CNA FINANCIAL CORP
Form 10-Q
April 30, 2007

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

FORM 10-Q

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2007
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________
Commission File Number 1-5823

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

Delaware	**36-6169860**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
333 S. Wabash	
Chicago, Illinois	**60604**
(Address of principal executive offices)	(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 þ No o

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 þ Accelerated filer o Non-accelerated filer o

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

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

Class	Outstanding at April 25, 2007
Common Stock, Par value $2.50	271,511,301

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

Three months ended March 31 (In millions, except per share data)	**2007**	**2006**
Revenues		
Net earned premiums	$ 1,863	$ 1,869
Net investment income	608	570
Realized investment gains (losses), net of participating policyholders and minority interests	(21)	9
Other revenues	67	53
Total revenues	2,517	2,501
Claims, Benefits and Expenses		
Insurance claims and policyholders benefits	1,448	1,492
Amortization of deferred acquisition costs	381	370
Other operating expenses	218	257
Interest	34	30
Total claims, benefits and expenses	2,081	2,149
Income before income tax and minority interest	436	352
Income tax expense	(132)	(108)
Minority interest	(10)	(9)
Income from continuing operations	294	235
Income (loss) from discontinued operations, net of income tax expense of $1 and $0	2	(6)
Net income	$ 296	$ 229
Basic and Diluted Earnings Per Share		
Income from continuing operations	$ 1.08	$ 0.84
Income (loss) from discontinued operations	0.01	(0.02)
Basic and diluted earnings per share available to common stockholders	$ 1.09	$ 0.82

Weighted average outstanding common stock and common stock equivalents		
Basic	271.3	256.0
Diluted	271.6	256.0

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

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CNA FINANCIAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In millions, except share data)	March 31, 2007	December 31, 2006
Assets		
Investments:		
Fixed maturity securities at fair value (amortized cost of $33,985 and $35,135)	$ 34,719	$ 35,851
Equity securities at fair value (cost of $417 and $408)	673	657
Limited partnership investments	1,940	1,852
Other invested assets	25	26
Short term investments	7,846	5,710
Total investments	45,203	44,096
Cash	91	84
Reinsurance receivables (less allowance for uncollectible receivables of $469 and $469)	9,373	9,478
Insurance receivables (less allowance for doubtful accounts of $365 and $368)	2,170	2,108
Accrued investment income	321	313
Receivables for securities sold	470	303
Deferred acquisition costs	1,189	1,190
Prepaid reinsurance premiums	373	342
Deferred income taxes	805	855
Property and equipment at cost (less accumulated depreciation of $578 and $571)	296	277
Goodwill and other intangible assets	142	142
Other assets	657	592
Separate account business	515	503
Total assets	$ 61,605	$ 60,283
Liabilities and Stockholders Equity		
Liabilities:		
Insurance reserves:		
Claim and claim adjustment expenses	$ 29,510	$ 29,636
Unearned premiums	3,825	3,784
Future policy benefits	6,755	6,645
Policyholders funds	977	1,015
Collateral on loaned securities	2,914	2,851
Payables for securities purchased	1,190	221
Participating policyholders funds	50	50
Long term debt	2,156	2,156
Federal income taxes payable (includes $95 and $38 due to Loews Corporation)	100	40
Reinsurance balances payable	577	539
Other liabilities	2,550	2,740

Separate account business	515	503
Total liabilities	51,119	50,180
Commitments and contingencies (Notes D, G, H and J)		
Minority interest	347	335
Stockholders equity:		
Common stock ($2.50 par value; 500,000,000 shares authorized; 273,040,543 shares issued; and 271,506,815 and 271,108,780 shares outstanding)	683	683
Additional paid-in capital	2,168	2,166
Retained earnings	6,825	6,486
Accumulated other comprehensive income	563	549
Treasury stock (1,533,728 and 1,931,763 shares), at cost	(44)	(58)
	10,195	9,826
Notes receivable for the issuance of common stock	(56)	(58)
Total stockholders equity	10,139	9,768
Total liabilities and stockholders equity	$ 61,605	$ 60,283

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

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CNA FINANCIAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

Three months ended March 31 (In millions)	**2007**	**2006**
Cash Flows from Operating Activities:		
Net income	$ 296	$ 229
Adjustments to reconcile net income to net cash flows provided by operating activities:		
(Income) loss from discontinued operations	(2)	6
Loss on disposal of property and equipment	2	4
Minority interest	10	9
Deferred income tax provision	20	41
Trading securities activity	(6)	267
Realized investment (gains) losses, net of participating policyholders and minority interests	21	(9)
Undistributed earnings of equity method investees	(24)	(15)
Net amortization of bond (discount) premium	(56)	(62)
Depreciation	13	12
Changes in:		
Receivables, net	43	252
Deferred acquisition costs	1	(1)
Accrued investment income	(8)	33
Federal income taxes recoverable/payable	60	116
Prepaid reinsurance premiums	(31)	(100)
Reinsurance balances payable	38	(17)
Insurance reserves	32	(181)
Other assets	(2)	39
Other liabilities	(178)	3
Other, net	6	5
Total adjustments	(61)	402
Net cash flows provided by operating activities-continuing operations	$ 235	$ 631
Net cash flows used by operating activities-discontinued operations	$ (18)	$ (5)
Net cash flows provided by operating activities-total	$ 217	$ 626
Cash Flows from Investing Activities:		
Purchases of fixed maturity securities	$ (15,552)	$ (9,951)
Proceeds from fixed maturity securities:		
Sales	16,435	11,697
Maturities, calls and redemptions	1,016	1,089

Purchases of equity securities		(67)		(596)
Proceeds from sales of equity securities		69		582
Change in short term investments		(2,060)		(4,014)
Change in collateral on loaned securities		63		1,022
Change in other investments		(37)		(86)
Purchases of property and equipment		(34)		(16)
Dispositions				(2)
Other, net		(35)		(29)
Net cash flows used by investing activities-continuing operations	$	(202)	$	(304)
Net cash flows provided (used) by investing activities-discontinued operations	$	1	$	(3)
Net cash flows used by investing activities-total	$	(201)	$	(307)

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

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CNA FINANCIAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

Three months ended March 31 (In millions)	2007	2006
Cash Flows from Financing Activities:		
Return of investment contract account balances	(46)	(344)
Receipts of investment contract account balances	1	1
Stock options exercised	15	1
Other, net	4	(1)
Net cash flows used by financing activities-continuing operations	$ (26)	$ (343)
Net cash flows used by financing activities-discontinued operations	$	$
Net cash flows used by financing activities-total	$ (26)	$ (343)
Net change in cash	(10)	(24)
Net cash transactions from continuing operations to discontinued operations		16
Net cash transactions from discontinued operations to continuing operations		(16)
Cash, beginning of year	124	125
Cash, end of period	$ 114	$ 101
Cash-continuing operations	$ 91	$ 96
Cash-discontinued operations	23	5
Cash-total	$ 114	$ 101

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

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

Three months ended March 31 (In millions)	**2007**	**2006**
Preferred Stock		
Balance, beginning and end of period	$	$ 750
Common Stock		
Balance, beginning and end of period	683	645
Additional Paid-in Capital		
Balance, beginning of period	2,166	1,701
Stock options exercised and other	2	1
Balance, end of period	2,168	1,702
Retained Earnings		
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
Net income	296	229
Balance, end of period	6,825	5,850
Accumulated Other Comprehensive Income		
Balance, beginning of period	549	359
Other comprehensive income (loss)	14	(239)
Balance, end of period	563	120
Treasury Stock		
Balance, beginning of period	(58)	(67)
Stock options exercised and other	14	
Balance, end of period	(44)	(67)

Notes Receivable for the Issuance of Common Stock		
Balance, beginning of period	(58)	(59)
(Increase) decrease in notes receivable for the issuance of common stock	2	(1)
Balance, end of period	(56)	(60)
Total Stockholders Equity	$ 10,139	$ 8,940

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

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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 March 31, 2007.

The accompanying Condensed Consolidated Financial Statements (Unaudited) 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 (Unaudited) 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 March 31, 2007 and for the three months ended March 31, 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 has 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 Consolidated Statement of Operations for the three months ended March 31, 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

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

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 $108 million at March 31, 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 as of March 31, 2007.

Values as of March 31, 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	60	$ 6	$ 38
2008	80	8	50
2009	80	8	49
2010	80	8	49
2011	80	9	51
Thereafter	1,075	69	538
Total	1,455	$ 108	$ 775

The unrealized gain (change in fair value) recognized during the first quarter of 2007 on contracts still being held on March 31, 2007 is $1 million. The gain recognized during the first quarter of 2007 on contracts that matured is $14 million.

FASB Interpretation No. 48, <u>Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109</u> (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. See Note F for further discussion.

Statement of Accounting Financial Standard (SFAS) No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140 (SFAS 155)

In February 2006, the FASB issued SFAS 155. SFAS 155 amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133), and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS 155 also resolves issues addressed in SFAS 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets. SFAS 155 eliminates the exemption from applying SFAS 133 to interests in certain securitized financial assets so that similar instruments are accounted for in the same manner regardless of the form of the

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

instruments. SFAS 155 also allows a preparer to elect fair value measurement at acquisition, at issuance, or when a previously recognized financial instrument is subject to a remeasurement (new basis) event, on an instrument-by-instrument basis. The fair value election provided for in paragraph 4(c) of SFAS 155 may also be applied upon adoption of SFAS 155 for hybrid financial instruments that had been bifurcated under paragraph 12 of SFAS 133 prior to the adoption of this Statement. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. The adoption of SFAS 155 as of January 1, 2007 had no impact on the results of operations or financial condition of the Company.

SFAS 133 Implementation Issue No. B40, Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets (Issue B40)

In January 2007, the FASB released Issue B40 which is to be applied upon adoption of SFAS 155. Issue B40 provides a narrow scope exception from paragraph 13(b) of SFAS 133 for securitized interests that meet certain criteria and contain only an embedded derivative that is tied to the prepayment risk of the underlying prepayable financial assets. There were no securities impacted by the adoption of Issue B40 in conjunction with SFAS 155.

Statement of Position 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts (SOP 05-1)

In September 2005, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued SOP 05-1. SOP 05-1 provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in SFAS No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments. SOP 05-1 defines an internal replacement as a modification in product benefits, features, rights, or coverages that occurs by the exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by the election of a feature or coverage within a contract. SOP 05-1 was adopted by the Company as of January 1, 2007 and had no impact on the results of operations or financial condition of the Company.

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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 months ended March 31, 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

Three months ended March 31	**2007**	**2006**
(In millions, except per share amounts)		
Income from continuing operations	$ 294	$ 235
Less: undeclared preferred stock dividend through repurchase date		(19)
Income from continuing operations available to common stockholders	$ 294	$ 216
Weighted average outstanding common stock and common stock equivalents	271.3	256.0
Effect of dilutive securities, employee stock options and appreciation rights	0.3	
Adjusted weighted average outstanding common stock and common stock equivalents assuming conversions	271.6	256.0
Basic and diluted earnings per share from continuing operations available to common stockholders	$ 1.08	$ 0.84

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.

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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

Three months ended March 31 (In millions)	**2007**	**2006**
Fixed maturity securities	$ 496	$ 415
Short term investments	50	65
Limited partnerships	52	74
Equity securities	5	6
Income from trading portfolio (a)	3	42
Interest on funds withheld and other deposits	(1)	(25)
Other	11	3
Gross investment income	616	580
Investment expense	(8)	(10)
Net investment income	$ 608	$ 570

(a) The change in net unrealized gains on trading securities, included in net investment income, was $2 million for the three months ended March 31, 2007 and 2006.
The components of realized investment results for available-for-sale securities are presented in the following table.

Realized Investment Gains (Losses)

Three months ended March 31 (In millions)	**2007**	**2006**
Fixed maturity securities:		
U.S. Government bonds	$ 2	$ 4
Corporate and other taxable bonds	25	(20)
Tax-exempt bonds	(11)	25
Asset-backed bonds	(33)	(9)
Total fixed maturity securities	(17)	
Equity securities	3	3
Derivative securities	(8)	7
Short term investments		(2)
Other, net of participating policyholders interest	1	

Realized investment gains (losses) before allocation to participating policyholders and minority interests		(21)		8
Allocated to participating policyholders and minority interests				1
Realized investment gains (losses)	$	(21)	$	9

For the three months ended March 31, 2007, other-than-temporary impairment (OTTI) losses of $87 million were recorded primarily in the asset-backed bonds and corporate and other taxable bonds sectors. This compared to OTTI losses for the three months ended March 31, 2006 of $10 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.

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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

March 31, 2007 (In millions)	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses: Less than 12 Months	Gross Unrealized Losses: Greater than 12 Months	Estimated Fair Value
Fixed maturity securities available-for-sale:					
U.S. Treasury securities and obligations of government agencies	$ 4,531	$ 106	$ 1	$ 1	$ 4,635
Asset-backed securities	12,604	33	24	129	12,484
States, municipalities and political subdivisions tax-exempt	5,451	221	3	4	5,665
Corporate securities	6,708	307	3	9	7,003
Other debt securities	3,497	209	4	3	3,699
Redeemable preferred stock	994	39			1,033
Total fixed maturity securities available-for-sale	33,785	915	35	146	34,519
Total fixed maturity securities trading	200				200
Equity securities available-for-sale:					
Common stock	217	244			461
Preferred stock	134	12			146
Total equity securities available-for-sale	351	256			607
Total equity securities trading	66				66
Total	$ 34,402	$ 1,171	$ 35	$ 146	$ 35,392

Summary of Fixed Maturity and Equity Securities

	Cost or	Gross	Estimated

December 31, 2006 (In millions)	Amortized Cost	Unrealized Gains	Gross Unrealized Losses Less than 12 Months	Gross Unrealized Losses Greater than 12 Months	Fair Value
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

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

The following table summarizes, for fixed maturity and equity securities in an unrealized loss position at March 31, 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

	March 31, 2007		December 31, 2006	
(In millions)	Estimated Fair Value	Gross Unrealized Loss	Estimated Fair Value	Gross Unrealized Loss
Fixed maturity securities:				
Investment grade:				
0-6 months	$ 3,380	$ 27	$ 9,829	$ 24
7-12 months	459	6	1,267	12
13-24 months	4,796	92	5,248	127
Greater than 24 months	1,679	54	1,022	41
Total investment grade	10,314	179	17,366	204
Non-investment grade:				
0-6 months	143	1	509	2
7-12 months	30	1	87	2
13-24 months	7		24	
Greater than 24 months	2		2	
Total non-investment grade	182	2	622	4
Total fixed maturity securities	10,496	181	17,988	208
Equity securities:				
0-6 months	20		10	1
7-12 months			1	
13-24 months				
Greater than 24 months	3		3	
Total equity securities	23		14	1

Total fixed maturity and equity securities	$ 10,519	$ 181	$ 18,002	$ 209

At March 31, 2007, the carrying value of the general account fixed maturities was $34,719 million, representing 77% of the total investment portfolio. The net unrealized position associated with the fixed maturity portfolio included $181 million in gross unrealized losses, consisting of asset-backed securities which represented 85%, corporate bonds which represented 7%, municipal securities which represented 4%, and all other fixed maturity securities which represented 4%. The gross unrealized loss for any single issuer was no greater than 0.1% of the carrying value of the total general account fixed maturity portfolio. The total fixed maturity portfolio gross unrealized losses included 1,253 securities which were, in aggregate, approximately 2% 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 March 31, 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 March 31, 2007 is presented below.

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Asset-Backed Securities

The unrealized losses on the Company s investments in asset-backed securities were caused primarily by a change in interest rates. This category includes mortgage-backed securities guaranteed by an agency of the U.S. government. There were 350 agency mortgage-backed pass-through securities and 3 agency collateralized mortgage obligations (CMOs) in an unrealized loss position as of March 31, 2007. The aggregate severity of the unrealized loss on these securities was approximately 4% of amortized cost. These securities do not tend to be influenced by the credit of the issuer but rather the characteristics and projected principal payments of the underlying collateral.

The remainder of the holdings in this category are corporate mortgage-backed pass-through, CMOs and corporate asset-backed structured securities. The holdings in these sectors include 446 securities in an unrealized loss position with over 89% of these unrealized losses related to securities rated AAA. The aggregate severity of the unrealized loss was approximately 2% 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 March 31, 2007, there was no adverse change in estimated cash flows noted for the securities subject to EITF 99-20, which have an aggregate unrealized loss of $9 million and an aggregate severity of the unrealized loss of approximately 1% of amortized cost.

Because the decline in fair value was primarily attributable to changes in interest rates and not credit quality and because the Company has the ability and intent to hold those investments until an anticipated recovery of fair value, which may be maturity, the Company considers these investments to be temporarily impaired at March 31, 2007.

Investment Commitments

As of March 31, 2007 and December 31, 2006, the Company had committed approximately $114 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 March 31, 2007 and December 31, 2006, the Company had commitments to purchase $136 million and $60 million, and sell $41 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 March 31, 2007 and December 31, 2006, the Company had obligations on unfunded bank loan participations in the amount of $17 million and $29 million.

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Note E. Derivative Financial Instruments
A summary of the recognized gains (losses) related to derivative financial instruments follows.

Derivative Financial Instruments Recognized Gains (Losses)

Three months ended March 31 (In millions)	**2007**	**2006**
General account		
Without hedge designation		
Swaps	$ (7)	$ 6
Futures sold, not yet purchased		2
Currency forwards	(1)	
Commitments to purchase government and municipal securities (TBAs)		(1)
Trading activities		
Futures purchased	(5)	29
Currency forwards		1
Total	$ (13)	$ 37

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

March 31, 2007 (In millions)	**Contractual/ Notional Amount**	**Estimated Fair Value Asset (Liability)**
General account		
Without hedge designation		
Swaps	$ 5,161	$ (34)
Currency forwards	28	(1)
Equity warrants	6	2
Options embedded in convertible debt securities	9	
Trading activities		
Futures purchased	678	
Futures sold, not yet purchased	138	
Currency forwards	27	

Total general account	$	6,047	$	(33)
Separate accounts				
Options written	$	8	$	
Total separate accounts	$	8	$	

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Derivative Financial Instruments

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

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. Income Taxes

CNA and its eligible subsidiaries are included in the consolidated federal income tax return of Loews and its eligible subsidiaries.

For the three months ended March 31, 2007, CNA paid Loews $36 million. For the three months ended March 31, 2006, CNA received from Loews $68 million. CNA s consolidated federal income taxes payable at March 31, 2007 includes a $95 million payable to Loews and a $5 million payable related to domestic affiliates less than 80% owned and/or foreign subsidiaries. At December 31, 2006, CNA s consolidated federal income tax liability included a $38 million payable to Loews and a $2 million payable related to domestic affiliates less than 80% owned and/or foreign subsidiaries.

The 2005 and 2006 tax years remain subject to examination by the Internal Revenue Service (IRS). The federal income tax return for 2005 is currently under examination by the IRS. The Company believes the outcome of this examination will not have a material effect on the financial condition or results of operations of the Company.

For 2007, the IRS has invited Loews and the Company to participate in the Compliance Assurance Process (CAP), which is a voluntary program for a limited number of large corporations. Under CAP, the IRS conducts a real-time audit and works contemporaneously with the Company to resolve any issues prior to the filing of the 2007 tax return. Loews and the Company have agreed to participate. The Company believes this approach should reduce tax-related uncertainties, if any.

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized an increase to beginning retained earnings on January 1, 2007 of $5 million. The total amount of unrecognized tax benefits as of the date of adoption is $3 million. Included in the balance at January 1, 2007, are $2 million of tax positions that if recognized would affect the effective tax rate.

The Company anticipates that it is reasonably possible that a payment of $3 million will be made at the conclusion of a state income tax examination within the next 12 months related primarily to a previous IRS examination.

The Company recognizes interest accrued related to: (1) unrecognized tax benefits in Other operating expenses and (2) tax refund claims in Other revenues on the Condensed Consolidated Statements of Operations. The Company

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recognizes penalties (if any) in Income tax expense (benefit) on the Condensed Consolidated Statements of Operations. There is $2 million accrued for the payment of interest and no amount accrued for the payment of penalties at January 1, 2007.

Note G. 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 $32 million and $12 million for the three months ended March 31, 2007 and 2006. Catastrophe losses in the first quarter of 2007 related primarily to tornadoes and winter storms. Catastrophe losses in the first quarter of 2006 related primarily to tornadoes. There can be no assurance that CNA s ultimate cost for catastrophes will not exceed estimates.

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

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.

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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

	March 31, 2007		December 31, 2006	
(In millions)	**Asbestos**	**Environmental Pollution and Mass Tort**	**Asbestos**	**Environmental Pollution and Mass Tort**
Gross reserves	$ 2,503	$ 629	$ 2,635	$ 647
Ceded reserves	(1,115)	(220)	(1,183)	(231)
Net reserves	$ 1,388	$ 409	$ 1,452	$ 416

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 March 31, 2007 and December 31, 2006, CNA carried approximately $1,388 million and $1,452 million of claim and claim adjustment expense reserves, net of reinsurance recoverables, for reported and unreported asbestos-related claims. There was no asbestos-related net claim and claim adjustment expense reserve development recorded for the three months ended March 31, 2007. The Company recorded $1 million of unfavorable asbestos-related net claim and claim adjustment expense reserve development for the three months ended March 31, 2006. The Company paid asbestos-related claims, net of reinsurance recoveries, of $64 million and $47 million for the three months ended March 31, 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

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on August 18, 2003. The court has held a confirmation hearing on the bankruptcy plan containing an injunction to protect CNA from any future claims and the parties are awaiting a ruling on confirmation.

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, Keasbey s involvement at a number of work sites is a highly contested issue. Therefore, the defense disputes the percentage of valid claims against Keasbey. 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. The court dismissed a claim alleging bad faith and seeking unspecified damages on March 21, 2004; that ruling was affirmed on March 31, 2005 by Appellate Division, First Department. The trial in the Keasbey coverage action commenced on July 13, 2005; closing arguments concluded on October 28, 2005. The Court reopened the record in January 2006 for additional evidentiary submissions and briefing, and additional closing arguments were held March 27, 2006. It is unclear when the Company will have a decision from the trial court. With respect to this litigation 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, among others: (a) whether the Company has any further responsibility to compensate claimants against Keasbey under its policies and, if so, under which policies; (b) whether the Company s responsibilities 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 in some of the policies apply to exclude certain claims; (e) the extent to which claimants can establish exposures to asbestos materials as to which Keasbey has any responsibility; (f) the legal theories which must be pursued by such claimants to establish the liability of Keasbey and whether such theories can, in fact, be established; (g) the diseases and damages alleged by such claimants; and (h) the extent that such liability would be shared with other responsible parties. 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. The litigation involves disputes over the confirmation of the Plan of Reorganization in bankruptcy, the scope and extent of coverage, if any, afforded to Burns & Roe for its asbestos liabilities. On December 5, 2005, Burns & Roe filed its Third Amended Plan of Reorganization (Plan). A confirmation hearing relating to that Plan is anticipated in 2007. Coverage issues will be determined in a later proceeding. 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;

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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. 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, many 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. The insurers have 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. With respect to this litigation 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 various Statutes of Limitation 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 are 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 March 31, 2007 and December 31, 2006, CNA carried approximately $409 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. There was no environmental pollution and mass tort net claim and claim adjustment expense reserve development recorded for the three months ended March 31, 2007 or 2006. The Company recorded $15 million and $10 million of current accident year losses related to mass tort for the three months ended March 31, 2007 and 2006. The Company paid environmental pollution-related claims and mass tort-related claims, net of reinsurance recoveries, of $22 million and $37 million for the three months ended March 31, 2007 and 2006.

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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.

Net Prior Year Development

The following table includes the net prior year development recorded for Standard Lines, Specialty Lines and Corporate and Other Non-Core for the three months ended March 31, 2007. The development presented below includes premium development due to its direct relationship to claim and claim adjustment expense reserve development. The development presented below excludes the impact of the provision for uncollectible reinsurance, but includes the impact of commutations.

Net Prior Year Development
Three months ended March 31, 2007

(In millions)	Standard Lines	Specialty Lines	Corporate and Other Non-Core	Total
Pretax unfavorable (favorable) net prior year claim and allocated claim adjustment expense reserve development:				
Core (Non-APMT)	$ 13	$ 7	$	$ 20
APMT				
Pretax unfavorable (favorable) net prior year development before impact of premium development	13	7		20
Total unfavorable (favorable) premium development	(27)	(9)	2	(34)
Total unfavorable (favorable) net prior year development (pretax)	$ (14)	$ (2)	$ 2	$ (14)

The following discussion relates to net prior year development recorded for Standard Lines for the three months ended March 31, 2007.

Approximately $46 million of favorable premium development was recorded mainly due to additional premium resulting from audits on recent policies related to workers compensation and general liability books of business. This was offset by $30 million of unfavorable claim and claim adjustment expense development.

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

The following table includes the net prior year development recorded for Standard Lines, Specialty Lines and Corporate and Other Non-Core for the three months ended March 31, 2006.

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Net Prior Year Development
Three months ended March 31, 2006

(In millions)	Standard Lines	Specialty Lines	Corporate and Other Non-Core	Total
Pretax unfavorable net prior year claim and allocated claim adjustment expense reserve development:				
Core (Non-APMT)	$ 59	$ 5	$ 6	$ 70
APMT			1	1
Pretax unfavorable net prior year development before impact of premium development	59	5	7	71
Total unfavorable (favorable) premium development	(49)	(8)	7	(50)
Total unfavorable (favorable) net prior year development (pretax)	$ 10	$ (3)	$ 14	$ 21

The following discussion relates to net prior year development recorded for Standard Lines for the three months ended March 31, 2006.

Approximately $17 million of unfavorable claim and allocated claim adjustment expense reserve development was due to higher frequency and severity on claims related to commercial auto, monoline and package liability, primarily in accident years 2004, 2000 and prior. The change was driven by increases in individual claim case reserve estimates leading to higher results from projections that rely on case incurred loss.

Approximately $11 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 $22 million of favorable claim and allocated claim adjustment expense reserve development was related to continued improvement in the severity and number of claims for property coverages, primarily in accident year 2005. The improvements in severity and frequency were substantially due to underwriting actions taken by the Company that significantly improved the results from this business.

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

The remainder of the unfavorable claim and allocated claim adjustment expense reserve development in Standard Lines was primarily attributed to increased severity trends for workers compensation. This increased severity was due to continuing cost inflation in older accident years, primarily 2002 and prior. The primary drivers of the continuing claim cost inflation were increasing medical inflation and advances in medical care. The favorable net prior year premium development was recorded mainly as a result of additional premium resulting from audits on recent policies, primarily workers compensation.

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Note H. 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 Act and for recovery under various state common law theories. By an order entered on April 5, 2007, the Court dismissed the plaintiffs complaints but gave plaintiffs another opportunity to amend their claims. 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, served on CCC on May 24, 2005, 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. 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

In 1997, CNA Reinsurance Company Limited (CNA Re Ltd.) entered into an arrangement with IOA Global, Ltd. (IOA), an independent managing general agent based in Philadelphia, Pennsylvania, to develop and manage a book of accident and health coverages. Pursuant to this arrangement, IGI Underwriting Agencies, Ltd. (IGI), a personal accident reinsurance managing general underwriter, was appointed to underwrite and market the book under the supervision of IOA. Between April 1, 1997 and December 1, 1999, IGI underwrote a number of reinsurance arrangements with respect to personal accident insurance worldwide (the IGI Program). Under various arrangements, CNA Re Ltd. both assumed risks as a reinsurer and also ceded a substantial portion of those risks to other companies, including other CNA insurance subsidiaries and ultimately to a group of reinsurers participating in a reinsurance pool known as the Associated Accident and Health Reinsurance Underwriters (AAHRU) Facility. CNA s group operations business unit participated as a pool member in the AAHRU Facility in varying percentages between 1997 and 1999.

A portion of the premiums assumed under the IGI Program related to United States workers compensation carve-out business. Some of these premiums were received from John Hancock Mutual Life Insurance Company (John Hancock) under four excess of loss reinsurance treaties (the Treaties) issued by CNA Re Ltd. While John Hancock has indicated that it is not able to accurately quantify its potential exposure to its cedents on business which is retroceded to CNA, John Hancock has reported $295 million of incurred losses under these Treaties. John Hancock is disputing portions of its assumed obligations resulting in these reported losses, and has advised CNA that it is, or has been, involved in multiple arbitrations with its own cedents, in which proceedings John Hancock is seeking to avoid and/or reduce risks that would otherwise arguably be ceded to CNA through the Treaties. John Hancock has further informed CNA that it has settled several of these disputes, but has not provided CNA with details of the settlements. To the extent that John Hancock is successful in reducing its liabilities in these disputes, that development may have an impact on the recoveries it is seeking under the Treaties from CNA, although CNA

CNA FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued
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believes that Hancock s ultimate losses will probably materially exceed incurred losses reported to date under the Treaties.

As indicated, CNA arranged substantial reinsurance protection to manage its exposures under the IGI Program, including the United States workers compensation carve-out business ceded from John Hancock and other reinsurers. While certain reinsurers of CNA, including participants in the AAHRU Facility, disputed their liabilities under the reinsurance contracts with respect to the IGI Program, those disputes have been resolved and substantial reinsurance coverage exists for those exposures.

CNA has instituted arbitration proceedings against John Hancock seeking rescission of the Treaties. The hearing before the arbitration panel commenced in April 2007. Based on information known at this time, CNA believes it has strong grounds to successfully challenge its alleged exposure derived from John Hancock through the ongoing arbitration proceedings, although the outcome of the arbitration cannot be guaranteed with any certainty.

CNA has established reserves for its estimated exposure under the IGI Program, other than that derived from John Hancock, and an estimate for recoverables from retrocessionaires. CNA has not established any reserve for any exposure derived from John Hancock because, as indicated, CNA believes the contract will be rescinded. Although the results of the Company s various loss mitigation strategies with respect to the entire IGI Program to date support the recorded reserves, the estimate of ultimate losses is subject to considerable uncertainty due to the complexities described above, and the Company s inability to guarantee any outcome in the arbitration proceedings. As a result of these uncertainties, the results of operations in future periods may be adversely affected by potentially significant reserve additions. However, the extent of losses beyond any amounts that may be accrued are not readily determinable at this time. Management does not believe that any such reserve additions would be material to the equity of the Company. The Company s position in relation to the IGI Program was unaffected by the sale of CNA Re Ltd. in 2002.

New Jersey Wage and Hour Litigation

<u>W. Curtis Himmelman, individually and on behalf of all others similarly situated v. Continental Casualty Company</u>, 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 seeks to represent others similarly situated who opt in to the action and who also allege they are 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 seeks 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 Company denies the material allegations of the Complaint and intends to vigorously contest the claims on numerous substantive and procedural grounds.

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.

California Long Term Care Litigation

<u>Shaffer v. Continental Casualty Company, et al.</u>, U.S. District Court, Central District of California, CV06-2235 RGK, is a class action on behalf of certain California long term health care policyholders, alleging that CCC knowingly used unrealistic actuarial assumptions in pricing these policies, which according to plaintiff, would inevitably necessitate premium increases. The plaintiff asserts claims for intentional fraud, negligent misrepresentation, and violations of various California statutes. On January 26, 2007, the court certified the case to proceed as a class action, although CCC is currently seeking review of that decision in the Ninth Circuit Court of Appeals. CCC has denied the material allegations of the amended complaint and intends to vigorously contest the claims. In February 2007, CCC and CNAF

filed motions for summary judgment seeking judgment as a matter of law in their favor. In April 2007, the Court denied the motions for summary judgment with the exception of the

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CNA FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued
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motion relating to plaintiffs claim under the California Legal Remedies Act (CLRA), which was dismissed. The claim under CLRA involved a provision for claims of awards for attorneys fees and enhanced damages.

Numerous unresolved factual and legal issues remain that are critical to the final result with regard to the surviving claims, the outcome of which cannot be predicted with any reliability. Accordingly, the extent of losses are not readily determinable at this time. However, based on facts and circumstances presently known in the opinion of management, an unfavorable outcome would not materially adversely affect the equity of the Company, although results of operations may be adversely affected.

Asbestos, Environmental Pollution and Mass Tort (APMT) Reserves

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

Other Litigation

CNA 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 results of operations or equity of CNA.

Note I. 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 **Three months ended March 31** (In millions)	**2007**	**2006**
Pension benefits		
Service cost	$ 7	$ 8
Interest cost on projected benefit obligation	38	37
Expected return on plan assets	(43)	(40)
Prior service cost amortization		1
Actuarial loss	4	10
Net periodic pension cost	$ 6	$ 16
Postretirement benefits		
Service cost	$ 1	$ 1

Interest cost on projected benefit obligation		2		3
Prior service cost amortization		(5)		(7)
Actuarial loss		1		1
Net periodic postretirement benefit	$	(1)	$	(2)

CNA FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued
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At December 31, 2006, CNA expected to contribute $58 million to its pension plans and $12 million to its postretirement healthcare and life insurance benefit plans in 2007. As of March 31, 2007, $2 million of contributions have been made to its pension plans and $3 million to its postretirement healthcare and life insurance benefit plans. CNA plans to contribute an additional $57 million to its pension plans and $9 million to its postretirement healthcare and life insurance benefit plans during the remainder of 2007.

Note J. Operating Leases, Other Commitments and Contingencies, and Guarantees

Operating Leases

The Company is obligated to make future payments totaling $248 million for non-cancelable operating leases primarily for office space and data processing, office and transportation equipment. Estimated future minimum payments under these contracts are as follows: $34 million in 2007; $39 million in 2008; $36 million in 2009; $33 million in 2010; $28 million in 2011; and $78 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 March 31, 2007 that the Company could be required to pay under this guarantee are approximately $233 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 March 31, 2007 there were approximately $31 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 $12 million as of March 31, 2007. Estimated future minimum payments under these contracts are $9 million in 2007 and $3 million in 2008.

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 March 31, 2007, the aggregate amount of quantifiable indemnification agreements in effect for sales of business entities, assets and third party loans was $933 million.

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 March 31, 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

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CNA FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued
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of limitation expire, or until the agreed upon contract terms expire. As of March 31, 2007 and December 31, 2006, the Company has recorded approximately $28 million of liabilities related to these indemnification agreements.

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 K. Comprehensive Income (Loss)

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

Comprehensive Income (Loss)

Three months ended March 31 (In millions)	**2007**	**2006**
Net income	$ 296	$ 229
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 ($28) and $132	52	(244)
Reclassification adjustment for (gains) losses included in net income, net of tax expense (benefit) of $20 and $3	(35)	(7)
Net change in unrealized gains (losses) on general account investments, net of tax (expense) benefit of ($8) and $135	17	(251)
Net change in unrealized gains on discontinued operations and other, net of tax (expense) benefit of ($1) and $2	1	1
Net change in foreign currency translation adjustment	(7)	3
Net change related to pensions, net of tax (expense) benefit of ($1) and $0	4	(1)
Allocation to participating policyholders and minority interests	(1)	9
Other comprehensive income (loss), net of tax (expense) benefit of ($10) and $137	14	(239)
Total comprehensive income (loss)	$ 310	$ (10)

CNA FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued
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Note L. 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.

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

Three months ended March 31, 2007 (In millions)	Standard Lines	Specialty Lines	Life and Group Non-Core	Corporate and Other Non-Core	Eliminations	Total
Net earned premiums	$ 1,060	$ 648	$ 156	$	$ (1)	$ 1,863
Net investment income	259	110	161	78		608
Other revenues	23	41	12	2	(11)	67
Total operating revenues	1,342	799	329	80	(12)	2,538
Claims, benefits and expenses:						
Net incurred claims and benefits	738	398	273	34		1,443
Policyholders dividends	5	1	(1)			5
Amortization of deferred acquisition costs	242	134	5			381
Other insurance related expenses	66	40	51	4	(1)	160
Other expenses	25	38	9	31	(11)	92
Total claims, benefits and expenses	1,076	611	337	69	(12)	2,081
Operating income (loss) from continuing operations before income tax and minority interest	266	188	(8)	11		457
Income tax (expense) benefit on operating income (loss)	(86)	(62)	10	(2)		(140)
Minority interest	(2)	(8)				(10)
Net operating income from continuing operations	178	118	2	9		307
Realized investment gains (losses), net of participating policyholders and minority interests	(28)	(10)	1	16		(21)
	10	4		(6)		8

Income tax (expense) benefit on realized investment gains						
Income from continuing operations	$ 160	$ 112	$ 3	$ 19	$	$ 294
March 31, 2007 (In millions)						
Reinsurance receivables	$ 3,249	$ 1,349	$ 2,320	$ 2,924	$	$ 9,842
Insurance receivables	$ 2,106	$ 419	$ 61	$ (51)	$	$ 2,535
Insurance reserves:						
Claim and claim adjustment expense	$ 14,936	$ 5,714	$ 3,085	$ 5,775	$	$ 29,510
Unearned premiums	2,012	1,630	180	2	1	3,825
Future policy benefits			6,755			6,755
Policyholders funds	33		944			977
Deferred acquisition costs	$ 407	$ 287	$ 495	$	$	$ 1,189

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CNA FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued
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Three months ended March 31, 2006 (In millions)	**Standard Lines**	**Specialty Lines**	**Life and Group Non-Core**	**Corporate And Other Non-Core**	**Eliminations**	**Total**
Net earned premiums	$ 1,086	$ 628	$ 163	$ (7)	$ (1)	$ 1,869
Net investment income	228	87	187	68		570
Other revenues	20	33	12	1	(13)	53
Total operating revenues	1,334	748	362	62	(14)	2,492
Claims, benefits and expenses:						
Net incurred claims and benefits	780	372	306	28	1	1,487
Policyholders dividends	4	1				5
Amortization of deferred acquisition costs	238	127	4	1		370
Other insurance related expenses	101	37	53	17	(2)	206
Other expenses	19	32	13	30	(13)	81
Total claims, benefits and expenses	1,142	569	376	76	(14)	2,149
Operating income (loss) from continuing operations before income tax and minority interest	192	179	(14)	(14)		343
Income tax (expense) benefit on operating income (loss)	(56)	(59)	11	4		(100)
Minority interest	(3)	(6)				(9)
Net operating income (loss) from continuing operations	133	114	(3)	(10)		234
Realized investment gains (losses), net of participating policyholders and minority interests	13	3	(12)	5		9

Income tax (expense) benefit on realized investment gains (losses)	(4)	(1)	5	(8)		(8)
Income (loss) from continuing operations	$ 142	$ 116	$ (10)	$ (13)	$	$ 235
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 expense	$ 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

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CNA FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued
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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.

Revenue by Line of Business

Three months ended March 31 (In millions)	**2007**	**2006**
Standard Lines		
Property	$ 317	$ 287
Casualty	818	887
CNA Global	179	173
Standard Lines revenue	1,314	1,347
Specialty Lines		
US Specialty Lines	608	581
Surety	110	102
Warranty	71	68
Specialty Lines revenue	789	751
Life and Group Non-Core		
Life & Annuity	81	108
Health	233	224
Other	16	18
Life and Group Non-Core revenue	330	350
Corporate and Other Non-Core		
CNA Re	47	17
Other	49	50
Corporate and Other Non-Core revenue	96	67
Eliminations	(12)	(14)

Total revenue	$ 2,517	$ 2,501

CNA FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued
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Note M. Discontinued Operations

CNA has discontinued operations which consist of run-off insurance operations acquired in its merger with The Continental Corporation in 1995. 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, the London Market and marine liabilities. The run-off operations are concentrated in United Kingdom and Bermuda subsidiaries also acquired in the merger.

Results of the discontinued operations were as follows:

Discontinued Operations **Three months ended March 31** (In millions)	**2007**	**2006**
Revenues:		
Net investment income	$ 5	$ 4
Realized investment losses and other	(1)	
Total revenues	4	4
Insurance related expenses	1	10
Income (loss) before income taxes	3	(6)
Income tax expense	(1)	
Income (loss) from discontinued operations, net of tax	$ 2	$ (6)

On March 3, 2007, the Company entered into an agreement to sell 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. The Company expects this transaction to be completed by the end of the second quarter of 2007, subject to customary closing conditions and regulatory approvals. In anticipation of the sale, the Company recorded an impairment loss of approximately $29 million in 2006. The assets and liabilities subject to the sale are $227 million and $145 million at March 31, 2007. Net loss for this business was $1 million and $5 million for the three months ended March 31, 2007 and 2006. The Company s subsidiary, The Continental Corporation, provides a guarantee for a portion of the subject liabilities related to certain marine products. The sale agreement includes provisions that significantly limit the Company s exposure related to this guarantee.

Net assets of discontinued operations, including the assets and liabilities subject to the sale discussed above, are included in Other assets on the Condensed Consolidated Balance Sheets and were as follows:

Discontinued Operations (In millions)	**March 31, 2007**	**December 31, 2006**
Assets:		
Investments	$ 320	$ 317
Reinsurance receivables	35	33
Cash	23	40
Other assets	7	3

Total assets		385		393
Liabilities:				
Insurance reserves		302		308
Other liabilities		10		17
Total liabilities		312		325
Net assets of discontinued operations	$	73	$	68

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CNA FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, Continued
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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 (APB 30). At March 31, 2007 and December 31, 2006, the insurance reserves are net of discount of $92 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.

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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 2005 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 G of the Condensed Consolidated Financial Statements included under Item 1.

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CNA FINANCIAL CORPORATION
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.

Three months ended March 31 (In millions, except per share data)	**2007**	**2006**
Revenues		
Net earned premiums	$ 1,863	$ 1,869
Net investment income	608	570
Other revenues	67	53
Total operating revenues	2,538	2,492
Claims, Benefits and Expenses		
Net incurred claims and benefits	1,443	1,487
Policyholders dividends	5	5
Amortization of deferred acquisition costs	381	370
Other insurance related expenses	160	206
Other expenses	92	81
Total claims, benefits and expenses	2,081	2,149
Operating income from continuing operations before income tax and minority interest	457	343
Income tax expense on operating income	(140)	(100)
Minority interest	(10)	(9)
Net operating income from continuing operations	307	234
Realized investment gains (losses), net of participating policyholders and minority interests	(21)	9
Income tax (expense) benefit on realized investment gains (losses)	8	(8)
Income from continuing operations	294	235
Income (loss) from discontinued operations, net of income tax expense of $1 and $0	2	(6)
Net income	$ 296	$ 229

Basic and Diluted Earnings Per Share		
Income from continuing operations	$ 1.08	$ 0.84
Income (loss) from discontinued operations	0.01	(0.02)
Basic and diluted earnings per share available to common stockholders	$ 1.09	$ 0.82
Weighted average outstanding common stock and common stock equivalents		
Basic	271.3	256.0
Diluted	271.6	256.0

CNA FINANCIAL CORPORATION
MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, Continued

Net income increased $67 million for the three months ended March 31, 2007 as compared with the same period in 2006. This increase was due to increased net operating income from continuing operations, 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 operating income from continuing operations for the three months ended March 31, 2007 increased $73 million as compared with the same period in 2006. The improvement in net operating income was due to increased net investment income, favorable net prior year development in the current year as compared to unfavorable net prior year development for the same period in 2006, and lower acquisition expenses. These increases to net operating income were partially offset by increased catastrophe losses.

Favorable net prior year development of $14 million was recorded for the three months ended March 31, 2007 related to our Standard Lines, Specialty Lines and Corporate and Other Non-core segments. This amount consisted of $20 million of unfavorable claim and allocated claim adjustment expense reserve development and $34 million of favorable premium development. Unfavorable net prior year development of $21 million was recorded for the three months ended March 31, 2006 related to our Standard Lines, Specialty Lines and Corporate and Other Non-core segments. This amount consisted of $71 million of unfavorable claim and allocated claim adjustment expense reserve development and $50 million of favorable premium development.

Net earned premiums decreased $6 million for the three months ended March 31, 2007 as compared with the same period in 2006, including a $26 million decrease related to Standard Lines and a $20 million increase related to Specialty Lines. Net earned premiums for the Life and Group Non-Core segment decreased by $7 million. See the segment discussions of this MD&A for further discussion.

Results from discontinued operations increased $8 million for the three months ended March 31, 2007 as compared to the same period in 2006. The 2007 results were impacted by favorable net prior year development. Results in 2006 were impacted by an increase in unallocated loss adjustment expense reserves and an increase in the bad debt provision for reinsurance receivables.

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 (Unaudited) 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

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Results of Operations included under Item 7 of our Form 10-K for the year ended December 31, 2006 for further information.

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 L of the Condensed Consolidated Financial Statements included under Item 1. In evaluating the results of the Standard Lines and Specialty Lines, we utilize the combined ratio, the loss ratio, the expense ratio and the dividend 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

Three months ended March 31	**2007**	**2006**
(In millions)		
Net written premiums	$ 1,081	$ 1,110
Net earned premiums	1,060	1,086
Net investment income	259	228
Net operating income	178	133
Net realized investment gains (losses), after-tax	(18)	9
Net income	160	142
Ratios		
Loss and loss adjustment expense	69.6%	71.8%
Expense	29.1	31.2
Dividend	0.4	0.4
Combined	99.1%	103.4%

Net written premiums for Standard Lines decreased $29 million for the three months ended March 31, 2007 as compared with the same period in 2006, primarily due to decreased favorable premium development. Net earned premiums decreased $26 million for the three months ended March 31, 2007 as compared with the same period in 2006, consistent with the decreased premiums written.

Standard Lines averaged rate decreases of 3% for the three months ended March 31, 2007, as compared to average rate decreases of 1% for the three months ended March 31, 2006 for the contracts that renewed during those periods. Retention rates of 79% and 80% were achieved for those contracts that were available for renewal in each period.

Net income increased $18 million for the three months ended March 31, 2007 as compared with the same period in 2006. This increase was primarily attributable to improved net operating results, 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 operating income increased $45 million for the three months ended March 31, 2007 as compared with the same period in 2006. This increase was primarily driven by increased net investment income, favorable net prior year development in 2007 as compared to unfavorable net prior year development in 2006, and lower acquisition expenses. These increases to net operating income were partially offset by increased catastrophe losses.

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Catastrophe losses were $20 million after-tax in the first quarter of 2007, as compared to $8 million after-tax in the same period of 2006.

The combined ratio improved 4.3 points for the three months ended March 31, 2007 as compared with the same period in 2006. The loss ratio improved 2.2 points primarily due to the favorable impact of net prior year development as discussed below, partially offset by increased catastrophe losses.

The expense ratio improved 2.1 points for the three months ended March 31, 2007 as compared with the same period in 2006. This improvement was primarily due to increased ceding commissions and a change in estimate for an insurance-related assessment liability.

Favorable net prior year development of $14 million was recorded for the three months ended March 31, 2007, including $13 million of unfavorable claim and allocated claim adjustment expense reserve development and $27 million of favorable premium development. Unfavorable net prior year development of $10 million, including $59 million of unfavorable claim and allocated claim adjustment expense reserve development and $49 million of favorable premium development, was recorded for the three months ended March 31, 2006. Further information on Standard Lines Net Prior Year Development for the three months ended March 31, 2007 and 2006 is included in Note G of the Condensed Consolidated Financial Statements included under Item 1.

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

Gross and Net Carried
Claim and Claim Adjustment Expense Reserves

(In millions)		March 31, 2007		December 31, 2006
Gross Case Reserves	$	6,729	$	6,746
Gross IBNR Reserves		8,207		8,188
Total Gross Carried Claim and Claim Adjustment Expense Reserves	$	14,936	$	14,934
Net Case Reserves	$	5,199	$	5,234
Net IBNR Reserves		6,642		6,632
Total Net Carried Claim and Claim Adjustment Expense Reserves	$	11,841	$	11,866

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SPECIALTY LINES

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

Results of Operations

Three months ended March 31	**2007**	**2006**
(In millions)		
Net written premiums	$ 650	$ 648
Net earned premiums	648	628
Net investment income	110	87
Net operating income	118	114
Net realized investment gains (losses), after-tax	(6)	2
Net income	112	116
Ratios		
Loss and loss adjustment expense	61.5%	59.3%
Expense	26.8	26.1
Dividend	0.2	0.2
Combined	88.5%	85.6%

Net written premiums for Specialty Lines increased $2 million for the three months ended March 31, 2007 as compared to the same period in 2006. Premiums written were unfavorably impacted by declining rates and decreased new business as compared to the first quarter of 2006. These unfavorable impacts were more than offset by decreased ceded premiums. Net earned premiums increased $20 million for the three months ended March 31, 2007 as compared with the same period in 2006, which reflects the increased net premiums over the past several quarters in Specialty Lines.

Specialty Lines averaged rate decreases of 4% for the three months ended March 31, 2007, as compared to flat averaged rates for the three months ended March 31, 2006 for the contracts that renewed during those periods. Retention rates of 86% and 88% were achieved for those contracts that were available for renewal in each period.

Net income decreased $4 million for the three months ended March 31, 2007 as compared with the same period in 2006. This decrease was attributable to reduced net realized investment results, partially offset by increased 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 $4 million for the three months ended March 31, 2007 as compared with the same period in 2006. This increase was primarily driven by an increase in net investment income, partially offset by less favorable current accident year results.

The combined ratio increased 2.9 points for the three months ended March 31, 2007 as compared with the same period in 2006. The loss ratio increased 2.2 points, primarily due to higher current accident year loss ratios across several lines of business related to the declining rate environment.

The expense ratio increased 0.7 points for the three months ended March 31, 2007 as compared with the same period in 2006. The increase was primarily due to higher direct commissions on the mix of accounts written and reduced ceding commissions.

Favorable net prior year development of $2 million, including $7 million of unfavorable claim and allocated claim adjustment expense reserve development and $9 million of favorable premium development, was recorded for the three months ended March 31, 2007. Favorable net prior year development of $3 million, including $5 million of unfavorable claim and allocated claim adjustment expense reserve development and $8 million of favorable premium development, was recorded for the three months ended March 31, 2006.

The current US Specialty Lines reinsurance structure is primarily quota share reinsurance which is in place through April 2007. We reviewed this structure and have elected not to renew this coverage upon its expiration. With our current diversification in the subject lines of business and our management of the gross limits on the business written, we do not believe the cost of renewing the program is commensurate with its projected benefit.

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

Gross and Net Carried
Claim and Claim Adjustment Expense Reserves

(In millions)	March 31, 2007	December 31, 2006
Gross Case Reserves	$ 1,689	$ 1,715
Gross IBNR Reserves	4,025	3,814
Total Gross Carried Claim and Claim Adjustment Expense Reserves	$ 5,714	$ 5,529
Net Case Reserves	$ 1,352	$ 1,350
Net IBNR Reserves	3,034	2,921
Total Net Carried Claim and Claim Adjustment Expense Reserves	$ 4,386	$ 4,271

LIFE AND GROUP NON-CORE

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

Results of Operations

Three months ended March 31 (In millions)	**2007**	**2006**
Net earned premiums	$ 156	$ 163
Net investment income	161	187
Net operating income (loss)	2	(3)
Net realized investment gains (losses), after-tax	1	(7)
Net income (loss)	3	(10)

Net earned premiums for Life and Group Non-Core decreased $7 million for the three months ended March 31, 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 results increased $13 million for the three months ended March 31, 2007 as compared with the same period in 2006. The increase in net results was primarily due to improved net realized investment results and an increase in life settlement contract results. The decrease in net investment income was more than offset by a corresponding decrease in the policyholders funds reserves supported by the trading portfolio. See the Investments section of this MD&A for further discussion of net investment income and net realized investment results.

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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

Three months ended March 31 (In millions)	**2007**	**2006**
Net investment income	$ 78	$ 68
Revenues	84	53
Net operating income (loss)	9	(10)
Net realized investment gains (losses), after-tax	10	(3)
Net income (loss)	19	(13)

Revenues increased $31 million for the three months ended March 31, 2007 as compared with the same period in 2006. The increase in revenues was primarily due to improved net realized investment results and increased net investment income. See the Investments section of this MD&A for further discussion of net investment income and net realized investment results.

Net results increased $32 million for the three months ended March 31, 2007 as compared with the same period in 2006. The increase in net results was primarily due to increased revenues as discussed above, decreased net prior year development and a loss in 2006 related to a commutation. These favorable impacts were partially offset by an increase in interest costs on corporate debt and increased current accident year losses related to mass torts.

Unfavorable premium development of $2 million was recorded for the three months ended March 31, 2007. There was no claim and allocated claim adjustment expense reserve development recorded for the three months ended March 31, 2007. Unfavorable net prior year development of $14 million was recorded for the three months ended March 31, 2006, including $7 million of unfavorable net prior year claim and allocated claim adjustment expense reserve development and $7 million of unfavorable premium development.

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

Gross and Net Carried
Claim and Claim Adjustment Expense Reserves

(In millions)	**March 31, 2007**	**December 31, 2006**
Gross Case Reserves	$ 2,484	$ 2,511
Gross IBNR Reserves	3,291	3,528
Total Gross Carried Claim and Claim Adjustment Expense Reserves	$ 5,775	$ 6,039
Net Case Reserves	$ 1,469	$ 1,453
Net IBNR Reserves	1,864	1,999

Total Net Carried Claim and Claim Adjustment Expense Reserves	$	3,333	$	3,452

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APMT Reserves

Our property and casualty insurance subsidiaries have actual and potential exposures related to asbestos, environmental pollution and mass tort (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 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 G of the Condensed Consolidated Financial Statements included under Item 1.

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

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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 closing large accounts a significant management priority. Small accounts are defined as active accounts with $100 thousand or less of cumulative paid losses. Approximately 79% and 80% of our total active asbestos accounts are classified as small accounts at March 31, 2007 and December 31, 2006.

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.

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

Pending Asbestos Accounts and Associated Reserves
March 31, 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	16	$ 15	$ 172	12%
Wellington	3		14	1
Coverage in place	37	36	79	6
Total with settlement agreements	56	51	265	19
Other policyholders with active accounts				
Large asbestos accounts	223	7	257	18
Small asbestos accounts	1,062	3	93	7
Total other policyholders	1,285	10	350	25