CNA FINANCIAL CORP
Form 10-K
February 26, 2008

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, 2007

OR

o 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 incorporation or organization)	**(I.R.S. Employer Identification No.)**
333 S. Wabash **Chicago, Illinois**	**60604**
(Address of principal executive offices)	**(Zip Code)**

(312) 822-5000
(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

<u>**Title of each class**</u>	**Name of each exchange on which registered**
Common Stock with a par value of $2.50 per share	New York Stock Exchange Chicago Stock Exchange

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

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

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 o No þ

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 þ No o

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 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. þ

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

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

As of February 22, 2008, 270,716,622 shares of common stock were outstanding. The aggregate market value of the common stock held by non-affiliates of the registrant as of June 30, 2007 was approximately $1,438 million based on the closing price of $47.69 per share of the common stock on the New York Stock Exchange on June 30, 2007.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the CNA Financial Corporation Proxy Statement prepared for the 2008 annual meeting of shareholders, pursuant to Regulation 14A, are incorporated by reference into Part III of this Report.

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PART I

ITEM 1. BUSINESS

CNA Financial Corporation (CNAF) was incorporated in 1967 and is an insurance holding company. Collectively, CNAF and its subsidiaries are referred to as CNA or the Company. References to CNA, the Company, we, our, like terms refer to the business of CNA and its subsidiaries. Our property and casualty insurance operations are conducted by Continental Casualty Company (CCC), incorporated in 1897, and The Continental Insurance Company (CIC), organized in 1853, and affiliates. CIC became a subsidiary of ours in 1995 as a result of the acquisition of The Continental Corporation (Continental). Loews Corporation (Loews) owned approximately 89% of our outstanding common stock as of December 31, 2007.

We serve a wide variety of customers, including small, medium and large businesses, associations, professionals, and groups and individuals with a broad range of insurance and risk management products and services.

Our insurance products primarily include commercial property and casualty coverages. Our services include risk management, information services, warranty and claims administration. Our products and services are marketed through independent agents, brokers, managing general agents and direct sales.

Our core business, commercial property and casualty insurance operations, is reported in two business segments: Standard Lines and Specialty Lines. Our non-core operations are managed in two business segments: Life & Group Non-Core and Corporate & Other Non-Core. These segments are managed separately because of differences in their product lines and markets. Discussions of each segment including the products offered, the customers served, the distribution channels used and competition are set forth in the Management s Discussion and Analysis (MD&A) included under Item 7 and in Note N of the Consolidated Financial Statements included under Item 8.

Competition

The property and casualty insurance industry is highly competitive both as to rate and service. Our consolidated property and casualty subsidiaries compete not only with other stock insurance companies, but also with mutual insurance companies, reinsurance companies and other entities for both producers and customers. We must continuously allocate resources to refine and improve our insurance products and services.

Rates among insurers vary according to the types of insurers and methods of operation. We compete for business not only on the basis of rate, but also on the basis of availability of coverage desired by customers, ratings and quality of service, including claim adjustment services.

There are approximately 2,300 individual companies that sell property and casualty insurance in the United States. Our consolidated property and casualty subsidiaries ranked as the 13th largest property and casualty insurance organization and we are the seventh largest commercial insurance writer in the United States based upon 2006 statutory net written premiums.

Regulation

The insurance industry is subject to comprehensive and detailed regulation and supervision throughout the United States. Each state has established supervisory agencies with broad administrative powers relative to licensing insurers and agents, approving policy forms, establishing reserve requirements, fixing minimum interest rates for accumulation of surrender values and maximum interest rates of policy loans, prescribing the form and content of statutory financial reports and regulating solvency and the type, quality and amount of investments permitted. Such regulatory powers also extend to premium rate regulations, which require that rates not be excessive, inadequate or unfairly discriminatory. In addition to regulation of dividends by insurance subsidiaries, intercompany transfers of assets may be subject to prior notice or approval by the state insurance regulators, depending on the size of such transfers and payments in relation to the financial position of the insurance affiliates making the transfer or payment.

Insurers are also required by the states to provide coverage to insureds who would not otherwise be considered eligible by the insurers. Each state dictates the types of insurance and the level of coverage that must be provided to such involuntary risks. Our share of these involuntary risks is mandatory and generally a function of our respective share of the voluntary market by line of insurance in each state.

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Further, insurance companies are subject to state guaranty fund and other insurance-related assessments. Guaranty fund assessments are levied by the state departments of insurance to cover claims of insolvent insurers. Other insurance-related assessments are generally levied by state agencies to fund various organizations including disaster relief funds, rating bureaus, insurance departments, and workers compensation second injury funds, or by industry organizations that assist in the statistical analysis and ratemaking process.

Reform of the U.S. tort liability system is another issue facing the insurance industry. Over the last decade, many states have passed some type of reform. In recent years, for example, significant state general tort reforms have been enacted in Georgia, Ohio, Mississippi and South Carolina. Specific state legislation addressing state asbestos reform has been passed in Ohio, Georgia, Florida and Texas in past years as well. Although these states legislatures have begun to address their litigious environments, some reforms are being challenged in the courts and it will take some time before they are finalized. Even though there has been some tort reform success, new causes of action and theories of damages continue to be proposed in state court actions or by legislatures. For example, some state legislatures are considering legislation addressing direct actions against insurers related to bad faith claims. As a result of this unpredictability in the law, insurance underwriting and rating are expected to continue to be difficult in commercial lines, professional liability and some specialty coverages and therefore could materially adversely affect our results of operations and equity.

Although the federal government and its regulatory agencies do not directly regulate the business of insurance, federal legislative and regulatory initiatives can impact the insurance industry in a variety of ways. These initiatives and legislation include tort reform proposals; proposals addressing natural catastrophe exposures; terrorism risk mechanisms; federal regulation of insurance; and various tax proposals affecting insurance companies.

In addition, our domestic insurance subsidiaries are subject to risk-based capital requirements. Risk-based capital is a method developed by the National Association of Insurance Commissioners to determine the minimum amount of statutory capital appropriate for an insurance company to support its overall business operations in consideration of its size and risk profile. The formula for determining the amount of risk-based capital specifies various factors, weighted based on the perceived degree of risk, which are applied to certain financial balances and financial activity. The adequacy of a company s actual capital is evaluated by a comparison to the risk-based capital results, as determined by the formula. Companies below minimum risk-based capital requirements are classified within certain levels, each of which requires specified corrective action. As of December 31, 2007 and 2006, all of our domestic insurance subsidiaries exceeded the minimum risk-based capital requirements.

Subsidiaries with insurance operations outside the United States are also subject to regulation in the countries in which they operate. We have operations in the United Kingdom, Canada and other countries.

Employee Relations

As of December 31, 2007, we had approximately 9,400 employees and have experienced satisfactory labor relations. We have never had work stoppages due to labor disputes.

We have comprehensive benefit plans for substantially all of our employees, including retirement plans, savings plans, disability programs, group life programs and group healthcare programs. See Note J of the Consolidated Financial Statements included under Item 8 for further discussion of our benefit plans.

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Supplementary Insurance Data

The following table sets forth supplementary insurance data.

Supplementary Insurance Data

Years ended December 31 (In millions)	**2007**	**2006**	**2005**
Trade Ratios GAAP basis (a)			
Loss and loss adjustment expense ratio	77.7%	75.7%	89.4%
Expense ratio	30.0	30.0	31.2
Dividend ratio	0.2	0.3	0.3
Combined ratio	107.9%	106.0%	120.9%
Trade Ratios Statutory basis (preliminary) (a)			
Loss and loss adjustment expense ratio	79.8%	78.7%	92.2%
Expense ratio	30.0	30.2	30.0
Dividend ratio	0.3	0.2	0.5
Combined ratio	110.1%	109.1%	122.7%
Individual Life and Group Life Insurance Inforce			
Individual life	$ 9,204	$ 9,866	$ 10,711
Group life	4,886	5,787	9,838
Total	$ 14,090	$ 15,653	$ 20,549
Other Data Statutory basis (preliminary) (b)			
Property and casualty companies capital and surplus (c)	$ 8,511	$ 8,137	$ 6,940
Life company s capital and surplus	471	687	627
Property and casualty companies written premiums to surplus ratio	0.8	0.9	1.0
Life company s capital and surplus-percent to total liabilities	28.2%	38.9%	33.1%
Participating policyholders-percent of gross life insurance inforce	4.7%	4.4%	3.5%

(a) Trade ratios reflect the results of our property and casualty insurance subsidiaries. Trade ratios are

industry measures of property and casualty underwriting results. The loss and loss adjustment expense ratio is the percentage of net incurred claim and claim adjustment expenses and the expenses incurred related to uncollectible reinsurance receivables to net earned premiums. The primary difference in this ratio between accounting principles generally accepted in the United States of America (GAAP) and statutory accounting practices (SAP) is related to the treatment of active life reserves (ALR) related to long term care insurance products written in property and casualty insurance subsidiaries. For GAAP, ALR is classified as claim and claim adjustment

expense
reserves
whereas for
SAP, ALR is
classified as
unearned
premium
reserves. The
expense ratio,
using amounts
determined in
accordance with
GAAP, is the
percentage of
underwriting
and acquisition
expenses
(including the
amortization of
deferred
acquisition
expenses) to net
earned
premiums. The
expense ratio,
using amounts
determined in
accordance with
SAP, is the
percentage of
acquisition and
underwriting
expenses (with
no deferral of
acquisition
expenses) to net
written
premiums. The
dividend ratio,
using amounts
determined in
accordance with
GAAP, is the
ratio of
policyholders
dividends
incurred to net
earned
premiums. The
dividend ratio,
using amounts

determined in accordance with SAP, is the ratio of policyholders dividends paid to net earned premiums. The combined ratio is the sum of the loss and loss adjustment expense, expense and dividend ratios.

(b) Other data is determined in accordance with SAP. Life statutory capital and surplus as a percent of total liabilities is determined after excluding separate account liabilities and reclassifying the statutorily required Asset Valuation Reserve to surplus.

(c) Surplus includes the property and casualty companies equity ownership of the life company s capital and surplus.

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The following table displays the distribution of gross written premiums for our operations by geographic concentration.

Gross Written Premiums

	Percent of Total		
Years ended December 31	**2007**	**2006**	**2005**
California	9.1%	9.6%	9.0%
Florida	7.3	7.9	7.1
New York	6.8	7.3	7.9
Texas	5.9	5.9	5.7
Illinois	3.7	4.1	4.2
New Jersey	3.6	4.4	3.8
Missouri	3.4	3.0	2.8
Pennsylvania	3.2	3.4	4.2
Massachusetts	2.3	2.4	3.3
All other states, countries or political subdivisions (a)	54.7	52.0	52.0
Total	100.0%	100.0%	100.0%

(a) No other individual state, country or political subdivision accounts for more than 3.0% of gross written premiums.

Approximately 8.4%, 7.1% and 6.1% of our gross written premiums were derived from outside of the United States for the years ended December 31, 2007, 2006 and 2005. Premiums from any individual foreign country were not significant.

Property and Casualty Claim and Claim Adjustment Expenses

The following loss reserve development table illustrates the change over time of reserves established for property and casualty claim and claim adjustment expenses at the end of the preceding ten calendar years for our property and casualty insurance operations. The table excludes our life subsidiary(ies), and as such, the carried reserves will not agree to the Consolidated Financial Statements included under Item 8. The first section shows the reserves as originally reported at the end of the stated year. The second section, reading down, shows the cumulative amounts paid as of the end of successive years with respect to the originally reported reserve liability. The third section, reading down, shows re-estimates of the originally recorded reserves as of the end of each successive year, which is the result of our property and casualty insurance subsidiaries expanded awareness of additional facts and circumstances that pertain to the unsettled claims. The last section compares the latest re-estimated reserves to the reserves originally established, and indicates whether the original reserves were adequate or inadequate to cover the estimated costs of unsettled claims.

The loss reserve development table for property and casualty companies is cumulative and, therefore, ending balances should not be added since the amount at the end of each calendar year includes activity for both the current and prior years. Additionally, the development amounts in the table below are the amounts prior to consideration of any related reinsurance bad debt allowance impacts.

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Schedule of Loss Reserve Development

alendar Year Ended n millions)	1997	1998	1999 (a)	2000	2001 (b)	2002 (c)	2003	2004	2005	2006	2007
riginally reported oss reserves for npaid claim and claim ljustment expenses	$ 28,731	$ 28,506	$ 26,850	$ 26,510	$ 29,649	$ 25,719	$ 31,284	$ 31,204	$ 30,694	$ 29,459	$ 28,41
riginally reported eded recoverable	5,056	5,182	6,091	7,333	11,703	10,490	13,847	13,682	10,438	8,078	6,94
riginally reported net serves for unpaid aim and claim ljustment expenses	$ 23,675	$ 23,324	$ 20,759	$ 19,177	$ 17,946	$ 15,229	$ 17,437	$ 17,522	$ 20,256	$ 21,381	$ 21,47
umulative net paid as f:											
ne year later	$ 5,954	$ 7,321	$ 6,547	$ 7,686	$ 5,981	$ 5,373	$ 4,382	$ 2,651	$ 3,442	$ 8,713	$
wo years later	11,394	12,241	11,937	11,992	10,355	8,768	6,104	4,963	7,022		
hree years later	14,423	16,020	15,256	15,291	12,954	9,747	7,780	7,825			
our years later	17,042	18,271	18,151	17,333	13,244	10,870	10,085				
ve years later	18,568	20,779	19,686	17,775	13,922	12,814					
x years later	20,723	21,970	20,206	18,970	15,493						
even years later	21,649	22,564	21,231	20,297							
ght years later	22,077	23,453	22,373								
ine years later	22,800	24,426									
en years later	23,491										
et reserves -estimated as of:											
nd of initial year	$ 23,675	$ 23,324	$ 20,759	$ 19,177	$ 17,946	$ 15,229	$ 17,437	$ 17,522	$ 20,256	$ 21,381	$ 21,47
ne year later	23,904	24,306	21,163	21,502	17,980	17,650	17,671	18,513	20,588	21,601	
wo years later	24,106	24,134	23,217	21,555	20,533	18,248	19,120	19,044	20,975		
hree years later	23,776	26,038	23,081	24,058	21,109	19,814	19,760	19,631			
our years later	25,067	25,711	25,590	24,587	22,547	20,384	20,425				
ve years later	24,636	27,754	26,000	25,594	22,983	21,076					
x years later	26,338	28,078	26,625	26,023	23,603						
even years later	26,537	28,437	27,009	26,585							
ght years later	26,770	28,705	27,541								
ine years later	26,997	29,211									
en years later	27,317										
otal net (deficiency) dundancy	$ (3,642)	$ (5,887)	$ (6,782)	$ (7,408)	$ (5,657)	$ (5,847)	$ (2,988)	$ (2,109)	$ (719)	$ (220)	$

econciliation to gross -estimated reserves:											
et reserves -estimated	$ 27,317	$ 29,211	$ 27,541	$ 26,585	$ 23,603	$ 21,076	$ 20,425	$ 19,631	$ 20,975	$ 21,601	$
e-estimated ceded coverable	7,221	7,939	10,283	11,047	16,487	15,846	14,257	13,112	10,505	8,230	
otal gross -estimated reserves	$ 34,538	$ 37,150	$ 37,824	$ 37,632	$ 40,090	$ 36,922	$ 34,682	$ 32,743	$ 31,480	$ 29,831	$
et (deficiency) dundancy related to:											
sbestos claims	$ (2,367)	$ (2,125)	$ (1,549)	$ (1,485)	$ (713)	$ (712)	$ (71)	$ (17)	$ (7)	$ (6)	$
nvironmental claims	(541)	(533)	(533)	(476)	(129)	(123)	(51)	(51)	(1)	(1)	
otal asbestos and nvironmental	(2,908)	(2,658)	(2,082)	(1,961)	(842)	(835)	(122)	(68)	(8)	(7)	
ther claims	(734)	(3,229)	(4,700)	(5,447)	(4,815)	(5,012)	(2,866)	(2,041)	(711)	(213)	
otal net (deficiency) dundancy	$ (3,642)	$ (5,887)	$ (6,782)	$ (7,408)	$ (5,657)	$ (5,847)	$ (2,988)	$ (2,109)	$ (719)	$ (220)	$

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(a) Ceded recoverable includes reserves transferred under retroactive reinsurance agreements of $784 million as of December 31, 1999.

(b) Effective January 1, 2001, we established a new life insurance company, CNA Group Life Assurance Company (CNAGLA). Further, on January 1, 2001 $1,055 million of reserves were transferred from CCC to CNAGLA.

(c) Effective October 31, 2002, we sold CNA Reinsurance Company Limited. As a result of the sale, net reserves were reduced by $1,316 million.

Additional information regarding our property and casualty claim and claim adjustment expense reserves and reserve development is set forth in the MD&A included under Item 7 and in Notes A and F of the Consolidated Financial Statements included under Item 8.

Investments

Information on our investments is set forth in the MD&A included under Item 7 and in Notes A, B, C and D of the Consolidated Financial Statements included under Item 8.

Available Information

We file annual, quarterly and current reports, proxy statements and other documents with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934 (Exchange Act). The public may read and copy any materials that we file with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers, including CNA, that file electronically with the SEC. The public can obtain any documents that we file with the SEC at http://www.sec.gov.

We also make available free of charge on or through our internet website (http://www.cna.com) our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Copies of these reports may also be obtained, free of charge, upon written request to: CNA Financial Corporation, 333 S. Wabash Avenue, Chicago, IL 60604, Attn. Jonathan D. Kantor, Executive Vice President, General Counsel and Secretary.

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ITEM 1A. RISK FACTORS

Our business faces many risks. We have described below some of the more significant risks which we face. There may be additional risks that we do not yet know of or that we do not currently perceive to be significant that may also impact our business. Each of the risks and uncertainties described below could lead to events or circumstances that have a material adverse effect on our business, results of operations, financial condition or equity. You should carefully consider and evaluate all of the information included in this Report and any subsequent reports we may file with the Securities and Exchange Commission or make available to the public before investing in any securities we issue.

If we determine that loss reserves are insufficient to cover our estimated ultimate unpaid liability for claims, we may need to increase our loss reserves.

We maintain loss reserves to cover our estimated ultimate unpaid liability for claims and claim adjustment expenses for reported and unreported claims and for future policy benefits. Reserves represent our best estimate at a given point in time. Insurance reserves are not an exact calculation of liability but instead are complex estimates derived by us, generally utilizing a variety of reserve estimation techniques from numerous assumptions and expectations about future events, many of which are highly uncertain, such as estimates of claims severity, frequency of claims, mortality, morbidity, expected interest rates, inflation, claims handling, case reserving policies and procedures, underwriting and pricing policies, changes in the legal and regulatory environment and the lag time between the occurrence of an insured event and the time of its ultimate settlement. Many of these uncertainties are not precisely quantifiable and require significant judgment on our part. As trends in underlying claims develop, particularly in so-called long tail or long duration coverages, we are sometimes required to add to our reserves. This is called unfavorable development and results in a charge to our earnings in the amount of the added reserves, recorded in the period the change in estimate is made. These charges can be substantial and can have a material adverse effect on our results of operations and equity. Additional information on our reserves is included in MD&A under Item 7 and Note F to the Consolidated Financial Statements included under Item 8.

We are subject to the uncertain effects of emerging or potential claims and coverage issues that arise as industry practices and legal, judicial, social and other environmental conditions change. These issues have had, and may continue to have, a negative effect on our business by either extending coverage beyond the original underwriting intent or by increasing the number or size of claims, resulting in further increases in our reserves which can have a material adverse effect on our results of operations and equity. The effects of these and other unforeseen emerging claim and coverage issues are extremely hard to predict. Examples of emerging or potential claims and coverage issues include:

- increases in the number and size of claims relating to injuries from medical products;
- the effects of accounting and financial reporting scandals and other major corporate governance failures, which have resulted in an increase in the number and size of claims, including director and officer and errors and omissions insurance claims;
- class action litigation relating to claims handling and other practices;
- construction defect claims, including claims for a broad range of additional insured endorsements on policies;
- clergy abuse claims, including passage of legislation to reopen or extend various statutes of limitations; and
- mass tort claims, including bodily injury claims related to silica, welding rods, benzene, lead and various other chemical exposure claims.

In light of the many uncertainties associated with establishing the estimates and making the assumptions necessary to establish reserve levels, we review and change our reserve estimates in a regular and ongoing process as experience develops and further claims are reported and settled. In addition, we periodically undergo state regulatory financial examinations, including review and analysis of our reserves. If estimated reserves are insufficient for any reason, the required increase in reserves would be recorded as a charge against our earnings for the period in which reserves are determined to be insufficient. These charges could be substantial and could

materially adversely affect our results of operations, equity, business and insurer financial strength and debt ratings.

Loss reserves for asbestos and environmental pollution are especially difficult to estimate and may result in more frequent and larger additions to these reserves.

Our experience has been that establishing reserves for casualty coverages relating to asbestos and environmental pollution (which we refer to as A&E) claim and claim adjustment expenses are subject to uncertainties that are greater than those presented by other claims. Estimating the ultimate cost of both reported and unreported claims are subject to a higher degree of variability due to a number of additional factors including, among others, the following:

- coverage issues including whether certain costs are covered under the policies and whether policy limits apply;
- inconsistent court decisions and developing legal theories;
- continuing aggressive tactics of plaintiffs lawyers;
- the risks and lack of predictability inherent in major litigation;
- changes in the volume of asbestos and environmental pollution claims;
- the impact of the exhaustion of primary limits and the resulting increase in claims on any umbrella or excess policies we have issued;
- the number and outcome of direct actions against us;
- our ability to recover reinsurance for these claims; and
- changes in the legal and legislative environment in which we operate.

As a result of this higher degree of variability, we have necessarily supplemented traditional actuarial methods and techniques with additional estimating techniques and methodologies, many of which involve significant judgment on our part. Consequently, we may periodically need to record changes in our claim and claim adjustment expense reserves in the future in these areas in amounts that could materially adversely affect our results of operations, equity, business and insurer financial strength and debt ratings. Additional information on A&E claims is included in MD&A under Item 7 and Note F to the Consolidated Financial Statements included under Item 8.

Environmental pollution claims. The estimation of reserves for environmental pollution claims is complicated by the assertion by many policyholders of claims for defense costs and indemnification. We and others in the insurance industry are disputing coverage for many such claims. Key coverage issues in these claims include the following:

- whether cleanup costs are considered damages under the policies (and accordingly whether we would be liable for these costs);
- the trigger of coverage and the allocation of liability among triggered policies;
- the applicability of pollution exclusions and owned property exclusions;
- the potential for joint and several liability; and
- the definition of an occurrence.

To date, courts have been inconsistent in their rulings on these issues, thus adding to the uncertainty of the outcome of many of these claims.

Further, the scope of federal and state statutes and regulations determining liability and insurance coverage for environmental pollution liabilities have been the subject of extensive litigation. In many cases, courts have expanded the scope of coverage and liability for cleanup costs beyond the original intent of our insurance policies. Additionally, the standards for cleanup in environmental pollution matters are unclear, the number of sites potentially subject to cleanup under applicable laws is unknown, and the impact of various proposals to reform existing statutes and regulations is difficult to predict.

Asbestos claims. The estimation of reserves for asbestos claims is particularly difficult for many of the same reasons discussed above for environmental pollution claims, as well as the following:

- inconsistency of court decisions and jury attitudes, as well as future court decisions;
- specific policy provisions;
- allocation of liability among insurers and insureds;
- missing policies and proof of coverage;
- the proliferation of bankruptcy proceedings and attendant uncertainties;
- novel theories asserted by policyholders and their legal counsel;
- the targeting of a broader range of businesses and entities as defendants;
- uncertainties in predicting the number of future claims and which other insureds may be targeted in the future;
- volatility in claim numbers and settlement demands;
- increases in the number of non-impaired claimants and the extent to which they can be precluded from making claims;
- the efforts by insureds to obtain coverage that is not subject to aggregate limits;
- the long latency period between asbestos exposure and disease manifestation, as well as the resulting potential for involvement of multiple policy periods for individual claims;
- medical inflation trends;
- the mix of asbestos-related diseases presented; and
- the ability to recover reinsurance.

In addition, a number of our insureds have asserted that their claims for insurance are not subject to aggregate limits on coverage. If these insureds are successful in this regard, our potential liability for their claims would be unlimited. Some of these insureds contend that their asbestos claims fall within the so-called non-products liability coverage within their policies, rather than the products liability coverage, and that this non-products liability coverage is not subject to any aggregate limit. It is difficult to predict the extent to which these claims will succeed and, as a result, the ultimate size of these claims.

Catastrophe losses are unpredictable.

Catastrophe losses are an inevitable part of our business. Various events can cause catastrophe losses, including hurricanes, windstorms, earthquakes, hail, explosions, severe winter weather, and fires, and their frequency and severity are inherently unpredictable. In addition, longer-term natural catastrophe trends may be changing and new types of catastrophe losses may be developing due to climate change, a phenomenon that has been associated with extreme weather events linked to rising temperatures, and includes effects on global weather patterns, greenhouse gases, sea, land and air temperatures, sea levels, rain, and snow. For example, in 2005, we experienced substantial losses from Hurricanes Katrina, Rita and Wilma. The extent of our losses from catastrophes is a function of both the total amount of our insured exposures in the affected areas and the severity of the events themselves. In addition, as in the case of catastrophe losses generally, it can take a long time for the ultimate cost to us to be finally determined. As our claim experience develops on a particular catastrophe, we may be required to adjust our reserves, or take unfavorable development, to reflect our revised estimates of the total cost of claims. We believe we could incur significant catastrophe losses in the future. Therefore, our results of operations, equity, business and insurer financial strength and debt ratings could be materially adversely impacted. Additional information on catastrophe losses is included in the MD&A under Item 7 and Note F to the Consolidated Financial Statements included under Item 8.

Our key assumptions used to determine reserves and deferred acquisition costs for our long term care product offerings could vary significantly from actual experience.

Our reserves and deferred acquisition costs for our long term care product offerings are based on certain key assumptions including morbidity, which is the frequency and severity of illness, sickness and diseases contracted, policy persistency, which is the percentage of policies remaining in force, interest rates and future health care cost trends. If actual experience differs from these assumptions, the deferred acquisition asset may not be fully realized and the reserves may not be adequate, requiring us to add to reserves, or take unfavorable development. Therefore, our results of operations, equity, business and insurer financial strength and debt ratings could be materially adversely impacted.

We continue to face exposure to losses arising from terrorist acts, despite the passage of the Terrorism Risk Insurance Program Reauthorization Act of 2007.

The Terrorism Risk Insurance Program Reauthorization Act of 2007 extended, until December 31, 2014, the program established within the U.S. Department of Treasury by the Terrorism Risk Insurance Act of 2002. This program requires insurers to offer terrorism coverage and the federal government to share in insured losses arising from acts of terrorism. Given the unpredictability of the nature, targets, severity and frequency of potential terrorist acts, this program does not provide complete protection for future losses derived from acts of terrorism. Further, the laws of certain states restrict our ability to mitigate this residual exposure. For example, some states mandate property insurance coverage of damage from fire following a loss, thereby prohibiting us from excluding terrorism exposure. In addition, some states generally prohibit us from excluding terrorism exposure from our primary workers compensation policies. Consequently, there is substantial uncertainty as to our ability to contain our terrorism exposure effectively since we continue to issue forms of coverage, in particular, workers compensation, that are exposed to risk of loss from a terrorism act. As a result, our results of operations, equity, business and insurer financial strength and debt ratings could be materially adversely impacted.

High levels of retained overhead expenses associated with business lines in run-off negatively impact our operating results.

During the past several years, we ceased offering certain insurance products relating principally to our life, group and reinsurance segments. Many of these business lines were sold, others have been placed in run-off and, as a result, revenue has decreased. Our results of operations have been materially adversely affected by the high levels of retained overhead expenses associated with these run-off operations, and will continue to be so affected if we are not successful in eliminating or reducing these costs.

Our premium writings and profitability are affected by the availability and cost of reinsurance.

We purchase reinsurance to help manage our exposure to risk. Under our reinsurance arrangements, another insurer assumes a specified portion of our claim and claim adjustment expenses in exchange for a specified portion of policy premiums. Market conditions determine the availability and cost of the reinsurance protection we purchase, which affects the level of our business and profitability, as well as the level and types of risk we retain. If we are unable to obtain sufficient reinsurance at a cost we deem acceptable, we may be unwilling to bear the increased risk and would reduce the level of our underwriting commitments. Therefore, our financial results of operations could be materially adversely impacted. Additional information on reinsurance is included in Note H to the Consolidated Financial Statements included under Item 8.

We may not be able to collect amounts owed to us by reinsurers.

We have significant amounts recoverable from reinsurers which are reported as receivables in our balance sheets and are estimated in a manner consistent with claim and claim adjustment expense reserves or future policy benefits reserves. The ceding of insurance does not, however, discharge our primary liability for claims. As a result, we are subject to credit risk relating to our ability to recover amounts due from reinsurers. Certain of our reinsurance carriers have experienced deteriorating financial conditions or have been downgraded by rating agencies. In addition, reinsurers could dispute amounts which we believe are due to us. If we are not able to collect the amounts due to us from reinsurers, our claims expenses will be higher which could materially adversely affect our results of operations, equity, business and insurer financial strength and debt ratings. Additional information on reinsurance is included in Note H to the Consolidated Financial Statements included under Item 8.

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Rating agencies may downgrade their ratings of us and thereby adversely affect our ability to write insurance at competitive rates or at all.

Ratings are an important factor in establishing the competitive position of insurance companies. Our insurance company subsidiaries, as well as our public debt, are rated by rating agencies, namely, A.M. Best Company, Fitch Ratings, Moody s Investors Service and Standard & Poor s. Ratings reflect the rating agency s opinions of an insurance company s financial strength, capital adequacy, operating performance, strategic position and ability to meet its obligations to policyholders and debtholders.

Due to the intense competitive environment in which we operate, the uncertainty in determining reserves and the potential for us to take material unfavorable development in the future, and possible changes in the methodology or criteria applied by the rating agencies, the rating agencies may take action to lower our ratings in the future. If our property and casualty insurance financial strength ratings are downgraded below current levels, our business and results of operations could be materially adversely affected. The severity of the impact on our business is dependent on the level of downgrade and, for certain products, which rating agency takes the rating action. Among the adverse effects in the event of such downgrades would be the inability to obtain a material volume of business from certain major insurance brokers, the inability to sell a material volume of our insurance products to certain markets, and the required collateralization of certain future payment obligations or reserves.

In addition, it is possible that a lowering of the debt ratings of Loews Corporation by certain of the rating agencies could result in an adverse impact on our ratings, independent of any change in our circumstances. We have entered into several settlement agreements and assumed reinsurance contracts that require collateralization of future payment obligations and assumed reserves if our ratings or other specific criteria fall below certain thresholds. The ratings triggers are generally more than one level below our current ratings. Additional information on our ratings is included in the MD&A under Item 7.

We are subject to extensive federal, state and local governmental regulations that restrict our ability to do business and generate revenues.

The insurance industry is subject to comprehensive and detailed regulation and supervision throughout the United States. Most insurance regulations are designed to protect the interests of our policyholders rather than our investors. Each state in which we do business has established supervisory agencies that regulate the manner in which we do business. Their regulations relate to, among other things, the following:

- standards of solvency including risk-based capital measurements;
- restrictions on the nature, quality and concentration of investments;
- restrictions on our ability to withdraw from unprofitable lines of insurance or unprofitable market areas;
- the required use of certain methods of accounting and reporting;
- the establishment of reserves for unearned premiums, losses and other purposes;
- potential assessments for funds necessary to settle covered claims against impaired, insolvent or failed private or quasi-governmental insurers;
- licensing of insurers and agents;
- approval of policy forms;
- limitations on the ability of our insurance subsidiaries to pay dividends to us; and
- limitations on the ability to non-renew, cancel or change terms and conditions in policies.

Regulatory powers also extend to premium rate regulations which require that rates not be excessive, inadequate or unfairly discriminatory. The states in which we do business also require us to provide coverage to persons whom we would not otherwise consider eligible. Each state dictates the types of insurance and the level of coverage that must be provided to such involuntary risks. Our share of these involuntary risks is mandatory and generally a function of our respective share of the voluntary market by line of insurance in each state.

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We are subject to capital adequacy requirements and, if we do not meet these requirements, regulatory agencies may restrict or prohibit us from operating our business.

Insurance companies such as us are subject to risk-based capital standards set by state regulators to help identify companies that merit further regulatory attention. These standards apply specified risk factors to various asset, premium and reserve components of our statutory capital and surplus reported in our statutory basis of accounting financial statements. Current rules require companies to maintain statutory capital and surplus at a specified minimum level determined using the risk-based capital formula. If we do not meet these minimum requirements, state regulators may restrict or prohibit us from operating our business. If we are required to record a material charge against earnings in connection with a change in estimates or circumstances, we may violate these minimum capital adequacy requirements unless we are able to raise sufficient additional capital. Examples of events leading us to record a material charge against earnings include impairment of our investments or unexpectedly poor claims experience.

Our insurance subsidiaries, upon whom we depend for dividends in order to fund our working capital needs, are limited by state regulators in their ability to pay dividends.

We are a holding company and are dependent upon dividends, loans and other sources of cash from our subsidiaries in order to meet our obligations. Dividend payments, however, must be approved by the subsidiaries domiciliary state departments of insurance and are generally limited to amounts determined by formula which varies by state. The formula for the majority of the states is the greater of 10% of the prior year statutory surplus or the prior year statutory net income, less the aggregate of all dividends paid during the twelve months prior to the date of payment. Some states, however, have an additional stipulation that dividends cannot exceed the prior year s earned surplus. If we are restricted, by regulatory rule or otherwise, from paying or receiving inter-company dividends, we may not be able to fund our working capital needs and debt service requirements from available cash. As a result, we would need to look to other sources of capital which may be more expensive or may not be available at all.

We received subpoenas, interrogatories and inquiries relating to insurance brokers and agents, contingent commissions and bidding practices, and certain finite-risk insurance products.

Along with other companies in the industry, we received subpoenas, interrogatories and inquiries from and have produced documents and/or provided information to: (i) California, Connecticut, Delaware, Florida, Hawaii, Illinois, Michigan, Minnesota, New Jersey, New York, North Carolina, Ohio, Pennsylvania, South Carolina, West Virginia and the Canadian Council of Insurance Regulators concerning investigations into practices including contingent compensation arrangements, fictitious quotes, and tying arrangements; (ii) the SEC, the New York State Attorney General, the United States Attorney for the Southern District of New York, the Connecticut Attorney General, the Connecticut Department of Insurance, the Delaware Department of Insurance, the Georgia Office of Insurance and Safety Fire Commissioner and the California Department of Insurance concerning reinsurance products and finite insurance products purchased and sold by us; (iii) the Massachusetts Attorney General and the Connecticut Attorney General concerning investigations into anti-competitive practices; and (iv) the New York State Attorney General concerning declinations of attorney malpractice insurance.

The SEC and representatives of the United States Attorney s Office for the Southern District of New York conducted interviews with several of our current and former executives relating to the restatement of our financial results for 2004, including our relationship with and accounting for transactions with an affiliate that were the basis for the restatement. We have also provided the SEC with information relating to our restatement in 2006 of prior period results. It is possible that our analyses of, or accounting treatment for, finite reinsurance contracts or discontinued operations could be questioned or disputed by regulatory authorities.

Our investment portfolio, which is a key component of our overall profitability, may suffer reduced returns or losses, in the event of changing interest rates or adverse credit conditions in the capital markets.

Investment returns are an important part of our overall profitability. General economic conditions, changes in financial markets such as fluctuations in interest rates, long term periods of low interest rates, credit conditions and currency, commodity and stock prices, including the short and long-term effects of losses produced or threatened in relation to sub-prime residential mortgage-backed securities, and many other factors beyond our control can adversely affect the returns and the overall value of our investments and the realization of

investment income. In addition, any defaults in the payments due to us for our investments, especially with respect to fixed maturity securities, could reduce our investment income and could cause us to incur investment losses. Further, we invest a portion of our assets in equity securities and limited partnerships, which may be subject to greater volatility than our fixed income investments. In some cases, limited partnerships use leverage and are thereby subject to even greater volatility. Although limited partnership investments generally provide higher expected return, they present greater risk and are more illiquid than our fixed income investments. As a result of all of these factors, we may not realize an adequate return on our investments, may incur losses on sales of our investments, and may be required to write down the value of our investments. Therefore, our results of operations, equity, business and insurer financial strength and debt ratings could be materially adversely impacted.

We have incurred and may incur further investment losses and may incur underwriting losses, relating to the sub-prime crisis and the related credit crisis.

We face sub-prime valuation and credit exposure risks within our investment portfolio through our holdings in corporate asset-backed structured securities and collateralized mortgage obligations (CMOs) which are typically collateralized with residential mortgages. During the course of 2007, the market value of some of these securities decreased as a result of the increase in delinquency rates on the underlying mortgages and a decrease in the value of the homes held as collateral for the investment. This deterioration of the collateral underlying the securities caused downgrades by rating agencies, decreased liquidity, and led to some securities going into default and has led to a material adverse impact on financial markets generally. The potential for higher delinquency and default rates may continue to adversely impact our sub-prime market valuations. In addition, the process of validating fair values provided by third parties for securities that are not regularly traded requires significant judgment on our part. Accordingly, we may conclude that other-than-temporary write downs of these securities are required or we may experience unanticipated losses in other sectors of our overall investment portfolio. Consequently, our results of operations, equity, business and insurer financial strength and debt ratings could be materially adversely impacted.

We provide management and professional liability insurance and surety bonds to businesses engaged in finance, professional services and real estate. Many of these businesses have exposure directly or indirectly to the sub-prime crisis and the related credit crisis. As a result, we may experience unanticipated underwriting losses with respect to these lines of business. Consequently, our results of operations, equity, business and insurer financial strength and debt ratings could be materially adversely impacted.

We face intense competition in our industry and may be adversely affected by the cyclical nature of the property and casualty business.

All aspects of the insurance industry are highly competitive and we must continuously allocate resources to refine and improve our insurance products and services. We compete with a large number of stock and mutual insurance companies and other entities for both distributors and customers. Insurers compete on the basis of factors including products, price, services, ratings and financial strength. We may lose business to competitors offering competitive insurance products at lower prices. The property and casualty market is cyclical and has experienced periods characterized by relatively high levels of price competition, less restrictive underwriting standards and relatively low premium rates, followed by periods of relatively lower levels of competition, more selective underwriting standards and relatively high premium rates. As a result, our premium levels, expense ratio, results of operations, equity, business and insurer financial strength and debt ratings could be materially adversely impacted.

We may suffer losses from non-routine litigation and arbitration matters which may exceed the reserves we have established.

We face substantial risks of litigation and arbitration beyond ordinary course claims and A&E matters, which may contain assertions in excess of amounts covered by reserves that we have established. These matters may be difficult to assess or quantify and may seek recovery of very large or indeterminate amounts that include punitive or treble damages. Accordingly, unfavorable results in these proceedings could have a material adverse impact on our results of operations, equity, business and insurer financial strength and debt ratings.

Additional information on litigation is included in the MD&A under Item 7 and Note G to the Consolidated Financial Statements included under Item 8.

We are dependent on a small number of key executives and other key personnel to operate our business successfully.

Our success substantially depends upon our ability to attract and retain high quality key executives and other employees. We believe there are only a limited number of available qualified executives in the business lines in which we compete. We rely substantially upon the services of our executive officers to implement our business strategy. The loss of the services of any members of our management team or the inability to attract and retain other talented personnel could impede the implementation of our business strategies. We do not maintain key man life insurance policies with respect to any of our employees.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The 333 S. Wabash Avenue building, located in Chicago, Illinois and owned by CCC, a wholly-owned subsidiary of CNAF, serves as our home office. Our subsidiaries own or lease office space in various cities throughout the United States and in other countries. The following table sets forth certain information with respect to our principal office locations.

Location	Amount (Square Feet) of Building Owned and Occupied or Leased and Occupied by CNA	Principal Usage
333 S. Wabash Avenue, Chicago, Illinois	904,990	Principal executive offices of CNAF
401 Penn Street, Reading, Pennsylvania	171,406	Property and casualty insurance offices
2405 Lucien Way, Maitland, Florida	147,815	Property and casualty insurance offices
40 Wall Street, New York, New York	110,131	Property and casualty insurance offices
675 Placentia Avenue, Brea, California	78,655	Property and casualty insurance offices
600 N. Pearl Street, Dallas, Texas	75,544	Property and casualty insurance offices
4267 Meridian Parkway, Aurora, Illinois	70,004	Data Center
1249 South River Road, Cranbury, New Jersey	67,853	Property and casualty insurance offices
3175 Satellite Boulevard, Duluth, Georgia	48,696	Property and casualty insurance offices
405 Howard Street, San Francisco, California	47,195	Property and casualty insurance offices

We lease the office space described above except for the Chicago, Illinois building, the Reading, Pennsylvania building and the Aurora, Illinois building, which are owned. We consider that our properties are generally in good condition, are well maintained and are suitable and adequate to carry on our business.

ITEM 3. LEGAL PROCEEDINGS

Information on our legal proceedings is set forth in Notes F and G of the Consolidated Financial Statements included under Item 8.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

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PART II

ITEM 5. MARKET FOR THE REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is listed on the New York Stock Exchange, the Chicago Stock Exchange and is traded on the Philadelphia Stock Exchange, under the symbol CNA.

As of February 22, 2008, we had 270,716,622 shares of common stock outstanding. Approximately 89% of our outstanding common stock is owned by Loews. We had 1,965 stockholders of record as of February 22, 2008 according to the records maintained by our transfer agent.

The table below shows the high and low sales prices for our common stock based on the New York Stock Exchange Composite Transactions.

Common Stock Information

	2007			2006		
	High	Low	Dividends Declared	High	Low	Dividends Declared
Quarter:						
First	$44.29	$39.09	$	$33.60	$29.88	$
Second	51.96	42.96	0.10	33.20	30.90	
Third	49.18	37.12	0.10	36.04	33.05	
Fourth	41.84	32.26	0.15	40.32	36.19	

The following graph compares the total return of our common stock, the Standard & Poor s (S&P) 500 Index and the S&P 500 Property & Casualty Insurance Index for the five year period from December 31, 2002 through December 31, 2007. The graph assumes that the value of the investment in our common stock and for each index was $100 on December 31, 2002 and that dividends were reinvested.

Stock Price Performance Graph

Company / Index	2002	2003	2004	2005	2006	2007
CNA Financial Corporation	100.00	94.14	104.49	127.85	157.50	132.85
S&P 500 Index	100.00	128.68	142.69	149.70	173.34	182.86
S&P 500 Property & Casualty Insurance Index	100.00	126.41	139.58	160.68	181.36	156.04

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ITEM 6. SELECTED FINANCIAL DATA

The following table presents selected financial data. The table should be read in conjunction with Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 8 Financial Statements and Supplementary Data of this Form 10-K.

Selected Financial Data

As of and for the Years Ended December 31 (In millions, except per share data)	**2007**	**2006**	**2005**	**2004**	**2003**
Results of Operations:					
Revenues	$ 9,885	$ 10,376	$ 9,862	$ 9,924	$ 11,715
Income (loss) from continuing operations	$ 857	$ 1,137	$ 243	$ 446	$ (1,419)
Income (loss) from discontinued operations, net of tax	(6)	(29)	21	(21)	2
Net income (loss)	$ 851	$ 1,108	$ 264	$ 425	$ (1,417)
Basic Earnings (Loss) Per Share:					
Income (loss) from continuing operations	$ 3.15	$ 4.17	$ 0.68	$ 1.49	$ (6.52)
Income (loss) from discontinued operations	(0.02)	(0.11)	0.08	(0.09)	0.01
Basic earnings (loss) per share available to common stockholders	$ 3.13	$ 4.06	$ 0.76	$ 1.40	$ (6.51)
Diluted Earnings (Loss) Per Share:					
Income (loss) from continuing operations	$ 3.15	$ 4.16	$ 0.68	$ 1.49	$ (6.52)
Income (loss) from discontinued operations	(0.02)	(0.11)	0.08	(0.09)	0.01
Diluted earnings (loss) per share available to common stockholders	$ 3.13	$ 4.05	$ 0.76	$ 1.40	$ (6.51)
Dividends declared per common share	$ 0.35	$	$	$	$
Financial Condition:					
Total investments	$ 41,762	$ 44,096	$ 39,695	$ 39,231	$ 38,100
Total assets	56,732	60,283	59,016	62,496	68,296
Insurance reserves	40,222	41,080	42,436	43,653	45,494
Long and short term debt	2,157	2,156	1,690	2,257	1,904
Stockholders equity	10,150	9,768	8,950	8,974	8,735

Book value per share	$ 37.36	$ 36.03	$ 31.26	$ 31.63	$ 30.95
Statutory Surplus (preliminary):					
Property and casualty companies (a)	$ 8,511	$ 8,137	$ 6,940	$ 6,998	$ 6,170
Life company(ies)	471	687	627	1,177	707

(a) Surplus includes the property and casualty companies equity ownership of the life company(ies) capital and surplus.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

The following discussion should be read in conjunction with Item 1A Risk Factors, Item 6 Selected Financial Data and Item 8 Financial Statements and Supplementary Data of this Form 10-K.

Index to this MD&A

Management s discussion and analysis of financial condition and results of operations is comprised of the following sections:

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CONSOLIDATED OPERATIONS

Results of Operations

The following table includes the consolidated results of our operations. For more detailed components of our business operations and the net operating income financial measure, see the segment discussions within this MD&A.

Years ended December 31 (In millions, except per share data)	**2007**	**2006**	**2005**
Revenues			
Net earned premiums	$ 7,484	$ 7,603	$ 7,569
Net investment income	2,433	2,412	1,892
Other revenues	279	275	411
Total operating revenues	10,196	10,290	9,872
Claims, Benefits and Expenses			
Net incurred claims and benefits	5,995	6,025	6,975
Policyholders dividends	14	22	24
Amortization of deferred acquisition costs	1,520	1,534	1,543
Other insurance related expenses	733	757	829
Restructuring and other related charges		(13)	
Other expenses	401	401	329
Total claims, benefits and expenses	8,663	8,726	9,700
Operating income from continuing operations before income tax and minority interest	1,533	1,564	172
Income tax (expense) benefit on operating income	(425)	(450)	105
Minority interest	(48)	(44)	(24)
Net operating income from continuing operations	1,060	1,070	253
Realized investment gains (losses), net of participating policyholders and minority interests	(311)	86	(10)
Income tax (expense) benefit on realized investment gains (losses)	108	(19)	
Income from continuing operations	857	1,137	243
Income (loss) from discontinued operations, net of income tax (expense) benefit of $0, $7 and $(2)	(6)	(29)	21
Net income	$ 851	$ 1,108	$ 264

Basic Earnings per Share			
Income from continuing operations	$ 3.15	$ 4.17	$ 0.68
Income (loss) from discontinued operations	(0.02)	(0.11)	0.08
Basic earnings per share available to common stockholders	$ 3.13	$ 4.06	$ 0.76
Diluted Earnings per Share			
Income from continuing operations	$ 3.15	$ 4.16	$ 0.68
Income (loss) from discontinued operations	(0.02)	(0.11)	0.08
Diluted earnings per share available to common stockholders	$ 3.13	$ 4.05	$ 0.76
Weighted Average Outstanding Common Stock and Common Stock Equivalents			
Basic	271.5	262.1	256.0
Diluted	271.8	262.3	256.0

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2007 Compared with 2006

Net income decreased $257 million in 2007 as compared with 2006. This decrease was primarily due to decreased net realized investment results.

Net realized investment results decreased by $270 million in 2007 compared with 2006. This decrease was primarily driven by higher impairment losses. See the Investments section of this MD&A for further discussion of net investment income and net realized investment results.

Net operating income from continuing operations in 2007 decreased $10 million as compared with 2006. The decrease in net operating income primarily related to the after-tax loss of $108 million related to the settlement of the IGI contingency as discussed in the Life & Group Non-core segment discussion of this MD&A and decreased current accident year underwriting results in our Standard and Specialty Lines segments. The decreased net operating income was partially offset by favorable net prior year development in 2007 as compared to unfavorable net prior year development in 2006 and increased net investment income. The increased net investment income included a decline of net investment income in the trading portfolio of $93 million, a significant portion of which was offset by a corresponding decrease in the policyholders funds reserves supported by the trading portfolio.

Favorable net prior year development of $73 million was recorded in 2007 related to our Standard Lines, Specialty Lines and Corporate & Other Non-core segments. This amount consisted of $38 million of favorable claim and allocated claim adjustment expense reserve development and $35 million of favorable premium development. Unfavorable net prior year development of $172 million was recorded in 2006 related to our Standard Lines, Specialty Lines and Corporate & Other Non-core segments. This amount consisted of $233 million of unfavorable claim and allocated claim adjustment expense reserve development and $61 million of favorable premium development. Further information on Net Prior Year Development for 2007 and 2006 is included in Note F of the Consolidated Financial Statements included under Item 8.

Net earned premiums decreased $119 million in 2007 as compared with 2006, including a $178 million decrease related to Standard Lines and a $73 million increase related to Specialty Lines. See the Segment Results section of this MD&A for further discussion.

Results from discontinued operations improved $23 million in 2007 as compared to 2006. The loss in 2007 was primarily driven by unfavorable net prior year development. Results in 2006 reflected a $29 million impairment loss related to the 2007 sale of a portion of the run-off business. Further information on this impairment loss is included in Note P of the Consolidated Financial Statement included under Item 8.

2006 Compared with 2005

Net income increased $844 million in 2006 as compared with 2005. This increase was primarily due to increased net operating income and net realized investment results. These favorable impacts were partially offset by unfavorable results from discontinued operations. See the Investments section of this MD&A for further discussion of net investment income and net realized investment results.

Net operating income from continuing operations increased $817 million in 2006 as compared with 2005. Favorably impacting net operating income was increased net investment income and significantly lower unfavorable net prior year development as discussed below. The 2005 results included a $334 million after-tax impact of catastrophes resulting from Hurricanes Katrina, Wilma, Rita, Dennis and Ophelia, net of anticipated reinsurance recoveries. Additionally, the 2005 results included a $115 million benefit related to a federal income tax settlement and release of federal income tax reserves.

Unfavorable net prior year development of $172 million was recorded in 2006 related to our Standard Lines, Specialty Lines and Corporate & Other Non-Core segments. This amount consisted of $233 million of unfavorable claim and allocated claim adjustment expense reserve development and $61 million of favorable premium development. Unfavorable net prior year development of $812 million was recorded in 2005 related to our Standard Lines, Specialty Lines and Corporate & Other Non-Core segments. This amount consisted of $897 million of unfavorable claim and allocated claim adjustment expense reserve development and $85 million

of favorable premium development. Further information on Net Prior Year Development for 2006 and 2005 is included in Note F of the Consolidated Financial Statements included under Item 8.

During 2006 and 2005, we commuted several significant reinsurance contracts that resulted in unfavorable development of $110 million and $433 million, which is included in the development above, and which were partially offset by the release of previously established allowance for uncollectible reinsurance. These commutations resulted in an unfavorable impact of $31 million after-tax and $259 million after-tax in 2006 and 2005. These contracts contained interest crediting provisions and maintenance charges. Interest charges associated with the reinsurance contracts commuted were $9 million after-tax and $55 million after-tax in 2006 and 2005. The 2005 amount includes the interest charges associated with the contract commuted in 2006. There will be no further interest crediting charges or other charges related to these commuted contracts in future periods.

Net earned premiums increased $34 million in 2006 as compared with 2005, including a $44 million increase related to the Specialty Lines segment and a $39 million increase related to the Standard Lines segment. Net earned premiums for the Life & Group Non-Core segment decreased $63 million. See the Segment Results section of this MD&A for further discussion.

Loss from discontinued operations was $29 million for the year ended December 31, 2006. Results in 2006 reflected a $29 million impairment loss related to the 2007 sale of a portion of the run-off business. The 2006 results were also impacted by an increase in unallocated loss adjustment expense reserves and bad debt provision for reinsurance receivables. These items were partially offset by the release of tax reserves and net investment income.

Critical Accounting Estimates

The preparation of the Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States of America (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 Consolidated Financial Statements and the amounts of revenues and expenses reported during the period. Actual results may differ from those estimates.

Our 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 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 discussed below are considered by us to be critical to an understanding of our Consolidated Financial Statements as their application places the most significant demands on our judgment. Note A of the Consolidated Financial Statements included under Item 8 should be read in conjunction with this section to assist with obtaining an understanding of the underlying accounting policies related to these estimates. 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 and/or equity.

Insurance Reserves

Insurance reserves are established for both short and long-duration insurance contracts. Short-duration contracts are primarily related to property and casualty insurance policies where the reserving process is based on actuarial estimates of the amount of loss, including amounts for known and unknown claims. Long-duration contracts typically include traditional life insurance, payout annuities and long term care products and are estimated using actuarial estimates about mortality, morbidity and persistency as well as assumptions about expected investment returns. The reserve for unearned premiums on property and casualty and accident and health contracts represents the portion of premiums written related to the unexpired terms of coverage. The inherent risks associated with the reserving process are discussed in the Reserves Estimates and Uncertainties section below.

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Reinsurance

Amounts recoverable from reinsurers are estimated in a manner consistent with claim and claim adjustment expense reserves or future policy benefits reserves and are reported as receivables in the Consolidated Balance Sheets. The ceding of insurance does not discharge us of our primary liability under insurance contracts written by us. An exposure exists with respect to property and casualty and life reinsurance ceded to the extent that any reinsurer is unable to meet its obligations or disputes the liabilities assumed under reinsurance agreements. An estimated allowance for doubtful accounts is recorded on the basis of periodic evaluations of balances due from reinsurers, reinsurer solvency, our past experience and current economic conditions. Further information on our reinsurance program is included in Note H of the Consolidated Financial Statements included under Item 8.

Valuation of Investments and Impairment of Securities

Invested assets are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain invested assets and the level of uncertainty related to changes in the value of these assets, it is possible that changes in risks in the near term could have an adverse material impact on our results of operations or equity.

Our investment portfolio is subject to market declines below amortized cost that may be other-than-temporary. We have an Impairment Committee, which reviews the investment portfolio on a quarterly basis, with ongoing analysis as new information becomes available. Any decline that is determined to be other-than-temporary is recorded as an other-than-temporary impairment loss in the results of operations in the period in which the determination occurred. Further information on our process for evaluating impairments is included in Note B of the Consolidated Financial Statements included under Item 8.

Long Term Care Products

Reserves and deferred acquisition costs for our long term care products are based on certain assumptions including morbidity, policy persistency and interest rates. The recoverability of deferred acquisition costs and the adequacy of the reserves are contingent on actual experience related to these key assumptions and other factors such as future health care cost trends. If actual experience differs from these assumptions, the deferred acquisition costs may not be fully realized and the reserves may not be adequate, requiring us to add to reserves, or take unfavorable development. Therefore, our financial results could be adversely impacted.

Pension and Postretirement Benefit Obligations

We make a significant number of assumptions in estimating the liabilities and costs related to our pension and postretirement benefit obligations to employees under our benefit plans. The assumptions that most impact these costs are the discount rate, the expected return on plan assets and the rate of compensation increases. These assumptions are evaluated relative to current market factors such as inflation, interest rates and fiscal and monetary policies. Changes in these assumptions can have a material impact on pension obligations and pension expense.

In determining the discount rate assumption, we utilized current market information, including a discounted cash flow analysis of our pension and postretirement obligations and general movements in the current market environment. In particular, the basis for our discount rate selection was fixed income debt securities that receive one of the two highest ratings given by a recognized rating agency. In 2007 and historically, the Moody s Aa Corporate Bond Index was the benchmark for discount rate selection. The index is used as the basis for the change in discount rate from the last measurement date. Additionally, we have supplemented our discount rate decision with a yield curve analysis. The yield curve was applied to expected future retirement plan payments to adjust the discount rate to reflect the cash flow characteristics of the plans. The yield curve is a hypothetical double A yield curve represented by a series of annualized discount rates reflecting bond issues having a rating of Aa or better by Moody s Investors Service, Inc. or a rating of AA or better by Standard & Poor s. Based on all available information, it was determined that 6.00% and 5.875% were the appropriate discount rates as of December 31, 2007 to calculate our accrued pension and postretirement liabilities, respectively. Accordingly, the 6.00% and 5.875% rates will also be used to determine our 2008 pension and postretirement expense. At December 31, 2006, the discount rates used to calculate our accrued pension and postretirement liabilities were 5.750% and 5.625%, respectively.

Further information on our pension and postretirement benefit obligations is included in Note J of the Consolidated Financial Statements included under Item 8.

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Legal Proceedings

We are involved in various legal proceedings that have arisen during the ordinary course of business. We evaluate the facts and circumstances of each situation, and when we determine it is necessary, a liability is estimated and recorded. Further information on our legal proceedings and related contingent liabilities is provided in Notes F and G of the Consolidated Financial Statements included under Item 8.

Reserves - Estimates and Uncertainties

We maintain reserves to cover our estimated ultimate unpaid liability for claim and claim adjustment expenses, including the estimated cost of the claims adjudication process, for claims that have been reported but not yet settled (case reserves) and claims that have been incurred but not reported (IBNR). Claim and claim adjustment expense reserves are reflected as liabilities and are included on the Consolidated Balance Sheets under the heading Insurance Reserves. 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. The carried case and IBNR reserves are provided in the Segment Results section of this MD&A and in Note F of the Consolidated Financial Statements included under Item 8.

The level of reserves we maintain represents our best estimate, as of a particular point in time, of what the ultimate settlement and administration of claims will cost based on our assessment of facts and circumstances known at that time. Reserves are not an exact calculation of liability but instead are complex estimates that we derive, generally utilizing a variety of actuarial reserve estimation techniques, from numerous assumptions and expectations about future events, both internal and external, many of which are highly uncertain.

We are subject to the uncertain effects of emerging or potential claims and coverage issues that arise as industry practices and legal, judicial, social and other environmental conditions change. These issues have had, and may continue to have, a negative effect on our business by either extending coverage beyond the original underwriting intent or by increasing the number or size of claims. Examples of emerging or potential claims and coverage issues include:

- increases in the number and size of claims relating to injuries from medical products;
- the effects of accounting and financial reporting scandals and other major corporate governance failures, which have resulted in an increase in the number and size of claims, including directors and officers (D&O) and errors and omissions (E&O) insurance claims;
- class action litigation relating to claims handling and other practices;
- construction defect claims, including claims for a broad range of additional insured endorsements on policies;
- clergy abuse claims, including passage of legislation to reopen or extend various statutes of limitations; and
- mass tort claims, including bodily injury claims related to silica, welding rods, benzene, lead and various other chemical exposure claims.

Our experience has been that establishing reserves for casualty coverages relating to asbestos and environmental pollution (A&E) claim and claim adjustment expenses are subject to uncertainties that are greater than those presented by other claims. Estimating the ultimate cost of both reported and unreported A&E claims are subject to a higher degree of variability due to a number of additional factors, including among others:

- coverage issues, including whether certain costs are covered under the policies and whether policy limits apply;
- inconsistent court decisions and developing legal theories;
- continuing aggressive tactics of plaintiffs lawyers;
- the risks and lack of predictability inherent in major litigation;
- changes in the volume of A&E claims;

the impact of the exhaustion of primary limits and the resulting increase in claims on any umbrella or excess policies we have issued;
the number and outcome of direct actions against us; and
our ability to recover reinsurance for A&E claims.

It is also not possible to predict changes in the legal and legislative environment and the impact on the future development of A&E claims. This development will be affected by future court decisions and interpretations, as well as changes in applicable legislation. It is difficult to predict the ultimate outcome of large coverage disputes until settlement negotiations near completion and significant legal questions are resolved or, failing settlement, until the dispute is adjudicated. This is particularly the case with policyholders in bankruptcy where negotiations often involve a large number of claimants and other parties and require court approval to be effective. A further uncertainty exists as to whether a national privately financed trust to replace litigation of asbestos claims with payments to claimants from the trust will be established and approved through federal legislation, and, if established and approved, whether it will contain funding requirements in excess of our carried loss reserves.

Traditional actuarial methods and techniques employed to estimate the ultimate cost of claims for more traditional property and casualty exposures are less precise in estimating claim and claim adjustment reserves for A&E, particularly in an environment of emerging or potential claims and coverage issues that arise from industry practices and legal, judicial and social conditions. Therefore, these traditional actuarial methods and techniques are necessarily supplemented with additional estimation techniques and methodologies, many of which involve significant judgments that are required of management. For A&E, we regularly monitor our exposures, including reviews of loss activity, regulatory developments and court rulings. In addition, we perform a comprehensive ground up analysis on our exposures annually. Our actuaries, in conjunction with our specialized claim unit, use various modeling techniques to estimate our overall exposure to known accounts. We use this information and additional modeling techniques to develop loss distributions and claim reporting patterns to determine reserves for accounts that will report A&E exposure in the future. Estimating the average claim size requires analysis of the impact of large losses and claim cost trend based on changes in the cost of repairing or replacing property, changes in the cost of legal fees, judicial decisions, legislative changes, and other factors. Due to the inherent uncertainties in estimating reserves for A&E claim and claim adjustment expenses and the degree of variability due to, among other things, the factors described above, we may be required to record material changes in our claim and claim adjustment expense reserves in the future, should new information become available or other developments emerge. See the A&E Reserves section of this MD&A and Note F of the Consolidated Financial Statements included under Item 8 for additional information relating to A&E claims and reserves.

The impact of these and other unforeseen emerging or potential claims and coverage issues is difficult to predict and could materially adversely affect the adequacy of our claim and claim adjustment expense reserves and could lead to future reserve additions. See the Segment Results sections of this MD&A and Note F of the Consolidated Financial Statements included under Item 8 for a discussion of changes in reserve estimates and the impact on our results of operations.

Establishing Reserve Estimates

In developing claim and claim adjustment expense (loss or losses) reserve estimates, our actuaries perform detailed reserve analyses that are staggered throughout the year. The data is organized at a product level. A product can be a line of business covering a subset of insureds such as commercial automobile liability for small and middle market customers, it can encompass several lines of business provided to a specific set of customers such as dentists, or it can be a particular type of claim such as construction defect. Every product is analyzed at least once during the year, and many products are analyzed multiple times. The analyses generally review losses gross of ceded reinsurance and apply the ceded reinsurance terms to the gross estimates to establish estimates net of reinsurance. In addition to the detailed analyses, we review actual loss emergence for all products each quarter.

The detailed analyses use a variety of generally accepted actuarial methods and techniques to produce a number of estimates of ultimate loss. We determine a point estimate of ultimate loss by reviewing the various estimates and assigning weight to each estimate given the characteristics of the product being reviewed. The reserve

estimate is the difference between the estimated ultimate loss and the losses paid to date. The difference between the estimated ultimate loss and the case incurred loss (paid loss plus case reserve) is IBNR. IBNR calculated as such includes a provision for development on known cases (supplemental development) as well as a provision for claims that have occurred but have not yet been reported (pure IBNR).

Most of our business can be characterized as long-tail. For long-tail business, it will generally be several years between the time the business is written and the time when all claims are settled. Our long-tail exposures include commercial automobile liability, workers compensation, general liability, medical malpractice, other professional liability coverages, assumed reinsurance run-off and products liability. Short-tail exposures include property, commercial automobile physical damage, marine and warranty. Each of our property/casualty segments, Standard Lines, Specialty Lines and Corporate & Other Non-Core, contain both long-tail and short-tail exposures.

The methods used to project ultimate loss for both long-tail and short-tail exposures include, but are not limited to, the following:

- Paid Development,
- Incurred Development,
- Loss Ratio,
- Bornhuetter-Ferguson Using Premiums and Paid Loss,
- Bornhuetter-Ferguson Using Premiums and Incurred Loss, and
- Average Loss.

The paid development method estimates ultimate losses by reviewing paid loss patterns and applying them to accident years with further expected changes in paid loss. Selection of the paid loss pattern requires analysis of several factors including the impact of inflation on claims costs, the rate at which claims professionals make claim payments and close claims, the impact of judicial decisions, the impact of underwriting changes, the impact of large claim payments and other factors. Claim cost inflation itself requires evaluation of changes in the cost of repairing or replacing property, changes in the cost of medical care, changes in the cost of wage replacement, judicial decisions, legislative changes and other factors. Because this method assumes that losses are paid at a consistent rate, changes in any of these factors can impact the results. Since the method does not rely on case reserves, it is not directly influenced by changes in the adequacy of case reserves.

For many products, paid loss data for recent periods may be too immature or erratic for accurate predictions. This situation often exists for long-tail exposures. In addition, changes in the factors described above may result in inconsistent payment patterns. Finally, estimating the paid loss pattern subsequent to the most mature point available in the data analyzed often involves considerable uncertainty for long-tail products such as workers compensation.

The incurred development method is similar to the paid development method, but it uses case incurred losses instead of paid losses. Since the method uses more data (case reserves in addition to paid losses) than the paid development method, the incurred development patterns may be less variable than paid patterns. However, selection of the incurred loss pattern requires analysis of all of the factors above. In addition, the inclusion of case reserves can lead to distortions if changes in case reserving practices have taken place, and the use of case incurred losses may not eliminate the issues associated with estimating the incurred loss pattern subsequent to the most mature point available.

The loss ratio method multiplies premiums by an expected loss ratio to produce ultimate loss estimates for each accident year. This method may be useful if loss development patterns are inconsistent, losses emerge very slowly, or there is relatively little loss history from which to estimate future losses. The selection of the expected loss ratio requires analysis of loss ratios from earlier accident years or pricing studies and analysis of inflationary trends, frequency trends, rate changes, underwriting changes, and other applicable factors.

The Bornhuetter-Ferguson using premiums and paid loss method is a combination of the paid development approach and the loss ratio approach. The method normally determines expected loss ratios similar to the approach used to estimate the expected loss ratio for the loss ratio method and requires analysis of the same factors described above. The method assumes that only future losses will develop at the expected loss ratio

level. The percent of paid loss to ultimate loss implied from the paid development method is used to determine what percentage of ultimate loss is yet to be paid. The use of the pattern from the paid development method requires consideration of all factors listed in the description of the paid development method. The estimate of losses yet to be paid is added to current paid losses to estimate the ultimate loss for each year. This method will react very slowly if actual ultimate loss ratios are different from expectations due to changes not accounted for by the expected loss ratio calculation.

The Bornhuetter-Ferguson using premiums and incurred loss method is similar to the Bornhuetter-Ferguson using premiums and paid loss method except that it uses case incurred losses. The use of case incurred losses instead of paid losses can result in development patterns that are less variable than paid patterns. However, the inclusion of case reserves can lead to distortions if changes in case reserving have taken place, and the method requires analysis of all the factors that need to be reviewed for the loss ratio and incurred development methods.

The average loss method multiplies a projected number of ultimate claims by an estimated ultimate average loss for each accident year to produce ultimate loss estimates. Since projections of the ultimate number of claims are often less variable than projections of ultimate loss, this method can provide more reliable results for products where loss development patterns are inconsistent or too variable to be relied on exclusively. In addition, this method can more directly account for changes in coverage that impact the number and size of claims. However, this method can be difficult to apply to situations where very large claims or a substantial number of unusual claims result in volatile average claim sizes. Projecting the ultimate number of claims requires analysis of several factors including the rate at which policyholders report claims to us, the impact of judicial decisions, the impact of underwriting changes and other factors. Estimating the ultimate average loss requires analysis of the impact of large losses and claim cost trend based on changes in the cost of repairing or replacing property, changes in the cost of medical care, changes in the cost of wage replacement, judicial decisions, legislative changes and other factors.

For other more complex products where the above methods may not produce reliable indications, we use additional methods tailored to the characteristics of the specific situation. Such products include construction defect losses and A&E.

For construction defect losses, our actuaries organize losses by report year. Report year groups claims by the year in which they were reported. To estimate losses from claims that have not been reported, various extrapolation techniques are applied to the pattern of claims that have been reported to estimate the number of claims yet to be reported. This process requires analysis of several factors including the rate at which policyholders report claims to us, the impact of judicial decisions, the impact of underwriting changes and other factors. An average claim size is determined from past experience and applied to the number of unreported claims to estimate reserves for these claims.

For many exposures, especially those that can be considered long-tail, a particular accident year may not have a sufficient volume of paid losses to produce a statistically reliable estimate of ultimate losses. In such a case, our actuaries typically assign more weight to the incurred development method than to the paid development method. As claims continue to settle and the volume of paid loss increases, the actuaries may assign additional weight to the paid development method. For most of our products, even the incurred losses for accident years that are early in the claim settlement process will not be of sufficient volume to produce a reliable estimate of ultimate losses. In these cases, we will not assign any weight to the paid and incurred development methods. We will use loss ratio, Bornhuetter-Ferguson and average loss methods. For short-tail exposures, the paid and incurred development methods can often be relied on sooner primarily because our history includes a sufficient number of years to cover the entire period over which paid and incurred losses are expected to change. However, we may also use loss ratio, Bornhuetter-Ferguson and average loss methods for short-tail exposures.

Periodic Reserve Reviews

The reserve analyses performed by our actuaries result in point estimates. Each quarter, the results of the detailed reserve reviews are summarized and discussed with our senior management to determine the best estimate of reserves. This group considers many factors in making this decision. The factors include, but are not limited to, the historical pattern and volatility of the actuarial indications, the sensitivity of the actuarial indications to changes in paid and incurred loss patterns, the consistency of claims handling processes, the consistency of case reserving practices, changes in our pricing and underwriting, and overall pricing and underwriting trends in the insurance

market.

Our recorded reserves reflect our best estimate as of a particular point in time based upon known facts, current law and our judgment. The carried reserve may differ from the actuarial point estimate as the result of our consideration of the factors noted above as well as the potential volatility of the projections associated with the specific product being analyzed and other factors impacting claims costs that may not be quantifiable through traditional actuarial analysis. This process results in management s best estimate which is then recorded as the loss reserve.

Currently, our reserves are slightly higher than the actuarial point estimate. We do not establish a specific provision for uncertainty. For Standard and Specialty Lines, the difference between our reserves and the actuarial point estimate is primarily due to the three most recent accident years. The claim data from these accident years is very immature. We believe it is prudent to wait until actual experience confirms that the loss reserves should be adjusted. For Corporate & Other Non-Core, the carried reserve is slightly higher than the actuarial point estimate. For A&E exposures, we feel it is prudent, based on the history of developments in this area and the volatility associated with the reserves, to be above the point estimate until the ultimate outcome of the issues associated with these exposures is clearer.

The key assumptions fundamental to the reserving process are often different for various products and accident years. Some of these assumptions are explicit assumptions that are required of a particular method, but most of the assumptions are implicit and cannot be precisely quantified. An example of an explicit assumption is the pattern employed in the paid development method. However, the assumed pattern is itself based on several implicit assumptions such as the impact of inflation on medical costs and the rate at which claim professionals close claims. As a result, the effect on reserve estimates of a particular change in assumptions usually cannot be specifically quantified, and changes in these assumptions cannot be tracked over time.

Our recorded reserves are management s best estimate. In order to provide an indication of the variability associated with our net reserves, the following discussion provides a sensitivity analysis that shows the approximate estimated impact of variations in the most significant factor affecting our reserve estimates for particular types of business. These significant factors are the ones that could most likely materially impact the reserves. This discussion covers the major types of business for which we believe a material deviation to our reserves is reasonably possible. There can be no assurance that actual experience will be consistent with the current assumptions or with the variation indicated by the discussion. In addition, there can be no assurance that other factors and assumptions will not have a material impact on our reserves.

Within Standard Lines, the two types of business for which we believe a material deviation to our net reserves is reasonably possible are workers compensation and general liability.

For Standard Lines workers compensation, since many years will pass from the time the business is written until all claim payments have been made, claim cost inflation on claim payments is the most significant factor affecting workers compensation reserve estimates. Workers compensation claim cost inflation is driven by the cost of medical care, the cost of wage replacement, expected claimant lifetimes, judicial decisions, legislative changes and other factors. If estimated workers compensation claim cost inflation increases by one point for the entire period over which claim payments will be made, we estimate that our net reserves would increase by approximately $450 million. If estimated workers compensation claim cost inflation decreases by one point for the entire period over which claim payments will be made, we estimate that our net reserves would decrease by approximately $400 million. Our net reserves for Standard Lines workers compensation were approximately $4.5 billion at December 31, 2007.

For Standard Lines general liability, the predominant method used for estimating reserves is the incurred development method. Changes in the cost to repair or replace property, the cost of medical care, the cost of wage replacement, judicial decisions, legislation and other factors all impact the pattern selected in this method. The pattern selected results in the incurred development factor that estimates future changes in case incurred loss. If the estimated incurred development factor for general liability increases by 13%, we estimate that our net reserves would increase by approximately $300 million. If the estimated incurred development factor for general liability decreases by 9%, we estimate that our net reserves would decrease by approximately $200 million. Our net reserves for Standard Lines general liability were approximately $3.5 billion at December 31, 2007.

Within Specialty Lines, we believe a material deviation to our net reserves is reasonably possible for professional liability and related business in the U.S. Specialty Lines group. This business includes

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professional liability coverages provided to various professional firms, including architects, realtors, small and mid-sized accounting firms, law firms and technology firms. This business also includes D&O, employment practices, fiduciary and fidelity coverages as well as insurance products serving the healthcare delivery system. The most significant factor affecting reserve estimates for this business is claim severity. Claim severity is driven by the cost of medical care, the cost of wage replacement, legal fees, judicial decisions, legislation and other factors. Underwriting and claim handling decisions such as the classes of business written and individual claim settlement decisions can also impact claim severity. If the estimated claim severity increases by 7%, we estimate that the net reserves would increase by approximately $300 million. If the estimated claim severity decreases by 2%, we estimate that net reserves would decrease by approximately $100 million. Our net reserves for this business were approximately $4.4 billion at December 31, 2007.

Within Corporate & Other Non-Core, the two types of business for which we believe a material deviation to our net reserves is reasonably possible are CNA Re and A&E.

For CNA Re, the predominant method used for estimating reserves is the incurred development method. Changes in the cost to repair or replace property, the cost of medical care, the cost of wage replacement, the rate at which ceding companies report claims, judicial decisions, legislation and other factors all impact the incurred development pattern for CNA Re. The pattern selected results in the incurred development factor that estimates future changes in case incurred loss. If the estimated incurred development factor for CNA Re increases by 22%, we estimate that our net reserves for CNA Re would increase by approximately $150 million. If the estimated incurred development factor for CNA Re decreases by 22%, we estimate that our net reserves would decrease by approximately $150 million. Our net reserves for CNA Re were approximately $1.0 billion at December 31, 2007.

For A&E, the most significant factor affecting reserve estimates is overall account size trend. Overall account size trend for A&E reflects the combined impact of economic trends (inflation), changes in the types of defendants involved, the expected mix of asbestos disease types, judicial decisions, legislation and other factors. If the estimated overall account size trend for A&E increases by 4 points, we estimate that our A&E net reserves would increase by approximately $350 million. If the estimated overall account size trend for A&E decreases by 4 points, we estimate that our A&E net reserves would decrease by approximately $250 million. Our net reserves for A&E were approximately $1.6 billion at December 31, 2007.

Given the factors described above, it is not possible to quantify precisely the ultimate exposure represented by claims and related litigation. As a result, we regularly review the adequacy of our reserves and reassess our reserve estimates as historical loss experience develops, additional claims are reported and settled and additional information becomes available in subsequent periods.

In light of the many uncertainties associated with establishing the estimates and making the assumptions necessary to establish reserve levels, we review our reserve estimates on a regular basis and make adjustments in the period that the need for such adjustments is determined. These reviews have resulted in our identification of information and trends that have caused us to increase our reserves in prior periods and could lead to the identification of a need for additional material increases in claim and claim adjustment expense reserves, which could materially adversely affect our results of operations, equity, business and insurer financial strength and debt ratings. See the Ratings section of this MD&A for further information regarding our financial strength and debt ratings.

Reinsurance

Due to significant catastrophes during 2005, the cost of our catastrophe reinsurance program has increased. Our catastrophe reinsurance protection cost us $93 million and $79 million in 2007 and 2006, neither of which included reinstatement premiums. Currently, the 2008 catastrophe reinsurance program will cost us $55 million before the impact of any reinstatement premiums.

The terms of our 2008 catastrophe programs are different than those of our 2007 programs. The Corporate Property Catastrophe treaty provides coverage for the accumulation of losses between $300 million and $900 million arising out of a single catastrophe occurrence in the United States, its territories and possessions, and Canada. Our co-participation is 35% of the first $100 million layer of the coverage provided and 5% of the remaining layers. Additional protection above $900 million may be purchased in either the traditional reinsurance or financial markets prior to June 1, 2008 depending on market conditions.

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Further information on our reinsurance program is included in Note H of the Consolidated Financial Statements included under Item 8.

Restructuring

In 2001, we finalized and approved a plan related to restructuring the property and casualty segments and Life & Group Non-Core segment, discontinuation of our variable life and annuity business and consolidation of real estate locations. During 2006, we reevaluated the sufficiency of the remaining accrual, which related to lease termination costs, and determined that the liability was no longer required as we had completed our lease obligations. As a result, the excess remaining accrual was released in 2006, resulting in income of $8 million after-tax for the year ended December 31, 2006.

Segment Results

The following discusses the results of continuing operations for our operating segments.

CNA s core property and casualty commercial insurance operations are reported in two business segments: Standard Lines and Specialty Lines. As a result of our realignment of management responsibilities in the fourth quarter of 2007, we have revised our property and casualty segments as if the current segment changes occurred as of the beginning of the earliest period presented. Standard Lines includes standard property and casualty coverages sold to small businesses and middle market entities and organizations in the U.S. primarily through an independent agency distribution system. Standard Lines also includes commercial insurance and risk management products sold to large corporations in the U.S. primarily through insurance brokers. Specialty Lines provides a broad array of professional, financial and specialty property and casualty products and services, including excess and surplus lines, primarily through insurance brokers and managing general underwriters. Specialty Lines also includes insurance coverages sold globally through our foreign operations (CNA Global). Previously, excess and surplus lines and CNA Global were included in Standard Lines.

Standard Lines previously included other revenues and expenses related to claim services provided by CNA ClaimPlus, Inc. to other units within the Standard Lines segment because these revenues and expenses were eliminated at the consolidated level. These amounts are now eliminated within Standard Lines for all periods presented.

Our property and casualty field structure consists of 33 branch locations across the country organized into 2 territories. Each branch provides the marketing, underwriting and risk control expertise on the entire portfolio of products. The Centralized Processing Operation for small and middle-market customers, located in Maitland, Florida, handles policy processing, billing and collection activities, and also acts as a call center to optimize customer service. The claims structure consists of a centralized claim center designed to efficiently handle property damage and medical only claims and 14 claim office locations around the country handling the more complex claims.

We utilize the net operating income financial measure to monitor our operations. Net operating income is calculated by excluding from net income the after-tax effects of 1) net realized investment gains or losses, 2) income or loss from discontinued operations and 3) any cumulative effects of changes in accounting principles. See further discussion regarding how we manage our business in Note N of the Consolidated Financial Statements included under Item 8. In evaluating the results of our Standard Lines and Specialty Lines 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 costs, 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.

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STANDARD LINES

Business Overview

Standard Lines works with an independent agency distribution system and network of brokers to market a broad range of property and casualty insurance products and services primarily to small, middle-market and large businesses and organizations domestically. The Standard Lines operating model focuses on underwriting performance, relationships with selected distribution sources and understanding customer needs. Property products provide standard and excess property coverages, as well as marine coverage, and boiler and machinery. Casualty products provide standard casualty insurance products such as workers compensation, general and product liability and commercial auto coverage through traditional products. Most insurance programs are provided on a guaranteed cost basis; however, we have the capability to offer specialized, loss-sensitive insurance programs to those customers viewed as higher risk and less predictable in exposure.

These property and casualty products are offered as part of our **Business** and **Commercial** insurance groups. Our Business insurance group serves our smaller commercial accounts and the Commercial insurance group serves our middle markets and our larger risks. In addition, Standard Lines provides total risk management services relating to claim and information services to the large commercial insurance marketplace, through a wholly-owned subsidiary, CNA ClaimPlus, Inc., a third party administrator.

The following table details results of operations for Standard Lines.

Results of Operations

Years ended December 31	**2007**	**2006**	**2005**
(In millions)			
Net written premiums	$ 3,267	$ 3,598	$ 3,473
Net earned premiums	3,379	3,557	3,518
Net investment income	878	840	632
Net operating income (loss)	602	446	(87)
Net realized investment gains (losses), after-tax	(97)	48	19
Net income (loss)	505	494	(68)
Ratios			
Loss and loss adjustment expense	67.4%	72.5%	90.3%
Expense	32.5	31.6	32.7
Dividend	0.2	0.5	0.6
Combined	100.1%	104.6%	123.6%

2007 Compared with 2006

Net written premiums for Standard Lines decreased $331 million in 2007 as compared with 2006, primarily due to decreased production. The decreased production reflects our disciplined participation in the current competitive market. The competitive market conditions are expected to put ongoing pressure on premium and income levels, and the expense ratio. Net earned premiums decreased $178 million in 2007 as compared with 2006, consistent with the decreased premiums written.

Standard Lines averaged rate decreases of 4% for 2007, as compared to flat rates for 2006 for the contracts that renewed during those periods. Retention rates of 79% and 81% were achieved for those contracts that were available for renewal in each period.

Net income increased $11 million in 2007 as compared with 2006. This increase was primarily attributable to improved net operating income, offset by decreased net realized investment results. See the Investments section of this MD&A for further discussion of net investment income and net realized investment results.

Net operating income increased $156 million in 2007 as compared with 2006. This increase was primarily driven by favorable net prior year development in 2007 as compared to unfavorable net prior year development in 2006 and increased net investment income. These favorable impacts were partially offset by decreased current accident year underwriting results including increased catastrophe losses. Catastrophe losses were $48 million after-tax in 2007, as compared to $35 million after-tax in 2006.

The combined ratio improved 4.5 points in 2007 as compared with 2006. The loss ratio improved 5.1 points primarily due to favorable net prior year development in 2007 as compared to unfavorable net prior year development in 2006. This favorable impact was partially offset by higher current accident year loss ratios primarily related to the decline in rates.

The dividend ratio improved 0.3 points in 2007 as compared with 2006 due to favorable dividend development in the workers compensation line of business.

The expense ratio increased 0.9 points in 2007 as compared with 2006, primarily reflecting the impact of declining earned premiums.

Favorable net prior year development of $123 million was recorded in 2007, including $104 million of favorable claim and allocated claim adjustment expense reserve development and $19 million of favorable premium development. Unfavorable net prior year development of $150 million, including $208 million of unfavorable claim and allocated claim adjustment expense reserve development and $58 million of favorable premium development, was recorded in 2006. Further information on Standard Lines Net Prior Year Development for 2007 and 2006 is included in Note F of the Consolidated Financial Statements included under Item 8.

The following table summarizes the gross and net carried reserves as of December 31, 2007 and 2006 for Standard Lines.

Gross and Net Carried
Claim and Claim Adjustment Expense Reserves

December 31	**2007**	**2006**
(In millions)		
Gross Case Reserves	$ 5,988	$ 5,826
Gross IBNR Reserves	6,060	6,691
Total Gross Carried Claim and Claim Adjustment Expense Reserves	$ 12,048	$ 12,517
Net Case Reserves	$ 4,750	$ 4,571
Net IBNR Reserves	5,170	5,543
Total Net Carried Claim and Claim Adjustment Expense Reserves	$ 9,920	$ 10,114

2006 Compared with 2005

Net written premiums for Standard Lines increased $125 million in 2006 as compared with 2005. This increase was primarily driven by favorable new business, rate and retention in the property products. Net earned premiums increased $39 million in 2006 as compared with 2005, consistent with the increased premiums written.

Standard Lines averaged flat rates for 2006, as compared to decreases of 2% for 2005 for the contracts that renewed during those periods. Retention rates of 81% and 76% were achieved for those contracts that were up for renewal in each period.

Net results increased $562 million in 2006 as compared with 2005. This increase was attributable to increases in net operating results and net realized investment gains. See the Investments section of this MD&A for further discussion of net investment income and net realized investment gains.

Net operating results increased $533 million in 2006 as compared with 2005. This increase was primarily driven by significantly reduced catastrophe losses in 2006, an increase in net investment income and a decrease in unfavorable net prior year development as discussed below. The 2006 net operating results included catastrophe impacts of $31 million after-tax. The 2005 net operating results included catastrophe impacts of $318 million after-tax related to Hurricanes Katrina, Wilma, Rita, Dennis and Ophelia, net of reinsurance recoveries.

The combined ratio improved 19.0 points in 2006 as compared with 2005. The loss ratio improved 17.8 points due to decreased unfavorable net prior year development as discussed below and decreased catastrophe losses in 2006. The 2006 and 2005 loss ratios included 1.5 and 13.9 points related to the impact of catastrophes.

The expense ratio improved 1.1 points in 2006 as compared with 2005. This improvement was primarily due to a decrease in the provision for insurance bad debt. In addition, the 2005 ratio included increased ceded commissions as a result of an unfavorable arbitration ruling related to two reinsurance treaties. Changes in estimates for premium taxes partially offset these favorable impacts.

Unfavorable net prior year development of $150 million was recorded in 2006, including $208 million of unfavorable claim and allocated claim adjustment expense reserve development and $58 million of favorable premium development. Unfavorable net prior year development of $403 million, including $433 million of unfavorable claim and allocated claim adjustment expense reserve development and $30 million of favorable premium development, was recorded in 2005. Further information on Standard Lines Net Prior Year Development for 2006 and 2005 is included in Note F of the Consolidated Financial Statements included under Item 8.

During 2006 and 2005, we commuted several significant reinsurance contracts that resulted in unfavorable development of $110 million and $255 million, which is included in the development above, and which was partially offset by the release of previously established allowance for uncollectible reinsurance. These commutations resulted in an unfavorable after-tax impact of $31 million and $152 million in 2006 and 2005. Several of the commuted contracts contained interest crediting provisions. The interest charges associated with the reinsurance contracts commuted were $9 million after-tax and $40 million after-tax in 2006 and 2005. The 2005 amount includes the interest charges associated with the contract commuted in 2006. There will be no further interest crediting charges related to these commuted contracts in future periods.

SPECIALTY LINES

Business Overview

Specialty Lines provides professional, financial and specialty property and casualty products and services, both domestically and abroad, through a network of brokers, managing general underwriters and independent agencies. Specialty Lines provides solutions for managing the risks of its clients, including architects, lawyers, accountants, healthcare professionals, financial intermediaries and public and private companies. Product offerings also include surety and fidelity bonds, and vehicle warranty services.

Specialty Lines includes the following business groups:

U.S. Specialty Lines provides management and professional liability insurance and risk management services and other specialized property and casualty coverages, primarily in the United States. This group provides professional liability coverages to various professional firms, including architects, realtors, small and mid-sized accounting firms, law firms and technology firms. U.S. Specialty Lines also provides D&O, employment practices, fiduciary and fidelity coverages. Specific areas of focus include small and mid-size firms as well as privately held firms and not-for-profit organizations where tailored products for this client segment are offered. Products within U.S. Specialty Lines are distributed through brokers, agents and managing general underwriters.

U.S. Specialty Lines, through CNA HealthPro, also offers insurance products to serve the healthcare delivery system. Products, which include professional liability as well as associated standard property and casualty coverages, are distributed on a national basis through a variety of channels including brokers, agents and managing general underwriters. Key customer segments include long term care facilities, allied healthcare providers, life sciences, dental professionals and mid-size and large healthcare facilities and delivery systems.

Also included in U.S. Specialty Lines is Excess and Surplus (E&S). E&S provides specialized insurance and other financial products for selected commercial risks on both an individual customer and program basis. Customers insured by E&S are generally viewed as higher risk and less predictable in exposure than those covered by standard insurance markets. E&S s products are distributed throughout the United States through specialist producers, program agents and brokers.

Surety consists primarily of CNA Surety and its insurance subsidiaries and offers small, medium and large contract and commercial surety bonds. CNA Surety provides surety and fidelity bonds in all 50 states through a combined network of independent agencies. CNA owns approximately 62% of CNA Surety.

Warranty provides vehicle warranty service contracts that protect individuals from the financial burden associated with mechanical breakdown.

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CNA Global consists of subsidiaries operating in Europe, Latin America, Canada and Hawaii. These affiliates offer property and casualty insurance to small and medium size businesses and capitalize on strategic indigenous opportunities.

The following table details results of operations for Specialty Lines.

Results of Operations

Years ended December 31	**2007**	**2006**	**2005**
(In millions)			
Net written premiums	$ 3,506	$ 3,431	$ 3,372
Net earned premiums	3,484	3,411	3,367
Net investment income	621	554	416
Net operating income	619	635	382
Net realized investment gains (losses), after-tax	(53)	25	2
Net income	566	660	384
Ratios			
Loss and loss adjustment expense	62.8%	60.4%	68.3%
Expense	26.7	27.4	27.4
Dividend	0.2	0.1	0.1
Combined	89.7%	87.9%	95.8%

2007 Compared with 2006

Net written premiums for Specialty Lines increased $75 million in 2007 as compared with 2006. Premiums written were unfavorably impacted by decreased production as compared with the same period in 2006. The decreased production reflects our disciplined participation in the current competitive market. The competitive market conditions are expected to put ongoing pressure on premium and income levels, and the expense ratio. This unfavorable impact was more than offset by decreased ceded premiums. The U.S. Specialty Lines reinsurance structure was primarily quota share reinsurance through April 2007. We elected not to renew this coverage upon its expiration. With our current diversification in the previously reinsured lines of business and our management of the gross limits on the business written, we did not believe the cost of renewing the program was commensurate with its projected benefit.

Net earned premiums increased $73 million as compared with the same period in 2006, consistent with the increased net premiums written.

Specialty Lines averaged rate decreases of 3% for 2007, as compared to decreases of 1% for 2006 for the contracts that renewed during those periods. Retention rates of 83% and 85% were achieved for those contracts that were up for renewal in each period.

Net income decreased $94 million in 2007 as compared with 2006. This decrease was primarily attributable to decreases in net realized investment results. See the Investments section of this MD&A for further discussion of net investment income and net realized investment results.

Net operating income decreased $16 million in 2007 as compared with 2006. This decrease was primarily driven by decreased current accident year underwriting results and less favorable net prior year development. These decreases were partially offset by increased net investment income and favorable experience in the warranty line of business.

The combined ratio increased 1.8 points in 2007 as compared with 2006. The loss ratio increased 2.4 points, primarily due to higher current accident year losses related to the decline in rates and less favorable net prior year development as discussed below.

The expense ratio improved 0.7 points in 2007 as compared with 2006. This improvement was primarily due to a favorable change in estimate related to dealer profit commissions in the warranty line of business.

Favorable net prior year development of $36 million was recorded in 2007, including $25 million of favorable claim and allocated claim adjustment expense reserve development and $11 million of favorable premium development. Favorable net prior year development of $66 million, including $61 million of favorable claim and allocated claim adjustment expense reserve development and $5 million of favorable premium

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development, was recorded in 2006. Further information on Specialty Lines Net Prior Year Development for 2007 and 2006 is included in Note F of the Consolidated Financial Statements included under Item 8.
The following table summarizes the gross and net carried reserves as of December 31, 2007 and 2006 for Specialty Lines.

Gross and Net Carried
Claim and Claim Adjustment Expense Reserves

December 31	**2007**	**2006**
(In millions)		
Gross Case Reserves	$ 2,585	$ 2,635
Gross IBNR Reserves	5,818	5,311
Total Gross Carried Claim and Claim Adjustment Expense Reserves	$ 8,403	$ 7,946
Net Case Reserves	$ 2,090	$ 2,013
Net IBNR Reserves	4,527	4,010

	(Date)		**Jerry W. Nix**	(Date)
Director		Director		
		Vice Chairman and Chief Financial Officer		
		(Principal Financial and Accounting Officer)		

/s/ Gary W. Rollins	2/18/13
Gary W. Rollins	(Date)
Director	

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Report of Management

Genuine Parts Company

Management s Responsibility for the Financial Statements

We have prepared the accompanying consolidated financial statements and related information included herein for the years ended December 31, 2012, 2011 and 2010. The opinion of Ernst & Young LLP, the Company s independent registered public accounting firm, on those consolidated financial statements is included herein. The primary responsibility for the integrity of the financial information included in this annual report rests with management. Such information was prepared in accordance with generally accepted accounting principles appropriate in the circumstances based on our best estimates and judgments and giving due consideration to materiality.

Management s Report on Internal Control over Financial Reporting

The management of Genuine Parts Company and its subsidiaries (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934.

The Company s internal control system was designed to provide reasonable assurance to the Company s management and to the board of directors regarding the preparation and fair presentation of the Company s published consolidated financial statements. The Company s internal control over financial reporting includes those policies and procedures that:

i. pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;

ii. provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

iii. provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company s assets that could have a material effect on the financial statements.

All internal control systems, no matter how well designed, have inherent limitations and may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

The Company s management, including our Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2012.

In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on this assessment, management concluded that, as of December 31, 2012, the Company s internal control over financial reporting was effective.

Ernst & Young LLP has issued an audit report on the Company s operating effectiveness of internal control over financial reporting as of December 31, 2012. This report appears on page F-3.

Audit Committee Responsibility

The Audit Committee of Genuine Parts Company s Board of Directors is responsible for reviewing and monitoring the Company s financial reports and accounting practices to ascertain that they are within acceptable limits of sound practice in such matters. The membership of the Committee consists of non-employee Directors. At periodic meetings, the Audit Committee discusses audit and financial reporting matters and the internal audit function with representatives of financial management and with representatives from Ernst & Young LLP.

/s/ Jerry W. Nix

JERRY W. NIX
Vice Chairman and Chief Financial Officer

February 26, 2013

Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting

The Board of Directors and Shareholders of Genuine Parts Company and Subsidiaries

We have audited Genuine Parts Company and Subsidiaries internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Genuine Parts Company and Subsidiaries management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management s Report on Internal Control Over Financial Reporting section of the accompanying Report of Management. Our responsibility is to express an opinion on the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Genuine Parts Company and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on the COSO criteria**.**

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Genuine Parts Company and Subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of income and comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2012 of Genuine Parts Company and Subsidiaries and our report dated February 26, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Atlanta, Georgia

February 26, 2013

Report of Independent Registered Public Accounting Firm on the Financial Statements

The Board of Directors and Shareholders of Genuine Parts Company and Subsidiaries

We have audited the accompanying consolidated balance sheets of Genuine Parts Company and Subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of income and comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2012. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Genuine Parts Company and Subsidiaries at December 31, 2012 and 2011, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Genuine Parts Company and Subsidiaries internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 26, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Atlanta, Georgia

February 26, 2013

Genuine Parts Company and Subsidiaries

Consolidated Balance Sheets

	December 31	
	2012	**2011**
	(In thousands, except share data and per share amounts)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 403,095**	$ 525,054
Trade accounts receivable, net	**1,490,028**	1,461,011
Merchandise inventories, net	**2,602,560**	2,440,111
Prepaid expenses and other current assets	**324,448**	328,534
Total current assets	**4,820,131**	4,754,710
Goodwill and other intangible assets, less accumulated amortization	**497,839**	279,775
Deferred tax asset	**279,463**	261,608
Other assets	**643,263**	406,477
Property, plant, and equipment:		
Land	**88,710**	74,332
Buildings, less allowance for depreciation (2012 $237,504; 2011 $226,396)	**266,694**	233,242
Machinery and equipment, less allowance for depreciation (2012 $522,136; 2011 $505,994)	**210,961**	192,630
Net property, plant, and equipment	**566,365**	500,204
	$ 6,807,061	$ 6,202,774
Liabilities and equity		
Current liabilities:		
Trade accounts payable	**$ 1,681,900**	$ 1,440,762
Current portion of debt	**250,000**	
Accrued compensation	**115,348**	149,102
Other accrued expenses	**359,395**	331,582
Dividends payable	**76,641**	70,021
Income taxes payable	**4,354**	21,081
Total current liabilities	**2,487,638**	2,012,548
Long-term debt	**250,000**	500,000
Pension and other post-retirement benefit liabilities	**572,988**	493,721
Other long-term liabilities	**488,256**	442,914
Equity:		
Preferred stock, par value $1 per share authorized 10,000,000 shares; none issued		
Common stock, par value $1 per share authorized 450,000,000 shares; issued and outstanding 154,841,438 in 2012 and 155,651,116 shares in 2011	**154,841**	155,651
Accumulated other comprehensive loss	**(501,492)**	(482,038)
Retained earnings	**3,344,538**	3,070,394
Total parent equity	**2,997,887**	2,744,007
Noncontrolling interests in subsidiaries	**10,292**	9,584
Total equity	**3,008,179**	2,753,591
	$ 6,807,061	$ 6,202,774

See accompanying notes.

Genuine Parts Company and Subsidiaries

Consolidated Statements of Income and Comprehensive Income

	Year Ended December 31		
	2012	**2011**	**2010**
	(In thousands, except per share amounts)		
Net sales	**$ 13,013,868**	$ 12,458,877	$ 11,207,589
Cost of goods sold	**9,235,777**	8,852,837	7,954,645
Gross margin	**3,778,091**	3,606,040	3,252,944
Operating expenses:			
Selling, administrative, and other expenses	**2,648,430**	2,594,372	2,366,667
Depreciation and amortization	**98,383**	88,936	89,332
Provision for doubtful accounts	**8,047**	13,248	10,597
Total operating expenses	**2,754,860**	2,696,556	2,466,596
Non-operating expenses (income):			
Interest expense	**20,482**	27,036	28,061
Other	**(16,183)**	(8,358)	(3,496)
Total non-operating expenses	**4,299**	18,678	24,565
Income before income taxes	**1,018,932**	890,806	761,783
Income taxes	**370,891**	325,690	286,272
Net income	**$ 648,041**	$ 565,116	$ 475,511
Basic net income per common share	**$ 4.17**	$ 3.61	$ 3.01
Diluted net income per common share	**$ 4.14**	$ 3.58	$ 3.00
Weighted average common shares outstanding	**155,413**	156,656	158,032
Dilutive effect of stock options and nonvested restricted stock awards	**1,007**	1,004	429
Weighted average common shares outstanding assuming dilution	**156,420**	157,660	158,461
Net income	**$ 648,041**	$ 565,116	$ 475,511
Other comprehensive income (loss), net of tax:			
Foreign currency translation adjustment	**23,846**	(22,017)	33,742
Pension and postretirement benefit adjustments, net of income taxes of 2012 $26,465, 2011 $98,973, and 2010 $11,083	**(43,300)**	(161,669)	(22,197)
Other comprehensive income (loss), net of tax	**(19,454)**	(183,686)	11,545
Comprehensive income	**$ 628,587**	$ 381,430	$ 487,056

See accompanying notes.

Genuine Parts Company and Subsidiaries

Consolidated Statements of Equity

(In thousands, except share and per share amounts)

	Common Stock						Non-controlling Interests	
	Shares	Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total Parent Equity	in Subsidiaries	Total Equity
Balance at January 1, 2010	158,917,846	$ 158,918	$	$ (309,897)	$ 2,733,081	$ 2,582,102	$ 8,042	$ 2,590,144
Net income					475,511	475,511		475,511
Other comprehensive income, net of tax				11,545		11,545		11,545
Cash dividends declared, $1.64 per share					(258,912)	(258,912)		(258,912)
Stock options exercised, including tax benefit of $3,251	564,288	564	11,772			12,336		12,336
Share-based compensation			7,016			7,016		7,016
Purchase of stock	(1,845,873)	(1,846)	(18,788)		(54,373)	(75,007)		(75,007)
Noncontrolling interest activities							853	853
Balance at December 31, 2010	157,636,261	157,636		(298,352)	2,895,307	2,754,591	8,895	2,763,486
Net income					565,116	565,116		565,116
Other comprehensive loss, net of tax				(183,686)		(183,686)		(183,686)
Cash dividends declared, $1.80 per share					(281,790)	(281,790)		(281,790)
Stock options exercised, including tax benefit of $5,356	443,170	443	3,864			4,307		4,307
Share-based compensation			7,547			7,547		7,547
Purchase of stock	(2,428,315)	(2,428)	(11,411)		(108,239)	(122,078)		(122,078)
Noncontrolling interest activities							689	689
Balance at December 31, 2011	155,651,116	155,651		(482,038)	3,070,394	2,744,007	9,584	2,753,591
Net income					**648,041**	**648,041**		**648,041**
Other comprehensive loss, net of tax				**(19,454)**		**(19,454)**		**(19,454)**
Cash dividends declared, $1.98 per share					**(307,603)**	**(307,603)**		**(307,603)**
Stock options exercised, including tax benefit of $11,018	**551,779**	**552**	**3,423**			**3,975**		**3,975**
Share-based compensation			**10,747**			**10,747**		**10,747**
Purchase of stock	**(1,361,457)**	**(1,362)**	**(14,170)**		**(66,294)**	**(81,826)**		**(81,826)**
Noncontrolling interest activities							**708**	**708**
Balance at December 31, 2012	**154,841,438**	**$ 154,841**	**$**	**$ (501,492)**	**$ 3,344,538**	**$ 2,997,887**	**$ 10,292**	**$ 3,008,179**

See accompanying notes.

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Genuine Parts Company and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended December 31		
	2012	**2011**	**2010**
		(In thousands)	
Operating activities			
Net income	**$ 648,041**	$ 565,116	$ 475,511
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**98,383**	88,936	89,332
Excess tax benefits from share-based compensation	**(11,018)**	(5,356)	(3,251)
Gain on sale of property, plant, and equipment	**(3,943)**	(3,012)	(1,685)
Deferred income taxes	**14,751**	(2,337)	11,994
Share-based compensation	**10,747**	7,547	7,016
Changes in operating assets and liabilities:			
Trade accounts receivable, net	**13,365**	(85,011)	(140,562)
Merchandise inventories, net	**(25,845)**	(19,624)	44,865
Trade accounts payable	**220,694**	85,766	280,739
Other long-term assets	**(45,248)**	(12,943)	(48,423)
Other, net	**(13,489)**	5,845	(36,873)
	258,397	59,811	203,152
Net cash provided by operating activities	**906,438**	624,927	678,663
Investing activities			
Purchases of property, plant and equipment	**(101,987)**	(103,469)	(85,379)
Proceeds from sale of property, plant, and equipment	**8,504**	8,908	3,676
Acquisition of businesses and other investing activities	**(558,384)**	(136,936)	(90,645)
Net cash used in investing activities	**(651,867)**	(231,497)	(172,348)
Financing activities			
Proceeds from debt	**750,000**	250,000	
Payments on debt	**(750,000)**	(250,000)	
Stock options exercised	**(7,043)**	(1,049)	9,085
Excess tax benefits from share-based compensation	**11,018**	5,356	3,251
Dividends paid	**(300,983)**	(276,369)	(257,898)
Purchase of stock	**(81,826)**	(122,078)	(75,007)
Net cash used in financing activities	**(378,834)**	(394,140)	(320,569)
Effect of exchange rate changes on cash	**2,304**	(4,204)	7,419
Net (decrease) increase in cash and cash equivalents	**(121,959)**	(4,914)	193,165
Cash and cash equivalents at beginning of year	**525,054**	529,968	336,803
Cash and cash equivalents at end of year	**$ 403,095**	$ 525,054	$ 529,968
Supplemental disclosures of cash flow information			
Cash paid during the year for:			
Income taxes	**$ 381,407**	$ 317,748	$ 275,979
Interest	**$ 20,416**	$ 27,640	$ 28,061

See accompanying notes.

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2012

1. Summary of Significant Accounting Policies

Business

Genuine Parts Company and all of its majority-owned subsidiaries (the Company) is a distributor of automotive replacement parts, industrial replacement parts, office products, and electrical/electronic materials. The Company serves a diverse customer base through approximately 2,000 locations in North America and, therefore, has limited exposure from credit losses to any particular customer, region, or industry segment. The Company performs periodic credit evaluations of its customers financial condition and generally does not require collateral. The Company has evaluated subsequent events through the date the financial statements were issued.

Principles of Consolidation

The consolidated financial statements include all of the accounts of the Company. The net income attributable to noncontrolling interests is not material to the Company s consolidated net income. Intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of the consolidated financial statements, in conformity with U.S. generally accepted accounting principles, requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results may differ from those estimates and the differences could be material.

Revenue Recognition

The Company records revenue when the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the Company s price to the customer is fixed and determinable and collectability is reasonably assured. Delivery is not considered to have occurred until the customer assumes the risks and rewards of ownership.

Customer Sales Returns

Subsequent to September 30, 2012, the Company reconsidered its interpretation of the authoritative literature related to accounting for potential sales returns of automotive parts sold by the NAPA distribution businesses in its automotive segment. Upon review, the Company concluded that there was an error in the Company s method of accounting for such potential sales returns. The error is not material to any individual year, but material on a cumulative basis and, therefore, an adjustment to correct the cumulative effect of the error, as calculated at December 31, 2012, has been reflected on the Company s consolidated balance sheets and is summarized below as of December 31, 2011. The consolidated statements of income and comprehensive income for 2012, 2011, and 2010 presented herein have not been adjusted because the impact of the correction of the error is not material to these financial statements.

The effect of the understatement of inventory (included in merchandise inventories, net and other assets) and customer deposits (included in accrued expenses and other long-term liabilities) resulted in an adjustment to the consolidated balance sheet increasing both assets and liabilities with the net result being an immaterial impact on working capital. The impact on retained earnings, net of deferred taxes, is $39,228,000, or less than 2% of consolidated equity as of December 31, 2012 and 2011. Retained earnings as of January 1, 2010 has been adjusted by $39,228,000 on the consolidated statements of equity. The impact on net income was less than $3,000,000, or less than 1% of consolidated net income for each of the years ended December 31, 2012, 2011,

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

and 2010; therefore, the Company recorded the errors arising in these three years as of January 1, 2010. The impact on the consolidated statements of cash flows was considered immaterial for each of the years ended December 31, 2012, 2011, and 2010.

	December 31, 2011		
	As Previously Reported	Adjustment	As Revised
		(In thousands)	
Merchandise inventories, net	$ 2,261,997	$ 178,114	$ 2,440,111
Total current assets	4,576,596	178,114	4,754,710
Deferred tax asset	250,906	10,702	261,608
Other assets	272,110	134,367	406,477
Total assets	$ 5,879,591	$ 323,183	$ 6,202,774
Other accrued expenses	$ 116,921	$ 214,661	$ 331,582
Income taxes payable	35,267	(14,186)	21,081
Total current liabilities	1,812,073	200,475	2,012,548
Other long-term liabilities	280,978	161,936	442,914
Retained earnings	3,109,622	(39,228)	3,070,394
Total parent equity	2,783,235	(39,228)	2,744,007
Total equity	2,792,819	(39,228)	2,753,591
Total liabilities and equity	$ 5,879,591	$ 323,183	$ 6,202,774

Foreign Currency Translation

The consolidated balance sheets and statements of income and comprehensive income of the Company s foreign subsidiaries have been translated into U.S. dollars at the current and average exchange rates, respectively. The foreign currency translation adjustment is included as a component of accumulated other comprehensive loss.

Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of three months or less when purchased to be cash equivalents.

Trade Accounts Receivable and the Allowance for Doubtful Accounts

The Company evaluates the collectability of trade accounts receivable based on a combination of factors. Initially, the Company estimates an allowance for doubtful accounts as a percentage of net sales based on historical bad debt experience. This initial estimate is periodically adjusted when the Company becomes aware of a specific customer s inability to meet its financial obligations (e.g., bankruptcy filing) or as a result of changes in the overall aging of accounts receivable. While the Company has a large customer base that is geographically dispersed, a general economic downturn in any of the industry segments in which the Company operates could result in higher than expected defaults and, therefore, the need to revise estimates for bad debts. For the years ended December 31, 2012, 2011, and 2010, the Company recorded provisions for doubtful accounts of approximately $8,047,000, $13,248,000, and $10,597,000, respectively. At December 31, 2012 and 2011, the allowance for doubtful accounts was approximately $19,180,000 and $16,916,000, respectively.

Merchandise Inventories, Including Consideration Received From Vendors

Merchandise inventories are valued at the lower of cost or market. Cost is determined by the last-in, first-out (LIFO) method for a majority of automotive parts, electrical/electronic materials, and industrial parts, and by the

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

first-in, first-out (FIFO) method for office products and certain other inventories. If the FIFO method had been used for all inventories, cost would have been approximately $428,260,000 and $422,178,000 higher than reported at December 31, 2012 and 2011, respectively. During 2012, 2011, and 2010 reductions in inventory levels in automotive parts inventories (2012), industrial parts inventories, and electrical parts inventories (2012 and 2011) resulted in liquidations of LIFO inventory layers. The effect of the LIFO liquidation in 2012, 2011, and 2010 was to reduce cost of goods sold by approximately $6,000,000, $16,000,000, and $25,000,000, respectively.

The Company identifies slow moving or obsolete inventories and estimates appropriate provisions related thereto. Historically, these losses have not been significant as the vast majority of the Company s inventories are not highly susceptible to obsolescence and are eligible for return under various vendor return programs. While the Company has no reason to believe its inventory return privileges will be discontinued in the future, its risk of loss associated with obsolete or slow moving inventories would increase if such were to occur.

The Company enters into agreements at the beginning of each year with many of its vendors that provide for inventory purchase incentives. Generally, the Company earns inventory purchase incentives upon achieving specified volume purchasing levels or other criteria. The Company accrues for the receipt of these incentives as part of its inventory cost based on cumulative purchases of inventory to date and projected inventory purchases through the end of the year. While management believes the Company will continue to receive consideration from vendors in 2013 and beyond, there can be no assurance that vendors will continue to provide comparable amounts of incentives in the future.

Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist primarily of prepaid expenses and amounts due from vendors.

Goodwill and Other Intangible Assets

The Company reviews its goodwill and indefinite lived intangible assets annually in the fourth quarter, or sooner if circumstances indicate that the carrying amount may exceed fair value. The present value of future cash flows approach was used to determine any potential impairment. The Company determined that these assets were not impaired and, therefore, no impairments were recognized for the years ended December 31, 2012, 2011, or 2010. If an impairment occurs at a future date, it may have the effect of increasing the volatility of the Company s earnings.

Other Assets

Other assets are comprised of the following:

	December 31	
	2012	**2011**
	(In thousands)	
Retirement benefit assets	**$ 4,021**	$ 4,374
Deferred compensation benefits	**20,642**	18,218
Investments	**206,487**	27,810
Cash surrender value of life insurance policies	**78,860**	70,109
Customer sales returns inventories	**134,367**	134,367
Other long-term prepayments and receivables	**198,886**	151,599
Total other assets	**$ 643,263**	$ 406,477

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Depreciation and amortization is primarily determined on a straight-line basis over the following estimated useful life of each asset: buildings and improvements, 10 to 40 years; machinery and equipment, 5 to 15 years.

Long-Lived Assets Other Than Goodwill

The Company assesses its long-lived assets other than goodwill for impairment whenever facts and circumstances indicate that the carrying amount may not be fully recoverable. To analyze recoverability, the Company projects undiscounted net future cash flows over the remaining life of such assets. If these projected cash flows are less than the carrying amount, an impairment would be recognized, resulting in a write-down of assets with a corresponding charge to earnings. Impairment losses, if any, are measured based upon the difference between the carrying amount and the fair value of the assets.

Other Long-Term Liabilities

Other long-term liabilities are comprised of the following:

	December 31	
	2012	2011
	(In thousands)	
Post-employment and other benefit/retirement liabilities	**$ 35,273**	$ 35,797
Insurance liabilities	**45,865**	45,509
Other lease obligations	**33,748**	34,186
Other taxes payable	**57,510**	56,366
Customer deposits	**161,936**	161,936
Other	**153,924**	109,120
Total other long-term liabilities	**$ 488,256**	$ 442,914

Self-Insurance

The Company is self-insured for the majority of group health insurance costs. A reserve for claims incurred but not reported is developed by analyzing historical claims data provided by the Company s claims administrators. These reserves are included in accrued expenses in the accompanying consolidated balance sheets as the expenses are expected to be paid within one year.

Long-term insurance liabilities consist primarily of reserves for the workers compensation program. In addition, the Company carries various large risk deductible workers compensation policies for the majority of workers compensation liabilities. The Company records the workers compensation reserves based on an analysis performed by an independent actuary. The analysis calculates development factors, which are applied to total reserves as provided by the various insurance companies who underwrite the program. While the Company believes that the assumptions used to calculate these liabilities are appropriate, significant differences in actual experience or significant changes in these assumptions may materially affect workers compensation costs.

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss is comprised of the following:

	December 31	
	2012	**2011**
	(In thousands)	
Foreign currency translation	**$ 131,084**	$ 107,238
Unrecognized net actuarial loss, net of tax	**(644,244)**	(617,623)
Unrecognized prior service credit, net of tax	**11,668**	28,347
Total accumulated other comprehensive loss	**$ (501,492)**	$ (482,038)

Fair Value of Financial Instruments

The carrying amounts reflected in the consolidated balance sheets for cash and cash equivalents, trade accounts receivable and trade accounts payable approximate their respective fair values based on the short-term nature of these instruments. At December 31, 2012 and 2011, the fair value of fixed rate debt was approximately $516,000,000 and $509,000,000, respectively. The fair value of fixed rate debt is designated as Level 2 in the fair value hierarchy (i.e., significant observable inputs) and is based primarily on the discounted value of future cash flows using current market interest rates offered for debt of similar credit risk and maturity.

Shipping and Handling Costs

Shipping and handling costs are classified as selling, administrative and other expenses in the accompanying consolidated statements of income and comprehensive income and totaled approximately $220,000,000, $190,000,000, and $180,000,000 for the years ended December 31, 2012, 2011, and 2010, respectively.

Advertising Costs

Advertising costs are expensed as incurred and totaled $43,200,000, $45,100,000, and $36,800,000 in the years ended December 31, 2012, 2011, and 2010, respectively.

Accounting for Legal Costs

The Company s legal costs expected to be incurred in connection with loss contingencies are expensed as such costs are incurred.

Share-Based Compensation

The Company maintains various long-term incentive plans, which provide for the granting of stock options, stock appreciation rights (SARs), restricted stock, restricted stock units (RSUs), performance awards, dividend equivalents and other share-based awards. SARs represent a right to receive upon exercise an amount, payable in shares of common stock, equal to the excess, if any, of the fair market value of the Company s common stock on the date of exercise over the base value of the grant. The terms of such SARs require net settlement in shares of common stock and do not provide for cash settlement. RSUs represent a contingent right to receive one share of the Company s common stock at a future date. The majority of awards previously granted vest on a pro-rata basis for periods ranging from one to five years and are expensed accordingly on a straight-line basis. The Company issues new shares upon exercise or conversion of awards under these plans.

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Net Income per Common Share

Basic net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the year. The computation of diluted net income per common share includes the dilutive effect of stock options, stock appreciation rights and nonvested restricted stock awards options. Options to purchase approximately 730,000, 850,000, and 4,500,000 shares of common stock ranging from $42 $63 per share were outstanding at December 31, 2012, 2011, and 2010, respectively. These options were excluded from the computation of diluted net income per common share because the options exercise price was greater than the average market price of common stock in each respective year.

Recently Adopted Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2011-05, Presentation of Comprehensive Income, which requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate, but consecutive statements for annual periods. Additionally, ASU 2011-05 eliminates the option to present comprehensive income and its components as part of the statement of equity. ASU 2011-05 was effective for the Company s interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-05 only changed the manner of comprehensive income presentation in the consolidated financial statements for the years ended December 31, 2012, 2011, and 2010. The adoption of this ASU had no impact on the Company s reported financial position, cash flows, or results of operations in the consolidated financial statements.

2. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill during the years ended December 31, 2012, 2011, and 2010 by reportable segment, as well as other identifiable intangible assets, are summarized as follows (in thousands):

	Goodwill					
	Automotive	**Industrial**	**Office Products**	**Electrical/ Electronic Materials**	**Other Intangible Assets, Net**	**Total**
Balance as of January 1, 2011	$ 44,271	$ 86,810	$ 10,554	$ 8,647	$ 59,266	$ 209,548
Additions		12,379		15,703	50,128	78,210
Amortization					(6,774)	(6,774)
Foreign currency translation	(566)	(178)			(465)	(1,209)
Balance as of December 31, 2011	43,705	99,011	10,554	24,350	102,155	279,775
Additions	**114,206**			**5,355**	**110,014**	**229,575**
Amortization					**(12,991)**	**(12,991)**
Foreign currency translation	**638**	**221**			**621**	**1,480**
Balance as of December 31, 2012	**$ 158,549**	**$ 99,232**	**$ 10,554**	**$ 29,705**	**$ 199,799**	**$ 497,839**

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

The gross carrying amounts and accumulated amortization relating to other intangible assets at December 31, 2012 and 2011 is as follows (in thousands):

	2012			2011		
	Gross Carrying Amount	**Accumulated Amortization**	**Net**	**Gross Carrying Amount**	**Accumulated Amortization**	**Net**
Customer relationships	**$ 209,328**	**$ (38,030)**	**$ 171,298**	$ 100,921	$ (26,098)	$ 74,823
Trademarks	**29,337**	**(1,944)**	**27,393**	26,996	(1,197)	25,799
Non-competition agreements	**4,483**	**(3,375)**	**1,108**	5,416	(3,883)	1,533
	$ 243,148	**$ (43,349)**	**$ 199,799**	$ 133,333	$ (31,178)	$ 102,155

Amortization expense for other intangible assets totaled $12,991,000, $6,774,000, and $4,737,000 for the years ended December 31, 2012, 2011, and 2010, respectively. Estimated other intangible assets amortization expense for the succeeding five years is as follows (in thousands):

2013	$ 15,500
2014	15,300
2015	15,100
2016	14,600
2017	14,200
	$ 74,700

3. Credit Facilities

There were no amounts subject to variable rates at December 31, 2012 and 2011. The weighted average interest rate on the Company s outstanding borrowings was approximately 4.01% at December 31, 2012 and 2011.

The Company maintains an $850,000,000 unsecured revolving line of credit with a consortium of financial institutions that matures in September 2017 and bears interest at LIBOR plus a margin, which is based on the Company s leverage ratio (0.96% at December 31, 2012). The Company also has the option under this agreement to increase its borrowing an additional $350,000,000, as well as an option to decrease the borrowing capacity or terminate the Syndicated Facility with appropriate notice. No amounts were outstanding under this line of credit at December 31, 2012 and 2011. Certain borrowings require the Company to comply with a financial covenant with respect to a maximum debt-to-capitalization ratio. At December 31, 2012, the Company was in compliance with all such covenants. Due to the workers compensation and insurance reserve requirements in certain states, the Company also had unused letters of credit of $61,119,000 and $53,703,000 outstanding at December 31, 2012 and 2011, respectively.

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Amounts outstanding under the Company s credit facilities consist of the following:

	December 31	
	2012	**2011**
	(In thousands)	
Unsecured term notes:		
November 30, 2008, Series C Senior Unsecured Notes, $250,000,000, 4.67% fixed, due November 30, 2013	**$ 250,000**	$ 250,000
November 30, 2011, Series D and E Senior Unsecured Notes, $250,000,000, 3.35% fixed, due November 30, 2016	**250,000**	250,000
Total debt	**500,000**	500,000
Less debt due within one year	**250,000**	
Long-term debt, excluding current portion	**$ 250,000**	$ 500,000

4. Leased Properties

Future minimum payments, by year and in the aggregate, under the noncancelable operating leases with initial or remaining terms of one year or more was approximately the following at December 31, 2012 (in thousands):

2013	$ 136,900
2014	110,300
2015	84,400
2016	62,800
2017	42,200
Thereafter	153,500
Total minimum lease payments	$ 590,100

Rental expense for operating leases was approximately $158,200,000, $154,500,000, and $147,886,000, for 2012, 2011, and 2010, respectively.

5. Share-Based Compensation

At December 31, 2012, total compensation cost related to nonvested awards not yet recognized was approximately $20,400,000. The weighted-average period over which this compensation cost is expected to be recognized is approximately three years. The aggregate intrinsic value for options and RSUs outstanding at December 31, 2012 and 2011 was approximately $90,300,000 and $110,300,000, respectively. The aggregate intrinsic value for options and RSUs vested totaled approximately $57,600,000 and $77,800,000 at December 31, 2012 and 2011, respectively. At December 31, 2012, the weighted-average contractual life for outstanding and exercisable options and RSUs was six and five years, respectively. Share-based compensation cost of $10,747,000, $7,547,000, and $7,016,000, was recorded for the years ended December 31, 2012, 2011, and 2010, respectively. The total income tax benefit recognized in the consolidated statements of income and comprehensive income for share-based compensation arrangements was approximately $4,300,000, $3,000,000, and $2,800,000, for 2012, 2011, and 2010, respectively. There have been no modifications to valuation methodologies or methods during the years ended December 31, 2012, 2011, and 2010.

For the years ended December 31, 2012, 2011 and 2010 the fair value for options and SARs granted was estimated using a Black-Scholes option pricing model with the following weighted-average assumptions,

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

respectively: risk-free interest rate of 2.0%, 3.6%, and 3.6%; dividend yield of 3.3%, 3.8%, and 4.6%; annual historical volatility factor of the expected market price of the Company s common stock of 19% for each of the three years; an average expected life and estimated turnover based on the historical pattern of existing grants of approximately seven years and 5.0% to 6.0%, respectively. The fair value of RSUs is based on the price of the Company s stock on the date of grant. The total fair value of shares vested during the years ended December 31, 2012, 2011, and 2010, was $6,700,000, $7,200,000, and $9,200,000, respectively.

A summary of the Company s share-based compensation activity and related information is as follows:

	2012	
	Shares (1) (In thousands)	**Weighted-Average Exercise Price (2)**
Outstanding at beginning of year	5,987	$ 45
Granted	1,003	63
Exercised	(1,834)	41
Forfeited	(56)	52
Outstanding at end of year (3)	5,100	$ 50
Exercisable at end of year	2,993	$ 45
Shares available for future grants	2,961	

(1) Shares include *Restricted Stock Units* (RSUs).

(2) The weighted-average exercise price excludes RSUs.

(3) The exercise prices for options and SARs outstanding as of December 31, 2012 ranged from approximately $37 to $63. The weighted-average remaining contractual life of all options and SARs outstanding is approximately six years.

The weighted-average grant date fair value of options and SARs granted during the years 2012, 2011, and 2010 was $7.96, $8.18, and $5.41, respectively. The aggregate intrinsic value of options exercised during the years ended December 31, 2012, 2011, and 2010 was $41,500,000, $25,100,000, and $15,700,000.

In 2012, the Company granted approximately 858,000 SARs and 145,000 RSUs. In 2011, the Company granted approximately 1,028,000 SARs and 126,000 RSUs. In 2010, the Company granted approximately 1,002,000 SARs and 124,000 RSUs.

A summary of the Company s nonvested share awards (RSUs) activity is as follows:

Nonvested Share Awards (RSUs)	Shares (In thousands)	Weighted-Average Grant Date Fair Value
Nonvested at January 1, 2012	222	$ 48
Granted	145	63
Vested	(40)	51
Forfeited	(11)	49
Nonvested at December 31, 2012	316	$ 54

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

For the years ended December 31, 2012, 2011, and 2010 approximately $11,000,000, $5,400,000, and $3,300,000, respectively, of excess tax benefits was classified as a financing cash inflow.

6. Income Taxes

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and amounts used for income tax purposes. Approximately $382,000,000 of undistributed earnings of the Company s foreign subsidiaries is considered to be indefinitely reinvested. As such, no U.S. federal and state income taxes have been provided thereon, and it is not practicable to determine the amount of the related unrecognized deferred income tax liability. Significant components of the Company s deferred tax assets and liabilities are as follows:

	2012	2011
	(In thousands)	
Deferred tax assets related to:		
Expenses not yet deducted for tax purposes	**$ 362,265**	$ 347,605
Pension liability not yet deducted for tax purposes	**405,048**	377,846
Capital loss	**16,803**	16,803
Valuation allowance	**(16,803)**	(16,803)
	767,313	725,451
Deferred tax liabilities related to:		
Employee and retiree benefits	**205,268**	188,206
Inventory	**191,047**	188,063
Property, plant, and equipment	**41,130**	47,413
Other	**51,616**	43,225
	489,061	466,907
Net deferred tax asset	**278,252**	258,544
Current portion of deferred tax liability	**1,211**	3,064
Noncurrent net deferred tax asset	**$ 279,463**	$ 261,608

The current portion of the deferred tax liability is included in income taxes payable in the consolidated balance sheets. The Company has a capital loss carryforward of approximately $42,000,000 that will expire in 2013.

The components of income before income taxes are as follows:

	2012	2011	2010
		(In thousands)	
United States	**$ 903,698**	$ 784,841	$ 693,580
Foreign	**115,234**	105,965	68,203
Income before income taxes	**$ 1,018,932**	$ 890,806	$ 761,783

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

The components of income tax expense are as follows:

	2012	2011	2010
		(In thousands)	
Current:			
Federal	**$ 288,135**	$ 260,222	$ 221,770
State	**44,653**	41,511	36,291
Foreign	**23,352**	26,294	16,217
Deferred	**14,751**	(2,337)	11,994
	$ 370,891	$ 325,690	$ 286,272

The reasons for the difference between total tax expense and the amount computed by applying the statutory Federal income tax rate to income before income taxes are as follows:

	2012	2011	2010
		(In thousands)	
Statutory rate applied to income	**$ 356,626**	$ 311,782	$ 266,624
Plus state income taxes, net of Federal tax benefit	**30,227**	26,790	24,621
Other	**(15,962)**	(12,882)	(4,973)
	$ 370,891	$ 325,690	$ 286,272

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, various states, and foreign jurisdictions. With few exceptions, the Company is no longer subject to federal, state and local tax examinations by tax authorities for years before 2008 or subject to non-United States income tax examinations for years ended prior to 2002. The Company is currently under audit in the United States and Canada. Some audits may conclude in the next twelve months and the unrecognized tax benefits recorded in relation to the audits may differ from actual settlement amounts. It is not possible to estimate the effect, if any, of the amount of such change during the next twelve months to previously recorded uncertain tax positions in connection with the audits. However, the Company does not anticipate total unrecognized tax benefits will significantly change during the year due to the settlement of audits and the expiration of statutes of limitations.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	2012	2011	2010
		(In thousands)	
Balance at beginning of year	**$ 46,845**	$ 39,425	$ 33,322
Additions based on tax positions related to the current year	**5,702**	6,035	4,243
Additions for tax positions of prior years	**2,172**	7,966	3,493
Reductions for tax positions for prior years	**(5,025)**	(481)	(624)
Reduction for lapse in statute of limitations	**(2,658)**	(4,563)	(451)
Settlements	**(1,581)**	(1,537)	(558)
Balance at end of year	**$ 45,455**	$ 46,845	$ 39,425

The amount of gross tax effected unrecognized tax benefits, including interest and penalties, as of December 31, 2012 and 2011 was approximately $58,020,000 and $59,532,000, respectively, of which approximately $17,615,000 and $18,966,000, respectively, if recognized, would affect the effective tax rate. During the years ended December 31, 2012, 2011, and 2010, the Company paid interest and penalties of approximately

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

$493,000, $759,000, and $272,000, respectively. The Company had approximately $12,565,000 and $12,687,000 of accrued interest and penalties at December 31, 2012 and 2011, respectively. The Company recognizes potential interest and penalties related to unrecognized tax benefits as a component of income tax expense.

7. Employee Benefit Plans

The Company s defined benefit pension plans cover employees in the U.S. and Canada who meet eligibility requirements. The plan covering U.S. employees is noncontributory and benefits are based on the employees compensation during the highest five of their last ten years of credited service. The Canadian plan is contributory and benefits are based on career average compensation. The Company s funding policy is to contribute an amount equal to the minimum required contribution under applicable pension legislation. The Company may increase its contribution above the minimum if appropriate to its tax and cash position and the plans funded position.

In December 2012, the U.S. defined benefit plan was amended to reflect a hard freeze as of December 31, 2013. Therefore, no further benefit accruals will be provided after that date for additional credited service or earnings. In addition, all participants will become fully vested as of December 31, 2013. The Company recorded a one-time noncash curtailment gain of $23,507,000 in connection with this amendment.

The Company also sponsors supplemental retirement plans covering employees in the U.S. and Canada and other postretirement benefit plans in the U.S. The Company uses a measurement date of December 31 for its pension and other postretirement benefit plans.

	Pension Benefits		**Other Postretirement Benefits**	
	2012	**2011**	**2012**	**2011**
		(In thousands)		
Changes in benefit obligation				
Benefit obligation at beginning of year	**$ 1,958,399**	$ 1,689,011	**$ 7,514**	$ 12,329
Service cost	**15,254**	13,039		
Interest cost	**100,338**	97,293	**267**	474
Plan participants contributions	**3,962**	3,887	**3,074**	3,412
Plan amendments	**(4,217)**			362
Actuarial loss (gain)	**330,028**	219,804	**(370)**	(3,911)
Exchange rate changes	**5,489**	(4,656)		
Gross benefits paid	**(67,767)**	(59,979)	**(5,112)**	(5,326)
Less Federal subsidy	**N/A**	N/A	**105**	174
Curtailments	**(175,794)**			
Benefit obligation at end of year	**$ 2,165,692**	$ 1,958,399	**$ 5,478**	$ 7,514

The benefit obligations for the Company s U.S. pension plans included in the above were $1,955,414,000 and $1,775,994,000 at December 31, 2012 and 2011, respectively. The total accumulated benefit obligation for the Company s defined benefit pension plans was approximately $2,112,134,000 and $1,756,546,000 at December 31, 2012 and 2011, respectively.

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

The assumptions used to measure the pension and other postretirement plan benefit obligations for the plans at December 31, 2012 and 2011, were:

	Pension Benefits		Other Postretirement Benefits	
	2012	**2011**	**2012**	**2011**
Weighted-average discount rate	**4.17%**	5.17%	**3.05%**	4.00%
Rate of increase in future compensation levels	**3.30%**	3.30%		

A 7.60% annual rate of increase in the per capita cost of covered health care benefits was assumed on December 31, 2012. The rate was assumed to decrease ratably to 4.80% at December 31, 2019, and thereafter.

	Pension Benefits		Other Postretirement Benefits	
	2012	**2011**	**2012**	**2011**
	(In thousands)			
Changes in plan assets				
Fair value of plan assets at beginning of year	**$ 1,470,030**	$ 1,439,711	**$**	$
Actual return on plan assets	**168,491**	31,528		
Exchange rate changes	**4,498**	(3,598)		
Employer contributions	**16,465**	58,481	**2,038**	1,914
Plan participants contributions	**3,962**	3,887	**3,074**	3,412
Benefits paid	**(67,767)**	(59,979)	**(5,112)**	(5,326)
Fair value of plan assets at end of year	**$ 1,595,679**	$ 1,470,030	**$**	$

The fair values of plan assets for the Company s U.S. pension plans included in the above were $1,425,047,000 and $1,320,036,000 at December 31, 2012 and 2011, respectively.

The asset allocations for the Company s funded pension plans at December 31, 2012 and 2011, and the target allocation for 2013, by asset category were:

	Target Allocation	Percentage of Plan Assets at December 31	
	2013	**2012**	**2011**
Asset Category			
Equity securities	**71%**	68%	69%
Debt securities	**29%**	32%	31%
	100%	100%	100%

The Company s benefit plan committees in the U.S. and Canada establish investment policies and strategies and regularly monitor the performance of the funds. The pension plan strategy implemented by the Company s management is to achieve long-term objectives and invest the pension assets in accordance with the applicable pension legislation in the U.S. and Canada, as well as fiduciary standards. The long-term primary objectives for the pension plans are to provide for a reasonable amount of long-term growth of capital, without undue exposure to risk,

protect the assets from erosion of purchasing power, and provide investment results that meet or exceed the pension plans actuarially assumed long-term rates of return. The Company s investment strategy with respect to pension plan assets is to generate a return in excess of the passive portfolio benchmark (49% S&P 500

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Index, 5% Russell Mid Cap Index, 8% Russell 2000 Index, 5% MSCI EAFE Index, 5% DJ Global Moderate Index, and 28% BarCap U.S. Govt/Credit).

The fair values of the plan assets as of December 31, 2012 and 2011, by asset category, are shown in the tables below. Various inputs are considered when determining the value of the Company s pension plan assets. The inputs or methodologies used for valuing securities are not necessarily an indication of the risk associated with investing in these securities. Level 1 represents observable market inputs that are unadjusted quoted prices for identical assets or liabilities in active markets. Level 2 represents other significant observable inputs (including quoted prices for similar securities, interest rates, credit risk, etc.). Level 3 represents significant unobservable inputs (including the Company s own assumptions in determining the fair value of investments).

The valuation methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date. Equity securities are valued at the closing price reported on the active market on which the individual securities are traded on the last day of the calendar plan year. Debt securities including corporate bonds, U.S. Government securities, and asset-backed securities are valued using price evaluations reflecting the bid and/or ask sides of the market for an investment as of the last day of the calendar plan year.

	2012			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In thousands)			
Equity Securities				
Common stocks mutual funds equity	$ 342,846	$ 342,846	$	$
Genuine Parts Company	128,236	128,236		
Other stocks	608,017	608,017		
Debt Securities				
Short-term investments	37,626	37,626		
Cash and equivalents	45,719	45,719		
Government bonds	166,413	74,707	91,706	
Corporate bonds	127,824		127,824	
Asset-backed and mortgage-backed securities	24,077		24,077	
Other-international	10,188	10,188		
Municipal bonds	532		532	
Municipal funds-fixed income	101,578		101,578	
Cash surrender value of life insurance policies	2,623			2,623
Total	$ 1,595,679	$ 1,247,339	$ 345,717	$ 2,623

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

	2011			
	Total	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
	(In thousands)			
Equity Securities				
Common stocks mutual funds equity	$ 348,909	$ 348,909	$	$
Genuine Parts Company	123,436	123,436		
Other stocks	546,995	546,995		
Debt Securities				
Short-term investments	38,968	38,968		
Cash and equivalents	16,888	16,888		
Government bonds	145,966	66,334	79,632	
Corporate bonds	127,698		127,698	
Asset-backed and mortgage-backed securities	21,441		21,441	
Other-international	12,084	12,084		
Municipal bonds	593		593	
Mutual funds-fixed income	87,052		87,052	
Total	$ 1,470,030	$ 1,153,614	$ 316,416	$

Equity securities include Genuine Parts Company common stock in the amounts of $128,236,000 (8.0% of total plan assets) and $123,436,000 (8.4% of total plan assets) at December 31, 2012 and 2011, respectively. Dividend payments received by the plan on Company stock totaled approximately $3,994,000 and $3,630,000 in 2012 and 2011, respectively. Fees paid during the year for services rendered by parties in interest were based on customary and reasonable rates for such services.

The changes in the fair value measurement of plan assets using significant unobservable inputs (Level 3) during 2012 and the 2011 changes were not material.

Based on the investment policy for the pension plans, as well as an asset study that was performed based on the Company s asset allocations and future expectations, the Company s expected rate of return on plan assets for measuring 2013 pension cost or income is 7.83% for the plans. The asset study forecasted expected rates of return for the approximate duration of the Company s benefit obligations, using capital market data and historical relationships.

The following table sets forth the funded status of the plans and the amounts recognized in the consolidated balance sheets at December 31:

Amounts recognized in the consolidated balance sheets consist of:

	Pension Benefits		**Other Postretirement Benefits**	
	2012	**2011**	**2012**	**2011**
	(In thousands)			
Other long-term asset	**$ 4,021**	$ 4,374	**$**	$
Other current liability	**(5,402)**	(4,918)	**(1,122)**	(1,618)
Pension and other post-retirement liabilities	**(568,632)**	(487,825)	**(4,356)**	(5,896)
	$ (570,013)	$ (488,369)	**$ (5,478)**	$ (7,514)

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Amounts recognized in accumulated other comprehensive loss consist of:

	Pension Benefits		Other Postretirement Benefits	
	2012	**2011**	**2012**	**2011**
	(In thousands)			
Net actuarial loss	**$ 1,043,089**	$ 999,189	**$ 12,963**	$ 14,588
Prior service credit	**(10,612)**	(37,172)	**(8,515)**	(9,445)
	$ 1,032,477	$ 962,017	**$ 4,448**	$ 5,143

For the pension benefits, the following table reflects the total benefits expected to be paid from the plans or the Company s assets. Of the pension benefits expected to be paid in 2013, approximately $5,471,000 is expected to be paid from employer assets. For pension benefits, expected employer contributions reflect amounts expected to be contributed to funded plans. For other postretirement benefits, the employer contributions in the table below reflect only the Company s share of the benefit cost. Information about the expected cash flows for the pension plans and other postretirement benefit plans follows:

	Pension Benefits	Other Postretirement Benefits
	(In thousands)	
Employer contribution		
2013 (expected)	$ 70,099	$ 1,122
Expected benefit payments		
2013	$ 76,390	$ 1,122
2014	86,670	965
2015	91,697	824
2016	97,333	644
2017	103,708	451
2018 through 2022	612,723	1,232

Net periodic benefit cost included the following components:

	Pension Benefits			Other Postretirement Benefits		
	2012	**2011**	**2010**	**2012**	**2011**	**2010**
	(In thousands)					
Service cost	**$ 15,254**	$ 13,039	$ 12,312	**$**	$	$
Interest cost	**100,338**	97,293	95,453	**267**	474	605
Expected return on plan assets	**(128,208)**	(124,150)	(114,166)			
Amortization of prior service credit	**(7,270)**	(6,970)	(6,979)	**(930)**	(930)	(1,059)
Amortization of actuarial loss	**70,161**	53,039	35,264	**1,254**	1,708	1,759
Curtailment gain	**(23,507)**					
Net periodic benefit cost	**$ 26,768**	$ 32,251	$ 21,884	**$ 591**	$ 1,252	$ 1,305

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Other changes in plan assets and benefit obligations recognized in other comprehensive income (loss) are as follows:

	Pension Benefits			Other Postretirement Benefits		
	2012	**2011**	**2010**	**2012**	**2011**	**2010**
	(In thousands)					
Current year actuarial loss (gain)	**$ 114,061**	$ 311,038	$ 60,777	**$ (371)**	$ (3,911)	$ 340
Recognition of actuarial loss	**(70,161)**	(53,039)	(35,264)	**(1,254)**	(1,708)	(1,759)
Current year prior service (credit) cost	**(4,217)**		1,148		362	
Recognition of prior service credit	**30,777**	6,970	6,979	**930**	930	1,059
Total recognized in other comprehensive income (loss)	**$ 70,460**	$ 264,969	$ 33,640	**$ (695)**	$ (4,327)	$ (360)
Total recognized in net periodic benefit cost and other comprehensive income (loss)	**$ 97,228**	$ 297,220	$ 55,524	**$ (104)**	$ (3,075)	$ 945

The estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic benefit cost in 2013 are as follows:

	Pension Benefits	Other Post-retirement Benefits
	(In thousands)	
Actuarial loss	$ 84,572	$ 1,124
Prior service credit	(7,598)	(956)
Total	$ 76,974	$ 168

The assumptions used in measuring the net periodic benefit costs for the plans follow:

	Pension Benefits			Other Postretirement Benefits		
	2012	**2011**	**2010**	**2012**	**2011**	**2010**
Weighted average discount rate	**5.17%**	5.74%	6.54%	**4.00%**	4.25%	5.20%
Rate of increase in future compensation levels	**3.30%**	3.39%	3.75%			
Expected long-term rate of return on plan assets	**7.84%**	7.87%	8.00%			

An 8.00% annual rate of increase in the per capita cost of covered health care benefits was assumed on December 31, 2011. The rate was assumed to decrease ratably to 4.80% at December 31, 2019, and thereafter. The effect of a one-percentage-point change in the assumed health care cost trend rate is not significant.

The Company has two defined contribution plans that cover substantially all of its domestic employees. The Company s matching contributions are determined based on the employee s participation in the U.S. pension plan. Pension plan participants who continue earning credited service after 2008 receive a matching contribution of 20% of the first 6% of the employee s salary. Other employees receive a matching contribution of 100% of the first 5% of the employee s salary. In December 2012, the Company approved an amendment to merge the two plans effective January 1, 2014. Beginning in 2014, all employees will receive a matching contribution of 100% of the first 5% of the employees salary. Total plan expense for both plans was approximately $43,155,000 in 2012, $38,773,000 in 2011, and $33,476,000 in 2010.

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

8. Guarantees

The Company guarantees the borrowings of certain independently controlled automotive parts stores (independents) and certain other affiliates in which the Company has a noncontrolling equity ownership interest (affiliates). Presently, the independents are generally consolidated by unaffiliated enterprises that have a controlling financial interest through ownership of a majority voting interest in the entity. The Company has no voting interest or other equity conversion rights in any of the independents. The Company does not control the independents or the affiliates, but receives a fee for the guarantee. The Company has concluded that the independents are variable interest entities, but that the Company is not the primary beneficiary. Specifically, the equity holders of the independents have the power to direct the activities that most significantly impact the entity s economic performance including, but not limited to, decisions about hiring and terminating personnel, local marketing and promotional initiatives, pricing and selling activities, credit decisions, monitoring and maintaining appropriate inventories, and store hours. Separately, the Company concluded the affiliates are not variable interest entities. The Company s maximum exposure to loss as a result of its involvement with these independents and affiliates is generally equal to the total borrowings subject to the Company s guarantee. While such borrowings of the independents and affiliates are outstanding, the Company is required to maintain compliance with certain covenants, including a maximum debt to capitalization ratio and certain limitations on additional borrowings. At December 31, 2012, the Company was in compliance with all such covenants.

At December 31, 2012, the total borrowings of the independents and affiliates subject to guarantee by the Company were approximately $231,500,000. These loans generally mature over periods from one to six years. In the event that the Company is required to make payments in connection with guaranteed obligations of the independents or the affiliates, the Company would obtain and liquidate certain collateral (e.g., accounts receivable and inventory) to recover all or a portion of the amounts paid under the guarantee. When it is deemed probable that the Company will incur a loss in connection with a guarantee, a liability is recorded equal to this estimated loss. To date, the Company has had no significant losses in connection with guarantees of independents and affiliates borrowings.

The Company has accrued for guarantees related to the independents and affiliates borrowings as of December 31, 2012 and 2011. These liabilities are not material to the financial position of the Company and are included in other long-term liabilities in the accompanying consolidated balance sheets.

9. Acquisitions

On May 1, 2012 the Company acquired Quaker City Motor Parts Co. (Quaker City) for $343,000,000, net of cash acquired. Quaker City, headquartered in Middleton, Delaware, is a long-standing NAPA distributor with annual revenues of approximately $300,000,000. Quaker City serves approximately 270 auto parts stores, of which approximately 140 are company-owned. The Company funded the acquisition with cash on hand and short-term borrowings under credit facilities.

During 2011, the Company acquired three companies in the Industrial Group and one company in the Electrical/Electronic Materials Group for approximately $115,600,000. During 2010, the Company acquired four companies in the Industrial and Electrical/Electronic Materials Groups for approximately $90,645,000.

The Company allocated the purchase price to the assets acquired and the liabilities assumed based on their fair values as of their respective acquisition dates. The results of operations for the acquired companies were included in the Company s consolidated statements of income and comprehensive income beginning on their respective acquisition dates. The Company recorded approximately $230,000,000, $78,210,000, and $40,247,000 of goodwill and other intangible assets associated with the 2012, 2011, and 2010 acquisitions, respectively. The Company is in the process of analyzing the estimated values of assets and liabilities acquired as of the acquisition

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

date for the Quaker City acquisition and is obtaining third-party valuations of certain tangible and intangible assets. The acquisition accounting is therefore preliminary and subject to revision.

For the 2012 acquisitions, other intangible assets acquired consisted of customer relationships of $108,000,000 and trademarks of $2,000,000, with weighted average amortization lives of 15 and 40 years, respectively. For the 2011 acquisitions, other intangible assets acquired consisted of customer relationships of $37,378,000, trademarks of $12,100,000, and non-competition agreements of $650,000, with weighted average amortization lives of 15, 40, and 5 years, respectively. For the 2010 acquisitions, other intangible assets acquired consisted of customer relationships of $16,688,000, trademarks of $7,104,000, and non-competition agreements of $500,000, with weighted average amortization lives of 14, 40, and 5 years, respectively.

10. Equity Investment

Effective January 1, 2012, the Company acquired a 30% investment in the Exego Group for approximately $165,600,000. The acquisition was funded with the Company s cash on hand. The Exego Group, which is headquartered in Melbourne, Australia, is a leading aftermarket distributor of automotive replacement parts and accessories in Australasia, with annual revenues of approximately $1,000,000,000 and a company-owned store footprint of more than 430 locations across Australia and New Zealand. The Company has an option to acquire the remaining 70% of Exego at a later date contingent upon Exego achieving certain earnings thresholds. The Company has accounted for the 30% investment under the equity method of accounting.

11. Segment Data

The Company s reportable segments consist of automotive, industrial, office products, and electrical/electronic materials. Within the reportable segments, certain of the Company s operating segments are aggregated since they have similar economic characteristics, products and services, type and class of customers, and distribution methods.

The Company s automotive segment distributes replacement parts (other than body parts) for substantially all makes and models of automobiles, trucks, and other vehicles.

The Company s industrial segment distributes a wide variety of industrial bearings, mechanical and fluid power transmission equipment, including hydraulic and pneumatic products, material handling components, and related parts and supplies.

The Company s office products segment distributes a wide variety of office products, computer supplies, office furniture, and business electronics.

The Company s electrical/electronic materials segment distributes a wide variety of electrical/electronic materials, including insulating and conductive materials for use in electronic and electrical apparatus.

Inter-segment sales are not significant. Operating profit for each industry segment is calculated as net sales less operating expenses excluding general corporate expenses, interest expense, equity in income from investees, amortization, and noncontrolling interests. Approximately $115,200,000, $106,000,000 and $68,200,000 of income before income taxes was generated in jurisdictions outside the United States for the years ended December 31, 2012, 2011, and 2010, respectively. Net sales and net long-lived assets by country relate directly to the Company s operations in the respective country. Corporate assets are principally cash and cash equivalents and headquarters facilities and equipment.

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

For management purposes, net sales by segment exclude the effect of certain discounts, incentives, and freight billed to customers. The line item other represents the net effect of the discounts, incentives, and freight billed to customers that are reported as a component of net sales in the Company s consolidated statements of income and comprehensive income.

	2012	2011	2010	2009	2008
			(In thousands)		
Net sales:					
Automotive	**$ 6,320,882**	$ 6,061,424	$ 5,608,101	$ 5,225,389	$ 5,321,536
Industrial	**4,453,574**	4,173,574	3,521,863	2,885,782	3,514,661
Office products	**1,686,690**	1,689,368	1,641,963	1,639,018	1,732,514
Electrical/electronic materials	**582,820**	557,537	449,770	345,808	465,889
Other	**(30,098)**	(23,026)	(14,108)	(38,485)	(19,337)
Total net sales	**$ 13,013,868**	$ 12,458,877	$ 11,207,589	$ 10,057,512	$ 11,015,263
Operating profit:					
Automotive	**$ 540,678**	$ 467,806	$ 421,109	$ 387,945	$ 385,356
Industrial	**352,119**	337,628	255,616	162,353	294,652
Office products	**134,441**	134,124	131,746	126,104	144,127
Electrical/electronic materials	**50,910**	40,663	30,910	25,254	36,721
Total operating profit	**1,078,148**	980,221	839,381	701,656	860,856
Interest expense, net	**(19,619)**	(24,608)	(26,598)	(27,112)	(29,847)
Corporate expense	**(25,668)**	(56,971)	(45,451)	(24,913)	(55,119)
Intangible asset amortization	**(12,991)**	(6,774)	(4,737)	(3,644)	(2,861)
Other expense	**(938)**	(1,062)	(812)	(1,822)	(4,561)
Income before income taxes	**$ 1,018,932**	$ 890,806	$ 761,783	$ 644,165	$ 768,468
Assets:					
Automotive	**$ 3,411,252**	$ 3,218,931	$ 3,177,644	$ 3,148,876	$ 3,123,084
Industrial	**1,130,877**	1,100,024	955,241	865,431	1,025,292
Office products	**731,564**	700,720	694,166	619,612	638,854
Electrical/electronic materials	**137,237**	129,933	113,757	76,716	95,655
Corporate	**898,292**	773,391	637,871	445,705	67,823
Goodwill and other intangible assets	**497,839**	279,775	209,548	171,532	158,825
Total assets	**$ 6,807,061**	$ 6,202,774	$ 5,788,227	$ 5,327,872	$ 5,109,533

Genuine Parts Company and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

	2012	2011	2010	2009	2008
			(In thousands)		
Depreciation and amortization:					
Automotive	**$ 60,630**	$ 60,252	$ 63,942	$ 65,554	$ 65,309
Industrial	**8,307**	7,495	7,208	7,611	7,632
Office products	**10,837**	9,999	9,737	9,685	9,825
Electrical/electronic materials	**1,733**	1,554	1,414	1,666	1,572
Corporate	**3,885**	2,862	2,294	2,251	1,499
Intangible asset amortization	**12,991**	6,774	4,737	3,644	2,861
Total depreciation and amortization	**$ 98,383**	$ 88,936	$ 89,332	$ 90,411	$ 88,698
Capital expenditures:					
Automotive	**$ 67,482**	$ 61,795	$ 46,888	$ 53,911	$ 72,628
Industrial	**13,015**	9,851	4,307	2,987	7,575
Office products	**16,013**	22,036	29,866	5,782	9,539
Electrical/electronic materials	**1,029**	1,762	1,957	676	1,406
Corporate	**4,448**	8,025	2,361	6,089	13,878
Total capital expenditures	**$ 101,987**	$ 103,469	$ 85,379	$ 69,445	$ 105,026
Net sales:					
United States	**$ 11,299,291**	$ 10,791,303	$ 9,793,820	$ 8,935,651	$ 9,716,029
Canada	**1,616,921**	1,571,733	1,327,552	1,078,799	1,219,759
Mexico	**127,754**	118,867	100,325	81,547	98,812
Other	**(30,098)**	(23,026)	(14,108)	(38,485)	(19,337)
Total net sales	**$ 13,013,868**	$ 12,458,877	$ 11,207,589	$ 10,057,512	$ 11,015,263
Net long-lived assets:					
United States	**$ 466,473**	$ 411,193	$ 398,318	$ 402,937	$ 352,314
Canada	**93,496**	84,210	80,978	78,502	67,731
Mexico	**6,396**	4,801	4,834	3,585	3,220
Total net long-lived assets	**$ 566,365**	$ 500,204	$ 484,130	$ 485,024	$ 423,265

Annual Report on Form 10-K

Item 15(a)

Financial Statement Schedule II Valuation and Qualifying Accounts

Genuine Parts Company and Subsidiaries

	Balance at Beginning of Period	Charged to Costs and Expenses	Deductions	Balance at End of Period
Year ended December 31, 2010:				
Reserves and allowances deducted from asset accounts:				
Allowance for doubtful accounts	$ 16,589,779	$ 10,597,432	$ (11,588,299)(1)	$ 15,598,912
Year ended December 31, 2011:				
Reserves and allowances deducted from asset accounts:				
Allowance for doubtful accounts	$ 15,598,912	$ 13,247,731	$ (11,930,188)(1)	$ 16,916,455
Year ended December 31, 2012:				
Reserves and allowances deducted from asset accounts:				
Allowance for doubtful accounts	$ 16,916,455	$ 8,046,605	$ (5,782,870)(1)	$ 19,180,190

(1) Doubtful accounts written off, net of recoveries.

ANNUAL REPORT ON FORM 10-K

INDEX OF EXHIBITS

The following exhibits are filed (or furnished, if so indicated) herewith as a part of this Report:

10.27*	Amendment No. 2 to the Genuine Parts Company Director s Deferred Compensation Plan, dated December 7, 2012, effective December 7, 2012.
10.28*	Amendment No. 8 to the Genuine Parts Company Tax-Deferred Savings Plan, dated December 7, 2012, effective December 7, 2012.
10.29*	Amendment No. 3 to the Genuine Parts Company Supplemental Retirement Plan, as amended and restated January 1, 2009, dated December 7, 2012, effective December 31, 2013.
10.30*	Form of Amendment to the Amended and Restated Change in Control Agreement.
10.31*	Genuine Parts Company Stock Appreciation Rights Agreement.
21	Subsidiaries of the Company.
23	Consent of Independent Registered Public Accounting Firm.
31.1	Certification signed by the Chief Executive Officer pursuant to SEC Rule 13a-14(a).
31.2	Certification signed by the Chief Financial Officer pursuant to SEC Rule 13a-14(a).
32.1	Statement of Chief Executive Officer of Genuine Parts Company pursuant to 18 U.S.C. Section 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
32.2	Statement of Chief Financial Officer of Genuine Parts Company pursuant to 18 U.S.C. Section 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
101	Interactive data files pursuant to Rule 405 of Regulation S-T.

The following exhibits are incorporated by reference as set forth in Item 15 of this Form 10-K:

3.1	Amended and Restated Articles of Incorporation of the Company, amended April 23, 2007.
3.2	By-Laws of the Company as amended and restated August 20, 2007.
4.2	Specimen Common Stock Certificate.

Instruments with respect to long-term debt where the total amount of securities authorized there under does not exceed 10% of the total assets of the Registrant and its subsidiaries on a consolidated basis have not been filed. The Registrant agrees to furnish to the Commission a copy of each such instrument upon request.

10.1*	The Genuine Parts Company Restated Tax-Deferred Savings Plan, effective January 1, 1993.
10.2*	Amendment No. 1 to the Genuine Parts Company Tax-Deferred Savings Plan, dated June 1, 1996, effective June 1, 1996.
10.3*	Genuine Parts Company Death Benefit Plan, effective July 15, 1997.
10.4*	Amendment No. 2 to the Genuine Parts Company Tax-Deferred Savings Plan, dated April 19, 1999, effective April 19, 1999.
10.5*	The Genuine Parts Company Original Deferred Compensation Plan, as amended and restated as of August 19, 1996.
10.6*	Amendment to the Genuine Parts Company Original Deferred Compensation Plan, dated April 19, 1999, effective April 19, 1999.
10.7*	Amendment No. 3 to the Genuine Parts Company Tax-Deferred Savings Plan, dated November 28, 2001, effective July 1, 2001.
10.8*	Genuine Parts Company 1999 Long-Term Incentive Plan, as amended and restated as of November 19, 2001.

10.9*	Amendment No. 4 to the Genuine Parts Company Tax-Deferred Savings Plan, dated June 5, 2003, effective June 5, 2003.
10.10*	Genuine Parts Company Directors Deferred Compensation Plan, as amended and restated effective January 1, 2003, and executed November 11, 2003.
10.11*	Amendment No. 5 to the Genuine Parts Company Tax-Deferred Savings Plan.
10.12*	Amendment No. 2 to the Genuine Parts Company Death Benefit Plan.
10.13*	Genuine Parts Company 2006 Long-Term Incentive Plan, effective April 17, 2006.
10.14*	Amendment to the Genuine Parts Company 2006 Long-Term Incentive Plan, dated November 20, 2006, effective November 20, 2006.
10.15*	Amendment No. 1 to the Genuine Parts Company Directors Deferred Compensation Plan, dated November 19, 2007, effective January 1, 2008.
10.16*	Amendment No. 6 to the Genuine Parts Company Tax-Deferred Savings Plan, dated November 28, 2007, effective January 1, 2008.
10.17*	Amendment No. 2 to the Genuine Parts Company 2006 Long-Term Incentive Plan, dated November 19, 2007, effective November 19, 2007.
10.18*	Genuine Parts Company Performance Restricted Stock Unit Award Agreement.
10.19*	Genuine Parts Company Restricted Stock Unit Award Agreement.
10.20*	Form of Amended and Restated Change in Control Agreement.
10.21*	Genuine Parts Company Supplemental Retirement Plan, as amended and restated as of January 1, 2009.
10.22*	Genuine Parts Company 2009 Annual Incentive Bonus Plan, dated March 31, 2009, effective January 1, 2009.
10.23*	Amendment No. 1 to the Genuine Parts Company Supplemental Retirement Plan, as amended and restated as of January 1, 2009, dated August 16, 2010, effective August 16, 2010.
10.24*	Amendment No. 2 to the Genuine Parts Company Supplemental Retirement Plan, as amended and restated January 1, 2009, dated November 16, 2010, effective January 1, 2011.
10.25*	Amendment No. 7 to the Genuine Parts Company Tax-Deferred Savings Plan, dated November 16, 2010, effective January 1, 2011.
10.26*	Description of Director Compensation.

* Indicates management contracts and compensatory plans and arrangements.