

CNA FINANCIAL CORP
Form 10-Q
August 02, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
R QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2011

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 1-5823

CNA FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

333 S. Wabash
Chicago, Illinois
(Address of principal executive offices)

(312) 822-5000
(Registrant's telephone number, including area code)

36-6169860
(I.R.S. Employer
Identification No.)

60604
(Zip Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes R No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes R No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer
(Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at July 29, 2011
Common Stock, Par value \$2.50	269,274,559

Item Number		Page Number
	<u>PART I. Financial Information</u>	
1.	<u>Condensed Consolidated Financial Statements (Unaudited):</u>	
	<u>Condensed Consolidated Statements of Operations for the Three and Six months ended June 30, 2011 and 2010</u>	<u>3</u>
	<u>Condensed Consolidated Statements of Comprehensive Income for Three and Six months ended June 30, 2011 and 2010</u>	<u>4</u>
	<u>Condensed Consolidated Balance Sheets at June 30, 2011 and December 31, 2010</u>	<u>5</u>
	<u>Condensed Consolidated Statements of Cash Flows for the Six months ended June 30, 2011 and 2010</u>	<u>6</u>
	<u>Condensed Consolidated Statements of Equity for the Six months ended June 30, 2011 and 2010</u>	<u>8</u>
	<u>Notes to Condensed Consolidated Financial Statements</u>	<u>9</u>
2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>45</u>
3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>62</u>
4.	<u>Controls and Procedures</u>	<u>63</u>
	<u>PART II. Other Information</u>	
1.	<u>Legal Proceedings</u>	<u>64</u>
6.	<u>Exhibits</u>	<u>65</u>

Table of Contents

CNA Financial Corporation

Part I. Financial Information

Item 1. Condensed Consolidated Financial Statements

Condensed Consolidated Statements of Operations (Unaudited)

Periods ended June 30 (In millions, except per share data)	Three Months		Six Months	
	2011	2010	2011	2010
Revenues				
Net earned premiums	\$1,595	\$1,608	\$3,210	\$3,223
Net investment income	517	521	1,137	1,111
Net realized investment gains, net of participating policyholders' interests:				
Other-than-temporary impairment losses	(41	) (58	) (61	) (148
Portion of other-than-temporary impairments recognized in Other comprehensive income	(21	) 1	(42	) 31
Net other-than-temporary impairment losses recognized in earnings	(62	) (57	) (103	) (117
Other net realized investment gains	77	86	131	180
Net realized investment gains, net of participating policyholders' interests	15	29	28	63
Other revenues	71	75	138	151
Total revenues	2,198	2,233	4,513	4,548
Claims, Benefits and Expenses				
Insurance claims and policyholders' benefits	1,367	1,147	2,731	2,455
Amortization of deferred acquisition costs	350	345	695	687
Other operating expenses	259	258	484	530
Interest	43	37	89	73
Total claims, benefits and expenses	2,019	1,787	3,999	3,745
Income from continuing operations before income tax	179	446	514	803
Income tax expense	(47	) (145	) (149	) (247
Income from continuing operations	132	301	365	556
Income (loss) from discontinued operations, net of income tax (expense) benefit of \$0, \$0, \$0 and \$0	—	1	(1	) 1
Net income	132	302	364	557
Net (income) loss attributable to noncontrolling interests	(6	) (19	) (15	) (29
Net income attributable to CNA	\$126	\$283	\$349	\$528
Income Attributable to CNA Common Stockholders				
Income from continuing operations attributable to CNA	\$126	\$282	\$350	\$527
Dividends on 2008 Senior Preferred	—	(25	) —	(50
Income from continuing operations attributable to CNA common stockholders	126	257	350	477
Income (loss) from discontinued operations attributable to CNA common stockholders	—	1	(1	) 1
Income attributable to CNA common stockholders	\$126	\$258	\$349	\$478
Basic and Diluted Earnings Per Share Attributable to CNA Common Stockholders				
Income from continuing operations attributable to CNA common stockholders	\$0.47	\$0.96	\$1.30	\$1.77

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Income (loss) from discontinued operations attributable to CNA common stockholders	—	—	—	0.01
Basic and diluted earnings per share attributable to CNA common stockholders	\$0.47	\$0.96	\$1.30	\$1.78
Weighted Average Outstanding Common Stock and Common Stock Equivalents				
Basic	269.3	269.1	269.3	269.1
Diluted	269.6	269.3	269.6	269.3

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements (Unaudited).

3

Table of Contents

CNA Financial Corporation

Condensed Consolidated Statements of Comprehensive Income (Unaudited)

Periods ended June 30 (In millions)	Three Months		Six Months		
	2011	2010	2011	2010	
Other Comprehensive Income, Net of Tax					
Changes in:					
Net unrealized gains on investments with other-than-temporary impairments	\$1	\$17	\$39	\$42	
Net unrealized gains on other investments	300	377	322	700	
Net unrealized gains on investments	301	394	361	742	
Net unrealized gains (losses) on discontinued operations and other	—	1	1	8	
Foreign currency translation adjustment	5	17	30	7	
Pension and postretirement benefits	1	2	2	3	
Allocation to participating policyholders	(1) (5) (1) (28)
Other comprehensive income, net of tax	306	409	393	732	
Net income	132	302	364	557	
Comprehensive income	438	711	757	1,289	
Changes in:					
Net unrealized (gains) losses on investments attributable to noncontrolling interests	(10) (8) (8) (14)
Pension and postretirement benefits attributable to noncontrolling interests	—	—	—	(3)
Other comprehensive (income) loss attributable to noncontrolling interests	(10) (8) (8) (17)
Net (income) loss attributable to noncontrolling interests	(6) (19) (15) (29)
Comprehensive (income) loss attributable to noncontrolling interests	(16) (27) (23) (46)
Total comprehensive income attributable to CNA	\$422	\$684	\$734	\$1,243	

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements (Unaudited).

Table of Contents

CNA Financial Corporation

Condensed Consolidated Balance Sheets (Unaudited)

(In millions, except share data)	June 30, 2011	December 31, 2010
Assets		
Investments:		
Fixed maturity securities at fair value (amortized cost of \$36,791 and \$36,427)	\$38,554	\$37,577
Equity securities at fair value (cost of \$320 and \$422)	346	440
Limited partnership investments	2,554	2,309
Other invested assets	16	27
Mortgage loans	198	87
Short term investments	1,709	2,215
Total investments	43,377	42,655
Cash	84	77
Reinsurance receivables (less allowance for uncollectible receivables of \$125 and \$125)	6,802	7,079
Insurance receivables (less allowance for uncollectible receivables of \$145 and \$160)	1,695	1,557
Accrued investment income	436	425
Deferred acquisition costs	1,106	1,079
Deferred income taxes	376	667
Property and equipment at cost (less accumulated depreciation of \$567 and \$543)	300	333
Goodwill and other intangible assets	141	141
Other assets (includes \$120 and \$139 due from Loews Corporation)	1,007	868
Separate account business	450	450
Total assets	\$55,774	\$55,331
Liabilities and Equity		
Liabilities:		
Insurance reserves:		
Claim and claim adjustment expenses	\$25,196	\$25,496
Unearned premiums	3,409	3,203
Future policy benefits	9,021	8,718
Policyholders' funds	166	173
Participating policyholders' funds	64	60
Short term debt	—	400
Long term debt	2,648	2,251
Other liabilities	3,071	3,056
Separate account business	450	450
Total liabilities	44,025	43,807
Commitments and contingencies (Notes C, D, G, and I)		
Equity:		
Common stock (\$2.50 par value; 500,000,000 shares authorized; 273,040,243 shares issued; 269,274,559 and 269,139,198 shares outstanding)	683	683
Additional paid-in capital	2,143	2,200
Retained earnings	8,171	7,876
Accumulated other comprehensive income	730	326
Treasury stock (3,765,684 and 3,901,045 shares), at cost	(102)	(105)
Notes receivable for the issuance of common stock	(23)	(26)
Total CNA stockholders' equity	11,602	10,954
Noncontrolling interests	147	570
Total equity	11,749	11,524

Total liabilities and equity	\$55,774	\$55,331
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The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements (Unaudited).

Table of Contents

CNA Financial Corporation

Condensed Consolidated Statements of Cash Flows (Unaudited)

Six months ended June 30

(In millions)

Cash Flows from Operating Activities

	2011	2010	
Net income	\$364	\$557	
Adjustments to reconcile net income to net cash flows provided by operating activities:			
(Income) loss from discontinued operations	1	(1)
Loss on disposal of property and equipment	8	—	
Deferred income tax expense	98	82	
Trading portfolio activity	(9	) 153	
Net realized investment gains, net of participating policyholders' interests	(28	) (63)
Equity method investees	(108	) 14	
Amortization of investments	(37	) (59)
Depreciation	38	41	
Changes in:			
Receivables, net	139	314	
Accrued investment income	(11	) (9)
Deferred acquisition costs	(27	) 13	
Insurance reserves	93	(437)
Other assets	37	40	
Other liabilities	(153	) (52)
Other, net	9	2	
Total adjustments	50	38	
Net cash flows provided by operating activities-continuing operations	\$414	\$595	
Net cash flows used by operating activities-discontinued operations	\$(2	) \$(14)
Net cash flows provided by operating activities-total	\$412	\$581	
Cash Flows from Investing Activities			
Purchases of fixed maturity securities	\$(6,200	) \$(9,478)
Proceeds from fixed maturity securities:			
Sales	4,112	6,388	
Maturities, calls and redemptions	1,825	1,866	
Purchases of equity securities	(44	) (62)
Proceeds from sales of equity securities	153	128	
Origination of mortgage loans	(112	) (14)
Change in short term investments	514	789	
Change in other investments	(131	) (199)
Purchases of property and equipment	(24	) (23)
Dispositions	—	65	
Other, net	2	3	
Net cash flows provided (used) by investing activities-continuing operations	\$95	\$(537)
Net cash flows provided by investing activities-discontinued operations	\$2	\$14	
Net cash flows provided (used) by investing activities-total	\$97	\$(523)

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements (Unaudited).

Table of Contents

Six months ended June 30 (In millions)	2011	2010
Cash Flows from Financing Activities		
Acquisition of CNA Surety noncontrolling interest	\$(426)) \$—
Dividends paid to common stockholders	(54)) —
Dividends paid to Loews Corporation for 2008 Senior Preferred	—	(50)
Proceeds from the issuance of debt	396	—
Repayment of debt	(409)	) (50)
Stock options exercised	2	1
Other, net	(13)	) (25)
Net cash flows used by financing activities-continuing operations	\$(504)	) \$(124)
Net cash flows provided (used) by financing activities-discontinued operations	\$—	\$—
Net cash flows used by financing activities-total	\$(504)	) \$(124)
Effect of foreign exchange rate changes on cash-continuing operations	2	(2)
Net change in cash	\$7	\$(68)
Cash, beginning of year	77	140
Cash, end of period	\$84	\$72
Cash-continuing operations	\$84	\$72
Cash-discontinued operations	—	—
Cash-total	\$84	\$72

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements (Unaudited).

Table of Contents

CNA Financial Corporation

Condensed Consolidated Statements of Equity (Unaudited)

Six months ended June 30

(In millions)

	2011	2010	
Preferred Stock			
Balance, beginning of period	\$—	\$1,000	
Balance, end of period	—	1,000	
Common Stock			
Balance, beginning of period	683	683	
Balance, end of period	683	683	
Additional Paid-in Capital			
Balance, beginning of period	2,200	2,177	
Stock-based compensation	1	—	
Acquisition of CNA Surety noncontrolling interest	(60) —	
Other	2	23	
Balance, end of period	2,143	2,200	
Retained Earnings			
Balance, beginning of period	7,876	7,264	
Dividends paid to common stockholders	(54) —	
Dividends paid to Loews Corporation for 2008 Senior Preferred	—	(50)
Net income attributable to CNA	349	528	
Balance, end of period	8,171	7,742	
Accumulated Other Comprehensive Income (Loss)			
Balance, beginning of period	326	(325)
Other comprehensive income attributable to CNA	385	715	
Acquisition of CNA Surety noncontrolling interest	19	—	
Balance, end of period	730	390	
Treasury Stock			
Balance, beginning of period	(105	) (109)
Stock-based compensation	3	3	
Balance, end of period	(102	) (106)
Notes Receivable for the Issuance of Common Stock			
Balance, beginning of period	(26	) (30)
Decrease in notes receivable for the issuance of common stock	3	—	
Balance, end of period	(23	) (30)
Total CNA Stockholders' Equity	11,602	11,879	
Noncontrolling Interests			
Balance, beginning of period	570	506	
Net income (loss)	15	29	
Other comprehensive income (loss)	8	17	
Acquisition of CNA Surety noncontrolling interest	(434) —	
Other	(12	) (26)
Balance, end of period	147	526	
Total Equity	\$ 11,749	\$ 12,405	

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements (Unaudited).

Table of Contents

CNA Financial Corporation

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note A. General

Basis of Presentation

The Condensed Consolidated Financial Statements (Unaudited) include the accounts of CNA Financial Corporation (CNAF) and its controlled subsidiaries. Collectively, CNAF and its controlled subsidiaries are referred to as CNA or the Company. CNA's property and casualty and remaining life and group insurance operations are primarily conducted by Continental Casualty Company (CCC), The Continental Insurance Company (CIC), Continental Assurance Company (CAC) and CNA Surety Corporation (CNA Surety). Loews Corporation (Loews) owned approximately 90% of the outstanding common stock of CNAF as of June 30, 2011.

The accompanying Condensed Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). Certain financial information that is normally included in annual financial statements, including certain financial statement notes, prepared in accordance with GAAP, is not required for interim reporting purposes and has been condensed or omitted. These statements should be read in conjunction with the Consolidated Financial Statements and notes thereto included in CNAF's Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) for the year ended December 31, 2010, including the summary of significant accounting policies in Note A. The preparation of Condensed Consolidated Financial Statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the Condensed Consolidated Financial Statements and the reported amounts of revenues and expenses during the reporting periods. Actual results may differ from those estimates.

The interim financial data as of June 30, 2011 and for the three and six months ended June 30, 2011 and 2010 is unaudited. However, in the opinion of management, the interim data includes all adjustments, consisting of normal recurring accruals, necessary for a fair statement of the Company's results for the interim periods. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year.

Intercompany amounts have been eliminated.

CNA Surety

On June 10, 2011, CNA completed its previously announced acquisition of the noncontrolling interest of CNA Surety. Previously the Company owned approximately 61% of the outstanding publicly-traded common stock of CNA Surety. CNA Surety is now a wholly-owned subsidiary of CCC, and, effective after the close of the stock market on June 10, 2011, trading in CNA Surety common stock ceased.

The aggregate purchase price was approximately \$475 million, based on the offer price of \$26.55 per share and inclusive of the retirement of CNA Surety employee stock options. The amount paid to acquire the common stock of CNA Surety not owned by the Company in excess of the closing date noncontrolling interest included in the Company's equity of \$434 million was reflected as an adjustment to Additional Paid-in Capital and Accumulated Other Comprehensive Income on the Condensed Consolidated Statement of Equity. For the three and six months ended June 30, 2011, net income attributable to the noncontrolling interest in CNA Surety through the acquisition date of June 10, 2011 was \$4 million and \$12 million and is reflected on the Condensed Consolidated Statement of Operations. For the three and six months ended June 30, 2010, net income attributable to the noncontrolling interest in CNA Surety was \$11 million and \$19 million.

Reinsurance Receivables

The Company has established an allowance for uncollectible reinsurance receivables which relates to both amounts already billed on ceded paid losses as well as ceded reserves that will be billed when losses are paid in the future. The allowance for uncollectible reinsurance receivables is estimated on the basis of periodic evaluations of balances due from reinsurers, reinsurer creditworthiness, management's experience and current economic conditions. Financial strength ratings are updated and reviewed on an annual basis or sooner if the Company becomes aware of significant changes related to a reinsurer. Because billed receivables are less than 5% of total reinsurance receivables the age of the reinsurance receivables related to paid losses is not a significant input into the allowance analysis. For the six

months ended June 30, 2011, there was no significant change in the Company's allowance for uncollectible reinsurance receivables.

Table of Contents

Note B. Earnings Per Share

Earnings per share attributable to the Company's common stockholders is based on the weighted average number of outstanding common shares. Basic earnings per share excludes the impact of dilutive securities and is computed by dividing net income attributable to CNA by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

For the three and six months ended June 30, 2011, approximately 352 thousand and 329 thousand potential shares attributable to exercises under stock-based employee compensation plans were included in the calculation of diluted earnings per share. For those same periods, approximately 931 thousand and 1.0 million potential shares attributable to exercises under stock-based employee compensation plans were not included in the calculation of diluted earnings per share because the effect would have been antidilutive.

For the three and six months ended June 30, 2010, approximately 245 thousand and 193 thousand potential shares attributable to exercises under stock-based employee compensation plans were included in the calculation of diluted earnings per share. For those same periods, approximately 1.2 million and 1.4 million potential shares attributable to exercises under stock-based employee compensation plans were not included in the calculation of diluted earnings per share because the effect would have been antidilutive.

Table of Contents

Note C. Investments

The significant components of net investment income are presented in the following table.

Net Investment Income

Periods ended June 30 (In millions)	Three Months		Six Months	
	2011	2010	2011	2010
Fixed maturity securities	\$505	\$519	\$1,011	\$1,029
Short term investments	2	5	4	11
Limited partnership investments	11	(4	) 125	68
Equity securities	6	9	12	19
Mortgage loans	2	—	4	—
Trading portfolio (a)	3	2	6	6
Other	3	3	5	5
Gross investment income	532	534	1,167	1,138
Investment expense	(15	) (13	) (30	) (27
Net investment income	\$517	\$521	\$1,137	\$1,111

(a) There were no net unrealized gains (losses) related to changes in fair value of trading securities still held included in net investment income for the three and six months ended June 30, 2011 and 2010.

Net realized investment gains are presented in the following table.

Net Realized Investment Gains

Periods ended June 30 (In millions)	Three Months		Six Months	
	2011	2010	2011	2010
Net realized investment gains:				
Fixed maturity securities:				
Gross realized gains	\$89	\$133	\$177	\$231
Gross realized losses	(69	) (67	) (137	) (138
Net realized investment gains on fixed maturity securities	20	66	40	93
Equity securities:				
Gross realized gains	1	—	6	4
Gross realized losses	(3	) (28	) (8	) (29
Net realized investment losses on equity securities	(2	) (28	) (2	) (25
Derivatives	—	—	(1) —
Short term investments and other (a) (b)	(3	) (9	) (9	) (5
Net realized investment gains, net of participating policyholders' interests	\$15	\$29	\$28	\$63

(a) The six months ended June 30, 2011 includes a \$9 million loss related to the early extinguishment of \$400 million of senior notes originally due August 15, 2011.

(b) There were no net unrealized gains (losses) included in the three months ended June 30, 2011 and \$1 million of net unrealized gains included in the six months ended June 30, 2011 related to changes in fair value of securities for which the fair value option has been elected.

Table of Contents

The components of net other-than-temporary impairment (OTTI) losses recognized in earnings by asset type are summarized in the following table.

Periods ended June 30 (In millions)	Three Months		Six Months	
	2011	2010	2011	2010
Fixed maturity securities available-for-sale:				
Corporate and other bonds	\$15	\$24	\$24	\$42
States, municipalities and political subdivisions	—	6	—	20
Asset-backed:				
Residential mortgage-backed	46	11	74	37
Commercial mortgage-backed	—	—	—	2
Other asset-backed	—	2	—	2
Total asset-backed	46	13	74	41
Total fixed maturity securities available-for-sale	61	43	98	103
Equity securities available-for-sale:				