

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

State of Delaware



Department of Insurance

Dover, Delaware



I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of December 31, 2003 of the

THE GLENS FALLS INSURANCE COMPANY

is a true and correct copy of the document filed with this Department.

ATTEST BY: *Jennifer L. Miller*

DATE: 29TH JUNE, 2005



In Witness Whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 29TH DAY OF JUNE, 2005.

Matthew Denn

Insurance Commissioner


Deputy Insurance Commissioner

REPORT ON EXAMINATION
OF THE
THE GLENS FALLS INSURANCE COMPANY
AS OF
December 31, 2003

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Matthew Denn", written in a cursive style.

MATTHEW DENN
INSURANCE COMMISSIONER

DATED this 29TH day of JUNE, 2005.

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SALUTATION

May 9, 2005

Honorable Alfred W. Gross
Chairman, Financial Condition (E)
Committee, NAIC
State Corporation Commission
Bureau of Insurance
Commonwealth of Virginia
1300 East Main Street
Richmond, VA 23218

Honorable Matthew Denn
Commissioner of Insurance
State of Delaware
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Honorable Julie Bowler
Secretary, Northeastern Zone (I), NAIC
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Honorable Walter Bell
Secretary, Southeastern Zone (II), NAIC
Alabama Department of Insurance
201 Monroe Street, Suite 1700
Montgomery, AL 36104

Honorable John Morrison
Secretary, Western Zone (IV), NAIC
Montana Department of Insurance
840 Helena Avenue
Helena, MT 59601

Commissioners:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 04-004, dated February 4, 2004, an Association examination has been made of the affairs, financial condition and management of the

THE GLENS FALLS INSURANCE COMPANY

hereinafter referred to as “Company” or “Glens Falls” and incorporated under the laws of the State of Delaware as a stock company with its home office located at 1209 Orange Street, Wilmington, Delaware. The examination was conducted at the main administrative office of the Company, located at CNA Plaza, Chicago, IL 60685.

The report of such examination is submitted herewith.

SCOPE OF EXAMINATION

The last examination was conducted as of December 31, 1998. This examination covers the period since that date through December 31, 2003, and consisted of a general review of the Company's business policies and practices, management, any corporate matters incident thereto, a verification and evaluation of assets and determination of liabilities. Transactions subsequent to the latter date were reviewed where deemed necessary.

The format of this report is designed to explain the procedures employed on examination and the text will explain changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible officials during the course of the examination.

The general procedures of the examination followed the rules established by the Committee on Financial Condition Examiners Handbook of the National Association of Insurance Commissioners ("NAIC") and generally accepted statutory insurance examination standards consistent with the Insurance Laws and Regulations of the State of Delaware. In accordance with the aforementioned Handbook, the consulting firm of INS Services, Inc performed an information systems review.

Glens Falls was examined as part of a coordinated, multi-state examination. The lead state for the coordinated examination was Illinois, where Continental Casualty Company is domiciled. Thirty-one insurance companies were examined concurrently as part of the coordinated examination.

In addition to items hereinafter incorporated as a part of the written report, the following areas were checked and made part of the work papers of this examination.

The Glens Falls Insurance Company

Corporate Records Fidelity Bonds and Other Insurance

HISTORY

Glens Falls was originally incorporated as the Metropolitan Plate Glass Insurance Company and commenced business in 1874 under the laws of the State of New York. Originally incorporated for the purpose of transacting plate glass insurance, the writing authority of the Company was later broadened to transact additional lines of business and the reinsurance business was also obtained. Glens Falls operated under its original name until 1904, and has since operated under the following names:

<u>Company Name</u>	<u>Year Changed</u>
Metropolitan Plate Glass and Casualty Company	1904
Metropolitan Casualty Insurance Company of New York	1906
Fidelity Phoenix Insurance Company	1959
American International Insurance Company	1967
Fidelity Phoenix Insurance Company	1969
The Glens Falls Insurance Company	1971

In April 1923, The United States Fidelity and Guaranty Company of Baltimore, Maryland acquired the Company. In 1928, The Firemen's Insurance Company of Newark, New Jersey, a member of a group of insurance companies known as The Loyalty Group, acquired the Company. In 1957, the Loyalty Group was acquired by the New York holding company known as The Continental Corporation. Through dividend transactions that occurred on February 1, 1974, The Continental Corporation obtained direct ownership of the Company. Direct ownership of Glens Falls was then passed back to Firemen's Insurance Company of Newark,

The Glens Falls Insurance Company

New Jersey (Firemen's) on December 31, 1974. The Company was re-domiciled to Delaware in 1977. In May 1995, CNA Financial Corporation (CNA) a Delaware holding company, with its headquarters in Chicago, IL, acquired The Continental Corporation and thus gained control of the daily business affairs of both Firemen's and Glens Falls.

CAPITALIZATION

Common Capital Stock

The Certificate of Incorporation, as amended, provides that the authorized capital stock of the Company shall be 24,000 shares of \$175 par value per share. At December 31, 2003, 24,000 shares were issued and outstanding. The Company has no preferred stock outstanding. Further, the Company is owned by The Firemen's Insurance Company of Newark ("Firemen's"), which is wholly owned by the Continental Casualty Company ("CCC")

Dividends

There were no stockholder dividends paid in the period 1999-2003.

In 2003, the Company paid \$35,000,000 to its parent as a return of capital. This transaction was approved by the Delaware Insurance Department.

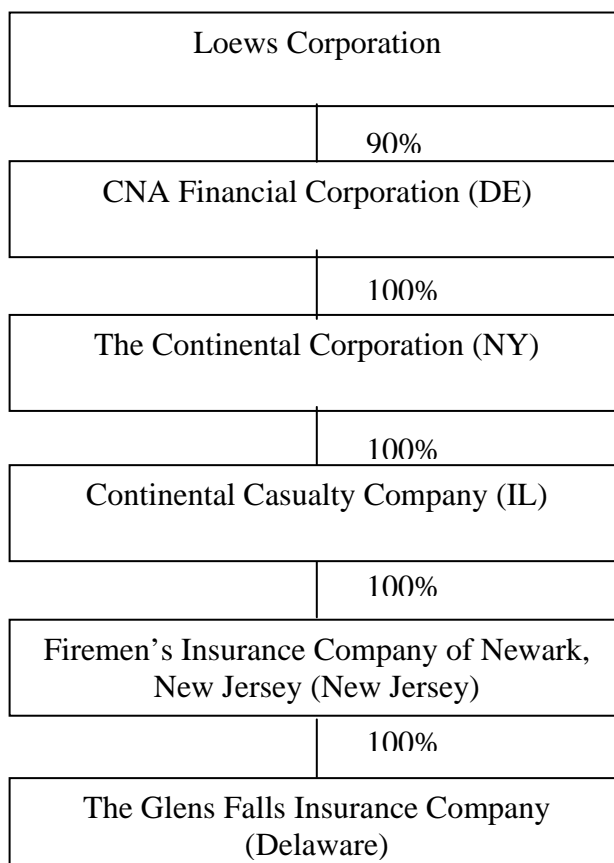
MANAGEMENT AND CONTROL

Holding Company System

Glens Falls is a member of a complex holding system and is currently wholly owned by Firemen's Insurance Company, which is solely owned by Continental Casualty Company. The ultimate parent of the holding company system is the Loews Corporation (Loews). Loews is a diversified financial holding company which is publicly traded on the New York Stock

The Glens Falls Insurance Company

Exchange. The following is a partial chart that reflects the principle identities and relationships between the Company, the Parent, and some affiliated insurers.



Relationships between other members of the holding company structure can be found in Schedule Y of the 2003 Annual Statement.

At December 31, 2003, Continental Casualty Company (CCC), the intermediary parent of Glens Falls and the Company's ultimate reinsurer, reported the following:

Assets	\$34,589,154,000
Policyholders Surplus	6,045,822,000
Premiums Earned (2003)	5,929,490,000
Net Income	(1,563,151,000)

The Glens Falls Insurance Company

Largely due to reserve strengthening, CCC reported an underwriting loss of \$3,344,091,000 for 2003. As noted in the Continental Casualty Company Loss Reserves section of this report, the coordinated multi-state examination noted a deficiency in CCC's total Loss Reserves at December 31, 2003 of 7%.

In compliance with Chapter 50 of the Delaware Insurance Code, the Company filed the appropriate Holding Company Registration Statement with the State of Delaware for each period currently under review.

Board of Directors

Pursuant to the By-Laws of the Company, the Board of Directors shall manage the business and affairs of the corporation. The Directors serving at December 31, 2003 were as follows:

Stephen W. Lilienthal	Chairman, Chief Executive Officer & President
Robert V. Deutsch	Executive Vice President & Chief Financial Officer
Jonathan D. Kantor	Executive Vice President, Secretary & General Counsel
Robert L. McGinnis	President & CEO, CNA Life & Group Operations
Thomas Pontarelli	Executive Vice President, Human Resources & Corp. Services

The Articles of Incorporation of Glens Falls, as amended May 26, 1977, state that the property and daily business affairs are to be managed by a Board of Directors that is elected at the annual shareholder's meeting for 1-year terms. The number of persons serving on the Board can vary between three (3) and twelve (12) persons as determined by the By-Laws from time to time. Those who serve on the Board must be at least 21 years of age.

Officers

The Officers of the Company listed as of December 31, 2003, were as follows:

Stephen W. Lilienthal	Chairman, Chief Executive Officer & President
Dennis R. Hemme	Vice President & Treasurer
Jonathan D. Kantor	Executive Vice President, Secretary & General Counsel
Robert V. Deutsch	Executive Vice President & Chief Financial Officer
Michael Fusco	Executive Vice President

The Glens Falls Insurance Company

John P. Golden	Executive Vice President, Chief Information Officer
Dean K. Haring	Executive Vice President, Claims
Robert V. James*	Executive Vice President, U.S. Insurance Operations
James R. Lewis	President & CEO, Property & Casualty Operations
Robert L. McGinnis	President & CEO, CNA Life & Group Operations
Thomas Pontarelli	Executive Vice President, Human Resources & Corp. Services
Peter W. Wilson	Executive Vice President, Global Specialty Operations

*Resigned effective 1/2/04

The amended By-Laws of Glens Falls require the election or appointment of a President, a Vice-President, a Secretary, a Treasurer, and a Controller. The By-Laws also allow for the election or appointment of Senior Vice Presidents, Executive Vice-Presidents, and other Officers as may be deemed necessary. All corporate Officers are elected for one-year terms.

Although the Company had several changes in its directors and principal officers during the examination period, not every appointment and resignation was reported in the Board of Director's minutes. Furthermore, the Company did not report every appointment and resignation to the Delaware Insurance Department, as required by 18 Del. C. §4919, which states,

“Every domestic stock or mutual insurer shall promptly notify the Commissioner in writing of any change of personnel among its directors or principal officers.”

Therefore, as also noted in the prior examination report, the following recommendation will be made:

The failure of the management of Glens Falls to disclose the resignation of key management personnel to the Commissioner of the Delaware Insurance Department constitutes non-compliance with Section 4919 of the Delaware Insurance Code. This is the THIRD examination in succession that the Company has failed to comply with the provisions of Section 4919 of the Delaware Insurance Code.

It is recommended that the Company immediately initiate measures to comply with the provisions of Section 4919 of the Delaware Insurance Code regarding the proper reporting of changes in the principal Officers and Directors of the Company.

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By-Laws

A review of the Company's By-Laws revealed that no changes were made during the examination period.

Corporate Records

The Articles of Incorporation have not changed during the period under review.

TERRITORY AND PLAN OF OPERATION

Territory

As of December 31, 2003, Glens Falls is licensed in all fifty (50) States, and the District of Columbia.

Plan of Operation

The Company currently only writes commercial lines property and casualty insurance. In 2003, Glens Falls wrote \$683,545,209 in direct premiums. All of the Company's gross premiums are ceded to Continental Insurance Company, which in turn retrocedes the Glens Falls business to Continental Casualty Company under a 100% Quota Share Agreement. See the Reinsurance section of this report for further information.

Agency Relations and Third Party Administrators:

Glens Falls has no agents of its own nor does it directly contract with independent agents or brokers.

CNA refers to certain agents as having Delegated Underwriting Authority, identified as a DUA, whereby these entities have authority to bind the company, but do not handle claims and do not place reinsurance. There are approximately 40 DUA's for Standard Lines and 40 for Global Specialty Lines

The Glens Falls Insurance Company

Best's Rating:

Based on Best's current opinion of the consolidated financial condition and operating performance of the members of the CNA Property and Casualty Group, Best has issued an "A" rating for all participants in that group.

GROWTH OF THE COMPANY

The following information was extracted from copies of the Company's filed Annual Statements with the Delaware Insurance Department for each year indicated.

Year	Admitted Assets	Policyholder Surplus	Gross Written Premium	Net Premiums Written	Underwriting Profit (Losses)	Net Income (Loss)
1999	\$71,582,652	\$23,436,256	\$97,494,390	\$16,184,739	\$(2,052,055)	\$2,891,684
2000	66,463,845	22,669,380	92,614,742	19,374,588	(2,459,755)	1,114,345
2001	160,480,122	119,816,702	778,555,877	(5,483,147)	0	7,815,158
2002	159,033,247	132,410,072	785,698,763	0	0	6,572,785
2003	139,864,882	115,861,580	663,686,478	0	0	11,005,385

* Note: Due to de-pooling and 100% quota share agreement with CCC, no premium, or loss balance sheet lines are recognized in 2000-2003.

Following is a reconciliation of capital and surplus for the period under examination:

Policyholders' Surplus, December 31, 1998		\$20,857,729
Net income	\$2,891,684	
Net unrealized capital gains or (losses)	82,030	
Change in non-admitted assets	(695,522)	
Change in provision for reinsurance	297,492	
Change foreign exchange adjustment	2,843	
		<u>2,578,528</u>
Policyholder's Surplus, December 31, 1999		23,436,256
Net income	(1,276,263)	

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Net unrealized capital gains or (losses)	(206,176)	
Change in non-admitted assets	882,667	
Change in provision for reinsurance	(158,743)	
Change foreign exchange adjustment	(8,361)	
		<u>(766,876)</u>
Capital and Surplus, December 31, 2000		22,669,380

Surplus as Regards Policyholders		22,669,380
Net income	7,815,158	
Net unrealized capital gains or (losses)	1,696,571	
Change net unrealized foreign exchange capital gain	0	
Change in net deferred income tax	844,960	
Change in non-admitted assets	(524,798)	
Change in provision for reinsurance	(35,197,880)	
Cumulative change in accounting principles	(1,986,689)	
Surplus Paid-In	124,500,000	
		<u>97,147,322</u>
Capital and Surplus, December 31, 2001		119,816,702

Net income	6,572,785	
Net unrealized capital gains or (losses)	(3,409,339)	
Change in net deferred income tax	6,540,291	
Change in non-admitted assets	(7,187,131)	
Change in provision for reinsurance	10,173,836	
Aggregate Write-ins	(97,072)	
		<u>12,593,370</u>
Capital and Surplus, December 31, 2002		132,410,072

Net income	11,005,385	
Net unrealized capital gains or (losses)	1,582,878	
Change in net deferred income tax	(3,362,342)	
Change in non-admitted assets	6,390,650	
Change in provision for reinsurance	2,737,866	
Aggregate write-ins	97,072	
Capital changes, paid-in	(35,000,000)	
		<u>(16,548,491)</u>
Surplus as Regards Policyholders		<u>\$115,861,581</u>

In 2001, the Company received a surplus infusion of \$124,500,000. The additional surplus allowed Glens Falls to substantially increase its gross premiums in 2001.

NAIC RATIOS

The NAIC Insurance Regulatory Information System (IRIS) did not designate the Company as requiring regulatory attention based on its Annual Statement filings for any of the five years under examination. In addition, the NAIC Examiner Team did not select for review any of the Annual Statements filed by the Company during the examination period.

The Company’s NAIC IRIS Ratio tests were available for all years under review. During the last year of the examination period, 2003, two (2) IRIS ratios produced “unusual values” as defined by the NAIC Examiner Team in each year under review, as shown in the following table:

Year	Ratio	Ratio Description	Usual range of Values Over/Under	Company Results
2003	4	Surplus Aid to Policyholder Surplus	15	61.0
2003	7	Change in Policy holder Surplus	50 -10	-12.0

The Company reported an unusual value for Ratio #4 because of its 100% cession of all gross premiums written. The unusual value for Ratio #7 was primarily due to the \$35 million return of capital paid in 2003.

DE-POOLING

During 2002 CNA began the process of streamlining its United States property-casualty insurance entity structure. Towards that purpose, CNA has been conducting research and investigating ways to create a simpler, more efficient organization. By the end of 2005, CNA planned to complete the process of reevaluating 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-casualty insurance companies into a total of four states (down from 14) and to merge redundant companies.

The Glens Falls Insurance Company

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 will reinsure 100% of the business of The Continental Insurance Company. These actions have established Continental Casualty Company as the net risk bearer of nearly the entire U.S. property-casualty insurance operations of CNA.

REINSURANCE

Prior to January 1, 2001, the Company was a member of the Continental Insurance Company (CIC) reinsurance pool under an amended and restated Inter-company Pooling Agreement. In the last quarter of 2000, the Company submitted a Form D filing to the Delaware

The Glens Falls Insurance Company

Department of Insurance, requesting regulatory approval for a revised pool structure. As proposed, the new structure would remove seven companies from the pool, and reinsure 100% of their in-force insurance liabilities with CIC, including Glens Falls. The Delaware Department approved the cancellation, commutation, and release to the amended Intercompany Pooling Agreement.

During the fourth quarter of 2002, the CIC reinsurance pool structure was replaced with a separate 100% quota share reinsurance agreement effective January 1, 2003, between CIC and each of its former pool participants, including the Company, whereby CIC assumes, as an intermediate step, the net underwriting activity previously reflected in the CIC pool. As the final step, CIC now cedes this net underwriting activity to the Continental Casualty Company (CCC) under the 100% quota share reinsurance agreement between CCC and CIC.

The following three reinsurance agreements were implemented in order to accomplish the first step in the consolidation of the net risks of the CIC pool into CIC, prior to transacting external reinsurance, and to the ultimate cession to CCC:

- The commutation of the current CIC pool agreement effective January 1, 2001.
- A 100% retroactive reinsurance agreement between CIC and each former CIC pool participant covering all direct in-force business as of December 31, 2002.
- Prospective 100% quota share reinsurance agreement between CIC and each former CIC pool participant effective January 1, 2003. The Company received approval from the Delaware Department of Insurance in order to execute and implement these reinsurance agreements.

As a result of this transaction, all balances assumed and ceded under the then CIC pool agreement were reversed and the transaction reflecting the execution of the new quota share reinsurance agreement was recorded retroactive to January 1, 2003. Under the new quota share

The Glens Falls Insurance Company

reinsurance agreement, the former CIC pool participants will cede all in-force business, including outstanding loss reserves, and prospective underwriting activity to CIC, prior to external reinsurance, and prior to ultimately ceding its net reinsurance risks to CCC.

During the coordinated multi-state exam, the following exception was noted and has been carried to this report.

“Many of CCC's 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-Part 1, Columns 6 and 10 concerning reinsurance transactions conducted with affiliated entities.

Also, there are reinsurance-related receivables and payables reported as receivable from or payable to Parent, Subsidiary or Affiliates. SSAP 62, paragraph 26 of the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions for Property-Casualty Insurance Companies instructs companies to report reinsurance-related receivables/payables on Annual Statement line items specifically titled for reinsurance. The Delaware Insurance Code requires companies to prepare their Annual Statements in accordance with NAIC Annual Statement Instructions.”

The following recommendation is made:

It is recommended that the Company comply with SSAP 62, paragraph 26 by completing its Annual Statement in accordance with Annual Statement Instructions and Accounting Practices and Procedures adopted by the NAIC.

CONTINENTAL CASUALTY COMPANY LOSS RESERVES

As of December 31, 2003, the Company appropriately reported no net loss and loss adjustment expense reserves. As previously mentioned, the Company reinsures 100% of its business under quota share treaties with its ultimate insurance parent, CCC.

The examination of the Company was conducted concurrently with the multi-state examinations of the CNA group of companies. The Illinois Division of Insurance contracted with Towers, Perrin, Tillinghast (Tillinghast), independent actuaries, to provide an estimate of

The Glens Falls Insurance Company

the CCC and CIC loss and loss adjustment expense reserves for core lines, as well as, asbestos, pollution and mass torts (APMT) reserves. In various reports and correspondence, Tillinghast uses the term CNA to refer to the combined reserve positions of CCC and CIC.

In a letter of opinion addressed to the Illinois Division of Insurance, Tillinghast advised that CNA's net loss and loss adjustment expense reserve for the segments reviewed, fall below Tillinghast's point estimates in total, but fall within a range of reasonable estimates. As such, no financial adjustment was made to CCC or CIC regarding loss and loss adjustment expense reserves. However, it should be noted that actual future losses and or loss adjustment expenses may show adverse development within the range, which could significantly impact the Company's financials. If APMT reserves were to develop to the high end of the range, the deficiency would have substantial impact on the surplus position of the Company. To note, Tillinghast's point estimates for the relevant business reviewed, exceed CNA's carried reserves, as of December 31, 2003, by approximately 18% of CNA's consolidated policyholders' surplus.

INTERCOMPANY AGREEMENTS

The Company had the following inter-company agreements and arrangements in effect as of December 31, 2003:

Consolidated Income Tax Allocation Agreement

Glens Falls participates in an inter-company tax allocation agreement (effective May 11, 1995) with Loews. The agreement allows for Glens Falls to file federal income taxes on a consolidated basis through Loews.

The Glens Falls Insurance Company

Expense Allocation Agreement

As of the year-end 2003, the daily business affairs and financial records of the Company are handled and maintained by employees of CCC pursuant to an expense allocation agreement. The agreement, between CCC and other affiliated insurers, including Glens Falls, provides for employees of CCC to perform certain marketing, administrative, investment and other incidental functions and for the use of all necessary equipment and other such facilities of CNA. In return CCC receives a periodic service fee.

During the coordinated multi-state exam, the following exception was noted and has been carried to this report.

“A review was performed of the CNA Intercompany Expense Agreement. Based on this review, it was determined that the agreement (in place as of December 31, 2003) 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.”

The following recommendation is made:

It is recommended that the CNA Inter-company 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 in the Delaware Insurance Code.

EXTERNAL AGREEMENTS

In addition to the above inter-company agreements, the Company had the following external agreements in effect at December 31, 2003:

Custodial Agreement

The examiner acquired the Domestic Custody Agreement between the Company and Chase Manhattan Bank. The original agreement was dated November 26, 1996.

The Glens Falls Insurance Company

From language reviewed in this agreement, the custodian is charged to maintain a separate accounting of all assets held for the benefit of the Company. These funds are not to be co-mingled for the investment purposes of any other assets held by the custodian.

Furthermore, the custodians are obligated to indemnify the Company for loss of securities due to negligence, robbery, and damage by the custodians. In the event of such losses, the custodians are responsible to replace the value of the securities.

Securities Lending Agreement

The Company has in place a securities lending agreement with the aforementioned investment custodian. The agreement goes into some detail as to authority granted to the custodian to engage in the lending of the Company's securities and the credit needed by borrowers to enter into agreements with the custodian. Further discussion is made into the collateral held by the custodian, and the types of transactions for the collateral account. The agreement also grants indemnification to the Company, and holds harmless from loss of securities and any legal expenses in enforcing this indemnification.

This agreement is substantiated further in that it is an integral part of CNA's written investment plan.

LEGAL ACTIONS

The Company is a party to various litigation and claims, common to its business. Management believes that the outcome of such matters will not have a material adverse impact on the financial position or results of operations of the Company. In accordance with NAIC

The Glens Falls Insurance Company

Annual Statement Instructions, the Company has made adequate disclosure of its material contingent liabilities where required.

ACCOUNTS AND RECORDS

Accounting System

Glens Falls utilizes automated systems to maintain and account for most transactions. The PeopleSoft General Ledger, Query and Archive Warehouse constitute the Company's official book of record for financial reporting. The General Ledger consists of various ledgers that contain specific types of information required to support GAAP, STAT, SEC and Internal Management Reporting.

The internal auditors perform regular reviews of accounts and records of the Company and may recommend changes in Company 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.

Independent Accountants

The Company's financial statements are audited each year by the firm of Deloitte and Touche, LLP or "D&T", of Chicago, IL. The examiners reviewed the audited statutory financial statements for all years under review and noted that D&T issued an unqualified opinion each year.

Actuarial Opinion

The Company's loss reserves and related actuarial items were reviewed by Ronald J. Swanstrom, FCAS, MAAA, the Senior Vice-President who issued a statement of actuarial opinion, based on the financial information presented by the Company. The opinion stated that

The Glens Falls Insurance Company

the reserves and related actuarial values carried on the balance sheet are fairly stated and met the requirements of the insurance laws of the State of Delaware.

See Reinsurance section above for more information regarding the cession of 100% of Glens Falls' balance sheet risk.

Information Systems Control Review

During the course of the coordinated multi-state examination of the CNA companies, the Illinois Insurance Department's Information System audit specialist reviewed the Company's information systems with respect to the following:

- a) The presence of an Information System audit function
- b) Data Center and Local Area Network (LAN) security and control
- c) Contingency planning for recovery of Information Systems

During the examination of Glens Falls as of December 31, 2003, INS Services, Inc (INS) was engaged to participate on behalf of the state insurance regulators. As part of that effort, INS did an extensive review of the CNA Information Systems area. These workpapers, together with recommendations for resolving deficiencies were made available to the state examiners at the conclusion of the INS audit. INS identified deficiencies in the control environment, formulated recommendations to improve the controls and passed that information to management, which responded to each recommendation within an agreed timeframe. All conclusions by the financial examination staff with respect to the Company's information systems general control environment are the result of that review.

FINANCIAL STATEMENTS

The following pages contain a statement of assets, liabilities, surplus and other funds as of December 31, 2003, as determined by this examination, along with supporting exhibits as detailed below:

- Analysis of Assets, December 31, 2003
- Statement of Liabilities, Surplus and Other Funds, December 31, 2003
- Underwriting and Investment Exhibit, December 31, 2003
- Schedule of Examination Adjustments

It should be noted that the various schedules and exhibits may not sum to the totals shown due to rounding.

**Analysis of Assets
As of December 31, 2003**

	<u>Ledger</u> <u>Assets</u>	<u>Non-admitted</u> <u>Assets</u>	<u>Net Admitted</u> <u>Assets</u>
Bonds	\$ 123,598,077		\$ 123,598,077
Stocks:			
Common	3,183,997		3,183,997
Cash and short-term investments	1,861,945	3,815	1,858,130
Other invested assets	45,848		45,848
Receivable for securities	1,269		1,269
Investment Income Due and Accrued	976,336		976,336
Reinsurance:			
Amounts recoverable from reinsurers	211,236		211,236
Net deferred tax asset	6,029,127	3,798,737	2,230,390
Guaranty funds receivable or on deposit	6,244,190		6,244,190
Receivable from parent, subsidiaries and affiliates	1,511,595		1,511,595
Aggregate write-ins for other than invested assets	<u>3,815</u>	<u>0</u>	<u>3,815</u>
Total Assets	<u>\$143,667,434</u>	<u>\$3,802,552</u>	<u>\$139,864,882</u>

The Glens Falls Insurance Company

**Statement of Liabilities, Surplus and Other Funds
As of December 31, 2003**

Losses	\$ 0
Reinsurance payable on paid losses	0
Loss adjustment expenses	0
Contingent commissions	0
Other expenses	0
Taxes, licenses and fees	0
Unearned premiums	0
Ceded reinsurance premiums payable	72,258
Provision for reinsurance	23,475,659
Payable to parent, subsidiaries, and affiliates	451,571
Aggregate write-ins for liabilities	<u>3,815</u>
Total Liabilities	<u>\$24,003,302</u>
Common capital stock	4,200,000
Gross paid-in and contributed surplus	104,105,203
Unassigned funds (surplus)	<u>7,556,378</u>
Surplus as regards policyholders	<u>\$115,861,580</u>
Total Liabilities and Surplus	<u>\$ 139,864,882</u>

**Underwriting and Investment Exhibit
Year Ended December 31, 2003**

UNDERWRITING INCOME

Premiums earned \$ 0

DEDUCTIONS

Losses incurred	\$ 0
Loss expenses incurred	0
Aggregate write-ins for underwriting deductions	3,801
Other underwriting expenses incurred	<u>(3,801)</u>
Total underwriting deductions	<u>\$ 0</u>
Net underwriting gain or (loss)	<u>\$ 0</u>

INVESTMENT INCOME

Net investment income earned	\$ 6,804,538
Net realized capital gains or (losses)	<u>4,202,762</u>
Net investment gain or (loss)	<u>\$ 11,007,300</u>

OTHER INCOME

Net gain or (loss) from agents' or premium balances charged off	\$ 0
Aggregate write-ins for miscellaneous income	<u>(1,916)</u>
Total other income	<u>\$ (1,916)</u>
Net income before dividends to policyholders and before federal income taxes	\$ 11,005,385
Dividends to policyholders	<u>0</u>
Net income after dividends to policyholder but before federal income taxes	\$ 11,005,385
Federal and foreign income taxes incurred	<u>0</u>
Net income	<u>\$ 11,005,385</u>

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2002 \$ 132,410,072

GAINS AND (LOSSES) IN SURPLUS

Net income	\$ 11,005,385
Net unrealized capital gains or (losses)	1,582,878
Change in net deferred income tax	(3,362,342)
Change in non-admitted assets	6,390,650
Change in provision for reinsurance	2,737,866
Capital Paid In	(35,000,000)
Aggregate Write-ins	<u>97,072</u>
Change in surplus as regards policyholders for the year	<u>\$ (16,548,492)</u>
Surplus as regards policyholder, December 31, 2003	<u>\$ 115,861,580</u>

SCHEDULE OF EXAMINATION ADJUSTMENTS

<u>Description</u>	<u>Per Examination</u>	<u>Per Company</u>	<u>Surplus Increase (Decrease)</u>
Assets:	\$139,864,882	\$139,864,882	0
Adjusted Admitted Assets	\$139,864,882	\$139,864,882	0
Liabilities and Surplus:	\$139,864,882	\$139,864,882	
Adjusted Liabilities and Surplus	\$139,864,882	\$139,864,882	0

There were no Surplus adjustments as per the examination.

MARKET CONDUCT ACTIVITIES

Sales and Advertising

A review was made of the Company’s sales and advertising materials for its core lines of business. It appears from this review that the Company is in compliance with 18 Del.C. §2304, and does not appear to be using deceptive or misleading sales and advertising practices

Underwriting and Rating

A review of the forms and endorsements filed during the period under examination revealed that the Company appears to be in compliance with Title 18 Del.C. §2712.

Agents Licensing

Based on our scope of agents’ license testing, the Company appears to be in compliance with Regulation 36 of the Delaware Insurance Regulations.

Complaint Handling

The Company maintains a complaint log as required by 18 Del.C. §2304(17). A review of registered complaints from 2001 to 2003 did not indicate a pattern of complaints. Further, there did not appear to be any trends in states where the Company markets insurance products.

However, a significant number of complaints were filed with the NAIC that were not reported and logged by the Company. The following recommendation will be made:

The Company should immediately apply its complaint handling procedure and properly record all claims received against it.

Claims Practices

Based upon the procedures performed, it appears that the Company's claims practices are performed in accordance with Delaware Insurance Laws and Regulations.

COMPLIANCE WITH PRIOR REPORT RECOMMENDATIONS

A review was performed of appropriate balance sheet and forepart files to verify corrective action had been taken with regards to prior examination report comments and recommendations.

Management and Control

1. Prior Exam Comment: It is again recommended that the current management of Glens Falls initiate measures in the near future to ensure compliance with Section 4919 of the Delaware Insurance Code pertaining to notification to the Insurance Commissioner of any changes to key management personnel. The Delaware Insurance Department was not notified about the resignation and replacement of several key employees throughout the period under review.

The Glens Falls Insurance Company

Current Exam Finding: A review revealed that all changes to officers and directors of the Company during the examination period had not been reported to the Delaware Insurance Department in accordance with 18 Del.C. §4919. Accordingly, the prior report recommendation remains open as of December 31, 2003.

2. Prior Exam Comment: It is again recommended that the current management of Glens Falls initiate corrective measures in the near future to make sure that the number of Directors elected to the Board complies with the requirement stipulated in the Company By-Laws and the Articles of Incorporation.

Current Exam Finding: It appears that the Company has elected an appropriate number of directors to its board as directed by its own Articles of Incorporation and By-Laws.

3. Prior Exam Comment: It is recommended that the current management of Glens Falls initiate measures in the near future to ensure compliance with Sections 5004(b)(3)(c) and 5004(d) of the Delaware Insurance Code pertaining to the disclosure of material affiliated company transactions not in the ordinary course of business to the Delaware Insurance Department. A material inter-company refinancing of mortgage debt occurred in 1998 which Glens Falls did not disclose in the 1990 Form "B" filing.

Current Exam Finding: It appears that the Company has properly filed its Form B with the Delaware Insurance Department. Furthermore, it appears that all necessary disclosures have been made in regards to affiliated transactions.

Access to Records for Review

4. Prior Exam Comment: It is again recommended that the current management of Glens Falls initiate measures in the near future to ensure compliance with Section 320(c) of the Delaware Insurance Code pertaining to the Examiners having free access to the Company records without restrictive constraints encountered during the current examination.

Current Exam Finding: It is of the opinion of the Examiner-in-Charge that the management of the company has made a concerted effort to better facilitate the Examiners' access to Company records and personnel.

5. Prior Exam Comment: It is recommended that the current management of Glens Falls initiate measures in the near future to remedy the numerous record-keeping problems documented in the "Record Keeping Deficiencies" subsection of the "Accounts and Records" section of this examination report.

Current Exam Finding: It is of the opinion of the Examiner-in-Charge that there have been no major issues encountered on the Company's PeopleSoft General Ledger System that would warrant the above referenced recommendation. There appeared to be no record keeping problems in other areas.

Compliance with Prior Report Recommendations

6. Prior Exam Comment: The current management of Glens Falls should implement measures in the future (sic) ensure that examination report recommendations are complied with, not ignored.

Current Exam Finding: From the first recommendation above, it appears that the Company has made no effort to comply with this recommendation of the prior exam report.

SUMMARY OF RECOMMENDATIONS

1. The failure of the management of Glens Falls to disclose the resignation of key management personnel to the Commissioner of the Delaware Insurance Department constitutes non-compliance with Section 4919 of the Delaware Insurance Code. This is the THIRD examination in succession that the Company has filed to comply with the provisions of Section 4919 of the Delaware Insurance Code.

It is recommended that the Company immediately initiate measures to comply with the provisions of Section 4919 of the Delaware Insurance Code regarding the proper reporting of changes in the principal Officers and Directors of the Company. (See Management and Control, page 7)

2. It is recommended that the Company comply with SSAP 62, paragraph 26 by completing its Annual Statement in accordance with Annual Statement Instructions and Accounting Practices and Procedures adopted by the NAIC. (See Reinsurance, Page 14)

3. It is recommended that the CNA Intercompany 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 in the Delaware Insurance Code. (See Intercompany Agreements, page 16)

4. The Company should immediately apply its complaint handling procedure and properly record all claims received against it. (See Market Conduct, page 24)

CONCLUSION

The following schedule shows the results of this examination and the results of the prior examination with changes between the examination periods:

<u>Description</u>	<u>December 31, 1999</u>	<u>December 31, 2003</u>	<u>Increase/(Decrease)</u>
Assets	71,582,652	139,864,882	68,282,230
Liabilities	48,146,396	24,003,302	(24,143,094)
Surplus as Regards Policyholders	23,436,256	115,861,580	92,425,324

Respectfully submitted,



Craig P. Jackson, CFE
Examiner-In-Charge
State of Delaware
Northeastern Zone, NAIC