# CNA Financial Corporation NYSE:CNA

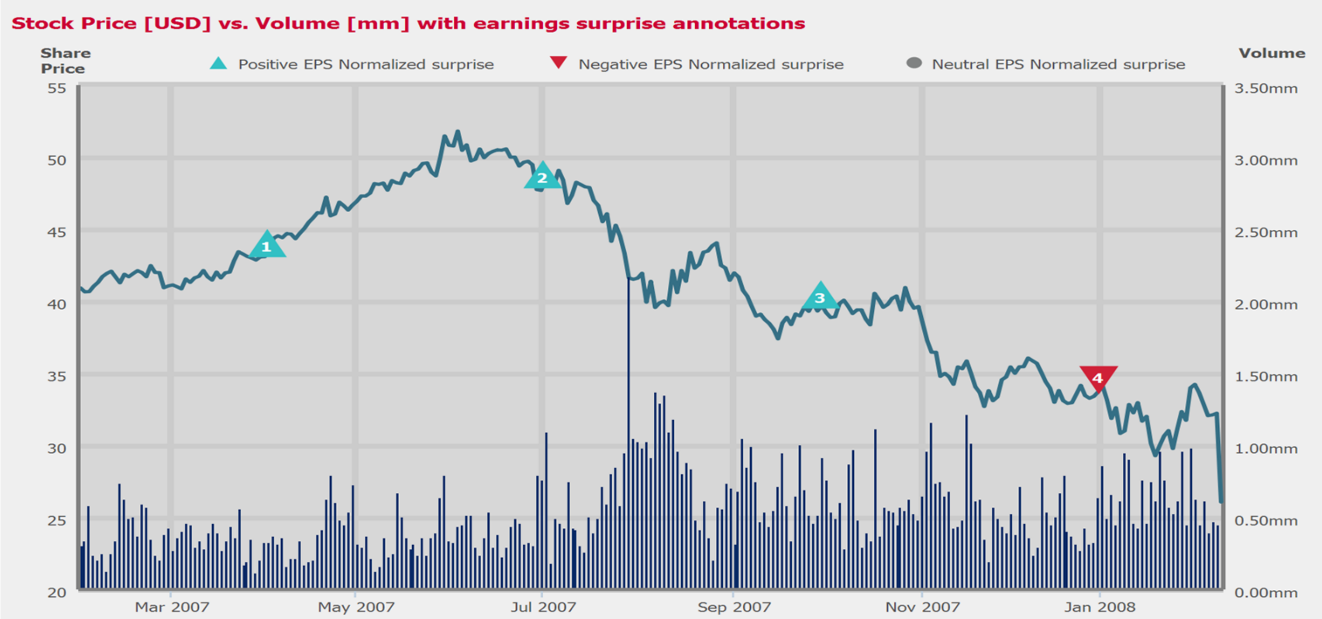
# FQ1 2008 Earnings Call Transcripts

## Monday, April 28, 2008 2:00 PM GMT

## S&P Global Market Intelligence Estimates

| | -FQ1 2008- | | | -FQ2 2008- | -FY 2008- | -FY 2009- |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | CONSENSUS |
| **EPS Normalized** | 1.01 | 0.82 | ▲(18.81 %) | 1.02 | 3.90 | 3.95 |
| **Revenue** | - | - | ▲(1.21 %) | - | - | - |
| **Revenue (mm)** | 1638.80 | 1619.00 | - | 1704.10 | 6451.00 | 6312.90 |

Currency: USD
Consensus as of Apr-28-2008 10:14 AM GMT




- EPS NORMALIZED -

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ1 2007** | 1.03 | 1.13 | ▲9.71 % |
| **FQ2 2007** | 1.09 | 1.17 | ▲7.34 % |
| **FQ3 2007** | 0.68 | 0.78 | ▲14.71 % |
| **FQ4 2007** | 1.02 | 0.82 | ▼(19.61 %) |

# Table of Contents

# Call Participants

**EXECUTIVES**

**D. Craig Mense**

**James R. Lewis**

**Jonathan D. Kantor**

**Nancy M. Bufalino**

**Stephen W. Lilienthal**

**ANALYSTS**

**Bob Glasspiegel**
*Langen McAlenney*

**Charles Gates**
*Credit Suisse*

**Dan Johnson**
*Citadel Investment Group*

**Jay Cohen**
*Merrill Lynch*

**Unidentified Analyst**

# Presentation

**Operator**

Good day everyone and welcome to the CNA Financial Corporation's First Quarter 2008 Earnings Conference Call. Today's conference is being recorded.

At this time, I would like to turn the call over Nancy Bufalino. Please go ahead.

**Nancy M. Bufalino**

Thank you, Steve and good morning. Welcome to CNA's first quarter 2008 financial results conference call. With us this morning are Steve Lilienthal, Chairman and CEO; Craig Mense, CFO; and Jim Lewis, President and CEO of P&C Operations. Hopefully everyone got an opportunity to review the press release and financial supplements, which were released earlier this morning and can be found on the CNA's website.

I'd like to advise everyone that during this call there may be forward-looking statements made and references to non-GAAP financial measures. Please see the section of the earnings release headed Forward-Looking Statements with regard to both. In addition, the forward-looking statements speak only as of today, April 28, 2008. CNA expressly disclaims any obligation to update or revise any forward-looking statements made during this call.

This call is being recorded and webcast. During the next week, the call may be accessed again on CNA's website at www.cna.com. Following the conclusion of today's remarks by senior management, we will be happy to take questions. And with that, I will turn the call over to CNA's Chairman and CEO, Steve Lilienthal.

**Stephen W. Lilienthal**

Thank you Nancy and good morning everybody. Thank you for joining us today.

Before I get started, I'd like to introduce Larry Haefner, who will be succeeding Mike Fusco, as our Chief Actuary. Larry joins us from the Travelers and previously XL, where he held a number of senior actuarial positions. So welcome Larry. I'd also like to thank Mike Fusco for his contributions and very distinguished service over the last several years. Both Mike and Larry are with us on the call today.

Now I am turning to business of the call. While there is certainly is a significant amount of distraction provided by the financial markets, courtesy of the sub-prime and the boarder credit crisis, and while there certainly is a measurable amount of pressure provided by the continuous softening of the insurance markets, CNA continues to grind ahead with focus and commitment through strategies we have talked about for the past several years.

CNA has a highly disciplined and skilled underwriter, as measured by continued sub-100 combined ratios, solid retention levels across a high-quality renewal book, better rate levels than reported by peers and industry observers, reduced new business to appropriate levels given pricing spreads between new and renewal business exactly and at the level that we said we would do five years ago, positive spreads on our renewal efficiency reports which answers the age-old question as how do you know what you are being selected against?

We are also skilled from an operating standpoint, as measured by sub-30 expense ratios for virtually all of the last two-plus years, very much inline and competitive with our peer group, answering the question as to whether or not our expense ratio is a disadvantage? No, it is not.

Continued and aggressive cross-selling across what we believe is one of the highly diversified commercial portfolios in the business; it is also less volatile, less price sensitive than the so called new, new [ph] business. Constant rationalization of our infrastructure as recently as the third quarter 2007 to fit market opportunity needs and our business size, without losing staff which is what we said we would do.

A balanced well spread distribution network, based on the leaders and consolidators and not dependant on or vulnerable to any one sector or segment of the distribution food chain. Our high lease [ph] segment and recently award winning claims operations that has been redesigned and has implemented, things... issues to address indemnity, litigation management, fraud and overall expense issues without missing its staff. Jim Lewis will give you more detail on this in a moment.

CNA is financially quite strong, very liquid and very well-capitalized as measured by the size and quality of its investment portfolio, a very low leverage ratio, including paying down a $150 million of debt in January, continued positive cash flows, stock repurchases of $70 million in the quarter, continued payment of a two-step dividend plan put in place in 2007, a 2007 upgrade from Fitch ratings to A in the face of falling financial and insurance markets to go alone with our A rating from AM Best and stable outlooks from all four rating agencies, our ability to withstand the incredible volatility in the current financial markets without any impact on our day-to-day operations.

I point this out, in the context of once having refocused the business several years ago, we laid a new foundation based on a balance sheet that addressed reserve and bad-debt issues, cut reinsurance receivables and have eliminated our infinite reinsurance, refinanced to prefer with a less expense of debt and equity combination, steadily increase book value, introduce the two-step dividend, purchased back the stock, paid down the debt and delivered record earnings back-to-back for 2006 and 2007.

So, yes the softening markets concern us. But Jim Lewis and I have dealt with this or even more Draconian conditions during 25 years plus of our 36 year careers... respective careers. And yes there sub-prime and credit spread and investment income is of concern to us. But we are large, well-capitalized, liquid and well positioned to deal with this issues which we ultimately believe will resolve themselves. Jim Lewis and Craig Mense will now provide more information on these issues.

But let me conclude my remarks by reminding you that we laid out underwriting operational and financial plans several years ago and we did exactly what we said we would do on-time, on-budget, no excuses and we think the results speak very strongly for themselves. Now let turn it over to Craig.

**D. Craig Mense**

Thanks Steve. Good morning everyone. I am pleased to share our first quarter results. Our net operating income was $221 million, reflecting solid underlying operating performance from our businesses in an increasingly competitive environment, but dampened by a lower level of net investment income primarily related to the decline of limited partnership return.

Operating return on equity was 8.8% below our targeted range. Book value per share declined from year end to $34.79, reflecting the adverse change in unrealized investment gains and losses, which was driven by a significant credit spread widening related to the difficult credit market conditions during the quarter. Our balance sheet remains strong. We have a relatively low level of financial leverage and maintain a high degree of liquidity in our investment portfolio.

Our financial flexibility continues to improve. We chose to retire the $150 million of debt that matured in January. We are pleased to continue to return capital to our shareholders via our quarterly dividend of $0.15 per share. CNA repurchased 2.6 million shares of its common stock in the first quarter at an average price of $26.53 for a total cost of $70 million.

Now I would like to give you a bit more detail on the financials. For the first quarter, net operating income from continuing operations was $221 million or $0.82 per diluted share, compared with $307 million or a $1.13 per diluted share in the prior year period. Net income for the quarter which includes the impact of realized investment gains or losses, as well as discontinued operations was $187 million or $0.69 per diluted share compared with $296 million or $1.09 per diluted share last year.

Property and casualty operations produced first quarter net operating income of $290 million compared to $296 million in the prior year period. The decrease was primarily driven by a lower net investment income, higher current accident year and catastrophe losses. Pre-tax catastrophe losses were $53 million this quarter, which compares to $32 million in the prior year period.

We believe the action we've taken to book higher accident-year loss ratios in response to rate declines is prudent. With respect to non-core segments, Life & Group produced a first quarter net operating loss of $3 million compared to income of $2 million in the prior year period. The corporate segment had first quarter net operating income of $5 million compared to $9 million in the prior year period. As mentioned in previous calls, results for the non-core segment may vary from quarter-to-quarter.

The driver of our first quarter results at our non-core segments was reduced net investment income. The underlying operations continued their orderly run-off. Pretax net investment income in the first quarter was $434 million, compared to $608 million in the prior year period. The primary drivers of the decline were limited partnership results and the trading portfolio.

Our fixed income portfolio continues to deliver steady results. Short-term investments and fixed income produced $550 million of income, roughly comparable to the prior year period income of $553 million and down from the $564 million in last year's fourth quarter. The declines in the fourth quarter reflects the impact of lower interest rate on our short-term holdings.

The change in trading portfolio income on a quarter-over-quarter basis was an $80 million decline, but you'll recall that the trading portfolio results are largely passed on to contract holders. Limited partnership loss is of $39 million this quarter, a negative 1.8% return compared to LP income of $52 million, a positive 2.8% return in the first quarter of '07 and to $41 million, a positive 2% return in the fourth quarter of '07.

Last year's limited partnership returns were $183 million or 9%. It's worth noting that this is the first negative quarterly return that we've experienced in over five years. Our portfolio of limited partnership investment remains a very attractive source of diversification and long-term returns for the company. The volatility is expected and we are confident that they will continue to perform well over the long term.

After-tax net realized investment losses were $33 million this quarter, compared to losses of $30 million in the prior year period. Impairments were $56 million this quarter. Further write-downs of the sub-prime and Alt-A investments accounted for a $29 million of that total. Our invested assets were $41.2 billion as measured by book value, roughly equivalent to year end. Operating cash flow remains positive and we chose to use our improved liquidity and capital position to retire a $150 million of debt maturing in January and repurchased $70 million of our common stock this quarter.

We've again provided expanded disclosure on our financial supplement; please see pages six through nine. I trust, this information along with the disclosures in our 10-Q to be filed later today, will provide you with further insight as well as improved understanding of why we continue to be so comfortable with our portfolio.

During the quarter, you will note that we increased our position in sub-prime and Alt-A exposures by over $550 million, as we continue to find market opportunities to acquire structurally-advanced securities with short weighted-average lives at very attractive prices.

Our investment portfolio ended the quarter with a net pretax unrealized loss of $1.3 billion, compared to an unrealized gain of $74 million at year end. The change in unrealized was primarily the result of significant credit spread widening that took place during the quarter that affected both taxable and tax-exempt securities, and was not related to any specific asset class or sector. We do not consider these losses to be reflective of an overall deterioration of the credit-worthiness or a significant increase in the credit risk in the portfolio.

We continue to sustain our emphasis on expense management which remains a key component of our cycle management strategy. The P&C Ops expense ratio was 28.4% for the first quarter in line with the prior period and an improvement from the fourth quarter of '07. But remember there is some seasonality in our spending levels. We also recognize that the competitive market will continue to pressure our ratios, but we are committed to taking timely steps to sustain our much improved competitive position.

With that, I will turn it over to Jim.

**James R. Lewis**

Thanks Craig, and good morning everyone. Property and Casualty Operations turned in a solid first quarter continuing our run of sub-100 combined ratios. Specialty lines performed well and we continue to strengthen the operating fundamentals of standard lines. As for the market, it's tougher. Retention of good accounts is a battle, new business is a war and regional competitors are especially aggressive. Against this backdrop, our strategies continue to serve us well.

We continued to adjust our mix to business to optimize our portfolio, refine our predictive modeling tools, segment and sub-segment our middle market book, maximize our market and outreach through cross-sell and invest in our people and infrastructure to sharpen our competitive edge. These strategies combined with a well-diversified book of business and a strong market franchise position us well to stay on a profit course.

Now let's turn to a key... few of our key operating metric starting with premium. Property and Casualty Operations' net written premium of $1.6 billion were down 6% for the quarter. Premiums decreased 11% in standard lines and 2% in specialty lines. Overall, our productions levels reflect a disciplined approach to the markets. We won't chase business when we can't make money on it, but aren't shutting our door either. Selective underwriting is our mantra.

In standard lines, we are focused on our underwriting sweet spot and strengthen our position in the competitive small business and small-middle segment. Overall, we like middle market and we know what it takes to win. In construction for instance, our long established programs many of which are endorsed by trade associations have made us a strong competitor. Now we are building the same type of franchise in targeted non-construction segments. The objective is not rapid growth overnight, not in the current markets. Instead we're building a portfolio of good risks and profitable classes. When the market turns back up, we will be positioned to grow our non-construction book.

In specialty, meanwhile we continue to build out our strong franchise, find profitable new niches and shift our book towards more profitable small and mid-sized risks. In our HealthPro business for instance, we are pursuing growth opportunities in long-term care, specialty hospitals and advanced medical technology funds. In other specialty units, we are increasing our penetration of smaller privately-held companies with our packaged management liability products and we continue to strengthen our market-leading programs for lawyers, accountants and other professionals.

Now let's look at rate and retention. For our book of business as a whole, average rates decreased by approximately four points in the first quarter. Standard line was also a little more and fresh [ph] pay lines a little less. But sometimes, we've seen our rates incrementally declining at a rate of about a point per quarter. In the first quarter, however this gradual slide actually came back a point from fourth quarter '07. Not that one quarter makes a trend, but it does reflect our discipline in the market that continues to give up more rate than we do. We are seeing more rates from our competitors and we're reflecting the discipline.

As for our retentions, our book of business continues to hold up very well. Property and Casualty Operations came in at just over 81% for the quarter, up a point from a year ago. Standard lines' retention was 79%, specialty lines was 84% which is a very strong retention in our most profitable business. The 80-plus percent retention we have been reporting since 2006 reflects a normal level of turnover in a quality book of business.

With respect to quality of our renewals, we continue to track the spread between the incurred loss ratios of renewed business, versus non-renewed business. We call this measure renewal efficiency and it tells us whether we are retaining the right business in the right way. Our underwriters are getting in front of renewals early and lock-in demand before bidding more and ups [ph]. Our risk control and claim services give our underwriters something to sell beyond price and when we give up rate we're giving it up on better account that share our focus on managing risk.

Now let's turn to new business and cross-sell. We wrote approximately $274 million of new business in the first quarter which represents approximately 17% of total production. This is exactly where we said we would be and continues to be right where we should be under current market conditions. Most of this new business is coming from our targeted segment. With respect to risk assessment, pricing and terms and conditions, CNA is a bit more conservative than the market and yes, it affects our ability to write new business. However, it enables up to maintain and continue to build a quality book of business, while providing a consistent market presence over time.

As we have discussed with you before, a cornerstone of our new business strategy is cross-sell. Cross-sell allows us to further leverage our well-diversified portfolio. For instance, when we sell a commercial package policy to a manufacturer, we also are looking at the opportunity to sell the international D&O, employment practices liability coverage. Cross-sell like this generated $81 million or 31...30% of total new business in the first quarter.

Now let's turn to loss ratio. Our first quarter net count and year loss ratio was 69 versus 67 in the prior year period, and alliance loss ratio was 74% of prior point, which especially was up 1% to 65%. First quarter loss ratio was pushed up by two major factors, first was catastrophe losses which were entirely under standard lines and second was the continued pressure on rate, the Cat set at 3.2 points to the P&C Ops loss ratio and 6.8 points to the standard lines loss ratio. Simply put, these storms are not abnormal; rather there were a couple of severe tornados that happened to occur in this quarter. These factors more than offset approximately one point of favorable development in P&C in the first quarter of '08. There is more information on the impact of Cats and development on page ten of the financial supplement.

On a net estimate year basis, Property and Casualty loss ratio was approximately 70%, an increase of four points reflected in the aforementioned sectors. Especially our loss ratio underscores the importance of our strategies to protect it. I've already mentioned segmentation predictive modeling and portfolio optimizations, to these I would like to add two other items. First, we continue to invest in our risk-control services which are widely recognized for their excellence. Risk control is the key to optimal risk assessment and selection, particularly in the soft markets. Second, our segmented claims operations, direct routing claims to our low touch [ph] highly automated service center, while the most complex claims go to most experienced adjustors. Not only is our approach cost effective, I'm pleased to add that two weeks ago CNA was recognized with an industry award for claims management excellence.

Now let's turn to combined ratios; in the first quarter we came in at 98%, our 9th consecutive sub-100 quarters. The three-point increase from the prior period is almost entirely related to the loss ratio as previously discussed. Specialty lines' first quarter combined ratio remained in the low 90s, while our Standard lines came in at 104%.

Writing down the combined and standard lines is a priority, we will address in our many funds. In small businesses for instance, we're in the midst of our major system upgrade to automate renewal processes. We're also making it much easier for our agents to do business with us. Earlier this month, our agency interface capability was recognized for excellence with an award from the user group of the leading a vendor of agency management system.

In middle market, we have segmented our $1.8 billion cost in rolling out focused prices and industry programs, that give our underwriters to choose and support their need to penetrate profitable classes. In addition, we continue to refine our predictive modeling and our other underwriting systems. These new tools not only improve risks assessments, they also free up our underwriters to spend more time in agent's office.

In claims, we're addressing the loss side of the combine ratio by enhanced litigation management procedures, medical case management and fraud controls. From the expense side, we're rationalizing our vendor relationships and streamlining work flows. In short, we're putting on a full court press [ph] with one simple objective, improving our standard lines combined ratio.

Turning to our expenditures ratio for a moment, as you heard from Craig our first quarter expense ratio was flat to the prior year period at approximately 28%. With our premiums under pressure in the market, expense discipline becomes an even more important part of our strategy for managing through the cycle.

In summary Property and Casualty Operations had a solid quarter and start of the year. The market continues to test our strategies, but we are responding well with disciplined underwriting, strong retention, appropriate levels of new business and proactive expense management.

There is nothing here new that I haven't told you before. It's all about patient and intelligent participation in the market, optimizing our business mix and being willing to shrink the top lines for the sake of the bottom. In short, we're executing our strategies and we continue to feel good about our ability to maneuver through the softening market.

Operator, we're now available for our Q&A
Question And Answer

# Question and Answer

**Operator**

Thank you. [Operator Instructions]. We'll go to Jay Cohen with Merrill Lynch.

**Jay Cohen**
*Merrill Lynch*

Yes. Good morning. I've got a couple of questions. I guess first on the balance sheet side. If I recall, you began... you are actually buying some sub-prime and I think even Alt-A related securities in the first quarter and I was wondering how those purchases have worked out, because clearly you are kind of trailing at that point. I want to see if those have worked out okay? Mark-to-market standpoint, were there significant marks in the more recent purchases?

**D. Craig Mense**

No. not Jay.

**Jay Cohen**
*Merrill Lynch*

Okay. So, that the marks that we saw were largely the stuff that you had a while ago?

**D. Craig Mense**

No you are talking about the mark across the entire portfolio?

**Jay Cohen**
*Merrill Lynch*

Yes, it was... more specifically in the asset-backed portfolio.

**D. Craig Mense**

No, they are pretty... I mean they are... there were some further declines in the sub-prime and Alt-A marks. But I would tell you that the securities we bought and talked to you about in last quarter turned out well. We're confident and we are confident of the purchases we've made this quarter.

**Jay Cohen**
*Merrill Lynch*

And with these purchases this quarter, can you give us... I'm not sure how to ask the question but, can I get a sense about the spread differential. What kind of extra yield are you getting? I know it's going to vary by security. I'm not sure you can answer it, but can you at least speak qualitatively to it?

**D. Craig Mense**

Well, I think you can... I think you can see it if you look at the supplement of disclosures as well. What we told you before was, we are going to buy structurally advantage securities, high quality at attractive yields with short-weighted average lives, right. And so, I say if you look at the exhibit in the supplement, you'll see that the amount of sub-prime is AAA has gone from 63% of the portfolio to 77%. The weighted-average life which last year I told you.... last quarter I told you sub-prime was 1.7 years, it's now 1.2 years. The weighted average life of all the sub-prime is under one year. Last quarter it was 55% and is now 59%. And I can tell you the yields on these investments are over 10%.

**Jay Cohen**
*Merrill Lynch*

10% yields. Okay.

**D. Craig Mense**

So 10% yield, weighted average life... very short weighted average life and moving up the quality curve.

**Jay Cohen**
*Merrill Lynch*

Okay. Next question, I don't know if you can answer this one either, but second quarter it seems that credit markets have... some spreads have come back in again. Do you have any sense towards say your portfolio what the... what would be happening from a mark standpoint kind of year-to-date... quarter-to-date in the second quarter through this week?

**D. Craig Mense**

I think what you see is our portfolio reaction to market is going to be reflective of the changes in the market. But with the credit spread tightening, the changes won't be that significant.

**Jay Cohen**
*Merrill Lynch*

Okay. Next question, what's the word from Loewe's. I mean clearly you have got to be disappointed in how the stock has performed and the value being associated with CNA by the market. What are they telling you guys?

**Stephen W. Lilienthal**

Jay this is Steve. I think they are telling us to stick to the fundamentals of the business, which has gone quite well for the past several years. They have given us guidance not to look at stock market via report card but let the operating results speak to that and they have also told us that they believe that the underlying quality of the company would emerge again as it had just recently, as all of these issues settle down, as we believe they will.

**Jay Cohen**
*Merrill Lynch*

And the last question may be for Jim Lewis, do you guys think you can keep the overall combine below a 100 over the next couple of years. Just giving the direction of the market, is it a sort of forgone conclusion that it goes above a 100?

**James R. Lewis**

There is no question that we're feeling pressure, when you look at where rates are going and as we look at the marketplace that we're in right now, we think we're actually doing better than the overall market if you believe external surveys of late. But it is having pressure on the overall loss ratio. That's why within my remarks what I've really indicated is there's not going to be one look silver bullet, that's really going to help us to protect the overall loss ratio. It's a multitude of things. We've talked about portfolio optimization and then in our specialty portfolio, we have been optimizing every part of that portfolio with all the different crisis and sub-segments of business that we have either within helpful, within our pro-commercial open brokerage part of our book, we shifted that book from large accounts to the smaller mid-sized accounts. We've actually increased our overall writings of specialty in our overall book of business.

Last year especially, our net premium basis to the first quarter represented 50% of the book. It's now up to 52% and I think you'll continue to see specialty via place that we will continue to grow, especially with the combine ratios that we have in that portfolio and the fact that there are still opportunities to cross-sell into that book. In our middle market part of the portfolio, we have been optimizing the portfolio from an account-size perspective. Also from an industry perspective, we've launched several classes of business, focused prices in the fourth quarter and the first quarter of this year, we'll continue to launch those throughout this year. We will be launching 3-5 classes of business that these are classes that as we've looked at our historical loss ratio over a ten-year period, they actually have the best loss ratios of our overall book of business. We are not only just launching those, we are also using our predictive modeling tools to help as rewrite new business in those targeted classes as the predictive modeling gives our underwriters a lot more direction, we get a lot more consistency on how we are pricing the new business and target, which ones to really go after are the better performing account, what the walk away price will be and we're using that same tool as respect to our renewable.

Small business has been a key investment for us. That's a place where we have made a huge investment in technology product and we have made an investment in technology. That is really paying off for us; we are starting to see traction in our small business part of the portfolio. We have talked about this in the past as far as our new business writing is there. We are also emphasizing the lower end of middle market within small business and new rise [ph] in our technology and our current products to go after that lower end of the middle market which is the most profitable piece of the overall portfolio, indicated that we were recently recognized by an agency interface management group for the technology that we have and the ease of business that we are creating on the small size. We have got our risk control operations that we already consider as lower class and as [Inaudible] we look at, are we still at risk? How we service the risk so that we are really just getting away from a pricing side of the equation. From a claim standpoint, we have been [Inaudible] already the management procedures, our medical case management, our overall fraud control.

We have a much more efficient operation. We are actually sending all of our low touch claims into an automated service center. So we've segmented so that that service center handles a low touch claims [ph] for the more complex claims, we are going to assign those to our adjustors. From a expense standpoint we're looking at quality prices we can really get in our overall operation and so we're taking a look at the end-to-end processes in every part of our operations; in claims, in risk control, even in our on middle market underwriting side of our operations.

And just to give you an example of something that we think is going to pay dividend on the efficiency side for small business is we just automated our overall renewal process. We had a process where every renewal was being touched by someone in the overall organization. Now, we actually have that the whole end-to-end process automated where the 50% of our renewals are automatically going through our rolls engine and not being touched. Over time we think we can get that to 70% of those items.

So as I indicated it's not one thing. It's really focused on the fundamentals and making sure that we're doing the right thing to protect the loss ratio and I think you can say Jay we're actually doing that when you look at what's happening to the top line. And our top-line is down 11%. And the top line is down 11% in standard lines and again it's primarily in middle market, which is the place where we're seeing the most pricing pressure and we're not going to chase business. It's in large property, where I'm amazed to see how the capacity is being utilized on the coast and people have forgotten that there was a hurricane. And then it's down to risk management and casualty. The overall pricing terms there have gotten to the point that is really becoming very tedious [ph] and so we're not planned. So we are doing the things to protect the bottom-line and walk away when we can't really get rates and terms that we think are going to be attractive in the market for us.

**Jay Cohen**
*Merrill Lynch*

Great. Thanks Jim.

**Operator**

We'll go next to Charles Gates with Credit Suisse.

**Charles Gates**
*Credit Suisse*

Hi. Good morning. My first question; could you zero down on some of the key components of limited partnerships which contributed to the swing in results there?

**D. Craig Mense**

Charlie this is Craig Mense, again. I don't mean... that's just really a reflection of what was going on in the market last quarter and there wasn't a whole lot that went right in the market last quarter, I think if you recall. So I think what's important to know is that the LPs are well diversified across strategies, we have over 90 different limited partnerships that we invest in. Yes, the results produced the negative 1.8% return last quarter, but last year as I said the returns were 9% and if you look back on time on a rolling ten-year basis, the returns were over 13% and on a rolling five-year basis they were 16%.

**Charles Gates**
*Credit Suisse*

Are the preponderance of this limited partnerships real estate-based?

**D. Craig Mense**

No, there's very little real estate, little private equity, but the best way to think about it, think of that negative 1.8 debt return against the S&P was down over 6%.

**Charles Gates**
*Credit Suisse*

Is there any place where analyst or observer can get good insight into the structure of those limited partnerships?

**D. Craig Mense**

Whatever you can see from the stats line, but that's really... and we've not talked about it before at investment presentations and conferences. But we don't disclose a lot of details about those expect that what I have said to you before about the degree of diversification and the long-term performance.

**James R. Lewis**

And I would just reiterate, we are very confident of the long-term performance there.

**Charles Gates**
*Credit Suisse*

My second question. To what extent were insurance underrating results; say in E&O and D&O adversely impacted by the sub-prime mess?

**Jonathan D. Kantor**

Well, this is Jon Kantor. If you are asking about claims activity...

**Charles Gates**
*Credit Suisse*

Yes sir, that's what I was trying to do.

**Jonathan D. Kantor**

Yes, I mean there's not... no material adverse developments since the last quarter when I reported in pretty much detail the situation with sub-prime. Just to recap very high level, I mean... our financial institutions book was $72 million of premium in '07, which was only 2% of our overall specialty book. We are not a very big player in the financial institutions.

**Charles Gates**
*Credit Suisse*

One of you said that I think the worst part of the market... may be I got this wrong, was what you call the middle-market. How do you define the middle market?

**James R. Lewis**

Yes, this is Jim Lewis. On the middle-market if you just kind of... and this just a kind of an arbitrary definition; if you look at small business, small business is the low touch type of business where you can use automation as a means to handle it. You can either preset roll engines that you would have the low touch claims and low touch type of business going through this. If you look at it from a volume standpoint or a premium size, it is primarily accounts that are 50,000 and under. Middle market then goes really from the 50,000 up to roughly $1 million from an account size perspective.

**Charles Gates**
*Credit Suisse*

So it's $50,000 roughly to $1million.

**James R. Lewis**

Right and as I look at that middle market, we have sub-segmented the middle market. The most profitable part of our middle market book are the accounts that are 250,000 and less. And that's why we've got an emphasis to when using our technology and our product from small business to even write more of our share of that book of business. Where we're seeing the most pricing pressure is really accounts that are greater than $500,000.

**Charles Gates**
*Credit Suisse*

Roughly... and I realize this is a tough question, roughly what portion of your... this is my last question; roughly what portion of your standard markets business is this roughly $500,000 to a $1 million in annual premium?

**D. Craig Mense**

We don't have a number exactly right now for you Charlie, but I can get that for you.

**Charles Gates**
*Credit Suisse*

Thank you.

**Operator**

And we will go next to Bob Glasspiegel with Langen and McAlenney.

**Bob Glasspiegel**
*Langen McAlenney*

Good morning and you get it all right. Good job. Your answer to Jay's question on how upset Loewe's is given how the stock is doing. It seems to me... this is an observation, I mean the most recent weakness is more related to investment portfolio and the partnership results, I am correct that they are sort of running that correct, Loewe's manages the portfolio?

**D. Craig Mense**

Yes they do and that's obviously where the majority of the issues that we're talking about this quarter and last and the fundamental operation that Property and Casualty business has performed quite well through not only this quarter but over the past several. So, I wouldn't describe Loews' position as being like extraordinarily worried or whatever. I mean they're asset investment manager and they want to do the right thing in terms of maximizing the return.

**Bob Glasspiegel**
*Langen McAlenney*

Right and my perception from outside is that Loewe's has done an outstanding job creating long-term shareholder value from investment point of view, recognizing their contrarians and often take outside the bucks, positions that are controversial. If my perception is wrong, correct me and may be the next investor day you might want to outline how your overall portfolio over time has created excess value and shareholders?

**D. Craig Mense**

I think Bob that was fairly put and we'll take you up on that point for our next investor day.

**Bob Glasspiegel**
*Langen McAlenney*

Okay, how much wriggle room do you have with respect to capital on A) buyback, B) taking more risky assets on the portfolio before rating agencies might give you some pull back?

**D. Craig Mense**

I don't think we can. I can't give you... this is Craig. Bob, I can't give you a number but I would just tell you that certainly our capital position has improved significantly over some period of time and you can see that and the decisions we made about retiring the debt that came to in January. And so that's indicative of improved liquidity, dividend capacity at the insurance company level and improved capital strength relative to rating agencies or how we looking at ourselves. So, we have significantly more room and flexibility than I think, we're given credit for.

**Bob Glasspiegel**
*Langen McAlenney*

Let me rephrase the question. How much excess capital do you think you have right now, to maintain your ratings?

**D. Craig Mense**

We are not prepared to disclose that or talk about that Bob.

**Bob Glasspiegel**
*Langen McAlenney*

Hundreds of millions of dollars? Is that bigger than a bread basket... box or smaller?

**D. Craig Mense**

I think let me just... rather than saying that if you look at dividend capacity and the casualty company, hundreds of millions of dollars and you look at the flexibility we have on the debt side, next portfolio the level of the low level leverage we have which would be indicative of our ability to raise leverage if we needed to and at appropriate time. So I think we have lots of... you can just say, we have much improved financial flexibility.

**Bob Glasspiegel**
*Langen McAlenney*

Where could you take your adjusted capital just to keep your ratings?

**D. Craig Mense**

And we haven't really talked to the rating agencies about it. We have said before that we are comfortable at 20%.

**Bob Glasspiegel**
*Langen McAlenney*

Okay, well that at least gives me one number I can calculate, I appreciate. I am numbers guy, sorry. Thank you.

**D. Craig Mense**

You are welcome.

**Operator**

We will go next to Dan Johnson, Citadel Investment Group.

**Dan Johnson**
*Citadel Investment Group*

Thank you very much. Let's see. Can I follow up on Charlie's question on the LPs if its not real estate then its not priced at equity, those are typically what we see when people talk about their limited partnerships as opposed to say, alternative investments which typically would qualify hedge funds and other such similar vehicles. So can you at least buy some sort of categorization, tell us a little bit more about what's in the LPs?

**D. Craig Mense**

Well, as I said it's a broad variety of strategy. So... and I didn't mean to say that there was no real estate and no private equity as you sell a smaller portion. But we do some fixed income arbitrage, some risk arbitrage, there is some global macro strategies followed, there is a little... there is some equity-related value strategies, there is some distress strategies as a result of some long short equity plays in the --

**Dan Johnson**
*Citadel Investment Group*

I got. This is a definitional issue and whereas some people break it out into those two categories, alternatives and LPs. You guys have may be more than one bucket and they all go in there and it might be more alternatives and less LPs than the name would imply and therefore the equity sensitivity to it?

**D. Craig Mense**

I think that's fair.

**Dan Johnson**
*Citadel Investment Group*

Okay thanks very much on that. Then if we go to the Alt-A and the sub-prime pieces, kind of hard to exactly tie this out. But can you give us a rough sense as to what your view via the mark you took through the AOCI, what sort of reduction percentage-wise we thought was appropriate for sub-prime and specifically Alt-A in the first quarter? Thank you.

**D. Craig Mense**

And I'm sorry Dan... you're asking what we thought was appropriate or how much we took?

**Dan Johnson**
*Citadel Investment Group*

Well I was actually assuming those were probably the same. So actually what you took?

**D. Craig Mense**

Well, what we took was about another... remember that the prices where we're using are market prices, here. So and we're using independent. Our primary evaluation and data source for pricing is independent pricing services, as well as broker dealers. So, those are market prices and I think that, overall the sub-prime and Alt-A, the decline in unrealized is about a $100 million on the sub-prime. So and I would say that we think the market prices are not reflective of the underlying value of those investments.

**Dan Johnson**
*Citadel Investment Group*

That $100 million is your cumulative mark, not the one that you took in the first quarter?

**D. Craig Mense**

That's right, that's the cumulative.

**Dan Johnson**
*Citadel Investment Group*

Right and that's kind of where I was going just in the sense things had moved around quite a bit in the first quarter. That's where I was curious as to what sort of marks you took there?

**D. Craig Mense**

Did I answer your question or?

**Dan Johnson**
*Citadel Investment Group*

Well actually I think you helped with... if I did the math right, I've got your cumulative marks, it would look like the sub-prime and the Alt-A took very low sequential marks in the first quarter. But I can't tell you that I have that number perfectly calculated so, we...

**D. Craig Mense**

You can look at those sequential marks and you can also remember that we did impair, we took about 29 million after-tax impairments against those securities in the first quarter. So it was a relatively small change.

**Dan Johnson**
*Citadel Investment Group*

Okay. Then finally may be more on operational front, can we talk about the warranty business that was highlighted in the press release, just may be a little more color about where the... what sort of products were generating the... what I thought was a reserved redundancy and may be from years that came from?

**James R. Lewis**

Yes. On our warranty business itself, this is an automobile warranty business that we have in place. It is located out of Arizona and they provide the vehicle warranties. They also provide the warranties from a motorcycle perspective. And that's really limitative... their operation is providing the warranty services on non-vehicles and also on the motorcycles and then also handling the claims with respect to those particular two-items.

**Dan Johnson**
*Citadel Investment Group*

Okay.Thank you very much.

**Operator**

We'll go next to Bill Van Ornum [ph] with Principal Global Investors.

**Unidentified Analyst**

Good morning. I guess a couple of my questions have been answered. But I guess just for further clarification on investment partnerships. First are the sub-prime asset-backed securities, are they part of the investment partnerships or are they separate?

**Stephen W. Lilienthal**

The majority... vast majority are separate. Those are all detailed in supplement. We do have another about little less... about $20 million of sub prime exposure in the limited partnerships.

**Unidentified Analyst**

And since Loewe's is involved in these partnerships are they also involved in the sub-prime investments?

**Stephen W. Lilienthal**

I think that... the answer to the question was Loewe's is our investment manager. So we do sub-contract... I mean Loewe's does manage all of the CNA's investments.

**Unidentified Analyst**

Okay, got it. And I guess so far in the second quarter on the marks that are on the fair market value that you're taking, I assume the fair market value estimates are actually doing the opposite of what happened in the first quarter. Is that correct?

**Stephen W. Lilienthal**

There has been a rally in the... on the credit side to the market. But remember, risk-free rate have also increased some. So as I said our marks going to be relatively reflective of what's happening in the market. So in the intermediate term, funds are going to see some increase in the risk-free rate and you will see credit spread coming in quite a bit, while offsetting a lot of that particularly at the longer end.

**Unidentified Analyst**

Okay and I guess final question. Just how large an investment are you willing to make in this area?

**Stephen W. Lilienthal**

We are not prepared to talk about that. I'll just reiterate were confident in the ones we've made and were confident going forward, extremely confident.

**Unidentified Analyst**

Thank you.

**James R. Lewis**

This is Jim Lewis, Charlie. I haven't answered your question on how much of our middle market book is greater than 500,000 in premiums. Our overall middle market book is $1.8 billion and 20% of that is greater than $500,000.

**Operator**

And we have a follow-up question. Jay Cohen, Merrill Lynch.

**Jay Cohen**
*Merrill Lynch*

Yes, back to the limited partnerships, I'm assuming that the losses that are showing up this quarter the $35 million roughly, those are essentially marks. In other words if those same investments were held in your regular portfolio, if they would not be going through... much of it or some of that wouldn't be going through the P&L. Is that fair?

**D. Craig Mense**

That's right. All of the changes in market values in the limited partnerships goes to the P&L. So we account of those on equity methods.

**Jay Cohen**
*Merrill Lynch*

Can you say how much of that related to marks versus real losses?

**D. Craig Mense**

No, I don't think. I mean those are just... those are changes in equity value. So I don't know that I really differentiate that in terms of how we account for it.

**Jay Cohen**
*Merrill Lynch*

Fair enough. Okay, I get it. Thanks.

**Operator**

We'll go to Charles Gates, Credit Suisse

**Charles Gates**
*Credit Suisse*

Thanks you for the follow-up. I guess two questions. If one was to zero-in roughly on that $450 million of sales in that specific market, what kind of pricing competition are you seeing there?

**D. Craig Mense**

I think... let's just talk about middle market in general. When we look at middle market pricing, our rates in the quarter were down six points, slightly up from where it was in the fourth quarter by a half a point. But what we're seeing is increased pricing competition across the portfolio, but more on the larger side and it's really coming from everywhere. The regional carriers are getting significantly much more aggressive that used to play in the lower end of middle market and they are beginning to play in the upper end of middle market on an individual risk basis.

If someone really wants to go after an individual account, even though rates are going down, six points in reality, the rates for that account so far it could be anywhere from 10-15-20 points for an individual risk. But in the aggregate we have been able to up to manage the overall portfolio where that... our reserve has only gone down six points. But we know that if an account goes to the market, that particular account could be priced a lot more aggressive which is why, our underwriters have done a very good job of getting up front on pricing and really locking in overall rate levels itself.

But this is the point right now in the middle market that we play very close attention to the prices. We give a lot directions based on accounts size by industry segment itself to our underwriters from a new and a renewal perspective. And that's why when you look at our standard lines, our middle market volume is down and down the prior year just as a result of what we are seeing with rates and the fact that we are walking away from business because of the rate levels.

**Charles Gates**
*Credit Suisse*

Maybe I got you wrong, but you said pricing was up, a half a point versus the fourth quarter, I didn't understand that?

**D. Craig Mense**

This was for middle market overall. If you look at middle market rate levels in middle market were down six points for the quarter but it was actually up roughly a half a point from fourth quarter of '07.

**Charles Gates**
*Credit Suisse*

The other question that I had was the fact that basically to what extent... is it the regional companies or a regional company your small written that aren't they, as far as what they're writing?

**James R. Lewis**

There's smaller, but I think normally what they would go after is the lower end accounts anywhere from $50,000 to $150,000 but now in order to grow the overall top line with the economy slowing and there is not a lot of new, new business, what they are doing is rack it in up their overall appetite. So now what they're doing is plans fully offset or they're normal appetite level until it's not surprising. They're really going after at very aggressively accounts that are $500,000 or more and the question you had that is just that. Do they have all of the capability from risk controlling claim standpoint to really handover their business.

But they're much more aggressive on that upper end now just because the there is not a lot of new, new business. It's moving and there is not a lot of new business that's being developed to where from an investment standpoint. So to grow the top line they're now expanding beyond their normal appetite.

**Stephen W. Lilienthal**

This is Steve Lilienthal just to add in addition to Jim's clarify middle market or regional carry is coming out market and playing out of their box and getting into some foreign turf for themselves. The large cap market whether it's a standard casualty book or the specialty lines is actually the most --. So to checking around for worthy competitors, you might want to take a look at that when you get some of these guys on the phone find out what that market's looking like. Now, we retreated from that market very quietly 3 or 4 years ago. So we're not experiencing the same volatility that some of our brethren are experiencing out there competing with Fortune 250 or 500 accounts. So... and that's pretty much across the port. Our comp has heated up big time based on the proceed advantages of benefit improvements or containment which we think is more notional than real and the excess comp markets come white hot. So that's the stuff that's out there. Much of it is not within CNA's appetite, we kind of moved away from that a long time ago.

**Charles Gates**
*Credit Suisse*

But it's the very large risk as you said the Fortune 250, it's probably the most competitive market place.

**James R. Lewis**

250 to 500, yes.

**Charles Gates**
*Credit Suisse*

The final question, what do you see as the impact on the industry in total of the acquisition of Cisco by Liberty Mutual.

**Stephen W. Lilienthal**

I think that's got to play out Charlie. I think... We were very interested to see that, that acquisition take place. We think we understood it. We thought it was very expensive. So I guess we will just have to see how to play that. I think there is lot of executional risks that is embedded there, a lot you know not a lot of these good size mergers have been successful over the last couple of years. So we are hoping that this opportunity for CNA as these two companies go together and create some disruption with the distributors. That's quite frankly what we are interested in and so we will see.

**Charles Gates**
*Credit Suisse*

Thank you.

**Operator**

This will conclude our question-and-answer session. I would now like to turn the conference over to Nancy Bufalino for any additional or closing comments.

**Nancy M. Bufalino**

Thank you Steven. Thank you all for joining us today. A taped replay of today's remarks will be available for one week immediately following this call until May 5th. Please see the earnings release if you have any doubts. We appreciate your participation in today's call and thank you again.

**Operator**
This does conclude today's conference. Thank you for your participation. You may now disconnect.