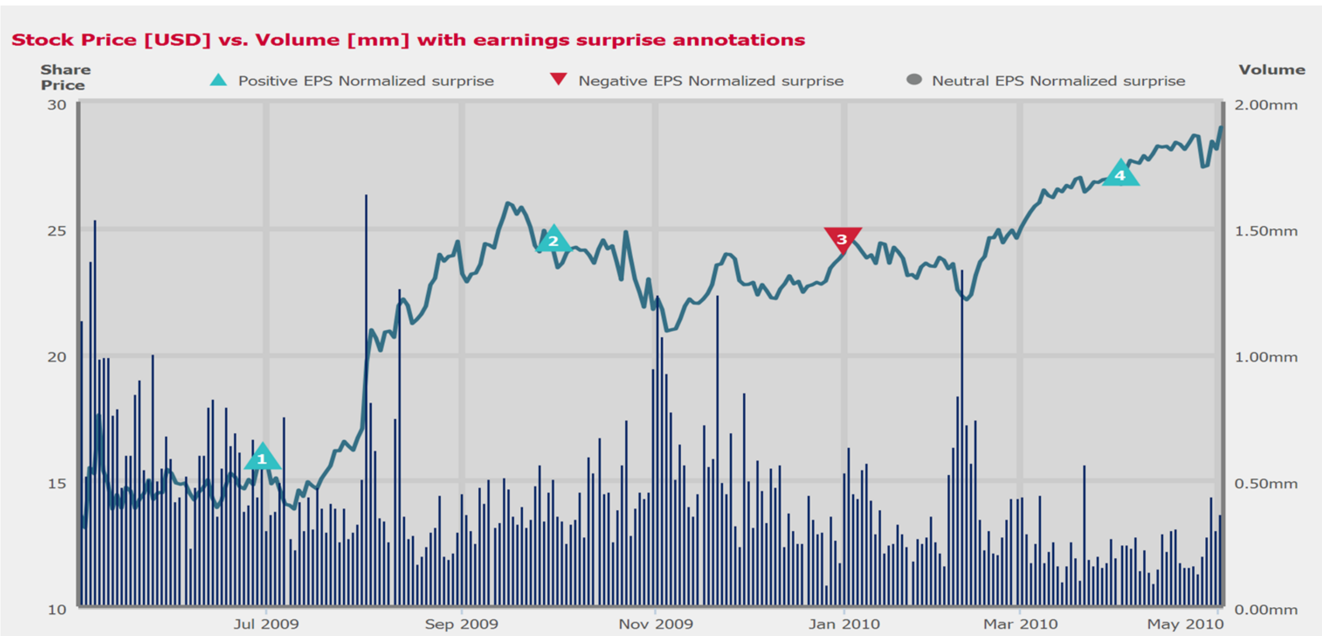
S&P Global
Market Intelligence

CNA Financial Corporation NYSE:CNA
FQ2 2010 Earnings Call Transcripts
Monday, August 02, 2010 2:00 PM GMT
S&P Global Market Intelligence Estimates

	-FQ2 2010-			-FQ3 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.58	0.91	▲56.90	(0.09)	2.90	2.83

Currency: USD
Consensus as of Aug-02-2010 12:16 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2009	0.68	1.02	▲47.83 %
FQ3 2009	0.87	1.11	▲27.59 %
FQ4 2009	0.73	0.63	▼(13.70 %)
FQ1 2010	0.65	0.74	▲13.85 %

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Nancy Bufalino

Tom Motamed

ANALYSTS

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Jay Cohen

Ron Bobman
Capital Returns

Presentation

Operator

Good day, everyone, and welcome to the CNA Financial Corporation second quarter 2010 earnings conference call. Today’s program is being recorded. At this time for opening remarks, I’d like to turn things over to Ms. Nancy Bufalino. Please go ahead, ma’am.

Nancy Bufalino

Thank you, Kelly [ph], and good morning, everyone. Welcome to CNA’s discussion of second quarter 2010 financial results. Our press release was issued earlier this morning. And hopefully, everyone has had an opportunity to review it along with the financial supplement, which can be found on the CNA Web site.

With us this morning are Tom Motamed, our chairman and chief executive officer; and, Craig Mense, our chief financial officer. Tom and Craig will provide their remarks about the quarter, and then we will open it up for questions.

Before we get started, I would like to remind everyone that during this call, there may be forward-looking statements made and references to non-GAAP financial measures. Please see the sections of the earnings release headed "Financial Measures and Forward-Looking Statements" for further detail.

In addition, the forward-looking statements speak only as of today, August 2nd, 2010. 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 week, the call may be accessed again on CNA's Web site at www.cna.com.

And with that, I'll turn the call over to CNA's chairman and CEO, Tom Motamed.

Tom Motamed

Thank you, Nancy. Good morning, everyone, and thank you for joining us today. We are pleased to report on our second quarter, which was marked by solid operating and financial performance as well as an important agreement to transfer CNA’s legacy asbestos and pollution liabilities to National Indemnity Company, a subsidiary of Berkshire Hathaway.

Second quarter net operating income was $269 million or $0.91 per common share as compared to $305 million or $1.02 per common share in the second quarter of 2009. Net income was $283 million or $0.96 per common share, compared with $105 million or $0.27 per common share in 2009. Our results were driven by favorable prior year loss development, substantial investment income, and positive real life investment results.

We are also pleased to report improvement in our capital position. Book value for common share increased 13% from year-end 2009 to $40.43, reflecting $10.9 billion of GAAP common shareholders' equity.

In our core property and casualty operations, the second quarter combined ratio was 89.4, compared with 98.1 in the second quarter of 2009. The difference is primarily due to 18.4 points of favorable prior year loss development, compared with 4.9 points in last year’s second quarter. In addition to development, the combined ratio included 3.3 points of catastrophe losses, as compared to 2.9 points in the second quarter last year. Before development and catastrophes, the second quarter combined ratio was 104.5 as compared to 100.1 in 2009.

The accident year ex-cat loss ratio was 70.2 in the second quarter as compared to 68.6 in the prior year period. The 2010 accident year ex-cat loss ratio was 69.3 as compared to 69.1 in 2009.

Net written premiums decreased 7%, reflecting the ongoing competitive market and weak economy. We continue to execute our underwriting strategy to improve the profitability of our commercial segment. The second quarter of property and casualty expense ratio increased 2.3 points to 33.8, approximately one point is attributable to reduce earned premium. The other point relates to the investments we are making in our field operations.

CNA specialty continues to perform very well, delivering a combined ratio of 79, compared with 89.8 in the second quarter of 2009. These ratios benefited from favorable prior year loss development of 18.6 points and 5.1 points, respectively. Catastrophes added a 0.5 point, compared with 0.3 points in the second quarter last year. Before catastrophes and development, specialty's combined ratio was 97.1, compared with 94.6 in the second quarter of 2009. The increase was driven by higher expenses and the impact of negative earned rate.

Specialty's accident year ex-cat loss ratio was 66.3 in the second quarter as compared to 65.2 in the prior year period. The 2010 accident year ex-cat loss ratio was 65.9 as compared to 65 in 2009.

Specialty's net written premiums declined 1% in the quarter and 2% year-to-date. With respect to renewals, our rates decreased 2%, a slight deterioration from the prior year period. Retention improved one point to 85%. The ratio of new-to-loss business in specialty was 1.2 to 1. Quarter-over-quarter submissions increased 20%, and new policies were up 10%.

Turning to CNA commercial, the second quarter combined ratio was 98.2, compared with 104.6 in the prior year period. These ratios benefited from favorable prior year loss development of 18 points and 4.5 points, respectively. Catastrophes added 5.7 points, compared with 4.8 points in the second quarter of last year. Before catastrophes and development, the combined ratio was 110.5, compared with 104.3 in the second quarter of 2009.

A recently discontinued segment in CNA select, our excess and surplus lines division, had a three-point impact on the loss ratio this quarter. The three-point expense ratio increase is primarily related to decreased net earned premium and the important investment we are making to improve commercial’s long term health by adding to our production and underwriting capabilities. In addition, last year’s second quarter benefited from favorable dividend development related to worker's compensation coverages.

Commercial accident year ex-cat loss ratio was 73.3 in the second quarter as compared to 71.2 in the prior year period. The 2010 accident year ex-cat loss ratio was 72 as compared to 72.3 in 2009. Commercial's net written premiums decreased 11% in the quarter and 10% year-to-date. Four points of the year-to-date decline were from decreased exposures and returned premiums.

One of the hardest hit areas was our construction business, which accounts for 20% of our commercial segment. Its net written premium decreased 19% year-to-date. The decline in commercial's net written premium also reflects our decision to significantly reduce our large property portfolio, where we believe pricing is inadequate as well as our ongoing practice of non-renewing accounts if we cannot get the necessary price.

Rate increases were 2% in the second quarter. Retention declined one point to 79%. And the new-to-loss businesses ratio was 0.8 to 1. We believe that achieving rate increases while accepting lower retention is a more favorable long term approach to improving profitability. Second quarter submissions in commercial were up 10%. However, our written quoted ratio decreased two points to 25% in line with our more selective underwriting and pricing strategy.

Before turning it over to Craig, I would like to comment on two recently announced transactions starting with the agreement to transfer our legacy asbestos and pollution liabilities to National Indemnity. We believe the benefits of the agreement are compelling. It will effectively eliminate the overhang from these legacy liabilities. The $4 billion in reinsurance cover will give us the survival ratio of more than 20 years, which we feel puts these liabilities behind us. We will free up capital that can be directed to support our ongoing business strategies. Finally, the transaction will simplify our cost structure, with National Indemnity assuming the claims handling and reinsurance collections, we will eliminate annual cost of approximately $20 million.

In June, we also completed the sale of our worker's compensation business in Argentina. The sale is consistent with our desire to focus on the United States, Canada, and Europe as our core geographies. Craig will provide more details on both transactions along with his regular review of the quarter. Craig?

Craig Mense

Thanks, Tom. Good morning, everyone. Highlights of the second quarter include net operating income on $269 million and operating return on equity on 9.5%, and net income of $283 million. The quarter also marked the 14th consecutive quarter of favorable P&C reserve development.

Book value for common share increased 6% from the end of the first quarter of 2010 to $40.43 per share, reflecting our earnings and a continued meaningful improvement in the market value of our investment portfolio. Book value per share has increased 13% from year-end 2009, and is up 47% as compared to June of 2009.

We announced two transactions since our last call, the agreement to transfer our legacy asbestos and pollution liabilities and the sale of our operations in Argentina that will improve our capital efficiency and sharpen our focus on CNA's ongoing business strategy. Overall, the second quarter reflects CNA's the same focus and measurable progress on delivering improved levels of both earnings consistency and financial stability.

As you heard from Tom, our net operating income was helped by $264 million of pretax favorable prior year reserve development in our core property and casualty operation. This lowered our account to year loss ratio by over 18 points. We recognized favorable development in first party property lines associated with both non-catastrophe and catastrophe losses in the two most recent accident years. We also recognized substantial favorable development in auto and professional liability lines from accident years 2007 and prior.

The reserve releases were driven by better than expected loss frequencies as well as favorable individual claim outcomes. The decisions were based on the analysis completed this quarter, which covered approximately 30% of our reserve base. Our specialty business continues to perform very well while we continue our progress toward re-profiling the commercial business and improving its profitability.

Net operating income included pretax net investment income of $521 million, a decrease of 23% from the prior year period. The unfavorable year-over-year comparison is driven by limited partnership investment results.

Our LP investment produced a second quarter pretax loss of $4 million as compared to the rather exceptional $165 million of income during the second quarter of 2009. Our LP investments are performing as expected and continue to produce higher accumulative returns and less volatility than equities.

Second quarter and year-to-date rates of returns for our LPs were a negative 0.2% and a positive 3.8%, respectively. These returns compared to a negative 11.4% and a negative 6.7% for the S&P 500 total return index for the same respective periods.

Pretax income from the remainder of our portfolio, mainly fixed maturities, increased 3% from $510 million to $525 million, largely as a result of the year-over-year reduction in our short term position.

Second quarter net income of $283 million included real life capital gains of $13 million. Those results include the impact of $37 million of impairment. Almost all of those impairments reflect intense to-sell decisions that are part of our ongoing management of the portfolio. Credit impairments accounted for less than $9 million of the total.

The market value of our investment portfolio increased more than $600 million over the course of the second quarter. The portfolio's pretax net unrealized gain was approximately $1.2 billion at June 30th, 2010. This compared to a $25 million net gain position at year-end 2009. The portfolio evaluation improvement was driven by investment grade corporate and the continued recovery of our structured portfolio.

We made very little change to our investment portfolio of asset allocation during the quarter. We continue to effectively run off our non-agency RMBS portfolio. This asset class was reduced another $375 million from $3.8 billion to approximately $3.4 billion. We also continued to shift our state and municipal investments from tax exempt to taxable holdings, including approximately $900 million of net purchases in the second quarter.

Our cash and short term position increased to $3.1 billion at quarter-end as compared to $2.6 billion at the end of the first quarter 2010 as we begin to accumulate cash to affect the asbestos and environmental loss portfolio transfer transactions. Overall, our investment decisions continue to reflect our sustained emphasis on diversification, quality, and liquidity as well as the importance of insuring that our portfolio is aligned with our business objective.

The average credit quality of the fixed maturity portfolio remained unchanged from the prior quarter. We continue to segment our portfolio to facilitate our asset net liability management discipline. The effective duration of the assets, which support our traditional P&P liabilities was 4.2 years at quarter's end, down slightly from 4.4 years at the end of 2010's first quarter and reflective on the increased short term position. The effective duration of the assets, which support our long duration life-like liabilities had a duration of 11 years, virtually unchanged for the first quarter and in line with portfolio targets.

Our capital position and balance sheet remained very strong. We continued to maintain a very conservative capital structure and to exhibit a strong liquidity profile. Our operating cash flow has continued to be robust. In the second quarter of 2010, we generated approximately $150 million of operating cash flow, excluding trading activity and after paying preferred dividends. Additionally, during the quarter, we received nearly $900 million of principal cash repayments through pay-downs, bond calls, and maturities.

All of our capital adequacy metrics are well above our target levels and will be further enhanced after the pending loss portfolio transferred transaction is closed. Our statutory surplus totaled $9.9 billion at the end of the second quarter, up from $9.3 billion at year-end 2009. We have more than $ 900 million of dividend capacity in our primary insurance subsidiary.

Our capital flexibility is further enhanced by the approximately $300 million of cash and short term investments, held at the holding company level. This holding company cash position is more than two times our annual net corporate obligations. We did pay down another $ 15 million of our credit facility. And the total outstanding is now $100 million against the $250 million facility.

Our life and group non-core segment produced a second quarter net offering loss $18 million, compared with a net operating loss of $26 million in 2009. The favorable year-over-year comparison reflects a legal accrual in the second quarter of 2009 that dampened those results. There were no significant changes in the fundamental underlying performance of these businesses.

The corporate segment produced a second net operating loss of $5 million in 2010 as compared to a net operating income of $13 million in 2009. The change was driven by reduced net investment income mainly LP.

I know that you are interested in hearing more of our thinking around the decision to transfer our A&E liabilities to National Indemnity as well as the decision to sell our Argentine operation to QBE. Let me offer a few comments before I turn the call back to Tom.

Both decisions were guided by the strategic operational and financial priorities that we established soon after Tom arrived in January of 2009. Our over-arching objective has been, and still is, to deliver improved levels of operating earnings on a consistent basis and to continuously improve our financial stability. You heard us say after this strategic review that we completed in early 2009 that we saw opportunities for meaningful growth in North American and Europe.

Our Argentine operation, while profitable, was not seen as core. We did not see the opportunity for scale nor did we see an attractive opportunity for growth in Latin America. The sale, which we think was negotiated at an attractive valuation, slightly over $66 million or 2.2 times book value, allows us to redeploy that capital to support growth in our core businesses and eliminate the sovereign and currency risk that came along with that operation.

Let me briefly recap the agreement with Natural Indemnity. We will have an inception date of January 1st, 2010. And we'll provide protection against legacy asbestos and pollution claims. CNA will pay a premium of $2 billion and transfer a premium section date reinsurance recoverable with a net book value of approximately $200 million. Natural indemnity will provide reinsurance cover up to a $4 billion-limit net of collectible third party reinsurance.

Both net losses and any of the $1.2 billion of related third party reinsurance that may prove to be uncollectible will be covered within the limit. National indemnity will establish a $2.2 billion collateral trust for the benefit of CNA at closing. And Berkshire Hathaway will guarantee National Indemnity's payments obligations under the agreement. In addition, National Indemnity will take over claim handling and reinsurance collections. These claim handling costs will not be charged against the $4 billion reinsurance cover limit. We anticipate closing the transaction during the third quarter. At closing, we expect to recognize an after tax loss of approximately $375 million.

As you heard from Tom, we believe the benefits from the agreement to transfer A&E liabilities to National Indemnity are compelling. Our transaction objectives were to enhance our earnings' consistency and financial stability and to differentiate CNA from the majority of our competitors to the effective elimination of CNA's asbestos and pollution reserve risk as well as the related reinsure dispute and credit risk.

It was also critically important to us not to trade reserve risk for credit risk given the expected length of this agreement. Our ability to successfully negotiate the collateral trust and the Berkshire Hathaway guarantee allowed us to meet that objective and significantly approve the transaction's capital efficiency. As a result, we will be able to reallocate the approximately $500 million of capital that we hold to support these reserve risks to support the growth of our ongoing business.

Looking forward, while the transaction will reduce future net investment income, we will benefit from the annual direct claim expense savings. This expense has been running a little over $20 million a year. We will also eliminate the prospect of future adverse reserve development, which accounts for more that $250 million in reserve charges over the past two years. While we have no reason to believe our current reserves are inadequate, these liabilities have a history of volatility and we saw little prospect for these claim outcomes to improve.

You should be aware that the reinsurance agreement with the National Indemnity will be considered retroactive reinsurance, which receives special accounting under current GAAP. If future adverse asbestos and pollution reserve development exceeds the $2.2 billion of premium paid, it will have a timing difference impact on CNA's reported income because retroactive accounting requires that a portion of the reinsurance credit will be deferred and recognized over the settlement period of the asbestos and pollution reserves.

Overall, the transaction fully meets our objectives, effectively eliminating asbestos and pollution reserve risks, effectively eliminating legacy reinsured dispute and credit risk, enhancing our capital flexibility, and enhancing management focus on our ongoing businesses and strategy.

With that, I will turn it back to Tom.

Tom Motamed

Thanks, Craig. All-in-all, we had another good quarter, net operating income of $269 million or $0.91 per common share, net income of $283 million or $0.96 per common share, strong investment results with $521 million of pretax net investment income, $13 million in after tax capital gains, and approximately $600 improvement in our unrealized position.

Improvement in our capital position reflected a 13% increase in book value per common share to $40.43 from year-end 2009, with GAAP common shareholders equity increasing to $10.9 billion, disciplined underwriting and reserving practices as reflected in 14 consecutive quarters of favorable prior year development. The agreement to transfer our legacy asbestos and pollution liabilities to National Indemnity is a very significant accomplishment for us.

Before we take your questions, I'd like to say a few words about the market and our strategy going forward. The market continues to be very competitive in both commercial and special line - specialty lines. The industry has now endured a declining rate environment for approximately seven years. We are currently seeing erosion in terms and conditions, signaling the final move in this current soft market cycle. From where we sit, we do not see any let up in the aggressive competition for new business. New entrants, lives of capacity, appetite expansion among established players, and a fear of losing existing business on renewal will continue to put pressure on rates, and ultimately accelerate the deterioration of accident year loss ratios.

At the same time, there appears to be some optimism surrounding the stabilization of exposure levels, which will buoy premium, but do little thing, if anything, on the loss side. The recent flurry of catastrophe also signals the industry and our need to focus on loss ratio. As the economy stabilizes and ultimately improves as evidenced by flat deposit of exposure growth, we believe customers will be able to absorb rate increases since exposure growth is an indicator of the viability of a business.

We must be cognizant of the fact that the longer current recession lasts, the greater the price sensitivity on the part of buyers. Therefore, at CNA, we will continue to focus on risk selection, pricing to exposure, and adequate rates to maintain our margins in specialty and improve our commercial results.
We will now take your questions.

Question and Answer

Operator

Thank you. (Operator Instructions) We'll pause for just a moment. We'll go first to Amit Kumar with Macquarie.

Amit Kumar
Macquarie

Good morning, and congrats on a very strong quarter.

Tom Motamed

Amit, thank you.

Amit Kumar
Macquarie

In just listening to - you're going through this list of things, which needed to be done, it seems a lot have been done or are close to be getting done. I'm just trying to understand a bit better, what are your thoughts on the loss preferred? Do you think that that it is something you might revisit in 2010?

Craig Mense

Amit, this is Craig. And first I'd say, as you know, we don't comment on any capital plans that we may have. But I would go on to say that, certainly, completing this transaction with National Indemnity enhances our ability to act on that score.

Amit Kumar
Macquarie

Okay. That's helpful. Just moving on to the discussion on your submissions, I think the numbers were up 20% in specialty and up 10% in commercial. I'm just trying to understand that a bit better. Is that a function of your expanded platform or what is exactly going on?

Tom Motamed

The numbers you quoted were submission activity, is that correct?

Amit Kumar
Macquarie

Yes, that's right.

Tom Motamed

Yes. We expanded our appetite back in 2009. We have been a company that was really known for healthcare and construction. We now have expanded that. We have 11 industry verticals or nine more than what we had. So we have a broader appetite. So when you have a broader appetite, when producers know that, they will send you business. So we are getting more submissions because of our expanded appetite.

Also, we have built out our field presence in an aggressive way. We've opened up four new offices this year. And we'll add another office in the fourth quarter, so we are becoming much more externally focused; and in the face of our producers, with a broadened appetite and asking for the business. So the submission activity is a reflection of all of those points.

Amit Kumar
Macquarie

Okay. That’s helpful. Just one final question, then I’ll re-queue. You talked about rates redefined in different segments. Can you also touch upon the rate adequacy in your new business? I know you talked about the renewal business, maybe talk to us how that has been coming along.

Tom Motamed

Yes. We actually, in our specialty business, believe that our new business is better priced than our renewal book. We have developed tools that we think can measure reserve adequacy. We are building tools on the commercial side, but anecdotally, I would tell you that when I hear the stories on particular accounts, and the rate online that we are charging for new business, I would tell you that we’re pricing the business to make a profit in commercial. That is also reflected on the fact that our hit ratio is down a few points in commercial. We are being much more selective on new business even with submissions up.

So we have confidence that the business we’re putting on the books today fits our appetite, as indicated by industry verticals, as well as we’re pricing it better in some cases, and at least that’s good in others. So we don't think we’re giving anything away on the future.

Amit Kumar
Macquarie

Okay. That’s helpful. I’ll re-queue. Thanks.

Operator

We’ll go next to Jay Cohen with Bank of America.

Jay Cohen

Thank you, good morning.

Tom Motamed

Good morning, Jay.

Jay Cohen

A couple of just quick ones. First, the level of premiums in your Argentinean business, do you have that?

Tom Motamed

It’s about a $100 million, Jay, US dollars annual.

Jay Cohen

And that was in your specialty segment?

Tom Motamed

No, it actually would have been reflected in the commercial segment.

Jay Cohen

In commercial, okay. And the business you highlighted that had some losses, the CNA Select business that was in run up, that contributed quite a bit to the loss ratio, can you give us more information on that?

Tom Motamed

Yes. The segment was habitational real estate, you know, apartment buildings. It was three points in commercial. We have basically gotten out of that. It was under-priced, the losses. This was a book that we started writing in 2008. The losses seem to come in a lot slower at the beginning, and then all of a sudden they showed up in bushel baskets, so we made a decision to get off them.

As you know, the excess surplus lines market is under tremendous pressure on pricing. A lot of that business is moving back into the retail segment. And the good news is we could get off of that quickly. So we are getting off of that and get that behind us.

Jay Cohen

Okay. That's helpful. Again, another quick one, the $20 million of expense related to the runoff business, I assume that's in the runoff operation, or is that in the commercial? Where does that reside?

Tom Motamed

That would be reflected in the corporate segment, the corporate non-accrual.

Jay Cohen

Okay, got it. And now, I guess I have two more. The next one is pretty quick. The Lowe's preferred - your desire, if you wanted to pay that back, does Lowe's have any input as to whether or not you pay that back?

Tom Motamed

Yes. That has to be mutually agreed to.

Jay Cohen

Okay. Because I would presume that, frankly, they wouldn't want it to be paid back so quickly, given a 10% yield in this current environment.

Tom Motamed

We can't speak for them, Jay.

Jay Cohen

Okay. And then the last question, maybe the bigger picture. I look at the 2Q result, and if I normalize for cash, when you reduce the cat load - give you back some for limited partnership income, so normalize the investment income. If I take out the favorable developments, I'm looking - trying to get to an accident year ROE normalized, I come up with about 5% or 6%. And again, I didn't normalize for the CNA Select business or habitational business, but that stuff always happens. But I'm coming up with mid-single digit number, is that - do you think that's in the ballpark as far as where the business is being written today?

Craig Mense

Well, that means - that number is reflective of what we're reporting today. I mean, it's not necessarily reflective of that. I mean that's reflective of the CNA today. So if you're trying to get at what's in the property casualty business itself, maybe a little bit more than that? But your numbers are pretty close.

Jay Cohen

Okay. Yes, I guess I would have to - if I wanted to adjust further, I could adjust for what I believe is excess capital. But I guess that would be another adjustment. Anyway, thanks for the answers. I appreciate it.

Operator

We'll hear now from Ron Bobman with Capital Returns.

Ron Bobman
Capital Returns

Hi. Thanks a lot, congrats on great results. I had two questions. One, Tom, since you've joined, the company's put out over 30 press releases where you have announced either new hires or appointments to positions. Nearly that number of press releases are actually new hires and largely, I guess, in the field force. And I guess you've been here about 18 months. I think in the 18 months before you, there was a whopping four press releases announcing just a couple of new hires. Could you talk about that? And maybe whether that case of appointment in hiring is going to continue, but maybe really in a broader sense, could you talk about the personnel additions? And I guess you would refer to it as the investment in the field. That's my first question, thanks.

Tom Motamed

Well, I can't speak to before I got here. So I'll just talk about since I have been here. I'm a strong proponent that if you have the best players, you can win. And I felt that in some of our key roles, whether they were here in Chicago or in the field. We could get some new players that could help us improve our results, whether that be on the loss ratio side, or the gross side. So clearly, when you look at talent management, human capital, I am a believer that you're always trying to bring in the best talent to make the organization better. So that's my philosophy.

Yes, we have opened some new offices, so we had to hire some new people, but I think, when you really get down to it, all of our hires had been either upgrades in talent or strategic moves. And by strategic, I mean, we have hired probably 15 heavy-duty commercial underwriters to sit in the branch offices. We have hired field marketing people. Those two positions, underwriting officers and field marketing, we did not have at CNA. So the underwriting people will certainly help us improve our loss ratio and write good business and the marketing people will help drive submission activity up so we get a look at all the business we need to look at.

We've also hired quite a few underwriters in our specialty business in the branch operations. And the reasons for that, once again, it's strategic. We believe there are lots of opportunities in the specialty business that can be gathered in the local branch environment and the yearly returns on that are very successful. That's why we're seeing an increase in our policy count in specialty. Now these are smaller policies but this is really the type of business that requires hunters and gatherers. So I would say, strategically, we're building upon what we said we would build, which is we're going to grow specialty in a tough market. Today we believe we're getting ourselves well positioned. And in the commercial business, we have to fix the loss ratio before we grow it. We don't want to grow it unless we know we're moving into profitable territory.

I didn't know there were 30 press releases. Thanks for telling me. But we're going to do our best to keep bringing talent into CNA wherever it will help us improve our loss ratio and our profitability, ultimately, as well as growth.

Ron Bobman
Capital Returns

Thanks. My second question relates to the ever popular topic of the preferreds [ph]. I don't remember you or the company previously describing the preferred as requiring mutual agreements. But except for CNA's - Lowe's agreement, is the company CNA in a position to pay back or redeem the preferred, all other factors incorporated, whether it be excess capital in the eyes of the rating agency, excess capital in the eyes of management, financial flexibility, et cetera? In all other accounts, do you feel that you are a position and have the wherewithal to pay it back and just lack the mutual agreement? Or are there other items that need to be lined up prior there, too? Thanks. And that's it for me, best of luck.

Craig Mense

Thanks, Ron. This is Craig. Well first, let me say, even though it's a requirement, let's not - please don't interpret that as a gating item. We didn't say that that was a constraint at the moment. Just to answer your question, it does require mutual consent. So as far as - and as I said - also to the first question, we don't comment on any specific capital plans we have. I think I have said before in these calls that our capital flexibility continues to improve. I gave you the numbers on stat surplus; this loss portfolio transaction, Berkshire Hathaway; this further enhances our ability. So the only - really the gating items are our own, it's the market and as well as some of our own caution about retiring equity.

Ron Bobman

Capital Returns

Craig, is the market eating capital markets?

Craig Mense

Yes.

Ron Bobman
Capital Returns

Okay. Thanks again.

Craig Mense

You're welcome.

Operator

Moving on to Bob Glasspiegel with Langen McAlenney

Bob Glasspiegel

Good morning, everyone. A couple of small questions on the NICO transaction, how much capital do you think it frees up by itself?

Craig Mense

I said $500 million, Bob.

Bob Glasspiegel

About $500 million, okay. And on our models, I followed the $20 million reduction in expenses in corporate, and what's the offset in investment income was?

Craig Mense

Well, it depends on how you want to look at it. I would say that the way that we looked at it, it was that we're paying for it mainly with cash and short term securities that we hold. So it's really the opportunity costs, the investment opportunity costs we have, which right now, the general account new money rate is about 4%. So we go on that - on a declining value, maybe $80 million (inaudible) of opportunity costs given up.

Bob Glasspiegel

Okay. So what's the dollar amount of assets that - there're several numbers thrown out there. I just want to make sure I got the right.

Tom Motamed

We are paying $2 billion of premium.

Bob Glasspiegel

Okay. So there's no offset on that - on invested assets or - okay. I got it. Let's see. Tom, question for you, it sounds like, in your market commentary, you're closer to Mr. Finnegan and Mr. Fishman from Chubb and Travelers, who say the second quarter was a delta down. And we'll argue with Bill Berkley's commentary that the second quarter was an inflection point towards getting better. Would you characterize the second quarter as more of the same?

Tom Motamed

I think it's much of the same. This is a competitive marketplace. Our issues are probably different than the companies that you mentioned. So we're worried about ourselves on what we need to do. We need to improve our profitability in commercial. And that's why we're pushing rate. You know you have to push rate. You've got to get price adequacy, and you got to get rid of business that is unprofitable or hurting you. I think the other companies probably feel that their portfolios are pretty solid. And if I looked at their numbers, their numbers are pretty solid when we look at commercial compared to ours.

So we know we have work to do in commercial. We're not hiding anything here. I think you know - you look at our specialty business, I'm pleased this much. It's a great business. It's very competitive today. As I said in my remarks, Bob, new entrants, existing markets being really tough retaining their business, so you're not getting a lot out there. So I think it's a competitive market.

And as I said on one other conference call, I don't know when it's not been competitive. And the fact is in this economic malaise, the fact is it's even tougher to get overall price increases in the commercial sector. So I don't know how I line up with the other guys, but our issues are the issues we're going to grapple with. And we're here in Chicago. The weather changes every 20 minutes. And I think everybody's opinion as to what's happening out there could change every quarter. So I haven't seen any trends that tell me, "Boy, happy days are here again."

Bob Glasspiegel
Langen McAlenney

Thank you. That's a thoughtful response. Your shift away from taxing (inaudible) and taxables, is that driven by a portfolio call or was there a change in your tax position that drove that?

Craig Mense

No. That's really just, again, search for tax efficiency. And remember, we're a consolidated taxpayer with load.

Bob Glasspiegel
Langen McAlenney

Okay. And last question, the other revenues, other expense line within property-casualty has been running pretty good net profits, $6 million, $7 million a quarter for the last three quarters. Is that representative of a breakout towards getting your other operations to a profitable level? Or is that just random quarterly (inaudible)?

Craig Mense

No. Those represent, really, the results of our warranty business in the main.

Bob Glasspiegel
Langen McAlenney

And the outlook, does that continue to be profitable, you think, with the current environment? Okay. Thank you very much.

Craig Mense

You're welcome.

Operator

(Operator Instructions) We'll take a follow-up from Amit Kumar.

Amit Kumar
Macquarie

Thanks. Two quick follow-ups, first of all, just going back to the discussion on reserve releases, I think you give a 30% reserve-based number. Was that an internal study, which looked at 30% of reserves, maybe just expand on that a bit? And what about the remaining 70%, is that going to split up in the next two quarters? Or when is the next big reserve study?

Tom Motamed

Yes, first of all, this is internal work. We do these ourselves. And it was 30% of the reserves in the second quarter. We look at reserves every quarter. And the fact to the matter is, as a philosophy, we believe you don't reserve any - or you don’t release a reserve until it’s got its time, right? The fact is we’re a bit cautious. This was a lumpy quarter for reserve releases. But if you look at the 14 consecutive quarters of reserve releases, on average, it’s about 5.1 points, including the 18 points in this quarter, so a little bit lumpy. It just so happens what we looked at reduced greater redundancy, which we thought should be released. But the fact is if you look at it over time, it’s averaging about five points a quarter.

Amit Kumar
Macquarie

Okay. And can you break up that number, that $264 million, between different buckets. I couldn’t write it down fast enough.

Tom Motamed

That’s why we talk fast.

Craig Mense

The first thing I mentioned was property, which is mostly cat and non-cat. That came from both 2008 and 2009. So that’s about $100 million - little less than $100 million. And you’ll see it - it'll be described in a 10-Q, which we expect to file in the next day or so as well.

So (inaudible) and property about $100 million, 50% cat and 50% none. We also had very favorable auto development, which is about $60 million, and those are ’07 and prior years, and then - especially the professional liability, again ’07 and prior. And it's mainly ’03 to ’07 for specialty and auto. Those are the years.

Amit Kumar
Macquarie

Okay, guys, ’03 to ’07. Okay. That’s very helpful. And I guess just finally going back to the sale of your Argentinean sub. You mentioned that you'll keep on looking at non-core entities. Without giving up too much, are there any other companies or entities like that which could be on the radar screen going forward? Or do you think you are done as of now?

Tom Motamed

Well, I think you always look at your businesses and see which ones are performing at a high level, which ones don’t have great prospects for the future.

And we’re trying to simplify our business and really get focused on, what I'll call, core P&C and commercial and specialty in the United States, Canada, and Europe. But everything is always up for grabs. That’s what happens when you manage a business. You'll look at everything. But we’re not going to signal anything in particular.

But as Craig mentioned, Argentina was $100 million worker's compensation operation. We did not feel it was in our best interest to invest a lot of capital in Latin America to build a large business. We thought that would be very difficult, take a lot of time, and cost a lot of money. And quite honestly, we think the opportunities are better in the US, Canada, and Europe. So that was a strategic move.

As Craig said, we outlined some things. And one is we look at businesses that don’t have a lot of upside or things that have been a drag, such as asbestos and pollution. So we’ll continue to look at everything, but we’re not going to signal anything to you -anything in particular.

Amit Kumar
Macquarie

Well, I tried. Okay. Thanks so much.

Tom Motamed

Yes, good try.

Operator

We appear to have no further questions. I'll turn the conference back to you all for closing remarks.

Tom Motamed

Okay. Thank you very much. See you next quarter.

Operator

That concludes today's conference. Thank you all for joining us.