

CNA FINANCIAL CORP  
Form 10-Q  
October 30, 2007

**Table of Contents**

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

**FORM 10-Q**

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

For the quarterly period ended September 30, 2007

OR

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)

**36-6169860**

(I.R.S. Employer  
Identification No.)

**333 S. Wabash**

**Chicago, Illinois**

(Address of principal executive offices)

**60604**

(Zip Code)

**(312) 822-5000**

**(Registrant's telephone number, including area 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  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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.

<b>Class</b>	<b>Outstanding at October 24, 2007</b>
Common Stock, Par value \$2.50	271,656,478

**CNA FINANCIAL CORPORATION  
INDEX**

Item Number		Page Number
<b><u>PART I. Financial Information</u></b>		
<u>1.</u>	<u>Condensed Consolidated Financial Statements (Unaudited):</u>	
	<u>Condensed Consolidated Statements of Operations for the Three and Nine months Ended September 30, 2007 and 2006</u>	3
	<u>Condensed Consolidated Balance Sheets at September 30, 2007 and December 31, 2006</u>	4
	<u>Condensed Consolidated Statements of Cash Flows for the Nine months Ended September 30, 2007 and 2006</u>	5
	<u>Condensed Consolidated Statements of Stockholders' Equity for the Nine months Ended September 30, 2007 and 2006</u>	7
	<u>Notes to Condensed Consolidated Financial Statements</u>	8
<u>2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	41
<u>3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	73
<u>4.</u>	<u>Controls and Procedures</u>	74
<b><u>PART II. Other Information</u></b>		
<u>1.</u>	<u>Legal Proceedings</u>	75
<u>6.</u>	<u>Exhibits</u>	75
	<u>Employment Agreement</u>	
	<u>Certification of Chief Executive Officer</u>	
	<u>Certification of Chief Financial Officer</u>	
	<u>Written Statement of the Chief Executive Officer</u>	
	<u>Written Statement of the Chief Financial Officer</u>	

**Table of Contents****CNA FINANCIAL CORPORATION****PART I. FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**

<b>Period ended September 30</b> (In millions, except per share data)	<b>Three months</b>		<b>Nine months</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Revenues</b>				
Net earned premiums	\$ 1,882	\$ 1,943	\$ 5,617	\$ 5,704
Net investment income	580	600	1,859	1,722
Realized investment gains (losses), net of participating policyholders and minority interests	(57)	21	(217)	(68)
Other revenues	79	56	211	175
<b>Total revenues</b>	<b>2,484</b>	<b>2,620</b>	<b>7,470</b>	<b>7,533</b>
<b>Claims, Benefits and Expenses</b>				
Insurance claims and policyholders benefits	1,575	1,522	4,496	4,446
Amortization of deferred acquisition costs	384	390	1,137	1,132
Other operating expenses	244	224	722	723
Restructuring and other related charges				(13)
Interest	35	35	104	93
<b>Total claims, benefits and expenses</b>	<b>2,238</b>	<b>2,171</b>	<b>6,459</b>	<b>6,381</b>
Income before income tax and minority interest	246	449	1,011	1,152
Income tax expense	(56)	(131)	(279)	(339)
Minority interest	(16)	(13)	(37)	(32)
Income from continuing operations	174	305	695	781
Income (loss) from discontinued operations, net of income tax (expense) benefit of \$(1), \$9, \$0 and \$9		6	(8)	(2)
<b>Net Income</b>	<b>\$ 174</b>	<b>\$ 311</b>	<b>\$ 687</b>	<b>\$ 779</b>
<b>Basic and Diluted Earnings Per Share</b>				
Income from continuing operations	\$ 0.64	\$ 1.13	\$ 2.56	\$ 2.84
Income (loss) from discontinued operations		0.02	(0.03)	(0.01)

Basic and diluted earnings per share available to common stockholders	\$ 0.64	\$ 1.15	\$ 2.53	\$ 2.83
---	---------	---------	---------	---------

**Weighted average outstanding common stock and common stock equivalents**

Basic	271.6	265.0	271.5	259.0
Diluted	271.9	265.2	271.8	259.2

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)**

	<b>September 30, 2007</b>	<b>December 31, 2006</b>
(In millions, except share data)		
<b>Assets</b>		
Investments:		
Fixed maturity securities at fair value (amortized cost of \$34,107 and \$35,135)	\$ 34,196	\$ 35,851
Equity securities at fair value (cost of \$346 and \$408)	608	657
Limited partnership investments	2,093	1,852
Other invested assets	43	26
Short term investments	6,972	5,710
Total investments	43,912	44,096
Cash	80	84
Reinsurance receivables (less allowance for uncollectible receivables of \$464 and \$469)	8,893	9,478
Insurance receivables (less allowance for doubtful accounts of \$343 and \$368)	2,084	2,108
Accrued investment income	339	313
Receivables for securities sold	668	303
Deferred acquisition costs	1,189	1,190
Prepaid reinsurance premiums	321	342
Deferred income taxes	1,076	855
Property and equipment at cost (less accumulated depreciation of \$595 and \$571)	353	277
Goodwill and other intangible assets	142	142
Other assets	586	592
Separate account business	472	503
<b>Total assets</b>	<b>\$ 60,115</b>	<b>\$ 60,283</b>
<b>Liabilities and Stockholders Equity</b>		
Liabilities:		
Insurance reserves:		
Claim and claim adjustment expenses	\$ 28,992	\$ 29,636
Unearned premiums	3,753	3,784
Future policy benefits	6,993	6,645
Policyholders funds	1,013	1,015
Collateral on loaned securities and derivatives	83	2,851
Payables for securities purchased	3,062	221
Participating policyholders funds	43	50
Short term debt	150	
Long term debt	2,007	2,156

Edgar Filing: GNA FINANCIAL CORP - Form 10-Q

Federal income taxes payable (includes \$3 and \$38 due to Loews Corporation)	5	40
Reinsurance balances payable	483	539
Other liabilities	2,575	2,740
Separate account business	472	503
<b>Total liabilities</b>	<b>49,631</b>	<b>50,180</b>
Commitments and contingencies (Notes D, F, G, I and N)		
Minority interest	369	335
Stockholders' equity:		
Common stock (\$2.50 par value; 500,000,000 shares authorized; 273,040,243 shares issued; and 271,656,478 and 271,108,480 shares outstanding)	683	683
Additional paid-in capital	2,168	2,166
Retained earnings	7,162	6,486
Accumulated other comprehensive income	192	549
Treasury stock (1,383,765 and 1,931,763 shares), at cost	(39)	(58)
	10,166	9,826
Notes receivable for the issuance of common stock	(51)	(58)
<b>Total stockholders' equity</b>	<b>10,115</b>	<b>9,768</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 60,115</b>	<b>\$ 60,283</b>

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)**

<b>Nine months ended September 30</b> (In millions)	<b>2007</b>	<b>2006</b>
<b>Cash Flows from Operating Activities:</b>		
Net income	\$ 687	\$ 779
Adjustments to reconcile net income to net cash flows provided by operating activities:		
Loss from discontinued operations	8	2
Loss on disposal of property and equipment	1	
Minority interest	37	32
Deferred income tax provision	(26)	163
Trading securities activity	(44)	391
Realized investment losses, net of participating policyholders and minority interests	217	68
Undistributed earnings of equity method investees	(74)	(70)
Net amortization of bond (discount) premium	(195)	(211)
Depreciation	46	35
Changes in:		
Receivables, net	609	1,503
Deferred acquisition costs	1	(23)
Accrued investment income	(26)	(14)
Federal income taxes recoverable/payable	(35)	153
Prepaid reinsurance premiums	21	(27)
Reinsurance balances payable	(56)	(750)
Insurance reserves	(272)	(315)
Other assets	31	67
Other liabilities	(117)	37
Other, net	(84)	(37)
 Total adjustments	 42	 1,004
 <b>Net cash flows provided by operating activities-continuing operations</b>	 \$ 729	 \$ 1,783
 <b>Net cash flows used by operating activities-discontinued operations</b>	 \$ (16)	 \$
 <b>Net cash flows provided by operating activities-total</b>	 \$ 713	 \$ 1,783
 <b>Cash Flows from Investing Activities:</b>		
Purchases of fixed maturity securities	\$ (53,496)	\$ (32,425)
Proceeds from fixed maturity securities:		
Sales	53,003	30,942
Maturities, calls and redemptions	3,720	3,114
Purchases of equity securities	(157)	(267)



Edgar Filing: GNA FINANCIAL CORP - Form 10-Q

Proceeds from sales of equity securities	182	153
Change in short term investments	(963)	(4,381)
Change in collateral on loaned securities	(2,768)	1,618
Change in other investments	(95)	(139)
Purchases of property and equipment	(118)	(87)
Dispositions		7
Other, net	(17)	(49)
<b>Net cash flows used by investing activities-continuing operations</b>	<b>\$ (709)</b>	<b>\$ (1,514)</b>
<b>Net cash flows provided by investing activities-discontinued operations, including proceeds from disposition</b>	<b>\$ 42</b>	<b>\$ 24</b>
<b>Net cash flows used by investing activities-total</b>	<b>\$ (667)</b>	<b>\$ (1,490)</b>

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)**

<b>Nine months ended September 30</b> (In millions)	<b>2007</b>	<b>2006</b>
<b>Cash Flows from Financing Activities:</b>		
Dividends paid to stockholders	(54)	
Proceeds from the issuance of long-term debt		759
Principal payments on debt		(44)
Return of investment contract account balances	(59)	(510)
Receipts of investment contract account balances	2	2
Payment to repurchase Series H Issue preferred stock		(993)
Proceeds from the issuance of common stock		499
Stock options exercised	17	4
Other, net	11	1
<b>Net cash flows used by financing activities-continuing operations</b>	<b>\$ (83)</b>	<b>\$ (282)</b>
<b>Net cash flows used by financing activities-discontinued operations</b>	<b>\$</b>	<b>\$</b>
<b>Net cash flows used by financing activities-total</b>	<b>\$ (83)</b>	<b>\$ (282)</b>
Net change in cash	(37)	11
Net cash transactions from continuing operations to discontinued operations	59	15
Net cash transactions from discontinued operations to continuing operations	(59)	(15)
<b>Cash, beginning of year</b>	<b>124</b>	<b>125</b>
<b>Cash, end of period</b>	<b>\$ 87</b>	<b>\$ 136</b>
Cash-continuing operations	\$ 80	\$ 98
Cash-discontinued operations	7	38
<b>Cash-total</b>	<b>\$ 87</b>	<b>\$ 136</b>

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

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**  
**(UNAUDITED)**

<b>Nine months ended September 30</b> (In millions)	<b>2007</b>	<b>2006</b>
<b>Preferred Stock</b>		
Balance, beginning of period	\$	\$ 750
Repurchase of Series H Issue		(750)
Balance, end of period		
<b>Common Stock</b>		
Balance, beginning of period	683	645
Issuance of common stock		38
Balance, end of period	683	683
<b>Additional Paid-in Capital</b>		
Balance, beginning of period	2,166	1,701
Issuance of common stock and other	2	465
Balance, end of period	2,168	2,166
<b>Retained Earnings</b>		
Balance, beginning of period	6,486	5,621
Adjustment to initially apply FSP 85-4-1, net of tax	38	
Adjustment to initially apply FIN 48	5	
Adjusted balance, beginning of period	6,529	5,621
Dividends paid to stockholders	(54)	
Net income	687	779
Liquidation preference in excess of par value on Series H Issue		(243)
Balance, end of period	7,162	6,157
<b>Accumulated Other Comprehensive Income</b>		
Balance, beginning of period	549	359
Other comprehensive income (loss)	(357)	88

Balance, end of period	192	447
<b>Treasury Stock</b>		
Balance, beginning of period	(58)	(67)
Stock options exercised	19	2
Balance, end of period	(39)	(65)
<b>Notes Receivable for the Issuance of Common Stock</b>		
Balance, beginning of period	(58)	(59)
Decrease in notes receivable for the issuance of common stock	7	
Balance, end of period	(51)	(59)
<b>Total Stockholders Equity</b>	<b>\$ 10,115</b>	<b>\$ 9,329</b>

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. 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 subsidiaries are referred to as CNA or the Company. CNA's property and casualty and the remaining life and group insurance operations are primarily conducted by Continental Casualty Company (CCC), The Continental Insurance Company (CIC) and Continental Assurance Company (CAC). Loews Corporation (Loews) owned approximately 89% of the outstanding common stock of CNAF as of September 30, 2007.

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 Form 10-K filed with the Securities and Exchange Commission (SEC) for the year ended December 31, 2006. 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 September 30, 2007 and for the three and nine months ended September 30, 2007 and 2006 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. All significant intercompany amounts have been eliminated.

**Note B. Accounting Pronouncements**

***Financial Accounting Standards Board (FASB) Staff Position Technical Bulletin No. 85-4-1, Accounting for Life Settlement Contracts by Third-Party Investors (FSP 85-4-1)***

In March 2006, the FASB issued FSP 85-4-1. A life settlement contract for purposes of FSP 85-4-1 is a contract between the owner of a life insurance policy (the policy owner) and a third-party investor (investor). The previous accounting guidance, FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance (FTB 85-4), required the purchaser of life insurance contracts to account for the life insurance contract at its cash surrender value. Because life insurance contracts are purchased in the secondary market at amounts in excess of the policies' cash surrender values, the application of guidance in FTB 85-4 created a loss upon acquisition of policies. FSP 85-4-1 provides initial and subsequent measurement guidance and financial statement presentation and disclosure guidance for investments by third-party investors in life settlement contracts. FSP 85-4-1 allows an investor to elect to account for its investments in life settlement contracts using either the investment method or the fair value method. The election shall be made on an instrument-by-instrument basis and is irrevocable. The Company adopted FSP 85-4-1 on January 1, 2007.

Prior to 2002, the Company purchased investments in life settlement contracts. Under a life settlement contract, the Company obtained the ownership and beneficiary rights of an underlying life insurance policy. The Company elected to account for its investment in life settlement contracts using the fair value method and the initial impact upon adoption of FSP 85-4-1 under the fair value method was an increase to retained earnings of \$38 million, net of tax.

Under the fair value method, each life settlement contract is carried at its fair value at the end of each reporting period. The change in fair value, life insurance proceeds received and periodic maintenance costs, such as premiums, necessary to keep the underlying policy in force, are recorded in Other revenues on the Condensed

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

Consolidated Statement of Operations for the three and nine months ended September 30, 2007. Amounts presented related to the prior year were accounted for under the previous accounting guidance, FTB 85-4, where the carrying value of life settlement contracts was the cash surrender value, and revenue was recognized and included in Other revenues on the Condensed Consolidated Statement of Operations when the life insurance policy underlying the life settlement contract matured. Under the previous accounting guidance, maintenance expenses were expensed as incurred and included in Other operating expenses on the Condensed Consolidated Statement of Operations. The Company's investment in life settlement contracts of \$111 million at September 30, 2007 is included in Other assets on the Condensed Consolidated Balance Sheet. The cash receipts and payments related to life settlement contracts are included in Cash flows from operating activities on the Condensed Consolidated Statements of Cash Flows for both periods presented.

The fair value of each life insurance policy is determined as the present value of the anticipated death benefits less anticipated premium payments for that policy. These anticipated values are determined using mortality rates and policy terms that are distinct for each insured. The discount rate used reflects current risk-free rates at applicable durations and the risks associated with assessing the current medical condition of the insured, the potential volatility of mortality experience for the portfolio and longevity risk. The Company used its own experience to determine the fair value of its portfolio of life settlement contracts. The mortality experience of this portfolio of life insurance policies may vary by quarter due to its relatively small size.

The following table details the values for life settlement contracts.

September 30, 2007	Number of Life Settlement Contracts	Fair Value of Life Settlement Contracts (In millions)	Face Amount of Life Insurance Policies (In millions)
Estimated maturity during:			
2007	20	\$ 4	\$ 13
2008	80	15	51
2009	80	13	50
2010	80	12	50
2011	80	11	50
Thereafter	1,076	56	536
Total	1,416	\$ 111	\$ 750

The Company uses an actuarial model to estimate the aggregate face amount of life insurance that is expected to mature in each future year and the corresponding fair value. This model projects the likelihood of the insured's death for each in force policy based upon the Company's estimated mortality rates. The number of life settlement contracts presented in the table above is based upon the average face amount of in force policies estimated to mature in each future year.

The unrealized gains (change in fair value) recognized for the three and nine months ended September 30, 2007 on contracts still being held on September 30, 2007 were \$5 million and \$8 million. The gains recognized during the three and nine months ended September 30, 2007 on contracts that matured were \$15 million and \$36 million.

**FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48)**

In June 2006, the FASB issued FIN 48. FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken

or expects to take on a tax return. FIN 48 states that a tax benefit from an uncertain position may be recognized only if it is more likely than not that the position is sustainable, based on its technical merits. The tax benefit of a qualifying position is the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority having full knowledge of all relevant information. The adoption of FIN 48 as of January 1, 2007 increased retained earnings by \$5 million.

**Table of Contents****CNA FINANCIAL CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued  
(UNAUDITED)****Note C. Earnings Per Share**

Earnings per share available to common stockholders is based on weighted average outstanding shares. Basic earnings per share excludes dilution and is computed by dividing net income attributable to common stockholders 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 nine months ended September 30, 2007 and 2006, less than one million shares attributable to exercises under stock-based employee compensation plans were excluded from the calculation of diluted earnings per share because they were antidilutive.

The computation of earnings per share is as follows:

**Earnings Per Share**

<b>Period ended September 30</b> (In millions, except per share amounts)	<b>Three Months</b>		<b>Nine Months</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Income from continuing operations	\$ 174	\$ 305	\$ 695	\$ 781
Less: undeclared preferred stock dividend through repurchase date		(8)		(46)
Income from continuing operations available to common stockholders	\$ 174	\$ 297	\$ 695	\$ 735
Weighted average outstanding common stock and common stock equivalents	271.6	265.0	271.5	259.0
Effect of dilutive securities, employee stock options and appreciation rights	0.3	0.2	0.3	0.2
Adjusted weighted average outstanding common stock and common stock equivalents assuming conversions	271.9	265.2	271.8	259.2
<b>Basic and diluted earnings per share from continuing operations available to common stockholders</b>	<b>\$ 0.64</b>	<b>\$ 1.13</b>	<b>\$ 2.56</b>	<b>\$ 2.84</b>

The Series H Cumulative Preferred Stock Issue (Series H Issue) was held by Loews and accrued cumulative dividends at an initial rate of 8% per year, compounded annually. In August 2006, the Company repurchased the Series H Issue for approximately \$993 million, a price equal to the liquidation preference.



**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

**Note D. Investments**

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

**Net Investment Income**

<b>Period ended September 30</b> (In millions)	<b>Three Months</b>		<b>Nine Months</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Fixed maturity securities	\$ 501	\$ 477	\$ 1,523	\$ 1,372
Short term investments	57	61	146	184
Limited partnerships	19	46	142	173
Equity securities	7	4	18	18
Income (loss) from trading portfolio (a)	(2)	30	41	63
Interest on funds withheld and other deposits		(10)	(1)	(65)
Other	9	2	32	10
Gross investment income	591	610	1,901	1,755
Investment expense	(11)	(10)	(42)	(33)
<b>Net investment income</b>	<b>\$ 580</b>	<b>\$ 600</b>	<b>\$ 1,859</b>	<b>\$ 1,722</b>

(a) The change in net unrealized gains (losses) on trading securities, included in net investment income, was \$(12) million and \$(9) million for the three and nine months ended September 30, 2007 and \$3 million and \$(1) million for the three and nine months ended September 30, 2006.

The components of realized investment results for available-for-sale securities are presented in the following table.

**Realized Investment Gains (Losses)**

<b>Period ended September 30</b> (In millions)	<b>Three Months</b>		<b>Nine Months</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Fixed maturity securities:				
U.S. Government bonds	\$ 131	\$ 18	\$ 37	\$ 22
Corporate and other taxable bonds	(88)	(18)	(113)	(114)
Tax-exempt bonds	10	40	(43)	51
Asset-backed bonds	(81)	(1)	(191)	(15)
Redeemable preferred stock	(11)	(2)	(12)	(3)
Total fixed maturity securities	(39)	37	(322)	(59)
Equity securities	16	(3)	30	3
Derivative securities	(45)	(12)	62	(7)
Short term investments	5	(2)	5	(6)
Other, net of participating policyholders' interest	8	1	9	(1)

Realized investment gains (losses) before allocation to participating policyholders and minority interests	(55)	21	(216)	(70)
Allocated to participating policyholders and minority interests	(2)		(1)	2
<b>Realized investment gains (losses)</b>	<b>\$ (57)</b>	<b>\$ 21</b>	<b>\$ (217)</b>	<b>\$ (68)</b>

Realized investment losses for the three months ended September 30, 2007 included other-than-temporary impairment (OTTI) losses of \$188 million, recorded primarily in the corporate and other taxable bonds and asset-backed bonds sectors. This compared to OTTI losses for the three months ended September 30, 2006 of \$46 million recorded primarily in the corporate and other taxable bonds sector.

**Table of Contents**

**CNA FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**(UNAUDITED)**

Realized investment losses for the nine months ended September 30, 2007 included OTTI losses of \$451 million, recorded primarily in the corporate and other taxable bonds and asset-backed bonds sectors. This compared to OTTI losses for the nine months ended September 30, 2006 of \$87 million recorded primarily in the corporate and other taxable bonds sector.

The Company's investment policies emphasize high credit quality and diversification by industry, issuer and issue. Assets supporting interest rate sensitive liabilities are segmented within the general account to facilitate asset/liability duration management.

**Table of Contents**
**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

The following tables provide a summary of fixed maturity and equity securities investments.

**Summary of Fixed Maturity and Equity Securities**

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		Estimated Fair Value
			Less than 12 Months	Greater than 12 Months	
<b>September 30, 2007</b> (In millions)					
Fixed maturity securities available-for-sale:					
U.S. Treasury securities and obligations of government agencies	\$ 3,059	\$ 78	\$ 1	\$ 1	\$ 3,135
Asset-backed securities	11,615	31	234	167	11,245
States, municipalities and political subdivisions tax-exempt	6,573	189	64	4	6,694
Corporate securities	7,693	215	77	11	7,820
Other debt securities	3,835	183	23	6	3,989
Redeemable preferred stock	1,159	9	28		1,140
<b>Total fixed maturity securities available-for-sale</b>	<b>33,934</b>	<b>705</b>	<b>427</b>	<b>189</b>	<b>34,023</b>
<b>Total fixed maturity securities trading</b>	<b>173</b>				<b>173</b>
Equity securities available-for-sale:					
Common stock	217	259	1		475
Preferred stock	129	5	1		133
<b>Total equity securities available-for-sale</b>	<b>346</b>	<b>264</b>	<b>2</b>		<b>608</b>
<b>Total</b>	<b>\$ 34,453</b>	<b>\$ 969</b>	<b>\$ 429</b>	<b>\$ 189</b>	<b>\$ 34,804</b>

**Summary of Fixed Maturity and Equity Securities**

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		Estimated Fair Value
			Less than 12 Months	Greater than 12 Months	
<b>December 31, 2006</b>					

(In millions)

## Fixed maturity securities available-for-sale:

U.S. Treasury securities and obligations of government agencies

\$ 5,056 \$ 86 \$ 3 \$ 1 \$ 5,138

Asset-backed securities

13,821 28 20 152 13,677

States, municipalities and political subdivisions

tax-exempt

4,915 237 1 5 5,146

Corporate securities

6,811 338 8 9 7,132

Other debt securities

3,443 207 7 1 3,642

Redeemable preferred stock

885 28 1 912

Total fixed maturity securities available-for-sale

34,931 924 40 168 35,647

Total fixed maturity securities trading

204 204

## Equity securities available-for-sale:

Common stock

214 239 1 452

Preferred stock

134 11 145

Total equity securities available-for-sale

348 250 1 597

Total equity securities trading

60 60

**Total**

\$ 35,543 \$ 1,174 \$ 41 \$ 168 \$ 36,508

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

The following table summarizes, for fixed maturity and equity securities available-for-sale in an unrealized loss position at September 30, 2007 and December 31, 2006, the aggregate fair value and gross unrealized loss by length of time those securities have been continuously in an unrealized loss position.

**Unrealized Loss Aging**

	<b>September 30, 2007</b>		<b>December 31, 2006</b>	
	<b>Estimated</b>	<b>Gross</b>	<b>Estimated</b>	<b>Gross</b>
	<b>Fair</b>	<b>Unrealized</b>	<b>Fair</b>	<b>Unrealized</b>
	<b>Value</b>	<b>Loss</b>	<b>Value</b>	<b>Loss</b>
(In millions)				
Fixed maturity securities:				
Investment grade:				
0-6 months	\$ 6,102	\$ 312	\$ 9,829	\$ 24
7-12 months	1,116	78	1,267	12
13-24 months	1,145	37	5,248	127
Greater than 24 months	4,444	150	1,022	41
Total investment grade	12,807	577	17,366	204
Non-investment grade:				
0-6 months	1,889	37	509	2
7-12 months	4		87	2
13-24 months	28	2	24	
Greater than 24 months	2		2	
Total non-investment grade	1,923	39	622	4
Total fixed maturity securities	14,730	616	17,988	208
Equity securities:				
0-6 months	82	1	10	1
7-12 months	2	1	1	
13-24 months				
Greater than 24 months	3		3	
Total equity securities	87	2	14	1

<b>Total fixed maturity and equity securities</b>	\$ 14,817	\$ 618	\$ 18,002	\$ 209
---	-----------	--------	-----------	--------

At September 30, 2007, the carrying value of the general account fixed maturities was \$34,196 million, representing 78% of the total investment portfolio. The unrealized position associated with the fixed maturity portfolio included \$616 million in gross unrealized losses, consisting of asset-backed securities which represented 65%, corporate bonds which represented 14%, municipal securities which represented 11%, and all other fixed maturity securities which represented 10%. The gross unrealized loss for any single issuer was no greater than 0.2% of the carrying value of the total general account fixed maturity portfolio. The total fixed maturity portfolio gross unrealized losses included 1,689 securities which were, in aggregate, approximately 4% below amortized cost.

Given the current facts and circumstances, the Company has determined that the securities presented in the above unrealized gain/loss tables were temporarily impaired when evaluated at September 30, 2007 or December 31, 2006, and therefore no related realized losses were recorded. A discussion of some of the factors reviewed in making that determination as of September 30, 2007 is presented below.

***Asset-Backed Securities***

The unrealized losses on the Company's investments in asset-backed securities were caused by a combination of factors during the third quarter of 2007 related to the market disruption caused by a general lack of liquidity in the asset-backed securities market. This disruption was triggered by issues surrounding sub-prime residential mortgage-backed securities (sub-prime issue), but also extended into other asset-backed securities in the market and specifically in our portfolio.

**Table of Contents****CNA FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued****(UNAUDITED)**

The majority of the holdings in this category are corporate mortgage-backed pass-through securities, collateralized mortgage obligations (CMOs) and corporate asset-backed structured securities. The holdings in these sectors include 561 securities in a gross unrealized loss position of \$395 million. Of these securities in an unrealized loss position, 47% are rated AAA, 25% are rated AA, 25% are rated A and 3% are rated BBB. The aggregate severity of the unrealized loss was approximately 5% of amortized cost. The contractual cash flows on the asset-backed structured securities are pass-through but may be structured into classes of preference. The structured securities held are generally secured by over collateralization or default protection provided by subordinated tranches. Within this category, securities subject to Emerging Issues Task Force (EITF) Issue No. 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets (EITF 99-20), are monitored for adverse changes in cash flow projections. If there are adverse changes in cash flows, the amount of accretable yield is prospectively adjusted and an OTTI loss is recognized. As of September 30, 2007, there was no adverse change in estimated cash flows noted for the securities held subject to EITF 99-20, which have a gross unrealized loss of \$94 million and an aggregate severity of the unrealized loss of approximately 9% of amortized cost. There were OTTI losses recorded on asset-backed securities of \$68 million and \$153 million for the three and nine months ended September 30, 2007.

The remainder of the holdings in this category includes mortgage-backed securities guaranteed by an agency of the U.S. Government. There were 322 agency mortgage-backed pass-through securities and 3 agency CMOs in an unrealized loss position as of September 30, 2007. The aggregate severity of the unrealized loss on these securities was approximately 5% of amortized cost. These securities do not tend to be influenced by the credit of the issuer but rather the characteristics and projected cash flows of the underlying collateral.

The decline in fair value was primarily attributable to the market disruption caused by the sub-prime issue and not credit quality. Because the Company has the ability and intent to hold these investments until an anticipated recovery of fair value, which may be maturity, the Company considers these investments to be temporarily impaired at September 30, 2007.

***States, Municipalities and Political Subdivisions Tax-Exempt Securities***

The unrealized losses on the Company's investments in municipal securities were caused primarily by changes in credit spreads, and to a lesser extent, changes in interest rates. The Company invests in tax-exempt municipal securities as an asset class for economic benefits of the returns on the class compared to like after-tax returns on alternative classes. The holdings in this category include 235 securities in an unrealized loss position with 100% of these unrealized losses related to investment grade securities (rated BBB- or higher) where the cash flows are secured by the credit of the issuer. The aggregate severity of the unrealized loss was approximately 5% of amortized cost. Because the Company has the ability and intent to hold these investments until an anticipated recovery of fair value, which may be maturity, the Company considers these investments to be temporarily impaired at September 30, 2007.

***Corporate Securities***

The Company's portfolio management objective for corporate bonds focuses on sector and issuer exposures and value analysis within sectors. In order to maximize investment objectives, corporate bonds are analyzed on a risk adjusted basis compared to other opportunities that are available in the market. Trading decisions may be made based on an issuer that may be overvalued in the Company's portfolio compared to a like issuer that may be undervalued in the market. The Company also monitors issuer exposure and broader industry sector exposures and may reduce exposures based on its current view of a specific issuer or sector.

Of the unrealized losses in this category, over 58% relate to securities rated as investment grade. The total holdings in this category are diversified across 11 industry sectors and 410 securities. The aggregate severity of



**Table of Contents**

**CNA FINANCIAL CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued  
(UNAUDITED)**

the unrealized loss was approximately 2% of amortized cost. Within corporate bonds, the largest industry sectors were financial, consumer cyclical and communications, which as a percentage of total gross unrealized losses were 28%, 23% and 14% at September 30, 2007. The decline in fair value was primarily attributable to deterioration in the broader credit markets caused primarily by the sub-prime issue and liquidity concerns that stemmed from this issue, and macro conditions in certain sectors that the market views as out of favor. Because the decline was not related to specific credit quality issues, and because the Company has the ability and intent to hold these investments until an anticipated recovery of fair value, which may be maturity, the Company considers these investments to be temporarily impaired at September 30, 2007.

***Investment Commitments***

As of September 30, 2007 and December 31, 2006, the Company had committed approximately \$433 million and \$109 million to future capital calls from various third-party limited partnership investments in exchange for an ownership interest in the related partnerships.

The Company invests in multiple bank loan participations as part of its overall investment strategy and has committed to additional future purchases and sales. The purchase and sale of these investments are recorded on the date that the legal agreements are finalized and cash settlement is made. As of September 30, 2007 and December 31, 2006, the Company had commitments to purchase \$83 million and \$60 million, and sell \$98 million and \$21 million of various bank loan participations. When loan participation purchases are settled and recorded they may contain both funded and unfunded amounts. An unfunded loan represents an obligation by the Company to provide additional amounts under the terms of the loan participation. The funded portions are reflected on the Condensed Consolidated Balance Sheets, while any unfunded amounts are not recorded until a draw is made under the loan facility. As of September 30, 2007 and December 31, 2006, the Company had obligations on unfunded bank loan participations in the amount of \$23 million and \$29 million.

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

**Note E. Derivative Financial Instruments**

A summary of the recognized gains (losses) related to derivative financial instruments follows.

**Derivative Financial Instruments Recognized Gains (Losses)**

<b>Period ended September 30</b> (In millions)	<b>Three Months</b>		<b>Nine Months</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>General account</b>				
<b>Without hedge designation</b>				
Swaps	\$ (43)	\$ (14)	\$ 65	\$ (8)
Futures purchased	7		7	
Futures sold, not yet purchased	(8)	(1)	(8)	1
Currency forwards	(1)	1	(2)	(1)
Commitments to purchase government and municipal securities (TBAs)	(1)			
Options embedded in convertible debt securities	1		1	
<b>Trading activities</b>				
Futures purchased	5	22	32	33
Futures sold, not yet purchased	(1)	(1)		1
Currency forwards	1			
<b>Total</b>	<b>\$ (40)</b>	<b>\$ 7</b>	<b>\$ 95</b>	<b>\$ 26</b>

A summary of the aggregate contractual or notional amounts and estimated fair values related to derivative financial instruments follows. The contractual or notional amounts for derivatives are used to calculate the exchange of contractual payments under the agreements and are not representative of the potential for gain or loss on these instruments.

**Derivative Financial Instruments**

<b>September 30, 2007</b> (In millions)	<b>Contractual/ Notional Amount</b>	<b>Estimated Fair Value Asset (Liability)</b>
<b>General account</b>		
<b>Without hedge designation</b>		
Swaps	\$ 1,122	\$ 3
Currency forwards	108	(1)
Equity warrants	4	2
Options embedded in convertible debt securities	3	
<b>Trading activities</b>		

Edgar Filing: GNA FINANCIAL CORP - Form 10-Q

Futures purchased	820	(3)
Futures sold, not yet purchased	104	
Currency forwards	42	1
<b>Total general account</b>	<b>\$ 2,203</b>	<b>\$ 2</b>
<b>Separate accounts</b>		
Options written	\$ 1	\$
<b>Total separate accounts</b>	<b>\$ 1</b>	<b>\$</b>

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

**Derivative Financial Instruments**

<b>December 31, 2006</b> (In millions)	<b>Contractual/ Notional Amount</b>	<b>Estimated Fair Value Asset (Liability)</b>
<b>General account</b>		
<b>Without hedge designation</b>		
Swaps	\$ 4,795	\$ (30)
Currency forwards	8	
Equity warrants	6	2
Options embedded in convertible debt securities	9	
<b>Trading activities</b>		
Futures purchased	722	(3)
Futures sold, not yet purchased	79	
Currency forwards	25	
<b>Total general account</b>	<b>\$ 5,644</b>	<b>\$ (31)</b>
<b>Separate accounts</b>		
Options written	\$ 1	\$
<b>Total separate accounts</b>	<b>\$ 1</b>	<b>\$</b>

Options embedded in convertible debt securities are classified as Fixed maturity securities on the Condensed Consolidated Balance Sheets, consistent with the host instruments.

**Note F. Claim and Claim Adjustment Expense Reserves**

CNA's property and casualty insurance claim and claim adjustment expense reserves represent the estimated amounts necessary to settle all outstanding claims, including claims that are incurred but not reported (IBNR) as of the reporting date. The Company's reserve projections are based primarily on detailed analysis of the facts in each case, CNA's experience with similar cases and various historical development patterns. Consideration is given to such historical patterns as field reserving trends and claims settlement practices, loss payments, pending levels of unpaid claims and product mix, as well as court decisions, economic conditions and public attitudes. All of these factors can affect the estimation of claim and claim adjustment expense reserves.

Establishing claim and claim adjustment expense reserves, including claim and claim adjustment expense reserves for catastrophic events that have occurred, is an estimation process. Many factors can ultimately affect the final settlement of a claim and, therefore, the necessary reserve. Changes in the law, results of litigation, medical costs, the cost of repair materials and labor rates can all affect ultimate claim costs. In addition, time can be a critical part of reserving determinations since the longer the span between the incidence of a loss and the payment or settlement of the claim, the more variable the ultimate settlement amount can be. Accordingly, short-tail claims, such as property damage

claims, tend to be more reasonably estimable than long-tail claims, such as general liability and professional liability claims. Adjustments to prior year reserve estimates, if necessary, are reflected in the results of operations in the period that the need for such adjustments is determined.

Catastrophes are an inherent risk of the property and casualty insurance business and have contributed to material period-to-period fluctuations in the Company's results of operations and/or equity. Catastrophe losses, net of reinsurance, were \$10 million and \$22 million for the three months ended September 30, 2007 and 2006 and \$54 million and \$40 million for the nine months ended September 30, 2007 and 2006. There can be no assurance that CNA's ultimate cost for catastrophes will not exceed these estimates.

The following provides discussion of the Company's Asbestos, Environmental Pollution and Mass Tort (APMT) and core reserves.

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

**APMT Reserves**

CNA's property and casualty insurance subsidiaries have actual and potential exposures related to APMT claims. Establishing reserves for APMT claim and claim adjustment expenses is subject to uncertainties that are greater than those presented by other claims. Traditional actuarial methods and techniques employed to estimate the ultimate cost of claims for more traditional property and casualty exposures are less precise in estimating claim and claim adjustment expense reserves for APMT, particularly in an environment of emerging or potential claims and coverage issues that arise from industry practices and legal, judicial and social conditions. Therefore, these traditional actuarial methods and techniques are necessarily supplemented with additional estimating techniques and methodologies, many of which involve significant judgments that are required of management. Accordingly, a high degree of uncertainty remains for the Company's ultimate liability for APMT claim and claim adjustment expenses.

In addition to the difficulties described above, estimating the ultimate cost of both reported and unreported APMT claims is subject to a higher degree of variability due to a number of additional factors, including among others: the number and outcome of direct actions against the Company; coverage issues, including whether certain costs are covered under the policies and whether policy limits apply; allocation of liability among numerous parties, some of whom may be in bankruptcy proceedings, and in particular the application of joint and several liability to specific insurers on a risk; inconsistent court decisions and developing legal theories; continuing aggressive tactics of plaintiffs lawyers; the risks and lack of predictability inherent in major litigation; enactment of state and federal legislation to address asbestos claims; increases and decreases in asbestos, environmental pollution and mass tort claims which cannot now be anticipated; increases and decreases in costs to defend asbestos, pollution and mass tort claims; changing liability theories against the Company's policyholders in environmental and mass tort matters; possible exhaustion of underlying umbrella and excess coverage; and future developments pertaining to the Company's ability to recover reinsurance for asbestos, pollution and mass tort claims.

CNA has annually performed ground up reviews of all open APMT claims to evaluate the adequacy of the Company's APMT reserves. In performing its comprehensive ground up analysis, the Company considers input from its professionals with direct responsibility for the claims, inside and outside counsel with responsibility for representation of the Company and its actuarial staff. These professionals review, among many factors, the policyholder's present and predicted future exposures, including such factors as claims volume, trial conditions, prior settlement history, settlement demands and defense costs; the impact of asbestos defendant bankruptcies on the policyholder; the policies issued by CNA, including such factors as aggregate or per occurrence limits, whether the policy is primary, umbrella or excess, and the existence of policyholder retentions and/or deductibles; the existence of other insurance; and reinsurance arrangements.

The following table provides data related to CNA's APMT claim and claim adjustment expense reserves.

**APMT Reserves**

	September 30, 2007		December 31, 2006	
	Asbestos	Environmental Pollution and Mass Tort	Asbestos	Environmental Pollution and Mass Tort
(In millions)				
Gross reserves	\$ 2,400	\$ 597	\$ 2,635	\$ 647
Ceded reserves	(1,063)	(210)	(1,183)	(231)
<b>Net reserves</b>	<b>\$ 1,337</b>	<b>\$ 387</b>	<b>\$ 1,452</b>	<b>\$ 416</b>



**Table of Contents**

**CNA FINANCIAL CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued  
(UNAUDITED)**

***Asbestos***

CNA's property and casualty insurance subsidiaries have exposure to asbestos-related claims. Estimation of asbestos-related claim and claim adjustment expense reserves involves limitations such as inconsistency of court decisions, specific policy provisions, allocation of liability among insurers and insureds, and additional factors such as missing policies and proof of coverage. Furthermore, estimation of asbestos-related claims is difficult due to, among other reasons, the proliferation of bankruptcy proceedings and attendant uncertainties, the targeting of a broader range of businesses and entities as defendants, the uncertainty as to which other insureds may be targeted in the future and the uncertainties inherent in predicting the number of future claims.

As of September 30, 2007 and December 31, 2006, CNA carried approximately \$1,337 million and \$1,452 million of claim and claim adjustment expense reserves, net of reinsurance recoverables, for reported and unreported asbestos-related claims. The Company recorded \$6 million and \$2 million of unfavorable asbestos-related net claim and claim adjustment expense reserve development for the nine months ended September 30, 2007 and 2006. The Company paid asbestos-related claims, net of reinsurance recoveries, of \$121 million and \$76 million for the nine months ended September 30, 2007 and 2006. On February 2, 2007, CNA paid \$31 million to the Owens Corning Fibreboard Trust. Such payment was made pursuant to CNA's 1993 settlement with Fibreboard.

Certain asbestos claim litigation in which CNA is currently engaged is described below:

The ultimate cost of reported claims, and in particular APMT claims, is subject to a great many uncertainties, including future developments of various kinds that CNA does not control and that are difficult or impossible to foresee accurately. With respect to the litigation identified below in particular, numerous factual and legal issues remain unresolved. Rulings on those issues by the courts are critical to the evaluation of the ultimate cost to the Company. The outcome of the litigation cannot be predicted with any reliability. Accordingly, the extent of losses beyond any amounts that may be accrued are not readily determinable at this time.

On February 13, 2003, CNA announced it had resolved asbestos-related coverage litigation and claims involving A.P. Green Industries, A.P. Green Services and Bigelow Liptak Corporation. Under the agreement, CNA is required to pay \$70 million, net of reinsurance recoveries, over a ten year period commencing after the final approval of a bankruptcy plan of reorganization. The settlement resolves CNA's liabilities for all pending and future asbestos and silica claims involving A.P. Green Industries, Bigelow Liptak Corporation and related subsidiaries, including alleged non-products exposures. The settlement received initial bankruptcy court approval on August 18, 2003. The debtor's plan of reorganization includes an injunction to protect CNA from any future claims. The bankruptcy court issued an opinion on September 24, 2007 recommending confirmation of that plan; two parties have appealed that ruling.

CNA is engaged in insurance coverage litigation in New York State Court, filed in 2003, with a defendant class of underlying plaintiffs who have asbestos bodily injury claims against the former Robert A. Keasbey Company (Keasbey) (Continental Casualty Co. v. Employers Ins. of Wausau et al., No. 601037/03 (N.Y. County)). Keasbey, a currently dissolved corporation, was a seller and installer of asbestos-containing insulation products in New York and New Jersey. Thousands of plaintiffs have filed bodily injury claims against Keasbey. However, under New York court rules, asbestos claims are not cognizable unless they meet certain minimum medical impairment standards. Since 2002, when these court rules were adopted, only a small portion of such claims have met medical impairment criteria under New York court rules and as to the remaining claims, Keasbey's involvement at a number of work sites is a highly contested issue.

CNA issued Keasbey primary policies for 1970-1987 and excess policies for 1972-1978. CNA has paid an amount substantially equal to the policies' aggregate limits for products and completed operations claims in the confirmed CNA policies. Claimants against Keasbey allege, among other things, that CNA owes coverage under sections of the policies not subject to the aggregate limits, an allegation CNA vigorously contests in the lawsuit. In the litigation, CNA and the claimants seek declaratory relief as to the interpretation of various policy provisions. On May 8, 2007, the Court in the first phase of the trial held that all of CNA's primary policy products aggregates were exhausted and that past products liability claims could not be recharacterized as operations claims. The Court also found that while



operations claims would not be subject to products aggregates, such claims could be made only against the policies in effect when the claimants were exposed to

**Table of Contents****CNA FINANCIAL CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued  
(UNAUDITED)**

asbestos from Keasbey operations. These holdings limit CNA's exposure to those instances where Keasbey used asbestos in operations between 1970 and 1987. Keasbey largely ceased using asbestos in its operations in the early 1970's. CNA has noticed an appeal to the Appellate Division to challenge certain aspects of the Court's ruling. Keasbey's other two insurers, Wausau and One Beacon, have filed cross appeals, and the parties are in the process of filing briefs. Numerous legal issues remain to be resolved on appeal with respect to coverage that are critical to the final result, which cannot be predicted with any reliability. Accordingly, the extent of losses beyond any amounts that may be accrued are not readily determinable at this time.

CNA has insurance coverage disputes related to asbestos bodily injury claims against a bankrupt insured, Burns & Roe Enterprises, Inc. (Burns & Roe). These disputes are currently part of coverage litigation (stayed in view of the bankruptcy) and an adversary proceeding in In re: Burns & Roe Enterprises, Inc., pending in the U.S. Bankruptcy Court for the District of New Jersey, No. 00-41610. Burns & Roe provided engineering and related services in connection with construction projects. At the time of its bankruptcy filing, on December 4, 2000, Burns & Roe asserted that it faced approximately 11,000 claims alleging bodily injury resulting from exposure to asbestos as a result of construction projects in which Burns & Roe was involved. CNA allegedly provided primary liability coverage to Burns & Roe from 1956-1969 and 1971-1974, along with certain project-specific policies from 1964-1970. On December 5, 2005, Burns & Roe filed its Third Amended Plan of Reorganization (Plan). In September of 2007, CNA entered into an agreement with Burns & Roe, the Official Committee of Unsecured Creditors appointed by the Bankruptcy Court and the Future Claims Representative (the Addendum), which provides that claims allegedly covered by CNA policies will be adjudicated in the tort system, with any coverage disputes related to those claims to be decided in coverage litigation. On September 14, 2007, Burns & Roe moved the bankruptcy court for approval of the Addendum pursuant to Bankruptcy Rule 9019. The hearing on that motion was set for October 18, 2007. If approved, Burns & Roe has agreed to include the Addendum in the proposed plan, which will be the subject of a later confirmation hearing. With respect to both confirmation of the Plan and coverage issues, numerous factual and legal issues remain to be resolved that are critical to the final result, the outcome of which cannot be predicted with any reliability. These factors include, among others: (a) whether the Company has any further responsibility to compensate claimants against Burns & Roe under its policies and, if so, under which; (b) whether the Company's responsibilities under its policies extend to a particular claimant's entire claim or only to a limited percentage of the claim; (c) whether the Company's responsibilities under its policies are limited by the occurrence limits or other provisions of the policies; (d) whether certain exclusions, including professional liability exclusions, in some of the Company's policies apply to exclude certain claims; (e) the extent to which claimants can establish exposure to asbestos materials as to which Burns & Roe has any responsibility; (f) the legal theories which must be pursued by such claimants to establish the liability of Burns & Roe and whether such theories can, in fact, be established; (g) the diseases and damages alleged by such claimants; (h) the extent that any liability of Burns & Roe would be shared with other potentially responsible parties; and (i) the impact of bankruptcy proceedings on claims and coverage issue resolution. Accordingly, the extent of losses beyond any amounts that may be accrued are not readily determinable at this time.

Suits have also been initiated directly against the CNA companies and numerous other insurers in two jurisdictions: Texas and Montana. Approximately 80 lawsuits were filed in Texas beginning in 2002, against two CNA companies and numerous other insurers and non-insurer corporate defendants asserting liability for failing to warn of the dangers of asbestos (E.g. Boson v. Union Carbide Corp., (Nueces County, Texas)). During 2003, several of the Texas suits were dismissed as time-barred by the applicable Statute of Limitations. In other suits, the carriers argued that they did not owe any duty to the plaintiffs or the general public to advise the world generally or the plaintiffs particularly of the effects of asbestos and that Texas statutes precluded liability for such claims, and two Texas courts dismissed these suits. Certain of the Texas courts' rulings were appealed, but plaintiffs later dismissed their appeals. A different Texas court denied similar motions seeking dismissal at the pleading stage, allowing limited discovery to proceed. After that court denied a related challenge to jurisdiction, the insurers transferred those cases, among others, to a state multi-district litigation court in Harris County charged with handling asbestos cases, and the cases remain in that

court. In February 2006, the insurers petitioned the appellate court in Houston for an order of mandamus, requiring the multi-district litigation court to dismiss the cases on jurisdictional and substantive grounds. The Texas Attorney General filed an amicus curiae brief supporting the insurers position. After a long period of no activity, the court recently asked the plaintiffs to file a response to the petition for mandamus. With respect to this litigation

**Table of Contents****CNA FINANCIAL CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued  
(UNAUDITED)**

in particular, numerous factual and legal issues remain to be resolved that are critical to the final result, the outcome of which cannot be predicted with any reliability. These factors include: (a) the speculative nature and unclear scope of any alleged duties owed to individuals exposed to asbestos and the resulting uncertainty as to the potential pool of potential claimants; (b) the fact that imposing such duties on all insurer and non-insurer corporate defendants would be unprecedented and, therefore, the legal boundaries of recovery are difficult to estimate; (c) the fact that many of the claims brought to date are barred by the Statute of Limitations and it is unclear whether future claims would also be barred; (d) the unclear nature of the required nexus between the acts of the defendants and the right of any particular claimant to recovery; and (e) the existence of hundreds of co-defendants in some of the suits and the applicability of the legal theories pled by the claimants to thousands of potential defendants. Accordingly, the extent of losses beyond any amounts that may be accrued is not readily determinable at this time.

On March 22, 2002, a direct action was filed in Montana (Pennock, et al. v. Maryland Casualty, et al. First Judicial District Court of Lewis & Clark County, Montana) by eight individual plaintiffs (all employees of W.R. Grace & Co. (W.R. Grace)) and their spouses against CNA, Maryland Casualty and the State of Montana. This action alleges that the carriers failed to warn of or otherwise protect W.R. Grace employees from the dangers of asbestos at a W.R. Grace vermiculite mining facility in Libby, Montana. The Montana direct action is currently stayed because of W.R. Grace's pending bankruptcy. With respect to such claims, numerous factual and legal issues remain to be resolved that are critical to the final result, the outcome of which cannot be predicted with any reliability. These factors include: (a) the unclear nature and scope of any alleged duties owed to people exposed to asbestos and the resulting uncertainty as to the potential pool of potential claimants; (b) the potential application of Statutes of Limitation to many of the claims which may be made depending on the nature and scope of the alleged duties; (c) the unclear nature of the required nexus between the acts of the defendants and the right of any particular claimant to recovery; (d) the diseases and damages claimed by such claimants; (e) the extent that such liability would be shared with other potentially responsible parties; and (f) the impact of bankruptcy proceedings on claims resolution. Accordingly, the extent of losses beyond any amounts that may be accrued are not readily determinable at this time.

CNA is vigorously defending these and other cases and believes that it has meritorious defenses to the claims asserted. However, there are numerous factual and legal issues to be resolved in connection with these claims, and it is extremely difficult to predict the outcome or ultimate financial exposure represented by these matters. Adverse developments with respect to any of these matters could have a material adverse effect on CNA's business, insurer financial strength and debt ratings, results of operations and/or equity.

***Environmental Pollution and Mass Tort***

As of September 30, 2007 and December 31, 2006, CNA carried approximately \$387 million and \$416 million of claim and claim adjustment expense reserves, net of reinsurance recoverables, for reported and unreported environmental pollution and mass tort claims. The Company recorded \$1 million of unfavorable environmental pollution and mass tort net claim and claim adjustment expense reserve development for the nine months ended September 30, 2007. There was no environmental pollution and mass tort net claim and claim adjustment expense reserve development recorded for the nine months ended September 30, 2006. The Company recorded \$45 million and \$30 million of current accident year losses related to mass tort for the nine months ended September 30, 2007 and 2006. The Company paid environmental pollution-related claims and mass tort-related claims, net of reinsurance recoveries, of \$75 million and \$88 million for the nine months ended September 30, 2007 and 2006.

In addition to claims arising from exposure to asbestos as discussed above, the Company also has exposure arising from other mass tort claims. Such claims typically involve allegations by multiple plaintiffs alleging injury resulting from exposure to or use of similar substances or products over multiple policy periods. Examples include, but are not limited to, lead paint claims, hardboard siding, polybutylene pipe, mold, silica, latex gloves, benzene products, welding rods, diet drugs, breast implants, medical devices, and various other toxic chemical exposures.

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

**Net Prior Year Development**

The development presented below includes premium development due to its direct relationship to claim and allocated claim adjustment expense reserve development. The development presented below excludes the impact of the provision for uncollectible reinsurance, but includes the impact of commutations.

**Three Month Comparison**

The following tables include the net prior year development recorded for Standard Lines, Specialty Lines and Corporate and Other Non-Core for the three months ended September 30, 2007 and 2006.

**Net Prior Year Development****Three months ended September 30, 2007**

	<b>Standard Lines</b>	<b>Specialty Lines</b>	<b>Corporate and Other Non-Core</b>	<b>Total</b>
(In millions)				
Pretax unfavorable (favorable) net prior year claim and allocated claim adjustment expense reserve development:				
Core (Non-APMT)	\$ (77)	\$ 13	\$ 4	\$ (60)
APMT			3	3
Pretax unfavorable (favorable) net prior year development before impact of premium development	(77)	13	7	(57)
Pretax favorable premium development	(7)	(1)	(2)	(10)
<b>Total pretax unfavorable (favorable) net prior year development</b>	<b>\$ (84)</b>	<b>\$ 12</b>	<b>\$ 5</b>	<b>\$ (67)</b>

**Net Prior Year Development****Three months ended September 30, 2006**

	<b>Standard Lines</b>	<b>Specialty Lines</b>	<b>Corporate and Other Non-Core</b>	<b>Total</b>
(In millions)				
Pretax unfavorable (favorable) net prior year claim and allocated claim adjustment expense reserve development:				
Core (Non-APMT)	\$ 6	\$ (4)	\$ 2	\$ 4

APMT			1	1
Pretax unfavorable (favorable) net prior year development before impact of premium development	6	(4)	3	5
Pretax unfavorable (favorable) premium development	(19)	6	(3)	(16)
<b>Total pretax unfavorable (favorable) net prior year development</b>	<b>\$ (13)</b>	<b>\$ 2</b>	<b>\$</b>	<b>\$ (11)</b>

**Table of Contents**

**CNA FINANCIAL CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued  
(UNAUDITED)**

***2007 Net Prior Year Development***

**Standard Lines**

Approximately \$42 million of favorable claim and allocated claim adjustment expense reserve development was due to decreased severity on open claims within the general liability exposures in accident years 2003 and prior, as well as lower frequency in accident years 2004 through 2006.

Approximately \$25 million of favorable claim and allocated claim adjustment expense development was recorded related to property exposures, primarily due to decreased frequency and severity on claims in accident years 2005 and 2006. The severity change was driven by decreased incurred losses as a result of changes in individual claim reserve estimates.

**Specialty Lines**

Approximately \$39 million of unfavorable claim and allocated claim adjustment expense reserve development was recorded due to increased severity on professional liability claims in accident years 2005 and prior. The increase in severity was due to a comprehensive case by case claim review for Large Law Firm exposures, causing an overall increase in estimated ultimate loss.

Approximately \$17 million of favorable claim and allocated claim adjustment expense reserve development was recorded in healthcare facilities due to decreased frequency and severity across several accident years. This was primarily due to decreased severity on open claims within general liability exposures and decreased incurred losses as a result of changes in individual claim reserve estimates.

***2006 Net Prior Year Development***

**Standard Lines**

Approximately \$21 million of unfavorable claim and allocated claim adjustment expense reserve development was due to higher frequency and severity on claims related to excess workers' compensation, in accident years 2005 and prior. The primary drivers of the higher frequency and severity were increasing medical inflation and advances in medical care. Medical inflation and advances in medical care result in additional claims reaching the excess layers covered by the Company and increases the size of claims already in the excess layers.

Approximately \$8 million of unfavorable claim and allocated claim adjustment expense reserve development related to continued increases in individual claim reserve estimates on commercial auto business, in accident years 2005 and 2004. The increase is primarily due to larger claims. These changes in individual claim estimates result in higher projections of ultimate loss from the incurred development and average loss methods used by the Company's actuaries. Approximately \$30 million of favorable claim and allocated claim adjustment expense reserve development was due to decreased frequency and severity on claims related to monoline and package liability, primarily in accident years 2002 and prior. The change was driven by decreased incurred losses as a result of changes in individual claim reserve estimates. The lower incurred losses were less than expected based on the loss development factors selected by the Company's actuaries.

Approximately \$14 million of the favorable premium development was due to additional premium primarily resulting from audits and changes to premium on several ceded reinsurance agreements. Businesses impacted included various middle market liability coverages, workers' compensation, property, and large accounts. Unfavorable claim and allocated claim adjustment expense reserve development of approximately \$9 million was recorded as a result of this favorable premium development.

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

**Nine Month Comparison**

The following tables include the net prior year development recorded for Standard Lines, Specialty Lines and Corporate and Other Non-Core for the nine months ended September 30, 2007 and 2006.

**Net Prior Year Development****Nine months ended September 30, 2007**

	<b>Standard Lines</b>	<b>Specialty Lines</b>	<b>Corporate and Other Non-Core</b>	<b>Total</b>
(In millions)				
Pretax unfavorable (favorable) net prior year claim and allocated claim adjustment expense reserve development:				
Core (Non-APMT)	\$ (97)	\$ 19	\$ 12	\$ (66)
APMT			7	7
Pretax unfavorable (favorable) net prior year development before impact of premium development	(97)	19	19	(59)
Pretax favorable premium development	(20)	(8)	(5)	(33)
<b>Total pretax unfavorable (favorable) net prior year development</b>	<b>\$ (117)</b>	<b>\$ 11</b>	<b>\$ 14</b>	<b>\$ (92)</b>

**Net Prior Year Development****Nine months ended September 30, 2006**

	<b>Standard Lines</b>	<b>Specialty Lines</b>	<b>Corporate and Other Non-Core</b>	<b>Total</b>
(In millions)				
Pretax unfavorable (favorable) net prior year claim and allocated claim adjustment expense reserve development:				
Core (Non-APMT)	\$ 70	\$ (1)	\$ 13	\$ 82
APMT			2	2
	70	(1)	15	84



Pretax unfavorable (favorable) net prior year development  
before impact of premium development

Pretax unfavorable (favorable) premium development	(92)		1	(91)
<b>Total pretax unfavorable (favorable) net prior year development</b>	\$ (22)	\$ (1)	\$ 16	\$ (7)

***2007 Net Prior Year Development***

**Standard Lines**

Approximately \$42 million of favorable claim and allocated claim adjustment expense reserve development was due to decreased severity on open claims within the general liability exposures in accident years 2003 and prior, as well as lower frequency in accident years 2004 through 2006. In addition, approximately \$14 million of unfavorable premium development was taken primarily as a result of favorable claim and allocated claim adjustment expense reserve development on retrospectively rated large account policies relating to the automobile and general liability lines of business in accident years 2001 and subsequent. This favorable claim

**Table of Contents****CNA FINANCIAL CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued  
(UNAUDITED)**

and allocated claim adjustment expense reserve development was due to lower than anticipated frequency and severity.

Approximately \$58 million of favorable claim and allocated claim adjustment expense reserve development was due to decreased frequency and severity on claims related to property exposures, primarily in accident years 2005 and 2006. The change was driven by decreased incurred losses as a result of changes in individual claim reserve estimates. Approximately \$46 million of favorable premium development was recorded mainly as a result of additional premium resulting from audits on recent policies related to workers compensation and general liability books of business. This was partially offset by \$30 million of unfavorable claim and claim adjustment expense reserve development related to this premium.

Approximately \$16 million of unfavorable premium development was recorded due to the change in the Company's exposure related to its participation in the involuntary pools. This unfavorable premium development was partially offset by \$9 million of favorable claim and allocated claim adjustment expense development.

Additional unfavorable prior year reserve development was recorded in the workers' compensation line of business as a result of continued claim cost inflation in older accident years, driven by increasing medical inflation and advances in medical care. This unfavorable development was offset by favorable development in Commercial Auto, Monoline General Liability and Umbrella product lines. This favorable development was due to improved severity in recent accident years.

**Specialty Lines**

The net prior year development recorded for the nine months ended September 30, 2007 primarily relates to the items included in the three month discussion.

**Corporate and Other Non-Core**

Approximately \$9 million of unfavorable claim and allocated claim adjustment expense reserve development was related to commutation activity, a portion of which was offset by a release of a previously established allowance for uncollectible reinsurance.

**2006 Net Prior Year Development****Standard Lines**

Approximately \$41 million of unfavorable claim and allocated claim adjustment expense reserve development was primarily due to continued claim cost inflation for workers' compensation in older accident years, primarily 2002 and prior. The primary drivers of the continuing claim cost inflation are medical inflation and advances in medical care.

Approximately \$21 million of unfavorable claim and allocated claim adjustment expense reserve development was due to higher frequency and severity on claims related to excess workers' compensation, in accident years 2005 and prior. The primary drivers of the higher frequency and severity were increasing medical inflation and advances in medical care. Medical inflation and advances in medical care result in additional claims reaching the excess layers covered by the Company and increases the size of claims already in the excess layers.

Approximately \$16 million of unfavorable claim and allocated claim adjustment expense reserve development related to continued increases in individual claim reserve estimates on commercial auto business, in accident years 2005 and 2004. The increase is primarily due to a higher than expected number of large claims. These changes in individual claim estimates result in higher projections of ultimate loss from the incurred development and average loss methods used by the Company's actuaries.

Approximately \$15 million of unfavorable claim and allocated claim adjustment expense reserve development was due to increased severity in liability coverages for large account policies. These increases were driven by

**Table of Contents****CNA FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued  
(UNAUDITED)**

increasing medical inflation and larger verdicts than anticipated, both of which increase the severity of these claims resulting in higher case incurred losses and higher ultimate estimates.

Approximately \$11 million of unfavorable claim and allocated claim adjustment expense reserve development was due to the Company's share of an assessment from various Windstorm Underwriting Authority Pools.

Approximately \$45 million of favorable claim and allocated claim adjustment expense reserve development was related to continued improvement in the severity and frequency of claims for property coverages, primarily in accident year 2005. The improvements in severity and frequency are substantially due to underwriting actions taken by the Company that have significantly improved the results on this business. Underwriting actions taken include efforts to write more business in non-catastrophe prone areas.

Approximately \$21 million of favorable claim and allocated claim adjustment expense reserve development was due to decreased frequency and severity on claims related to monoline and package liability, primarily in accident years 2002 and prior. The change was driven by decreased incurred losses resulting from favorable outcomes on individual claims. The lower incurred losses were less than expected based on the loss development factors selected by the Company's actuaries.

Approximately \$16 million of favorable claim and allocated claim adjustment expense reserve development was related to lower severities on the excess and surplus lines business in accident years 2000 and subsequent. These severity changes were driven primarily by judicial decisions and settlement activities on individual cases. The severity changes led to lower case incurred loss and lower ultimate estimates.

Approximately \$16 million of favorable claim and allocated claim adjustment expense reserve development was due to umbrella products. The change covers several accident years. Initial reserves are normally estimated using the loss ratio expected for this business due to the long-tail nature of this business. The long-tail nature of the business is due to the long period of time that passes between the time the business is written and the time when all claims are known and settled. The favorable change on the recent accident years is the result of giving greater weight to projections that rely on case incurred loss thereby recognizing the low level of case incurred loss. The favorable change in older years is driven by favorable outcomes on individual claims.

Approximately \$12 million of favorable claim and allocated claim adjustment expense reserve development was due to improved experience for marine business, primarily in accident years 2005 and 2004. The case incurred loss (paid loss plus case reserve estimates for known claims) for these accident years has been less than expected. The expected case incurred loss was primarily based on the loss ratio expected for this business. The lower level of actual case incurred loss is driven by lower claim frequency and indicates a lower ultimate loss. The remainder of the favorable change in marine business is due to lowered individual case estimates from older accident years.

Approximately \$66 million of the favorable premium development was due to additional premium primarily resulting from audits and changes to premium on several ceded reinsurance agreements. Businesses impacted included various middle market liability coverages, workers' compensation, property, and large accounts. This favorable premium development was partially offset by approximately \$48 million of unfavorable claim and allocated claim adjustment expense reserve development recorded as a result of this favorable premium development.

**Corporate and Other Non-Core**

The unfavorable claim and allocated claim adjustment expense reserve development was primarily related to the financial guarantee line of business, and an adverse arbitration ruling that was offset by a release of a previously established allowance for uncollectible reinsurance. Reserves for the financial guarantee line of business are driven by individual claim estimates. This unfavorable claim and allocated claim adjustment expense reserve development was partially offset by the favorable loss development impact of an assumed reinsurance commutation. The unfavorable premium development was also related to this reinsurance commutation.

**Table of Contents****CNA FINANCIAL CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued  
(UNAUDITED)****Note G. Legal Proceedings and Contingent Liabilities*****Insurance Brokerage Antitrust Litigation***

On August 1, 2005, CNAF and several of its insurance subsidiaries were joined as defendants, along with other insurers and brokers, in multidistrict litigation pending in the United States District Court for the District of New Jersey, In re Insurance Brokerage Antitrust Litigation, Civil No. 04-5184 (FSH). The plaintiffs in this litigation allege improprieties in the payment of contingent commissions to brokers and bid rigging in connection with the sale of various lines of insurance. The plaintiffs further allege the existence of a conspiracy and assert claims for federal and state antitrust law violations, for violations of the federal Racketeer Influenced and Corrupt Organizations (RICO) Act, and for recovery under various state common law theories. On April 5, 2007, the Court dismissed the plaintiffs' complaint, but granted the plaintiffs an opportunity to amend their complaint. On May 22, 2007, the plaintiffs filed an amended complaint, and on June 21, 2007, the defendants filed a motion to dismiss this amended complaint. On August 31, 2007, the Court dismissed the federal antitrust claims of the complaint. On September 28, 2007, the Court dismissed the federal RICO claims, which were the sole remaining federal claims of the complaint, and, after declining to exercise supplemental jurisdiction over the state law claims, dismissed the complaint in its entirety. Plaintiffs have filed a notice of appeal from the foregoing orders to the Third Circuit Court of Appeals. The Company believes it has meritorious defenses to this action and intends to defend the case vigorously.

The extent of losses beyond any amounts that may be accrued are not readily determinable at this time. However, based on facts and circumstances presently known, in the opinion of management, an unfavorable outcome will not materially affect the equity of the Company, although results of operations may be adversely affected.

***Global Crossing Limited Litigation***

CCC has been named as a defendant in an action brought by the bankruptcy estate of Global Crossing Limited (Global Crossing) in the United States Bankruptcy Court for the Southern District of New York. In the Complaint, plaintiff seeks unspecified monetary damages from CCC and the other defendants for alleged fraudulent transfers and alleged breaches of fiduciary duties arising from actions taken by Global Crossing while CCC was a shareholder of Global Crossing. On August 3, 2006, the Court granted in part and denied in part CCC's motion to dismiss the Estate Representative's Amended Complaint. The case is now in discovery. CCC believes it has meritorious defenses to the remaining claims in this action and intends to defend the case vigorously.

The extent of losses beyond any amounts that may be accrued are not readily determinable at this time. However, based on facts and circumstances presently known, in the opinion of management, an unfavorable outcome will not materially affect the equity of the Company, although results of operations may be adversely affected.

***IGI Contingency***

Between April 1, 1997 and December 1, 1999, IGI Underwriting Agencies, Ltd. underwrote a number of reinsurance arrangements with respect to personal accident insurance worldwide (the IGI Program). Under various arrangements, CNA Reinsurance Company Limited (CNA Re Ltd.) both assumed risks in the IGI Program as a reinsurer and also ceded a substantial portion of those risks to other companies, including other of CNA's insurance subsidiaries and ultimately to a group of reinsurers participating in a reinsurance pool known as the Associated Accident and Health Reinsurance Underwriters Facility. A portion of the premiums assumed under the IGI Program relating to United States workers' compensation carve-out business was received from John Hancock Life Insurance Company, formerly known as John Hancock Mutual Life Insurance Company (John Hancock) under four excess of loss reinsurance treaties (the Treaties) issued by CNA Re Ltd. In 2000, CNA Re Ltd. instituted arbitration proceedings against John Hancock seeking rescission of the Treaties. The hearing before the arbitration panel commenced in April 2007 and final arguments were scheduled for September 2007.

**Table of Contents**

**CNA FINANCIAL CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued  
(UNAUDITED)**

On September 4, 2007, prior to the commencement of final arguments, CNA reached agreement with John Hancock to fully and finally settle all of its exposures under the Treaties for a one-time payment of \$250 million. During the third quarter of 2007, the Company recorded an incurred loss, net of reinsurance, of \$167 million pretax, in the Life and Group Non-Core segment. The after-tax impact of the settlement was \$108 million.

***New Jersey Wage and Hour Litigation***

W. Curtis Himmelman, individually and on behalf of all others similarly situated v. Continental Casualty Company, Civil Action: 06-166, District Court of New Jersey (Trenton Division) is a purported class action and representative action brought on behalf of present and former CNA environmental claims analysts and workers' compensation claims analysts asserting they worked hours for which they should have been compensated at a rate of one and one-half times their base hourly wage. The complaint was filed on January 12, 2006. The claims were originally brought under both federal and New Jersey state wage and hour laws on the basis that the relevant jobs are not exempt from overtime pay because the duties performed are not exempt duties. On August 11, 2006, the Court dismissed plaintiff's New Jersey state law claims. Under federal law, plaintiff sought to represent others similarly situated who opted in to the action and who also alleged they were owed overtime pay for hours worked over eight hours per day and/or forty hours per workweek for the period January 5, 2003 to the entry of judgment. Plaintiff sought overtime compensation, compensatory, punitive and statutory damages, interest, costs and disbursements and attorneys' fees without specifying any particular amounts (as well as an injunction).

The parties reached agreement to fully and finally resolve this matter. The agreement had no material impact on the Company's equity or results of operations.

***California Long Term Care Litigation***

Shaffer v. Continental Casualty Company, et al., U.S. District Court, Central District of California, CV06-2235 RGK, is a class action on behalf of certain California individual long term health care policyholders, alleging that CCC and CNAF knowingly or negligently used unrealistic actuarial assumptions in pricing these policies, which according to plaintiff, would inevitably necessitate premium increases. On October 10, 2007, CCC, CNAF and the plaintiffs reached agreement on terms, subject to entering into a binding settlement agreement. Under such terms, the case would be settled on a nationwide basis for the policy forms potentially affected by the allegations of the complaint. Furthermore, CCC would provide certain enhanced benefits to eligible class members including certain non-forfeiture benefits, opportunities to exchange policies and free health screenings. The agreement is subject to notice to the class, as well as Court approval, and had no material impact on the Company's equity or results of operations.

***Asbestos, Environmental Pollution and Mass Tort (APMT) Reserves***

The Company is also a party to litigation and claims related to APMT cases arising in the ordinary course of business. See Note F for further discussion.

***Other Litigation***

The Company is also a party to other litigation arising in the ordinary course of business. Based on the facts and circumstances currently known, such other litigation will not, in the opinion of management, materially affect the equity or results of operations of the Company.

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

**Note H. Benefit Plans*****Pension and Postretirement Healthcare and Life Insurance Benefit Plans***

CNAF and certain subsidiaries sponsor noncontributory pension plans typically covering full-time employees age 21 or over who have completed at least one year of service. In 2000, the CNA Retirement Plan was closed to new participants; instead, retirement benefits are provided to these employees under the Company's savings plans. While the terms of the pension plans vary, benefits are generally based on years of credited service and the employee's highest 60 consecutive months of compensation. CNA uses December 31 as the measurement date for the majority of its plans.

CNA's funding policy for defined benefit pension plans is to make contributions in accordance with applicable governmental regulatory requirements with consideration of the funded status of the plans. The assets of the plans are invested primarily in mortgage-backed securities, short term investments, equity securities and limited partnerships.

CNA provides certain healthcare and life insurance benefits to eligible retired employees, their covered dependents and their beneficiaries. The funding for these plans is generally to pay covered expenses as they are incurred.

The components of net periodic benefit costs are presented in the following table.

**Net Periodic Benefit Costs**

<b>Period ended September 30</b> (In millions)	<b>Three Months</b>		<b>Nine Months</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Pension benefits</b>				
Service cost	\$ 5	\$ 6	\$ 17	\$ 19
Interest cost on projected benefit obligation	36	35	109	107
Expected return on plan assets	(43)	(40)	(130)	(120)
Prior service cost amortization			1	1
Actuarial loss	2	4	8	21
<b>Net periodic pension cost</b>	<b>\$</b>	<b>\$ 5</b>	<b>\$ 5</b>	<b>\$ 28</b>
<b>Postretirement benefits</b>				
Service cost	\$	\$ 1	\$ 1	\$ 2
Interest cost on projected benefit obligation	2	3	7	7
Prior service cost amortization	(4)	(7)	(13)	(20)
Actuarial loss	1	1	2	3
<b>Net periodic postretirement benefit</b>	<b>\$ (1)</b>	<b>\$ (2)</b>	<b>\$ (3)</b>	<b>\$ (8)</b>

For the nine months ended September 30, 2007, \$23 million of contributions have been made to the pension plans and \$12 million to the postretirement healthcare and life insurance benefit plans. CNA plans to contribute an additional \$1 million to the pension plans and \$4 million to the postretirement healthcare and life insurance benefit plans during the remainder of 2007.

**Table of Contents****CNA FINANCIAL CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued  
(UNAUDITED)****Note I. Operating Leases, Other Commitments and Contingencies, and Guarantees*****Operating Leases***

The Company is obligated to make future payments totaling \$241 million for non-cancelable operating leases primarily for office space, office and transportation equipment. Estimated future minimum payments under these contracts are as follows: \$11 million in 2007; \$41 million in 2008; \$39 million in 2009; \$35 million in 2010; \$31 million in 2011; and \$84 million in 2012 and beyond.

The Company holds an investment in a real estate joint venture. In the normal course of business, CNA, on a joint and several basis with other unrelated insurance company shareholders, has committed to continue funding the operating deficits of this joint venture. Additionally, CNA and the other unrelated shareholders, on a joint and several basis, have guaranteed an operating lease for an office building, which expires in 2016. The guarantee of the operating lease is a parallel guarantee to the commitment to fund operating deficits; consequently, the separate guarantee to the lessor is not expected to be triggered as long as the joint venture continues to be funded by its shareholders and continues to make its annual lease payments.

In the event that the other parties to the joint venture are unable to meet their commitments in funding the operations of this joint venture, the Company would be required to assume the obligation for the entire office building operating lease. The maximum potential future lease payments at September 30, 2007 that the Company could be required to pay under this guarantee are approximately \$229 million. If CNA were required to assume the entire lease obligation, the Company would have the right to pursue reimbursement from the other shareholders and would have the right to all sublease revenues.

***Other Commitments and Contingencies***

In the normal course of business, CNA has provided letters of credit in favor of various unaffiliated insurance companies, regulatory authorities and other entities. At September 30, 2007 there were approximately \$16 million of outstanding letters of credit.

The Company has entered into a limited number of guaranteed payment contracts, primarily relating to telecommunication and software services, amounting to approximately \$19 million as of September 30, 2007. Estimated future minimum payments under these contracts are \$2 million in 2007; \$8 million in 2008; \$5 million in 2009 and \$4 million in 2010.

***Guarantees***

In the course of selling business entities and assets to third parties, the Company has agreed to indemnify purchasers for losses arising out of breaches of representation and warranties with respect to the business entities or assets being sold, including, in certain cases, losses arising from undisclosed liabilities or certain named litigation. Such indemnification provisions generally survive for periods ranging from nine months following the applicable closing date to the expiration of the relevant statutes of limitation. As of September 30, 2007, the aggregate amount of quantifiable indemnification agreements in effect for sales of business entities, assets and third party loans was \$873 million, including amounts related to a sold discontinued operation.

In addition, the Company has agreed to provide indemnification to third party purchasers for certain losses associated with sold business entities or assets that are not limited by a contractual monetary amount. As of September 30, 2007, the Company had outstanding unlimited indemnifications in connection with the sales of certain of its business entities or assets that included tax liabilities arising prior to a purchaser's ownership of an entity or asset, defects in title at the time of sale, employee claims arising prior to closing and in some cases losses arising from certain litigation and undisclosed liabilities. These indemnification agreements survive until the applicable statutes of limitation expire, or until the agreed upon contract terms expire. As of September 30, 2007 and December 31, 2006, the Company has recorded approximately \$23 million and \$28 million of liabilities related to these indemnification agreements.

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

In connection with the issuance of preferred securities by CNA Surety Capital Trust I, CNA Surety issued a guarantee of \$75 million to guarantee the payment by CNA Surety Capital Trust I of annual dividends of \$1.5 million over 30 years and redemption of \$30 million of preferred securities.

**Note J. Comprehensive Income (Loss)**

The components of comprehensive income (loss) are shown below.

**Comprehensive Income (Loss)**

<b>Period ended September 30</b> (In millions)	<b>Three months</b>		<b>Nine Months</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net income	\$ 174	\$ 311	\$ 687	\$ 779
Other comprehensive income (loss):				
Change in unrealized gains (losses) on general account investments:				
Holding gains (losses) arising during the period, net of tax (expense) benefit of \$10, (\$315), \$156 and (\$35)	(19)	586	(291)	66
Reclassification adjustment for (gains) losses included in net income, net of tax expense (benefit) of \$25, \$2, \$58 and \$6	(45)	(1)	(107)	(9)
Net change in unrealized gains (losses) on general account investments, net of tax (expense) benefit of \$35, (\$313), \$214 and (\$29)	(64)	585	(398)	57
Net change in unrealized gains (losses) on discontinued operations and other, net of tax (expense) benefit of \$0, (\$2), \$0 and \$0	1	(1)		
Net change in foreign currency translation adjustment	24	5	29	32
Net change related to pensions, net of tax (expense) benefit of \$0, \$0, (\$1) and \$0	(2)		1	(1)
Allocation to participating policyholders and minority interests	(2)	(15)	11	
Other comprehensive income (loss), net of tax (expense) benefit of \$35, (\$315), \$213 and (\$29)	(43)	574	(357)	88
<b>Total comprehensive income</b>	<b>\$ 131</b>	<b>\$ 885</b>	<b>\$ 330</b>	<b>\$ 867</b>



**Table of Contents**

**CNA FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**(UNAUDITED)**

**Note K. Business Segments**

CNA's core property and casualty insurance operations are reported in two business segments: Standard Lines and Specialty Lines. CNA's non-core operations are reported in two segments: Life and Group Non-Core and Corporate and Other Non-Core. These segments reflect the way CNA manages its operations and makes business decisions.

The Company manages most of its assets on a legal entity basis, while segment operations are conducted across legal entities. As such, only insurance and reinsurance receivables, insurance reserves and deferred acquisition costs are readily identifiable by individual segment. Distinct investment portfolios are not maintained for each segment; accordingly, allocation of assets to each segment is not performed. Therefore, net investment income and realized investment gains or losses are allocated primarily based on each segment's net carried insurance reserves, as adjusted. Income taxes have been allocated on the basis of the taxable income of the segments.

In the following tables, certain financial measures are presented to provide information used by management to monitor the Company's operating performance. Management utilizes these financial measures to monitor the Company's insurance operations and investment portfolio. Net operating income, which is derived from certain income statement amounts, is used by management to monitor performance of the Company's insurance operations. The Company's investment portfolio is monitored through analysis of various quantitative and qualitative factors and certain decisions related to the sale or impairment of investments that produce realized gains and losses. Net realized investment gains and losses are comprised of after-tax realized investment gains and losses, net of participating policyholders' and minority interests.

Net operating income is calculated by excluding from net income the after-tax effects of 1) net realized investment gains or losses, 2) income or loss from discontinued operations and 3) any cumulative effects of changes in accounting principles. In the calculation of net operating income, management excludes after-tax net realized investment gains or losses because net realized investment gains or losses related to the Company's investment portfolio are largely discretionary, except for losses related to other-than-temporary impairments, are generally driven by economic factors that are not necessarily consistent with key drivers of underwriting performance, and are therefore not an indication of trends in insurance operations.

The Company's investment portfolio is monitored by management through analyses of various factors including unrealized gains and losses on securities, portfolio duration and exposure to interest rate, market and credit risk. Based on such analyses, the Company may impair an investment security in accordance with its policy, or sell a security. Such activities will produce realized gains and losses.

The significant components of the Company's continuing operations and selected balance sheet items are presented in the following tables.

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

<b>Three months ended September 30, 2007</b> (In millions)	<b>Standard Lines</b>	<b>Specialty Lines</b>	<b>Life and Group Non-Core</b>	<b>Corporate and Other Non-Core</b>	<b>Eliminations</b>	<b>Total</b>
<b>Revenues:</b>						
Net earned premiums	\$ 1,054	\$ 672	\$ 156	\$ 1	\$ (1)	\$ 1,882
Net investment income	248	113	145	74		580
Other revenues	20	49	16	4	(10)	79
Total operating revenues	1,322	834	317	79	(11)	2,541
<b>Claims, benefits and expenses:</b>						
Net incurred claims and benefits	649	418	463	40		1,570
Policyholders dividends	3	2				5
Amortization of deferred acquisition costs	234	146	4			384
Other insurance related expenses	90	37	48	1	(1)	175
Other expenses	22	44	17	31	(10)	104
Total claims, benefits and expenses	998	647	532	72	(11)	2,238
Operating income (loss) from continuing operations before income tax and minority interest	324	187	(215)	7		303
Income tax (expense) benefit on operating income (loss)	(104)	(60)	84	5		(75)
Minority interest	(5)	(11)				(16)
Net operating income (loss) from continuing operations	215	116	(131)	12		212
Realized investment losses, net of participating policyholders and minority interests	(29)	(13)	(9)	(6)		(57)

Income tax benefit on realized investment losses	9	5	3	2	19
<b>Income (loss) from continuing operations</b>	\$ 195	\$ 108	\$ (137)	\$ 8	\$ 174

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

<b>Three months ended September 30, 2006</b> (In millions)	<b>Standard Lines</b>	<b>Specialty Lines</b>	<b>Life and Group Non-Core</b>	<b>Corporate and Other Non-Core</b>	<b>Eliminations</b>	<b>Total</b>
<b>Revenues:</b>						
Net earned premiums	\$ 1,128	\$ 654	\$ 160	\$ 3	\$ (2)	\$ 1,943
Net investment income	239	101	179	81		600
Other revenues	16	38	8	6	(12)	56
<b>Total operating revenues</b>	<b>1,383</b>	<b>793</b>	<b>347</b>	<b>90</b>	<b>(14)</b>	<b>2,599</b>
<b>Claims, benefits and expenses:</b>						
Net incurred claims and benefits	776	397	314	31		1,518
Policyholders dividends	4	1	(1)			4
Amortization of deferred acquisition costs	249	137	4			390
Other insurance related expenses	89	31	48	8	(1)	175
Other expenses	20	35	14	28	(13)	84
<b>Total claims, benefits and expenses</b>	<b>1,138</b>	<b>601</b>	<b>379</b>	<b>67</b>	<b>(14)</b>	<b>2,171</b>
Operating income (loss) from continuing operations before income tax and minority interest	245	192	(32)	23		428
Income tax (expense) benefit on operating income (loss)	(78)	(64)	17	(7)		(132)
Minority interest	(4)	(9)				(13)
<b>Net operating income (loss) from continuing operations</b>	<b>163</b>	<b>119</b>	<b>(15)</b>	<b>16</b>		<b>283</b>
Realized investment gains (losses), net of participating policyholders and minority interests	18	6	(10)	7		21

Income tax (expense) benefit on realized investment gains (losses)	(7)	(1)	3	6	1
<b>Income (loss) from continuing operations</b>	\$ 174	\$ 124	\$ (22)	\$ 29	\$ 305

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

<b>Nine months ended September 30, 2007</b> (In millions)	<b>Standard Lines</b>	<b>Specialty Lines</b>	<b>Life and Group Non-Core</b>	<b>Corporate and Other Non-Core</b>	<b>Eliminations</b>	<b>Total</b>
<b>Revenues:</b>						
Net earned premiums	\$ 3,169	\$ 1,977	\$ 469	\$ 5	\$ (3)	\$ 5,617
Net investment income	784	343	494	238		1,859
Other revenues	65	137	34	6	(31)	211
Total operating revenues	4,018	2,457	997	249	(34)	7,687
<b>Claims, benefits and expenses:</b>						
Net incurred claims and benefits	2,098	1,217	1,062	111		4,488
Policyholders dividends	4	4				8
Amortization of deferred acquisition costs	707	417	13			1,137
Other insurance related expenses	266	111	143	16	(3)	533
Other expenses	77	115	34	98	(31)	293
Total claims, benefits and expenses	3,152	1,864	1,252	225	(34)	6,459
Operating income (loss) from continuing operations before income tax and minority interest	866	593	(255)	24		1,228
Income tax (expense) benefit on operating income (loss)	(277)	(194)	113	4		(354)
Minority interest	(9)	(27)		(1)		(37)
Net operating income (loss) from continuing operations	580	372	(142)	27		837
Realized investment losses, net of participating policyholders and minority	(126)	(52)	(26)	(13)		(217)

interests						
Income tax benefit on realized investment losses	43	18	9	5		75
<b>Income (loss) from continuing operations</b>	\$ 497	\$ 338	\$ (159)	\$ 19	\$	\$ 695
<b>September 30, 2007</b>						
(In millions)						
<b>Reinsurance receivables</b>	\$ 3,151	\$ 1,371	\$ 2,316	\$ 2,519	\$	\$ 9,357
<b>Insurance receivables</b>	\$ 2,000	\$ 424	\$ (1)	\$ 4	\$	\$ 2,427
<b>Insurance reserves:</b>						
Claim and claim adjustment expenses	\$ 14,747	\$ 5,982	\$ 3,097	\$ 5,166	\$	\$ 28,992
Unearned premiums	2,031	1,553	166	4	(1)	3,753
Future policy benefits			6,993			6,993
Policyholders funds	26		987			1,013
<b>Deferred acquisition costs</b>	\$ 404	\$ 298	\$ 487	\$	\$	\$ 1,189

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

<b>Nine months ended September 30, 2006</b> (In millions)	<b>Standard Lines</b>	<b>Specialty Lines</b>	<b>Life and Group Non-Core</b>	<b>Corporate and Other Non-Core</b>	<b>Eliminations</b>	<b>Total</b>
<b>Revenues:</b>						
Net earned premiums	\$ 3,310	\$ 1,915	\$ 482	\$ 1	\$ (4)	\$ 5,704
Net investment income	705	287	504	226		1,722
Other revenues	49	112	44	8	(38)	175
Total operating revenues	4,064	2,314	1,030	235	(42)	7,601
<b>Claims, benefits and expenses:</b>						
Net incurred claims and benefits	2,297	1,157	886	90	1	4,431
Policyholders dividends	12	3				15
Amortization of deferred acquisition costs	725	395	12			1,132
Other insurance related expenses	293	109	141	24	(4)	563
Restructuring and other related charges				(13)		(13)
Other expenses	58	103	40	91	(39)	253
Total claims, benefits and expenses	3,385	1,767	1,079	192	(42)	6,381
Operating income (loss) from continuing operations before income tax and minority interest	679	547	(49)	43		1,220
Income tax (expense) benefit on operating income (loss)	(207)	(181)	36	(14)		(366)
Minority interest	(9)	(23)				(32)
Net operating income (loss) from continuing operations	463	343	(13)	29		822
	(6)	(4)	(56)	(2)		(68)



Realized investment losses,  
net of participating  
policyholders and minority  
interests

Income tax benefit on  
realized investment losses

2                      2                      19                      4                      27

**Income (loss) from  
continuing operations**

\$ 459      \$ 341      \$ (50)      \$ 31      \$ 781

**December 31, 2006**

(In millions)

**Reinsurance receivables**

\$ 3,260      \$ 1,296      \$ 2,378      \$ 3,013      \$ 9,947

**Insurance receivables**

\$ 2,053      \$ 424      \$ 52      \$ (53)      \$ 2,476

**Insurance reserves:**

Claim and claim adjustment  
expenses

\$ 14,934      \$ 5,529      \$ 3,134      \$ 6,039      \$ 29,636

Unearned premiums

2,007      1,599      173      5      3,784

Future policy benefits

6,645      6,645

Policyholders funds

35      980      1,015

**Deferred acquisition costs**

\$ 407      \$ 283      \$ 500      \$      \$ 1,190

37

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

The following table provides revenue by line of business for each reportable segment. Prior period amounts have been conformed to reflect the current product structure. Revenues are comprised of operating revenues and realized investment gains and losses, net of participating policyholders and minority interests.

**Revenues by Line of Business**

<b>Period ended September 30</b> (In millions)	<b>Three Months</b>		<b>Nine Months</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Standard Lines</b>				
Property	\$ 310	\$ 323	\$ 948	\$ 915
Casualty	780	884	2,365	2,592
CNA Global	203	194	579	551
<b>Standard Lines revenues</b>	<b>1,293</b>	<b>1,401</b>	<b>3,892</b>	<b>4,058</b>
<b>Specialty Lines</b>				
US Specialty Lines	621	615	1,834	1,775
Surety	125	113	352	323
Warranty	75	71	219	212
<b>Specialty Lines revenues</b>	<b>821</b>	<b>799</b>	<b>2,405</b>	<b>2,310</b>
<b>Life and Group Non-Core</b>				
Life & Annuity	47	100	226	266
Health	241	224	693	655
Other	20	13	52	53
<b>Life and Group Non-Core revenues</b>	<b>308</b>	<b>337</b>	<b>971</b>	<b>974</b>
<b>Corporate and Other Non-Core</b>				
CNA Re	24	35	96	78
Other	49	62	140	155
<b>Corporate and Other Non-Core revenues</b>	<b>73</b>	<b>97</b>	<b>236</b>	<b>233</b>
<b>Eliminations</b>	<b>(11)</b>	<b>(14)</b>	<b>(34)</b>	<b>(42)</b>

<b>Total revenues</b>	\$ 2,484	\$ 2,620	\$ 7,470	\$ 7,533
-----------------------	----------	----------	----------	----------

38

---

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**  
**(UNAUDITED)**

**Note L. Discontinued Operations**

CNA has discontinued operations, which consist of run-off insurance operations acquired in its merger with The Continental Corporation in 1995. As of September 30, 2007, the remaining run-off business is administered by Continental Reinsurance Corporation International, Ltd., a Bermuda subsidiary. The business consists of facultative property and casualty, treaty excess casualty and treaty pro-rata reinsurance with underlying exposure to a diverse, multi-line domestic and international book of business encompassing property, casualty, and marine liabilities.

Results of the discontinued operations were as follows:

**Discontinued Operations**

Period ended September 30 (In millions)	Three Months		Nine Months	
	2007	2006	2007	2006
Revenues:				
Net investment income	\$ 2	\$ 5	\$ 11	\$ 13
Realized investment gains (losses) and other	2		4	(3)
Total revenues	4	5	15	10
Insurance related expenses	(3)	(8)	(23)	(21)
Income (loss) before income taxes	1	(3)	(8)	(11)
Income tax (expense) benefit	(1)	9		9
Income (loss) from discontinued operations, net of tax	\$	\$ 6	\$ (8)	\$ (2)

On May 4, 2007, the Company sold Continental Management Services Limited (CMS), its United Kingdom discontinued operations subsidiary, to Tawa UK Limited, a subsidiary of Artemis Group, a diversified French-based holding company. In anticipation of the sale, the Company recorded an impairment loss of \$29 million in 2006. After closing the transaction in 2007, the loss was reduced by approximately \$5 million. The assets and liabilities sold were \$239 million and \$157 million at December 31, 2006. Net loss for the business through the date of the sale in 2007 was \$1 million. Net income (loss) for the business was \$1 million and \$(6) million for the three and nine months ended September 30, 2006. CNA's subsidiary, The Continental Corporation, provided a guarantee for a portion of the liabilities related to certain marine products. The sale agreement included provisions that significantly limit the Company's exposure related to this guarantee.

Net assets of discontinued operations, included in Other assets on the Condensed Consolidated Balance Sheets, were as follows:

**Discontinued Operations**

(In millions)	September 30, 2007	December 31, 2006
Assets:		
Investments	\$ 184	\$ 317
Reinsurance receivables	1	33
Cash	7	40
Other assets	2	3

Total assets		194		393
Liabilities:				
Insurance reserves		168		308
Other liabilities		5		17
Total liabilities		173		325
Net assets of discontinued operations	\$	21	\$	68

During the third quarter of 2007, the Company transferred an investment portfolio comprised of fixed maturity securities of \$22 million, short term investments of \$14 million and cash of \$4 million from its continuing operations to its discontinued operations.

**Table of Contents**

**CNA FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**(UNAUDITED)**

CNA's accounting and reporting for discontinued operations is in accordance with APB Opinion No. 30, Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions. At September 30, 2007 and December 31, 2006, the insurance reserves are net of discount of \$75 million and \$94 million. The income (loss) from discontinued operations reported above primarily represents the net investment income, realized investment gains and losses, foreign currency gains and losses, effects of the accretion of the loss reserve discount and re-estimation of the ultimate claim and claim adjustment expense of the discontinued operations.

**Note M. Restructuring and Other Related Charges**

In 2001, the Company finalized and approved a restructuring plan. During the second quarter of 2006, management reevaluated the sufficiency of the remaining accrual, which related to lease termination costs, and determined that the liability was no longer required as the Company had completed its lease obligations. As a result, the excess remaining accrual was released in 2006, resulting in pretax income of \$13 million for the nine months ended September 30, 2006.

**Note N. Debt**

***Revolving Credit Facility***

On August 1, 2007, the Company entered into a credit agreement with a syndicate of banks and other lenders. The credit agreement established a five-year \$250 million senior unsecured revolving credit facility which is intended to be used for general corporate purposes. At the Company's election, the commitments under the credit agreement may be increased from time to time up to an additional aggregate amount of \$100 million, and two one-year extensions are available prior to the first and second anniversary of the closing date subject to applicable consents. As of September 30, 2007, the Company has no outstanding borrowings under the agreement.

Under the credit agreement, the Company is required to pay certain fees, including a facility fee and a utilization fee, both of which would adjust automatically in the event of a change in the Company's financial ratings. The credit agreement includes several covenants, including maintenance of a minimum consolidated net worth and a specified ratio of consolidated indebtedness to consolidated total capitalization.

**Table of Contents**

**CNA FINANCIAL CORPORATION**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Overview**

The following discussion highlights significant factors impacting the consolidated operations and financial condition of CNA Financial Corporation (CNAF) and its subsidiaries (collectively CNA or the Company). References to CNA, the Company, we, our, us or like terms refer to the business of CNA and its subsidiaries. Based on 2006 statutory written premiums, we are the seventh largest commercial insurance writer and the thirteenth largest property and casualty company in the United States of America.

The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements in Item 1 of Part 1 of this Form 10-Q and Item 1A Risk Factors and Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations, which are included in our Form 10-K filed with the Securities and Exchange Commission (SEC) for the year ended December 31, 2006.

Changes in estimates of claim and allocated claim adjustment expense reserves and premium accruals, net of reinsurance, for prior years are defined as net prior year development within this MD&A. These changes can be favorable or unfavorable. Net prior year development does not include the impact of related acquisition expenses. Further information on our reserves is provided in Note F of the Condensed Consolidated Financial Statements included under Item 1.

**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued****CONSOLIDATED OPERATIONS****Results of Operations**

The following table includes the consolidated results of our operations. For more detailed components of our business operations and the net operating income financial measure, see the segment discussions within this MD&A.

<b>Period ended September 30</b> (In millions, except per share data)	<b>Three Months</b>		<b>Nine Months</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Revenues</b>				
Net earned premiums	\$ 1,882	\$ 1,943	\$ 5,617	\$ 5,704
Net investment income	580	600	1,859	1,722
Other revenues	79	56	211	175
<b>Total operating revenues</b>	<b>2,541</b>	<b>2,599</b>	<b>7,687</b>	<b>7,601</b>
<b>Claims, Benefits and Expenses</b>				
Net incurred claims and benefits	1,570	1,518	4,488	4,431
Policyholders' dividends	5	4	8	15
Amortization of deferred acquisition costs	384	390	1,137	1,132
Other insurance related expenses	175	175	533	563
Restructuring and other related charges				(13)
Other expenses	104	84	293	253
<b>Total claims, benefits and expenses</b>	<b>2,238</b>	<b>2,171</b>	<b>6,459</b>	<b>6,381</b>
Operating income from continuing operations before income tax and minority interest	303	428	1,228	1,220
Income tax expense on operating income	(75)	(132)	(354)	(366)
Minority interest	(16)	(13)	(37)	(32)
<b>Net operating income from continuing operations</b>	<b>212</b>	<b>283</b>	<b>837</b>	<b>822</b>
Realized investment gains (losses), net of participating policyholders' and minority interests	(57)	21	(217)	(68)
Income tax benefit on realized investment gains (losses)	19	1	75	27
<b>Income from continuing operations</b>	<b>174</b>	<b>305</b>	<b>695</b>	<b>781</b>
		6	(8)	(2)



Income (loss) from discontinued operations, net of income tax (expense) benefit of \$(1), \$9, \$0 and \$9

<b>Net Income</b>	\$ 174	\$ 311	\$ 687	\$ 779
-------------------	--------	--------	--------	--------

**Basic and Diluted Earnings Per Share**

Income from continuing operations	\$ 0.64	\$ 1.13	\$ 2.56	\$ 2.84
Income (loss) from discontinued operations		0.02	(0.03)	(0.01)

Basic and diluted earnings per share available to common stockholders	\$ 0.64	\$ 1.15	\$ 2.53	\$ 2.83
---	---------	---------	---------	---------

**Weighted average outstanding common stock and common stock equivalents**

<b>Basic</b>	271.6	265.0	271.5	259.0
--------------	-------	-------	-------	-------

<b>Diluted</b>	271.9	265.2	271.8	259.2
----------------	-------	-------	-------	-------

**Table of Contents**

**CNA FINANCIAL CORPORATION**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

**Three Month Comparison**

Net income decreased \$137 million for the three months ended September 30, 2007 as compared with the same period in 2006. This decrease was due to decreased net operating income from continuing operations and decreased net realized investment results.

Net realized investment results decreased \$60 million for the three months ended September 30, 2007 as compared with the same period in 2006. The decrease was primarily driven by higher impairment losses. See the Investments section of this MD&A for further discussion of net investment income and net realized investment results.

Net operating income from continuing operations for the three months ended September 30, 2007 decreased \$71 million as compared with the same period in 2006. The decrease in net operating income was driven by the after-tax loss of \$108 million related to the settlement of the IGI Contingency in the Life and Group Non-Core segment as further discussed in Note G of the Condensed Consolidated Financial Statements included under Item 1. This decrease was partially offset by increased favorable net prior year development.

Favorable net prior year development of \$67 million was recorded for the three months ended September 30, 2007 related to our Standard Lines, Specialty Lines and Corporate and Other Non-core segments. This amount consisted of \$57 million of favorable claim and allocated claim adjustment expense reserve development and \$10 million of favorable premium development. Favorable net prior year development of \$11 million was recorded for the three months ended September 30, 2006 related to our Standard Lines, Specialty Lines and Corporate and Other Non-core segments. This amount consisted of \$5 million of unfavorable claim and allocated claim adjustment expense reserve development and \$16 million of favorable premium development.

Net earned premiums decreased \$61 million for the three months ended September 30, 2007 as compared with the same period in 2006, including a \$74 million decrease related to Standard Lines and an \$18 million increase related to Specialty Lines. See the segment discussions of this MD&A for further discussion.

Results from discontinued operations decreased \$6 million for the three months ended September 30, 2007 as compared to the same period in 2006. Income from discontinued operations in 2006 was primarily driven by the release of tax reserves of \$7 million.

**Nine Month Comparison**

Net income decreased \$92 million for the nine months ended September 30, 2007 as compared with the same period in 2006. This decrease was due to higher net realized investment losses, partially offset by increased net operating income from continuing operations.

Net realized investment losses were \$101 million higher for the nine months ended September 30, 2007 compared with the same period in 2006. This increase was primarily driven by higher impairment losses. See the Investments section of this MD&A for further discussion of net investment income and net realized investment results.

Net operating income from continuing operations for the nine months ended September 30, 2007 increased \$15 million as compared with the same period in 2006. The improvement in net operating income was due to increased net investment income and increased favorable net prior year development. These increases to net operating income were partially offset by decreased net operating results in the Life and Group Non-Core segment related to the settlement of the IGI Contingency.

Favorable net prior year development of \$92 million was recorded for the nine months ended September 30, 2007 related to our Standard Lines, Specialty Lines and Corporate and Other Non-core segments. This amount consisted of \$59 million of favorable claim and allocated claim adjustment expense reserve development and \$33 million of favorable premium development. Favorable net prior year development of \$7 million was recorded for the nine months ended September 30, 2006 related to our Standard Lines, Specialty Lines and Corporate and Other Non-core segments. This amount consisted of \$84 million of unfavorable claim and allocated claim adjustment expense reserve development and \$91 million of favorable premium development.

**Table of Contents**

**CNA FINANCIAL CORPORATION**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

Net earned premiums decreased \$87 million for the nine months ended September 30, 2007 as compared with the same period in 2006, including a \$141 million decrease related to Standard Lines and a \$62 million increase related to Specialty Lines. See the segment discussions of this MD&A for further discussion.

Results from discontinued operations decreased \$6 million for the nine months ended September 30, 2007 as compared to the same period in 2006. The unfavorable 2007 results were primarily driven by unfavorable net prior year development. Results in 2006 were impacted by realized investment losses, unallocated loss adjustment expense reserves and bad debt provision for reinsurance receivables. These results were partially offset by the release of tax reserves.

**Critical Accounting Estimates**

The preparation of the Condensed Consolidated Financial Statements (Unaudited) in conformity with accounting principles generally accepted in the United States of America (GAAP) requires us 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 amounts of revenues and expenses reported during the period. Actual results may differ from those estimates.

Our Condensed Consolidated Financial Statements and accompanying notes have been prepared in accordance with GAAP applied on a consistent basis. We continually evaluate the accounting policies and estimates used to prepare the Condensed Consolidated Financial Statements. In general, our estimates are based on historical experience, evaluation of current trends, information from third party professionals and various other assumptions that are believed to be reasonable under the known facts and circumstances.

The accounting estimates below are considered by us to be critical to an understanding of our Condensed Consolidated Financial Statements as their application places the most significant demands on our judgment.

Insurance Reserves

Reinsurance

Valuation of Investments and Impairment of Securities

Long Term Care Products

Pension and Postretirement Benefit Obligations

Legal Proceedings

Due to the inherent uncertainties involved with these types of judgments, actual results could differ significantly from estimates and may have a material adverse impact on our results of operations or equity. See the Critical Accounting Estimates section of our Management's Discussion and Analysis of Financial Condition and Results of Operations included under Item 7 of our Form 10-K for the year ended December 31, 2006 for further information.

**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued****SEGMENT RESULTS**

The following discusses the results of continuing operations for our operating segments. We utilize the net operating income financial measure to monitor our operations. Net operating income is calculated by excluding from net income the after-tax effects of 1) net realized investment gains or losses, 2) income or loss from discontinued operations and 3) any cumulative effects of changes in accounting principles. See further discussion regarding how we manage our business in Note K of the Condensed Consolidated Financial Statements included under Item 1. In evaluating the results of the Standard Lines and Specialty Lines, we utilize the loss ratio, the expense ratio, the dividend ratio, and the combined ratio. These ratios are calculated using GAAP financial results. The loss ratio is the percentage of net incurred claim and claim adjustment expenses to net earned premiums. The expense ratio is the percentage of insurance underwriting and acquisition expenses, including the amortization of deferred acquisition costs, to net earned premiums. The dividend ratio is the ratio of policyholders' dividends incurred to net earned premiums. The combined ratio is the sum of the loss, expense and dividend ratios.

**STANDARD LINES**

The following table summarizes the results of operations for Standard Lines.

**Results of Operations**

<b>Period ended September 30</b> (In millions)	<b>Three Months</b>		<b>Nine Months</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net written premiums	\$ 956	\$ 1,121	\$ 3,171	\$ 3,394
Net earned premiums	1,054	1,128	3,169	3,310
Net investment income	248	239	784	705
Net operating income	215	163	580	463
Net realized investment gains (losses), after-tax	(20)	11	(83)	(4)
Net income	195	174	497	459
<b>Ratios</b>				
Loss and loss adjustment expense	61.6%	68.7%	66.2%	69.4%
Expense	30.8	30.1	30.8	30.7
Dividend	0.3	0.4	0.1	0.4
<b>Combined</b>	<b>92.7%</b>	<b>99.2%</b>	<b>97.1%</b>	<b>100.5%</b>

**Three Month Comparison**

Net written premiums for Standard Lines decreased \$165 million for the three months ended September 30, 2007 as compared with the same period in 2006, primarily due to decreased production. The decreased production reflects our disciplined participation in the current competitive market. The competitive market conditions are expected to put ongoing pressure on premium and income levels, and the expense ratio. Net earned premiums decreased \$74 million for the three months ended September 30, 2007 as compared with the same period in 2006, consistent with the decreased premiums written.

Standard Lines averaged rate decreases of 2% for the three months ended September 30, 2007, as compared to increases of 1% for the three months ended September 30, 2006 for the contracts that renewed during those periods. Retention rates of 76% and 80% were achieved for those contracts that were available for renewal in each period.

Net income increased \$21 million for the three months ended September 30, 2007 as compared with the same period in 2006. This increase was primarily attributable to improved net operating income, offset by decreased net realized investment results. See the Investments section of this MD&A for further discussion of net investment income and net realized investment results.

**Table of Contents**

**CNA FINANCIAL CORPORATION**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

Net operating income increased \$52 million for the three months ended September 30, 2007 as compared with the same period in 2006. This increase was primarily driven by increased favorable net prior year development and increased net investment income.

The combined ratio improved 6.5 points for the three months ended September 30, 2007 as compared with the same period in 2006. The loss ratio improved 7.1 points primarily due to increased favorable net prior year development and decreased catastrophe losses. Catastrophe losses were \$7 million after-tax in the third quarter of 2007, as compared to \$14 million after-tax in the same period of 2006. These favorable impacts were partially offset by higher current accident year loss ratios related to the decline in rates.

The expense ratio increased 0.7 points for the three months ended September 30, 2007 as compared with the same period in 2006, reflecting the impact of declining earned premiums.

Favorable net prior year development of \$84 million was recorded for the three months ended September 30, 2007, including \$77 million of favorable claim and allocated claim adjustment expense reserve development and \$7 million of favorable premium development. Favorable net prior year development of \$13 million, including \$6 million of unfavorable claim and allocated claim adjustment expense reserve development and \$19 million of favorable premium development, was recorded for the three months ended September 30, 2006. Further information on Standard Lines net prior year development for the three months ended September 30, 2007 and 2006 is included in Note F of the Condensed Consolidated Financial Statements included under Item 1.

**Nine Month Comparison**

Net written premiums for Standard Lines decreased \$223 million for the nine months ended September 30, 2007 as compared with the same period in 2006. Premiums written were primarily impacted by decreased production and decreased favorable premium development in 2007 as compared to 2006. Net earned premiums decreased \$141 million for the nine months ended September 30, 2007 as compared with the same period in 2006, consistent with the decreased premiums written.

Standard Lines averaged rate decreases of 3% for the nine months ended September 30, 2007, as compared to flat rates for the nine months ended September 30, 2006 for the contracts that renewed during those periods. Retention rates of 79% and 81% were achieved for those contracts that were available for renewal in each period.

Net income increased \$38 million for the nine months ended September 30, 2007 as compared with the same period in 2006. This increase was attributable to improved net operating results, partially offset by higher net realized investment losses. See the Investments section of this MD&A for further discussion of net investment income and net realized investment results.

Net operating income increased \$117 million for the nine months ended September 30, 2007 as compared with the same period in 2006. This increase was primarily driven by increased favorable net prior year development and increased net investment income.

The combined ratio improved 3.4 points for the nine months ended September 30, 2007 as compared with the same period in 2006. The loss ratio improved 3.2 points primarily due to increased favorable net prior year development, partially offset by higher current accident year loss ratios related to the decline in rates and increased catastrophe losses. Catastrophe losses were \$34 million after-tax for the nine months ended September 30, 2007, as compared to \$25 million after-tax in the same period of 2006.

The dividend ratio improved 0.3 points for the nine months ended September 30, 2007 as compared with the same period in 2006 due to favorable dividend development in the workers' compensation line of business.

**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

Favorable net prior year development of \$117 million was recorded for the nine months ended September 30, 2007, including \$97 million of favorable claim and allocated claim adjustment expense reserve development and \$20 million of favorable premium development. Favorable net prior year development of \$22 million, including \$70 million of unfavorable claim and allocated claim adjustment expense reserve development and \$92 million of favorable premium development, was recorded for the nine months ended September 30, 2006. Further information on Standard Lines net prior year development for the nine months ended September 30, 2007 and 2006 is included in Note F of the Condensed Consolidated Financial Statements included under Item 1.

The following table summarizes the gross and net carried reserves as of September 30, 2007 and December 31, 2006 for Standard Lines.

**Gross and Net Carried  
Claim and Claim Adjustment Expense Reserves**

	<b>September 30, 2007</b>	<b>December 31, 2006</b>
(In millions)		
Gross Case Reserves	\$ 6,868	\$ 6,746
Gross IBNR Reserves	7,879	8,188
<b>Total Gross Carried Claim and Claim Adjustment Expense Reserves</b>	<b>\$ 14,747</b>	<b>\$ 14,934</b>
Net Case Reserves	\$ 5,407	\$ 5,234
Net IBNR Reserves	6,376	6,632
<b>Total Net Carried Claim and Claim Adjustment Expense Reserves</b>	<b>\$ 11,783</b>	<b>\$ 11,866</b>

**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued****SPECIALTY LINES**

The following table summarizes the results of operations for Specialty Lines.

**Results of Operations**

Period ended September 30 (In millions)	Three Months		Nine Months	
	2007	2006	2007	2006
Net written premiums	\$ 683	\$ 675	\$ 1,972	\$ 1,948
Net earned premiums	672	654	1,977	1,915
Net investment income	113	101	343	287
Net operating income	116	119	372	343
Net realized investment gains (losses), after-tax	(8)	5	(34)	(2)
Net income	108	124	338	341
<b>Ratios</b>				
Loss and loss adjustment expense	62.3%	60.7%	61.6%	60.4%
Expense	27.3	25.8	26.7	26.4
Dividend	0.2	0.1	0.2	0.1
Combined	89.8%	86.6%	88.5%	86.9%

**Three Month Comparison**

Net written premiums for Specialty Lines increased \$8 million for the three months ended September 30, 2007 as compared to the same period in 2006. Premiums written were unfavorably impacted by decreased production as compared to the third quarter of 2006. The decreased production reflects our disciplined participation in the current competitive market. The competitive market conditions are expected to put ongoing pressure on premium and income levels, and the expense ratio. This unfavorable impact was more than offset by decreased ceded premiums. The US Specialty Lines reinsurance structure was primarily quota share reinsurance through April 2007. We elected not to renew this coverage upon its expiration. With our current diversification in the previously reinsured lines of business and our management of the gross limits on the business written, we did not believe the cost of renewing the program was commensurate with its projected benefit. Net earned premiums increased \$18 million for the three months ended September 30, 2007 as compared with the same period in 2006, which reflects the increased net written premiums over the past several quarters in Specialty Lines.

Specialty Lines averaged rate decreases of 5% for the three months ended September 30, 2007 as compared to decreases of 1% for the three months ended September 30, 2006 for the contracts that renewed during those periods. Retention rates of 83% and 86% were achieved for those contracts that were available for renewal in each period.

Net income decreased \$16 million for the three months ended September 30, 2007 as compared with the same period in 2006. This decrease was primarily attributable to decreases in net realized investment results. See the Investments section of this MD&A for further discussion of net investment income and net realized investment results.

Net operating income decreased \$3 million for the three months ended September 30, 2007 as compared with the same period in 2006. This decrease was primarily driven by increased unfavorable net prior year development and increased expenses. These decreases were partially offset by increased net investment income.

The combined ratio increased 3.2 points for the three months ended September 30, 2007 as compared with the same period in 2006. The loss ratio increased 1.6 points, primarily due to increased unfavorable net prior year development.





**Table of Contents**

**CNA FINANCIAL CORPORATION**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

The expense ratio increased 1.5 points for the three months ended September 30, 2007 as compared with the same period in 2006. The expense ratio was unfavorably impacted by higher direct commissions on the mix of accounts written during the quarter.

Unfavorable net prior year development of \$12 million, including \$13 million of unfavorable claim and allocated claim adjustment expense reserve development and \$1 million of favorable premium development, was recorded for the three months ended September 30, 2007. Unfavorable net prior year development of \$2 million, including \$4 million of favorable claim and allocated claim adjustment expense reserve development and \$6 million of unfavorable premium development, was recorded for the three months ended September 30, 2006. Further information on Specialty Lines net prior year development for the three months ended September 30, 2007 and 2006 is included in Note F of the Condensed Consolidated Financial Statements included under Item 1.

**Nine Month Comparison**

Net written premiums for Specialty Lines increased \$24 million and net earned premiums increased \$62 million for the nine months ended September 30, 2007 as compared with the same period in 2006, consistent with the reasons discussed in the three month comparison above.

Specialty Lines averaged rate decreases of 4% for the nine months ended September 30, 2007 as compared to flat rates for the nine months ended September 30, 2006 for the contracts that renewed during those periods. Retention rates of 84% and 87% were achieved for those contracts that were available for renewal in each period.

Net income decreased \$3 million for the nine months ended September 30, 2007 as compared with the same period in 2006. This decrease was primarily attributable to higher net realized investment losses, substantially offset by improved net operating income. See the Investments section of this MD&A for further discussion of net investment income and net realized investment results.

Net operating income increased \$29 million for the nine months ended September 30, 2007 as compared with the same period in 2006. This increase in net operating income was primarily due to increased net investment income, partially offset by unfavorable net prior year development in 2007.

The combined ratio increased 1.6 points for the nine months ended September 30, 2007 as compared with the same period in 2006. The loss ratio increased 1.2 points, primarily due to unfavorable net prior year development and higher current accident year loss ratios related to the decline in rates.

The expense ratio increased 0.3 points for the nine months ended September 30, 2007 as compared with the same period in 2006. The expense ratio was unfavorably impacted by higher direct commissions as discussed in the three month comparison, partially offset by a change in estimate related to dealer profit commissions in the warranty line of business.

Unfavorable net prior year development of \$11 million, including \$19 million of unfavorable claim and allocated claim adjustment expense reserve development and \$8 million of favorable premium development, was recorded for the nine months ended September 30, 2007. Favorable claim and allocated claim adjustment expense reserve development of \$1 million was recorded for the nine months ended September 30, 2006. There was no premium development recorded for the nine months ended September 30, 2006.

**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

The following table summarizes the gross and net carried reserves as of September 30, 2007 and December 31, 2006 for Specialty Lines.

**Gross and Net Carried****Claim and Claim Adjustment Expense Reserves**

(In millions)	<b>September 30, 2007</b>	<b>December 31, 2006</b>
Gross Case Reserves	\$ 1,705	\$ 1,715
Gross IBNR Reserves	4,277	3,814
<b>Total Gross Carried Claim and Claim Adjustment Expense Reserves</b>	<b>\$ 5,982</b>	<b>\$ 5,529</b>
Net Case Reserves	\$ 1,370	\$ 1,350
Net IBNR Reserves	3,263	2,921
<b>Total Net Carried Claim and Claim Adjustment Expense Reserves</b>	<b>\$ 4,633</b>	<b>\$ 4,271</b>

**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued****LIFE AND GROUP NON-CORE**

The following table summarizes the results of operations for Life and Group Non-Core.

**Results of Operations**

<b>Period ended September 30</b> (In millions)	<b>Three Months</b>		<b>Nine Months</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net earned premiums	\$ 156	\$ 160	\$ 469	\$ 482
Net investment income	145	179	494	504
Net operating loss	(131)	(15)	(142)	(13)
Net realized investment losses, after tax	(6)	(7)	(17)	(37)
Net loss	(137)	(22)	(159)	(50)

**Three Month Comparison**

Net earned premiums for Life and Group Non-Core decreased \$4 million for the three months ended September 30, 2007 as compared with the same period in 2006. The net earned premiums relate primarily to the group and individual long term care businesses.

Net loss increased \$115 million for the three months ended September 30, 2007 as compared with the same period in 2006. The increase in net loss was primarily due to the after-tax loss of \$108 million related to the settlement of the IGI Contingency as further discussed in Note G of the Condensed Consolidated Financial Statements included under Item 1. Net loss was also impacted by lower net investment income related to the pension deposit business. Partially offsetting these unfavorable impacts were improved results for life settlement contracts. See the Investments section of this MD&A for further discussion of net investment income and net realized investment results.

**Nine Month Comparison**

Net earned premiums for Life and Group Non-Core decreased \$13 million for the nine months ended September 30, 2007 as compared with the same period in 2006.

Net loss increased \$109 million for the nine months ended September 30, 2007 as compared with the same period in 2006. The increase in net loss was primarily related to the items discussed in the three month comparison. These unfavorable impacts were partially offset by lower net realized investment losses.

**Table of Contents**

**CNA FINANCIAL CORPORATION**  
**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND**  
**RESULTS OF OPERATIONS, Continued**  
**CORPORATE AND OTHER NON-CORE**

The following table summarizes the results of operations for the Corporate and Other Non-Core segment, including Asbestos, Environmental Pollution and Mass Tort (APMT) and intrasegment eliminations.

**Results of Operations**

<b>Period ended September 30</b> (In millions)	<b>Three Months</b>		<b>Nine Months</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net investment income	\$74	\$81	\$238	\$226
Revenues	62	83	202	191
Net operating income	12	16	27	29
Net realized investment gains (losses), after-tax	(4)	13	(8)	2
Net income	8	29	19	31

**Three Month Comparison**

Revenues decreased \$21 million for the three months ended September 30, 2007 as compared with the same period in 2006. Revenues were unfavorably impacted by decreased net realized investment results and decreased net investment income. See the Investments section of this MD&A for further discussion of net investment income and net realized investment results.

Net income decreased \$21 million for the three months ended September 30, 2007 as compared with the same period in 2006. The decrease in net results was primarily due to decreased revenues as discussed above, unfavorable net prior year development in 2007 and increased current accident year losses related to mass torts.

Unfavorable net prior year development of \$5 million was recorded for the three months ended September 30, 2007, including \$7 million of unfavorable net prior year claim and allocated claim adjustment expense reserve development and \$2 million of favorable premium development. There was \$3 million of unfavorable claim and allocated claim adjustment expense reserve development and \$3 million of favorable premium development, resulting in no net prior year development for the three months ended September 30, 2006.

**Nine Month Comparison**

Revenues increased \$11 million for the nine months ended September 30, 2007 as compared with the same period in 2006. The increase in revenues was primarily due to increased net investment income and favorable net prior year premium development. These favorable impacts were partially offset by decreased net realized investment results. See the Investments section of this MD&A for further discussion of net investment income and net realized investment results.

Net income decreased \$12 million for the nine months ended September 30, 2007 as compared with the same period in 2006. The decrease was primarily due to an increase in interest costs on corporate debt and increased current accident year losses related to mass torts. In addition, the 2006 results included a release of a restructuring accrual. These unfavorable impacts were partially offset by the increased revenues as discussed above and a loss in 2006 related to a commutation.

Unfavorable net prior year development of \$14 million was recorded for the nine months ended September 30, 2007, including \$19 million of unfavorable net prior year claim and allocated claim adjustment expense reserve development and \$5 million of favorable premium development. Unfavorable net prior year development of \$16 million, including \$15 million of unfavorable net prior year claim and allocated claim adjustment expense reserve development and \$1 million of unfavorable premium development, was recorded for the nine months ended September 30, 2006. Further information on Corporate and Other Non-Core net prior year development for the nine months ended September 30, 2007 and 2006 is included in Note F of the Condensed Consolidated Financial Statements under Item 1.



**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

The following table summarizes the gross and net carried reserves as of September 30, 2007 and December 31, 2006 for Corporate and Other Non-Core.

**Gross and Net Carried****Claim and Claim Adjustment Expense Reserves**

(In millions)	<b>September 30, 2007</b>	<b>December 31, 2006</b>
Gross Case Reserves	\$ 2,247	\$ 2,511
Gross IBNR Reserves	2,919	3,528
<b>Total Gross Carried Claim and Claim Adjustment Expense Reserves</b>	<b>\$ 5,166</b>	<b>\$ 6,039</b>
Net Case Reserves	\$ 1,388	\$ 1,453
Net IBNR Reserves	1,745	1,999
<b>Total Net Carried Claim and Claim Adjustment Expense Reserves</b>	<b>\$ 3,133</b>	<b>\$ 3,452</b>

**Table of Contents**

**CNA FINANCIAL CORPORATION**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

**APMT Reserves**

Our property and casualty insurance subsidiaries have actual and potential exposures related to asbestos, environmental pollution and mass tort claims.

Establishing reserves for APMT claim and claim adjustment expenses is subject to uncertainties that are greater than those presented by other claims. Traditional actuarial methods and techniques employed to estimate the ultimate cost of claims for more traditional property and casualty exposures are less precise in estimating claim and claim adjustment expense reserves for APMT, particularly in an environment of emerging or potential claims and coverage issues that arise from industry practices and legal, judicial, and social conditions. Therefore, these traditional actuarial methods and techniques are necessarily supplemented with additional estimating techniques and methodologies, many of which involve significant judgments that are required on our part. Accordingly, a high degree of uncertainty remains for our ultimate liability for APMT claim and claim adjustment expenses.

In addition to the difficulties described above, estimating the ultimate cost of both reported and unreported APMT claims is subject to a higher degree of variability due to a number of additional factors, including among others: the number and outcome of direct actions against us; coverage issues, including whether certain costs are covered under the policies and whether policy limits apply; allocation of liability among numerous parties, some of whom may be in bankruptcy proceedings, and in particular the application of joint and several liability to specific insurers on a risk; inconsistent court decisions and developing legal theories; continuing aggressive tactics of plaintiffs' lawyers; the risks and lack of predictability inherent in major litigation; enactment of state and federal legislation to address asbestos claims; the potential for increases and decreases in asbestos, environmental pollution and mass tort claims which cannot now be anticipated; the potential for increases and decreases in costs to defend asbestos, pollution and mass tort claims; the possibility of expanding theories of liability against our policyholders in environmental and mass tort matters; possible exhaustion of underlying umbrella and excess coverage; and future developments pertaining to our ability to recover reinsurance for asbestos, pollution and mass tort claims.

Due to the inherent uncertainties in estimating claim and claim adjustment expense reserves for APMT and due to the significant uncertainties described related to APMT claims, our ultimate liability for these cases, both individually and in aggregate, may exceed the recorded reserves. Any such potential additional liability, or any range of potential additional amounts, cannot be reasonably estimated currently, but could be material to our business, results of operations, equity, and insurer financial strength and debt ratings. Due to, among other things, the factors described above, it may be necessary for us to record material changes in our APMT claim and claim adjustment expense reserves in the future, should new information become available or other developments emerge.

We have annually performed ground up reviews of all open APMT claims to evaluate the adequacy of our APMT reserves. In performing our comprehensive ground up analysis, we consider input from our professionals with direct responsibility for the claims, inside and outside counsel with responsibility for our representation and our actuarial staff. These professionals consider, among many factors, the policyholder's present and predicted future exposures, including such factors as claims volume, trial conditions, prior settlement history, settlement demands and defense costs; the impact of asbestos defendant bankruptcies on the policyholder; facts or allegations regarding the policies we issued or are alleged to have issued, including such factors as aggregate or per occurrence limits, whether the policy is primary, umbrella or excess, and the existence of policyholder retentions and/or deductibles; the policyholders' allegations; the existence of other insurance; and reinsurance arrangements.

Further information on APMT claim and claim adjustment expense reserves and net prior year development is included in Note F of the Condensed Consolidated Financial Statements included under Item 1.



**Table of Contents**

**CNA FINANCIAL CORPORATION**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

***Asbestos***

In the past several years, we experienced, at certain points in time, significant increases in claim counts for asbestos-related claims. The factors that led to these increases included, among other things, intensive advertising campaigns by lawyers for asbestos claimants, mass medical screening programs sponsored by plaintiff lawyers and the addition of new defendants such as the distributors and installers of products containing asbestos. In recent years, the rate of new filings has decreased. Various challenges to mass screening claimants have been successful. Historically, the majority of asbestos bodily injury claims have been filed by persons exhibiting few, if any, disease symptoms. Studies have concluded that the percentage of unimpaired claimants to total claimants ranges between 66% and up to 90%. Some courts and some state statutes mandate that so-called unimpaired claimants may not recover unless at some point the claimant's condition worsens to the point of impairment. Some plaintiffs classified as unimpaired continue to challenge those orders and statutes. Therefore, the ultimate impact of the orders and statutes on future asbestos claims remains uncertain.

Several factors are, in our view, negatively impacting asbestos claim trends. Plaintiff attorneys who previously sued entities that are now bankrupt continue to seek other viable targets. As a result, companies with few or no previous asbestos claims are becoming targets in asbestos litigation and, although they may have little or no liability, nevertheless must be defended. Additionally, plaintiff attorneys and trustees for future claimants are demanding that policy limits be paid lump-sum into the bankruptcy asbestos trusts prior to presentation of valid claims and medical proof of these claims. Various challenges to these practices have succeeded in litigation, and are continuing to be litigated. Plaintiff attorneys and trustees for future claimants are also attempting to devise claims payment procedures for bankruptcy trusts that would allow asbestos claims to be paid under lax standards for injury, exposure and causation. This also presents the potential for exhausting policy limits in an accelerated fashion. Challenges to these practices are being mounted, though the ultimate impact or success of these tactics remains uncertain.

As a result of bankruptcies and insolvencies, we had in the past observed an increase in the total number of policyholders with current asbestos claims as additional defendants were added to existing lawsuits and were named in new asbestos bodily injury lawsuits. During the last few years the rate of new bodily injury claims had moderated and most recently the new claims filing rate has decreased although the number of policyholders claiming coverage for asbestos related claims has remained relatively constant in the past several years. We have resolved a number of our large asbestos accounts by negotiating settlement agreements. Structured settlement agreements provide for payments over multiple years as set forth in each individual agreement.

In 1985, 47 asbestos producers and their insurers, including The Continental Insurance Company (CIC), executed the Wellington Agreement. The agreement was intended to resolve all issues and litigation related to coverage for asbestos exposures. Under this agreement, signatory insurers committed scheduled policy limits and made the limits available to pay asbestos claims based upon coverage blocks designated by the policyholders in 1985, subject to extension by policyholders. CIC was a signatory insurer to the Wellington Agreement.

We have also used coverage in place agreements to resolve large asbestos exposures. Coverage in place agreements are typically agreements between us and our policyholders identifying the policies and the terms for payment of asbestos related liabilities. Claims payments are contingent on presentation of adequate documentation showing exposure during the policy periods and other documentation supporting the demand for claims payment. Coverage in place agreements may have annual payment caps. Coverage in place agreements are evaluated based on claims filings trends and severities.

We categorize active asbestos accounts as large or small accounts. We define a large account as an active account with more than \$100 thousand of cumulative paid losses. We have made resolving large accounts a significant management priority. Small accounts are defined as active accounts with \$100 thousand or less of cumulative paid losses. Approximately 82% and 83% of our total active asbestos accounts are classified as small accounts at September 30, 2007 and December 31, 2006.



**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

We also evaluate our asbestos liabilities arising from our assumed reinsurance business and our participation in various pools, including Excess & Casualty Reinsurance Association (ECRA).

IBNR reserves relate to potential development on accounts that have not settled and potential future claims from unidentified policyholders.

The tables below depict our overall pending asbestos accounts and associated reserves at September 30, 2007 and December 31, 2006.

**Pending Asbestos Accounts and Associated Reserves****September 30, 2007**

	Number of Policyholders	Net Paid Losses in 2007 (In millions)	Net Asbestos Reserves (In millions)	Percent of Asbestos Net Reserves
Policyholders with settlement agreements				
Structured Settlements	14	\$ 27	\$ 158	12%
Wellington	3	1	13	1
Coverage in place	36	39	84	7
Total with settlement agreements	53	67	255	20
Other policyholders with active accounts				
Large asbestos accounts	228	43	206	15
Small asbestos accounts	1,028	4	84	6
Total other policyholders	1,256	47	290	21
Assumed reinsurance and pools		7	134	10
Unassigned IBNR			658	49
<b>Total</b>	1,309	\$ 121	\$ 1,337	100%

**Pending Asbestos Accounts and Associated Reserves****December 31, 2006**

	Number of	Net Paid (Recovered) Losses in 2006	Net Asbestos Reserves	Percent of Asbestos
--	-----------	--	-----------------------------	---------------------------

	<b>Policyholders</b>	<b>(In millions)</b>	<b>(In millions)</b>	<b>Net Reserves</b>
Policyholders with settlement agreements				
Structured Settlements	15	\$ 22	\$ 171	12%
Wellington	3	(1)	14	1
Coverage in place	38	(18)	132	9
Total with settlement agreements	56	3	317	22
Other policyholders with active accounts				
Large asbestos accounts	220	76	254	17
Small asbestos accounts	1,080	17	101	7
Total other policyholders	1,300	93	355	24
Assumed reinsurance and pools		6	141	10
Unassigned IBNR			639	44
<b>Total</b>	1,356	\$ 102	\$ 1,452	100%

Some asbestos-related defendants have asserted that their insurance policies are not subject to aggregate limits on coverage. We have such claims from a number of insureds. Some of these claims involve insureds facing

**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

exhaustion of products liability aggregate limits in their policies, who have asserted that their asbestos-related claims fall within so-called non-products liability coverage contained within their policies rather than products liability coverage, and that the claimed non-products coverage is not subject to any aggregate limit. It is difficult to predict the ultimate size of any of the claims for coverage purportedly not subject to aggregate limits or predict to what extent, if any, the attempts to assert non-products claims outside the products liability aggregate will succeed. Our policies also contain other limits applicable to these claims and we have additional coverage defenses to certain claims. We have attempted to manage our asbestos exposure by aggressively seeking to settle claims on acceptable terms. There can be no assurance that any of these settlement efforts will be successful, or that any such claims can be settled on terms acceptable to us. Where we cannot settle a claim on acceptable terms, we aggressively litigate the claim. However, adverse developments with respect to such matters could have a material adverse effect on our results of operations and/or equity.

As a result of the uncertainties and complexities involved, reserves for asbestos claims cannot be estimated with traditional actuarial techniques that rely on historical accident year loss development factors. In establishing asbestos reserves, we evaluate the exposure presented by each insured. As part of this evaluation, we consider the available insurance coverage; limits and deductibles; the potential role of other insurance, particularly underlying coverage below any of our excess liability policies; and applicable coverage defenses, including asbestos exclusions. Estimation of asbestos-related claim and claim adjustment expense reserves involves a high degree of judgment on our part and consideration of many complex factors, including: inconsistency of court decisions, jury attitudes and future court decisions; specific policy provisions; allocation of liability among insurers and insureds; missing policies and proof of coverage; the proliferation of bankruptcy proceedings and attendant uncertainties; novel theories asserted by policyholders and their counsel; the targeting of a broader range of businesses and entities as defendants; the uncertainty as to which other insureds may be targeted in the future and the uncertainties inherent in predicting the number of future claims; volatility in claim numbers and settlement demands; increases in the number of non-impaired claimants and the extent to which they can be precluded from making claims; the efforts by insureds to obtain coverage not subject to aggregate limits; long latency period between asbestos exposure and disease manifestation and the resulting potential for involvement of multiple policy periods for individual claims; medical inflation trends; the mix of asbestos-related diseases presented and the ability to recover reinsurance.

We are involved in significant asbestos-related claim litigation, which is described in Note F of the Condensed Consolidated Financial Statements included under Item 1.

**Environmental Pollution and Mass Tort**

Environmental pollution cleanup is the subject of both federal and state regulation. By some estimates, there are thousands of potential waste sites subject to cleanup. The insurance industry has been involved in extensive litigation regarding coverage issues. Judicial interpretations in many cases have expanded the scope of coverage and liability beyond the original intent of the policies. The Comprehensive Environmental Response Compensation and Liability Act of 1980 (Superfund) and comparable state statutes (mini-Superfunds) govern the cleanup and restoration of toxic waste sites and formalize the concept of legal liability for cleanup and restoration by Potentially Responsible Parties (PRPs). Superfund and the mini-Superfunds establish mechanisms to pay for cleanup of waste sites if PRPs fail to do so and assign liability to PRPs. The extent of liability to be allocated to a PRP is dependent upon a variety of factors. Further, the number of waste sites subject to cleanup is unknown. To date, approximately 1,500 cleanup sites have been identified by the Environmental Protection Agency (EPA) and included on its National Priorities List (NPL). State authorities have designated many cleanup sites as well.

Many policyholders have made claims against us for defense costs and indemnification in connection with environmental pollution matters. The vast majority of these claims relate to accident years 1989 and prior, which coincides with our adoption of the Simplified Commercial General Liability coverage form, which includes what is referred to in the industry as absolute pollution exclusion. We and the insurance industry are disputing coverage for many such claims. Key coverage issues include whether cleanup costs are considered damages under the policies,

trigger of coverage, allocation of liability among triggered policies, applicability of

57

---

**Table of Contents**

**CNA FINANCIAL CORPORATION**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

pollution exclusions and owned property exclusions, the potential for joint and several liability and the definition of an occurrence. To date, courts have been inconsistent in their rulings on these issues.

We have made resolution of large environmental pollution exposures a management priority. We have resolved a number of our large environmental accounts by negotiating settlement agreements. In our settlements, we sought to resolve those exposures and obtain the broadest release language to avoid future claims from the same policyholders seeking coverage for sites or claims that had not emerged at the time we settled with our policyholder. While the terms of each settlement agreement vary, we sought to obtain broad environmental releases that include known and unknown sites, claims and policies. The broad scope of the release provisions contained in those settlement agreements should, in many cases, prevent future exposure from settled policyholders. It remains uncertain, however, whether a court interpreting the language of the settlement agreements will adhere to the intent of the parties and uphold the broad scope of language of the agreements.

We classify our environmental pollution accounts into several categories, which include structured settlements, coverage in place agreements and active accounts. Structured settlement agreements provide for payments over multiple years as set forth in each individual agreement.

We have also used coverage in place agreements to resolve pollution exposures. Coverage in place agreements are typically agreements between us and our policyholders identifying the policies and the terms for payment of pollution related liabilities. Claims payments are contingent on presentation of adequate documentation of damages during the policy periods and other documentation supporting the demand for claims payment. Coverage in place agreements may have annual payment caps.

We categorize active accounts as large or small accounts in the pollution area. We define a large account as an active account with more than \$100 thousand cumulative paid losses. We have made closing large accounts a significant management priority. Small accounts are defined as active accounts with \$100 thousand or less cumulative paid losses. Approximately 76% and 75% of our total active pollution accounts are classified as small accounts as of September 30, 2007 and December 31, 2006.

We also evaluate our environmental pollution exposures arising from our assumed reinsurance and our participation in various pools, including ECRA.

We carry unassigned IBNR reserves for environmental pollution. These reserves relate to potential development on accounts that have not settled and potential future claims from unidentified policyholders.

**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

The tables below depict our overall pending environmental pollution accounts and associated reserves at September 30, 2007 and December 31, 2006.

**Pending Environmental Pollution Accounts and Associated Reserves****September 30, 2007**

	Number of Policyholders	Net Paid Losses in 2007 (In millions)	Net Environmental Pollution Reserves (In millions)	Percent of Environmental Pollution Net Reserve
Policyholders with Settlement Agreements				
Structured settlements	9	\$ 5	\$ 6	2%
Coverage in place	18	3	11	4
Total with Settlement Agreements	27	8	17	6
Other Policyholders with Active Accounts				
Large pollution accounts	108	16	55	22
Small pollution accounts	336	5	42	17
Total Other Policyholders	444	21	97	39
Assumed Reinsurance & Pools				
Unassigned IBNR		1	31	12
			110	43
<b>Total</b>	<b>471</b>	<b>\$ 30</b>	<b>\$ 255</b>	<b>100%</b>

**Pending Environmental Pollution Accounts and Associated Reserves****December 31, 2006**

	Number of Policyholders	Net Paid Losses in 2006 (In millions)	Net Environmental Pollution Reserves (In millions)	Percent of Environmental Pollution Net Reserve
Policyholders with Settlement Agreements				
Structured settlements	11	\$ 16	\$ 9	3%



Edgar Filing: GNA FINANCIAL CORP - Form 10-Q

Coverage in place	18	5	14	5
Total with Settlement Agreements	29	21	23	8
Other Policyholders with Active Accounts				
Large pollution accounts	115	20	58	20
Small pollution accounts	346	9	46	17
Total Other Policyholders	461	29	104	37
Assumed Reinsurance & Pools		1	32	11
Unassigned IBNR			126	44
<b>Total</b>	490	\$ 51	\$ 285	100%

59

---

**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued****INVESTMENTS***Net Investment Income*

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

**Net Investment Income**

<b>Period ended September 30</b> (In millions)	<b>Three Months</b>		<b>Nine Months</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Fixed maturity securities	\$ 501	\$ 477	\$ 1,523	\$ 1,372
Short term investments	57	61	146	184
Limited partnerships	19	46	142	173
Equity securities	7	4	18	18
Income (loss) from trading portfolio (a)	(2)	30	41	63
Interest on funds withheld and other deposits		(10)	(1)	(65)
Other	9	2	32	10
Gross investment income	591	610	1,901	1,755
Investment expense	(11)	(10)	(42)	(33)
<b>Net investment income</b>	<b>\$ 580</b>	<b>\$ 600</b>	<b>\$ 1,859</b>	<b>\$ 1,722</b>

(a) The change in net unrealized gains (losses) on trading securities, included in net investment income, was \$(12) million and \$(9) million for the three and nine months ended September 30, 2007 and \$3 million and \$(1) million for the three and nine months ended September 30, 2006.

Net investment income decreased by \$20 million for the three months ended September 30, 2007 compared with the same period of 2006. The decrease was primarily driven by decreases in limited partnership income and results from the trading portfolio.

Net investment income increased by \$137 million for the nine months ended September 30, 2007 compared with the same period of 2006. The improvement was primarily driven by an increase in the overall invested asset base and a reduction of interest expense on funds withheld and other deposits. During 2006, we commuted several significant finite reinsurance contracts which contained interest crediting provisions. As of December 31, 2006, no further interest expense was due on the funds withheld on the commuted contracts. This improvement was partially offset by a decrease in net investment income from short term investments, limited partnerships and the trading portfolio.

The bond segment of the investment portfolio yielded approximately 5.8% and 5.6% for the nine months ended September 30, 2007 and 2006.

**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued*****Net Realized Investment Gains (Losses)***

The components of net realized investment results for available-for-sale securities are presented in the following table.

**Net Realized Investment Gains (Losses)**

Period ended September 30 (In millions)	Three Months		Nine Months	
	2007	2006	2007	2006
Fixed maturity securities:				
U.S. Government bonds	\$ 131	\$ 18	\$ 37	\$ 22
Corporate and other taxable bonds	(88)	(18)	(113)	(114)
Tax-exempt bonds	10	40	(43)	51
Asset-backed bonds	(81)	(1)	(191)	(15)
Redeemable preferred stock	(11)	(2)	(12)	(3)
Total fixed maturity securities	(39)	37	(322)	(59)
Equity securities	16	(3)	30	3
Derivative securities	(45)	(12)	62	(7)
Short term investments	5	(2)	5	(6)
Other, net of participating policyholders' interest	8	1	9	(1)
Realized investment gains (losses) before allocation to participating policyholders' and minority interests	(55)	21	(216)	(70)
Allocated to participating policyholders' and minority interests	(2)		(1)	2
Income tax benefit	19	1	75	27
<b>Net realized investment gains (losses), net of participating policyholders' and minority interests</b>	<b>\$ (38)</b>	<b>\$ 22</b>	<b>\$ (142)</b>	<b>\$ (41)</b>

Net realized investment results decreased \$60 million for the three months ended September 30, 2007 compared with the same period of 2006. The decrease was primarily driven by an increase in other-than-temporary impairment (OTTI) losses on securities for which we did not assert an intent to hold until an anticipated recovery in value. For the three months ended September 30, 2007, OTTI losses of \$122 million driven mainly by credit issues were recorded primarily in the corporate and other taxable bonds and asset-backed bonds sectors. This compares to OTTI losses for the three months ended September 30, 2006 of \$30 million recorded primarily in the corporate and other taxable bonds sector. The increase in OTTI losses was partially offset by an increase in realized investment gains, primarily related to U.S. Government bonds.

Net realized investment losses increased \$101 million for the nine months ended September 30, 2007 compared with the same period of 2006. The increase was primarily driven by an increase in OTTI losses on securities for which we did not assert an intent to hold until an anticipated recovery in value. For the nine months ended September 30, 2007, OTTI losses of \$293 million driven by a combination of interest and credit issues were recorded primarily in the

corporate and other taxable bonds and asset-backed bonds sectors. This compares to OTTI losses for the nine months ended September 30, 2006 of \$56 million recorded primarily in the corporate and other taxable bonds sector. The increase in OTTI losses was partially offset by an increase in net realized investment gains on derivative securities, primarily related to interest rate swaps. The interest rate swaps were entered into as an economic hedge of fixed maturity securities based on the potential for rising interest rates.

A primary objective in the management of the fixed maturity and equity portfolios is to optimize return relative to underlying liabilities and respective liquidity needs. Our views on the current interest rate environment, tax regulations, asset class valuations, specific security issuer and broader industry segment conditions, and the domestic and global economic conditions, are some of the factors that enter into an investment decision. We also continually monitor exposure to issuers of securities held and broader industry sector exposures and may from time to time adjust such exposures based on our views of a specific issuer or industry sector. A further consideration in the management of the investment portfolio is the characteristics of the underlying liabilities and the ability to align the duration of the portfolio to those liabilities to meet future liquidity needs, minimize

**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

interest rate risk and maintain a level of income sufficient to support the underlying insurance liabilities. For portfolios where future liability cash flows are determinable and long term in nature, we segregate investments for asset/liability management purposes.

The segregated investments support liabilities primarily in the Life and Group Non-Core segment including annuities, structured benefit settlements and long term care products. The remaining investments are managed to support the Standard Lines, Specialty Lines and Corporate and Other Non-Core segments.

The effective durations of fixed maturity securities, short term investments and interest rate derivatives are presented in the table below. Short term investments are net of securities lending collateral and account payable and receivable amounts for securities purchased and sold, but not yet settled. The segregated investments had an effective duration of 10.5 years and 9.8 years at September 30, 2007 and December 31, 2006. The remaining interest sensitive investments had an effective duration of 3.5 years and 3.2 years at September 30, 2007 and December 31, 2006. The overall effective duration was 5.1 years and 4.7 years at September 30, 2007 and December 31, 2006.

**Effective Durations**

	<b>September 30, 2007</b>		<b>December 31, 2006</b>	
	<b>Fair Value</b>	<b>Effective Duration (In years)</b>	<b>Fair Value</b>	<b>Effective Duration (In years)</b>
(In millions)				
Segregated investments	\$ 8,899	10.5	\$ 8,524	9.8
Other interest sensitive investments	29,740	3.5	30,178	3.2
<b>Total</b>	<b>\$ 38,639</b>	<b>5.1</b>	<b>\$ 38,702</b>	<b>4.7</b>

The investment portfolio is periodically analyzed for changes in duration and related price change risk. Additionally, we periodically review the sensitivity of the portfolio to the level of foreign exchange rates and other factors that contribute to market price changes. A summary of these risks and specific analysis on changes is included in the Quantitative and Qualitative Disclosures About Market Risk in Item 7A of our Form 10-K for the year ended December 31, 2006.

We invest in certain derivative financial instruments primarily to reduce our exposure to market risk (principally interest rate, equity price and foreign currency risk) and credit risk (risk of nonperformance of underlying obligor). Derivative securities are recorded at fair value at the reporting date. We also use derivatives to mitigate market risk by purchasing S&P 500<sup>®</sup> index futures in a notional amount equal to the contract liability relating to Life and Group Non-Core indexed group annuity contracts. We provided collateral to satisfy margin deposits on exchange-traded derivatives totaling \$30 million as of September 30, 2007. For over-the-counter derivative transactions we utilize International Swaps and Derivatives Association Master Agreements that specify certain limits over which collateral is exchanged. As of September 30, 2007, we provided \$45 million of cash as collateral for over-the-counter derivative instruments.

We classify our fixed maturity securities and our equity securities as either available-for-sale or trading, and as such, they are carried at fair value. The amortized cost of fixed maturity securities is adjusted for amortization of premiums and accretion of discounts to maturity, which is included in net investment income. Changes in fair value related to available-for-sale securities are reported as a component of other comprehensive income. Changes in fair value of

trading securities are reported within net investment income.

62

---

**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

The following table provides further detail of gross realized investment gains and losses, which include OTTI losses, on available-for-sale fixed maturity and equity securities.

**Realized Investment Gains (Losses)**

<b>Period ended September 30</b> (In millions)	<b>Three Months</b>		<b>Nine Months</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net realized investment gains (losses) on fixed maturity and equity securities:				
Fixed maturity securities:				
Gross realized gains	\$ 181	\$ 114	\$ 324	\$ 216
Gross realized losses	(220)	(77)	(646)	(275)
Net realized investment gains (losses) on fixed maturity securities	(39)	37	(322)	(59)
Equity securities:				
Gross realized gains	30	1	50	9
Gross realized losses	(14)	(4)	(20)	(6)
Net realized investment gains (losses) on equity securities	16	(3)	30	3
<b>Net realized investment gains (losses) on fixed maturity and equity securities</b>	<b>\$ (23)</b>	<b>\$ 34</b>	<b>\$ (292)</b>	<b>\$ (56)</b>

The following table provides details of the largest realized investment losses from sales of securities aggregated by issuer including: the fair value of the securities at date of sale, the amount of the loss recorded and the period of time that the securities had been in an unrealized loss position prior to sale. The period of time that the securities had been in an unrealized loss position prior to sale can vary due to the timing of individual security purchases. Also included is a narrative providing the industry sector along with the facts and circumstances giving rise to the loss.

**Largest Realized Investment Losses from Securities Sold at a Loss**

<b>Nine months ended September 30, 2007</b>  <b>Issuer Description and Discussion</b> (In millions)	<b>Fair</b>	<b>Loss</b>	<b>Months</b>
	<b>Value at</b>		<b>On</b>
	<b>Date of</b>	<b>Sale</b>	<b>Unrealized</b>
	<b>Sale</b>	<b>Sale</b>	<b>Loss</b>
			<b>Prior</b>
			<b>To Sale</b>
			<b>(a)</b>

Various notes and bonds issued by the United States Treasury. Securities sold due to outlook on interest rates.	\$ 10,674	\$ 83	0-6
Mortgage-backed pass-through securities sold based on view of interest rate changes.	394	9	0-6
Bank and financial issuer that came under pressure due to the mortgage market disruption.	35	5	0-6
State specific general obligation municipal bonds sold to reduce exposure due to change in outlook.	513	5	0-6
<b>Total</b>	\$ 11,616	\$ 102	

(a) Represents the range of consecutive months the various positions were in an unrealized loss prior to sale. 0-12+ means certain positions were less than 12 months, while others were greater than 12 months.



**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued*****Valuation and Impairment of Investments***

The following table details the carrying value of our general account investments.

**Carrying Value of Investments**

(In millions)	<b>September 30, 2007</b>	<b>%</b>	<b>December 31, 2006</b>	<b>%</b>
General account investments:				
Fixed maturity securities available-for-sale:				
U.S. Treasury securities and obligations of government agencies	\$ 3,135	7%	\$ 5,138	12%
Asset-backed securities	11,245	26	13,677	31
States, municipalities and political subdivisions tax-exempt	6,694	15	5,146	12
Corporate securities	7,820	18	7,132	16
Other debt securities	3,989	9	3,642	8
Redeemable preferred stock	1,140	3	912	2
<b>Total fixed maturity securities available-for-sale</b>	<b>34,023</b>	<b>78</b>	<b>35,647</b>	<b>81</b>
Fixed maturity securities trading:				
U.S. Treasury securities and obligations of government agencies	3		2	
Asset-backed securities	35		55	
Corporate securities	119		133	1
Other debt securities	16		14	
<b>Total fixed maturity securities trading</b>	<b>173</b>		<b>204</b>	<b>1</b>
Equity securities available-for-sale:				
Common stock	475	1	452	1
Preferred stock	133		145	
<b>Total equity securities available-for-sale</b>	<b>608</b>	<b>1</b>	<b>597</b>	<b>1</b>
<b>Total equity securities trading</b>			<b>60</b>	

Edgar Filing: CNA FINANCIAL CORP - Form 10-Q

Short term investments available-for-sale	6,748	15	5,538	13
Short term investments trading	224	1	172	
Limited partnerships	2,093	5	1,852	4
Other investments	43		26	
<b>Total general account investments</b>	<b>\$ 43,912</b>	<b>100%</b>	<b>\$ 44,096</b>	<b>100%</b>

A significant judgment in the valuation of investments is the determination of when an OTTI has occurred. We analyze securities on at least a quarterly basis. Part of this analysis is to monitor the length of time and severity of the decline below amortized cost for those securities in an unrealized loss position.

Investments in the general account had a net unrealized gain of \$354 million at September 30, 2007 compared with a net unrealized gain of \$966 million at December 31, 2006. The unrealized position at September 30, 2007 was comprised of a net unrealized gain of \$89 million for fixed maturity securities, a net unrealized gain of \$262 million for equity securities and a net unrealized gain of \$3 million for short term investments. The unrealized position at December 31, 2006 was comprised of a net unrealized gain of \$716 million for fixed maturity securities, a net unrealized gain of \$249 million for equity securities and a net unrealized gain of \$1 million for short term investments. See Note D of the Condensed Consolidated Financial Statements included under Item 1 for further detail on the unrealized position of our general account investment portfolio.

**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

The following table provides the composition of fixed maturity securities available-for-sale in a gross unrealized loss position at September 30, 2007 by maturity profile. Securities not due at a single date are allocated based on weighted average life.

**Maturity Profile**

	<b>Percent of Market Value</b>	<b>Percent of Unrealized Loss</b>
Due in one year or less	6%	2%
Due after one year through five years	33	29
Due after five years through ten years	31	31
Due after ten years	30	38
<b>Total</b>	100%	100%

Our non-investment grade fixed maturity securities available-for-sale at September 30, 2007 that were in a gross unrealized loss position had a fair value of \$1,923 million. The following tables summarize the fair value and gross unrealized loss of non-investment grade securities categorized by the length of time those securities have been in a continuous unrealized loss position and further categorized by the severity of the unrealized loss position in 10% increments as of September 30, 2007 and December 31, 2006.

**Unrealized Loss Aging for Non-investment Grade Securities**

<b>September 30, 2007</b> (In millions)	<b>Estimated Fair Value</b>	<b>Fair Value as a Percentage of Amortized Cost</b>				<b>Gross Unrealized Loss</b>
		<b>90-99%</b>	<b>80-89%</b>	<b>70-79%</b>	<b>&lt;70%</b>	
Fixed maturity securities:						
0-6 months	\$ 1,889	\$ 36	\$ 1	\$	\$	\$ 37
7-12 months	4					
13-24 months	28	1	1			2
Greater than 24 months	2					
<b>Total non-investment grade</b>	<b>\$ 1,923</b>	<b>\$ 37</b>	<b>\$ 2</b>	<b>\$</b>	<b>\$</b>	<b>\$ 39</b>

**Unrealized Loss Aging for Non-investment Grade Securities**

<b>Estimated</b>	<b>Fair Value as a Percentage of Amortized Cost</b>				<b>Gross Unrealized</b>
	<b>90-99%</b>	<b>80-89%</b>	<b>70-79%</b>	<b>&lt;70%</b>	

<b>December 31, 2006</b> (In millions)	<b>Fair Value</b>	<b>90-99%</b>	<b>80-89%</b>	<b>70-79%</b>	<b>&lt;70%</b>	<b>Loss</b>
Fixed maturity securities:						
0-6 months	\$ 509	\$ 2	\$	\$	\$	\$ 2
7-12 months	87	1	1			2
13-24 months	24					
Greater than 24 months	2					
<b>Total non-investment grade</b>	<b>\$ 622</b>	<b>\$ 3</b>	<b>\$ 1</b>	<b>\$</b>	<b>\$</b>	<b>\$ 4</b>

As part of the ongoing OTTI monitoring process, we evaluated the facts and circumstances based on available information for each of the non-investment grade securities and determined that the securities presented in the above tables were temporarily impaired when evaluated at September 30, 2007 or December 31, 2006. This determination was based on a number of factors that we regularly consider including, but not limited to: the issuers' ability to meet current and future interest and principal payments, an evaluation of the issuers' financial condition and near term prospects, our assessment of the sector outlook and estimates of the fair value of any underlying collateral. In all cases where a decline in value is judged to be temporary, we have the intent and ability to hold these securities for a period of time sufficient to recover the amortized cost of our investment through an anticipated recovery in the fair value of such securities or by holding the securities to maturity. In

**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

many cases, the securities held are matched to liabilities as part of ongoing asset/liability duration management. As such, we continually assess our ability to hold securities for a time sufficient to recover any temporary loss in value or until maturity. We believe we have sufficient levels of liquidity so as to not impact the asset/liability management process.

Invested assets are exposed to various risks, such as market and credit risk. Due to the level of risk associated with certain invested assets and the level of uncertainty related to changes in the value of these assets, it is possible that changes in these risks in the near term, including increases in interest rates, could have an adverse material impact on our results of operations or equity.

The general account portfolio consists primarily of high quality bonds, 89% and 91% of which were rated as investment grade (rated BBB- or higher) at September 30, 2007 and December 31, 2006. The following table summarizes the ratings of our general account bond portfolio at carrying value.

**General Account Bond Ratings**

	<b>September</b>		<b>December</b>	
	<b>30,</b>		<b>31,</b>	
	<b>2007</b>	<b>%</b>	<b>2006</b>	<b>%</b>
(In millions)				
U.S. Government and affiliated agency securities	\$ 3,216	10%	\$ 5,285	15%
Other AAA rated	15,758	48	16,311	47
AA and A rated	5,463	16	5,222	15
BBB rated	5,124	15	4,933	14
Non-investment grade	3,495	11	3,188	9
<b>Total</b>	<b>\$ 33,056</b>	<b>100%</b>	<b>\$ 34,939</b>	<b>100%</b>

At September 30, 2007 and December 31, 2006, approximately 97% and 96% of the general account portfolio was issued by U.S. Government and affiliated agencies or was rated by Standard & Poor's or Moody's Investors Service. The remaining bonds were rated by other rating agencies or internally.

Non-investment grade bonds, as presented in the table above, are high-yield securities rated below BBB- by bond rating agencies, as well as other unrated securities that, according to our analysis, are below investment grade. High-yield securities generally involve a greater degree of risk than investment grade securities. However, expected returns should compensate for the added risk. This risk is also considered in the interest rate assumptions for the underlying insurance products.

The carrying value of securities that are either subject to trading restrictions or trade in illiquid private placement markets at September 30, 2007 was \$243 million which represents 0.6% of our total investment portfolio. These securities were in a net unrealized gain position of \$160 million at September 30, 2007. Of these securities, 90% were priced by independent third party sources.

***Sub-prime Mortgage Exposure***

Included in our fixed maturity securities at September 30, 2007 were \$11.3 billion of asset-backed securities, at fair value, consisting of approximately 65% in collateralized mortgage obligations, 23% in corporate asset-backed obligations, 11% in corporate mortgage-backed pass-through certificates and 1% in U.S. Government agency issued pass-through certificates. The majority of asset-backed securities are actively traded in liquid markets and priced by a third party pricing service. Of the total asset-backed holdings, \$903 million or 8% have exposure to sub-prime mortgage collateral, measured by the original deal structure. This represents 2% of total invested assets. Of the

securities with sub-prime exposure, approximately 98% are rated as investment grade. All asset-backed securities, including those with sub-prime exposure, are reviewed as part of the ongoing OTTI monitoring process. Included in the after-tax OTTI losses discussed above for the three and nine months ended September 30, 2007 were \$31 million and \$66 million related to securities with sub-prime exposure. In addition to sub-prime exposure in fixed maturity securities, there is an additional exposure of approximately \$35 million through other investments, including limited partnerships. We have mitigated a portion of our sub-

**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

prime exposure through an economic hedge position in Credit Default Swaps (CDS). The net notional value of the CDS sub-prime position was \$60 million as of September 30, 2007 with a recognized gain of \$25 million for the nine months ended September 30, 2007.

***Short Term Investments***

The carrying value of the components of the general account short term investment portfolio is presented in the following table.

**Short term Investments**

	<b>September 30, 2007</b>	<b>December 31, 2006</b>
(In millions)		
Short term investments available-for-sale:		
Commercial paper	\$ 4,493	\$ 923
U.S. Treasury securities	590	1,093
Money market funds	412	196
Other, including collateral held related to securities lending	1,253	3,326
Total short term investments available-for-sale	6,748	5,538
Short term investments trading:		
Commercial paper	35	43
U.S. Treasury securities	1	2
Money market funds	171	127
Other	17	
Total short term investments trading	224	172
<b>Total short term investments</b>	<b>\$ 6,972</b>	<b>\$ 5,710</b>

The fair value of collateral held related to securities lending, included in other short term investments, was \$82 million and \$2,851 million at September 30, 2007 and December 31, 2006.

**Table of Contents**

**CNA FINANCIAL CORPORATION**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**  
**LIQUIDITY AND CAPITAL RESOURCES**

***Cash Flow***

Our principal operating cash flow sources are premiums and investment income from our insurance subsidiaries. Our primary operating cash flow uses are payments for claims, policy benefits and operating expenses.

For the nine months ended September 30, 2007, net cash provided by operating activities was \$713 million as compared with \$1,783 million for the same period in 2006. The decrease in cash provided by operating activities is partially related to decreased net sales of trading securities to fund policyholder withdrawals of investment contract products issued by us. The policyholder fund withdrawals are reflected as financing cash outflows. Additionally, operating cash flows were adversely impacted by higher income tax payments in 2007 as compared to 2006 and lower premium collections.

Cash flows from investing activities include the purchase and sale of available-for-sale financial instruments, as well as the purchase and sale of land, buildings, equipment and other assets not generally held for resale.

For the nine months ended September 30, 2007, net cash used by investing activities was \$667 million as compared with \$1,490 million for the same period in 2006. Cash flows used for investing activities related principally to purchases of fixed maturity securities and short term investments. Net cash flows provided by investing activities-discontinued operations included \$65 million of cash proceeds related to the sale of the United Kingdom discontinued operations business.

Cash flows from financing activities include proceeds from the issuance of debt or equity securities, outflows for dividends or repayment of debt, outlays to reacquire equity instruments, and deposits and withdrawals related to investment contract products issued by us.

For the nine months ended September 30, 2007, net cash used by financing activities was \$83 million as compared with \$282 million for the same period in 2006. The decrease in cash used by financing activities is related to decreased policyholder fund withdrawals in 2007 as compared to 2006, which are reflected as Return of investment contract account balances on the Condensed Consolidated Statements of Cash Flows included under Item 1. Additionally, financing cash flows in 2006 included proceeds from the issuance of new debt and common stock, partially offset by the repurchase of the Series H Cumulative Preferred Stock Issue.

We believe that our present cash flows from operating activities, investing activities and financing activities are sufficient to fund our working capital needs.

On August 1, 2007, we entered into a five-year \$250 million senior unsecured revolving credit facility. See Note N of the Condensed Consolidated Financial Statements included under Item 1 for further detail.

We have an effective shelf registration statement under which we may issue debt or equity securities.

***Dividends***

On September 4, 2007, we paid a quarterly dividend of \$0.10 per share, to shareholders of record on August 13, 2007. On October 24, 2007, the Company's Board of Directors declared a quarterly dividend of \$0.15 per share, payable December 6, 2007 to shareholders of record on November 8, 2007. The declaration and payment of future dividends to holders of our common stock will be at the discretion of our Board of Directors and will depend on many factors, including our earnings, financial condition, business needs, and regulatory constraints.



**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued*****Regulatory Matters***

We previously established a plan to reorganize and streamline our U.S. property and casualty insurance legal entity structure in order to realize capital, operational, and cost efficiencies. The remaining phase of this plan is the merger of Transcontinental Insurance Company, a New York domiciled insurer, into its parent company, National Fire Insurance Company of Hartford, which is a CCC subsidiary. Subject to regulatory approval, this merger is planned to be completed effective December 31, 2007.

Along with other companies in the industry, we received subpoenas, interrogatories and inquiries from and have produced documents and/or provided information to: (i) California, Connecticut, Delaware, Florida, Hawaii, Illinois, Michigan, Minnesota, New Jersey, New York, North Carolina, Ohio, Pennsylvania, South Carolina, West Virginia and the Canadian Council of Insurance Regulators concerning investigations into practices including contingent compensation arrangements, fictitious quotes and tying arrangements; (ii) the Securities and Exchange Commission (SEC), the New York State Attorney General, the United States Attorney for the Southern District of New York, the Connecticut Attorney General, the Connecticut Department of Insurance, the Delaware Department of Insurance, the Georgia Office of Insurance and Safety Fire Commissioner and the California Department of Insurance concerning reinsurance products and finite insurance products purchased and sold by us; (iii) the Massachusetts Attorney General and the Connecticut Attorney General concerning investigations into anti-competitive practices; and (iv) the New York State Attorney General concerning declinations of attorney malpractice insurance. We continue to respond to these subpoenas, interrogatories and inquiries to the extent they are still open.

The SEC and representatives of the United States Attorney's Office for the Southern District of New York conducted interviews with several of our current and former executives relating to the restatement of our financial results for 2004, including our relationship with and accounting for transactions with an affiliate that were the basis for the restatement. We have also provided the SEC with information relating to our restatement in 2006 of prior period results. It is possible that our analyses of, or accounting treatment for, finite reinsurance contracts or discontinued operations could be questioned or disputed by regulatory authorities. As a result, further restatements of our financial results are possible.

***Ratings***

Ratings are an important factor in establishing the competitive position of insurance companies. Our insurance company subsidiaries are rated by major rating agencies, and these ratings reflect the rating agency's opinion of the insurance company's financial strength, operating performance, strategic position and ability to meet our obligations to policyholders. Agency ratings are not a recommendation to buy, sell or hold any security, and may be revised or withdrawn at any time by the issuing organization. Each agency's rating should be evaluated independently of any other agency's rating. One or more of these agencies could take action in the future to change the ratings of our insurance subsidiaries. If our insurance financial strength ratings were downgraded below current levels, our business and results of operations could be materially adversely affected. In addition, a lowering of the debt ratings of Loews Corporation by certain of the rating agencies could result in an adverse impact on our ratings, independent of any change in our circumstances.

The table below reflects the various group ratings issued by A.M. Best Company (A.M. Best), Fitch Ratings (Fitch), Moody's Investors Service (Moody's) and Standard & Poor's (S&P) for the property and casualty and life companies. The table also includes the ratings for CNAF senior debt and The Continental Corporation (Continental) senior debt.

	Insurance Financial Strength		Debt Ratings	
	Ratings		CNAF Senior Debt	Continental Senior Debt
	Property & Casualty CCC Group	Life CAC		
A.M. Best	A	A-	bbb	Not rated

Edgar Filing: CNA FINANCIAL CORP - Form 10-Q

Fitch	A	Not rated	BBB	BBB
Moody's	A3	Not rated	Baa3	Baa3
S&P	A-	BBB+	BBB-	BBB-

---

**Table of Contents****CNA FINANCIAL CORPORATION****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

Fitch upgraded the senior debt ratings of CNAF and Continental to BBB. Fitch also upgraded the insurer financial strength ratings of our property and casualty insurance subsidiaries to A and withdrew the A- insurance financial strength rating of Continental Assurance Company (CAC). Moody's withdrew the Baa1 insurance financial strength rating of CAC. Moody's and Fitch withdrew the insurance financial strength ratings of CAC at our request given that our life business is in run-off.

**Accounting Pronouncements*****Statement of Financial Accounting Standard (SFAS) No. 157, Fair Value Measurement (SFAS 157)***

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS 157. SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with GAAP and expands disclosures about fair value measurements. SFAS 157 retains the exchange price notion in the definition of fair value and clarifies that the exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability in the market in which the reporting entity would transact for the asset or liability. SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement and the fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. SFAS 157 expands disclosures surrounding the use of fair value to measure assets and liabilities and specifically focuses on the sources used to measure fair value. In instances of recurring use of fair value measures using unobservable inputs, SFAS 157 requires separate disclosure of the effect on earnings for the period. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within the year of adoption. We are currently evaluating the impact that adopting SFAS 157 will have on our results of operations and financial condition, if any.

***SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159)***

On February 15, 2007, the FASB issued SFAS 159, which provides companies with an option to report selected financial assets and liabilities at fair value, with changes in fair value recorded in earnings. SFAS 159 helps to mitigate accounting-induced earnings volatility by enabling companies to report related assets and liabilities at fair value, which may reduce the need for companies to comply with detailed rules for hedge accounting. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities.

SFAS 159 requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company's choice to use fair value on its earnings. It also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The new Statement does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in SFAS 157 and SFAS 107, Disclosures about Fair Value of Financial Instruments. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact that adopting SFAS 159 will have on our results of operations and financial condition, if any.

**Table of Contents**

**CNA FINANCIAL CORPORATION**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

**FORWARD-LOOKING STATEMENTS**

This report contains a number of forward-looking statements which relate to anticipated future events rather than actual present conditions or historical events. You can identify forward-looking statements because generally they include words such as believes, expects, intends, anticipates, estimates, and similar expressions. Forward-looking statements in this report include any and all statements regarding expected developments in our insurance business, including losses and loss reserves for asbestos, environmental pollution and mass tort claims which are more uncertain, and therefore more difficult to estimate than loss reserves respecting traditional property and casualty exposures; the impact of routine ongoing insurance reserve reviews we are conducting; our expectations concerning our revenues, earnings, expenses and investment activities; expected cost savings and other results from our expense reduction and restructuring activities; and our proposed actions in response to trends in our business. Forward-looking statements, by their nature, are subject to a variety of inherent risks and uncertainties that could cause actual results to differ materially from the results projected in the forward-looking statement. We cannot control many of these risks and uncertainties. Some examples of these risks and uncertainties are:

- general economic and business conditions, including inflationary pressures on medical care costs, construction costs and other economic sectors that increase the severity of claims;
- changes in financial markets such as fluctuations in interest rates, long term periods of low interest rates, credit conditions and currency, commodity and stock prices, including the short and long-term effects of losses produced or threatened in relation to sub-prime residential mortgage-backed securities;
- the effects of corporate bankruptcies, such as Enron and WorldCom, on capital markets, and on the markets for directors and officers and errors and omissions coverages;
- changes in foreign or domestic political, social and economic conditions;
- regulatory initiatives and compliance with governmental regulations, judicial decisions, including interpretation of policy provisions, decisions regarding coverage and theories of liability, trends in litigation and the outcome of any litigation involving us, and rulings and changes in tax laws and regulations;
- effects upon insurance markets and upon industry business practices and relationships of current litigation, investigations and regulatory activity by the New York State Attorney General's office and other authorities concerning contingent commission arrangements with brokers and bid solicitation activities;
- legal and regulatory activities with respect to certain non-traditional and finite-risk insurance products, and possible resulting changes in accounting and financial reporting in relation to such products, including our restatement of financial results in May of 2005 and our relationship with an affiliate, Accord Re Ltd., as disclosed in connection with that restatement;
- regulatory limitations, impositions and restrictions upon us, including the effects of assessments and other surcharges for guaranty funds and second-injury funds and other mandatory pooling arrangements;
- the impact of competitive products, policies and pricing and the competitive environment in which we operate, including changes in our book of business;
- product and policy availability and demand and market responses, including the level of ability to obtain rate increases and decline or non-renew under priced accounts, to achieve premium targets and profitability and to realize growth and retention estimates;
- development of claims and the impact on loss reserves, including changes in claim settlement policies;
- the effectiveness of current initiatives by claims management to reduce loss and expense ratios through more efficacious claims handling techniques;
- the performance of reinsurance companies under reinsurance contracts with us;
- results of financing efforts, including the availability of bank credit facilities;
- changes in our composition of operating segments;

**Table of Contents**

**CNA FINANCIAL CORPORATION**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued**

weather and other natural physical events, including the severity and frequency of storms, hail, snowfall and other winter conditions, natural disasters such as hurricanes and earthquakes, as well as climate change, including effects on weather patterns, greenhouse gases, sea, land and air temperatures, sea levels, rain and snow;

man-made disasters, including the possible occurrence of terrorist attacks and the effect of the absence or insufficiency of applicable terrorism legislation on coverages;

the unpredictability of the nature, targets, severity or frequency of potential terrorist events, as well as the uncertainty as to our ability to contain our terrorism exposure effectively, notwithstanding the extension through December 31, 2007 of the Terrorism Risk Insurance Act of 2002;

the occurrence of epidemics;

exposure to liabilities due to claims made by insureds and others relating to asbestos remediation and health-based asbestos impairments, as well as exposure to liabilities for environmental pollution, mass tort, construction defect claims and exposure to liabilities due to claims made by insureds and others relating to lead-based paint;

whether a national privately financed trust to replace litigation of asbestos claims with payments to claimants from the trust will be established or approved through federal legislation, or, if established and approved, whether it will contain funding requirements in excess of our established loss reserves or carried loss reserves;

the sufficiency of our loss reserves and the possibility of future increases in reserves;

regulatory limitations and restrictions, including limitations upon our ability to receive dividends from our insurance subsidiaries imposed by state regulatory agencies and minimum risk-based capital standards established by the National Association of Insurance Commissioners;

the risks and uncertainties associated with our loss reserves as outlined in the Critical Accounting Estimates and the Reserves Estimates and Uncertainties sections of our Annual Report on Form 10-K for the period ended December 31, 2006;

the level of success in integrating acquired businesses and operations, and in consolidating, or selling existing ones;

the possibility of changes in our ratings by ratings agencies, including the inability to access certain markets or distribution channels and the required collateralization of future payment obligations as a result of such changes, and changes in rating agency policies and practices; and

the actual closing of contemplated transactions and agreements.

Our forward-looking statements speak only as of the date on which they are made and we do not undertake any obligation to update or revise any forward-looking statement to reflect events or circumstances after the date of the statement, even if our expectations or any related events or circumstances change.

**Table of Contents**

**CNA FINANCIAL CORPORATION**

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There were no material changes in our market risk components for the nine months ended September 30, 2007. See the Quantitative and Qualitative Disclosures About Market Risk included in Item 7A of our Form 10-K for the year ended December 31, 2006 for further information. Additional information related to portfolio duration is discussed in the Investments section of the Management's Discussion and Analysis of Financial Condition and Results of Operations included in Part I, Item 2.

**Table of Contents**

**CNA FINANCIAL CORPORATION**

**ITEM 4. CONTROLS AND PROCEDURES**

The Company maintains a system of disclosure controls and procedures which are designed to ensure that information required to be disclosed by the Company in reports that it files or submits to the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended (the Exchange Act ), including this report, is recorded, processed, summarized and reported on a timely basis. These disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed under the Exchange Act is accumulated and communicated to the Company's management on a timely basis to allow decisions regarding required disclosure.

The Company's management, including the Chief Executive Officer and Chief Financial Officer, undertook an evaluation of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this report and concluded that the Company's controls and procedures were effective as of September 30, 2007.

There were no changes in the Company's internal control over financial reporting identified in connection with the foregoing evaluation that occurred during the quarter ended September 30, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents****CNA FINANCIAL CORPORATION****PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

Information on our legal proceedings is set forth in Notes F and G of the Condensed Consolidated Financial Statements included under Part I, Item 1.

**Item 6. Exhibits****(a) Exhibits**

Description of Exhibit	Exhibit Number
Employment Agreement	10.1
Certification of Chief Executive Officer	31.1
Certification of Chief Financial Officer	31.2
Written Statement of the Chief Executive Officer of CNA Financial Corporation Pursuant to 18 U.S.C. Section 1350 (As adopted by Section 906 of the Sarbanes-Oxley Act of 2002)	32.1
Written Statement of the Chief Financial Officer of CNA Financial Corporation Pursuant to 18 U.S.C. Section 1350 (As adopted by Section 906 of the Sarbanes-Oxley Act of 2002)	32.2



**Table of Contents**

**CNA FINANCIAL CORPORATION  
PART II. OTHER INFORMATION  
SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CNA Financial Corporation

Dated: October 29, 2007

By                    /s/ D. Craig Mense  
                          D. Craig Mense  
                          Executive Vice President and  
                          Chief Financial Officer

76