

CNA SURETY CORP  
Form 10-K  
February 17, 2009

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

**FORM 10-K**

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

**For the Fiscal Year Ended December 31, 2008**

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

**Commission File Number: 1-13277**

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

**Delaware**  
**(State or other jurisdiction of incorporation**  
**organization)**  
**333 South Wabash Avenue, Chicago, Illinois**  
**(Address of principal executive offices)**

**36-4144905**  
**(I.R.S. Employer Identification No.)**

**60604**  
**(Zip Code)**

**(312) 822-5000**

**(Registrant's telephone number, including area code)**

Securities registered pursuant to Section 12(b) of the Act: **None**

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Securities registered pursuant to Section 12(g) of the Act:  
**Common Stock, \$0.01 Par Value**  
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

The aggregate market value of voting stock held by non-affiliates was \$211.3 million based upon the closing price of \$12.64 per share on June 30, 2008, using beneficial ownership of stock rules adopted pursuant to Section 13 of the Securities Exchange Act of 1934 to exclude voting stock owned by Directors, Officers and Major Stockholders, some of whom may not be held to be affiliates upon judicial determination.

At February 6, 2009, 44,176,212 shares of the Registrant's Common Stock were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE:**

Portions of the CNA Surety Corporation Proxy Statement prepared for the 2009 annual meeting of shareholders, pursuant to Regulation 14A, are incorporated by reference into Part III of this report.

**CNA SURETY CORPORATION AND SUBSIDIARIES**

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**CNA SURETY CORPORATION AND SUBSIDIARIES**

**PART I.**

**ITEM 1. BUSINESS**

**General**

CNA Surety Corporation ( CNA Surety or Company ) is an insurance holding company in the United States formed through the September 30, 1997 combination of the surety business of CNA Financial Corporation ( CNAF ) with Capsure Holdings Corp. s ( Capsure ) insurance subsidiaries. CNA Surety is currently one of the largest surety providers in the United States with approximately an 8.0% market share (based upon 2007 Surety Association of America ( SAA ) written premium data). CNA Surety s wide selection of surety products ranges from very small commercial bonds to large contract bonds.

**Formation of CNA Surety and Merger**

In December 1996, CNAF and Capsure agreed to merge (the Merger ) the surety business of CNAF with Capsure s insurance subsidiaries, Western Surety Company ( Western Surety ), Surety Bonding Company of America ( Surety Bonding ) and Universal Surety of America ( Universal Surety ), into CNA Surety. CNAF, through its operating subsidiaries, writes multiple lines of property and casualty insurance, including surety business that is reinsured by Western Surety. CNAF owns approximately 62% of the outstanding common stock of CNA Surety. Loews Corporation ( Loews ) owns approximately 90% of the outstanding common stock of CNAF. The principal operating subsidiaries of CNAF that wrote the surety line of business for their own account prior to the Merger were Continental Casualty Company and its property and casualty affiliates (collectively, CCC ) and The Continental Insurance Company and its property and casualty affiliates (collectively, CIC ). CIC was acquired by CNAF on May 10, 1995. The combined surety operations of CCC and CIC are referred to herein as CCC Surety Operations.

**Description of Business**

The Company s corporate objective is to be the leading provider of surety and surety-related products in North America and to be the surety of choice for its customers and independent agents and brokers. CNA Surety s insurance subsidiaries write surety and fidelity bonds in all 50 states through a combined network of approximately 37,000 independent agencies. CNA Surety s insurance subsidiaries are Western Surety, Surety Bonding and Universal Surety. The insurance subsidiaries write, on a direct basis or as business assumed from CCC and CIC, small fidelity and non-contract surety bonds, referred to as commercial bonds; small, medium and large contract bonds; and errors and omissions ( E&O ) liability insurance. Western Surety is a licensed insurer in all 50 states, the District of Columbia and Puerto Rico. Surety Bonding is licensed in 28 states and the District of Columbia. Universal Surety is licensed in 44 states and the District of Columbia.

**Financial Strength Ratings**

***A.M. Best Company, Inc.***

Western Surety, Surety Bonding and Universal Surety are currently rated A (Excellent) with a stable rating outlook by A.M. Best Company, Inc. ( A.M. Best ). An A (Excellent) rating is assigned to those companies which A.M. Best believes have an excellent ability to meet their ongoing obligations to policyholders. A (Excellent) rated insurers have been shown to be among the strongest in ability to meet policyholder and other contractual obligations. A.M. Best s letter ratings range from A++ (Superior) to F (In Liquidation) with A++ being highest. The rating outlook indicates

the potential direction of a company's rating for an intermediate period, generally defined as the next 12 to 36 months.

Through intercompany reinsurance and related agreements, CNA Surety's customers have access to CCC's broader underwriting capacity. CCC is currently rated A (Excellent) by A.M. Best. On February 13, 2009 A.M. Best affirmed CCC's A rating, however, CCC's rating outlook was changed from stable to negative. CNA Surety's rating and outlook were not impacted.

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### ***Standard and Poor's***

CCC, Western Surety, Surety Bonding and Universal Surety are currently rated A- (Stable) by Standard and Poor's (S&P). S&P's letter ratings range from AAA (Extremely Strong) to CC (Extremely Weak) with AAA being highest. Ratings from AA to CCC may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories. An insurer rated A has strong financial security characteristics, but is somewhat more likely to be affected by adverse business conditions than are insurers with higher ratings.

### **Product Information**

The United States surety market is represented by bonds required by federal statutes, state laws and local ordinances. These bonding requirements range from federal construction projects, where the contractor is required to post performance and payment bonds which guarantee performance of contracts to the government as well as payment of bills to subcontractors and suppliers, to license and permit bonds which guarantee compliance with legal requirements for business operations.

### ***Products and Policies***

Unlike a standard, two-party insurance policy, surety bonds are three-party agreements in which the issuer of the bond (the surety) joins with a second party (the principal) in guaranteeing to a third party (the owner/obligee) the fulfillment of some obligation on the part of the principal. The surety is the party who guarantees fulfillment of the principal's obligation to the obligee. In addition, sureties are generally entitled to recover from the principal any losses and expenses paid to third parties. The surety's responsibility is to evaluate the risk and determine if the principal meets the underwriting requirements for the bond. Accordingly, surety bond premiums primarily reflect the type and class of risk and related costs associated with both processing the bond transaction and investigating the applicant including, if necessary, an analysis of the applicant's credit-worthiness and ability to perform.

There are two broad types of surety products—contract surety and commercial surety bonds. Contract surety bonds secure a contractor's performance and/or payment obligation generally with respect to a construction project. Contract surety bonds are generally required by federal, state and local governments for public works projects. Commercial surety bonds include all surety bonds other than contract and cover obligations typically required by law or regulation.

Contract bond guarantee obligations include the following:

*Bid bonds:* used by contractors submitting proposals on potential contracts. These bonds guarantee that a contractor will enter into a contract at the amount bid and post the appropriate performance bonds.

*Performance bonds:* guarantee to the owner the performance of the contractor's obligations according to the terms and conditions of the contract.

*Payment bonds:* guarantee payment of the contractor's obligations under the contract for labor, subcontractors and materials supplied to the project. Payment bonds are utilized in public projects where liens are not permitted.

Other examples of contract bonds are completion, maintenance and supply bonds.

Commercial surety business is comprised of bonds covering obligations typically required by law or regulation, such as the following:



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*License and Permit bonds:* required by statutes or ordinances for a number of purposes including guaranteeing the payment of certain taxes and fees and providing consumer protection as a condition to granting licenses related to selling real estate or motor vehicles and contracting services.

*Judicial and Fiduciary bonds:* required by statutes, courts or legal documents for the protection of those on whose behalf a fiduciary acts. Examples of such fiduciaries include executors and administrators of estates, and guardians of minors and incompetents.

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*Public Official bonds:* required by statutes and ordinances to guarantee the lawful and faithful performance of the duties of office by public officials.

CNA Surety also assumes contract and commercial surety bonds for international risks. Such bonds are written to satisfy the international bond requirements of domestic customers and for select foreign clients.

In addition, the Company markets surety-related products such as fidelity bonds and E&O insurance. Fidelity bonds cover losses arising from employee dishonesty. Examples of purchasers of fidelity bonds are law firms, insurance agencies and janitorial service companies. CNA Surety writes E&O policies for two classes of insureds: notaries public and tax preparers. The notary public E&O policy is marketed as a companion product to the notary public bond and the tax preparer E&O policy is marketed to small tax return preparation firms.

Although all of its products are sold through the same independent insurance agent and broker distribution network, the Company's underwriting is organized by the two broad types of surety products—contract surety and commercial surety, which also includes fidelity bonds and other insurance products for these purposes. These two operating segments have been aggregated into one reportable business segment for financial reporting purposes because of their similar economic and operating characteristics.

The following tables set forth, for each principal class of bonds, gross written premiums, net written premiums and number of domestic bonds and policies in force and the respective percentages of the total for the past three years (amounts in thousands, except average bond amounts):

	<b>Gross Written Premiums</b>					
	<b>2008</b>	<b>% of Total</b>	<b>2007</b>	<b>% of Total</b>	<b>2006</b>	<b>% of Total</b>
Contract	\$ 300,236	64.3%	\$ 305,624	64.8%	\$ 285,157	63.2%
Commercial:						
License and permit	80,291	17.2	78,875	16.7	79,144	17.5
Judicial and fiduciary	23,227	5.0	23,348	5.0	23,949	5.3
Public official	23,466	5.0	23,584	5.0	23,491	5.2
Other	9,015	1.9	9,021	1.9	8,287	1.9
Total commercial	135,999	29.1	134,828	28.6	134,871	29.9
Fidelity and other	30,892	6.6	31,208	6.6	31,328	6.9
	\$ 467,127	100.0%	\$ 471,660	100.0%	\$ 451,356	100.0%
Domestic	\$ 461,998	98.9%	\$ 467,285	99.1%	\$ 448,387	99.3%
International	5,129	1.1	4,375	0.9	2,969	0.7
	\$ 467,127	100.0%	\$ 471,660	100.0%	\$ 451,356	100.0%

**Net Written Premiums**

	<b>2008</b>	<b>% of Total</b>	<b>2007</b>	<b>% of Total</b>	<b>2006</b>	<b>% of Total</b>
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Contract	\$ 268,085	62.1%	\$ 266,749	62.3%	\$ 247,987	60.5%
Commercial	132,702	30.7	130,332	30.4	130,314	31.8
Fidelity and other	30,892	7.2	31,208	7.3	31,328	7.7
	\$ 431,679	100.0%	\$ 428,289	100.0%	\$ 409,629	100.0%
Domestic	\$ 426,570	98.8%	\$ 423,914	99.0%	\$ 406,684	99.3%
International	5,109	1.2	4,375	1.0	2,945	0.7
	\$ 431,679	100.0%	\$ 428,289	100.0%	\$ 409,629	100.0%

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	<b>Domestic Bonds/Policies in Force as of December 31,</b>					
	<b>2008</b>	<b>% of Total</b>	<b>2007</b>	<b>% of Total</b>	<b>2006</b>	<b>% of Total</b>
Contract	31	1.3%	30	1.2%	30	1.2%
Commercial	1,836	76.4	1,906	76.5	1,926	76.0
Fidelity and other	537	22.3	557	22.3	579	22.8
	2,404	100.0%	2,493	100.0%	2,535	100.0%

	<b>Average Bond Penalty/Policy Limit as of December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Contract	\$ 1,236,663	\$ 1,191,817	\$ 1,180,538
Commercial	14,460	14,115	14,236
Fidelity and other	19,914	19,437	19,486

In 2008 no individual agency generated more than 1.0% of aggregate gross written premiums. Approximately \$85.3 million, or 18.3%, of gross written premiums were generated from national insurance brokers in 2008 with the single largest national broker production comprising \$14.3 million, or 3.1%, of gross written premiums.

**Marketing**

The Company principally markets its products in all 50 states, as well as the District of Columbia and Puerto Rico. Its products are marketed primarily through independent producers, including multi-line agents and brokers such as surety specialists, many of whom are members of the National Association of Surety Bond Producers. CNA Surety enjoys broad national distribution of its products, which are marketed through approximately 37,000 of the approximately 44,000 independent property and casualty insurance agencies in the United States. In addition, the Company employs 40 full-time salaried marketing representatives and five telemarketing representatives to continually service its vast producer network. Relationships with these independent producers are maintained through the Company's 38 local branch offices.

The following table sets forth the distribution of CNA Surety's business, by state based upon gross written premiums in each of the last three years:

	<b>Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Gross Written Premiums by State:			
Texas	9.4%	9.4%	9.5%
California	9.2	9.1	8.9
Florida	6.0	7.6	7.8
New York	5.0	4.5	3.9
Illinois	4.5	4.5	4.6

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Georgia	3.4	3.3	3.0
Massachusetts	3.1	3.1	3.1
Pennsylvania	2.8	2.9	3.2
Colorado	2.7	2.3	2.3
Maryland	2.7	2.8	2.4
All other <sup>(a)</sup>	51.2	50.5	51.3
Total	100.0%	100.0%	100.0%

<sup>(a)</sup> Includes the District of Columbia and Puerto Rico. No other state represented more than 2.3% for the year ended December 31, 2008.

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*Contract Surety*

With respect to standard contract surety, the core target customers for the Company are contractors with less than \$50 million in contracted work in progress.