind of business for which it does not have authority in New York.</p> <p>The Company has complied with this recommendation.</p> <p>ii.    It is recommended that the Company reinsure only those lines of business that license permits, in compliance with the provisions of Section 1114(a) of the New York Insurance Law.</p> <p>The Company has complied with this recommendation.</p> <p>iii.   It is recommended that the Company not issue policies pursuant to Article 63 of the New York Insurance law without obtaining the license required by Section 6302(a), henceforth.</p> <p>The Company has complied with this recommendation.</p> | <p>8</p> <p>8</p> <p>11</p> |
| <p>C.     <u>Holding Company System</u></p> <p>i.     <u>Article 15 of the New York Insurance Law and Department Regulation 52</u></p> <p>(a)    It is recommended that the Company follow the prior notice requirements of Section 1505(d) of the New York Insurance Law, henceforth.</p> <p>The Company has complied with this recommendation.</p>   | <p>13</p>                   |

| <u>ITEM</u>  | <u>PAGE NO.</u> |
|--|-----------------|
| (b) It is recommended that the Company comply with Section 1505(b) of the New York Insurance law and maintain the accounting information necessary to support the reasonableness of the charges or fees to the respective parties and produce such information upon examination. | 14              |
| The Company has not complied with this recommendation. A similar recommendation is reiterated in this report.  |                 |
| (c) It is recommended that the Company and its affiliated companies adhere to the terms of any expense allocation agreements in effect henceforth.   | 14              |
| The Company has not complied with this recommendation. This report includes a recommendation that the expense agreement be rewritten to clarify the terms contained therein.   |                 |
| (d) It is recommended that the Company adhere to the reporting requirements of Regulation 52, Section 80-1.4 by furnishing all of the required information within one-hundred and twenty days following the end of each fiscal year.   | 15              |
| The Company has complied with this recommendation.   |                 |
| ii. <u>Schedule Y</u>  |                 |
| It is recommended that the Company complete Schedule Y-Part 2 in accordance with the annual statement instructions, henceforth.  | 15              |
| The Company has complied with this recommendation.   |                 |
| iii. <u>Section 1221 of the New York Insurance Law Compliance</u>  |                 |
| It is recommended that the Company ensure that all of its directors and officers make the required filings under Section 1221 of the New York Insurance Law, henceforth.   | 15              |
| The Company has not complied with this recommendation. A similar recommendation is reiterated in this report.  |                 |
| D. <u>Accounts and Records</u>   |                 |
| i. <u>CPA Contracts</u>  |                 |
| It is recommended that the Company ensure that the agreement with the CPA for all future audits, that include Transcontinental Insurance Company, contain the provisions required by Department Regulation 118.  | 19              |

ITEMPAGE NO.

The Company has not complied with this recommendation. A similar recommendation is reiterated in this report.

ii. Allocation of Expenses

- (a) Management is directed to establish and maintain written documentation supporting the allocation of each expense category to the major expense groups as required by Department Regulation 30. 20

The Company has complied with this recommendation.

- (b) It is recommended that the Company allocate its expenses to each expense category in accordance with Department Regulation 30. 20

The Company has complied with this recommendation.

iii. Premium Taxes on High Deductible Workers' Compensation Policies

It is recommended that the Company pay its premium taxes in accordance with Section 1510 of the New York Tax Law as reinforced by Department Circular Letter No. 10 (2001). In addition, the Company is directed to remit the taxes owed on the reimbursement of deductibles that it has received on high deductible workers' compensation policies from insureds, retroactive to the inception date of the Company's high deductible workers' compensation policy program. 21

The Company has not complied with this recommendation. A similar recommendation is reiterated in this report.

iv. Dividends to Policyholders

It is recommended that the Company maintain documentation necessary to determine if the dividends it is paying to policyholders agree to the dividend resolutions approved by the board of directors. 22

The Company has complied with this recommendation.

v. Assets and Liabilities that Could not be Verified

It is recommended that the Company maintain supporting detailed records and produce same upon examination for any amounts it reports in its financial statements, henceforth. 22

The Company has complied with this recommendation for the non-pooled accounts however, please refer to disclosure under Section G iv. "Continental Casualty Company Agents' Balances or Uncollected Premiums".

| <u>ITEM</u>  | <u>PAGE NO.</u> |
|--|-----------------|
| E. <u>Section 310 of the New York Insurance Law Compliance</u>   |                 |
| i. It is recommended that the Company comply with Section 310 of the New York Insurance Law.   | 25              |
| The Company has complied with this recommendation.   |                 |
| ii. It is recommended that the Company take the following corrective action to facilitate future examinations:   | 25              |
| <ul style="list-style-type: none"> <li>• The role of the Company contact person is to facilitate the examination. Individuals assigned to this function must have broad authority and appropriate knowledge;</li> <li>• Responses should be qualitatively reviewed before submission to examiners;</li> <li>• Examination requests for information/documentation must be responded to;</li> <li>• Sufficient human resources must be committed to facilitate the examination process.</li> </ul> |                 |
| The Company has complied with this recommendation.   |                 |
| F. <u>Losses and Loss Adjustment</u>   |                 |
| It is recommended that the Company provide an adequate reserve for unpaid losses and loss adjustment expenses in all future financial statements in order to comply with the requirements of Section 1303 of the New York Insurance Law.   | 32              |
| The Company has complied with this recommendation.   |                 |
| G. <u>Market Conduct Activities</u>  |                 |
| i. <u>Advertising</u>  | 34              |
| It is recommended that the Company maintain ad copy for all advertisements (print, radio, television, etc.) and, that it be able to cross reference each advertisement to the appropriate invoice, so as to provide a means upon examination to determine if its advertisements were in compliance with Section 1313 of the New York Insurance Law and if they were unfair or misleading.  |                 |
| The Company has complied with this recommendation.   |                 |
| ii. <u>Policy Forms</u>  |                 |
| It is recommended that the Company retain records evidencing Department approval for all policy forms issued by the Company and that require approval by this Department.  | 34              |

| <u>ITEM</u>  | <u>PAGE NO.</u> |
|--|-----------------|
| The Company has complied with this recommendation.   |                 |
| iii. <u>Agents</u>   |                 |
| (a) It is recommended that the Company ensure that agents it wishes to represent it are appointed in accordance with Section 2112(a) of the New York Insurance Law, henceforth.  | 35              |
| The Company has complied with this recommendation.   |                 |
| (b) It is recommended that the Company maintain and produce for examination the notices of termination of agents' contracts it issues in the future so as to allow verification that such notices comply with the requirements of Regulation 90. | 35              |
| The Company has not complied with this recommendation. A similar recommendation is reiterated in this report.  |                 |
| iv. <u>Mortgage Clause and Department Circular Letter No. 17 (1976)</u>  |                 |
| It is recommended that the Company comply with the provisions of the New York Standard Mortgage Clause and Department Circular Letter No. 17 (1976).   | 34              |
| The Company has not complied with this recommendation. A similar recommendation is reiterated in this report.  |                 |
| v. <u>Regulation 64</u>  |                 |
| It is recommended that the Company comply with the provisions of Section 216.11 of Department Regulation 64, henceforth.   | 34              |
| The Company has complied with this recommendation.   |                 |
| vi. <u>Complaint Log – Department Circular Letter No. 11 (1978)</u>  |                 |
| It is recommended that the Company ensure that its complaint log complies with the requirements of Department Circular Letter No. 11 (1978).   | 37              |
| The Company has complied with this recommendation.   |                 |

## **7. SUMMARY OF COMMENTS AND RECOMMENDATIONS**

The following is a summary of comments and recommendations made in the body of this report:

| <u>ITEM</u>  | <u>PAGE NO.</u> |
|--|-----------------|
| <p>A.     <u>Reinsurance Transactions</u></p> <p>It is recommended that the Company comply with the NAIC Accounting Practices and Procedures Manual, SSAP 62, paragraph 26 and the Annual Statement Instructions.</p>  | <p>10</p>       |
| <p>B.     <u>Holding Company System</u></p> <p>      <u>Section 1221 of the New York Insurance Law</u></p> <p>It is recommended that the Company ensure that all of its directors and officers make the required filings pursuant to Section 1221 of the New York Insurance Law.</p>   | <p>12</p>       |
| <p>C.     <u>Accounts and Records</u></p> <p>      i.    <u>Certified Public Accountants Contract</u></p> <p>It is recommended that the Company comply with the Department's Regulation No. 118 and include the recommended language into the engagement agreement between its independent auditors and the CNA Financial Corporation.</p>   | <p>15</p>       |
| <p>      ii.   <u>Allocation of Expenses</u></p> <p>It is recommended that the expense agreement be rewritten to more clearly define the specific services provided, the specific providers of the identified services, the specific recipients of the services, and reimbursement/payment terms under the agreement to meet the provisions set forth under New York Insurance Law.</p> <p>It is further recommended that the Company file the amended agreement in accordance with Section 1505(d) of the New York Insurance Law.</p> | <p>16</p>       |
| <p>      iii.   <u>Premium Taxes on High Deductible Workers' Compensation Policies</u></p> <p>It is recommended that the Company pay its premium taxes in accordance with Section 1510 of the New York Tax Law as reinforced by Department Circular Letter No. 10 (2001). In addition, the Company is directed to remit the taxes owed on the reimbursement of deductibles that it has received on high</p>  | <p>17</p>       |

| <u>ITEM</u>  | <u>PAGE NO.</u> |
|--|-----------------|
| deductible workers' compensation policies from insureds, retroactive to the inception date of the Company's high deductible workers' compensation policy program. This recommendation was included in the prior report on examination. |                 |
| iv. <u>Custodial Agreement</u>   |                 |
| It is recommended that the Company revise the custodial agreement to comply with the NAIC Financial Condition Examiner Handbook.   | 18              |
| v. <u>Federal and Foreign Income Taxes (Excluding Deferred Taxes)</u>  |                 |
| It is recommended that the Company settle inter-company tax liabilities in a timely manner as required by the federal tax allocation agreement and the NAIC Accounting Practices and Procedures Manual, SSAP No. 10.                   | 19              |
| D. <u>Market Conduct</u>   |                 |
| i. <u>Mortgage Clause and Department Circular Letter No. 17 (1976)</u>   |                 |
| It is recommended that the Company comply with the provisions of the New York Standard Mortgage Clause and Department Circular Letter No. 17 (1976).   | 27              |
| ii. <u>Agents</u>  |                 |
| It is recommended that the Company maintain and produce for examination the notices of termination of agent contracts to allow the Department to determine compliance with Department Regulation 90.                                   | 27              |

**Appendix A**  
**Organizational Chart**  
**Loews Corporation**

Loews Corporation \*

Lorillard, Inc.

    Lorillard Tobacco Company (DE)

TGT Pipeline Holding Corporation (DE)

    TGT Pipeline, LLC

        Texas Gas Transmission, LLC

Loews Hotels Holding Corporation (DE)

Diamond Offshore Drilling, Inc. (DE) 54%

Bulova Corporation (NY) 97%

CNA Financial Corporation (CNAF) (DE) 90%

    1897 Corporation (DE)

    CNA UniSource of America, Inc. (DE)

        Interlogic Systems, Inc. (IN)

    CNA Trust Corporation (CA) (1)

    CNA Europe Holdings, Ltd. (UK) 72.7% (2)

        CNA Insurance Company, Limited (UK)

            CNA Insurance Company (Europe), Ltd. (UK)

            R E Heathcock, Limited (UK)

                Marine & Transit Underwriters (Manchester), Ltd. (UK)

        Maritime Insurance Company, Limited (UK)

    CNA Lakeview Insurance Company (SC) (3)

    CNA National Warranty Corporation (AZ)

        CNA National Warranty Corporation – Florida (FL)

        Continental Service Plan, Inc. (NJ)

        Continental Service Provider, Inc. (IL)

    CNA Structured Settlements, Inc. (IL)

    CNA Warranty, Inc. (DE)

    Hedge Financial Products, Inc. (IL)

    South Street Insurance Brokers, Inc. (NY)

    Viaticus, Inc. (DE)

    The Continental Corporation (TCC) (NY)

        CNA Solutions, Inc. (IL)

            Financial Services Representative PG, Inc. (IL)

        North Pearl Management, Inc. (TX)

        Servicios y Comisiones Continental SA. de C.V.(MEX)

        Continental Management Services, Ltd. (UK) 73.3% (4)

            The Continental Insurance Holdings (Europe), Ltd. (UK)

                Continental Reinsurance Corporation (UK), Ltd. (UK)

                Global Resource Managers, Limited (UK)

        Continental Reinsurance Corp International, Ltd. (BM)

        Accord Underwriting Agency, Ltd. (BM) 50%

        CNA Risk Services, Ltd. (BM) 99% (5)

            Bishophouse, Limited (BM) 30%

        Continental Casualty Company (CCC) (IL)

            American Casualty Company of Reading (ACCO) (PA)

Valley Forge Insurance Company (VFIC) (PA)  
Encompass Home & Auto Insurance Company (EHAIC) (IL)  
Encompass Independent Insurance Company (EIIC) (IL)  
Encompass Insurance Company of America (EICOA) (IL)  
Encompass Property & Casualty Company (EPC) (IL)  
CNA Casualty of California (COC) (CA)  
Columbia Casualty Company (COL) (IL)  
Galway Insurance Company (GAL) (IL)  
National Fire Insurance Company of Hartford (NFI) (CT)  
**Transcontinental Insurance Company (TCI) (NY)**  
Transportation Insurance Company (TPI) (IL)  
CNA Lloyds of Texas (LYD) (TX) (6)  
Continental National Corporation (DE)  
    Continental National Indemnity Company (CNI) (OH)  
CNA Aseguradora de Riesgo de Trabejo SA (ARG)  
North Rock Insurance Company, Limited (BM)  
Continental Assurance Company (CAC) (IL)  
    Valley Forge Life Insurance Company (VFL) (PA) (7)  
    CNA International Life Company, SPC Limited  
Alexsis, Inc. (MD)  
CNA ClaimPlus, Inc. (NV)  
CNA Motor Transport Underwriters Agency, Inc. (TX)  
CNA Real Estate Services, Inc. (IL)  
CNA Realty Corporation (DE)  
    CLE, Inc. (NV)  
CNA Services, Inc. (IL)  
CNA Underwriting Agencies, Limited (UK)  
Collateral Holding Subsidiaries (non entity) (8)  
    E. G. Company  
    Lake Street Plaza, Inc.  
    Richland Apartments, Inc.  
The Entertainment Coalition (DE) 50%  
1911 Corporation (DE)  
    CNA Investor Services, Inc. (IL)  
    Financial Brokerage, Inc. (DE)  
        DMT, Inc. (NE)  
        Producers America, Inc. (NE)  
Envision Technology Solutions, LLC (DE) 50%  
Investigative Options, Inc. (DE)  
London Market Reinsurance Services, Ltd. (UK)  
Managed Care Holdings Corporation (DE)  
    Caronia Corporation (DE)  
Settlement Options, Inc. (IL)  
R.V.I. Guaranty Company, Ltd. (BM) 50%  
    R.V.I. America Corporation (DE)  
        R.V.I. Auto Services (CT)  
        R.V.I. America Insurance Company (CT)  
        R.V.I. Services Company (CT)  
        R.V.I. Associates, Inc. (DE)

Worldwide Credit Managers, LLC (DE) 50%  
 The Buckeye Union Insurance Company (BUC) (OH) (2)  
     Boston Old Colony Insurance Company (BOC)  
     CNA Insurance (International Agencies) Australia Pty, Ltd.  
     The Mayflower Insurance Company Ltd. (MFL) (IN) (9)  
     Niagara Fire Insurance Company (NIA) (DE)  
     First Insurance Company of Hawaii, Ltd. (HI) 50%  
         First Fire and Casualty Insurance of Hawaii, Inc. (HI)  
         First Security Insurance of Hawaii, Inc. (HI)  
         First Indemnity Insurance of Hawaii, Inc. (HI)  
         J. M. Lydgate, Limited (HI)  
         First Risk Management Services, Inc. (HI)  
 The Continental Insurance Company (CIC) (SC) (2) (4) (10) (12)  
 CIC Collateral Holding Subsidiaries (non entity) (8)  
     Bellerive Office Park, Inc. (IL)  
     Jackson Park Place II Apartments, Inc. (CA)  
     New Mexico Medical Offices, Inc. (IL)  
     The Fidelity & Casualty Company of NY (F&C) (SC) (4) (10)  
     IDBI Managers, Inc. (NY)  
     National-Ben Franklin Insurance Company of Illinois (NBF) (IL) (4)  
 Firemen's Insurance Company of Newark, NJ (FIR) (NJ) (2)  
     101 Morgan Lane Offices, Inc.  
     Commercial Insurance Company of Newark, NJ (COM) (NJ)  
         Continental Lloyd's Insurance Company (CLI) (TX) (11)  
     The Continental Insurance Company of New Jersey (NJ)  
     Continental Reinsurance Corporation (CRC) (CA)  
         Global Resource Managers, Inc.  
     The Glens Falls Insurance Company (GFL) (DE) (2)  
 The CPI Group, Inc. (DE)  
     Kansas City Fire & Marine Insurance Company (KAS) (SC)  
 Pacific Insurance Company (PAC) (CA)  
     Marine Office of America Corporation (NY) 82.7% (12)  
         CNA Canada Holdings, Inc. (CAN)  
         Eastern Marine Underwriters, Inc. (CAN)  
         Major, Cormier & Associates, Inc. (CAN)  
 CNA Surety Corporation 61.9% (13)  
     De Montfort Group, Ltd. (UK) 34%  
         De Montfort Holdings, PLC (UK)  
         De Montfort Insurance Company, PLC (UK)  
         De Montfort Investments, Limited (UK)  
         Credit Shield, Limited (UK)  
     Capsure Holdings Corporation (DE)  
         Capsure Financial Group, Inc. (OK)  
         NI Acquisition Corporation (TX)  
         SI Acquisition Corporation (TX)  
         Surewest Financial Corporation (DE)  
         Troy Fain Insurance, Inc. (FL)  
         Western Surety Company (SD)  
         Surety Bonding Company of America (SD)

Universal Surety Holding Corporation (TX)  
Universal Surety of America (TX)

Respectfully submitted,

\_\_\_\_\_/S/  
Patrick White, C.F.E.  
Insurance Examiner

STATE OF NEW YORK    )  
                                  )SS:  
                                  )  
COUNTY OF NEW YORK )

PATRICK WHITE, being duly sworn, deposes and says that the foregoing report, subscribed to by him, is true to the best of his knowledge and belief.

\_\_\_\_\_/S/  
Patrick White

Subscribed and sworn to before me

this \_\_\_\_\_ day of \_\_\_\_\_, 2006.

*Appointment No 22346*

**STATE OF NEW YORK  
INSURANCE DEPARTMENT**

*I, HOWARD MILLS, Acting Superintendent of Insurance of the State of New York,  
pursuant to the provisions of the Insurance Law, do hereby appoint:*

**Patrick White**

*as proper person to examine into the affairs of the*

**TRANSCONTINENTAL INSURANCE COMPANY**

*and to make a report to me in writing of the condition of the said*

**Company**

*with such other information as he shall deem requisite.*

*In Witness Whereof, I have hereunto subscribed by the  
name and affixed the official Seal of this Department, at  
the City of New York,*

*this 10th day of March, 2005*



A handwritten signature in cursive script, appearing to read "Howard Mills".

---

**HOWARD MILLS**  
*Acting Superintendent of Insurance*