

CNA FINANCIAL CORP
Form 10-Q
November 03, 2015

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

FORM 10-Q
 QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2015
OR
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____
Commission File Number 1-5823

CNA FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)
Delaware
(State or other jurisdiction of
incorporation or organization)
333 S. Wabash
Chicago, Illinois
(Address of principal executive offices)
(312) 822-5000
(Registrant's telephone number, including area code)

36-6169860
(I.R.S. Employer
Identification No.)
60604
(Zip Code)

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

Yes No

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

Yes No

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

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

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

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

Class Outstanding at October 30, 2015
Common Stock, Par value \$2.50 270,260,625

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Part I. Financial Information

Item 1. Condensed Consolidated Financial Statements

CNA Financial Corporation

Condensed Consolidated Statements of Operations (Unaudited)

Periods ended September 30

(In millions, except per share data)

	Three Months		Nine Months	
	2015	2014	2015	2014
Revenues				
Net earned premiums	\$1,751	\$1,810	\$5,173	\$5,427
Net investment income	354	480	1,412	1,556
Net realized investment gains (losses):				
Other-than-temporary impairment losses	(56)	(10)	(99)	(17)
Portion of other-than-temporary impairments recognized in Other comprehensive income	—	—	—	—
Net other-than-temporary impairment losses recognized in earnings	(56)	(10)	(99)	(17)
Other net realized investment gains (losses)	7	47	60	86
Net realized investment gains (losses)	(49)	37	(39)	69
Other revenues	97	84	286	262
Total revenues	2,153	2,411	6,832	7,314
Claims, Benefits and Expenses				
Insurance claims and policyholders' benefits	1,200	1,354	4,008	4,241
Amortization of deferred acquisition costs	319	332	936	996
Other operating expenses	362	384	1,061	984
Interest	39	48	117	138
Total claims, benefits and expenses	1,920	2,118	6,122	6,359
Income from continuing operations before income tax	233	293	710	955
Income tax expense	(55)	(84)	(161)	(265)
Income from continuing operations	178	209	549	690
Income (loss) from discontinued operations, net of income tax (expense) benefit of \$-, \$(3), \$- and \$34	—	4	—	(197)
Net income	\$178	\$213	\$549	\$493
Basic Earnings Per Share				
Income from continuing operations	\$0.66	\$0.77	\$2.03	\$2.56
Income (loss) from discontinued operations	—	0.02	—	(0.73)
Basic earnings per share	\$0.66	\$0.79	\$2.03	\$1.83
Diluted Earnings Per Share				
Income from continuing operations	\$0.66	\$0.77	\$2.03	\$2.55
Income (loss) from discontinued operations	—	0.02	—	(0.73)
Diluted earnings per share	\$0.66	\$0.79	\$2.03	\$1.82
Dividends declared per share	\$0.25	\$0.25	\$2.75	\$1.75
Weighted Average Outstanding Common Stock and Common Stock Equivalents				
Basic	270.3	269.9	270.2	269.9
Diluted	270.8	270.6	270.7	270.6

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 Comprehensive Income (Unaudited)

Periods ended September 30

(In millions)

Other Comprehensive Income (Loss), Net of Tax

Changes in:

Net unrealized gains on investments with other-than-temporary impairments

Net unrealized gains on other investments

Net unrealized gains on investments

Net unrealized gains on discontinued operations

Foreign currency translation adjustment

Pension and postretirement benefits

Other comprehensive income (loss), net of tax

Net income

Total comprehensive income

Three Months

2015

2014

Nine Months

2015

2014

\$2

\$1

\$(3

) \$15

(36

)

(83

)

(289

)

424

(34

)

(82

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(292

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439

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(37

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(22

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(53

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(73

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(100

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(39

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3

52

(47

)

(83

)

(189

)

(340

)

331

178

213

549

493

\$95

\$24

\$209

\$824

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

(In millions, except share data)	September 30, 2015 (Unaudited)	December 31, 2014
Assets		
Investments:		
Fixed maturity securities at fair value (amortized cost of \$37,568 and \$37,335)	\$40,201	\$ 40,768
Equity securities at fair value (cost of \$207 and \$210)	212	222
Limited partnership investments	2,738	2,937
Other invested assets	45	41
Mortgage loans	640	588
Short term investments	1,482	1,706
Total investments	45,318	46,262
Cash	236	190
Reinsurance receivables (less allowance for uncollectible receivables of \$48 and \$48)	4,491	4,694
Insurance receivables (less allowance for uncollectible receivables of \$54 and \$61)	2,057	1,936
Accrued investment income	439	405
Deferred acquisition costs	606	600
Deferred income taxes	279	191
Property and equipment at cost (less accumulated depreciation of \$387 and \$364)	320	295
Goodwill	151	152
Other assets	915	841
Total assets	\$54,812	\$ 55,566
Liabilities		
Insurance reserves:		
Claim and claim adjustment expenses	\$22,867	\$ 23,271
Unearned premiums	3,706	3,592
Future policy benefits	9,520	9,490
Policyholders' funds	—	27
Short term debt	350	—
Long term debt	2,211	2,559
Other liabilities (includes \$119 and \$153 due to Loews Corporation)	3,893	3,833
Total liabilities	42,547	42,772
Commitments and contingencies (Notes C, F and H)		
Stockholders' Equity		
Common stock (\$2.50 par value; 500,000,000 shares authorized; 273,040,243 shares issued; 270,260,625 and 269,980,202 shares outstanding)	683	683
Additional paid-in capital	2,150	2,151
Retained earnings	9,450	9,645
Accumulated other comprehensive income	60	400
Treasury stock (2,779,618 and 3,060,041 shares), at cost	(78	) (84
Notes receivable for the issuance of common stock	—	(1
Total stockholders' equity	12,265	12,794
Total liabilities and stockholders' equity	\$54,812	\$ 55,566

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)

Nine months ended September 30

(In millions)	2015	2014	
Cash Flows from Operating Activities			
Net income	\$549	\$493	
Adjustments to reconcile net income to net cash flows provided by operating activities:			
Loss on sale of subsidiaries	—	251	
Deferred income tax expense	27	81	
Trading portfolio activity	17	16	
Net realized investment (gains) losses	39	(72))
Equity method investees	127	65	
Net amortization of investments	(17)	(1))
Depreciation and amortization	62	62	
Changes in:			
Receivables, net	70	611	
Accrued investment income	(34)	(37))
Deferred acquisition costs	11	14	
Insurance reserves	195	(222))
Other assets	(61)	(49))
Other liabilities	(32)	(133))
Other, net	92	(32))
Total adjustments	496	554	
Net cash flows provided by operating activities	1,045	1,047	
Cash Flows from Investing Activities			
Dispositions:			
Fixed maturity securities - sales	3,590	4,005	
Fixed maturity securities - maturities, calls and redemptions	3,101	2,901	
Equity securities	43	23	
Limited partnerships	156	133	
Mortgage loans	22	36	
Purchases:			
Fixed maturity securities	(7,055)	(7,457))
Equity securities	(60)	(44))
Limited partnerships	(120)	(218))
Mortgage loans	(81)	(84))
Change in other investments	5	10	
Change in short term investments	222	(556))
Purchases of property and equipment	(84)	(42))
Proceeds from sale of subsidiaries	—	198	
Other, net	7	8	
Net cash flows used by investing activities	\$(254)	\$(1,087))

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

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Nine months ended September 30

(In millions)

	2015		2014	
Cash Flows from Financing Activities				
Dividends paid to common stockholders	\$(744	)	\$(473)
Proceeds from the issuance of debt	—		546	
Other, net	5		22	
Net cash flows provided (used) by financing activities	(739	)	95	
Effect of foreign exchange rate changes on cash	(6	)	(3)
Net change in cash	46		52	
Cash, beginning of year	190		195	
Cash, end of period	\$236		\$247	

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)

Nine months ended September 30

(In millions)	2015	2014	
Common Stock			
Balance, beginning of year	\$683	\$683	
Balance, end of period	683	683	
Additional Paid-in Capital			
Balance, beginning of year	2,151	2,145	
Stock-based compensation	(1	) 4	
Balance, end of period	2,150	2,149	
Retained Earnings			
Balance, beginning of year	9,645	9,495	
Dividends paid to common stockholders	(744	) (473)
Net income	549	493	
Balance, end of period	9,450	9,515	
Accumulated Other Comprehensive Income			
Balance, beginning of year	400	442	
Other comprehensive income (loss)	(340	) 331	
Balance, end of period	60	773	
Treasury Stock			
Balance, beginning of year	(84	) (91)
Stock-based compensation	6	6	
Balance, end of period	(78	) (85)
Notes Receivable for the Issuance of Common Stock			
Balance, beginning of year	(1	) (23)
Decrease in notes receivable for common stock	1	22	
Balance, end of period	—	(1)
Total stockholders' equity	\$12,265	\$13,034	

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. General

Basis of Presentation

The Condensed Consolidated Financial Statements include the accounts of CNA Financial Corporation (CNAF) and its subsidiaries. Collectively, CNAF and its subsidiaries are referred to as CNA or the Company. Loews Corporation (Loews) owned approximately 90% of the outstanding common stock of CNAF as of September 30, 2015.

The accompanying Condensed Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). Intercompany amounts have been eliminated. Certain financial information that is normally included in annual financial statements, including certain financial statement notes, prepared in accordance with GAAP, is not required for interim reporting purposes and has been condensed or omitted. These statements should be read in conjunction with the Consolidated Financial Statements and notes thereto included in CNAF's Annual Report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2014, including the summary of significant accounting policies in Note A. The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the Condensed Consolidated Financial Statements and the reported amounts of revenues and expenses during the reporting periods. Actual results may differ from those estimates.

The interim financial data as of September 30, 2015 and for the three and nine months ended September 30, 2015 and 2014 is unaudited. However, in the opinion of management, the interim data includes all adjustments, including normal recurring adjustments, 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.

Sale of Continental Assurance Company (CAC)

On August 1, 2014, the Company completed the sale of the common stock of CAC, the Company's former life insurance subsidiary. The Company elected to include CAC cash flow activity in the comparative Condensed Consolidated Statement of Cash Flows. Further information on discontinued operations is provided in Note K to the Condensed Consolidated Financial Statements.

In connection with the sale of CAC, the Company entered into a 100% coinsurance agreement on a separate small block of annuity business outside of CAC. As a result of the coinsurance agreement, the \$34 million difference between market value and book value of the funds withheld assets at the coinsurance contract's inception was recognized as a loss in Other operating expenses in the third quarter of 2014.

Recently Issued Accounting Standards Update (ASU) - Disclosures about Short-Duration Contracts

In May of 2015, the Financial Accounting Standards Board issued ASU No. 2015-09, Financial Services-Insurance (Topic 944): Disclosures about Short-Duration Contracts. The updated accounting guidance requires enhanced disclosures to provide additional information about insurance liabilities for short-duration contracts. The updated guidance is effective for annual financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within the annual periods beginning after December 15, 2016. The Company is currently evaluating the effect the updated guidance will have on the Company's financial statement disclosures.

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Note B. Earnings Per Share

Earnings per share is based on the weighted average number of outstanding common shares. Basic earnings (loss) per share excludes the effect of dilutive securities and is computed by dividing Net income (loss) by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

For the three and nine months ended September 30, 2015, approximately 514 thousand and 545 thousand potential shares attributable to exercises under stock-based employee compensation plans were included in the calculation of diluted earnings per share. For those same periods, approximately 106 thousand and 107 thousand potential shares attributable to exercises under stock-based employee compensation plans were not included in the calculation of diluted earnings per share because the effect would have been antidilutive.

For the three and nine months ended September 30, 2014, approximately 668 thousand and 654 thousand potential shares attributable to exercises under stock-based employee compensation plans were included in the calculation of diluted earnings per share. For those same periods, approximately 180 thousand and 167 thousand potential shares attributable to exercises under stock-based employee compensation plans were not included in the calculation of diluted earnings per share because the effect would have been antidilutive.

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Note C. Investments

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

Periods ended September 30 (In millions)	Three Months		Nine Months	
	2015	2014	2015	2014
Fixed maturity securities	\$449	\$453	\$1,344	\$1,356
Equity securities	3	2	9	7
Limited partnership investments	(93	) 29	69	199
Mortgage loans	8	7	25	22
Short term investments	2	1	4	2
Trading portfolio	1	2	6	8
Other	1	—	1	3
Gross investment income	371	494	1,458	1,597
Investment expense	(17	) (14	) (46	) (41
Net investment income	\$354	\$480	\$1,412	\$1,556

Net realized investment gains (losses) are presented in the following table.

Periods ended September 30 (In millions)	Three Months		Nine Months	
	2015	2014	2015	2014
Net realized investment gains (losses):				
Fixed maturity securities:				
Gross realized gains	\$22	\$51	\$91	\$124
Gross realized losses	(51	) (12	) (120	) (66
Net realized investment gains (losses) on fixed maturity securities	(29	) 39	(29	) 58
Equity securities:				
Gross realized gains	1	1	2	6
Gross realized losses	(19	) (4	) (21	) (4
Net realized investment gains (losses) on equity securities	(18	) (3	) (19	) 2
Derivative financial instruments	(1	) —	9	1
Short term investments and other	(1	) 1	—	8
Net realized investment gains (losses)	\$(49	) \$37	\$(39	) \$69

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

Periods ended September 30 (In millions)	Three Months		Nine Months	
	2015	2014	2015	2014
Fixed maturity securities available-for-sale:				
Corporate and other bonds	\$36	\$6	\$52	\$9
States, municipalities and political subdivisions	—	—	18	—
Asset-backed:				
Residential mortgage-backed	1	2	7	4
Other asset-backed	—	—	1	1
Total asset-backed	1	2	8	5
Total fixed maturity securities available-for-sale	37	8	78	14
Equity securities available-for-sale -- Common stock	19	2	20	3
Short term investments	—	—	1	—
Net OTTI losses recognized in earnings	\$56	\$10	\$99	\$17

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

September 30, 2015

(In millions)	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Unrealized OTTI Losses (Gains)
Fixed maturity securities available-for-sale:					
Corporate and other bonds	\$17,155	\$1,237	\$207	\$18,185	\$—
States, municipalities and political subdivisions	11,978	1,336	17	13,297	(5)
Asset-backed:					
Residential mortgage-backed	4,850	204	13	5,041	(46)
Commercial mortgage-backed	2,183	77	9	2,251	—
Other asset-backed	1,009	11	4	1,016	—
Total asset-backed	8,042	292	26	8,308	(46)
U.S. Treasury and obligations of government-sponsored enterprises	24	5	—	29	—
Foreign government	333	12	1	344	—
Redeemable preferred stock	33	2	—	35	—
Total fixed maturity securities available-for-sale	37,565	2,884	251	40,198	\$(51)
Total fixed maturity securities trading	3			3	
Equity securities available-for-sale:					
Common stock	62	3	—	65	
Preferred stock	145	4	2	147	
Total equity securities available-for-sale	207	7	2	212	
Total	\$37,775	\$2,891	\$253	\$40,413	

December 31, 2014

(In millions)	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Unrealized OTTI Losses (Gains)
Fixed maturity securities available-for-sale:					
Corporate and other bonds	\$17,210	\$1,721	\$61	\$18,870	\$—
States, municipalities and political subdivisions	11,285	1,463	8	12,740	—
Asset-backed:					
Residential mortgage-backed	5,028	218	13	5,233	(53)
Commercial mortgage-backed	2,056	93	5	2,144	(2)
Other asset-backed	1,234	11	10	1,235	—
Total asset-backed	8,318	322	28	8,612	(55)
U.S. Treasury and obligations of government-sponsored enterprises	26	5	—	31	—
Foreign government	438	16	—	454	—
Redeemable preferred stock	39	3	—	42	—
Total fixed maturity securities available-for-sale	37,316	3,530	97	40,749	\$(55)
Total fixed maturity securities trading	19			19	
Equity securities available-for-sale:					
Common stock	38	9	—	47	
Preferred stock	172	5	2	175	
Total equity securities available-for-sale	210	14	2	222	
Total	\$37,545	\$3,544	\$99	\$40,990	

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The net unrealized gains on investments included in the tables above are recorded as a component of Accumulated other comprehensive income (AOCI). When presented in AOCI, these amounts are net of tax and any required Shadow Adjustments. As of September 30, 2015 and December 31, 2014, the net unrealized gains on investments included in AOCI were net of after-tax Shadow Adjustments of \$1,046 million and \$1,288 million. To the extent that unrealized gains on fixed income securities supporting certain products within the Life & Group Non-Core segment would result in a premium deficiency if realized, a related decrease in Deferred acquisition costs and/or increase in Insurance reserves are recorded, net of tax, as a reduction of net unrealized gains through Other comprehensive income (loss) (Shadow Adjustments).

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The following tables present the estimated fair value and gross unrealized losses of fixed maturity and equity securities in a gross unrealized loss position by the length of time in which the securities have continuously been in that position.

September 30, 2015 (In millions)	Less than 12 Months		12 Months or Longer		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
Fixed maturity securities available-for-sale:						
Corporate and other bonds	\$3,744	\$177	\$188	\$30	\$3,932	\$207
States, municipalities and political subdivisions	655	11	131	6	786	17
Asset-backed:						
Residential mortgage-backed	308	3	211	10	519	13
Commercial mortgage-backed	479	6	81	3	560	9
Other asset-backed	354	4	9	—	363	4
Total asset-backed	1,141	13	301	13	1,442	26
U.S. Treasury and obligations of government-sponsored enterprises	1	—	—	—	1	—
Foreign government	23	—	3	1	26	1
Redeemable preferred stock	3	—	—	—	3	—
Total fixed maturity securities available-for-sale	5,567	201	623	50	6,190	251
Equity securities available-for-sale:						
Preferred stock	3					