

CNA FINANCIAL CORP
Form 10-Q
April 30, 2018

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

FORM 10-Q

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

For the quarterly period ended March 31, 2018
OR

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

For the transition period from _____ to _____
Commission File Number 1-5823

CNA FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)
Delaware 36-6169860
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)
333 S. Wabash 60604
Chicago, Illinois (Zip Code)
(Address of principal executive offices)
(312) 822-5000
(Registrant's telephone number, including area code)

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

Yes No

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

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to submit and post such files).

Yes No

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

| | | | | |
|---|--|--|--|--|
| Large accelerated filer <input checked="" type="checkbox"/> | Accelerated filer <input type="checkbox"/> | Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company <input type="checkbox"/> | Emerging growth company <input type="checkbox"/> |
|---|--|--|--|--|

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

| Class | Outstanding at April 26, 2018 |
|--------------------------------|-------------------------------|
| Common Stock, Par value \$2.50 | 271,372,358 |

| Item Number | | Page Number |
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PART I. Financial Information

Item 1. Condensed Consolidated Financial Statements

CNA Financial Corporation

Condensed Consolidated Statements of Operations (Unaudited)

Three months ended March 31

(In millions, except per share data)

| | 2018 | 2017 |
|--|---------|---------|
| Revenues | | |
| Net earned premiums | \$1,785 | \$1,645 |
| Net investment income | 490 | 545 |
| Net realized investment gains | | |
| Other-than-temporary impairment losses | (6) | (2) |
| Other net realized investment gains | 18 | 38 |
| Net realized investment gains | 12 | 36 |
| Non-insurance warranty revenue (Note J) | 238 | 93 |
| Other revenues | 10 | 11 |
| Total revenues | 2,535 | 2,330 |
| Claims, Benefits and Expenses | | |
| Insurance claims and policyholders' benefits | 1,339 | 1,293 |
| Amortization of deferred acquisition costs | 296 | 305 |
| Non-insurance warranty expense (Note J) | 216 | 70 |
| Other operating expenses | 303 | 276 |
| Interest | 35 | 43 |
| Total claims, benefits and expenses | 2,189 | 1,987 |
| Income before income tax | 346 | 343 |
| Income tax expense | (55) | (83) |
| Net income | \$291 | \$260 |
| Basic earnings per share | \$1.07 | \$0.96 |
| Diluted earnings per share | \$1.07 | \$0.96 |
| Dividends declared per share | \$2.30 | \$2.25 |
| Weighted Average Outstanding Common Stock and Common Stock Equivalents | | |
| Basic | 271.4 | 270.7 |
| Diluted | 272.4 | 271.7 |

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

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CNA Financial Corporation

Condensed Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

Three months ended March 31

(In millions)

Comprehensive (Loss) Income

2018 2017

Net income

\$291 \$260

Other Comprehensive (Loss) Income, Net of Tax

Changes in:

Net unrealized gains on investments with other-than-temporary impairments (9) (4)

Net unrealized gains on other investments (429) 67

Net unrealized gains on investments (438) 63

Foreign currency translation adjustment 12 11

Pension and postretirement benefits 10 7

Other comprehensive (loss) income, net of tax (416) 81

Total comprehensive (loss) income \$(125) \$341

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

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Condensed Consolidated Balance Sheets

| (In millions, except share data) | March 31, 2018 (Unaudited) | December 31, 2017 |
|---|----------------------------------|----------------------|
| Assets | | |
| Investments: | | |
| Fixed maturity securities at fair value (amortized cost of \$37,991 and \$38,215) | \$ 40,259 | \$ 41,487 |
| Equity securities at fair value (cost of \$749 and \$659) | 770 | 695 |
| Limited partnership investments | 2,364 | 2,369 |
| Other invested assets | 48 | 44 |
| Mortgage loans | 864 | 839 |
| Short term investments | 1,230 | 1,436 |
| Total investments | 45,535 | 46,870 |
| Cash | 282 | 355 |
| Reinsurance receivables (less allowance for uncollectible receivables of \$29 and \$29) | 4,408 | 4,261 |
| Insurance receivables (less allowance for uncollectible receivables of \$43 and \$44) | 2,371 | 2,292 |
| Accrued investment income | 414 | 411 |
| Deferred acquisition costs | 665 | 634 |
| Deferred income taxes | 238 | 137 |
| Property and equipment at cost (less accumulated depreciation of \$253 and \$274) | 346 | 326 |
| Goodwill | 149 | 148 |
| Other assets | 3,241 | 1,133 |
| Total assets | \$ 57,649 | \$ 56,567 |
| Liabilities | | |
| Insurance reserves: | | |
| Claim and claim adjustment expenses | \$ 22,067 | \$ 22,004 |
| Unearned premiums | 4,256 | 4,029 |
| Future policy benefits | 10,783 | 11,179 |
| Short term debt | 30 | 150 |
| Long term debt | 2,679 | 2,708 |
| Other liabilities (includes \$147 and \$143 due to Loews Corporation) | 6,409 | 4,253 |
| Total liabilities | 46,224 | 44,323 |
| Commitments and contingencies (Notes C and F) | | |
| Stockholders' Equity | | |
| Common stock (\$2.50 par value; 500,000,000 shares authorized; 273,040,243 shares issued; 271,371,607 and 271,205,390 shares outstanding) | 683 | 683 |
| Additional paid-in capital | 2,173 | 2,175 |
| Retained earnings | 9,028 | 9,414 |
| Accumulated other comprehensive (loss) income | (400) |) 32 |
| Treasury stock (1,668,636 and 1,834,853 shares), at cost | (59) |) (60) |
| Total stockholders' equity | 11,425 | 12,244 |
| Total liabilities and stockholders' equity | \$ 57,649 | \$ 56,567 |
| The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements (Unaudited). | | |

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CNA Financial Corporation

Condensed Consolidated Statements of Cash Flows (Unaudited)

Three months ended March 31

(In millions)

Cash Flows from Operating Activities

| | 2018 | 2017 |
|---|---------|---------|
| Net income | \$291 | \$260 |
| Adjustments to reconcile net income to net cash flows provided by operating activities: | | |
| Deferred income tax expense | 29 | 72 |
| Trading portfolio activity | (1) | (6) |
| Net realized investment gains | (12) | (36) |
| Equity method investees | (2) | 38 |
| Net amortization of investments | (15) | (12) |
| Depreciation and amortization | 20 | 21 |
| Changes in: | | |
| Receivables, net | (215) | 89 |
| Accrued investment income | (3) | (26) |
| Deferred acquisition costs | (29) | (24) |
| Insurance reserves | 311 | 135 |
| Other assets | (72) | (37) |
| Other liabilities | (99) | (206) |
| Other, net | 15 | 14 |
| Total adjustments | (73) | 22 |
| Net cash flows provided by operating activities | 218 | 282 |
| Cash Flows from Investing Activities | | |
| Dispositions: | | |
| Fixed maturity securities - sales | 2,576 | 1,359 |
| Fixed maturity securities - maturities, calls and redemptions | 531 | 823 |
| Equity securities | 7 | 16 |
| Limited partnerships | 69 | 57 |
| Mortgage loans | 11 | 3 |
| Purchases: | | |
| Fixed maturity securities | (2,690) | (2,097) |
| Equity securities | (98) | (7) |
| Limited partnerships | (62) | (18) |
| Mortgage loans | (36) | (23) |
| Change in other investments | (4) | (1) |
| Change in short term investments | 208 | 271 |
| Purchases of property and equipment | (38) | (30) |
| Other, net | 15 | 1 |
| Net cash flows provided by investing activities | 489 | 354 |

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

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Three months ended March 31

| (In millions) | 2018 | 2017 |
|---|---------|---------|
| Cash Flows from Financing Activities | | |
| Dividends paid to common stockholders | \$(624) | \$(609) |
| Repayment of debt | (150) | — |
| Other, net | (7) | — |
| Net cash flows used by financing activities | (781) | (609) |
| Effect of foreign exchange rate changes on cash | 1 | 1 |
| Net change in cash | (73) | 28 |
| Cash, beginning of year | 355 | 271 |
| Cash, end of period | \$282 | \$299 |

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

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CNA Financial Corporation

Condensed Consolidated Statements of Stockholders' Equity (Unaudited)

Three months ended March 31

(In millions)

Common Stock

| | 2018 | 2017 |
|------------------------------|-------|-------|
| Balance, beginning of period | \$683 | \$683 |
| Balance, end of period | 683 | 683 |

Additional Paid-in Capital

| | | |
|------------------------------|-------|-------|
| Balance, beginning of period | 2,175 | 2,173 |
| Stock-based compensation | (2 |) (12 |
| Balance, end of period | 2,173 | 2,161 |

Retained Earnings

| | | |
|---|-------|--------|
| Balance, beginning of period, as previously reported | 9,414 | 9,359 |
| Cumulative effect adjustments from changes in accounting guidance, net of tax | (50 |) — |
| Balance, beginning of period, as adjusted | 9,364 | 9,359 |
| Dividends paid to common stockholders | (627 |) (613 |
| Net income | 291 | 260 |
| Balance, end of period | 9,028 | 9,006 |

Accumulated Other Comprehensive (Loss)

| | | |
|---|------|-------|
| Balance, beginning of period, as previously reported | 32 | (173 |
| Cumulative effect adjustments from changes in accounting guidance, net of tax | (16 |) — |
| Balance, beginning of period, as adjusted | 16 | (173 |
| Other comprehensive (loss) income | (416 |) 81 |
| Balance, end of period | (400 |) (92 |

Treasury Stock

| | | |
|------------------------------|-----|-------|
| Balance, beginning of period | (60 |) (73 |
| Stock-based compensation | 1 | 8 |
| Balance, end of period | (59 |) (65 |

| | | |
|----------------------------|----------|----------|
| Total stockholders' equity | \$11,425 | \$11,693 |
|----------------------------|----------|----------|

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

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CNA Financial Corporation

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note A. General

Basis of Presentation

The Condensed Consolidated Financial Statements include the accounts of CNA Financial Corporation (CNAF) and its subsidiaries. Collectively, CNAF and its subsidiaries are referred to as CNA or the Company. Loews Corporation (Loews) owned approximately 89% of the outstanding common stock of CNAF as of March 31, 2018.

The accompanying Condensed Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). Intercompany amounts have been eliminated. Certain financial information that is normally included in annual financial statements prepared in accordance with GAAP, including certain financial statement notes, is not required for interim reporting purposes and has been condensed or omitted. These statements should be read in conjunction with the Consolidated Financial Statements and notes thereto included in CNAF's Annual Report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2017, including the summary of significant accounting policies in Note A. The preparation of Condensed Consolidated Financial Statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the Condensed Consolidated Financial Statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

The interim financial data as of March 31, 2018 and for the three months ended March 31, 2018 and 2017 is unaudited. However, in the opinion of management, the interim data includes all adjustments, including normal recurring adjustments, necessary for a fair statement of the Company's results for the interim periods. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year.

Recently Adopted Accounting Standards Updates (ASU)

ASU 2014-09: In May 2014, the Financial Accounting Standards Board (FASB) issued ASU No. 2014-09, Revenue Recognition (Topic 606): Revenue from Contracts with Customers. The standard excludes from its scope the accounting for insurance contracts, financial instruments, and certain other agreements that are governed under other GAAP guidance. The updated guidance requires an entity to recognize revenue as performance obligations are met, in an amount that reflects the consideration the entity is entitled to receive for the transfer of the promised goods or services.

On January 1, 2018, the Company adopted the updated guidance using the modified retrospective method applied to all contracts which were not completed as of the date of adoption, with the cumulative effect recognized as an adjustment to the opening balance of Retained earnings. Prior period amounts have not been adjusted and continue to be reported in accordance with the previous accounting guidance.

Under the new guidance, revenue on warranty products and services will be recognized more slowly compared to the historic revenue recognition pattern. In addition, for warranty products in which the Company acts as the principal in the transaction, Non-insurance warranty revenue and Non-insurance warranty expense are increased to reflect the gross amount paid by consumers, including the retail seller's markup which is considered a commission to the Company's agent. This gross-up of revenue and expense also resulted in an increase to Other assets and Other liabilities on the Company's Condensed Consolidated Balance Sheets as the revenue and expense are recognized over the actuarially determined expected claims emergence pattern.

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The cumulative effect changes to the Condensed Consolidated Balance Sheet for the adoption of the updated guidance on January 1, 2018 were as follows:

| (In millions) | Balance as of December 31, 2017 | Adjustments Due to Adoption of Topic 606 | Balance as of January 1, 2018 |
|-----------------------|---------------------------------|--|-------------------------------|
| Other assets | \$ 1,133 | \$ 1,882 | \$ 3,015 |
| Other liabilities | 4,253 | 1,969 | 6,222 |
| Deferred income taxes | 137 | 21 | 158 |
| Retained earnings | 9,414 | (66) | 9,348 |

The impact of adoption on the Condensed Consolidated Statement of Operations and Balance Sheet as of and for the three months ended March 31, 2018 was as follows:

| Three months ended March 31 (In millions) | 2018 Prior to Adoption | Effect of Adoption | 2018 as Reported |
|---|------------------------|--------------------|------------------|
| Statement of operations: | | | |
| Non-insurance warranty revenue | \$ 101 | \$ 137 | \$ 238 |
| Total revenues | 2,398 | 137 | 2,535 |
| Non-insurance warranty expense | 78 | 138 | 216 |
| Total claims, benefits and expenses | 2,051 | 138 | 2,189 |
| Income before income tax | 347 | (1) | 346 |
| Income tax expense | (55) | — | (55) |
| Net income | 292 | (1) | 291 |

Balance sheet⁽¹⁾:

| | | | |
|-----------------------|----------|-------|----------|
| Other assets | \$ 3,154 | \$ 87 | \$ 3,241 |
| Other liabilities | 6,321 | 88 | 6,409 |
| Deferred income taxes | 238 | — | 238 |
| Retained earnings | 9,029 | (1) | 9,028 |

(1) 2018 Prior to Adoption includes the cumulative effect adjustment at adoption.

See Note J to the Condensed Consolidated Financial Statements for additional information regarding non-insurance revenues from contracts with customers.

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ASU 2016-01: In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The updated accounting guidance requires changes to the reporting model for financial instruments. The guidance primarily changes the model for equity securities by requiring changes in the fair value of equity securities (except those accounted for under the equity method of accounting, those without readily determinable fair values and those that result in consolidation of the investee) to be recognized through the income statement. The Company adopted the updated guidance on January 1, 2018 and recognized a cumulative effect adjustment that increased beginning Retained earnings by \$28 million, net of tax. Prior period amounts have not been adjusted and continue to be reported in accordance with the previous accounting guidance.

For the three months ended March 31, 2018, the Company recognized a \$15 million pretax loss within Net realized investment gains (losses) for the change in fair value of non-redeemable preferred stock and less than a \$1 million pretax gain within Net investment income for the change in fair value of common stock as a result of this change. For the three months ended March 31, 2017 a \$1 million decrease in the fair value of common stock and a \$5 million increase in the fair value of non-redeemable preferred stock was recognized in Other comprehensive income. The Company's non-redeemable preferred stock contain characteristics of debt securities, are priced similarly to bonds, and are held primarily for income generation through periodic dividends. While recognition of gains and losses on these securities are no longer discretionary, management does not consider the changes in fair value of non-redeemable preferred stock to be reflective of our primary operations. As such, the changes in the fair value of these securities are recorded through Net realized investments gains (losses). During the first quarter of 2018, the Company increased its common stock with the intention of holding the securities primarily for market appreciation. As such, the changes in the fair value of these securities are recorded through Net investment income.

ASU 2017-07: In March 2017, the FASB issued ASU No. 2017-07, Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The updated accounting guidance requires changes to the presentation of the components of net periodic benefit cost on the income statement by requiring service cost to be presented with other employee compensation costs and other components of net periodic pension cost to be presented outside of any subtotal of operating income. The ASU also stipulates that only the service cost component of net benefit cost is eligible for capitalization. The Company adopted the updated guidance effective January 1, 2018. The guidance was applied on a prospective basis for capitalization of service costs and on a retrospective basis for the presentation of the service cost and other components of net periodic benefit costs in the Company's Condensed Consolidated Statements of Operations and in its disclosures. The Company expanded the related footnote disclosure, Note G to the Condensed Consolidated Financial Statements, to disclose the amount of service cost and non-service cost components of net periodic benefit cost and the line items in the Condensed Consolidated Statements of Operations in which such amounts are reported. The change limiting the costs eligible for capitalization is not material to the Company's results of operations or financial position.

ASU 2018-02: In February 2018, the FASB issued ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.

GAAP requires the remeasurement of deferred tax assets and liabilities due to a change in the tax rate to be included in Net income, even if the related income tax effects were originally recognized in Accumulated other comprehensive income (AOCI). The ASU allows a reclassification from AOCI to Retained earnings for stranded tax effects resulting from the new U.S. Federal corporate income tax rate enacted on December 22, 2017. The Company early adopted the updated guidance effective January 1, 2018 and elected to reclassify the stranded income tax effects relating to the reduction in the Federal corporate income tax rate from AOCI to Retained earnings at the beginning of the period of adoption. The net impact of the accounting change resulted in a \$12 million increase in AOCI and a corresponding decrease in Retained earnings. The \$12 million increase in AOCI is comprised of a \$142 million increase in net unrealized gains (losses) on investments partially offset by a \$130 million decrease in unrecognized pension and postretirement benefits.

The Company releases tax effects from AOCI utilizing the security-by-security approach for Net unrealized gains (losses) on investments with Other-than-temporary impairment (OTTI) losses and Net unrealized gains (losses) on other investments. For Pension and postretirement benefits, tax effects from AOCI are released at enacted tax rates

based on the pre-tax adjustments to pension liabilities or assets recognized within OCI.

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Accounting Standards Pending Adoption

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842): Accounting for Leases. The updated accounting guidance requires lessees to recognize on the balance sheet the assets and liabilities for the rights and obligations created by all leases, including those historically accounted for as operating leases. The guidance is effective for interim and annual periods beginning after December 15, 2018. The Company is currently evaluating the effect the updated guidance will have on the Company's financial statements. It is expected that assets and liabilities will increase based on the present value of remaining lease payments for leases in place at the adoption date; however, this is not expected to be material to the Company's results of operations or financial position.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The updated accounting guidance requires changes to the recognition of credit losses on financial instruments not accounted for at fair value through net income. The guidance is effective for interim and annual periods beginning after December 15, 2019. The Company is currently evaluating the effect the guidance will have on the Company's financial statements, but expects the primary changes to be the use of the expected credit loss model for its mortgage loan portfolio and reinsurance receivables and the presentation of credit losses within the available-for-sale fixed maturities portfolio through an allowance method rather than as a direct write-down. The expected credit loss model will require a financial asset to be presented at the net amount expected to be collected. The allowance method for available-for-sale debt securities will allow the Company to record reversals of credit losses if the estimate of credit losses declines.

Income Tax Reform Update

On December 22, 2017, H.R.1, "An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018," was signed into law (Tax Reform Legislation).

Shortly after enactment, the Securities and Exchange Commission Staff issued Staff Accounting Bulletin No. 118 (SAB 118) to provide guidance on accounting for the Tax Reform Legislation impacts when the measurements of the income tax effects are complete, incomplete, or incomplete but for which a provisional amount can be estimated. SAB 118 permits the recognition of provisional amounts, and adjustments to provisional amounts, in subsequent reporting periods within the one year measurement period.

The Company has reflected the following incomplete but reasonably estimated provisional items in Deferred income taxes on the Condensed Consolidated Balance Sheet at March 31, 2018. The effects of the adjustments to the Company's provisional amounts for the three months ended March 31, 2018 did not impact income tax expense.

• The Company has recalculated its insurance reserves and the transition adjustment from existing law.

• The Company has recalculated amounts under special accounting method provisions for recognizing income for Federal income tax purposes no later than for financial accounting purposes and the transition adjustment from existing law.

• The Company has not recorded current or deferred taxes with respect to the international provisions since it does not expect to have inclusions in U.S. taxable income for certain earnings of foreign subsidiaries in future years.

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Note B. Earnings (Loss) Per Share

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

For the three months ended March 31, 2018 and 2017, approximately 1,009 thousand and 974 thousand potential shares attributable to exercises or conversions into common stock under stock-based employee compensation plans were included in the calculation of diluted earnings per share. For those same periods, approximately 9 thousand and 148 thousand potential shares attributable to exercises or conversions into common stock under stock-based employee compensation plans were not included in the calculation of diluted earnings per share because the effect would have been antidilutive.

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Note C. Investments

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

Three months ended March 31

| (In millions) | 2018 | 2017 |
|---------------------------------|-------|-------|
| Fixed maturity securities | \$446 | \$455 |
| Equity securities | 10 | 1 |
| Limited partnership investments | 30 | 90 |
| Mortgage loans | 11 | 7 |
| Short term investments | 6 | 3 |
| Trading portfolio | 2 | 2 |
| Other | — | 1 |
| Gross investment income | 505 | 559 |
| Investment expense | (15) | (14) |
| Net investment income | \$490 | \$545 |

During the three months ended March 31, 2018, less than \$1 million of Net investment income was recognized due to the change in fair value of common stock still held as of March 31, 2018.

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

Three months ended March 31

| (In millions) | 2018 | 2017 |
|---|-------|-------|
| Net realized investment gains (losses): | | |
| Fixed maturity securities: | | |
| Gross realized gains | \$69 | \$49 |
| Gross realized losses | (51) | (17) |
| Net realized investment gains (losses) on fixed maturity securities | 18 | 32 |
| Equity securities | (15) | — |
| Derivatives | 5 | 1 |
| Short term investments and other | 4 | 3 |
| Net realized investment gains (losses) | \$12 | \$36 |

During the three months ended March 31, 2018, \$15 million of Net realized investment losses were recognized due to the change in fair value of non-redeemable preferred stock still held as of March 31, 2018.

The components of OTTI losses recognized in earnings by asset type are presented in the following table.

Three months ended March 31

| (In millions) | 2018 | 2017 |
|---|------|------|
| Fixed maturity securities available-for-sale: | | |
| Corporate and other bonds | \$ 5 | \$ 2 |
| Asset-backed | 1 | — |
| OTTI losses recognized in earnings | \$ 6 | \$ 2 |

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

| March 31, 2018 ⁽¹⁾ | Cost or Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value | Unrealized OTTI Losses (Gains) |
|---|------------------------------|------------------------------|-------------------------------|----------------------------|---|
| (In millions) | | | | | |
| Fixed maturity securities available-for-sale: | | | | | |
| Corporate and other bonds | \$ 17,538 | \$ 1,177 | \$ 115 | \$ 18,600 | \$ — |
| States, municipalities and political subdivisions | 11,682 | 1,205 | 12 | 12,875 | — |
| Asset-backed: | | | | | |
| Residential mortgage-backed | 5,050 | 83 | 78 | 5,055 | (27) |
| Commercial mortgage-backed | 1,948 | 29 | 22 | 1,955 | — |
| Other asset-backed | 1,185 | 10 | 7 | 1,188 | — |
| Total asset-backed | 8,183 | 122 | 107 | 8,198 | (27) |
| U.S. Treasury and obligations of government-sponsored enterprises | 124 | 2 | 7 | 119 | — |
| Foreign government | 448 | 7 | 5 | 450 | — |
| Redeemable preferred stock | 9 | 1 | — | 10 | — |
| Total fixed maturity securities available-for-sale | 37,984 | 2,514 | 246 | 40,252 | \$ (27) |
| Total fixed maturity securities trading | 7 | | | 7 | |
| Total fixed maturity securities | \$ 37,991 | \$ 2,514 | \$ 246 | \$ 40,259 | |
| December 31, 2017 | | | | | |
| (In millions) | | | | | |
| Fixed maturity securities available-for-sale: | | | | | |
| Corporate and other bonds | \$ 17,210 | \$ 1,625 | \$ 28 | \$ 18,807 | \$ — |
| States, municipalities and political subdivisions | 12,478 | 1,551 | 2 | 14,027 | (11) |
| Asset-backed: | | | | | |
| Residential mortgage-backed | 5,043 | 109 | 32 | 5,120 | (27) |
| Commercial mortgage-backed | 1,840 | 46 | 14 | 1,872 | — |
| Other asset-backed | 1,083 | 16 | 5 | 1,094 | — |
| Total asset-backed | 7,966 | 171 | 51 | 8,086 | (27) |
| U.S. Treasury and obligations of government-sponsored enterprises | 111 | 2 | 4 | 109 | — |
| Foreign government | 437 | 9 | 2 | 444 | — |
| Redeemable preferred stock | 10 | 1 | — | 11 | — |
| Total fixed maturity securities available-for-sale | 38,212 | 3,359 | 87 | 41,484 | \$ (38) |
| Total fixed maturity securities trading | 3 | | | 3 | |
| Equity securities available-for-sale: | | | | | |
| Common stock | 21 | 7 | 1 | 27 | |
| Preferred stock | 638 | 31 | 1 | 668 | |
| Total equity securities available-for-sale | 659 | 38 | 2 | 695 | |
| Total fixed maturity and equity securities | \$ 38,874 | \$ 3,397 | \$ 89 | \$ 42,182 | |

As of January 1, 2018, the Company adopted ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The change in fair value of equity securities is now recognized through the income statement. See Note A to the Condensed Consolidated Financial Statements for additional information.

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The net unrealized gains on investments included in the tables above are recorded as a component of AOCI. When presented in AOCI, these amounts are net of tax and any required Shadow Adjustments. To the extent that unrealized gains on fixed income securities supporting certain products within the Life & Group segment would result in a premium deficiency if realized, a related increase in Insurance reserves is recorded, net of tax, as a reduction of net unrealized gains through Other comprehensive income (loss) (Shadow Adjustments). As of March 31, 2018 and December 31, 2017, the net unrealized gains on investments included in AOCI were correspondingly reduced by Shadow Adjustments of \$1,338 million and \$1,411 million.

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

| March 31, 2018 ⁽¹⁾ (In millions) | Less than 12 Months | | 12 Months or Longer | | Total | |
|---|----------------------------|-------------------------------|----------------------------|-------------------------------|----------------------------|-------------------------------|
| | Estimated Fair Value | Gross Unrealized Losses | Estimated Fair Value | Gross Unrealized Losses | Estimated Fair Value | Gross Unrealized Losses |
| Fixed maturity securities available-for-sale: | | | | | | |
| Corporate and other bonds | \$4,229 | \$ 104 | \$146 | \$ 11 | \$4,375 | \$ 115 |
| States, municipalities and political subdivisions | 962 | 12 | 3 | — | 965 | 12 |
| Asset-backed: | | | | | | |
| Residential mortgage-backed | 2,570 | 55 | 504 | 23 | 3,074 | 78 |
| Commercial mortgage-backed | 668 | 11 | 200 | 11 | 868 | 22 |
| Other asset-backed | 441 | 5 | 15 | 2 | 456 | 7 |
| Total asset-backed | 3,679 | 71 | 719 | 36 | 4,398 | 107 |
| U.S. Treasury and obligations of government-sponsored enterprises | 59 | 4 | 26 | 3 | 85 | 7 |
| Foreign government | 214 | 5 | 4 | — | 218 | 5 |
| Total | \$9,143 | \$ 196 | \$898 | \$ 50 | \$10,041 | \$ 246 |
| December 31, 2017 (In millions) | | | | | | |
| Fixed maturity securities available-for-sale: | | | | | | |
| Corporate and other bonds | \$1,354 | \$ 21 | \$168 | \$ 7 | \$1,522 | \$ 28 |
| States, municipalities and political subdivisions | 72 | 1 | 85 | 1 | 157 | 2 |
| Asset-backed: | | | | | | |
| Residential mortgage-backed | 1,228 | 5 | 947 | 27 | 2,175 | 32 |
| Commercial mortgage-backed | 403 | 4 | 212 | 10 | 615 | 14 |
| Other asset-backed | 248 | 3 | 18 | 2 | 266 | 5 |
| Total asset-backed | 1,879 | 12 | 1,177 | 39 | 3,056 | 51 |
| U.S. Treasury and obligations of government-sponsored enterprises | 49 | 2 | 21 | 2 | 70 | 4 |
| Foreign government | 166 | 2 | 4 | — | 170 | 2 |
| Total fixed maturity securities available-for-sale | 3,520 | 38 | 1,455 | 49 | 4,975 | 87 |
| Equity securities available-for-sale: | | | | | | |
| Common stock | 7 | 1 | — | — | 7 | 1 |
| Preferred stock | 93 | 1 | — | — | 93 | 1 |
| Total equity securities available-for-sale | 100 | 2 | — | — | 100 | 2 |
| Total | \$3,620 | \$ 40 | \$1,455 | \$ 49 | \$5,075 | \$ 89 |

As of January 1, 2018, the Company adopted ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The change in fair value of equity securities is now recognized through the income statement. See Note A to the Condensed Consolidated Financial Statements for additional information.

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Based on current facts and circumstances, the Company believes the unrealized losses presented in the March 31, 2018 securities in a gross unrealized loss position table above are not indicative of the ultimate collectibility of the current amortized cost of the securities, but rather are attributable to changes in interest rates, credit spreads and other factors. The Company has no current intent to sell securities with unrealized losses, nor is it more likely than not that it will be required to sell prior to recovery of amortized cost; accordingly, the Company has determined that there are no additional OTTI losses to be recorded as of March 31, 2018.

The following table presents the activity related to the pretax credit loss component reflected in Retained earnings on fixed maturity securities still held as of March 31, 2018 and 2017 and for which a portion of an OTTI loss was recognized in Other comprehensive income (loss).

Three months ended March 31

| | | |
|---|------|------|
| (In millions) | 2018 | 2017 |
| Beginning balance of credit losses on fixed maturity securities | \$27 | \$36 |
| Reductions for securities sold during the period | (2) | (4) |
| Ending balance of credit losses on fixed maturity securities | \$25 | \$32 |

Contractual Maturity

The following table presents available-for-sale fixed maturity securities by contractual maturity.

| (In millions) | March 31, 2018 | | December 31, 2017 | |
|--|------------------------|----------------------|------------------------|----------------------|
| | Cost or Amortized Cost | Estimated Fair Value | Cost or Amortized Cost | Estimated Fair Value |
| Due in one year or less | \$1,323 | \$ 1,343 | \$1,135 | \$ 1,157 |
| Due after one year through five years | 8,277 | 8,495 | 8,165 | 8,501 |
| Due after five years through ten years | 15,802 | 16,093 | 16,060 | 16,718 |
| Due after ten years | 12,582 | 14,321 | 12,852 | 15,108 |
| Total | \$37,984 | \$ 40,252 | \$38,212 | \$ 41,484 |

Actual maturities may differ from contractual maturities because certain securities may be called or prepaid. Securities not due at a single date are allocated based on weighted average life.

Derivative Financial Instruments

The Company holds an embedded derivative on a funds withheld liability with a notional value of \$163 million and \$167 million as of March 31, 2018 and December 31, 2017 and a fair value of \$1 million and \$(3) million as of March 31, 2018 and December 31, 2017. The embedded derivative on the funds withheld liability is accounted for separately and reported with the funds withheld liability in Other liabilities on the Condensed Consolidated Balance Sheets.

Investment Commitments

As of March 31, 2018, the Company had committed approximately \$428 million to future capital calls from various third-party limited partnership investments in exchange for an ownership interest in the related partnerships.

As of March 31, 2018, the Company had mortgage loan commitments of \$47 million representing signed loan applications received and accepted.

The Company invests in various privately placed debt securities, including bank loans, as part of its overall investment strategy and has committed to additional future purchases, sales and funding. Purchases and sales of privately placed debt securities are recorded once funded. As of March 31, 2018, the Company had commitments to purchase or fund additional amounts of \$198 million and sell \$162 million under the terms of such securities.

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Note D. Fair Value

Fair value is the price that would be received upon sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following fair value hierarchy is used in selecting inputs, with the highest priority given to Level 1, as these are the most transparent or reliable.

Level 1 - Quoted prices for identical instruments in active markets.

Level 2 - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs are observable in active markets.

Level 3 - Valuations derived from valuation techniques in which one or more significant inputs are not observable. Prices may fall within Level 1, 2 or 3 depending upon the methodology and inputs used to estimate fair value for each specific security. In general, the Company seeks to price securities using third-party pricing services. Securities not priced by pricing services are submitted to independent brokers for valuation and, if those are not available, internally developed pricing models are used to value assets using a methodology and inputs the Company believes market participants would use to value the assets. Prices obtained from third-party pricing services or brokers are not adjusted by the Company.

The Company performs control procedures over information obtained from pricing services and brokers to ensure prices received represent a reasonable estimate of fair value and to confirm representations regarding whether inputs are observable or unobservable. Procedures may include i) the review of pricing service methodologies or broker pricing qualifications, ii) back-testing, where past fair value estimates are compared to actual transactions executed in the market on similar dates, iii) exception reporting, where period-over-period changes in price are reviewed and challenged with the pricing service or broker based on exception criteria, iv) deep dives, where the Company performs an independent analysis of the inputs and assumptions used to price individual securities and v) pricing validation, where prices received are compared to prices independently estimated by the Company.

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Assets and Liabilities Measured at Fair Value

Assets and liabilities measured at fair value on a recurring basis are presented in the following tables. Corporate bonds and other includes obligations of the U.S. Treasury, government-sponsored enterprises and foreign governments and redeemable preferred stock.

March 31, 2018

| (In millions) | Level | Level 2 | Level | Total Assets/Liabilities at Fair Value |
|---|--------|----------|--------|--|
| | 1 | | 3 | |
| Assets | | | | |
| Fixed maturity securities: | | | | |
| Corporate bonds and other | \$ 167 | \$18,917 | \$ 100 | \$ 19,184 |
| States, municipalities and political subdivisions | — | 12,876 | 1 | 12,877 |
| Asset-backed | — | 7,919 | 279 | 8,198 |
| Total fixed maturity securities | 167 | 39,712 | 380 | 40,259 |
| Equity securities: | | | | |
| Common stock | 83 | — | 4 | 87 |
| Non-redeemable preferred stock | 67 | 602 | 14 | 683 |
| Total equity securities | 150 | 602 | 18 | 770 |
| Short term and other | 156 | 978 | — | 1,134 |
| Total assets | \$473 | \$41,292 | \$ 398 | \$ 42,163 |
| Liabilities | | | | |
| Other liabilities | \$— | \$(1) | \$— | \$(1) |
| Total liabilities | \$— | \$(1) | \$— | \$(1) |

December 31, 2017

| (In millions) | Level | Level 2 | Level | Total Assets/Liabilities at Fair Value |
|---|--------|----------|-------|--|
| | 1 | | 3 | |
| Assets | | | | |
| Fixed maturity securities: | | | | |
| Corporate bonds and other | \$ 128 | \$19,148 | \$ 98 | \$ 19,374 |
| States, municipalities and political subdivisions | — | 14,026 | 1 | 14,027 |
| Asset-backed | — | 7,751 | 335 | 8,086 |
| Total fixed maturity securities | 128 | 40,925 | 434 | 41,487 |
| Equity securities: | | | | |
| Common stock | 23 | — | 4 | 27 |
| Non-redeemable preferred stock | 68 | 584 | 16 | 668 |
| Total equity securities | 91 | 584 | 20 | 695 |
| Short term and other | 396 | 958 | — | 1,354 |
| Total assets | \$615 | \$42,467 | \$454 | \$ 43,536 |
| Liabilities | | | | |
| Other liabilities | \$— | \$ 3 | \$— | \$ 3 |
| Total liabilities | \$— | \$ 3 | \$— | \$ 3 |

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The tables below present a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3).

| Level 3 (In millions) | Corporate bonds and other | States, municipalities and political subdivisions | Asset-backed | Equity securities | Derivative financial instruments | Total |
|---|------------------------------------|---|--------------|----------------------|--|---------|
| Balance as of January 1, 2018 | \$ 98 | \$ 1 | \$ 335 | \$ 20 | \$ | —\$454 |
| Total realized and unrealized investment gains (losses): | | | | | | |
| Reported in Net realized investment gains (losses) | (1) | — | 7 | (2) | — | 4 |
| Reported in Net investment income | — | — | — | — | — | — |
| Reported in Other comprehensive income | — | — | (5) | — | — | (5) |
| Total realized and unrealized investment gains (losses) | (1) | — | 2 | (2) | — | (1) |
| Purchases | — | — | 30 | — | — | 30 |
| Sales | — | — | (72) | — | — | (72) |
| Settlements | (2) | — | (6) | — | — | (8) |
| Transfers into Level 3 | 5 | — | — | — | — | 5 |
| Transfers out of Level 3 | — | — | (10) | — | — | (10) |
| Balance as of March 31, 2018 | \$ 100 | \$ 1 | \$ 279 | \$ 18 | \$ | —\$398 |
| Unrealized gains (losses) on Level 3 assets and liabilities held as of March 31, 2018 recognized in Net income (loss) | \$ — | \$ — | \$ — | \$ (2) | \$ | —\$(2) |

| Level 3 (In millions) | Corporate bonds and other | States, municipalities and political subdivisions | Asset-backed | Equity securities | Derivative financial instruments | Life settlement contracts | Total |
|---|------------------------------------|---|--------------|----------------------|--|---------------------------------|-------|
| Balance as of January 1, 2017 | \$ 130 | \$ 1 | \$ 199 | \$ 19 | \$ — | \$ 58 | \$407 |
| Total realized and unrealized investment gains (losses): | | | | | | | |
| Reported in Net realized investment gains (losses) | — | — | — | — | 1 | — | 1 |
| Reported in Other revenues | — | — | — | — | — | 6 | 6 |
| Reported in Other comprehensive income | 1 | — | 2 | 1 | — | — | 4 |
| Total realized and unrealized investment gains (losses) | 1 | — | 2 | 1 | 1 | 6 | 11 |
| Purchases | 5 | — | 38 | 1 | — | — | 44 |
| Sales | (1) | — | — | (2) | (1) | (13) | (17) |
| Settlements | (14) | — | (6) | — | — | (5) | (25) |
| Transfers into Level 3 | — | — | 28 | — | — | — | 28 |
| Transfers out of Level 3 | — | — | (5) | — | — | — | (5) |
| Balance as of March 31, 2017 | \$ 121 | \$ 1 | \$ 256 | \$ 19 | \$ — | \$ 46 | \$443 |
| Unrealized gains (losses) on Level 3 assets and liabilities held as of March 31, 2017 recognized in Net income (loss) | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — |

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Securities may be transferred in or out of levels within the fair value hierarchy based on the availability of observable market information and quoted prices used to determine the fair value of the security. The availability of observable market information and quoted prices varies based on market conditions and trading volume. During the three months ended March 31, 2018 there were \$29 million of transfers from Level 2 to Level 1 and no transfers from Level 1 to Level 2. During the three months ended March 31, 2017 there were no transfers between Level 1 and Level 2. The Company's policy is to recognize transfers between levels at the beginning of quarterly reporting periods.

Valuation Methodologies and Inputs

The following section describes the valuation methodologies and relevant inputs used to measure different financial instruments at fair value, including an indication of the level in the fair value hierarchy in which the instruments are generally classified.

Fixed Maturity Securities

Level 1 securities include highly liquid and exchange traded bonds and redeemable preferred stock, valued using quoted market prices. Level 2 securities include most other fixed maturity securities as the significant inputs are observable in the marketplace. All classes of Level 2 fixed maturity securities are valued using a methodology based on information generated by market transactions involving identical or comparable assets, a discounted cash flow methodology, or a combination of both when necessary. Common inputs for all classes of fixed maturity securities include prices from recently executed transactions of similar securities, marketplace quotes, benchmark yields, spreads off benchmark yields, interest rates and U.S. Treasury or swap curves. Specifically for asset-backed securities, key inputs include prepayment and default projections based on past performance of the underlying collateral and current market data. Fixed maturity securities are primarily assigned to Level 3 in cases where broker/dealer quotes are significant inputs to the valuation and there is a lack of transparency as to whether these quotes are based on information that is observable in the marketplace. Level 3 securities also include private placement debt securities whose fair value is determined using internal models with inputs that are not market observable.

Equity Securities

Level 1 securities include publicly traded securities valued using quoted market prices. Level 2 securities are primarily valued using pricing for similar securities, recently executed transactions and other pricing models utilizing market observable inputs. Level 3 securities are primarily priced using broker/dealer quotes and internal models with inputs that are not market observable.

Short Term and Other Invested Assets

Securities that are actively traded or have quoted prices are classified as Level 1. These securities include money market funds and treasury bills. Level 2 primarily includes commercial paper, for which all inputs are market observable. Fixed maturity securities purchased within one year of maturity are classified consistent with fixed maturity securities discussed above. Short term investments as presented in the tables above differ from the amounts presented on the Condensed Consolidated Balance Sheets because certain short term investments, such as time deposits, are not measured at fair value.

As of March 31, 2018 and December 31, 2017, there were approximately \$42 million and \$39 million of overseas deposits within other invested assets, which can be redeemed at net asset value in 90 days or less. Overseas deposits are excluded from the fair value hierarchy because their fair value is recorded using the net asset value per share (or equivalent) practical expedient.

Life Settlement Contracts

The Company sold its life settlement contracts to a third party in 2017. The valuation of the life settlement contracts was based on the terms of sale. The contracts were classified as Level 3 as there was not an active market for life settlement contracts.

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Derivative Financial Investments

Level 2 investments primarily include the embedded derivative on the funds withheld liability. The embedded derivative on funds withheld liability is valued using the change in fair value of the assets supporting the funds withheld liability, which are fixed maturity securities valued with observable inputs.

Significant Unobservable Inputs

The following tables present quantitative information about the significant unobservable inputs utilized by the Company in the fair value measurements of Level 3 assets. Valuations for assets and liabilities not presented in the tables below are primarily based on broker/dealer quotes for which there is a lack of transparency as to inputs used to develop the valuations. The quantitative detail of these unobservable inputs is neither provided nor reasonably available to the Company.

| March 31, 2018 | Estimated Fair Value (In millions) | Valuation Technique(s) | Unobservable Input(s) | Range (Weighted Average) |
|---------------------------|--|------------------------|-----------------------|-----------------------------|
| Fixed maturity securities | \$ 133 | Discounted cash flow | Credit spread | 1% - 12% (3%) |

| December 31, 2017 | Estimated Fair Value (In millions) | Valuation Technique(s) | Unobservable Input(s) | Range (Weighted Average) |
|---------------------------|--|------------------------|-----------------------|-----------------------------|
| Fixed maturity securities | \$ 136 | Discounted cash flow | Credit spread | 1% - 12% (3%) |

For fixed maturity securities, an increase to the credit spread assumptions would result in a lower fair value measurement.

Financial Assets and Liabilities Not Measured at Fair Value

The carrying amount and estimated fair value of the Company's financial assets and liabilities which are not measured at fair value on the Condensed Consolidated Balance Sheets are presented in the following tables.

| March 31, 2018 (In millions) | Carrying Amount | Estimated Fair Value | | | |
|---------------------------------|--------------------|----------------------|------------|------------|-------|
| | | Level 1 | Level 2 | Level 3 | Total |

Assets

| | | | | | |
|-----------------|--------|-----|-----|-------|-------|
| Mortgage loans | \$ 864 | \$— | \$— | \$856 | \$856 |
| Note receivable | 34 | — | 34 | 34 | 34 |

Liabilities

| | | | | | |
|-----------------|-------|-----|-------|-----|-------|
| Short term debt | \$ 30 | \$— | \$30 | \$— | \$30 |
| Long term debt | 2,679 | — | 2,786 | — | 2,786 |

| December 31, 2017 (In millions) | Carrying Amount | Estimated Fair Value | | | |
|------------------------------------|--------------------|----------------------|------------|------------|-------|
| | | Level 1 | Level 2 | Level 3 | Total |

Assets

| | | | | | |
|-----------------|--------|-----|-----|-------|-------|
| Mortgage loans | \$ 839 | \$— | \$— | \$844 | \$844 |
| Note receivable | 46 | — | 46 | 46 | 46 |

Liabilities

| | | | | | |
|-----------------|--------|-----|-------|-----|-------|
| Short term debt | \$ 150 | \$— | \$150 | \$— | \$150 |
| Long term debt | 2,708 | — | 2,896 | — | 2,896 |

The following methods and assumptions were used to estimate the fair value of these financial assets and liabilities.

The fair values of mortgage loans were based on the present value of the expected future cash flows discounted at the current interest rate for origination of similar quality loans, adjusted for specific loan risk.

The fair value of the note receivable was based on the present value of the expected future cash flows discounted at the current interest rate for origination of similar notes, adjusted for specific credit risk.

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The Company's senior notes and debentures were valued based on observable market prices. The fair value for other debt was estimated using discounted cash flows based on current incremental borrowing rates for similar borrowing arrangements.

The carrying amounts reported on the Condensed Consolidated Balance Sheets for Cash, Short term investments not carried at fair value, Accrued investment income and certain Other assets and Other liabilities approximate fair value due to the short term nature of these items. These assets and liabilities are not listed in the tables above.

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Note E. Claim and Claim Adjustment Expense Reserves

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

Establishing claim and claim adjustment expense reserves, including claim and claim adjustment expense reserves for catastrophic events that have occurred, is an estimation process. Many factors can ultimately affect the final settlement of a claim and, therefore, the necessary reserve. Changes in the law, results of litigation, medical costs, the cost of repair materials and labor rates can affect ultimate claim costs. In addition, time can be a critical part of reserving determinations since the longer the span between the incidence of a loss and the payment or settlement of the claim, the more variable the ultimate settlement amount can be. Accordingly, short-tail claims, such as property damage claims, tend to be more reasonably estimable than long-tail claims, such as workers' compensation, general liability and professional liability claims. Adjustments to prior year reserve estimates, if necessary, are reflected in the results of operations in the period that the need for such adjustments is determined. There can be no assurance that the Company's ultimate cost for insurance losses will not exceed current estimates.

Catastrophes are an inherent risk of the property and casualty insurance business and have contributed to material period-to-period fluctuations in the Company's results of operations and/or equity. The Company reported catastrophe losses, net of reinsurance, of \$34 million for the three months ended March 31, 2018 and 2017. Net catastrophe losses in the first quarter of 2018 and 2017 related primarily to U.S. weather-related events.

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Liability for Unpaid Claim and Claim Adjustment Expenses Rollforward

The following table presents a reconciliation between beginning and ending claim and claim adjustment expense reserves, including claim and claim adjustment expense reserves of the Life & Group segment.

For the three months ended March 31

| (In millions) | 2018 | 2017 |
|---|----------|----------|
| Reserves, beginning of year: | | |
| Gross | \$22,004 | \$22,343 |
| Ceded | 3,934 | 4,094 |
| Net reserves, beginning of year | 18,070 | 18,249 |
| Net incurred claim and claim adjustment expenses: | | |
| Provision for insured events of current year | 1,246 | 1,207 |
| Decrease in provision for insured events of prior years | (34) | (82) |
| Amortization of discount | 47 | 48 |
| Total net incurred ⁽¹⁾ | 1,259 | 1,173 |
| Net payments attributable to: | | |
| Current year events | (91) | (68) |
| Prior year events | (1,219) | (1,184) |
| Total net payments | (1,310) | (1,252) |
| Foreign currency translation adjustment and other | (9) | 14 |
| Net reserves, end of period | 18,010 | 18,184 |
| Ceded reserves, end of period | 4,057 | 4,076 |
| Gross reserves, end of period | \$22,067 | \$22,260 |

Total net incurred above does not agree to Insurance claims and policyholders' benefits as reflected on the Condensed Consolidated Statements of Operations due to amounts related to retroactive reinsurance deferred gain accounting, uncollectible reinsurance and loss deductible receivables, and benefit expenses related to future policy benefits, which are not reflected in the table above.

Net Prior Year Development

Changes in estimates of claim and claim adjustment expense reserves, net of reinsurance, for prior years are defined as net prior year loss reserve development (development). These changes can be favorable or unfavorable. The following table presents development recorded for the Specialty, Commercial, International and Corporate & Other segments.

For the three months ended March 31

| (In millions) | 2018 | 2017 |
|--|--------|--------|
| Pretax (favorable) unfavorable development: | | |
| Specialty | \$(30) | \$(12) |
| Commercial | (9) | (43) |
| International | — | (2) |
| Corporate & Other | — | — |
| Total pretax (favorable) unfavorable development | \$(39) | \$(57) |

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Specialty

The following table presents further detail of the development recorded for the Specialty segment.

Three months ended March 31

| (In millions) | 2018 | 2017 |
|---|--------|--------|
| Pretax (favorable) unfavorable development: | | |
| Medical Professional Liability | \$20 | \$20 |
| Other Professional Liability and Management Liability | (34) | (32) |
| Surety | (15) | — |
| Warranty | — | — |
| Other | (1) | — |
| Total pretax (favorable) unfavorable development | \$(30) | \$(12) |

2018

Unfavorable development for medical professional liability was primarily due to higher than expected severity in accident years 2014 and 2017 in our hospitals business.

Favorable development in other professional liability and management liability was primarily due to lower than expected claim frequency in accident years 2013 through 2015 related to financial institutions.

Favorable development for surety was due to lower than expected loss emergence for accident years 2015 and prior.

2017

Favorable development in other professional liability and management liability was primarily due to favorable settlements on closed claims and lower than expected frequency of large losses related to professional liability in accident years 2011 through 2016.

Unfavorable development in medical professional liability was primarily due to continued higher than expected frequency in aging services.

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Commercial

The following table presents further detail of the development recorded for the Commercial segment.

Three months ended March 31

| (In millions) | 2018 | 2017 |
|--|--------|---------|
| Pretax (favorable) unfavorable development: | | |
| Commercial Auto | \$ (1) | \$ (26) |
| General Liability | (8) | (18) |
| Workers' Compensation | (6) | — |
| Property and Other | 6 | 1 |
| Total pretax (favorable) unfavorable development | \$ (9) | \$ (43) |

2018

Favorable development for general liability was primarily due to lower than expected frequency and severity in accident years 2015 and prior for our middle market construction business.

2017

Favorable development for commercial auto was primarily due to lower than expected severity in accident years 2013 through 2015.

Favorable development for general liability was due to lower than expected severity in life sciences.

International

The following table presents further detail of the development recorded for the International segment.

Three months ended March 31

| (In millions) | 2018 | 2017 |
|--|------|--------|
| Pretax (favorable) unfavorable development: | | |
| Medical Professional Liability | \$ 1 | \$ — |
| Other Professional Liability | 1 | (1) |
| Liability | — | — |
| Property & Marine | (2) | 1 |
| Other | — | (2) |
| Total pretax (favorable) unfavorable development | \$ — | \$ (2) |

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Asbestos and Environmental Pollution (A&EP) Reserves

In 2010, Continental Casualty Company (CCC) together with several of the Company's other insurance subsidiaries completed a transaction with National Indemnity Company (NICO), a subsidiary of Berkshire Hathaway Inc., under which substantially all of the Company's legacy A&EP liabilities were ceded to NICO through a Loss Portfolio Transfer (LPT). At the effective date of the transaction, the Company ceded approximately \$1.6 billion of net A&EP claim and allocated claim adjustment expense reserves to NICO under a retroactive reinsurance agreement with an aggregate limit of \$4 billion. The \$1.6 billion of claim and allocated claim adjustment expense reserves ceded to NICO was net of \$1.2 billion of ceded claim and allocated claim adjustment expense reserves under existing third-party reinsurance contracts. The NICO LPT aggregate reinsurance limit also covers credit risk on the existing third-party reinsurance related to these liabilities. The Company paid NICO a reinsurance premium of \$2 billion and transferred to NICO billed third-party reinsurance receivables related to A&EP claims with a net book value of \$215 million, resulting in total consideration of \$2.2 billion.

Subsequent to the effective date of the LPT, the Company recognized adverse prior year development on its A&EP reserves which resulted in additional amounts ceded under the LPT. As a result, the cumulative amounts ceded under the LPT exceeded the \$2.2 billion consideration paid, resulting in the NICO LPT moving into a gain position, requiring retroactive reinsurance accounting. Under retroactive reinsurance accounting, this gain is deferred and only recognized in earnings in proportion to actual paid recoveries under the LPT. Over the life of the contract, there is no economic impact as long as any additional losses incurred are within the limit of the LPT. In a period in which the Company recognizes a change in the estimate of A&EP reserves that increases the amounts ceded under the LPT, the proportion of actual paid recoveries to total ceded losses is affected and the change in the deferred gain is recognized in earnings as if the revised estimate of ceded losses was available at the effective date of the LPT. The effect of the deferred retroactive reinsurance benefit is recorded in Insurance claims and policyholders' benefits in the Condensed Consolidated Statement of Operations.

The following table presents the impact of the Loss Portfolio Transfer on the Condensed Consolidated Statements of Operations.

Three months ended March 31

| (In millions) | 2018 | 2017 |
|---|--------|-------|
| Additional amounts ceded under LPT: | | |
| Net A&EP adverse development before consideration of LPT | \$ 113 | \$ 60 |
| Provision for uncollectible third-party reinsurance on A&EP | (16) | — |
| Total additional amounts ceded under LPT | 97 | 60 |
| Retroactive reinsurance benefit recognized | (57) | (40) |
| Pretax impact of deferred retroactive reinsurance | \$ 40 | \$ 20 |

Based upon the Company's annual A&EP reserve review, net unfavorable prior year development of \$113 million and \$60 million was recognized before consideration of cessions to the LPT for the three months ended March 31, 2018 and 2017. Additionally, in 2018, the Company released a portion of its provision for uncollectible third party reinsurance. The 2018 unfavorable development was driven by higher than anticipated defense costs on direct asbestos environmental accounts and paid losses on assumed reinsurance exposures. The 2017 unfavorable development was driven by modestly higher anticipated payouts on claims from known sources of asbestos exposure. While the unfavorable development was ceded to NICO under the LPT, the Company's Net income in the periods was negatively affected due to the application of retroactive reinsurance accounting.

As of March 31, 2018 and December 31, 2017, the cumulative amounts ceded under the LPT were \$3.0 billion and \$2.9 billion. The unrecognized deferred retroactive reinsurance benefit was \$366 million and \$326 million as of March 31, 2018 and December 31, 2017.

NICO established a collateral trust account as security for its obligations to the Company. The fair value of the collateral trust account was \$2.9 billion and \$3.1 billion as of March 31, 2018 and December 31, 2017. In addition, Berkshire Hathaway Inc. guaranteed the payment obligations of NICO up to the aggregate reinsurance limit as well as certain of NICO's performance obligations under the trust agreement. NICO is responsible for claims handling and billing and collection from third-party reinsurers related to the Company's A&EP claims.

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Note F. Legal Proceedings, Contingencies and Guarantees

CNA 401(k) Plus Plan Litigation

In September 2016, a class action lawsuit was filed against CCC, Continental Assurance Company (CAC) (a former subsidiary of CCC), CNAF, the Investment Committee of the CNA 401(k) Plus Plan (Plan), The Northern Trust Company and John Does 1-10 (collectively Defendants) related to the Plan. The complaint alleges that Defendants breached fiduciary duties to the Plan and caused prohibited transactions in violation of the Employee Retirement Income Security Act of 1974 when the Plan's Fixed Income Fund's annuity contract with CAC was canceled. The plaintiff alleges he and a proposed class of Plan participants who had invested in the Fixed Income Fund suffered lower returns in their Plan investments as a consequence of these alleged violations and seeks relief on behalf of the putative class. The Plan trustees have provided notice to their fiduciary coverage insurance carriers.

The plaintiff, Defendants and the Plan's fiduciary insurance carriers have agreed on terms to settle this matter. Upon execution of final settlement agreements, plaintiff and Defendants will propose a class settlement for court approval. Based on the executed term sheet, management has recorded its best estimate of the Company's probable loss and does not believe that the ultimate resolution of this matter will have a material impact on the Company's results of operations or financial position.

Small Business Premium Rate Adjustment

In 2016 and 2017, the Company identified rating errors related to its multi-peril package product and workers' compensation policies within its Small Business unit and determined that it would voluntarily issue premium refunds along with interest on affected policies. After the rating errors were identified, written and earned premium have been reported net of any impact from the premium rate adjustments. In the first quarter of 2017, the Company recorded a charge which reduced Earned premium by \$38 million and increased Interest expense by \$5 million for interest due to policyholders on the premium rate adjustments.

The policyholder refunds for the multi-peril package product were issued in the third quarter of 2017. The policyholder refunds for workers' compensation policies are expected to be refunded in the second half of 2018 and, as such, an additional \$1 million of Interest expense was recorded in the first quarter of 2018. The estimated refund liability, including interest, for the workers' compensation policies as of March 31, 2018 was \$60 million.

Other Litigation

The Company is a party to other routine litigation incidental to its business, which, based on the facts and circumstances currently known, is not material to the Company's results of operations or financial position.

Guarantees

As of March 31, 2018 and December 31, 2017, the Company had recorded liabilities of approximately \$5 million related to guarantee and indemnification agreements and management believes that it is not likely that any future indemnity claims will be significantly greater than the amounts recorded.

In the course of selling business entities and assets to third parties, the Company agreed to guarantee the performance of certain obligations of previously owned subsidiaries and to indemnify purchasers for losses arising out of breaches of representations and warranties with respect to the business entities or assets sold, including, in certain cases, losses arising from undisclosed liabilities or certain named litigation. Such guarantee and indemnification agreements in effect for sales of business entities, assets and third-party loans may include provisions that survive indefinitely. As of March 31, 2018, the aggregate amount related to quantifiable guarantees was \$375 million and the aggregate amount related to quantifiable indemnification agreements was \$252 million. In certain cases, should the Company be required to make payments under any such guarantee, it would have the right to seek reimbursement from an affiliate of a previously owned subsidiary.

In addition, the Company has agreed to provide indemnification to third-party purchasers for certain losses associated with sold business entities or assets that are not limited by a contractual monetary amount. As of March 31, 2018 the Company had outstanding unlimited indemnifications in connection with the sales of certain of its business entities or assets that included tax liabilities arising prior to a purchaser's ownership of an entity or asset, defects in title at the time of sale, employee claims arising prior to closing and in some cases losses arising from certain litigation and undisclosed liabilities. Certain provisions of the indemnification agreements survive

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indefinitely, while others survive until the applicable statutes of limitation expire, or until the agreed-upon contract terms expire.

The Company also provided guarantees, if the primary obligor fails to perform, to holders of structured settlement annuities provided by a previously owned subsidiary. As of March 31, 2018, the potential amount of future payments the Company could be required to pay under these guarantees was approximately \$1.8 billion, which will be paid over the lifetime of the annuitants. The Company does not believe any payment is likely under these guarantees, as the Company is the beneficiary of a trust that must be maintained at a level that approximates the discounted reserves for these annuities.

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Note G. Benefit Plans

The components of net periodic pension cost (benefit) are presented in the following table.

| Three months ended March 31 (In millions) | Pension Plans | |
|---|------------------|-------|
| | 2018 | 2017 |
| Net periodic pension cost (benefit) | | |
| Service cost | \$— | \$— |
| Non-service cost: | | |
| Interest cost on projected benefit obligation | 23 | 26 |
| Expected return on plan assets | (40) | (39) |
| Amortization of net actuarial loss | 9 | 9 |
| Settlement loss | 4 | 2 |
| Total non-service cost | (4) | (2) |
| Total net periodic pension cost (benefit) | \$(4) | \$(2) |

For the three months ended March 31, 2018, the Company recognized \$1 million of non-service cost in Insurance claims and policyholders' benefits and \$3 million of non-service cost in Other operating expenses. For the three months ended March 31, 2017, the Company recognized \$1 million of non-service costs in Insurance claims and policyholders' benefits and \$1 million of non-service costs in Other operating expenses.

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Note H. Accumulated Other Comprehensive Income (Loss) by Component

The tables below display the changes in Accumulated other comprehensive income (loss) by component.

| (In millions) | Net unrealized gains (losses) on investments with OTTI losses | Net unrealized gains (losses) on other investments | Pension and postretirement benefits | Cumulative foreign currency translation adjustment | Total |
|---|---|--|---|--|---------|
| Balance as of January 1, 2018, as previously reported | \$ 25 | \$ 750 | \$ (645) | \$ (98) | \$32 |
| Cumulative effect adjustment from accounting change for adoption of ASU 2018-02 ⁽¹⁾ | 5 | 137 | (130) | — | 12 |
| Cumulative effect adjustment from accounting change for adoption of ASU 2016-01 ⁽¹⁾ net of tax (expense) benefit of \$-, \$8, \$-, \$- and \$8 | — | (28) | — | — | (28) |
| Balance as of January 1, 2018, as adjusted | 30 | 859 | (775) | (98) | 16 |
| Other comprehensive income (loss) before reclassifications | (10) | (414) | — | 12 | (412) |
| Amounts reclassified from accumulated other comprehensive income (loss) net of tax (expense) benefit of \$-, \$(4), \$3, \$- and \$(1) | (1) | 15 | (10) | — | 4 |
| Other comprehensive income (loss) net of tax (expense) benefit of \$2, \$109, \$(3), \$- and \$108 | (9) | (429) | 10 | 12 | (416) |
| Balance as of March 31, 2018 | \$ 21 | \$ 430 | \$ (765) | \$ (86) | \$(400) |

(1) See Note A to the Condensed Consolidated Financial Statements for additional information.

| (In millions) | Net unrealized gains (losses) on investments with OTTI losses | Net unrealized gains (losses) on other investments | Pension and postretirement benefits | Cumulative foreign currency translation adjustment | Total |
|--|---|--|---|--|---------|
| Balance as of January 1, 2017 | \$ 30 | \$ 642 | \$ (647) | \$ (198) | \$(173) |
| Other comprehensive income (loss) before reclassifications | — | 85 | — | 11 | 96 |
| Amounts reclassified from accumulated other comprehensive income (loss) net of tax (expense) benefit of \$(2), \$(9), \$4, \$- and \$(7) | 4 | 18 | (7) | — | 15 |
| Other comprehensive income (loss) net of tax (expense) benefit of \$1, \$(38), \$(4), \$- and \$(41) | (4) | 67 | 7 | 11 | 81 |
| Balance as of March 31, 2017 | \$ 26 | \$ 709 | \$ (640) | \$ (187) | \$(92) |

Amounts reclassified from Accumulated other comprehensive income (loss) shown above are reported in Net income (loss) as follows:

| Component of AOCI | Condensed Consolidated Statements of Operations Line Item Affected by Reclassifications |
|---|---|
| Net unrealized gains (losses) on investments with OTTI losses | Net realized investment gains (losses) |

Net unrealized gains (losses) on other investments

Net realized investment gains (losses)

Pension and postretirement benefits

Other operating expenses and Insurance claims and
policyholders' benefits

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Note I. Business Segments

The Company's property and casualty commercial insurance operations are managed and reported in three business segments: Specialty, Commercial and International. These three segments are collectively referred to as Property & Casualty Operations. The Company's operations outside of Property & Casualty Operations are managed and reported in two segments: Life & Group and Corporate & Other.

Effective January 1, 2018, management changed the segment presentation of the life sciences business and technology and media related errors and omissions business within the Specialty and Commercial business segments. The life sciences business moved from the Specialty business segment to the Commercial business segment and the technology and media related errors and omissions business moved from the Commercial business segment to the Specialty business segment. The new management responsibility for these businesses better aligns with line of business underwriting expertise and the manner in which the products are sold. Prior period information has been conformed to the new segment presentation.

The accounting policies of the segments are the same as those described in Note A to the Consolidated Financial Statements within CNAF's Annual Report on Form 10-K for the year ended December 31, 2017. The Company manages most of its assets on a legal entity basis, while segment operations are generally conducted across legal entities. As such, only Insurance and Reinsurance receivables, Insurance reserves, Deferred acquisition costs and Goodwill are readily identifiable for individual segments. Distinct investment portfolios are not maintained for every individual segment; accordingly, allocation of assets to each segment is not performed. Therefore, a significant portion of Net investment income and Realized investment gains or losses are allocated primarily based on each segment's net carried insurance reserves, as adjusted. All significant intersegment income and expense has been eliminated. Income taxes have been allocated on the basis of the taxable income of the segments.

In the following tables, certain financial measures are presented to provide information used by management to monitor the Company's operating performance. Management utilizes these financial measures to monitor the Company's insurance operations and investment portfolio.

Core income (loss), which is derived from certain income statement amounts, is used by management to monitor performance of the Company's insurance operations. The Company's investment portfolio is monitored by management through analysis of various factors including unrealized gains and losses on securities, portfolio duration and exposure to market and credit risk.

Core income (loss) is calculated by excluding from net income (loss) the after-tax effects of i) net realized investment gains (losses), ii) income or loss from discontinued operations, iii) any cumulative effects of changes in accounting guidance and iv) deferred tax asset and liability remeasurement as a result of an enacted U.S. Federal tax rate change. The calculation of core income (loss) excludes net realized investment gains or losses because net realized investment gains or losses are generally driven by economic factors that are not necessarily consistent with key drivers of underwriting performance, and are therefore not considered an indication of trends in insurance operations.

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The Company's results of operations and selected balance sheet items by segment are presented in the following tables.

Three months ended March 31, 2018

| (In millions) | Specialty | Commercial | International | Life & Group | Corporate & Other | Eliminations | Total |
|--|-----------|------------|---------------|--------------|-------------------|--------------|---------|
| Operating revenues | | | | | | | |
| Net earned premiums | \$ 672 | \$ 743 | \$ 236 | \$ 134 | \$ — | \$ — | \$1,785 |
| Net investment income | 122 | 149 | 14 | 200 | 5 | — | 490 |
| Non-insurance warranty revenue | 238 | — | — | — | — | — | 238 |
| Other revenues | 1 | 8 | — | 1 | 1 | (1) | 10 |
| Total operating revenues | 1,033 | 900 | 250 | 335 | 6 | (1) | 2,523 |
| Claims, benefits and expenses | | | | | | | |
| Net incurred claims and benefits | 379 | 468 | 142 | 303 | 41 | — | 1,333 |
| Policyholders' dividends | 1 | 5 | — | — | — | — | 6 |
| Amortization of deferred acquisition costs | 145 | 121 | 30 | — | — | — | 296 |
| Non-insurance warranty expense | 216 | — | — | — | — | — | 216 |
| Other insurance related expenses | 64 | 127 | 56 | 30 | — | — | 277 |
| Other expenses | 11 | 11 | (4) | 2 | 42 | (1) | 61 |
| Total claims, benefits and expenses | 816 | 732 | 224 | 335 | 83 | (1) | 2,189 |
| Core income (loss) before income tax | 217 | 168 | 26 | — | (77) | — | 334 |
| Income tax (expense) benefit on core income (loss) | (46) | (35) | (3) | 14 | 17 | — | (53) |
| Core income (loss) | \$ 171 | \$ 133 | \$ 23 | \$ 14 | \$ (60) | \$ — | 281 |
| Net realized investment gains (losses) | | | | | | | 12 |
| Income tax (expense) benefit on net realized investment gains (losses) | | | | | | | (2) |
| Net realized investment gains (losses), after tax | | | | | | | 10 |
| Net income | | | | | | | \$291 |

March 31, 2018

(In millions)

| | | | | | | | |
|-------------------------------------|--------|--------|--------|--------|----------|------|----------|
| Reinsurance receivables | \$ 737 | \$ 690 | \$ 244 | \$ 436 | \$ 2,330 | \$ — | \$ 4,437 |
| Insurance receivables | 947 | 1,140 | 315 | 11 | 1 | — | 2,414 |
| Deferred acquisition costs | 318 | 241 | 106 | — | — | — | 665 |
| Goodwill | 117 | — | 32 | — | — | — | 149 |
| Insurance reserves | | | | | | | |
| Claim and claim adjustment expenses | 5,696 | 8,718 | 1,718 | 3,501 | 2,434 | — | 22,067 |
| Unearned premiums | 2,063 | 1,490 | 559 | 145 | — | (1) | 4,256 |
| Future policy benefits | — | — | — | 10,783 | — | — | 10,783 |

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Three months ended March 31, 2017

| (In millions) | Specialty | Commercial | International | Life & Group | Corporate & Other | Eliminations | Total |
|--|-----------|------------|---------------|--------------|-------------------|--------------|----------|
| Operating revenues | | | | | | | |
| Net earned premiums | \$ 654 | \$ 661 | \$ 197 | \$ 133 | \$ — | \$ — | \$ 1,645 |
| Net investment income | 148 | 183 | 12 | 197 | 5 | — | 545 |
| Non-insurance warranty revenue | 93 | — | — | — | — | — | 93 |
| Other revenues | 1 | 9 | — | 1 | — | — | 11 |
| Total operating revenues | 896 | 853 | 209 | 331 | 5 | — | 2,294 |
| Claims, benefits and expenses | | | | | | | |
| Net incurred claims and benefits | 400 | 423 | 115 | 330 | 21 | — | 1,289 |
| Policyholders' dividends | 1 | 3 | — | — | — | — | 4 |
| Amortization of deferred acquisition costs | 142 | 117 | 46 | — | — | — | 305 |
| Non-insurance warranty expense | 70 | — | — | — | — | — | 70 |
| Other insurance related expenses | 67 | 128 | 27 | 32 | — | — | 254 |
| Other expenses | 10 | 15 | (6) | 2 | 44 | — | 65 |
| Total claims, benefits and expenses | 690 | 686 | 182 | 364 | 65 | — | 1,987 |
| Core income (loss) before income tax | 206 | 167 | 27 | (33) | (60) | — | 307 |
| Income tax (expense) benefit on core income (loss) | (69) | (56) | (7) | 37 | 23 | — | (72) |
| Core income (loss) | \$ 137 | \$ 111 | \$ 20 | \$ 4 | \$ (37) | \$ — | \$ 235 |
| Net realized investment gains (losses) | | | | | | | 36 |
| Income tax (expense) benefit on net realized investment gains (losses) | | | | | | | (11) |
| Net realized investment gains (losses), after tax | | | | | | | 25 |
| Net income | | | | | | | \$ 260 |

December 31, 2017

(In millions)

| | | | | | | |
|-------------------------------------|--------|--------|--------|--------|----------|----------|
| Reinsurance receivables | \$ 671 | \$ 654 | \$ 212 | \$ 438 | \$ 2,315 | \$ 4,290 |
| Insurance receivables | 969 | 1,103 | 254 | 8 | 2 | 2,336 |
| Deferred acquisition costs | 318 | 223 | 93 | — | — | 634 |
| Goodwill | 117 | — | 31 | — | — | 148 |
| Insurance reserves | | | | | | |
| Claim and claim adjustment expenses | 5,669 | 8,764 | 1,636 | 3,499 | 2,436 | 22,004 |
| Unearned premiums | 2,020 | 1,409 | 472 | 128 | — | 4,029 |
| Future policy benefits | — | — | — | 11,179 | — | 11,179 |

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The following table presents operating revenue by line of business for each reportable segment.

Three months ended March 31

| (In millions) | 2018 | 2017 |
|---|---------|---------|
| Specialty | | |
| Management & Professional Liability | \$624 | \$638 |
| Surety | 129 | 124 |
| Warranty & Alternative Risks ⁽¹⁾ | 280 | 134 |
| Specialty revenues | 1,033 | 896 |
| Commercial | | |
| Middle Market | 504 | 468 |
| Small Business | 119 | 96 |
| Other Commercial Insurance | 277 | 289 |
| Commercial revenues | 900 | 853 |
| International | | |
| Canada | 58 | 51 |
| CNA Europe | 88 | 72 |
| Hardy | 104 | 86 |
| International revenues | 250 | 209 |
| Life & Group revenues | 335 | 331 |
| Corporate & Other revenues | 6 | 5 |
| Eliminations | (1) | — |
| Total operating revenues | 2,523 | 2,294 |
| Net realized investment gains (losses) | 12 | 36 |
| Total revenues | \$2,535 | \$2,330 |

As of January 1, 2018, the Company adopted ASU 2014-09 Revenue Recognition (Topic 606): Revenue from (1) Contracts with Customers. See Note A to the Condensed Consolidated Financial Statements for additional information.

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Note J. Non-Insurance Revenues from Contracts with Customers

Non-Insurance revenue is recognized when obligations under the terms of a contract with a customer are satisfied; generally this occurs over time as obligations are fulfilled. Revenue is measured as the amount of consideration the Company expects to receive in exchange for providing services.

Deferred Non-Insurance Warranty Revenue

Non-insurance warranty revenue is primarily generated from separately-priced service contracts that provide mechanical breakdown and other coverages to vehicle or consumer goods owners. The warranty contracts generally provide coverage from 1 month to 10 years. For warranty products in which the Company acts as the principal in the transaction, Non-insurance warranty revenues are reported on a gross basis, with amounts billed to customers reported as Non-insurance warranty revenue and commissions paid to agents reported as Non-insurance warranty expense. Non-insurance warranty revenue is reported net of any premiums related to contractual liability coverage issued by the Company's insurance operations. Additionally, the Company provides warranty administration services for dealer and manufacturer obligor warranty products, which include limited warranties and guaranteed automobile protection waivers.

The Company recognizes Non-insurance warranty revenues over the service period in proportion to the actuarially determined expected claims emergence pattern. Customers pay in full at the inception of the warranty contract. A liability for deferred revenue is recorded when cash payments are received or due in advance of the Company's performance. The deferred revenue balance includes amounts which are refundable on a pro rata basis upon cancellation.

The Company had deferred non-insurance warranty revenue balances of \$2.9 billion and \$3.0 billion reported in Other liabilities as of January 1, 2018 and March 31, 2018. The increase in the deferred revenue balance for the three months ended March 31, 2018 was primarily driven by cash payments received or due in advance of satisfying the Company's performance obligations, offset by cancellations and revenues recognized during the period. For the three months ended March 31, 2018, the Company recognized \$222 million of revenues that were included in the deferred revenue balance at the beginning of the period. For the three months ended March 31, 2018, Non-insurance warranty revenue recognized from performance obligations related to prior periods due to a change in estimate was not material. The Company expects to recognize approximately \$659 million of the deferred revenue in the remainder of 2018, \$761 million in 2019, \$593 million in 2020, and \$1 billion thereafter.

Cost to Obtain and Fulfill Non-Insurance Warranty Contracts with Customers

Dealers, retailers and agents earn commission for assisting the Company in obtaining non-insurance warranty contracts. Additionally, the Company utilizes a third-party to perform warranty administrator services for its consumer good warranties. These costs are deferred and recorded as Other assets. These costs are amortized to Non-insurance warranty expense consistent with how the related revenue is recognized.

A premium deficiency arises to the extent that estimated future costs associated with these contracts exceed unrecognized revenue. The Company evaluates deferred costs for recoverability as part of our premium deficiency assessment. Anticipated investment income is considered in the determination of the recoverability of deferred costs.

If necessary, adjustments to deferred costs and a premium deficiency reserve, if any, are recorded in current period results of operations. No premium deficiency was recognized in the three months ended March 31, 2018.

As of March 31, 2018, capitalized commission costs were \$2.2 billion and capitalized administrator service costs were \$17 million. For the three months ended March 31, 2018, the amount of amortization of capitalized costs was \$157 million and there was no impairment loss related to the costs capitalized.

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Item 2. Management's Discussion and Analysis (MD&A) of Financial Condition and Results of Operations

OVERVIEW

The following discussion highlights significant factors affecting the Company. References to “we,” “our,” “us” or like terms refer to the business of CNA. Based on 2016 statutory net written premiums, we are the eighth largest commercial insurer in the United States of America.

The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements included under Part I, Item 1 of this Form 10-Q and Item 1A Risk Factors and Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations, which are included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2017.

We utilize the core income (loss) financial measure to monitor our operations. Core income (loss) is calculated by excluding from net income (loss) the after-tax effects of i) net realized investment gains or losses, ii) income or loss from discontinued operations, iii) any cumulative effects of changes in accounting guidance and iv) deferred tax asset and liability remeasurement as a result of an enacted U.S. Federal tax rate change. The calculation of core income (loss) excludes net realized investment gains or losses because net realized investment gains or losses are generally driven by economic factors that are not necessarily consistent with key drivers of underwriting performance, and are therefore not considered an indication of trends in insurance operations. Management monitors core income (loss) for each business segment to assess segment performance. Presentation of consolidated core income (loss) is deemed to be a non-GAAP financial measure. See further discussion regarding how we manage our business in Note I to the Condensed Consolidated Financial Statements included under Part I, Item 1. For reconciliations of non-GAAP measures to the most comparable GAAP measures and other information, please refer herein and/or to CNA's most recent 10-K on file with the Securities and Exchange Commission.

In evaluating the results of our Specialty, Commercial and International segments, we utilize the loss ratio, the expense ratio, the dividend ratio and the combined ratio. These ratios are calculated using GAAP financial results. The loss ratio is the percentage of net incurred claim and claim adjustment expenses to net earned premiums. The expense ratio is the percentage of insurance underwriting and acquisition expenses, including the amortization of deferred acquisition cost, to net earned premiums. The dividend ratio is the ratio of policyholders' dividends incurred to net earned premiums. The combined ratio is the sum of the loss, expense and dividend ratios. In addition we also utilize renewal premium change, rate, retention and new business in evaluating operating trends. Renewal premium change represents the estimated change in average premium on policies that renew, including rate and exposure changes. Rate represents the average change in price on policies that renew excluding exposure change. Exposure represents the measure of risk used in the pricing of the insurance product. Retention represents the percentage of premium dollars renewed in comparison to the expiring premium dollars from policies available to renew. Renewal premium change, rate and retention presented for the prior year are updated to reflect subsequent activity on policies written in the period. New business represents premiums from policies written with new customers and additional policies written with existing customers.

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

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CRITICAL ACCOUNTING ESTIMATES

The preparation of the Condensed Consolidated Financial Statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the Condensed Consolidated Financial Statements and the amount of revenues and expenses reported during the period. Actual results may differ from those estimates.

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

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

Insurance Reserves

Reinsurance and Insurance Receivables

Valuation of Investments and Impairment of Securities

Long Term Care Policies

Income Taxes

Due to the inherent uncertainties involved with these types of judgments, actual results could differ significantly from estimates and may have a material adverse impact on our results of operations, equity, business, and insurer financial strength and corporate debt ratings. See the Critical Accounting Estimates section of our Management's Discussion and Analysis of Financial Condition and Results of Operations included under Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2017 for further information.

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CONSOLIDATED OPERATIONS

The following table includes the consolidated results of our operations including our financial measure, Core income (loss). For more detailed components of our business operations and the core income (loss) financial measure, see the segment discussions within this MD&A. For further discussion of Net investment income and Net realized investment results, see the Investments section of this MD&A.

Three months ended March 31

| (In millions) | 2018 | 2017 |
|---|---------|---------|
| Operating Revenues | | |
| Net earned premiums | \$1,785 | \$1,645 |
| Net investment income | 490 | 545 |
| Non-insurance warranty revenue | 238 | 93 |
| Other revenues | 10 | 11 |
| Total operating revenues | 2,523 | 2,294 |
| Claims, Benefits and Expenses | | |
| Net incurred claims and benefits | 1,333 | 1,289 |
| Policyholders' dividends | 6 | 4 |
| Amortization of deferred acquisition costs | 296 | 305 |
| Other insurance related expenses | 277 | 254 |
| Non-insurance warranty expense | 216 | 70 |
| Other expenses | 61 | 65 |
| Total claims, benefits and expenses | 2,189 | 1,987 |
| Core income before income tax | 334 | 307 |
| Income tax expense on core income | (53) | (72) |
| Core income | 281 | 235 |
| Net realized investment gains | 12 | 36 |
| Income tax expense on net realized investment gains | (2) | (11) |
| Net realized investment gains, after tax | 10 | 25 |
| Net income | \$291 | \$260 |

Core income increased \$46 million for the three months ended March 31, 2018 as compared with 2017. Excluding the effect of the corporate tax rate change, core income for our Property & Casualty Operations increased approximately \$4 million. Improved underwriting results more than offset lower net investment income driven by lower limited partnership returns. Excluding the effect of the Federal corporate income tax rate change, core income for our Life & Group segment improved \$22 million while core loss for our Corporate & Other segment increased \$12 million. Net catastrophe losses were \$34 million for the three months ended March 31, 2018 and 2017. Favorable net prior year loss reserve development of \$39 million and \$57 million was recorded in the three months ended March 31, 2018 and 2017 related to our Specialty, Commercial, International and Corporate & Other segments. Further information on net prior year loss reserve development is in Note E to the Condensed Consolidated Financial Statements included under Part I, Item 1.

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SEGMENT RESULTS

The following discusses the results of operations for our business segments. Our property and casualty commercial insurance operations are managed and reported in three business segments: Specialty, Commercial and International, which we refer to collectively as Property & Casualty Operations. Our operations outside of Property & Casualty Operations are managed and reported in two segments: Life & Group and Corporate & Other.

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Specialty

The following table details the results of operations for Specialty.

Three months ended March 31

| (In millions, except ratios, rate, renewal premium change and retention) | 2018 | 2017 |
|--|-------|-------|
| Net written premiums | \$686 | \$670 |
| Net earned premiums | 672 | 654 |
| Net investment income | 122 | 148 |
| Core income | 171 | 137 |

Other performance metrics:

| | | |
|--|--------|--------|
| Loss and loss adjustment expense ratio | 56.3 % | 61.2 % |
| Expense ratio | 31.0 | 31.9 |
| Dividend ratio | 0.2 | 0.1 |
| Combined ratio | 87.5 % | 93.2 % |

| | | | | |
|------------------------|------|---|------|---|
| Rate | 2 | % | 1 | % |
| Renewal premium change | 3 | | 4 | |
| Retention | 85 | | 88 | |
| New business | \$81 | | \$55 | |

Net written premiums for Specialty increased \$16 million for the three months ended March 31, 2018 as compared with the same period in 2017 due to higher new business and positive renewal premium change. The increase in net earned premiums was consistent with the trend in net written premiums.

Core income increased \$34 million for the three months ended March 31, 2018 as compared with the same period in 2017. Excluding the effect of the Federal corporate income tax rate change, core income increased approximately \$6 million. Improved underwriting results more than offset lower net investment income driven by lower limited partnership returns.

The combined ratio improved 5.7 points for the three months ended March 31, 2018 as compared with the same period in 2017. The loss ratio improved 4.9 points primarily due to 2.7 points of improvement in the current accident year loss ratio and higher favorable net prior year loss reserve development. Net catastrophe losses were \$3 million, or 0.5 points of the loss ratio, for the three months ended March 31, 2018, as compared to \$4 million, or 0.6 points of the loss ratio, for the three months ended March 31, 2017. The expense ratio decreased 0.9 points for the three months ended March 31, 2018 as compared with the same period in 2017.

Favorable net prior year loss reserve development of \$30 million and \$12 million was recorded for the three months ended March 31, 2018 and 2017. Further information on net prior year loss reserve development is in Note E to the Condensed Consolidated Financial Statements included under Part I, Item 1.

The following table summarizes the gross and net carried reserves for Specialty.

| (In millions) | March 31, December 31, | |
|---|------------------------|----------|
| | 2018 | 2017 |
| Gross case reserves | \$ 1,734 | \$ 1,742 |
| Gross IBNR reserves | 3,962 | 3,927 |
| Total gross carried claim and claim adjustment expense reserves | \$ 5,696 | \$ 5,669 |
| Net case reserves | \$ 1,585 | \$ 1,600 |
| Net IBNR reserves | 3,385 | 3,407 |
| Total net carried claim and claim adjustment expense reserves | \$ 4,970 | \$ 5,007 |

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Commercial

The following table details the results of operations for Commercial.

Three months ended March 31

| (In millions, except ratios, rate, renewal premium change and retention) | 2018 | 2017 |
|--|-------|-------|
| Net written premiums | \$832 | \$724 |
| Net earned premiums | 743 | 661 |
| Net investment income | 149 | 183 |
| Core income | 133 | 111 |

Other performance metrics:

| | | |
|--|--------|--------|
| Loss and loss adjustment expense ratio | 63.0 % | 63.9 % |
| Expense ratio | 33.5 | 37.3 |
| Dividend ratio | 0.6 | 0.5 |
| Combined ratio | 97.1 % | 101.7% |

| | | | | |
|------------------------|-------|---|-------|---|
| Rate | 1 | % | 0 | % |
| Renewal premium change | 3 | | 4 | |
| Retention | 84 | | 85 | |
| New business | \$181 | | \$140 | |

Net written premiums for Commercial were \$108 million higher for the three months ended March 31, 2018 as compared with the same period in 2017. The prior period included an unfavorable premium rate adjustment in Small Business which affected both net written premiums and net earned premiums as more fully discussed in Note F to the Condensed Consolidated Financial Statements under Part 1, Item 1. Excluding the Small Business premium rate adjustment, net written premiums increased \$61 million driven by higher new business and positive renewal premium change. The increase in net earned premiums was consistent with the trend in net written premiums.

Core income increased \$22 million for the three months ended March 31, 2018 as compared with the same period in 2017. Excluding the effect of the Federal corporate income tax rate change and the Small Business premium rate adjustment in the prior period, core income decreased approximately \$26 million due to improved underwriting results more than offset by lower net investment income driven by lower limited partnership returns.

Excluding the impact of the Small Business premium rate adjustment, the combined ratio increased 0.9 points, driven by 5.0 points of less favorable net prior year loss reserve development largely offset by a 2.4 point improvement in the current accident year loss ratio and a 1.8 point decrease in the expense ratio due to higher net earned premiums. Net catastrophe losses were \$29 million, or 3.9 points of the loss ratio, for the three months ended March 31, 2018, as compared to \$27 million, or 3.9 points of the loss ratio, for the three months ended March 31, 2017.

Favorable net prior year loss reserve development of \$9 million and \$43 million was recorded for the three months ended March 31, 2018 and 2017. Further information on net prior year loss reserve development is in Note E to the Condensed Consolidated Financial Statements included under Part I, Item 1.

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The following table summarizes the gross and net carried reserves for Commercial.

| (In millions) | March 31, December 31, | |
|---|------------------------|----------|
| | 2018 | 2017 |
| Gross case reserves | \$ 4,327 | \$ 4,427 |
| Gross IBNR reserves | 4,391 | 4,337 |
| Total gross carried claim and claim adjustment expense reserves | \$ 8,718 | \$ 8,764 |
| Net case reserves | \$ 4,008 | \$ 4,103 |
| Net IBNR reserves | 4,058 | 4,033 |
| Total net carried claim and claim adjustment expense reserves | \$ 8,066 | \$ 8,136 |

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International

The following table details the results of operations for International.

Three months ended March 31

| (In millions, except ratios, rate, renewal premium change and retention) | 2018 | 2017 |
|--|-------|-------|
| Net written premiums | \$295 | \$238 |
| Net earned premiums | 236 | 197 |
| Net investment income | 14 | 12 |
| Core income | 23 | 20 |

Other performance metrics:

| | | |
|--|--------|--------|
| Loss and loss adjustment expense ratio | 60.4 % | 58.3 % |
| Expense ratio | 36.2 | 36.8 |
| Combined ratio | 96.6 % | 95.1 % |

| | | | | |
|------------------------|------|---|------|---|
| Rate | 2 | % | 1 | % |
| Renewal premium change | 8 | | 1 | |
| Retention | 80 | | 78 | |
| New business | \$93 | | \$65 | |

Net written premiums for International increased \$57 million for the three months ended March 31, 2018 as compared with the same period in 2017 due to broad based growth across all of our platforms driven by higher new business, positive renewal premium change and higher retention. Excluding the effect of foreign currency exchange rates, net written premiums increased \$36 million or 14% for the three months ended March 31, 2018 as compared with the same period in 2017. The increase in net earned premiums was consistent with the trend in net written premiums. Core income increased \$3 million for the three months ended March 31, 2018 as compared with 2017. Excluding the effect of the Federal corporate income tax rate change, core income was consistent with the prior period.

The combined ratio increased 1.5 points for the three months ended March 31, 2018 as compared with 2017. The loss ratio increased 2.1 points, primarily due to lower favorable net prior year loss reserve development. Net catastrophe losses were \$2 million, or 0.7 points of the loss ratio, for the three months ended March 31, 2018, as compared to \$3 million, or 1.7 points of the loss ratio, for the three months ended March 31, 2017. The expense ratio decreased 0.6 points for the three months ended March 31, 2018 as compared with the same period in 2017 due to higher net earned premiums.

Favorable net prior year loss reserve development was nil and \$2 million for the three months ended March 31, 2018 and 2017. Further information on net prior year loss reserve development is in Note E to the Condensed Consolidated Financial Statements included under Part I, Item 1.

The following table summarizes the gross and net carried reserves for International.

| (In millions) | March 31, December 31, | |
|---|------------------------|----------|
| | 2018 | 2017 |
| Gross case reserves | \$ 841 | \$ 744 |
| Gross IBNR reserves | 877 | 892 |
| Total gross carried claim and claim adjustment expense reserves | \$ 1,718 | \$ 1,636 |
| Net case reserves | \$ 696 | \$ 640 |
| Net IBNR reserves | 782 | 792 |
| Total net carried claim and claim adjustment expense reserves | \$ 1,478 | \$ 1,432 |

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Life & Group

The following table details the results of operations for Life & Group.

Three months ended March 31

| (In millions) | 2018 | 2017 |
|---------------------------------|-------|-------|
| Net earned premiums | \$134 | \$133 |
| Net investment income | 200 | 197 |
| Core loss before income tax | — | (33) |
| Income tax benefit on core loss | 14 | 37 |
| Core income | 14 | 4 |

Core income increased \$10 million for the three months ended March 31, 2018 as compared with the same period in 2017. Excluding the effect of the Federal corporate income tax rate change, core income increased approximately \$22 million driven by favorable persistency, and further helped by premium rate increases. The favorable persistency was driven by a high proportion of policyholders choosing to reduce benefits in lieu of premium rate increases.

Corporate & Other

The following table details the results of operations for Corporate & Other.

Three months ended March 31

| (In millions) | 2018 | 2017 |
|-----------------------|-------|-------|
| Net investment income | \$ 5 | \$ 5 |
| Interest expense | 34 | 38 |
| Core loss | (60) | (37) |

Core loss increased \$23 million for the three months ended March 31, 2018 as compared with the same period in 2017. Excluding the effect of the Federal corporate income tax rate change, core loss increased approximately \$12 million due to higher adverse net prior year reserve development recorded in 2018 for A&EP under the LPT, as compared to the prior year period. This is further discussed in Note E to the Condensed Consolidated Financial Statements included under Part I, Item 1.

The following table summarizes the gross and net carried reserves for Corporate & Other.

| (In millions) | March 31, December 31, | |
|---|------------------------|----------|
| | 2018 | 2017 |
| Gross case reserves | \$ 1,210 | \$ 1,371 |
| Gross IBNR reserves | 1,224 | 1,065 |
| Total gross carried claim and claim adjustment expense reserves | \$ 2,434 | \$ 2,436 |
| Net case reserves | \$ 93 | \$ 94 |
| Net IBNR reserves | 110 | 111 |
| Total net carried claim and claim adjustment expense reserves | \$ 203 | \$ 205 |

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INVESTMENTS

Net Investment Income

The significant components of Net investment income are presented in the following table. Fixed income securities, as presented, include both fixed maturity and non-redeemable preferred stock.

Three months ended March 31

| (In millions) | 2018 | 2017 |
|--|-------|-------|
| Fixed income securities: | | |
| Taxable fixed income securities | \$350 | \$348 |
| Tax-exempt fixed income securities | 105 | 108 |
| Total fixed income securities | 455 | 456 |
| Limited partnership and common stock investments | 31 | 90 |
| Other, net of investment expense | 4 | (1) |
| Pretax net investment income | \$490 | \$545 |
| Fixed income securities, after tax | \$377 | \$331 |
| Net investment income, after tax | 405 | 389 |

Effective income yield for the fixed income securities portfolio, pretax 4.7 % 4.8 %

Effective income yield for the fixed income securities portfolio, after tax 3.9 % 3.4 %

Pretax net investment income decreased \$55 million for the three months ended March 31, 2018 as compared with the same period in 2017. The decrease was driven by limited partnership investments, which returned 1.2% in 2018 as compared with 3.8% in the prior year period. However, despite the decline in limited partnership income, net investment income, after tax, increased \$16 million for the three months ended March 31, 2018 as compared with the same period in 2017 given stable fixed income returns and the lower Federal corporate income tax rate.

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Net Realized Investment Gains (Losses)

The components of Net realized investment results are presented in the following table.

Three months ended March 31

| (In millions) | 2018 | 2017 |
|---|-------|-------|
| Fixed maturity securities: | | |
| Corporate bonds and other | \$19 | \$30 |
| States, municipalities and political subdivisions | 20 | 6 |
| Asset-backed | (21) | (4) |
| Total fixed maturity securities | 18 | 32 |
| Non-redeemable preferred stock | (15) | — |
| Short term and other | 9 | 4 |
| Net realized investment gains | 12 | 36 |
| Income tax expense on net realized investment gains | (2) | (11) |
| Net realized investment gains, after tax | \$10 | \$25 |

Pretax net realized investment gains decreased \$24 million for the three months ended March 31, 2018 as compared with the same period in 2017. The decrease was driven by the decline in fair value of non-redeemable preferred stock and lower net realized gains on sales of securities.

Further information on our realized gains and losses, including our OTTI losses, is set forth in Note C to the Condensed Consolidated Financial Statements included under Part I, Item 1.

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Portfolio Quality

The following table presents the estimated fair value and net unrealized gains (losses) of our fixed maturity securities by rating distribution.

| (In millions) | March 31, 2018 | | December 31, 2017 | |
|---|----------------------------|--|----------------------------|--|
| | Estimated Fair Value | Net Unrealized Gains (Losses) | Estimated Fair Value | Net Unrealized Gains (Losses) |
| U.S. Government, Government agencies and Government-sponsored enterprises | \$4,491 | \$ (52) | \$4,514 | \$ 21 |
| AAA | 3,265 | 259 | 1,954 | 152 |
| AA | 7,096 | 576 | 8,982 | 914 |
| A | 9,168 | 702 | 9,643 | 952 |
| BBB | 13,413 | 699 | 13,554 | 1,093 |
| Non-investment grade | 2,826 | 84 | 2,840 | 140 |
| Total | \$40,259 | \$ 2,268 | \$41,487 | \$ 3,272 |

As of March 31, 2018 and December 31, 2017, only 2% of our fixed maturity portfolio was rated internally.

The following table presents available-for-sale fixed maturity securities in a gross unrealized loss position by ratings distribution.

| (In millions) | March 31, 2018 | |
|---|----------------------------|-------------------------------|
| | Estimated Fair Value | Gross Unrealized Losses |
| U.S. Government, Government agencies and Government-sponsored enterprises | \$2,997 | \$ 82 |
| AAA | 451 | 12 |
| AA | 754 | 11 |
| A | 1,579 | 33 |
| BBB | 3,379 | 79 |
| Non-investment grade | 881 | 29 |
| Total | \$10,041 | \$ 246 |

The following table presents the maturity profile for these available-for-sale fixed maturity securities. Securities not due to mature on a single date are allocated based on weighted average life.

| (In millions) | March 31, 2018 | |
|--|----------------------------|-------------------------------|
| | Estimated Fair Value | Gross Unrealized Losses |
| Due in one year or less | \$113 | \$ 4 |
| Due after one year through five years | 1,779 | 41 |
| Due after five years through ten years | 6,569 | 164 |
| Due after ten years | 1,580 | 37 |
| Total | \$10,041 | \$ 246 |

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Duration

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

A further consideration in the management of the investment portfolio is the characteristics of the corresponding liabilities and the ability to align the duration of the portfolio to those liabilities and to meet future liquidity needs, minimize interest rate risk and maintain a level of income sufficient to support the underlying insurance liabilities. For portfolios where future liability cash flows are determinable and typically long term in nature, we segregate investments for asset/liability management purposes. The segregated investments support the long term care and structured settlement liabilities in the Life & Group segment.

The effective durations of fixed maturity securities, non-redeemable preferred stock and short term investments are presented in the following table. Amounts presented are net of payable and receivable amounts for securities purchased and sold, but not yet settled.

| (In millions) | March 31, 2018 | | December 31, 2017 | |
|-------------------------------------|----------------------------|--|----------------------------|--|
| | Estimated Fair Value | Effective Duration (In years) | Estimated Fair Value | Effective Duration (In years) |
| Investments supporting Life & Group | \$16,413 | 8.3 | \$16,797 | 8.4 |
| Other investments | 25,656 | 4.5 | 26,817 | 4.4 |
| Total | \$42,069 | 6.0 | \$43,614 | 5.9 |

The duration of the total portfolio is aligned with the cash flow characteristics of the underlying liabilities.

The investment portfolio is periodically analyzed for changes in duration and related price risk. Additionally, we periodically review the sensitivity of the portfolio to the level of foreign exchange rates and other factors that contribute to market price changes. A summary of these risks and specific analysis on changes is included in the Quantitative and Qualitative Disclosures About Market Risk included under Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2017.

Short Term Investments

The carrying value of the components of the Short term investments are presented in the following table.

| (In millions) | March 31, December 31, | |
|------------------------------|------------------------|----------|
| | 2018 | 2017 |
| Short term investments: | | |
| Commercial paper | \$ 946 | \$ 905 |
| U.S. Treasury securities | 134 | 355 |
| Money market funds | 23 | 44 |
| Other | 127 | 132 |
| Total short term investments | \$ 1,230 | \$ 1,436 |

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LIQUIDITY AND CAPITAL RESOURCES

Cash Flows

Our primary operating cash flow sources are premiums and investment income from our insurance subsidiaries. Our primary operating cash flow uses are payments for claims, policy benefits and operating expenses, including interest expense on corporate debt. Additionally, cash may be paid or received for income taxes.

For the three months ended March 31, 2018, net cash provided by operating activities was \$218 million as compared with \$282 million for the same period in 2017. The decrease in cash provided by operating activities was driven by a lower level of distributions on limited partnerships partially offset by an increase in premiums collected.

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

Net cash provided by investing activities was \$489 million for the three months ended March 31, 2018, as compared with \$354 million for the same period in 2017. The cash flow from investing activities is affected by various factors such as the anticipated payment of claims, financing activity, asset/liability management and individual security buy and sell decisions made in the normal course of portfolio management.

Cash flows from financing activities may include proceeds from the issuance of debt and equity securities, outflows for stockholder dividends or repayment of debt and outlays to reacquire equity securities.

For the three months ended March 31, 2018, net cash used by financing activities was \$781 million as compared with \$609 million for the same period in 2017. In the first quarter of 2018, we redeemed the \$150 million outstanding aggregate principal balance of our 6.950% senior notes due January 15, 2018.

Common Stock Dividends

A quarterly dividend of \$0.30 per share and a special dividend of \$2.00 per share of our common stock were declared and paid in the first quarter of 2018. On April 27, 2018, our Board of Directors declared a quarterly dividend of \$0.30 per share, payable May 30, 2018 to stockholders of record on May 14, 2018. The declaration and payment of future dividends to holders of our common stock will be at the discretion of our Board of Directors and will depend on many factors, including our earnings, financial condition, business needs and regulatory constraints.

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Liquidity

Later this year, management intends to pay down the \$30 million of subordinated variable rate debt of Hardy due September 15, 2036. We believe that our present cash flows from operating, investing and financing activities are sufficient to fund our current and expected working capital and debt obligation needs and we do not expect this to change in the near term. There are currently no amounts outstanding under our \$250 million senior unsecured revolving credit facility and no borrowings outstanding through our membership in the FHLBC.

Dividends from CCC are subject to the insurance holding company laws of the State of Illinois, the domiciliary state of CCC. Under these laws, ordinary dividends, or dividends that do not require prior approval by the Illinois Department of Insurance (the Department), are determined based on the greater of the prior year's statutory net income or 10% of statutory surplus as of the end of the prior year, as well as timing and amount of dividends paid in the preceding twelve months. Additionally, ordinary dividends may only be paid from earned surplus, which is calculated by removing unrealized gains from unassigned surplus. As of March 31, 2018 CCC was in a positive earned surplus position. The maximum allowable dividend CCC could pay during 2018 that would not be subject to the Department's prior approval is \$1,073 million, less dividends paid during the preceding twelve months measured at that point in time. CCC paid dividends of \$280 million during the nine months ended December 31, 2017 and \$670 million during the three months ended March 31, 2018. As of March 31, 2018 CCC is able to pay approximately \$123 million of dividends that would not be subject to prior approval of the Department. The actual level of dividends paid in any year is determined after an assessment of available dividend capacity, holding company liquidity and cash needs as well as the impact the dividends will have on the statutory surplus of the applicable insurance company.

We have an effective automatic shelf registration statement under which we may publicly issue debt, equity or hybrid securities from time to time.

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ACCOUNTING STANDARDS UPDATE

For a discussion of Accounting Standards Updates adopted in the current period and that will be adopted in the future, see Note A to the Condensed Consolidated Financial Statements included under Part I, Item 1.

FORWARD-LOOKING STATEMENTS

This report contains a number of forward-looking statements which relate to anticipated future events rather than actual present conditions or historical events. These statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and generally include words such as “believes,” “expects,” “intends,” “anticipates,” “estimates” and similar expressions. Forward-looking statements in this report include any and all statements regarding expected developments in our insurance business, including losses and loss reserves for A&EP and other mass tort claims which are more uncertain, and therefore more difficult to estimate than loss reserves respecting traditional property and casualty exposures; the impact of routine ongoing insurance reserve reviews we are conducting; our expectations concerning our revenues, earnings, expenses and investment activities; volatility in investment returns; expected cost savings and other results from our expense reduction activities; and our proposed actions in response to trends in our business. Forward-looking statements, by their nature, are subject to a variety of inherent risks and uncertainties that could cause actual results to differ materially from the results projected in the forward-looking statement. We cannot control many of these risks and uncertainties. These risks and uncertainties include, but are not limited to, the following:

Company-Specific Factors

the risks and uncertainties associated with our insurance reserves, as outlined in the Critical Accounting Estimates and the Reserves - Estimates and Uncertainties sections of our Annual Report on Form 10-K, including the sufficiency of the reserves and the possibility for future increases, which would be reflected in the results of operations in the period that the need for such adjustment is determined;

- the risk that the other parties to the transaction in which, subject to certain limitations, we ceded our legacy A&EP liabilities will not fully perform their obligations to CNA, the uncertainty in estimating loss reserves for A&EP liabilities and the possible continued exposure of CNA to liabilities for A&EP claims that are not covered under the terms of the transaction;

the performance of reinsurance companies under reinsurance contracts with us; and

the risks and uncertainties associated with potential acquisitions and divestitures, including the consummation of such transactions, the successful integration of acquired operations and the potential for subsequent impairment of goodwill or intangible assets.

Industry and General Market Factors

the impact of competitive products, policies and pricing and the competitive environment in which we operate, including changes in our book of business;

product and policy availability and demand and market responses, including the level of ability to obtain rate increases and decline or non-renew underpriced accounts, to achieve premium targets and profitability and to realize growth and retention estimates;

general economic and business conditions, including recessionary conditions that may decrease the size and number of our insurance customers and create additional losses to our lines of business, especially those that provide management and professional liability insurance, as well as surety bonds, to businesses engaged in real estate, financial services and professional services and inflationary pressures on medical care costs, construction costs and other economic sectors that increase the severity of claims;

conditions in the capital and credit markets, including continuing uncertainty and instability in these markets, as well as the overall economy, and their impact on the returns, types, liquidity and valuation of our investments;

conditions in the capital and credit markets that may limit our ability to raise significant amounts of capital on favorable terms; and

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

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Regulatory Factors

- regulatory initiatives and compliance with governmental regulations, judicial interpretations within the regulatory framework, including interpretation of policy provisions, decisions regarding coverage and theories of liability, legislative actions that increase claimant activity, trends in litigation and the outcome of any litigation involving us and rulings and changes in tax laws and regulations;
- regulatory limitations, impositions and restrictions upon us, including with respect to our ability to increase premium rates, and the effects of assessments and other surcharges for guaranty funds and second-injury funds, other mandatory pooling arrangements and future assessments levied on insurance companies; and
- regulatory limitations and restrictions, including limitations upon our ability to receive dividends from our insurance subsidiaries, imposed by regulatory authorities, including regulatory capital adequacy standards.

Impact of Catastrophic Events and Related Developments

- weather and other natural physical events, including the severity and frequency of storms, hail, snowfall and other winter conditions, natural disasters such as hurricanes and earthquakes, as well as climate change, including effects on global weather patterns, greenhouse gases, sea, land and air temperatures, sea levels, rain, hail and snow;
- regulatory requirements imposed by coastal state regulators in the wake of hurricanes or other natural disasters, including limitations on the ability to exit markets or to non-renew, cancel or change terms and conditions in policies, as well as mandatory assessments to fund any shortfalls arising from the inability of quasi-governmental insurers to pay claims;
- man-made disasters, including the possible occurrence of terrorist attacks, the unpredictability of the nature, targets, severity or frequency of such events, and the effect of the absence or insufficiency of applicable terrorism legislation on coverages; and
- the occurrence of epidemics.

Referendum on the United Kingdom's Membership in the European Union

in 2016, the United Kingdom (U.K.) held a referendum in which voters approved an exit from the European Union (E.U.), commonly referred to as "Brexit." As a result of the referendum, in 2017 the British government formally commenced the process to leave the E.U. and began negotiating the terms of treaties that will govern the U.K.'s future relationship with the E.U. Although the terms of any future treaties are unknown, we believe changes in our international operating platform will be required to allow us to continue to write business in the E.U. after the completion of Brexit. Therefore, we have begun the process of establishing a new European subsidiary in Luxembourg. As a result of these changes, the complexity and cost of regulatory compliance of our European business is likely to increase.

Our forward-looking statements speak only as of the date of the filing of this Quarterly Report on Form 10-Q and we do not undertake any obligation to update or revise any forward-looking statement to reflect events or circumstances after the date of the statement, even if our expectations or any related events or circumstances change.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

There were no material changes in our market risk components for the three months ended March 31, 2018. See the Quantitative and Qualitative Disclosures About Market Risk included in Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2017 for further information. Additional information related to portfolio duration is discussed in the Investments section of our Management's Discussion and Analysis of Financial Condition and Results of Operations included in Part I, Item 2.

Item 4. Controls and Procedures

The Company maintains a system of disclosure controls and procedures which are designed to ensure that information required to be disclosed by the Company in reports that it files or submits to the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), including this report, is recorded, processed, summarized and reported on a timely basis. These disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed under the Exchange Act is accumulated and communicated to the Company's management on a timely basis to allow decisions regarding required disclosure. As of March 31, 2018, the Company's management, including the Company's Chief Executive Officer (CEO) and Chief Financial Officer (CFO), conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based on this evaluation, the CEO and CFO have concluded that the Company's disclosure controls and procedures are effective as of March 31, 2018.

There has been no change in the Company's internal control over financial reporting (as defined in Rules 13a-15 (f) and 15d-15(f) under the Exchange Act) during the quarter ended March 31, 2018 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II. Other Information

Item 1. Legal Proceedings

Information on our legal proceedings is set forth in Note F to the Condensed Consolidated Financial Statements included under Part I, Item 1.

Item 6. Exhibits

See Exhibit Index.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CNA Financial Corporation

Dated: April 30, 2018 By/s/ D. Craig Mense

D. Craig Mense
Executive Vice President and
Chief Financial Officer

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EXHIBIT INDEX

| Description of Exhibit | Exhibit Number |
|---|----------------|
| <u>2018 CNA Non-qualified Savings Plan, Restated as of January 1, 2018</u> | 10.1 |
| <u>Certification of Chief Executive Officer</u> | 31.1 |
| <u>Certification of Chief Financial Officer</u> | 31.2 |
| <u>Written Statement of the Chief Executive Officer of CNA Financial Corporation Pursuant to 18 U.S.C. Section 1350 (As adopted by Section 906 of the Sarbanes-Oxley Act of 2002)</u> | 32.1 |
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