Lumber Liquidators Holdings, Inc.
Form 10-Q
August 05, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2015

or

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

For the transition period from to

Commission File Number: 001-33767

Lumber Liquidators Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**27-1310817**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
3000 John Deere Road Toano, Virginia	**23168**
(Address of Principal Executive Offices)	**(Zip Code)**

(757) 259-4280
(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 of 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. x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes £ No

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

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

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

As of August 3, 2015, there are 27,084,981 shares of the registrant's common stock, par value of $0.001 per share, outstanding.

LUMBER LIQUIDATORS HOLDINGS, INC.

Quarterly Report on Form 10-Q

For the quarter ended June 30, 2015

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PART I

FINANCIAL INFORMATION

Item 1. Financial Statements.

Lumber Liquidators Holdings, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except share data)

	June 30, 2015 (unaudited)	December 31, 2014
Assets		
Current Assets:		
Cash and Cash Equivalents	$ 45,266	$ 20,287
Merchandise Inventories	262,743	314,371
Prepaid Expenses	7,172	5,575
Other Current Assets	26,776	17,044
Total Current Assets	341,957	357,277
Property and Equipment, net	127,965	124,867
Goodwill	9,693	9,693
Other Assets	1,649	1,625
Total Assets	$ 481,264	$ 493,462
Liabilities and Stockholders’ Equity		
Current Liabilities:		
Accounts Payable	$ 58,673	$ 80,303
Customer Deposits and Store Credits	31,138	34,943
Accrued Compensation	6,201	3,693
Sales and Income Tax Liabilities	4,277	7,472
Other Current Liabilities	36,083	17,836
Total Current Liabilities	136,372	144,247
Other Long-Term Liabilities	11,630	6,603
Deferred Tax Liability	9,012	10,558
Revolving Credit Facility	20,000	—
Total Liabilities	177,014	161,408
Stockholders’ Equity:		
	30	30

Common Stock ($0.001 par value; 35,000,000 shares authorized; 27,084,841 and 27,069,307 shares outstanding, respectively)		
Treasury Stock, at cost (2,823,453 and 2,816,780 shares, respectively)	(138,968)	(138,692)
Additional Capital	178,260	177,479
Retained Earnings	265,906	294,033
Accumulated Other Comprehensive Loss	(978)	(796)
Total Stockholders' Equity	304,250	332,054
Total Liabilities and Stockholders' Equity	$ 481,264	$ 493,462

See accompanying notes to condensed consolidated financial statements

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Lumber Liquidators Holdings, Inc.

Condensed Consolidated Statements of Income (Loss)

(in thousands, except share data and per share amounts)

(unaudited)

	Three Months Ended June 30, 2015	Three Months Ended June 30, 2014	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
Net Sales	$247,944	$263,085	$507,905	$509,376
Cost of Sales	185,660	156,847	354,009	301,851
Gross Profit	62,284	106,238	153,896	207,525
Selling, General and Administrative Expenses	90,551	79,066	188,231	157,932
Operating (Loss) Income	(28,267)	27,172	(34,335)	49,593
Other Expense	65	70	81	164
(Loss) Income Before Income Taxes	(28,332)	27,102	(34,416)	49,429
Income Tax (Benefit) Expense	(7,985)	10,495	(6,289)	19,128
Net (Loss) Income	$(20,347)	$16,607	$(28,127)	$30,301
Net (Loss) Income per Common Share—Basic	$(0.75)	$0.61	$(1.04)	$1.10
Net (Loss) Income per Common Share—Diluted	$(0.75)	$0.60	$(1.04)	$1.09
Weighted Average Common Shares Outstanding:				
Basic	27,082,878	27,384,255	27,077,312	27,452,470
Diluted	27,082,878	27,610,969	27,077,312	27,721,161

See accompanying notes to condensed consolidated financial statements

Lumber Liquidators Holdings, Inc.

Condensed Consolidated Statements of Other Comprehensive Income (Loss)

(in thousands)

(unaudited)

	Three Months Ended		**Six Months Ended**	
	June 30,		**June 30,**	
	2015	2014	2015	2014
Net (Loss) Income	$(20,347)	$16,607	$(28,127)	$30,301
Foreign Currency Translation Adjustments	163	240	(182)	391
Comprehensive (Loss) Income	$(20,184)	$16,847	$(28,309)	$30,692

See accompanying notes to condensed consolidated financial statements

Lumber Liquidators Holdings, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Six Months Ended June 30, 2015	2014
Cash Flows from Operating Activities:		
Net (Loss) Income	$(28,127)	$30,301
Adjustments to Reconcile Net (Loss) Income to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	8,756	7,085
Stock-Based Compensation Expense	597	2,777
Non-Cash Impairment Charges	5,351	—
Deconsolidation of Variable Interest Entity	1,457	—
Changes in Operating Assets and Liabilities:		
Merchandise Inventories	46,872	(20,462)
Accounts Payable	(20,562)	3,509
Customer Deposits and Store Credits	(3,694)	8,899
Prepaid Expenses and Other Current Assets	(7,324)	(2,470)
Other Assets and Liabilities	15,894	(1,551)
Net Cash Provided by Operating Activities	19,220	28,088
Cash Flows from Investing Activities:		
Purchases of Property and Equipment	(14,251)	(28,269)
Net Cash Used in Investing Activities	(14,251)	(28,269)
Cash Flows from Financing Activities:		
Payments for Stock Repurchases	(276)	(38,507)
Proceeds from the Exercise of Stock Options	—	2,644
Excess Tax Benefit from Stock-Based Compensation	(169)	3,236
Borrowings on Revolving Credit Facility	39,000	—
Payments on Revolving Credit Facility	(19,000)	—
Net Cash Provided by (Used in) Financing Activities	19,555	(32,627)
Effect of Exchange Rates on Cash and Cash Equivalents	455	236
Net Increase (Decrease) in Cash and Cash Equivalents	24,979	(32,572)
Cash and Cash Equivalents, Beginning of Period	20,287	80,634
Cash and Cash Equivalents, End of Period	$45,266	$48,062

See accompanying notes to condensed consolidated financial statements

Lumber Liquidators Holdings, Inc.

Notes to Condensed Consolidated Financial Statements

(amounts in thousands, except share data and per share amounts)

(unaudited)

Note 1. Basis of Presentation

Lumber Liquidators Holdings, Inc. and its direct and indirect subsidiaries (collectively and, where applicable, individually, the "Company") engage in business as a multi-channel specialty retailer of hardwood flooring, and hardwood flooring enhancements and accessories, operating as a single business segment. The Company offers an extensive assortment of exotic and domestic hardwood species, engineered hardwood, laminate and vinyl plank flooring direct to the consumer. The Company also features the renewable flooring products, bamboo and cork, and provides a wide selection of flooring enhancements and accessories, including moldings, noise-reducing underlay, adhesives and flooring tools. These products are primarily sold under the Company's private label brands, including the premium Bellawood brand floors. The Company also provides in-home delivery and installation services to certain of its customers. The Company sells primarily to homeowners or to contractors on behalf of homeowners through a network of 354 store locations in primary or secondary metropolitan areas in 46 states and nine store locations in Canada at June 30, 2015. In addition to the store locations, the Company's products may be ordered, and customer questions/concerns addressed, through both its call center in Toano, Virginia, and its website, *www.lumberliquidators.com*. The Company finishes the majority of the Bellawood products on its finishing lines in Toano, Virginia, which along with the call center and corporate offices, represent the "Corporate Headquarters."

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q for interim financial reporting pursuant to the rules and regulations of the Securities and Exchange Commission. While these statements reflect all normal recurring adjustments which are, in the opinion of management, necessary for a fair presentation of the results of the interim period, they do not include all of the information and footnotes required by United States ("U.S.") generally accepted accounting principles for complete financial statements. Therefore, the interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Company's annual report filed on Form 10-K for the year ended December 31, 2014.

The condensed consolidated financial statements of the Company include the accounts of its wholly owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation. Certain amounts have been reclassified to conform to the current presentation.

In 2014, the Company entered into an arrangement to begin to vertically integrate its domestic hardwood supply to feed its finishing lines. During the quarter ended June 30, 2015, the Company decided to discontinue certain of these vertical integration initiatives, which were previously consolidated as a variable interest entity, and terminated its prior arrangement. As a result, the Company has recorded a charge of $1,457 in cost of sales in its condensed consolidated statements of income upon deconsolidation of the variable interest entity. The charge was measured as the difference between the fair value of the assets received upon termination and the carrying value of the related net assets.

Results of operations for the three and six months ended June 30, 2015 are not necessarily indicative of the results to be expected for the full year.

Note 2. Summary of Significant Accounting Policies

Fair Value of Financial Instruments

The carrying amounts of financial instruments such as cash and cash equivalents, accounts payable, other liabilities and borrowings under the revolving credit agreement approximate fair value because of the short-term nature of these items. Of these financial instruments, the cash equivalents are classified as Level 1 as defined in the Financial Accounting Standards Board ASC 820 (“ASC 820”) fair value hierarchy.

Certain non-financial assets, including property and equipment, have been written down and measured in the condensed consolidated financial statements at fair value. Fair value was based on expected future cash flows using Level 3 inputs under ASC 820.

Merchandise Inventories

The Company values merchandise inventories at the lower of cost or market value. The Company periodically reviews the carrying value of items in inventory and records an impairment charge when there is evidence that the utility of inventory will be less than its cost. In determining market value, the Company makes judgments and estimates as to the market value of its products, based on factors such as historical results and current sales trends. Although the Company believes its products are appropriately valued as of the balance sheet date, there can be no assurance that future events or changes in key assumptions would not significantly impact their value.

On May 7, 2015, the Company announced that it would suspend the sale of laminate flooring sourced from China. At June 30, 2015, the Company held merchandise inventories of that product with a cost of $19,828. The Company continues to evaluate the products and the potential release of the suspension. In determining that the value of this flooring exceeded its cost, the Company considered:

- The limited period of time available to evaluate the laminate flooring sourced from China since the suspension;
- The minimal risk of spoilage of laminate flooring;
- Strong consumer demand for laminate flooring sourced from China between March 2, 2015 and May 7, 2015;
- The observed market price of laminate products sourced from China sold by the Company's competitors during the suspension period;
- The current status of the Company's evaluation of its laminate flooring sourced from China; and
- The potential channels for disposition of these products, including distribution through the Company's stores, pending completion of the Company's review of its sourcing compliance program and its evaluation of its laminate flooring sourced from China.

During the quarter ended June 30, 2015, the Company recorded an impairment charge of approximately $339 within cost of sales on its condensed consolidated statements of income related to its laminate flooring sourced from China, primarily for flooring with less than job-lot quantities on hand as the Company does not currently intend to purchase additional quantities of such product. Should future events or key assumptions, including the potential channels for disposition of the laminate flooring sourced from China, differ from current expectations, the Company may be required to record a material impairment charge related to this flooring.

During the quarter ended June 30, 2015, the Company appointed its founder as acting chief executive officer. As a result of this and other management changes, the Company determined that it would refocus on its core business and it would not pursue an expansion into the tile flooring business in the near term. In 2014, the Company had begun to sell tile flooring and related accessories in three stores as a potential growth opportunity. As a result, the Company recorded a lower of cost or market adjustment of $3,663 for certain tile flooring and related accessories in cost of sales on the condensed consolidated statements of income.

Impairment of Long-Lived Assets

The Company evaluates potential impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets may be impaired, and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets. If the fair value of the assets is less than the carrying value, an impairment loss is recorded based on the difference between the values.

In the second quarter of 2015, the Company concluded that its decision to not pursue an expansion into the tile flooring business in the near term was a triggering event requiring assessment of impairment for certain of its long-lived assets. As a result, the Company reviewed the long-lived assets for impairment related to its store locations selling a significant assortment of tile flooring. The Company recorded a $1,350 impairment charge within selling, general and administrative ("SG&A") expenses on its condensed consolidated statements of income. The impairment charge was measured under an income approach utilizing forecasted discounted cash flows. Fair value was based on expected future cash flows using Level 3 inputs under ASC 820.

Recognition of Net Sales

The Company recognizes net sales for products purchased at the time the customer takes possession of the merchandise. Service revenue, primarily installation revenue and freight charges for in-home delivery, is included in net sales and recognized when the service has been rendered. The Company reports sales exclusive of sales taxes collected from customers and remitted to governmental taxing authorities, and net of an allowance for anticipated sales returns based on historical and current sales trends and experience. The sales returns allowance and related charges were not significant for the three and six month periods ended June 30, 2015 and 2014.

Cost of Sales

Cost of sales includes the cost of the product sold, cost of installation services, transportation costs from vendor to the Company's distribution centers or store locations, any applicable finishing costs related to production of the Company's proprietary brands, transportation costs from distribution centers to store locations, transportation costs for the delivery of products from store locations to customers, certain costs of quality control procedures, warranty and customer satisfaction costs, inventory adjustments including shrinkage, and costs to produce samples, reduced by vendor allowances.

The Company offers a range of limited warranties addressing matters ranging from the durability of the finish on its prefinished products to the services it provides. Warranty reserves are based primarily on claims experience, sales history and other considerations, including payments made to satisfy customers for claims not directly related to the warranty on the Company’s products. The total reserve was $4,254 at June 30, 2015, which includes additional reserves for the Company’s air quality testing program, and $1,568 at December 31, 2014. Warranty and customer satisfaction costs are recorded in cost of sales.

In early March 2015, the Company began voluntarily offering free indoor air quality screening to certain of its flooring customers, predominately those who had purchased laminate flooring sourced from China. From early March through June 30, 2015, approximately 41,400 testing kits were sent to Lumber Liquidators customers through the program and approximately 22,600 of those testing kits were returned. Of those returned, over 90% indicated indoor air concentrations of formaldehyde within the guidelines set by the World Health Organization (“WHO”) as protective against sensory irritation and long-term health effects. Direct costs related to this testing program of $4,876 and $7,231 were included in cost of sales for the three and six months ended June 30, 2015, respectively. At June 30, 2015, the Company’s warranty and customer satisfaction reserve included $2,350 for estimated future costs to evaluate whether the laminate flooring purchased from the Company was the primary driver of the air quality testing results being above WHO standards. The reserve was based on actual experience to date, estimated using information through the filing date of the financial statements and was included in other current liabilities as a portion of the total warranty and customer satisfaction reserve. Should the Company’s actual experience related to results of its indoor air quality testing program and subsequent follow-up with customers differ from these estimates, additional reserves for customer satisfaction and warranty costs may be recorded in the future.

For the three months ended June 30, 2015, the Company incurred customer satisfaction costs of $934, including a warranty and customer satisfaction reserve of $357, primarily related to projects using certain laminate or engineered hardwood products that were incomplete as of the date sales of such laminate and engineered hardwood products were suspended during the second quarter of 2015. Refer to Footnote 8, *Commitments and Contingencies,* for a discussion on engineered hardwood products that were suspended during the quarter.

Note 3. Stockholders’ Equity

Net (Loss) Income per Common Share

The following table sets forth the computation of basic and diluted net income (loss) per common share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014

Net (Loss) Income	$(20,347)	$16,607	$(28,127)	$30,301
Weighted Average Common Shares Outstanding—Basic	27,082,878	27,384,255	27,077,312	27,452,470
Effect of Dilutive Securities:				
Common Stock Equivalents	—	226,714	—	268,691
Weighted Average Common Shares Outstanding—Diluted	27,082,878	27,610,969	27,077,312	27,721,161
Net (Loss) Income per Common Share—Basic	$(0.75)	$0.61	$(1.04)	$1.10
Net (Loss) Income per Common Share—Diluted	$(0.75)	$0.60	$(1.04)	$1.09

10,000	2.6%	$ 24.60	08/06/13	154,708	392,0

(a) Options vest in installments of 25% on each anniversary of the date of grant, such that the options are fully exercisable on or after four years from the date of grant.

(b) The exercise price shown for individual optionees is the fair market value of the Company s Common Stock on the date of grant (calculated as the average of its high and low sales price on that date reported on the New York Stock Exchange Composite Tape).

The following table includes information concerning the exercise of stock options by the Named Executive Officers during the year ended December 31, 2003:

Aggregated Option Exercises in Last Fiscal Year

And Fiscal Year-End Option Value

Name	Shares Acquired on Exercise (#)	Value Realized ($)	Number of Securities Underlying Unexercised Options at Fiscal Year End(#)		Value of Unexercised In-the-Money Options at Fiscal Year End($)(a)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Stephen W. Lilienthal	-0-	-0-	51,250	133,750	-0-	-0-
Robert V. Deutsch	-0-	-0-	62,500	62,500	-0-	-0-
Jonathan D. Kantor	-0-	-0-	36,000	58,000	-0-	-0-
James R. Lewis	-0-	-0-	25,000	70,000	$ 2,100	$ 2,100
Robert L. McGinnis	-0-	-0-	7,500	32,500	-0-	-0-

(a) Value is based on the closing price of Company Common Stock on December 31, 2003 minus the exercise price.

Employment Contracts

Pursuant to an employment agreement dated July 25, 2002, Mr. Stephen W. Lilienthal serves as the Chief Executive Officer of the Company and as Chairman of the Board and Chief Executive Officer of the CNA insurance companies. The term of the agreement expires December 31, 2005 and the annual base compensation is $950,000, subject to discretionary adjustments by the Company s Incentive Compensation Committee (ICC). In addition, Mr. Lilienthal is entitled to earn annual incentive cash awards under the Incentive Compensation Plan, as well as certain long-term incentive awards in the form of annual stock option grants, all subject to approval and adjustment by the ICC.

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In accordance with an employment agreement dated August 9, 2002, Mr. James R. Lewis serves as the President and Chief Executive Officer of Property and Casualty Operations. The term of the agreement expires December 31, 2005 and the annual base compensation is $750,000, subject to discretionary adjustments by the ICC. In addition, Mr. Lewis is entitled to earn annual incentive cash awards under the Incentive Compensation Plan, as well as certain long-term incentive awards in the form of annual cash awards and annual stock option grants, all subject to approval and adjustment by the ICC.

Pursuant to an employment agreement dated August 16, 1999, as amended February 25, 2003, Mr. Robert V. Deutsch, who serves as the Company s Executive Vice President and Chief Financial Officer, earned annual incentive cash awards under the Incentive Compensation Plan, as well as certain long-term incentive awards in the form of annual cash awards and annual stock option grants. Mr. Deutsch s annual base salary was $700,000 until the expiration of the fixed term of his employment agreement with the Company on December 31, 2003. Pursuant to the terms of that agreement, Mr. Deutsch s employment is continuing on a month-to-month basis. He is continuing to serve as Executive Vice President and Chief Financial Officer of the Company and to perform his duties accordingly and, as provided in the employment agreement as amended, he is being paid a base salary equal to 300% of his annual base salary as of December 31, 2003.

Pursuant to an employment agreement dated March 20, 2003, Mr. Jonathan D. Kantor serves as a senior executive of the Company with duties and responsibilities as designated by the Chief Executive Officer. The term of the agreement expires March 31, 2005 and the annual base compensation is $650,000, subject to adjustments at the discretion of the Chief Executive Officer. In addition, Mr. Kantor is entitled to earn annual incentive cash awards under the Incentive Compensation Plan as well as certain long-term incentive awards, all subject to approval and negative adjustment by the ICC. For the 2003 performance period, Mr. Kantor earned $1,650,000 under the Incentive Compensation Plan. Mr. Kantor is additionally entitled to an aggregate deferred signing bonus of $1,500,000, payable in installments of $750,000 on March 15, 2004 and $750,000 on March 15, 2005, with interest payable at rates applicable to accounts maintained under the SES-CAP for the applicable period.

In the event any of the foregoing employment agreements is not renewed or is terminated prior to the respective expiration dates, each executive may be entitled to certain payments, the continuation of certain benefits, and the vesting of certain stock options, all as determined in accordance with the applicable provisions of the respective agreements. Following the expiration or earlier termination of the agreements, each of the foregoing executives remains subject to certain confidentiality, non-competition, non-solicitation, non-interference and claims assistance covenants.

Retirement Plans

CNA sponsors funded, tax-qualified retirement plans for salaried employees, including executive officers (the Qualified Plans) and unfunded, non-qualified equalization plans (the Non-Qualified Plans) which provide for accruals and contributions not available under the tax -qualified plans. The following description of the Qualified Plans also gives effect to the Non-Qualified Plans. The Qualified Plans and the Non-Qualified Plans both include defined contribution plans and defined benefit plans. The qualified and non-qualified defined contribution plans are the CNA Savings and Capital Accumulation Plan (the S-CAP) and the CNA Supplemental Executive Savings and Capital Accumulation Plan (the SES-CAP), respectively. The qualified and non-qualified defined benefit plans are the CNA Retirement Plan and the CNA Supplemental Executive Retirement Plan (the SERP), respectively.

Prior to 2000, the CNA Retirement Plan provided a normal retirement pension equal to 2% of a participant s final average compensation times the participant s first 25 years of service, plus .6667% of the participant s final average compensation times his or her next 15 years of participation, with the total reduced by 1.4% of the participant s social security benefit times the participant s first 35 years of service. Final average compensation is the highest average monthly compensation paid in a 60 consecutive-calendar-month period during a participant s entire employment history. Compensation includes regular base salary, overtime, incentive and performance bonuses, paid sales incentives and tax-deferred contributions, up to the eligible amounts under current Internal Revenue Service guidelines.

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In 2000, the CNA Retirement Plan was amended and employees who were employed at December 31, 1999 and were still employed on April 24, 2000 were required to make a choice regarding their future accruals in this plan. Employees were given two choices: (1) to continue earning additional benefits under the formula described above, or (2) to convert the present value of their accrued benefit as of December 31, 1999 to an accrued pension account, which is credited with interest at a rate based on 30 year treasury securities.

Employees who elected to forego earning additional benefits in the CNA Retirement Plan and all employees hired by Continental Casualty Company on or after January 1, 2000 receive an annual basic Company contribution to the S-CAP of 3% or 5% of their eligible compensation, depending on their age. In addition, these employees are eligible to receive discretionary annual performance contributions of up to 2% of eligible compensation and an additional Company match of up to 80% of the first 6% of salary contributed by the employee. The basic, performance and additional Company matching contributions are referred to herein as Enhanced S-CAP. All eligible employees, regardless of their choice, are entitled to a 70% Company matching contribution to the S-CAP on the first 6% of eligible compensation contributed by the employee. The Company matching contribution rates for employees during the first year of service are 50% of the foregoing.

All salary amounts and annual cash incentive compensation amounts are considered eligible compensation for purposes of the CNA Retirement Plan, the SERP, and for basic and performance contributions to the S-CAP and SES-CAP. Only salary is considered eligible compensation for purposes of Company matching contributions to the S-CAP and SES-CAP.

Messrs. Deutsch and Kantor chose to continue to accrue benefits under the CNA Retirement Plan and SERP. Messrs. Lewis, Lilienthal, and McGinnis are all participants in the Enhanced S-CAP and SES-CAP.

Pension Plan Table

Average Annual Compensation	Years of Accrual Service:				
	5	10	15	20	25
$ 400,000	$ 38,501	$ 77,003	$ 115,504	$ 154,006	$ 192,507
600,000	58,501	117,003	175,504	234,006	292,507
800,000	78,501	157,003	235,504	314,006	392,507
1,000,000	98,501	197,003	295,504	394,006	492,507
1,200,000	118,501	237,003	355,504	474,006	592,507
1,400,000	138,501	277,003	415,504	554,006	692,507
1,600,000	158,501	317,003	475,504	634,006	792,507
1,800,000	178,501	357,003	535,504	714,006	892,507
2,000,000	198,501	397,003	595,504	794,006	992,507
2,200,000	218,501	437,003	655,504	874,006	1,092,507
2,400,000	238,501	477,003	715,504	954,006	1,192,507
2,600,000	258,501	517,003	775,504	1,034,006	1,292,507
2,800,000	278,501	557,003	835,504	1,114,006	1,392,507

The amounts in the table reflect deductions for estimated Social Security payments.

Messrs. Deutsch and Kantor have approximately 14, and 10 years of credited service, respectively. Messrs. Lewis, Lilienthal and McGinnis are not participants in the CNA Retirement Plan and SERP because they were hired after December 31, 1999. Therefore, they have no years of credited service under these plans.

The following table includes information concerning long-term incentive cash awards made in 2003 to the Named Executive Officers:

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Long-Term Incentive Plan Awards in 2003

Name	Performance Period	Estimated Future Payouts($)(a) Threshold	Target	Maximum
Stephen W. Lilienthal(b)	2003-2005	-0-	-0-	-0-
Robert V. Deutsch	2003-2005	$ 80,000	$ 160,000	$ 320,000
Jonathan D. Kantor	2003-2005	$ 97,500	$ 195,000	$ 390,000
James R. Lewis	2003-2005	$ 75,000	$ 150,000	$ 300,000
Robert L. McGinnis	2003-2005	$ 52,500	$ 105,000	$ 210,000

(a) The long-term incentive cash awards are made under the Incentive Compensation Plan which is administered by the ICC. The long-term incentive cash awards are generally granted annually and are earned based on net operating income targets or other selected corporate financial goals for three-year performance periods and will become payable only to the extent that specified performance goals are achieved. The payouts can vary from 0% to 200% of the original target based on the attainment of performance goals. Only awards related to the 2003-2005 performance cycle are included in this table.

(b) Mr. Lilienthal did not receive a long-term incentive plan cash award in 2003.

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BOARD OF DIRECTORS REPORT ON EXECUTIVE COMPENSATION

Certain Executive Officers

The Board of Directors believes that the success of the Company and its subsidiaries is dependent upon the quality of management, and that compensation programs are important in attracting and retaining individuals of superior ability and motivating their efforts on behalf of the Company and its business interests.

Under Section 162(m) of the Internal Revenue Code, unless classified as qualified performance-based compensation , the amount of compensation deductible for federal income tax purposes which is paid by a publicly-held corporation to its CEO and certain highly compensated officers during any year is limited to $1,000,000 per person.

To the extent the Company s compensation policy can be implemented in a manner that maximizes the deductibility of compensation paid by the Company, the Board of Directors seeks to do so, subject to the Company s contractual obligations to executives in particular cases. Accordingly, in February 2000 the Company amended (and subsequently approved by the Stockholders) the existing annual and long-term compensation plans and merged them into an omnibus plan renamed as the CNA Financial Corporation 2000 Incentive Compensation Plan (the Incentive Compensation Plan), which covers annual, corporate long-term cash and share-related compensation for the Executive Officers of the Company. It is designed to qualify the amounts paid from time to time thereunder to certain of the Company s officers as qualified performance-based compensation under Section 162(m) of the Code.

General

The Company s compensation program is designed to recognize individual performance and contribution to CNA. This pay-for-performance philosophy is used to reward employees whose work meets or exceeds CNA s standards of quality and value-added customer service. It is CNA s objective to have a compensation policy that is internally equitable and externally competitive, rewards executives for long term strategic management, supports a performance-oriented environment that stresses attainment of corporate goals and individual expectations, and attracts and retains key executives critical to the Company s long term success.

The Incentive Compensation Committee (ICC) of the Board of Directors of the Company reviewed the compensation for Messrs. Lilienthal, Deutsch, Lewis, Kantor and McGinnis. The Chairman of the Board and Chief Executive Officer of the CNA insurance companies reviewed the compensation for all other Executive Officers. They are assisted in developing and evaluating the overall competitiveness of the compensation program by the Company s Human Resources staff, which is supported by an independent nationally recognized compensation consulting organization. Comparative compensation information regarding the Company s competitor group of companies is evaluated each year. The competitor group consists of companies within the property/casualty insurance industry, which includes two of the three companies in the Standard & Poor s Multi-Line Insurance Index (see Stock Price Performance Graph below). These companies represent the organizations against which CNA competes for key executives. This comparative compensation information, in conjunction with performance judgments as to past and expected future contributions of the individual, is used to develop annual compensation levels. In 2003, the Executive Officers were provided total compensation opportunities that approximated a minimum of the 50th percentile of total compensation opportunities for comparable individuals at the Company s competitor group.

Under the Incentive Compensation Plan, the annual incentive cash compensation awards for the Executive Officers are determined by performance compared to preset quantifiable financial goals approved by the ICC. The annual incentive opportunity is based, among other factors, on comparative market compensation data as described above. Final approval of annual incentive cash compensation payments is made by the ICC. The Company reserves the right to make discretionary changes to the award amounts and reserves the right to eliminate these bonuses, uniformly, due to adverse financial conditions, except where specified in contracts. In determining the annual incentive cash compensation awards for 2003, the ICC evaluated Company and business unit performance and individual performance against the pre-set goals categories and other

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performance measures where necessary. Based upon this evaluation, the 2003 bonuses ranged from 110% to 254% of the incentive targets for the Executive Officers.

The base salary of the Company s Chief Executive Officer was established pursuant to the employment agreement negotiated between the Company and the Chief Executive Officer. See Employment Agreements, above. The annual base compensation is $950,000, subject to discretionary adjustments by the Company s Incentive Compensation Committee (ICC). In addition, Mr. Lilienthal is entitled to earn annual incentive cash awards under the Incentive Compensation Plan as well as certain long-term incentive awards in the form of annual stock option grants, all subject to approval and adjustment by the ICC. For the 2003 performance period, Mr. Lilienthal earned $1,900,000 under the Incentive Compensation Plan.

By the Incentive Compensation Committee: Don M. Randel and Marvin Zonis (Chairperson).

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

Mr. Lilienthal, a Director of the Company, also serves as an officer of the Company and its subsidiaries.

CERTAIN TRANSACTIONS

Loews makes available to CNA the services of certain officers and executives of Loews. In February 1975 CNA entered into a management services agreement (the Services Agreement) with Loews which provides that Loews will make available to CNA these services, together with general corporate services, including financial, administrative and management consulting services. Loews is reimbursed on the basis of an allocation of a portion of the salaries and related payroll taxes and benefits of the officers and executives performing the services, in addition to travel and similar expenses incurred. The allocation may be adjusted in the event of any substantial change in the services performed and the Services Agreement may be terminated by CNA or Loews on the last day of any month. The Services Agreement has been reviewed each year since 1975 by CNA s Audit Committee. The last such review took place in February 2004 and the Audit Committee recommended renewal of the Services Agreement for the ensuing fiscal year, calling for a reimbursement allocation of approximately $210,000 per month, which recommendation was accepted by the Board of Directors. Under the Services Agreement CNA reimbursed Loews $2,520,000 for services performed during 2003, and $70,024 for travel and similar expenses incurred during 2003. Also during 2003, Loews or its subsidiaries paid premiums on insurance and administrative services to the CNA insurance companies at standard rates aggregating approximately $3,704,484.

The Loews ownership of the voting securities of CNA has exceeded 80% since 1980 requiring the inclusion of CNA and its eligible subsidiaries in the consolidated federal income tax returns filed by Loews. Accordingly, following approval by CNA s Audit Committee and Board of Directors, CNA and Loews entered into a tax allocation agreement that provides that CNA will (i) be paid by Loews the amount, if any, by which the Loews consolidated federal income tax liability is reduced by virtue of the inclusion of CNA and its subsidiaries in the Loews consolidated federal income tax return, or (ii) pay to Loews an amount, if any, equal to the federal income tax that would have been payable by CNA, if CNA and its subsidiaries had filed a separate consolidated return. In the event that Loews should have a net operating loss in the future computed on the basis of filing a separate consolidated tax return without CNA and its eligible subsidiaries, CNA may be required to repay tax recoveries previously received from Loews. This agreement may be cancelled by CNA or Loews upon thirty days prior written notice. In 2003, the inclusion of CNA and its eligible subsidiaries in the consolidated federal income tax return of Loews resulted in a decrease in the federal income tax liability for Loews. Accordingly, Loews has paid or will pay approximately $734,000,000 to CNA for 2003 under the tax allocation agreement.

CNA has also reimbursed to Loews or paid directly approximately $18,056,502 for expenses (consisting primarily of salaries and benefits and other out-of-pocket costs) incurred or owed by Loews during 2003 in maintaining investment facilities and services for CNA.

In November of 2003 the Company and its principal insurance subsidiary, Continental Casualty Company (CCC), entered into a Capital Support Agreement and related Guaranty Agreement (collectively the Support Agreements) with Loews, the 90% owner of CNA s outstanding shares. The Support Agreements provided for the sale in November of 2003 of $750 million of a new series of CNA preferred stock to Loews, and a commitment from Loews for additional capital support of up to $500 million by February 27, 2004 through the purchase of surplus notes of CCC, CNA s principal insurance subsidiary, in the event certain additions to CCC s statutory capital were not achieved through asset sales. The preferred stock is convertible into 32,327,015 shares of the Company s common stock. In addition, Loews committed up to an additional $150 million by March 31, 2004, in a form to be determined, to support the statutory capital of CCC in the event of additional shortfalls in relation to business and asset sales.

After consideration of the increase in CCC s statutory surplus resulting from the sale of the Company s Group Benefits business, Loews purchased a $46 million CCC surplus note under the Support Agreements in February of 2004. In addition, the sale of CNA s individual life business is expected to result in an addition to CCC s statutory surplus in excess of $400 million. However, the sale of the individual life business was not consummated by February 26, 2004. As a result, under the Support Agreements Loews purchased an additional $300 million CCC surplus note in February of 2004. Following the consummation of the individual life sale, CNA plans to seek approval from the relevant insurance regulatory authority for the repayment of the surplus note purchased in relation to such sale, although it is not certain that sale of the individual life business will be consummated or that the required regulatory approval will be obtained.

The Company has entered into a credit agreement with a large national contractor that undertakes projects for the construction of government and private facilities to provide an $86.4 million credit facility. CNA Surety Corporation has provided significant surety bond protection for projects by this contractor through surety bonds underwritten by affiliates of the Company. Loews and the Company have entered into a participation agreement, pursuant to which Loews has purchased a participation interest in one-third of the loans and commitments under the credit facility, on a dollar-for-dollar basis, up to a maximum of $25 million. At the time of filing of this Proxy Statement Loews participation was at the maximum level under the participation agreement. Although Loews does not have rights against the contractor directly under the participation agreement, it shares recoveries under the facility proportionally with the Company. Under the participation agreement, Loews also receives twenty-five percent of a closing fee from the contractor in the amount of $900,000, half of which was paid at closing and half of which is due to be paid when the credit facility matures.

Each of Messrs. Hengesbaugh, Deutsch and Kantor took a loan from the Company to assist him with the purchase of Common Stock under the terms of the Stock Ownership Plan. The loans were taken out at various times in 1998 and 1999 and the term of each loan is 10 years. Messrs. Hengesbaugh s and Kantor s loans are unconditional with full recourse against the maker. Mr. Deutsch s loan is non-recourse and is secured by additional collateral. As of December 31, 2003, the outstanding amounts of the loans were as follows: Mr. Hengesbaugh, $20,539,185, Mr. Kantor, $990,551 and Mr. Deutsch, $4,837,981. Mr. Kantor s loan was pre-paid in full in March of 2004, pursuant to the sale of Company stock he purchased in relation to the loan as noted above.

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STOCK PRICE PERFORMANCE GRAPH

The following graph compares the total return of the Company s Common Stock, the Standard & Poor s 500 Composite Stock Index (S&P 500) and the Standard & Poor s 500 Multi-Line Insurance Index for the five years ended December 31, 2003. The graph assumes that the value of the investment in the Company s Common Stock and for each Index was $100 on December 31, 1998 and that dividends were reinvested.

Company/Index	1998	1999	2000	2001	2002	2003
CNA FINANCIAL CORP	100	96.74	96.27	74.19	65.11	61.30
S&P 500 INDEX	100	121.04	110.02	96.95	75.52	97.18
S&P 500 MULTI-LINE INSURANCE	100	130.06	180.71	148.92	109.42	127.14

RATIFICATION OF APPOINTMENT OF INDEPENDENT AUDITORS
(Proposal No. 2)

The Audit Committee of the Board of Directors has selected Deloitte & Touche LLP to serve as independent auditors for 2004. Although it is not required to do so, the Board of Directors wishes to submit the selection of Deloitte & Touche LLP for ratification by the Company s shareholders at the meeting. Even if this selection is ratified by shareholders at the Annual Meeting, the Audit Committee may in its discretion change the appointment at any time during the year if it determines that such a change would be in the best interests of the Company and its shareholders. If the Company s shareholders do not ratify the selection of Deloitte & Touche LLP, the Audit Committee will reconsider its selection. Representatives of Deloitte & Touche LLP are expected to be at the Annual Meeting to answer appropriate questions and, if they choose to do so, to make a statement.

For the years ended December 31, 2003 and 2002, professional services were performed by Deloitte & Touche LLP, the member firms of Deloitte Touche Tohmatsu, and their respective affiliates (collectively, Deloitte), which includes Deloitte Consulting.

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Audit and audit-related fees aggregated $10.8 million and $8.1 million for the years ended December 31, 2003 and 2002, respectively and were composed of the following:

Audit Fees

The aggregate fees billed for the audit of the Company s annual financial statements for the years ended December 31, 2003 and 2002 and for the reviews of the financial statements included in the Company s Quarterly Reports on Form 10-Q were $7.7 million and $7.0 million, respectively.

Audit-Related Fees

The aggregate fees billed for Audit-Related services for the years ended December 31, 2003 and 2002 were $3.1 million and $1.1 million, respectively. These fees generally include fees for consents and comfort letters, audits of the Company s employee benefit plans, accounting consultations, Sarbanes Oxley Act Section 404 advisory services, and SEC related matters.

Tax Fees

The aggregate fees billed for tax services for the years ended December 31, 2003 and 2002 were $0.2 million and $0.3 million, respectively. These fees generally include fees for the preparation of expatriate tax returns.

All Other Fees

The aggregate fees for services not included above were $3.2 million and $12.0 million, respectively, for the years ended December 31, 2003 and 2002, including fees billed by Deloitte Consulting. These fees generally include fees for human capital advisory services, risk consulting services and other consulting or advisory services.

Certain fees for 2002 have been adjusted to reflect additional amounts for audit and audit related services performed and billed subsequent to the issuance of the 2002 Proxy Statement.

The Audit Committee has established a pre-approval policy with regard to audit, audit-related and certain non-audit engagements by the Company of its independent auditors. Under this policy, the Audit Committee annually pre-approves certain limited, specified recurring services which may be provided by Deloitte, subject to maximum dollar limitations. All other engagements for services to be performed by Deloitte must be separately pre-approved by the Audit Committee. The Audit Committee has also designated the Chairperson of the Committee as having authority to pre-approve such engagements as allowed by the policy, subject to reporting on such pre-approvals to the Committee at its next scheduled meeting.

The Board of Directors recommends that the Stockholders vote FOR Proposal No. 2.

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OTHER MATTERS

The Company does not know of any other business to come before the meeting. However, if any other matters come before the meeting, the persons named in the proxies will act on behalf of the Stockholders they represent according to their best judgment.

The cost of this solicitation of proxies will be borne by the Company. Solicitation will be made primarily through use of the mails, but regular employees of the Company may solicit proxies personally, by telephone or facsimile. Such employees will receive no special compensation for such solicitation. Brokers and nominees will be requested to obtain voting instructions of beneficial owners of stock registered in their names and will be reimbursed for their out-of-pocket expenses and reasonable clerical expenses.

STOCKHOLDER COMMUNICATIONS TO THE BOARD OF DIRECTORS

OR THE INDEPENDENT DIRECTORS

The Company has a process by which stockholders may communicate with the Board of Directors. Stockholders and other interested parties wishing to communicate directly to the Company s Board of Directors may submit written communications addressed to the Board of Directors, c/o General Counsel, CNA Financial Corporation, 43 South, Chicago, Illinois 60685. All such communications from stockholders will be forwarded to the members of the Board.

Any stockholder of the Company wishing to communicate with its Independent Directors may do so in the following ways:

By submitting the communication in writing addressed to:

Presiding Director, Non-Management Directors of CNA Financial Corporation
c/o Vice President, Internal Audit
CNA Financial Corporation
CNA Plaza
Chicago, Illinois 60685

By leaving a recorded message addressed to Presiding Director, Non-Management Directors of CNA Financial Corporation at the following telephone number: **1-888-679-9252**; or

By sending an email to the attention of the Presiding Director, Non-Management Directors of CNA Financial Corporation at: **corporateinvestigations@cna.com.**

STOCKHOLDER PROPOSALS FOR THE 2005 ANNUAL MEETING

Stockholder proposals for inclusion in proxy materials for the 2005 Annual Meeting should be addressed to the Company s Executive Vice President, General Counsel and Secretary, CNA Plaza, 43S, Chicago, Illinois 60685, and must be received by November 24, 2004. Proxies received in respect of Common Stock to be voted at the 2004 Annual Meeting will be voted in accordance with the best judgment of the persons appointed by such proxies with respect to any matters properly before such meeting submitted by Stockholders after January 2, 2005.

By order of the Board of Directors,

JONATHAN D. KANTOR
Executive Vice President, General Counsel and Secretary

Chicago, Illinois
March 29, 2004

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EXHIBIT A

CNA FINANCIAL CORPORATION

AUDIT COMMITTEE CHARTER

Purpose

The Audit Committee s primary function is to assist the Board of Directors of CNA Financial Corporation (the Company) with its responsibility of overseeing the integrity of the Company s financial statements, the Company s compliance with legal and regulatory requirements, the qualifications and independence of the Company s independent accountants and the performance of the Company s internal audit staff and independent accountants. The Committee shall prepare the Audit Committee Report for the Company s annual proxy statement.

Committee Membership

The Committee shall be comprised of three or more directors, as determined by the Board from time to time, except to the extent that temporary vacancies are created by the resignation or removal of a Committee member. The Board has authority to appoint the Committee members, who serve at the pleasure of the Board, and to designate the Committee Chairperson. Each member of the Committee must satisfy the independence, experience, financial expertise and other requirements of the New York Stock Exchange, Inc. (the Exchange) and applicable laws and regulations. Committee members may not serve on the audit committees of more than two other public companies unless approved by the Board and such approval is disclosed in the Company s proxy statement. No member of the Committee may receive, directly or indirectly, any consulting, advisory or other compensatory fee from the Company other than (i) director s fees, which may be received in cash, stock options or other in-kind consideration ordinarily available to directors; (ii) a pension or other deferred compensation for prior services that is not contingent on future service; and (iii) any other regular benefits that other directors receive.

Meetings

The Committee shall meet as often as it determines to be appropriate, but not less frequently than quarterly. The Committee shall periodically meet separately with management, the internal auditors and the independent accountants. The Committee shall also meet periodically in executive sessions without Company management present. The Committee may request any employee or officer of the Company or its outside counsel or independent accountants to attend a meeting or to meet with the Committee or its advisors. The Committee may fix its own rules of procedure, subject to the requirements of this Charter, Exchange rules and applicable laws and regulations.

Authority And Responsibilities

Company management is responsible for preparing financial statements. The Committee s primary responsibility is oversight. To carry out this responsibility, the Committee shall undertake the common recurring activities described below, but may diverge from this list as appropriate under the circumstances.

The Committee may form and delegate authority to sub-committees consisting of one or more members when appropriate.

1. *Oversight of the Independent Accountants.* The Committee shall:

(a) have sole authority to directly appoint, retain, compensate, evaluate and terminate the Company s independent accountants and to approve all engagement fees and terms, including mandatory pre-approval of all engagements of the independent accountants in accordance with policies and procedures adopted by the Committee from time to time or as required by Exchange rules or applicable laws or regulations;

(b) oversee the work of the independent accountants, including resolution of disagreements between management and the independent accountants regarding financial reporting, and the independent accountants shall report directly to the Committee;

(c) at least annually, review reports from the independent accountants regarding their internal quality-control procedures, any material issues raised by the most recent internal quality-control review or peer review or any regulatory or professional inquiry within the preceding five years, and all relationships between the independent accountants and the Company;

(d) annually evaluate the qualifications, performance and independence of the independent accountants and the lead partner, taking into account the opinions of management and the internal auditors, and present its conclusions to the Board;

(e) annually seek assurances that partners of the independent accountants who are directly involved in the audit are rotated as required by regulations or Exchange rules and that no partner earns or receives compensation based on the performance of any services for the Company other than audit, review or attest services;

(f) consider annually whether, in order to assure continuing auditor independence, the Company should rotate its independent accounting firm on a regular basis;

(g) set policies for the Company s hiring of current or former employees of the independent accountants;

(h) instruct the independent accountants that such firm is ultimately accountable to the Board of Directors of the Company and the Committee, as representatives of the shareholders;

(i) instruct the independent accountants to submit to the Committee annually a formal written statement of the fees billed in each of the last two fiscal years for each of the following categories of services rendered by the independent accountants to the Company and each of its subsidiaries: (i) the audit of the Company s annual financial statements and the reviews of its quarterly financial statements, or services that are normally provided by the independent accountants in connection with statutory and regulatory filings or engagements; (ii) assurance and related services not included in clause (i) that are reasonably related to the performance of the audit or review of financial statements, in the aggregate and by each service; (iii) tax compliance, tax advice and tax planning services, in the aggregate and by each service; and (iv) all other products and services rendered by the independent accountants, in the aggregate and by each service; and

(j) obtain from the independent accountants assurance that each audit is conducted in a manner consistent with Section 10A of the Securities Exchange Act of 1934, which sets forth certain procedures to be followed in any audit of financial statements required under that Act.

2. *Oversight of Financial Reporting and Controls.* The Committee shall:

(a) meet with the independent accountants prior to any audit to discuss the planning and staffing of the audit;

(b) review and discuss with management and the independent accountants the annual audited financial statements and quarterly financial statements to be included in the Company s reports filed with the Securities and Exchange Commission (SEC), including Management s Discussion and Analysis of Financial Condition and Results of Operations;

(c) review and discuss the following with management and the independent accountants, in connection with the Committee s review of the Company s annual financial statements and, as appropriate, quarterly financial statements and related disclosures:

critical accounting policies and financial statement presentation, including key accounting decisions and judgments, significant changes in the selection or application of accounting

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principles, the rationale for such choices and the alternatives available under generally accepted accounting principles (GAAP);

material written communications between the independent accountants and management, including any management or internal control letter issued or proposed to be issued by the independent accountants and management s responses;

any problems encountered in the audit or review of the financial statements, including any disagreements between management and the independent accountants or limitations on the activities of the independent accountants, and management s responses;

the effect of regulatory and accounting initiatives, as well as off-balance sheet structures, on the financial statements;

any accounting adjustments that were noted or proposed by the independent accountants but were passed (as immaterial or otherwise);

communications between the audit team and the independent accountants national office respecting auditing or accounting issues presented by the engagement;

the certifications made by the principal executive officer and principal financial officer with respect to the Company s periodic reports filed with the SEC;

management s report on internal control over financial reporting and the independent accountants related attestation report and any material changes in the Company s internal control over financial reporting;

any appointment or replacement of the director of the Internal Audit Division; and

major financial risk exposures and the steps management has taken to monitor and control such exposures, including the Company s risk assessment and risk management policies;

(d) review the type and presentation of information to be included in earnings press releases (particularly any pro forma or adjusted non-GAAP information), as well as financial information and earnings guidance which management may provide to analysts and rating agencies; *provided, however*, that such review need not take place in advance of each earnings release or each instance in which guidance may be provided;

(e) annually review and discuss with the independent accountants and management the Company s Internal Audit Division and its audit plan, responsibilities, budget and staffing;

(f) establish procedures for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls or auditing matters and the confidential, anonymous submission by employees of the Company of concerns regarding questionable accounting or auditing matters;

(g) advise management, the Internal Audit Division and the independent accountants that they are expected to provide to the Committee a timely analysis of significant financial reporting issues and practices;

(h) consider any reports or communications (and management s and/or the internal audit department s responses thereto) submitted to the Committee by the independent auditors required by or referred to in Statement of Accounting Standards 61; and

(i) inquire of the Company s Chief Executive Officer and Chief Financial Officer as to the existence of any significant deficiencies in the design or operation of internal controls that could adversely affect the Company s ability to record, process, summarize and report financial data, any material weakness in internal controls, and any fraud, whether or not material, that involves management or other employees who have a significant role in the Company s internal controls.

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3. *Compliance with Legal and Regulatory Requirements.* The Committee shall periodically discuss with the Company s General Counsel any significant legal, compliance or regulatory matters that may have a material effect on the Company s business, financial statements or compliance policies including material notices to or inquiries received from governmental agencies.

4. *Additional Responsibilities of the Committee.* The Committee shall make regular reports to the Board. The Committee shall annually review and evaluate the Committee s own performance and review and reassess the adequacy of this Charter and recommend any proposed changes to the Board for approval.

5. *Additional Powers of the Committee.* The Committee shall have the authority, to the extent it deems necessary or appropriate, to retain special legal, accounting or other experts to advise the Committee and carry out its duties, and to conduct or authorize investigations into any matters within its scope of responsibilities. The Committee shall be provided with the funding and other resources required to discharge its duties and responsibilities, including payment of reasonable compensation to the independent accountants and to any advisors employed by the Committee.

6. *Delegation to Subcommittee.* The Committee may in its discretion delegate all or a portion of its duties and responsibilities to a subcommittee of the Committee. The Committee may also, in its discretion, delegate to one or more of its members the authority to pre-approve any audit or non-audit services to be performed by the independent auditors as permitted by applicable law and regulation, provided that any such approvals are presented to the Committee for review at its next scheduled meeting.

Limitations of the Committee s Role

While the Committee has the responsibilities and powers set forth in this Charter, it is not the duty of the Committee to prepare financial statements, plan or conduct audits or determine that the Company s financial statements and disclosures are complete or accurate or in accordance with GAAP or applicable laws or regulations. The Committee s job is one of review and it recognizes that the Company s management is responsible for preparing the Company s financial statements and that the independent accountants are responsible for auditing or reviewing those financial statements, as applicable. The Committee recognizes that management and the independent accountants have more time, knowledge and detailed information concerning the Company than do Committee members. Consequently, in performing its functions, the Committee is not providing any expert or special assurance as to the Company s financial statements or any professional certification as to the independent accountants work.

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DETACH HERE

CNA FINANCIAL CORPORATION PROXY

**Solicited on Behalf of the Board of Directors
for the Annual Meeting, April 28, 2004, Chicago, Illinois**

The undersigned hereby appoints S.W. Lilienthal, J.S. Tisch, and P.R. Tisch, or any of them, with full power of substitution, to represent and to vote the Common Stock of the undersigned at the annual meeting of stockholders of CNA Financial Corporation, to be held at CNA Plaza (333 South Wabash Avenue), Chicago, Illinois, on April 28, 2004, at 10:00 A.M., or at any adjournment thereof as follows:

Nominees for Election of Directors:

Walter L. Harris, Stephen W. Lilienthal, Paul J. Liska, Don M. Randel, Joseph Rosenberg, James S. Tisch, Preston R. Tisch, Marvin Zonis.

You are encouraged to specify your choices by marking the appropriate boxes, SEE REVERSE SIDE, but you need not mark any boxes if you wish to vote in accordance with the Board of Directors recommendations. The Proxy Committee cannot vote your shares unless you sign and return this card.

SEE REVERSE SIDE

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CNA FINANCIAL CORPORATION

C/O EQUISERVE TRUST COMPANY, N.A.
P.O. BOX 8694
EDISON, NJ 08818-8694

DETACH HERE IF YOU ARE RETURNING YOUR PROXY CARD BY MAIL

ZCNAC1

#CNA

x **Please mark votes as in this example.**

The Board of Directors recommends a vote FOR the Election of Directors and FOR proposal 2.

1. Election of Directors (see reverse)

FOR	WITHHELD
o	o

o

For, except vote withheld from the above nominee(s):

		FOR	AGAINST	ABSTAIN
2.	Approval of Deloitte & Touche, LLP, as independent auditors.	o	o	o

This proxy when properly executed will be voted in the manner directed herein. If no direction is made, this proxy will be voted FOR election of directors and FOR proposal 2.

The signer hereby revokes all proxies heretofore given by the signer to vote at said meeting or any adjournments thereof.

NOTE: Please sign exactly as name appears hereon. Joint owners should each sign. When signing as attorney, executor, administrator, trustee or guardian, please give full title as such.

Signature: __________ Date: __________ Signature: __________ Date: __________