

CHUBB CORP  
Form 10-K  
March 15, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

**FORM 10-K**

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005  
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 No. 1-8661

**The Chubb Corporation**

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

**New Jersey**  
*(State or other jurisdiction of incorporation or organization)*

**13-2595722**  
*(I.R.S. Employer Identification No.)*

**15 Mountain View Road, P.O. Box 1615**  
**Warren, New Jersey**  
*(Address of principal executive offices)*

**07061-1615**  
*(Zip Code)*

**(908) 903-2000**

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

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

*(Title of each class)*

Common Stock, par value \$1 per share  
Series B Participating Cumulative  
Preferred Stock Purchase Rights  
Common Stock Purchase Contracts<sup>1</sup>  
2.25% Senior Notes due 2008<sup>1</sup>

*(Name of each exchange on which registered)*

New York Stock Exchange  
New York Stock Exchange  
New York Stock Exchange  
New York Stock Exchange

<sup>1</sup> Offered together in the form of 7% Equity Units.

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

None  
*(Title of class)*

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

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

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The aggregate market value of common stock held by non-affiliates of the registrant was \$16,942,712,627 as of June 30, 2005, computed on the basis of the closing sale price of the common stock on that date.

207,408,188

*Number of shares of common stock outstanding as of February 28, 2006*

### Documents Incorporated by Reference

Portions of the definitive Proxy Statement for the 2006 Annual Meeting of Shareholders are incorporated by reference in Part III of this Form 10-K.

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**PART I.**

**Item 1. Business**

**General**

The Chubb Corporation (Chubb) was incorporated as a business corporation under the laws of the State of New Jersey in June 1967. Chubb and its subsidiaries are referred to collectively as the Corporation. Chubb is a holding company for a family of property and casualty insurance companies known informally as the Chubb Group of Insurance Companies (the P&C Group). Since 1882, the P&C Group has provided property and casualty insurance to businesses and individuals around the world. According to A.M. Best, the P&C Group is the 10th largest U.S. property and casualty insurance group based on 2004 net written premiums.

At December 31, 2005, the Corporation had total assets of \$48.1 billion and shareholders' equity of \$12.4 billion. Revenues, income before income tax and assets for each operating segment for the three years ended December 31, 2005 are included in Note (14) of the Notes to Consolidated Financial Statements. The Corporation employed approximately 10,800 persons worldwide on December 31, 2005.

The Corporation's principal executive offices are located at 15 Mountain View Road, Warren, New Jersey 07059, and our telephone number is (908) 903-2000.

The Corporation's internet address is [www.chubb.com](http://www.chubb.com). The Corporation's 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 Securities Exchange Act of 1934 are available free of charge on this website as soon as reasonably practicable after they have been electronically filed with or furnished to the Securities and Exchange Commission. Chubb's Corporate Governance Guidelines, charters of certain key committees of its Board of Directors, Restated Certificate of Incorporation, By-Laws, Code of Business Conduct and Code of Ethics for CEO and Senior Financial Officers are also available on the Corporation's website or by writing to the Corporation's Corporate Secretary.

**Property and Casualty Insurance**

The P&C Group is divided into four strategic business units. Chubb Commercial Insurance offers a full range of commercial customer insurance products, including coverage for multiple peril, casualty, workers' compensation and property and marine. Chubb Commercial Insurance is known for writing niche business, where our expertise can add value for our agents, brokers and policyholders. Chubb Specialty Insurance offers a wide variety of specialized professional liability products for privately and publicly owned companies, financial institutions, professional firms and healthcare organizations. Chubb Specialty Insurance also includes our surety business. Chubb Personal Insurance offers products for individuals with fine homes and possessions who require more coverage choices and higher limits than standard insurance policies. Reinsurance Assumed includes the business produced by Chubb Re. In December 2005, the Corporation transferred its ongoing reinsurance assumed business to Harbor Point Limited. For a further discussion of this transaction, see the Property and Casualty Insurance - Transfer of Ongoing Reinsurance Assumed Business section of Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A).

The P&C Group provides insurance coverages principally in the United States, Canada, Europe, Australia, and parts of Latin America and Asia. Revenues of the P&C Group by geographic area for the three years ended December 31, 2005 are included in Note (14) of the Notes to Consolidated Financial Statements.

The principal members of the P&C Group are Federal Insurance Company (Federal), Pacific Indemnity Company (Pacific Indemnity), Vigilant Insurance Company (Vigilant), Great Northern Insurance Company (Great Northern), Chubb Custom Insurance Company (Chubb Custom), Chubb National Insurance Company (Chubb National), Chubb Indemnity Insurance Company (Chubb Indemnity), Chubb Insurance Company of New Jersey (Chubb New Jersey), Texas Pacific Indemnity Company, Northwestern Pacific Indemnity Company, Executive Risk Indemnity Inc. (Executive Risk

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Indemnity), Executive Risk Specialty Insurance Company (Executive Risk Specialty) and Quadrant Indemnity Company (Quadrant) in the United States, as well as Chubb Atlantic Indemnity Ltd. (a Bermuda company), Chubb Insurance Company of Canada, Chubb Insurance Company of Europe, S.A., Chubb Insurance Company of Australia Limited, Chubb Argentina de Seguros, S.A. and Chubb do Brasil Companhia de Seguros.

Federal is the manager of Vigilant, Pacific Indemnity, Great Northern, Chubb National, Chubb Indemnity, Chubb New Jersey, Executive Risk Indemnity, Executive Risk Specialty and Quadrant. Federal also provides certain services to other members of the P&C Group. Acting subject to the supervision and control of the boards of directors of the members of the P&C Group, Federal provides day to day executive management and operating personnel and makes available the economy and flexibility inherent in the common operation of a group of insurance companies.

### *Premiums Written*

A summary of the P&C Group's premiums written during the past three years is shown in the following table:

Year	Direct Premiums Written	Reinsurance Premiums Assumed(a)	Reinsurance Premiums Ceded(a)	Net Premiums Written
(in millions)				
2003	\$ 11,337.7	\$ 1,266.0	\$ 1,535.8	\$ 11,067.9
2004	12,001.3	1,397.7	1,346.1	12,052.9
2005	12,179.6	1,119.7	1,016.7	12,282.6

(a) Intercompany items eliminated.

The net premiums written during the last three years for major classes of the P&C Group's business are included in the Property and Casualty Insurance Underwriting Results section of MD&A.

One or more members of the P&C Group are licensed and transact business in each of the 50 states of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, Canada, Europe, Australia, and parts of Latin America and Asia. In 2005, approximately 80% of the P&C Group's direct business was produced in the United States, where the P&C Group's businesses enjoy broad geographic distribution with a particularly strong market presence in the Northeast. The four states accounting for the largest amounts of direct premiums written were New York with 12%, California with 10%, Texas with 5% and New Jersey with 5%. No other state accounted for 5% of such premiums. Approximately 11% of the P&C Group's direct premiums written was produced in Europe and 4% was produced in Canada.

### *Underwriting Results*

A frequently used industry measurement of property and casualty insurance underwriting results is the combined loss and expense ratio. The P&C Group uses the combined loss and expense ratio calculated in accordance with statutory accounting principles. This ratio is the sum of the ratio of losses and loss expenses to premiums earned (loss ratio) plus the ratio of statutory underwriting expenses to premiums written (expense ratio) after reducing both premium amounts by dividends to policyholders. When the combined ratio is under 100%, underwriting results are generally considered profitable; when the combined ratio is over 100%, underwriting results are generally considered unprofitable. Investment income is not reflected in the combined ratio. The profitability of property and casualty insurance companies depends on the results of both underwriting operations and investments.

The combined loss and expense ratios during the last three years in total and for the major classes of the P&C Group's business are included in the Property and Casualty Insurance Underwriting Operations section of MD&A.

Another frequently used measurement in the property and casualty insurance industry is the ratio of statutory net premiums written to policyholders surplus. At December 31, 2005 and 2004, the ratio for the P&C Group was 1.37 and 1.53, respectively.

#### *Producing and Servicing of Business*

The P&C Group does not utilize a significant in-house distribution model for its products. Instead, in the United States and Canada, the P&C Group is represented by approximately 5,000 independent agencies and accepts business on a regular basis from approximately 1,000 insurance brokers. In most instances, these agencies and brokers also represent other companies that compete with the P&C Group. The P&C Group's branch and service offices assist these agencies and brokers in producing and servicing the P&C Group's business. In addition to the administrative offices in Warren and Whitehouse Station, New Jersey, the P&C Group has zone, branch and service offices throughout the United States and Canada.

The P&C Group's overseas business is developed by its foreign agencies and brokers through local branch offices of the P&C Group and by its United States and Canadian agencies and brokers. In conducting its overseas business, the P&C Group reduces the risks relating to currency fluctuations by maintaining investments in those foreign currencies in which the P&C Group has loss reserves and other liabilities. Such investments generally have characteristics similar to liabilities in those currencies. The net asset or liability exposure to the various foreign currencies is regularly reviewed.

Business for the P&C Group is also produced through participation in certain underwriting pools and syndicates. Such pools and syndicates provide underwriting capacity for risks which an individual insurer cannot prudently underwrite because of the magnitude of the risk assumed or which can be more effectively handled by one organization due to the need for specialized loss control and other services.

#### *Reinsurance Ceded*

In accordance with the normal practice of the insurance industry, the P&C Group cedes reinsurance to other insurance companies. Reinsurance is ceded to provide greater diversification of risk and to limit the P&C Group's maximum net loss arising from large risks or from catastrophic events.

A large portion of the P&C Group's ceded reinsurance is effected under contracts known as treaties under which all risks meeting prescribed criteria are automatically covered. Most of the P&C Group's treaty reinsurance arrangements consist of excess of loss and catastrophe contracts that protect against a specified part or all of certain types of losses over stipulated amounts arising from any one occurrence or event. In certain circumstances, reinsurance is also effected by negotiation on individual risks. The amount of each risk retained by the P&C Group is subject to maximum limits that vary by line of business and type of coverage. Retention limits are regularly reviewed and are revised periodically as the P&C Group's capacity to underwrite risks changes. For a discussion of the cost and availability of reinsurance, see the Property and Casualty Insurance Underwriting Results section of MD&A.

Ceded reinsurance contracts do not relieve the P&C Group of the primary obligation to its policyholders. Thus, an exposure exists with respect to reinsurance recoverable to the extent that any reinsurer is unable or unwilling to meet the obligations assumed under the reinsurance contracts. The collectibility of reinsurance is subject to the solvency of the reinsurers, coverage interpretations and other factors. The P&C Group is selective in regard to its reinsurers, placing reinsurance with only

those reinsurers with strong balance sheets and superior underwriting ability. The P&C Group monitors the financial strength of its reinsurers on an ongoing basis.

*Unpaid Losses and Loss Adjustment Expenses and Related Amounts Recoverable from Reinsurers*

Insurance companies are required to establish a liability in their accounts for the ultimate costs (including loss adjustment expenses) of claims that have been reported but not settled and of claims that have been incurred but not reported. Insurance companies are also required to report as assets the portion of such liability that will be recovered from reinsurers.

The process of establishing the liability for unpaid losses and loss adjustment expenses is complex and imprecise as it must take into consideration many variables that are subject to the outcome of future events. As a result, informed subjective estimates and judgments as to our ultimate exposure to losses are an integral component of our loss reserving process.

The P&C Group's estimates of losses for reported claims are established judgmentally on an individual case basis. Such estimates are based on the P&C Group's particular experience with the type of risk involved and its knowledge of the circumstances surrounding each individual claim. These estimates are reviewed on a regular basis or as additional facts become known. The reliability of the estimation process is monitored through comparison with ultimate settlements.

The P&C Group's estimates of losses for unreported claims are principally derived from analyses of historical patterns of the development of paid and reported losses by accident year for each class of business. This process relies on the basic assumption that past experience, adjusted for the effects of current developments and likely trends, is an appropriate basis for predicting future outcomes. For certain classes of business where anticipated loss experience is less predictable because of the small number of claims and/or erratic claim severity patterns, estimates are based on both expected losses and actual reported losses. Salvage and subrogation estimates are developed from patterns of actual recoveries.

The P&C Group's estimates of unpaid loss adjustment expenses are based on analyses of the relationship of projected ultimate loss adjustment expenses to projected ultimate losses for each class of business. The claim staff has discretion to override these expense estimates on reported claims where judgment indicates such action is appropriate.

The P&C Group's estimates of reinsurance recoverable related to reported and unreported losses and loss adjustment expenses represent the portion of the gross liabilities that will be recovered from reinsurers. Amounts recoverable from reinsurers are estimated in a manner consistent with the gross losses associated with the reinsured policies.

Estimates are regularly reviewed and updated as appropriate. Any changes in estimates are reflected in operating results in the period in which the estimates are changed.

The anticipated effect of inflation is implicitly considered when estimating liabilities for unpaid losses and loss adjustment expenses. Estimates of the ultimate value of all unpaid losses are based in part on the development of paid losses, which reflect actual inflation. Inflation is also reflected in the case estimates established on reported open claims which, when combined with paid losses, form another basis to derive estimates of reserves for all unpaid losses. There is no precise method for subsequently evaluating the adequacy of the consideration given to inflation, since claim settlements are affected by many factors.

Additional information related to the P&C Group's estimates related to unpaid losses and loss adjustment expenses and the uncertainties in the estimation process is presented in the Property and Casualty Insurance Loss Reserves section of MD&A.

The P&C Group continues to emphasize early and accurate reserving, inventory management of claims and suits, and control of the dollar value of settlements. The number of outstanding claims at



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year-end 2005 was approximately 3% higher than the number at year-end 2004. This compares with a 1% increase in new arising claims during 2005.

The table on page 8 presents the subsequent development of the estimated year-end liability for unpaid losses and loss adjustment expenses, net of reinsurance recoverable, for the ten years prior to 2005. The Corporation acquired Executive Risk Inc. in 1999. The amounts in the table for the years 1995 through 1998 do not include Executive Risk's unpaid losses and loss adjustment expenses.

The top line of the table shows the estimated net liability for unpaid losses and loss adjustment expenses recorded at the balance sheet date for each of the indicated years. This liability represents the estimated amount of losses and loss adjustment expenses for claims arising in all years prior to the balance sheet date that were unpaid at the balance sheet date, including losses that had been incurred but not yet reported to the P&C Group.

The upper section of the table shows the reestimated amount of the previously recorded net liability based on experience as of the end of each succeeding year. The estimate is increased or decreased as more information becomes known about the frequency and severity of losses for each individual year. The increase or decrease is reflected in operating results of the period in which the estimate is changed. The cumulative deficiency (redundancy) as shown in the table represents the aggregate change in the reserve estimates from the original balance sheet dates through December 31, 2005. The amounts noted are cumulative in nature; that is, an increase in a loss estimate that is related to a prior period occurrence generates a deficiency in each intermediate year. For example, a deficiency recognized in 2005 relating to losses incurred prior to December 31, 1995 would be included in the cumulative deficiency amount for each year in the period 1995 through 2004. Yet, the deficiency would be reflected in operating results only in 2005. The effect of changes in estimates of the liabilities for losses occurring in prior years on income before income taxes in each of the past three years is shown in the reconciliation of the beginning and ending liability for unpaid losses and loss adjustment expenses in the Property and Casualty Insurance Loss Reserves section of MD&A.

The subsequent development of the net liability for unpaid losses and loss adjustment expenses as of year-ends 1995 through 2004 was adversely affected by substantial unfavorable development related to asbestos and toxic waste claims. The cumulative net deficiencies experienced related to asbestos and toxic waste claims were the result of: (1) an increase in the actual number of claims filed; (2) an increase in the number of potential claims estimated; (3) an increase in the severity of actual and potential claims; (4) an increasingly adverse litigation environment; and (5) an increase in litigation costs associated with such claims. In the years 1995 through 1999, the unfavorable development related to asbestos and toxic waste claims was offset in varying degrees by favorable loss experience for certain professional liability coverages, particularly directors and officers liability and fiduciary liability, and for commercial excess liability. In the years 2000 through 2003, in addition to the unfavorable development related to asbestos and toxic waste claims, there was significant unfavorable development in the professional liability classes, principally directors and officers liability and errors and omissions liability, due in large part to adverse loss trends related to corporate failures and allegations of management misconduct and accounting irregularities.

Conditions and trends that have affected development of the liability for unpaid losses and loss adjustment expenses in the past will not necessarily recur in the future. Accordingly, it is not appropriate to extrapolate future redundancies or deficiencies based on the data in this table.

The middle section of the table on page 8 shows the cumulative amount paid with respect to the reestimated net liability as of the end of each succeeding year. For example, in the 1995 column, as of December 31, 2005 the P&C Group had paid \$5,916.0 million of the currently estimated \$7,597.4 million of net losses and loss adjustment expenses that were unpaid at the end of 1995; thus, an estimated \$1,681.4 million of net losses incurred through 1995 remain unpaid as of December 31, 2005, approximately 65% of which relates to asbestos and toxic waste claims.

## ANALYSIS OF LOSS AND LOSS ADJUSTMENT EXPENSE DEVELOPMENT

December 31

Year Ended	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
	(in millions)										
Net Liability for Unpaid Losses and Loss Adjustment Expenses	\$ 7,614.5	\$ 7,755.9	\$ 8,564.6	\$ 9,049.9	\$ 9,748.8	\$ 10,051.3	\$ 11,009.7	\$ 12,641.6	\$ 14,521.2	\$ 16,808.7	\$ 18,712.5
Net Liability Reestimated as of:											
One year later	7,571.7	7,690.6	8,346.2	8,854.8	9,518.8	9,855.8	11,799.4	13,038.9	14,848.1	16,971.4	
Two years later	7,520.9	7,419.6	7,899.8	8,516.5	9,094.5	10,550.7	12,143.3	13,633.6	15,314.9		
Three years later	7,256.8	6,986.2	7,564.8	8,058.0	9,652.9	10,761.5	12,642.2	14,407.2			
Four years later	6,901.5	6,719.4	7,145.0	8,527.1	9,739.7	11,149.9	13,245.8				
Five years later	6,692.1	6,409.4	7,570.7	8,655.7	9,998.7	11,605.0					
Six years later	6,476.7	6,886.9	7,693.7	8,844.3	10,373.2						
Seven years later	7,035.9	7,051.5	7,821.8	9,118.9							
Eight years later	7,253.8	7,197.0	8,060.9								
Nine years later	7,422.9	7,411.4									
Ten years later	7,597.4										
Total Cumulative Net Deficiency (Redundancy)	(17.1)	(344.5)	(503.7)	69.0	624.4	1,553.7	2,236.1	1,765.6	793.7	162.7	
Cumulative Net Deficiency Related to Asbestos and Toxic Waste Claims (Included in Above Total)	1,583.5	1,432.8	1,307.6	1,239.8	1,193.0	1,162.0	1,101.1	360.0	110.0	35.0	
Cumulative Amount of Net Liability Paid as of:											
One year later	1,889.4	1,418.3	1,797.7	2,520.1	2,482.7	2,793.7	3,084.5	3,398.8	3,342.0	4,031.3	
Two years later	2,678.2	2,488.2	3,444.2	3,707.8	4,079.3	4,668.7	5,354.1	5,671.4	6,094.8		
Three years later	3,438.8	3,757.0	4,160.6	4,653.1	5,285.8	5,981.4	6,931.6	7,753.3			
	4,457.6	4,194.8	4,710.9	5,351.1	6,138.9	7,011.9	8,389.8				

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Four years later											
Five years later	4,755.4	4,555.6	5,132.9	5,894.3	6,829.0	7,894.2					
Six years later	5,010.6	4,857.2	5,481.1	6,325.5	7,382.1						
Seven years later	5,251.0	5,137.4	5,806.6	6,679.7							
Eight years later	5,480.9	5,420.3	6,059.6								
Nine years later	5,735.4	5,640.9									
Ten years later	5,916.0										
Gross Liability, End of Year	\$9,588.2	\$9,523.7	\$9,772.5	\$10,356.5	\$11,434.7	\$11,904.6	\$15,514.9	\$16,713.1	\$17,947.8	\$20,291.9	\$22,481.7
Reinsurance Recoverable, End of Year	1,973.7	1,767.8	1,207.9	1,306.6	1,685.9	1,853.3	4,505.2	4,071.5	3,426.6	3,483.2	3,769.2
Net Liability, End of Year	\$7,614.5	\$7,755.9	\$8,564.6	\$9,049.9	\$9,748.8	\$10,051.3	\$11,009.7	\$12,641.6	\$14,521.2	\$16,808.7	\$18,712.5
Reestimated Gross Liability	\$9,718.1	\$9,232.9	\$9,337.7	\$10,596.8	\$12,653.1	\$14,329.6	\$18,670.1	\$19,109.7	\$18,997.0	\$20,360.3	
Reestimated Reinsurance Recoverable	2,120.7	1,821.5	1,276.8	1,477.9	2,279.9	2,724.6	5,424.3	4,702.5	3,682.1	3,388.9	
Reestimated Net Liability	\$7,597.4	\$7,411.4	\$8,060.9	\$9,118.9	\$10,373.2	\$11,605.0	\$13,245.8	\$14,407.2	\$15,314.9	\$16,971.4	
Cumulative Gross Deficiency (Redundancy)	\$129.9	\$(290.8)	\$(434.8)	\$240.3	\$1,218.4	\$2,425.0	\$3,155.2	\$2,396.6	\$1,049.2	\$68.4	

The amounts for the years 1995 through 1998 do not include Executive Risk's unpaid losses and loss adjustment expenses. Executive Risk was acquired in 1999.

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The lower section of the table on page 8 shows the gross liability, reinsurance recoverable and net liability recorded at the balance sheet date for each of the indicated years and the reestimation of these amounts as of December 31, 2005.

The liability for unpaid losses and loss adjustment expenses, net of reinsurance recoverable, reported in the accompanying consolidated financial statements prepared in accordance with generally accepted accounting principles (GAAP) comprises the liabilities of U.S. and foreign members of the P&C Group as follows:

	<b>December 31</b>	
	<b>2005</b>	<b>2004</b>
	<b>(in millions)</b>	
U.S. subsidiaries	\$ 15,928.0	\$ 14,244.0
Foreign subsidiaries	2,784.5	2,564.7
	\$ 18,712.5	\$ 16,808.7

Members of the P&C Group are required to file annual statements with insurance regulatory authorities prepared on an accounting basis prescribed or permitted by such authorities (statutory basis). The difference between the liability for unpaid losses and loss expenses reported in the statutory basis financial statements of the U.S. members of the P&C Group and such liability reported on a GAAP basis in the consolidated financial statements is not significant.

### *Investments*

Investment decisions are centrally managed by investment professionals based on guidelines established by management and approved by the respective boards of directors for each company in the P&C Group.

Additional information about the Corporation's investment portfolio as well as its approach to managing risks is presented in the Invested Assets section of MD&A, the Investment Portfolio section of Quantitative and Qualitative Disclosures About Market Risk and Note (3) of the Notes to Consolidated Financial Statements.

The investment results of the P&C Group for each of the past three years are shown in the following table.

<b>Year</b>	<b>Average Invested Assets(a)</b>	<b>Investment Income(b)</b>	<b>Percent Earned</b>	
			<b>Before Tax</b>	<b>After Tax</b>
	<b>(in millions)</b>			
2003	\$ 22,168.5	\$ 1,058.4	4.77%	3.80%
2004	26,778.2	1,184.3	4.42	3.55
2005	30,570.3	1,315.3	4.30	3.45

(a) Average of amounts for the years presented with fixed maturity securities at amortized cost and equity securities at market value.

(b) Investment income after deduction of investment expenses, but before applicable income tax.

### **Competition**

The property and casualty insurance industry is highly competitive both as to price and service. Members of the P&C Group compete not only with other stock companies but also with mutual companies, other underwriting organizations and alternative risk sharing mechanisms.

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Some competitors obtain their business at a lower cost through the use of salaried personnel rather than independent agents and brokers. Rates are not uniform for all insurers and vary according to the types of insurers, product coverage and methods of operation. The P&C Group competes for business not only on the basis of price, but also on the basis of financial strength, availability of coverage desired by customers and quality of service, including claim adjustment service. The P&C Group's products and services are generally designed to serve specific customer groups or needs and to offer a degree of customization

that is of value to the insured. The P&C Group continues to work closely with its customers and to reinforce with them the stability, expertise and added value the P&C Group provides.

There are approximately 3,100 property and casualty insurance companies in the United States operating independently or in groups and no single company or group is dominant. The relatively large size and underwriting capacity of the P&C Group provide opportunities not available to smaller companies.

### **Regulation and Premium Rates**

Chubb is a holding company with subsidiaries primarily engaged in the property and casualty insurance business and is therefore subject to regulation by certain states as an insurance holding company. All states have enacted legislation that regulates insurance holding company systems such as the Corporation. This legislation generally provides that each insurance company in the system is required to register with the department of insurance of its state of domicile and furnish information concerning the operations of companies within the holding company system that may materially affect the operations, management or financial condition of the insurers within the system. All transactions within a holding company system affecting insurers must be fair and equitable. Notice to the insurance commissioners is required prior to the consummation of transactions affecting the ownership or control of an insurer and of certain material transactions between an insurer and any person in its holding company system and, in addition, certain of such transactions cannot be consummated without the commissioners' prior approval.

Companies within the P&C Group are subject to regulation and supervision in the respective states in which they do business. In general, such regulation is designed to protect the interests of policyholders, and not necessarily the interests of insurers, their shareholders and other investors. The extent of such regulation varies but generally has its source in statutes that delegate regulatory, supervisory and administrative powers to a department of insurance. The regulation, supervision and administration relate, among other things, to: the standards of solvency that must be met and maintained; the licensing of insurers and their agents; restrictions on insurance policy terminations; unfair trade practices; the nature of and limitations on investments; premium rates; restrictions on the size of risks that may be insured under a single policy; deposits of securities for the benefit of policyholders; approval of policy forms; periodic examinations of the affairs of insurance companies; annual and other reports required to be filed on the financial condition of companies or for other purposes; limitations on dividends to policyholders and shareholders; and the adequacy of provisions for unearned premiums, unpaid losses and loss adjustment expenses, both reported and unreported, and other liabilities.

The extent of insurance regulation on business outside the United States varies significantly among the countries in which the P&C Group operates. Some countries have minimal regulatory requirements, while others regulate insurers extensively. Foreign insurers in many countries are subject to greater restrictions than domestic competitors. In certain countries, the P&C Group has incorporated insurance subsidiaries locally to improve its competitive position.

The National Association of Insurance Commissioners (NAIC) has a risk-based capital requirement for property and casualty insurance companies. The risk-based capital formula is used by state regulatory authorities to identify insurance companies that may be undercapitalized and that merit further regulatory attention. The formula prescribes a series of risk measurements to determine a minimum capital amount for an insurance company, based on the profile of the individual company. The ratio of a company's actual policyholders' surplus to its minimum capital requirement will determine whether any state regulatory action is required. At December 31, 2005, each member of the P&C Group had more than sufficient capital to meet the risk-based capital requirement. The NAIC periodically reviews the risk-based capital formula and changes to the formula could be considered in the future.

Regulatory requirements applying to premium rates vary from state to state, but generally provide that rates not be excessive, inadequate or unfairly discriminatory. In many states, these regulatory

requirements can impact the P&C Group's ability to change rates, particularly with respect to personal lines products such as automobile and homeowners insurance, without prior regulatory approval even where the current rates are inadequate to the assumed risk. However, in certain states, prior regulatory approval of rates is not required for most lines of insurance that the P&C Group underwrites.

Subject to regulatory requirements, the P&C Group's management determines the prices charged for its policies based on a variety of factors including loss and loss adjustment expense experience, inflation, anticipated changes in the legal environment, both judicial and legislative, and tax law and rate changes. Methods for arriving at prices vary by type of business, exposure assumed and size of risk. Underwriting profitability is affected by the accuracy of these assumptions, by the willingness of insurance regulators to approve changes in those rates that they control and by such other matters as underwriting selectivity and expense control.

In all states, insurers authorized to transact certain classes of property and casualty insurance are required to become members of an insolvency fund. In the event of the insolvency of a licensed insurer writing a class of insurance covered by the fund in the state, companies in the P&C Group, together with the other fund members, are assessed in order to provide the funds necessary to pay certain claims against the insolvent insurer. Generally, fund assessments are proportionately based on the members' written premiums for the classes of insurance written by the insolvent insurer. In certain states, the P&C Group can recover a portion of these assessments through premium tax offsets and policyholder surcharges. In 2005, assessments of the members of the P&C Group amounted to \$10 million. The amount of future assessments cannot be reasonably estimated.

Insurance regulation in certain states requires the companies in the P&C Group, together with other insurers operating in the state, to participate in assigned risk plans, reinsurance facilities and joint underwriting associations, which are mechanisms that generally provide applicants with various basic insurance coverages when they are not available in voluntary markets. Such mechanisms are most prevalent for automobile and workers' compensation insurance, but a majority of states also mandate that insurers, such as the P&C Group, participate in Fair Plans or Windstorm Plans, which offer basic property coverages to insureds where not otherwise available. Some states also require insurers to participate in facilities that provide homeowners, crime and other classes of insurance where periodic market constrictions may occur. Participation is based upon the amount of a company's voluntary written premiums in a particular state for the classes of insurance involved. These involuntary market plans generally are underpriced and produce unprofitable underwriting results.

In several states, insurers, including members of the P&C Group, participate in market assistance plans. Typically, a market assistance plan is voluntary, of limited duration and operates under the supervision of the insurance commissioner to provide assistance to applicants unable to obtain commercial and personal liability and property insurance. The assistance may range from identifying sources where coverage may be obtained to pooling of risks among the participating insurers.

Although the federal government and its regulatory agencies generally do not directly regulate the business of insurance, federal initiatives often have an impact on the business in a variety of ways. Current and proposed federal measures that may significantly affect the P&C Group's business and the market as a whole include federal terrorism insurance, asbestos liability reform measures, tort reform, corporate governance including the increasing focus on public companies and public accounting firms, ergonomics, health care reform including the containment of medical costs, medical malpractice reform and patients' rights, privacy, e-commerce, international trade, federal regulation of insurance companies and the taxation of insurance companies.

Companies in the P&C Group are also affected by a variety of state and federal legislative and regulatory measures as well as by decisions of their courts that define and extend the risks and benefits for which insurance is provided. These include: redefinitions of risk exposure in areas such as water damage, including mold; products liability and commercial general liability; extension and protection of employee benefits, including workers' compensation and disability benefits; and credit scoring.

Another area of potential regulation and supervision of the P&C Group relates to the form of compensation paid to agents and brokers and the disclosure of such compensation. Several state Attorneys General and other regulatory agencies have entered into settlement agreements with a number of large insurance producers and at least one major property and casualty insurance carrier. Among other things, these settlements prohibit those parties from accepting or paying, as applicable, compensation in the form of contingent commissions for some or all lines of business. In addition, a number of states have announced that they are looking at compensation arrangements and considering regulatory action or reform in this area. The rules that would be imposed if these actions or reforms were adopted range in nature from disclosure requirements to prohibition of certain forms of compensation to imposition of new duties on insurance agents, brokers and/or carriers in dealing with customers. A small number of states have enacted compensation disclosure rules; however, in the majority of states, these proposals are still being developed. The Corporation cannot predict the potential impact of the foregoing on its business. For additional information see the Property and Casualty Insurance Regulatory Developments section of MD&A.

Legislative and judicial developments pertaining to asbestos and toxic waste exposures are discussed in the Property and Casualty Insurance Loss Reserves section of MD&A.

### **Real Estate**

The Corporation's wholly owned subsidiary, Bellemead Development Corporation (Bellemead), and its subsidiaries are involved in commercial development activities primarily in New Jersey and residential development activities primarily in central Florida. Additional information related to the Corporation's real estate operations is included in the Corporate and Other Real Estate section of MD&A.

### **Chubb Financial Solutions**

Chubb Financial Solutions (CFS) was organized in 2000 to develop and provide customized risk-financing services through both the capital and insurance markets. CFS's non-insurance business was primarily structured credit derivatives, principally as a counterparty in portfolio credit default swaps. In the second quarter of 2003, the Corporation implemented a plan to exit the credit derivatives business and is running off the financial products portfolio of CFS. Additional information related to CFS's operations is presented in the Chubb Financial Solutions section of MD&A.

### **Item 1A. Risk Factors**

The Corporation's business is subject to a number of risks, including those described below, that could have a material effect on the Corporation's results of operations, financial condition or liquidity and that could cause our operating results to vary significantly from period to period. References to we, us and our appearing in this Form 10-K under this heading should be read to refer to the Corporation.

#### **If our property and casualty loss reserves are insufficient, our results could be adversely affected.**

The process of establishing loss reserves is complex and imprecise as it must take into consideration many variables that are subject to the outcome of future events. As a result, informed subjective estimates and judgments as to our ultimate exposure to losses are an integral component of our loss reserving process. Variations between our loss reserve estimates and the actual emergence of losses could be material and could have a material adverse effect on our results of operations.

A further discussion of the risk factors related to our property and casualty loss reserves is presented in the Property and Casualty Insurance-Loss Reserves section of MD&A.



**The effects of emerging claim and coverage issues on our business are uncertain.**

We price and establish the terms and conditions of policies based upon an intended scope of policy coverage. However, as industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the number or size of claims. In some instances, these changes may not become apparent until some time after we have issued the insurance policies that are affected by the changes. As a result, the full extent of liability under our insurance policies may not be known for many years after the policies are issued. Emerging claim and coverage issues could have an adverse effect on our results of operations and financial condition.

**Catastrophe losses could materially reduce our profitability.**

As a property and casualty insurance holding company, our insurance operations expose us to claims arising out of catastrophes. Catastrophes can be caused by various natural perils, including hurricanes and other windstorms, earthquakes, winter storms and brush fires. Catastrophes can also be man-made, such as a terrorist attack. The frequency and severity of catastrophes are inherently unpredictable. It is possible that both the frequency and severity of natural and man-made catastrophic events will increase.

The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Most catastrophes are restricted to relatively small geographic areas; however, hurricanes and earthquakes may produce significant damage in larger areas, especially those that are heavily populated. Claims resulting from natural or man-made catastrophic events could cause substantial volatility in our financial results for any fiscal quarter or year and could materially reduce our profitability or harm our financial condition. Our ability to write new business could also be affected. We believe that increases in the value and geographic concentration of insured property and the effects of inflation could increase the severity of claims from catastrophic events in the future. In addition, states have from time to time passed legislation that has the effect of limiting the ability of insurers to manage catastrophe risk, such as legislation prohibiting insurers from withdrawing from catastrophe-exposed areas.

The occurrence of terrorist attacks in the geographic areas we serve could result in substantially higher claims under our insurance policies than we have anticipated. Private sector catastrophe reinsurance for terrorism losses is generally unavailable, especially for acts of terrorism involving nuclear, biological, chemical or radiological weapons. In addition, the continued threat of terrorism also could generally result in increased reinsurance prices and potentially cause us to retain more risk than we otherwise would retain if we were able to obtain reinsurance at lower prices. Terrorist attacks also could disrupt our operations centers in the U.S. or abroad. As a result, it is possible that any, or a combination of all, of these factors could have a material adverse effect on our business, results of operations, financial condition or liquidity.

A further discussion on the risk factors related to catastrophes is presented in the Property and Casualty Insurance Catastrophe Risk Management section of MD&A.

**The failure of the risk mitigation strategies we utilize could have a material adverse effect on our financial condition or results of operations.**

We utilize a number of strategies to mitigate our risk exposure, such as:

engaging in vigorous underwriting;

carefully evaluating terms and conditions of our policies;

focusing on our risk aggregations by geographic zones, industry type, credit exposure and other bases; and

ceding reinsurance.

However, there are inherent limitations in all of these tactics and no assurance can be given that an event or series of unanticipated events will not result in loss levels in excess of our probable maximum loss models, which could have a material adverse effect on our financial condition or results of operations.

**The availability of reinsurance coverage and our inability to collect amounts due from reinsurers could have a material adverse effect on our financial condition or results of operations.**

The availability and cost of reinsurance are subject to prevailing market conditions. In recent years, for certain coverages, we have elected not to renew reinsurance treaties that we believed were no longer economical. We have also increased the amount of the risk we retain in many of the treaties that we have renewed. Accordingly, our net exposure to liability has increased, which, in turn, could have a material adverse effect on our financial condition or results of operations.

With respect to reinsurance coverages we have purchased, our ability to recover amounts due from reinsurers may be affected by the creditworthiness and willingness to pay of the reinsurers from whom we have purchased coverage. The inability or unwillingness of any of our reinsurers to meet their obligations to us could have a material adverse effect on our results of operations.

**Cyclicality of the property and casualty insurance industry may cause fluctuations in our results.**

The property and casualty insurance business historically has been cyclical, experiencing periods characterized by intense price competition, relatively low premium rates and less restrictive underwriting standards followed by periods of relatively low levels of competition, high premium rates and more selective underwriting standards. We expect this cyclicality to continue. The periods of intense price competition in the cycle could adversely affect our financial condition, profitability or cash flows.

A number of factors, including many that are volatile and unpredictable, can have a significant impact on cyclical trends in the property and casualty insurance industry and the industry's profitability. These factors include:

an apparent trend of courts to grant increasingly larger awards for certain damages;

catastrophic hurricanes, windstorms, earthquakes and other natural disasters, as well as the occurrence of man-made disasters (e.g., a terrorist attack);

availability, price and terms of reinsurance;

fluctuations in interest rates;

changes in the investment environment that affect market prices of and income and returns on investments; and

inflationary pressures that may tend to affect the size of losses experienced by insurance companies.

We cannot predict whether or when market conditions will improve, remain constant or deteriorate. Negative market conditions may impair our ability to write insurance at rates that we consider appropriate relative to the risk assumed. If we cannot write insurance at appropriate rates, our ability to transact business would be materially and adversely affected.

**A downgrade in our ratings could adversely impact the competitive positions of our operating businesses.**

Ratings can be an important factor in establishing our competitive position in the insurance markets. There can be no assurance that our ratings will continue for any given period of time or that they will not be changed. If our credit ratings were downgraded in the future, we could incur higher borrowing costs and may have more limited means to access capital. In addition, a downgrade in our

financial strength ratings could adversely affect the competitive positions of our insurance operations, including a possible reduction in demand for our products in certain markets.

**Our businesses are heavily regulated, and changes in regulation may reduce our profitability and limit our growth.**

Our insurance subsidiaries are subject to extensive regulation and supervision in the jurisdictions in which they conduct business. This regulation is generally designed to protect the interests of policyholders, and not necessarily the interests of insurers, their shareholders and other investors. The regulation relates to authorization for lines of business, capital and surplus requirements, investment limitations, underwriting limitations, transactions with affiliates, dividend limitations, changes in control, premium rates and a variety of other financial and nonfinancial components of an insurance company's business.

Virtually all states in which we operate require us, together with other insurers licensed to do business in that state, to bear a portion of the loss suffered by some insureds as the result of impaired or insolvent insurance companies. In addition, in various states, our insurance subsidiaries must participate in mandatory arrangements to provide various types of insurance coverage to individuals or other entities that otherwise are unable to purchase that coverage from private insurers. The effect of these and similar arrangements could reduce our profitability in any given period or limit our ability to grow our business.

In recent years, the state insurance regulatory framework has come under increased scrutiny, including scrutiny by federal officials, and some state legislatures have considered or enacted laws that may alter or increase state authority to regulate insurance companies and insurance holding companies. Further, the NAIC and state insurance regulators are continually reexamining existing laws and regulations, specifically focusing on modifications to statutory accounting principles, interpretations of existing laws and the development of new laws and regulations. Any proposed or future legislation or NAIC initiatives, if adopted, may be more restrictive on our ability to conduct business than current regulatory requirements or may result in higher costs.

**The property and casualty insurance industry is the subject of a number of investigations by state and federal authorities in the U.S., as well as by regulators in jurisdictions outside the U.S. We cannot predict the outcome of these investigations or the impact on our business or financial results.**

As part of the ongoing investigations of market practices in the property and casualty insurance industry involving the payment of contingent commissions to brokers and agents, we have received subpoenas and requests for information from the Attorneys General of several states, as well as from various other regulatory agencies. We also have received subpoenas and requests for information as part of investigations by several state and federal regulators and enforcement agencies, including the U.S. Securities and Exchange Commission and the U.S. Attorney for the Southern District of New York, relating to certain loss mitigation and finite reinsurance products. In addition, we have received and responded to similar regulatory inquiries in Canada, the United Kingdom and elsewhere. We may receive additional subpoenas and other information requests from Attorneys General or other regulatory agencies regarding similar issues. We are cooperating, and intend to continue to cooperate, fully with these investigations. Although no regulatory action has been initiated against the Corporation, it is possible that one or more regulatory agencies may pursue an action against the Corporation in the future on the issues currently under investigation or on similar issues. We cannot predict the ultimate outcome of these investigations or the impact on our business or results of operations.

**Intense competition for our products could harm our ability to maintain or increase our profitability and premium volume.**

The property and casualty insurance industry is highly competitive. We compete not only with other stock companies but also with mutual companies, other underwriting organizations and alternative risk sharing mechanisms. We compete for business not only on the basis of price, but also on the basis of financial strength, availability of coverage desired by customers and quality of service, including claim adjustment service. We may have difficulty in continuing to compete successfully on any of these bases in the future.

If competition limits our ability to write new business at adequate rates, our future results of operations would be adversely affected.

**We are dependent on a network of independent insurance brokers and agents to distribute our products.**

We generally do not use salaried employees to promote and distribute our insurance products. Instead, we rely on a large network of independent brokers and agents. Accordingly, our business is dependent on the willingness of these brokers and agents to recommend our products to their customers. We have agreements in place with insurance agents and brokers under which we agree to pay commissions that are contingent on the volume and/or the profitability of business placed with us. The relationship between insurance carriers and brokers and agents has come under increasing scrutiny by state regulators, which may affect the manner in which we can interact with and compensate our distribution network in the future. For example, since the New York Attorney General's Office filed a civil complaint against Marsh & McLennan Companies, Inc. and Marsh, Inc. on October 14, 2004, several major brokers and some agents and, in at least one case, a major property and casualty insurance carrier have announced that they have discontinued the acceptance or payment, as applicable, of contingent commissions for some or all lines of business. Other industry participants may make similar, or different, determinations in the future. In addition, legislative, regulatory, business or other developments may require changes to market practices relative to contingent commissions. Changes to the manner in which we interact with and compensate insurance brokers and agents could have a material adverse impact on our ability to renew business or write new business, which, in turn, could have a material adverse impact on our results of operations.

**Payment of obligations under surety bonds could adversely affect our future operating results.**

The surety business tends to be characterized by infrequent but potentially high severity losses. The majority of our surety obligations are intended to be performance-based guarantees. When losses occur, they may be mitigated, at times, by the customer's balance sheet, contract proceeds, collateral and bankruptcy recovery.

We have substantial commercial and construction surety exposure for current and prior customers. In that regard, we have exposures related to surety bonds issued on behalf of companies that have experienced or may experience deterioration in creditworthiness. If the economy were to worsen and impact any of these companies or if the financial results of these companies were otherwise adversely affected, we may experience an increase in filed claims and may incur high severity losses, which could have a material adverse effect on our future results of operations.

**The inability of our insurance subsidiaries to pay dividends in sufficient amounts would harm our ability to meet our obligations and to pay future dividends.**

As a holding company, Chubb relies primarily on dividends from its insurance subsidiaries to meet its obligations for payment of interest and principal on outstanding debt obligations and to pay dividends to shareholders. The ability of our insurance subsidiaries to pay dividends in the future will depend on their statutory surplus, on earnings and on regulatory restrictions. We are subject to regulation by some states as an insurance holding company system. Such regulation generally provides

that transactions between companies within the holding company system must be fair and equitable. Transfers of assets among affiliated companies, certain dividend payments from insurance subsidiaries and certain material transactions between companies within the system may be subject to prior notice to, or prior approval by, state regulatory authorities. The ability of our insurance subsidiaries to pay dividends is also restricted by regulations that set standards of solvency that must be met and maintained, the nature of and limitations on investments and the nature of and limitations on dividends to shareholders. These regulations may affect Chubb's insurance subsidiaries' ability to provide Chubb with dividends.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

The executive offices of the Corporation are in Warren, New Jersey. The administrative offices of the P&C Group are in Warren and Whitehouse Station, New Jersey. The P&C Group maintains zone administrative and branch offices in major cities throughout the United States and also has offices in Canada, Europe, Australia, Latin America and Asia. Office facilities are leased with the exception of buildings in Whitehouse Station and Branchburg, New Jersey and Simsbury, Connecticut. Management considers its office facilities suitable and adequate for the current level of operations.

**Item 3. Legal Proceedings**

As previously disclosed, beginning in December 2002, Chubb Indemnity was named in a series of actions commenced by various plaintiffs against Chubb Indemnity and other non-affiliated insurers in the District Courts in Nueces, Travis and Bexar Counties in Texas. The plaintiffs generally allege that Chubb Indemnity and the other defendants breached duties to asbestos product end-users and conspired to conceal risks associated with asbestos exposure. The plaintiffs seek to impose liability on insurers directly. The plaintiffs seek unspecified monetary damages and punitive damages. Pursuant to the asbestos reform bill passed by the Texas legislature in May 2005, these actions were transferred to the Texas state asbestos Multidistrict Litigation on December 1, 2005. Chubb Indemnity is vigorously defending all of these actions and has been successful in getting a number of them dismissed through summary judgment, special exceptions, or voluntary withdrawal by the plaintiff.

Beginning in June 2003, Chubb Indemnity was also named in a number of similar cases in Cuyahoga, Mahoning, and Trumbull Counties in Ohio. The allegations and the damages sought in the Ohio actions are substantially similar to those in the Texas actions. In May 2005, the Ohio Court of Appeals sustained the trial court's dismissal of a group of nine cases for failure to state a claim. Following the appellate court's decision, Chubb Indemnity and other non-affiliated insurers were dismissed from the remaining cases filed in Ohio, except for a single case which had been removed to federal court and transferred to the federal asbestos Multidistrict Litigation. There has been no activity in that case since its removal.

As previously disclosed, as part of ongoing investigations of market practices in the insurance industry, in particular contingent commissions and loss mitigation and finite reinsurance arrangements, Chubb and certain of its subsidiaries have received subpoenas and other information requests from the Attorneys General and insurance regulators of several states, as well as from several foreign regulatory authorities, the U.S. Securities and Exchange Commission and the U.S. Attorney for the Southern District of New York. Officials from other jurisdictions may initiate investigations into similar matters and, because the Corporation operates throughout the United States and in many jurisdictions outside the United States, the Corporation may receive additional subpoenas and requests for information in connection with such inquiries. The Corporation is cooperating, and intends to continue to cooperate, fully in such investigations.

Purported class actions arising out of the aforementioned investigations into market practices in the property and casualty insurance industry involving the payment of contingent commissions to brokers and agents have been filed in a number of state and federal courts. As previously disclosed, on August 1, 2005, Chubb and certain of its subsidiaries were named in a putative class action entitled *In re Insurance Brokerage Antitrust Litigation* in the U.S. District Court for the District of New Jersey. This action, brought against several brokers and insurers on behalf of a class of persons who purchased insurance through the broker defendants, asserts claims under the Sherman Act and state law and the Racketeer Influenced and Corrupt Organizations Act ( RICO ) arising from the unlawful use of contingent commission agreements. The complaint seeks treble damages, injunctive and declaratory relief, and attorneys' fees. Chubb has also been named in two purported class actions in state court relating to allegations of unlawful use of contingent commission arrangements. The first was filed on February 16, 2005 in Seminole County, Florida. In October 2005, the Judicial Panel on Multidistrict Litigation issued an order transferring this case to the U.S. District Court for the District of New Jersey for consolidation with the *In re Insurance Brokerage Antitrust Litigation*. The second was filed on May 17, 2005 in Essex County, Massachusetts. In October 2005, the Judicial Panel on Multidistrict Litigation issued a Conditional Transfer Order conditionally transferring the case to the U.S. District Court for the District of New Jersey for consolidation with the *In re Insurance Brokerage Antitrust Litigation*. The plaintiff and one of Chubb's unaffiliated co-defendants have filed motions to vacate the Conditional Transfer Order. Those motions have not yet been decided. In December 2005, Chubb and certain of its subsidiaries were named in an action similar to the *In re Insurance Brokerage Antitrust Litigation*. The action is pending in the same court and has been assigned to the judge who is presiding over the *In re Insurance Brokerage Antitrust Litigation*. The complaint has not yet been served in this matter. In these actions, the plaintiffs generally allege that the defendants unlawfully used contingent commission agreements. The actions seek unspecified damages and attorneys' fees. The Corporation believes it has substantial defenses to all of the aforementioned lawsuits and intends to defend the actions vigorously.

It is reasonable to expect that, in the ordinary course of business, the Corporation may be involved in additional state litigation of this sort.

Information regarding certain litigation to which the P&C Group is a party is included in the Property and Casualty Insurance Loss Reserves section of MD&A.

Chubb and its subsidiaries are also defendants in various lawsuits arising out of their businesses. It is the opinion of management that the final outcome of these matters will not materially affect the consolidated financial condition of the registrant.

**Item 4. Submission of Matters to a Vote of Security Holders**

No matters were submitted to a vote of the shareholders during the quarter ended December 31, 2005.

*Executive Officers of the Registrant*

	<u>Age(a)</u>	<u>Year of Election(b)</u>
John D. Finnegan, Chairman, President and Chief Executive Officer	57	2002
Maureen A. Brundage, Executive Vice President and General Counsel	49	2005
Robert C. Cox, Executive Vice President of Chubb & Son, a division of Federal	47	2003
John J. Degnan, Vice Chairman and Chief Administrative Officer	61	1994
Paul J. Krump, Executive Vice President of Chubb & Son, a division of Federal	46	2001
Michael J. Marchio, Executive Vice President of Chubb & Son, a division of Federal	58	2002
Andrew A. McElwee, Jr., Executive Vice President of Chubb & Son, a division of Federal	51	1997
Thomas F. Motamed, Vice Chairman and Chief Operating Officer	57	1997
Dino Robusto, Executive Vice President of Chubb & Son, a division of Federal	47	2006
Michael O Reilly, Vice Chairman and Chief Financial Officer	62	1976
Henry B. Schram, Senior Vice President	59	1985

(a) Ages listed above are as of April 25, 2006.

(b) Date indicates year first elected or designated as an executive officer.

All of the foregoing officers serve at the pleasure of the Board of Directors of the Corporation and have been employees of the Corporation for more than five years except for Mr. Finnegan and Ms. Brundage.

Before joining the Corporation in 2002, Mr. Finnegan was Executive Vice President of General Motors Corporation and Chairman, President and Chief Executive Officer of General Motors Acceptance Corporation (GMAC). Previously, he had also served as President, Vice President and Group Executive of GMAC.

Before joining the Corporation in 2005, Ms. Brundage was a partner in the law firm of White & Case LLP, where she headed the securities practice in New York and co-chaired its global securities practice.

## PART II.

**Item 5. Market for the Registrant's Common Stock and Related Stockholder Matters**

The common stock of Chubb is listed and principally traded on the New York Stock Exchange (NYSE) under "CB". The following are the high and low closing sale prices as reported on the NYSE Composite Tape and the quarterly dividends declared per share for each quarter of 2005 and 2004.

	2005			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Common stock prices				
High	\$ 80.95	\$ 86.28	\$ 90.61	\$ 98.13
Low	73.34	77.02	85.44	83.86
Dividends declared	.43	.43	.43	.43

  

	2004			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Common stock prices				
High	\$ 73.66	\$ 72.07	\$ 71.37	\$ 77.00
Low	66.59	66.35	64.00	64.80
Dividends declared	.39	.39	.39	.39

At February 28, 2006, there were approximately 5,200 common shareholders of record.

The declaration and payment of future dividends to Chubb's shareholders will be at the discretion of Chubb's Board of Directors and will depend upon many factors, including the Corporation's operating results, financial condition and capital requirements, and the impact of regulatory constraints discussed in Note (18)(f) of the Notes to Consolidated Financial Statements.

The following table summarizes Chubb's stock repurchased each month in the quarter ended December 31, 2005.

Period	Total Number of Shares Purchased(a)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs(b)
October 2005		\$		3,287,100
November 2005				3,287,100
December 2005	1,393,900	96.81	1,393,900	12,606,100

- (a) The stated amounts exclude 69,463 shares, 40,250 shares and 8,731 shares delivered to Chubb during the months of October 2005, November 2005 and December 2005, respectively, by employees of the Corporation in connection with the Corporation's stock-based employee compensation plans.



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(b) On December 8, 2005, the Board of Directors replaced an existing share repurchase program with a new program, which authorized the repurchase of up to 14,000,000 shares of common stock. The authorization has no expiration date.

On March 3, 2006, the Board of Directors approved a two-for-one stock split payable to shareholders of record on March 31, 2006. The share and per share amounts in this Annual Report have not been adjusted to reflect the stock split.

## Item 6. Selected Financial Data

	2005	2004	2003	2002	2001
(in millions except for per share amounts)					
<b>FOR THE YEAR</b>					
<b>Revenues</b>					
Property and Casualty Insurance					
Premiums Earned	\$12,176.0	\$11,635.7	\$10,182.5	\$ 8,085.3	\$ 6,656.4
Investment Income	1,342.3	1,207.0	1,082.9	952.2	914.7
Corporate and Other	180.5	116.3	44.2	68.9	182.1
Realized Investment Gains	383.5	218.2	84.4	33.9	.8
<b>Total Revenues</b>	<b>\$14,082.3</b>	<b>\$13,177.2</b>	<b>\$11,394.0</b>	<b>\$ 9,140.3</b>	<b>\$ 7,754.0</b>
<b>Income</b>					
Property and Casualty Insurance					
Underwriting Income (Loss)(a)	\$ 920.6(e)	\$ 846.1(c)	\$ 104.5	\$ (625.9)(b)	\$ (903.5)(b)(c)
Investment Income	1,315.3	1,184.3	1,058.4	929.4	902.6
Other Charges	(.6)	(4.7)	(29.5)	(25.3)	(52.3)
Property and Casualty Insurance Income (Loss)	2,235.3	2,025.7	1,133.4	278.2	(53.2)
Chubb Financial Solutions Non-Insurance Business	(6.2)	(17.2)	(126.9)	(69.8)	9.2
Corporate and Other	(165.6)	(158.5)	(157.3)	(73.9)	(22.8)
Realized Investment Gains	383.5	218.2	84.4	33.9	.8
Income (Loss) Before Income Tax	2,447.0	2,068.2	933.6	168.4	(66.0)
Federal and Foreign Income Tax (Credit)	621.1	519.8	124.8(d)	(54.5)(d)	(177.5)
<b>Net Income</b>	<b>\$ 1,825.9</b>	<b>\$ 1,548.4</b>	<b>\$ 808.8</b>	<b>\$ 222.9</b>	<b>\$ 111.5</b>
<b>Per Share</b>					
Net Income	\$ 8.94	\$ 8.01	\$ 4.46	\$ 1.29	\$ .63
Dividends Declared on Common Stock	1.72	1.56	1.44	1.40	1.36
<b>AT DECEMBER 31</b>					
Total Assets	\$48,060.7	\$44,260.3	\$38,360.6	\$34,080.9	\$29,415.5
Long Term Debt	2,467.3	2,813.7	2,813.9	1,959.1	1,351.0
Total Shareholders Equity	12,407.0	10,126.4	8,522.0	6,825.7	6,491.8
Book Value Per Share	59.36	52.55	45.33	39.87	38.17

(a) Underwriting income has been reduced by net losses of \$35.0 million (\$22.8 million after-tax or \$0.11 per share) in 2005, \$75.0 million (\$48.8 million after-tax or \$0.25 per share) in 2004, \$250.0 million (\$162.5 million after-tax or \$0.90 per share) in 2003, \$741.1 million (\$481.7 million after-tax or \$2.79 per share) in 2002 and \$60.9 million (\$39.6 million after-tax or \$0.22 per share) in 2001 related to asbestos and toxic waste claims.

(b) Underwriting income in 2001 has been reduced by net surety bond losses of \$220.0 million (\$143.0 million after-tax or \$0.81 per share) related to the bankruptcy of Enron Corp. Underwriting income in 2002 has been increased by a reduction in net surety bond losses of \$88.0 million (\$57.2 million after-tax or \$0.33 per share) resulting from the settlement of litigation related to Enron Corp.

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- (c) Underwriting income in 2001 has been reduced by net costs of \$635.0 million (\$412.8 million after-tax or \$2.35 per share) related to the September 11 attack. Underwriting income in 2004 has been increased by a reduction in net losses of \$80.0 million (\$52.0 million after-tax or \$0.27 per share) related to the September 11 attack.
- (d) Federal and foreign income tax in 2002 included a \$40.0 million (\$0.23 per share) charge to establish a tax valuation allowance from not being able to recognize, for accounting purposes, certain U.S. tax benefits related to European losses. Federal and foreign income tax in 2003 included a \$40.0 million (\$0.22 per share) credit for the reversal of the tax valuation allowance established in 2002.
- (e) Underwriting income in 2005 has been reduced by net costs of \$462.2 million (\$300.4 million after-tax or \$1.47 per share) related to Hurricane Katrina.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Management's discussion and analysis of financial condition and results of operations address the financial condition of the Corporation as of December 31, 2005 compared with December 31, 2004 and the results of operations for each of the three years in the period ended December 31, 2005. This discussion should be read in conjunction with the consolidated financial statements and related notes and the other information contained in this report.

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**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION**

*Certain statements in this document are forward-looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995 (PSLRA). These forward-looking statements are made pursuant to the safe harbor provisions of the PSLRA and include statements regarding expectations as to the impact of future catastrophes on our financial condition and results of operations; the cost and availability of reinsurance in 2006; our loss reserve estimates and reinsurance recoverables, including our estimated gross and net losses from Hurricane Katrina; the impact of the 2005 hurricanes on the commercial insurance marketplace; competition and growth estimates; the impact of regulatory investigations and developments on our business; the number and severity of surety-related claims; our plans for exiting the reinsurance assumed business; our expected income stream from the transaction with Harbor Point Limited; the impact of asbestos liability developments; estimates with respect to our CFS credit derivatives exposure; and the possible recognition of additional impairment losses if real estate is not sold or does not perform as contemplated and the effect thereof on our results of operations. Forward-looking statements are made based upon management's current expectations and beliefs concerning trends and future developments and their potential effects on us. These statements are not guarantees of future performance. Actual results may differ materially from those suggested by forward-looking statements as a result of risks and uncertainties, which include, among others, those discussed or identified from time to time in our public filings with the Securities and Exchange Commission and those associated with:*

global political conditions and the occurrence of terrorist attacks, including any nuclear, biological, chemical or radiological events;

the effects of the outbreak or escalation of war or hostilities;

premium pricing and profitability or growth estimates overall or by lines of business or geographic area, and related expectations with respect to the timing and terms of any required regulatory approvals;

adverse changes in loss cost trends;

the ability to retain existing business;

our expectations with respect to cash flow projections and investment income and with respect to other income;

the adequacy of loss reserves, including:

our expectations relating to reinsurance recoverables;

the effects of proposed asbestos liability legislation, including the impact of claims patterns arising from the possibility of legislation and those that may arise if legislation is not passed;

our estimates relating to ultimate asbestos liabilities;

the impact from the bankruptcy protection sought by various asbestos producers and other related businesses;

the willingness of parties, including us, to settle disputes;

developments in judicial decisions or regulatory or legislative actions relating to coverage and liability for asbestos, toxic waste and mold claims;

development of new theories of liability;

the availability and cost of reinsurance coverage;

the occurrence of significant weather-related or other natural or human-made disasters, particularly in locations where we have concentrations of risk;

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the impact of economic factors on companies on whose behalf we have issued surety bonds, and in particular, on those companies that have filed for bankruptcy or otherwise experienced deterioration in creditworthiness;

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the effects of disclosures by, and investigations of, public companies relating to possible accounting irregularities, practices in the financial services industry and other corporate governance issues, including:

the effects on the capital markets and the markets for directors and officers and errors and omissions insurance;

claims and litigation arising out of actual or alleged accounting or other corporate malfeasance by other companies;

claims and litigation arising out of practices in the financial services industry;

legislative or regulatory proposals or changes;

the effects of investigations into market practices, in particular contingent commissions and loss mitigation and finite reinsurance arrangements, in the U.S. property and casualty insurance industry and related settlements, industry reform and any legal or regulatory proceedings arising therefrom;

the impact of legislative and regulatory developments on our business, including those relating to terrorism and large-scale catastrophes;

any downgrade in our claims-paying, financial strength or other credit ratings;

the ability of our subsidiaries to pay us dividends;

general economic and market conditions including:

changes in interest rates, market credit spreads and the performance of the financial markets;

the effects of inflation;

changes in domestic and foreign laws, regulations and taxes;

changes in competition and pricing environments;

regional or general changes in asset valuations;

the inability to reinsure certain risks economically;

changes in the litigation environment; and

our ability to implement management's strategic plans and initiatives.

The Corporation assumes no obligation to update any forward-looking information set forth in this document, which speak as of the date hereof.

### **CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS**

The consolidated financial statements include amounts based on informed estimates and judgments of management for transactions that are not yet complete. Such estimates and judgments affect the reported amounts in the financial statements. Those estimates and judgments that were most critical to the preparation of the financial statements involved the determination of loss reserves and the recoverability of related reinsurance recoverables, the fair value of future obligations under financial products contracts and the recoverability of the carrying value of real estate properties. These estimates and judgments, which are discussed within the following analysis of our results of operations, require the use of assumptions about matters that are highly uncertain and therefore are subject to change as facts and circumstances develop. If different estimates and judgments had been applied, materially different amounts might have been reported in the financial statements.





**EXECUTIVE OVERVIEW**

*The following highlights do not address all of the matters covered in the other sections of Management's Discussion and Analysis of Financial Condition and Results of Operations or contain all of the information that may be important to Chubb's shareholders or the investing public. This overview should be read in conjunction with the other sections of Management's Discussion and Analysis of Financial Condition and Results of Operations.*

Net income was \$1,826 million in 2005 compared with \$1,548 million in 2004 and \$809 million in 2003. The increase in net income in 2005 was driven by increases in both underwriting and investment income in our property and casualty insurance business.

Underwriting results in 2005 were adversely affected by pre-tax costs of \$462 million related to Hurricane Katrina, including estimated net losses of \$403 million and net reinsurance reinstatement premium costs of \$59 million. We also incurred a charge of about \$45 million, included in our corporate segment, representing our share of the losses from Hurricane Katrina estimated by an insurer in which we have a minority interest.

Despite the impact of Hurricane Katrina, underwriting results were highly profitable in 2005 as they were in 2004, compared with modestly profitable results in 2003. Our combined loss and expense ratio was 92.3% in both 2005 and 2004 compared with 98.0% in 2003.

Premium growth was 2% in 2005 and 9% in 2004. Premiums in our insurance business grew 4% in 2005 and 8% in 2004. The lower growth in 2005 reflects our maintaining underwriting discipline in a more competitive market environment. Rates were generally stable, but were under competitive pressure in some classes of business. In our reinsurance assumed business, premiums decreased 21% in 2005 after increasing 16% in 2004. The decrease in 2005 was in line with our expectations as we had anticipated fewer attractive opportunities in the reinsurance market.

During 2005, we experienced overall unfavorable development of \$163 million on loss reserves established as of the previous year end, due primarily to unfavorable development in the professional liability classes of business, principally errors and omissions liability, and in excess liability and certain other commercial liability classes, offset in part by favorable development in the property classes and in fidelity and surety.

Property and casualty investment income after taxes increased by 11% in 2005 and 13% in 2004.

In December 2005, we completed a transaction involving a new reinsurance company, Harbor Point Limited. As part of the transaction, we transferred our continuing reinsurance assumed business and certain related assets, including renewal rights, to Harbor Point. The transaction resulted in the recognition of a pre-tax realized investment gain of \$171 million in 2005.

A summary of our consolidated net income is as follows:

	<b>Years Ended December 31</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	(in millions)		
Property and casualty insurance	\$2,235	\$2,026	\$1,133
Chubb Financial Solutions non-insurance business	(6)	(17)	(127)
Corporate and other	(166)	(159)	(157)
Realized investment gains	384	218	85
	<u>2,447</u>	<u>2,068</u>	<u>934</u>
Consolidated income before income tax	2,447	2,068	934
Federal and foreign income tax	621	520	125
	<u>1,826</u>	<u>1,548</u>	<u>809</u>
Consolidated net income	<u>\$1,826</u>	<u>\$1,548</u>	<u>\$ 809</u>



**PROPERTY AND CASUALTY INSURANCE**

A summary of the results of operations of our property and casualty insurance business is as follows:

	<b>Years Ended December 31</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>(in millions)</b>		
<b>Underwriting</b>			
Net premiums written	\$ 12,283	\$ 12,053	\$ 11,068
Increase in unearned premiums	(107)	(417)	(885)
Premiums earned	12,176	11,636	10,183
Losses and loss expenses	7,813	7,321	6,867
Operating costs and expenses	3,436	3,516	3,356
Increase in deferred policy acquisition costs	(17)	(76)	(168)
Dividends to policyholders	23	29	23
Underwriting income	921	846	105
<b>Investments</b>			
Investment income before expenses	1,342	1,207	1,083
Investment expenses	27	23	25
Investment income	1,315	1,184	1,058
Other charges	(1)	(4)	(30)
Property and casualty income before tax	\$ 2,235	\$ 2,026	\$ 1,133
Property and casualty investment income after tax	\$ 1,056	\$ 949	\$ 843

Property and casualty income before tax in 2005 was higher than in 2004 which, in turn, was substantially higher than in 2003. Income in 2005 and 2004 benefited from highly profitable underwriting results. Underwriting income increased modestly in 2005 despite significantly higher catastrophe losses, primarily from Hurricane Katrina. Results in 2005 and 2004 also benefited from a significant increase in investment income.

The profitability of the property and casualty insurance business depends on the results of both underwriting operations and investments. We view these as two distinct operations. The underwriting functions are managed separately from the investment function. Accordingly, in assessing our performance, we evaluate underwriting results separately from investment results.

**Underwriting Operations**

We evaluate the underwriting results of our property and casualty insurance business in the aggregate and also for each of our separate business units.

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The combined loss and expense ratio, expressed as a percentage, is the key measure of underwriting profitability traditionally used in the property and casualty insurance business. Management evaluates the performance of our underwriting operations and of each of our business units using, among other measures, the combined loss and expense ratio calculated in accordance with statutory accounting principles. It is the sum of the ratio of losses and loss expenses to premiums earned (loss ratio) plus the ratio of statutory underwriting expenses to premiums written (expense ratio) after reducing both premium amounts by dividends to policyholders. When the combined ratio is under 100%, underwriting results are generally considered profitable; when the combined ratio is over 100%, underwriting results are generally considered unprofitable.

Statutory accounting principles applicable to property and casualty insurance companies differ in certain respects from generally accepted accounting principles (GAAP). Under statutory accounting principles, policy acquisition and other underwriting expenses are recognized immediately, not at the time premiums are earned. Management uses underwriting results determined in accordance with GAAP, among other measures, to assess the overall performance of our underwriting operations. To convert statutory underwriting results to a GAAP basis, policy acquisition expenses are deferred and amortized over the period in which the related premiums are earned. Underwriting income determined in accordance with GAAP is defined as premiums earned less losses incurred and GAAP underwriting expenses incurred.

#### *Change in Reporting Format*

The reporting format for property and casualty underwriting results by business unit was changed in 2005 to more closely reflect the way the business is now managed. Prior year amounts have been reclassified to conform with the new presentation.

The changes to the reporting format are as follows:

#### *Personal Insurance*

Valuable articles results, which had been included in other personal, are now included in homeowners.

Accident results, which had been included in other specialty, are now included in other personal.

#### *Commercial Insurance*

Commercial insurance results from our financial institutions business, which had been included in financial institutions results in specialty insurance, are now included in the appropriate commercial insurance lines.

#### *Specialty Insurance*

Executive protection results are now combined with the professional liability and financial fidelity results from our financial institutions business into a new professional liability line. Financial institutions results are no longer reported separately.

Surety results, which had been included in other specialty, are now reported separately within specialty insurance.

#### *Reinsurance Assumed*

Reinsurance assumed results, which had been included in other specialty, are now reported as a separate business unit.

### **Underwriting Results**

#### *Net Premiums Written*

Net premiums written amounted to \$12.3 billion in 2005, an increase of 2% over 2004. An increase in premiums from our insurance business was partially offset by a decline in premiums from our reinsurance business. Net premiums written increased 9% in 2004 compared with 2003, reflecting increases in premiums from both our insurance and reinsurance businesses.

Net premiums written by business unit were as follows:

	Years Ended December 31				
	2005	% Increase 2005 vs. 2004	2004	% Increase 2004 vs. 2003	2003
(dollars in millions)					
Personal insurance	\$ 3,307	6%	\$ 3,116	9%	\$ 2,868
Commercial insurance	5,030	2	4,938	11	4,468
Specialty insurance	3,042	6	2,860	4	2,748
	<hr/>		<hr/>		<hr/>
Total insurance	11,379	4	10,914	8	10,084
Reinsurance assumed	904	(21)	1,139	16	984
	<hr/>		<hr/>		<hr/>
Total	\$ 12,283	2	\$ 12,053	9	\$ 11,068
	<hr/>		<hr/>		<hr/>

Premiums from our insurance business grew 4% in 2005 and 8% in 2004. Premiums in 2005 reflected reinsurance reinstatement premium costs of \$102 million related to Hurricane Katrina. Approximately 80% of our insurance premiums in 2005 were written in the United States. Insurance premiums in the U.S. grew by 3% in 2005 and 7% in 2004. Insurance premiums outside the U.S. grew 8% in 2005 and 12% in 2004. In local currencies, such growth was 6% and 4% in 2005 and 2004, respectively, reflecting the weakness of the U.S. dollar.

We experienced modest premium growth in our insurance business in 2005. In a more competitive market environment, we maintained underwriting discipline by continuing to get acceptable rates and appropriate terms and conditions on business written. Rates were generally stable, but were under competitive pressure in some classes of business. We continued to retain a high percentage of our existing customers and to renew these accounts at adequate prices. In addition, while we continued to be selective, we found opportunities to write new business at acceptable rates. The premium growth in 2004 was largely the result of our retaining a higher percentage of our existing customers compared with the prior year and attracting new customers. We did get rate increases in 2004 on a significant portion of the business we wrote, although the size of such increases decelerated throughout the year.

Reinsurance assumed premiums generated by Chubb Re decreased by 21% in 2005 after increasing by 16% in 2004. Premiums in 2005 included net reinstatement premium revenue of \$43 million related to Hurricane Katrina. The premium decline in 2005 was in line with our expectations. As discussed below, we sold our ongoing reinsurance assumed business to Harbor Point Limited in December 2005.

### ***Reinsurance Ceded***

Our premiums written are net of amounts ceded to reinsurers who assume a portion of the risk under the insurance policies we write that are subject to the reinsurance.

Our overall reinsurance costs in 2004 were similar to those in 2003. We discontinued a casualty per risk treaty that responded primarily to excess liability exposures over \$25 million. Underwriting actions we have taken in recent years resulted in a reduction in the number of such exposures, which we believe made this treaty no longer economical. Our professional liability per risk treaty was renewed with coverage similar to the prior year. On our property per risk treaty, our retention remained at \$15 million. Our property catastrophe treaty for events in the United States was modified to increase our initial retention and to increase the reinsurance coverage at the top.

Our overall reinsurance costs in 2005 were lower than those in 2004. We discontinued our professional liability per risk treaty. Underwriting actions we have taken in recent years have resulted in lower average limits on those large risks we write, which we believe made this treaty no longer economical. On our casualty clash treaty, which operates like a catastrophe treaty, we increased our retention from \$50 million to \$75 million. This treaty now provides \$125 million of coverage in excess of \$75 million per insured event. We did not renew a high excess surety per risk treaty as we believe the cost was not justified. On our commercial property per risk treaty, our retention remained at



\$15 million. This treaty provides \$435 million of coverage per risk in excess of our retention. Our property catastrophe treaty for events in the United States was modified to increase the coverage in the northeastern part of the country by \$100 million. The program now provides coverage of approximately 85% of losses (net of recoveries from other available reinsurance) between \$250 million and \$1.25 billion, with additional coverage of 80% of losses between \$1.25 billion and \$1.6 billion in the northeastern part of the country. Our property catastrophe treaty for events outside the United States was modified to increase our retention from \$25 million to \$50 million. This treaty now provides coverage of 90% of losses between \$50 million and \$250 million. Our property reinsurance treaties generally contain terrorism exclusions for acts perpetrated by foreign terrorists. Since September 2001, we have changed our underwriting protocols to address terrorism and the limited availability of terrorism reinsurance.

Our 2006 reinsurance program has not been finalized. Our casualty clash treaty was extended through March 31, 2006 under its current terms. Our property reinsurance program renews on April 1. As a result of the substantial losses suffered by reinsurers from the catastrophes in the latter half of 2005, we are anticipating significant price increases on our property catastrophe treaties and our commercial property per risk treaty. The final structure and amount of coverage purchased will be determinants of our cost for these treaties. In addition, the availability of reinsurance for certain coverages, such as terrorism, will continue to be limited and expensive in 2006.

### ***Profitability***

Underwriting results in 2005 and 2004 were highly profitable compared with modestly profitable results in 2003. The combined loss and expense ratio for our overall property and casualty business was as follows:

	<b>Years Ended December 31</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
Loss ratio	64.3%	63.1%	67.6%
Expense ratio	28.0	29.2	30.4
Combined ratio	92.3%	92.3%	98.0%

The loss ratio was modestly higher in 2005 than in 2004 due to higher catastrophe losses, primarily from Hurricane Katrina. The loss ratio improved in 2004 compared with the prior year, reflecting the favorable experience resulting from our disciplined underwriting in recent years as well as substantially lower incurred losses related to asbestos claims.

Our estimated net losses from Hurricane Katrina were \$403 million and we incurred \$59 million of net reinsurance reinstatement premium costs related to the hurricane. In our insurance business, we incurred net losses of \$335 million as well as reinstatement premium costs of \$102 million, for an aggregate cost of \$437 million. In our reinsurance assumed business, we incurred net losses of \$68 million and recognized net reinstatement premium revenue of \$43 million, for a net cost of \$25 million.

We estimate that our gross losses from Hurricane Katrina were about \$1.2 billion. Almost all of the losses were from property exposure and business interruption claims. Our net losses of \$403 million were significantly lower than the gross amount due to a property per risk treaty that limited our net loss per risk and our property catastrophe treaty. We still have about \$400 million of reinsurance available for this event under our catastrophe treaty if our gross losses were higher than our current estimate. Therefore, while it is possible that our estimate of ultimate losses related to Hurricane Katrina may change in the future, we do not expect that any such change would have a material effect on the Corporation's consolidated financial condition or liquidity.

Our total net catastrophe losses in 2005 were \$630 million and related net reinsurance reinstatement premium costs were \$59 million. The aggregate impact accounted for 5.5 percentage points of the



loss ratio. Losses from catastrophes were \$270 million in 2004, which represented 2.3 percentage points of the loss ratio, and \$294 million or 2.9 percentage points in 2003. The 2004 catastrophe loss amount reflects an \$80 million reduction in loss reserves related to the September 11, 2001 attack, which reduced the impact of catastrophes on the loss ratio for the year by 0.7 of a percentage point. Other than the reinsurance recoverable related to Hurricane Katrina, we did not have any recoveries from our catastrophe reinsurance program during the three year period because there were no other individual catastrophes for which our losses exceeded our initial retention under the program.

Incurred losses related to asbestos claims were \$35 million in 2005, \$75 million in 2004 and \$250 million in 2003, which represented 0.3, 0.6 and 2.5 percentage points, respectively, of the loss ratio.

Our expense ratio improved in 2004 and again in 2005. The lower expense ratio in 2004 was due to premiums written growing at a higher rate than overhead expenses, as we made progress in reducing our expense structure, and to lower contingent commission expenses.

The decrease in contingent commissions in 2004 was due to two factors that reduced producer compensation. First, we did not pay contingent commissions in the fourth quarter to those large brokers who elected to terminate such arrangements before year end. Second, the slowdown of premium growth in the second half of the year resulted in lower compensation to other producers whose commissions, in part, were contingent on the volume of business placed with us.

The decrease in the expense ratio in 2005 was due to lower contingent commission expenses and, to a lesser extent, flat overhead expenses compared with 2004, as we continued to make progress in reducing our cost structure through outsourcing and other initiatives, and the discontinuation of a professional liability per risk reinsurance treaty, which resulted in an increase in net premiums written without a commensurate increase in expenses.

## Review of Underwriting Results by Business Unit

### *Personal Insurance*

Net premiums from personal insurance, which represented 27% of the premiums written by our property and casualty subsidiaries in 2005, increased by 6% in 2005 compared with a 9% increase in 2004. Net premiums written for the classes of business within the personal insurance segment were as follows:

	Years Ended December 31				
	2005	% Increase 2005 vs. 2004	2004	% Increase 2004 vs. 2003	2003
	(dollars in millions)				
Automobile	\$ 645	2%	\$ 629	7%	\$ 590
Homeowners	2,104	8	1,951	10	1,777
Other	558	4	536	7	501
Total personal	\$3,307	6	\$3,116	9	\$2,868

In both 2005 and 2004, premium growth was driven by our homeowners business. The growth in our homeowners business in both years was due to increased insurance-to-value and, to a lesser extent, higher rates. The in-force policy count for this class had minimal growth in both years. Homeowners premiums in 2005 were reduced by reinsurance reinstatement premium costs of \$17 million related to Hurricane Katrina. The low growth in our personal automobile business in 2005 was due to our maintaining underwriting discipline in a more competitive marketplace. Growth in our other personal business, which includes insurance for excess liability, yacht and accident coverages, was lower in 2005 than in the prior year. This was attributable to lower premiums in our U.S. accident business due to increased competition and the culling of our health care business.



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Our personal insurance business produced profitable underwriting results in each of the last three years. Overall results have shown substantial improvement in each succeeding year, driven largely by our homeowners results. The combined loss and expense ratios for the classes of business within the personal insurance segment were as follows:

	Years Ended December 31		
	2005	2004	2003
Automobile	95.3%	93.3%	98.9%
Homeowners	81.2	91.3	98.8
Other	96.2	96.0	91.0
Total personal	86.6%	92.5%	97.4%

Homeowners results were profitable in each of the last three years and showed significant improvement in 2004 and again in 2005. The improvement was largely the result of better pricing and a reduction in water damage losses primarily through contract wording changes related to mold damage and loss remediation measures that we have implemented over the past few years. Results in 2005 also benefited from lower catastrophe losses. The impact of catastrophes accounted for 9.8 percentage points of the combined loss and expense ratio for this class in 2005 compared with 12.6 percentage points in 2004 and 11.2 percentage points in 2003.

Our personal automobile results were profitable in each of the past three years. Results in 2005 were slightly less profitable than in 2004 due to reserve strengthening in the liability component related to prior accident years. The improvement in 2004 was due to lower claim frequency and stable loss severity as well as modest rate increases.

Other personal business produced profitable results in each of the past three years. Results in 2005 and 2004 were less profitable than those in 2003 due to higher losses in the excess liability and yacht components in both years. The yacht losses in 2005 were primarily related to catastrophes. Our accident business was profitable in all three years.

**Commercial Insurance**

Net premiums from commercial insurance, which represented 41% of our total writings in 2005, increased by 2% in 2005 compared with an 11% increase in 2004. Net premiums written for the classes of business within the commercial insurance segment were as follows:

	Years Ended December 31				
	2005	% Increase 2005 vs. 2004	2004	% Increase 2004 vs. 2003	2003
(dollars in millions)					
Multiple peril	\$1,286	(1)%	\$1,302	10%	\$1,188
Casualty	1,755	4	1,682	14	1,476
Workers compensation	930	5	881	18	749
Property and marine	1,059	(1)	1,073	2	1,055
Total commercial	\$5,030	2	\$4,938	11	\$4,468

Growth in 2004 occurred in all segments of this business but was particularly strong in the workers compensation and casualty classes. The premium growth was due in large part to higher rates as well as an increase in our in-force policy count. However, as expected, the level of rate increases declined throughout 2004 as we experienced more competition in the marketplace, particularly in the property classes. The low growth

in 2005 was the result of increased competition in the marketplace. Rates decreased slightly in 2005 compared with 2004. Multiple peril and property and marine premiums in 2005 were reduced by reinsurance reinstatement premium costs of \$19 million and \$66 million, respectively, related to Hurricane Katrina. Excluding the reinsurance reinstatement

premiums, multiple peril premiums were flat in 2005 compared with 2004 and property and marine premiums grew 5%.

Retention levels of our existing customers were somewhat higher in 2004 compared with 2003 and remained steady in 2005. New business volume has steadily declined since 2003 due to decreased submission activity, the result of our competitors working to retain their better accounts. We have maintained our discipline in the competitive market by continuing to get acceptable rates and appropriate terms and conditions on business written.

It is uncertain how the hurricanes in 2005 will affect the commercial insurance marketplace. We have seen significant price increases and tighter terms and conditions on property business in catastrophe exposed areas. We expect this trend to continue in 2006. However, we expect that property business in non-catastrophe exposed areas and casualty business will remain competitive.

Our commercial insurance business produced profitable underwriting results in each of the past three years, particularly in 2004. These profitable results were due in large part to the cumulative effect of price increases, better terms and conditions and more stringent risk selection in recent years. Results in 2005 and 2004 also benefited from unusually low non-catastrophe property losses. Results in 2005 were less profitable than in 2004 largely due to higher catastrophe losses, primarily from Hurricane Katrina. Results in 2003 were adversely affected by incurred losses related to asbestos claims. Incurred losses related to asbestos claims were \$35 million in 2005, \$75 million in 2004 and \$250 million in 2003.

The combined loss and expense ratios for the classes of business within commercial insurance were as follows:

	<b>Years Ended December 31</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
Multiple peril	87.8%	76.8%	90.3%
Casualty	96.1	89.8	104.5
Workers compensation	84.8	90.9	94.0
Property and marine	98.8	72.7	91.1
<b>Total commercial</b>	<b>92.4%</b>	<b>82.5%</b>	<b>95.6%</b>

Multiple peril results were highly profitable in each of the past three years, but more so in 2004. Results in 2005 were less profitable than in 2004 largely due to higher catastrophe losses. The property component of this business benefited from unusually low non-catastrophe losses in both years. Both the property and liability components of this business contributed to the substantial improvement in 2004 compared with 2003. The impact of catastrophes accounted for 9.1 percentage points of the combined loss and expense ratio for this class in 2005 and 3.4 percentage points in 2003. Catastrophe losses were negligible for this class in 2004 due to a \$30 million reduction in net loss reserves related to the September 11, 2001 attack.

Results for our casualty business were profitable in 2005 compared with highly profitable results in 2004 and unprofitable results in 2003. Casualty results in each year were adversely affected by asbestos losses, particularly in 2003. Asbestos losses represented 1.2, 2.8 and 18.6 percentage points of the combined loss and expense ratio for casualty business in 2005, 2004 and 2003, respectively. The automobile component of our casualty business was highly profitable in each of the past three years. Excluding the effects of asbestos losses, results in the primary liability component were also highly profitable in each of the past three years while results in the excess liability component were unprofitable in 2005, profitable in 2004 and near breakeven in 2003. Excess liability results in 2005 were adversely affected by unfavorable loss development related to accident years prior to 1998 due to significant reported loss activity that caused us to extend the expected loss emergence period. Results in 2004 for this component benefited from a \$30 million reduction in net loss reserves related to the September 11, 2001 attack.

Workers' compensation results were highly profitable in each of the past three years. Results were more profitable in each succeeding year. Results in all three years benefited from our disciplined risk selection during the past several years.

Property and marine results were marginally profitable in 2005 compared with highly profitable results in the previous two years, particularly in 2004. Results in each year benefited from improved pricing, higher deductibles and better terms and conditions. Results in 2005 and 2004 also benefited from unusually low non-catastrophe losses. Results in 2005 deteriorated, however, due to substantially higher catastrophe losses, primarily from Hurricane Katrina. The impact of catastrophes accounted for 27.2 percentage points of the combined loss and expense ratio for this class in 2005 compared with 1.8 percentage points in 2004 and 7.1 percentage points in 2003. The impact of catastrophes in 2004 reflects a \$20 million reduction in net loss reserves related to the September 11, 2001 attack.

### *Specialty Insurance*

Net premiums from specialty insurance, which represented 25% of our total writings in 2005, increased by 6% in 2005 compared with a 4% increase in 2004. Net premiums written for the classes of business within the specialty insurance segment were as follows:

	Years Ended December 31				
	2005	% Increase 2005 vs. 2004	2004	% Increase 2004 vs. 2003	2003
(dollars in millions)					
Professional liability	\$2,798	5%	\$2,654	4%	\$2,562
Surety	244	18	206	11	186
<b>Total specialty</b>	<b>\$3,042</b>	<b>6</b>	<b>\$2,860</b>	<b>4</b>	<b>\$2,748</b>

Growth in net premiums written for the professional liability classes of business was constrained in both 2005 and 2004 by the competitive pressure on rates that began in the latter half of 2003 and by our commitment to maintain underwriting discipline. Growth in 2005 was also dampened by the sale of renewal rights, effective July 1, 2005, on our hospital medical malpractice and managed care errors and omissions business. The net premium growth in 2005 in the professional liability classes was due solely to the non-renewal of a per risk reinsurance treaty.

Overall, rates increased slightly in 2004 and were down slightly in 2005. The most significant rate declines occurred in the for-profit directors and officers liability component. Retention levels were significantly higher in 2004 compared with 2003, while new business volume was similar to 2003 levels. Retention levels in 2005 were comparable to the 2004 levels, while new business volume was lower due in part to our exiting the hospital medical malpractice and managed care errors and omissions business. Overall, we continued to get adequate rates and favorable terms and conditions on both new business and renewals. While large public companies remain a significant component of our book of business, that component has decreased in recent years in line with our strategy to focus on small and middle market publicly traded and privately held companies.

The growth in net premiums written for our surety business was substantial in both 2005 and 2004. The growth in 2005 was due in part to the non-renewal of a high excess reinsurance treaty.

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Our specialty insurance business produced modestly profitable underwriting results in 2005 compared with unprofitable results in 2004 and 2003. The combined loss and expense ratios for the classes of business within specialty insurance were as follows:

	<b>Years Ended December 31</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
Professional liability	99.8%	112.0%	108.4%
Surety	62.9	57.2	39.0
Total specialty	97.3%	108.2%	103.9%

Our professional liability business improved substantially in 2005, producing near breakeven results compared with the highly unprofitable results in 2004 and 2003. Results have begun to benefit from the cumulative effect of price increases, lower policy limits and better terms and conditions in recent years. Results in all three years, but more so in 2004 and 2003, were adversely affected by unfavorable loss development related to accident years 2002 and prior, particularly in the errors and omissions class. The adverse development was predominantly from claims that have arisen due to corporate failures and allegations of management misconduct and accounting irregularities. Results were particularly unprofitable in 2004 due to an increase of about \$160 million in errors and omissions liability loss reserves in the second quarter related to investment banks. The fidelity component of our professional liability business was highly profitable in each of the past three years due to favorable loss experience.

Our surety business produced highly profitable results in each of the past three years due to favorable loss experience.

Our surety business tends to be characterized by infrequent but potentially high severity losses. We continue to manage our exposure on an absolute basis and by specific bond type. The majority of our obligations are intended to be performance-based guarantees. When losses occur, they are mitigated, at times, by the customer's balance sheet, contract proceeds, collateral and bankruptcy recovery.

We continue to have substantial commercial and construction surety exposure for current and prior customers. In that regard, we have exposures related to surety bonds issued on behalf of companies that have experienced deterioration in creditworthiness since we issued bonds to them. We therefore may experience an increase in filed claims and may incur high severity losses. Such losses would be recognized if and when claims are filed and determined to be valid, and could have a material adverse effect on the Corporation's results of operations and liquidity.

### ***Reinsurance Assumed***

Our reinsurance assumed business is treaty reinsurance, primarily casualty reinsurance. Premiums from our reinsurance assumed business, which represented 7% of our net premiums written in 2005, decreased by 21% in 2005 compared with a 16% increase in 2004. Premiums in 2005 included net reinsurance reinstatement premium revenue of \$43 million related to Hurricane Katrina. The significant decrease in premiums in 2005 was in line with our expectations as we had anticipated fewer attractive opportunities in the reinsurance market.

Our reinsurance assumed business was profitable in 2005, 2004 and 2003. The combined loss and expense ratio for this business was 96.1%, 94.3% and 93.6% in 2005, 2004 and 2003, respectively. The impact of catastrophes accounted for 5.2 percentage points of the combined loss and expense ratio in 2005 and 2.2 percentage points in 2004. Catastrophe losses were not significant in 2003.

### **Transfer of Ongoing Reinsurance Assumed Business**

In December 2005, we completed a transaction involving a new Bermuda-based reinsurance company, Harbor Point Limited. As part of the transaction, we transferred our continuing reinsurance assumed business and certain related assets, including renewal rights, to Harbor Point. In exchange, we received from Harbor Point \$200 million of 6% convertible notes and warrants to purchase common stock of Harbor Point. The notes and warrants represent in the aggregate on a fully diluted basis approximately 16% of the new company.

Harbor Point generally did not assume our reinsurance liabilities relating to reinsurance contracts incepting prior to December 31, 2005. We retained those liabilities and the related assets.

Other than pursuant to certain arrangements entered into with Harbor Point, we generally will no longer engage directly in the reinsurance assumed business. However, Harbor Point will have the right for a transition period of up to two years to underwrite specific reinsurance business on our behalf. We will retain a portion of any such business and will cede the balance to Harbor Point in return for a fronting commission.

The transaction resulted in a pre-tax gain of \$204 million, of which \$171 million was recognized as a realized investment gain in 2005. The remaining gain of \$33 million was deferred and will be recognized based on the timing of the ultimate disposition of our economic interest in Harbor Point.

We will receive additional payments over the next two years based on the amount of business renewed by Harbor Point, which will be recognized as realized investment gains when earned.

### **Regulatory Developments**

To promote and distribute our insurance products, we rely on a large network of independent brokers and agents. Accordingly, our business is dependent on the willingness of these brokers and agents to recommend our products to their customers. We have agreements in place with insurance brokers under which we agree to pay commissions that are contingent on the volume and/or the profitability of business placed with us. We also have in place contingent commission arrangements with agents who are appointed by us to sell our insurance.

The New York Attorney General and other regulators have commenced investigations with respect to potential conflicts of interest and anti-competitive behavior arising from the payment of contingent commissions to brokers and agents. In connection with these investigations, we have received subpoenas and requests for information from the Attorneys General of several states, as well as from various states' insurance regulators. We are cooperating, and intend to continue to cooperate, fully with these investigations.

As a result of these investigations, in certain instances, brokers and agents and, in at least one case, a major insurance carrier have entered into settlement agreements with such regulators. Among other things, these agreements prohibit the acceptance or payment, as applicable, of contingent commissions for some or all lines of business. Several other brokers and some agents have voluntarily eliminated the practice of receiving contingent compensation from insurers. Other industry participants may make similar or different determinations in the future. In addition, a number of states have announced that they are looking at compensation arrangements and considering regulatory action or reform in this area. The rules that would be imposed if these actions or reforms were adopted range in nature from disclosure requirements to prohibition of certain forms of compensation to imposition of new duties on insurance agents, brokers or carriers in dealing with customers. These or other developments may require changes to market practices relative to contingent commissions. Changes to the manner in which we interact with and compensate insurance brokers and agents could have a material adverse impact on our ability to renew business or write new business, which, in turn, could have a material adverse impact on our results of operations.

Certain regulators also have commenced investigations into certain loss mitigation and finite reinsurance arrangements in the property and casualty insurance industry. In connection with these investigations, we have received subpoenas and requests for information from various regulators including the U.S. Securities and Exchange Commission and the U.S. Attorney for the Southern



District of New York. We are cooperating, and intend to continue to cooperate, fully with these investigations.

We cannot predict at this time the outcome of these investigations or any impact on our business or results of operations.

### **Catastrophe Risk Management**

Our property and casualty subsidiaries have exposure to losses caused by natural perils such as hurricanes and other windstorms, earthquakes, winter storms and brush fires and from man-made catastrophic events such as terrorism. The frequency and severity of catastrophes are unpredictable.

#### ***Natural Catastrophes***

The extent of losses from a natural catastrophe is a function of both the total amount of insured exposure in an area affected by the event and the severity of the event. We regularly assess our concentration of risk exposures in catastrophe exposed areas globally and have strategies and underwriting standards to manage this exposure through individual risk selection, subject to regulatory constraints, and through the purchase of catastrophe reinsurance. We have invested in modeling technologies and a concentration management tool that allow us to monitor and control our accumulations of potential losses in catastrophe exposed areas in the United States, such as California and the gulf and east coasts, as well as in such areas in other countries. Actual results may differ materially from those suggested by the model. We also continue to actively explore and analyze credible scientific evidence, including the impact of global climate change, that may affect our ability to manage exposure under the insurance policies we issue.

Despite these efforts, the occurrence of one or more severe natural catastrophic events in heavily populated areas could have a material adverse effect on the Corporation's results of operations, financial condition or liquidity.

#### ***Terrorism Risk and Legislation***

The September 11, 2001 attack changed the way the property and casualty insurance industry views catastrophic risk. That tragic event demonstrated that numerous classes of business we write are subject to terrorism-related catastrophic risks in addition to the catastrophic risks related to natural occurrences. This has required us to change how we identify and evaluate risk accumulations. We have licensed a terrorism model that provides estimates of loss events. We also have a concentration management tool that enables us to identify locations and geographic areas that are exposed to risk accumulations. The information provided by the model and the tracking tool has resulted in our non-renewing some accounts and has restricted us from writing others. Actual results may differ materially from those suggested by the model.

The Terrorism Risk Insurance Act of 2002 (TRIA) established a temporary program under which the federal government will share the risk of loss from certain acts of international terrorism with the insurance industry. The program, which was applicable to most lines of commercial business, was scheduled to terminate on December 31, 2005. In December 2005, the federal government extended TRIA through December 31, 2007. Under the terms of the amended law, certain lines of business previously subject to the provisions of TRIA, including commercial automobile, surety and professional liability insurance, other than directors and officers liability, are excluded from the program. As a precondition to recovery under TRIA, insurance companies with direct commercial insurance exposure in the United States for TRIA lines of business are required to make insurance for covered acts of terrorism available under their policies. Each insurer has a separate deductible that it must meet in the event of an act of terrorism before federal assistance becomes available. The deductible is based on a percentage of direct U.S. earned premiums for the covered lines of business in the previous calendar year. For 2006, that deductible is 17.5% of direct premiums earned in 2005 for these lines of business. For losses above the deductible, the federal government will pay for 90% of covered losses, while the insurer retains 10%. In 2007, the deductible will increase to 20% of direct premiums earned in 2006 and the insurer share for losses above the deductible will increase to 15%. There is a combined

annual aggregate limit for the federal government and all insurers of \$100 billion. If acts of terrorism result in covered losses exceeding the \$100 billion annual limit, insurers are not liable for additional losses.

While the provisions of TRIA will serve to mitigate our exposure in the event of a large-scale terrorist attack, our deductible is substantial, approximating \$925 million in 2006. For certain classes of business, such as workers' compensation, terrorism insurance is mandatory under TRIA. For those classes of business where it is not mandatory, insureds may choose not to accept terrorism insurance, which would, subject to other statutory or regulatory restrictions, reduce our exposure.

We will continue to manage this type of catastrophic risk by monitoring terrorism risk aggregations. Nevertheless, given the unpredictability of the targets, frequency and severity of potential terrorist events as well as the limited terrorism coverage in our reinsurance program, the occurrence of any such events could have a material adverse effect on the Corporation's results of operations, financial condition or liquidity.

We also have exposure outside the United States to risk of loss from acts of terrorism. In some jurisdictions, we have access to government mechanisms that would mitigate our exposure.

### **Loss Reserves**

Unpaid losses and loss expenses, also referred to as loss reserves, are the largest liability of our property and casualty subsidiaries.

Our loss reserves include the accumulation of individual case estimates for claims that have been reported and estimates of claims that have been incurred but not reported as well as estimates of the expenses associated with processing and settling all reported and unreported claims. Estimates are based upon past loss experience modified for current trends as well as prevailing economic, legal and social conditions. Our loss reserves are not discounted to present value.

We regularly review our loss reserves using a variety of actuarial techniques. We update the reserve estimates as historical loss experience develops, additional claims are reported or settled and new information becomes available. Any changes in estimates are reflected in operating results in the period in which the estimates are changed.

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Our loss reserves include significant amounts related to asbestos and toxic waste claims, Hurricane Katrina and the September 11 attack. The components of our loss reserves were as follows:

	<b>December 31</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	(in millions)		
<b>Gross loss reserves</b>			
Related to asbestos and toxic waste claims	\$ 1,121	\$ 1,169	1,295
Related to Hurricane Katrina	967		
Related to September 11 attack	413	700	999
All other loss reserves	19,981	18,423	15,654
	<u>22,482</u>	<u>20,292</u>	<u>17,948</u>
<b>Reinsurance recoverable</b>			
Related to asbestos and toxic waste claims	50	55	57
Related to Hurricane Katrina	756		
Related to September 11 attack	354	582	748
All other reinsurance recoverable	2,609	2,846	2,622
	<u>3,769</u>	<u>3,483</u>	<u>3,427</u>
<b>Net loss reserves</b>	<u>\$ 18,713</u>	<u>\$ 16,809</u>	<u>\$ 14,521</u>

Loss reserves, net of reinsurance recoverable, increased by \$1.9 billion or 11% in 2005 compared with an increase of \$2.3 billion or 16% in 2004. The loss reserves related to asbestos and toxic waste claims, Hurricane Katrina and the September 11 attack are significant components of our total loss reserves, but they distort the growth trend in the loss reserves. Excluding such loss reserves, our loss reserves, net of reinsurance recoverable, increased by \$1.8 billion or 12% in 2005 compared with an increase of \$2.5 billion or 20% in 2004.

The components of our net loss reserves were as follows:

	<b>December 31</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	(in millions)		
Reserves related to asbestos and toxic waste claims	\$ 1,071	\$ 1,114	\$ 1,238
Reserves related to Hurricane Katrina	211		
Reserves related to September 11 attack	59	118	251
<b>All other loss reserves</b>			
Personal insurance	1,692	1,579	1,400
Commercial insurance	7,475	6,594	5,837
Specialty insurance	6,827	6,282	5,114
Reinsurance assumed	1,378	1,122	681
	<u>\$ 18,713</u>	<u>\$ 16,809</u>	<u>\$ 14,521</u>

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Loss reserves for each of our business units increased significantly in 2004 and again in 2005. The most significant increases occurred in the long tail liability classes of business within commercial and specialty insurance and reinsurance assumed.

Based on all information currently available, we believe that the aggregate loss reserves of our property and casualty subsidiaries at December 31, 2005 were adequate to cover claims for losses that had occurred, including both those known to us and those yet to be reported. In establishing such reserves, we consider facts currently known and the present state of the law and coverage litigation. However, given the judicial decisions and legislative actions that have broadened the scope of

coverage and expanded theories of liability in the past and the possibilities of similar interpretations in the future, particularly as they relate to asbestos claims and, to a lesser extent, toxic waste claims, it is possible that management's estimate of the ultimate liability for losses that had occurred as of December 31, 2005 may increase in future periods. Such increases in estimates could have a material adverse effect on the Corporation's future operating results. However, management does not expect that any such increases would have a material adverse effect on the Corporation's consolidated financial condition or liquidity.

#### *Estimates and Uncertainties*

The process of establishing loss reserves is complex and imprecise as it must take into consideration many variables that are subject to the outcome of future events. As a result, informed subjective estimates and judgments as to our ultimate exposure to losses are an integral component of our loss reserving process.

Due to the inherent complexity of the loss reserving process and the potential variability of the assumptions used, the actual emergence of losses could vary, perhaps substantially, from the estimate of losses included in our financial statements, particularly when settlements may not occur until well into the future. A relatively small percentage change in the estimate of net loss reserves would have a material effect on the Corporation's operating results. For example, a hypothetical 1% increase in net loss reserves at December 31, 2005 would have resulted in a pre-tax charge of approximately \$190 million.

Our loss reserves include amounts related to short tail and long tail classes of business. Tail refers to the time period between the occurrence of a loss and the settlement of the claim. The longer the time span between the incidence of a loss and the settlement of the claim, the more the ultimate settlement amount can vary.

Short tail classes consist principally of homeowners, commercial property and marine business. For these classes, the estimation of loss reserves is less complex because claims are generally reported and settled shortly after the loss occurs and the claims relate to tangible property. Typically, there is less variability in reserve estimates for these classes of business.

Most of our loss reserves relate to long tail liability classes of business. Long tail classes include directors and officers liability, errors and omissions liability and other professional liability coverages, commercial excess liability, and other liability coverages. For many liability claims significant periods of time, ranging up to several years or more, may elapse between the occurrence of the loss, the reporting of the loss to us and the settlement of the claim. As a result, loss experience in the more recent accident years for the long tail liability classes has limited statistical credibility because a relatively small proportion of losses in these accident years are reported claims and an even smaller proportion are paid losses. In addition, liability claims are more susceptible to litigation and can be significantly affected by changing contract interpretations and the legal environment. Consequently, the estimation of loss reserves for these classes is more complex and subject to a higher degree of variability.

Most of our reinsurance assumed business is long tailed casualty reinsurance. Reserve estimates for this business are therefore subject to the variability caused by extended loss emergence periods. The estimation of loss reserves for this business is further complicated by delays between the time the claim is reported to the ceding insurer and when it is reported by the ceding insurer to us and by our dependence on the quality and consistency of the loss reporting by the ceding company.

A relatively large proportion of our net loss reserves, particularly for long tail liability classes, are reserves for incurred but not reported (IBNR) losses—claims that have not yet been reported to us, some of which are not yet known to the insured, and future development on reported claims. In fact, approximately 65% of our aggregate net loss reserves at December 31, 2005 were for IBNR losses.

We regularly review the loss reserves for each of the numerous classes of business we write as part of our overall analysis of loss reserves, taking into consideration the variety of trends that impact the ultimate settlement of claims in each particular class of business.

To estimate loss reserves, our actuaries use a variety of actuarial methods that analyze experience, trends and other relevant factors. These methods generally utilize analyses of historical patterns of the development of paid and reported losses by accident year by class of business. This process relies on the basic assumption that past experience, adjusted for the effects of current developments and likely trends, is an appropriate basis for predicting future outcomes.

For certain long tail classes of business where anticipated loss experience is less predictable because of the small number of claims and/or erratic claim severity patterns, estimates are based on both expected losses and actual reported losses. These classes include directors and officers liability, errors and omissions liability and commercial excess liability, among others. For these classes, we judgmentally set an estimate of ultimate losses for each accident year based on our evaluation of loss trends and the current risk environment. The estimate of ultimate losses is adjusted as the accident years mature.

In completing their actuarial reserve analysis, our actuaries are required to make numerous assumptions, including the selection of loss development factors and loss cost trend factors. They are also required to determine the most appropriate actuarial methods to employ for each class of business. Each estimation method has its own set of assumption variables and its own advantages and disadvantages, with no estimation method being better than the others in all situations. The relative strengths and weaknesses of the various estimation methods can also change over time. The estimation methods chosen are those that are believed to produce the most reliable indication for the loss reserves being evaluated. In most cases, multiple estimation methods will be valid for the particular facts and circumstances of the loss reserves being evaluated. This will result in a number of point estimates for each class of business.

Using all available data, our actuaries select an indicated loss reserve amount for each class of business based on the various assumptions, projections and methods. The total indicated reserve amount determined by our actuaries is an aggregate of the indicated reserve amount for the individual classes of business. The ultimate liability is likely to fall within a range of potential outcomes around this indicated liability, but the indicated amount is not expected to be precisely the ultimate liability.

Actuarial ranges of reasonable estimates are not a true reflection of the potential volatility between carried loss reserves and the ultimate settlement amount of losses incurred prior to the balance sheet date. This is due, among other reasons, to the fact that actuarial ranges are developed based on known events as of the valuation date whereas the ultimate disposition of losses is subject to the outcome of events and circumstances that were unknown as of the valuation date.

After carefully reviewing our actuaries' loss reserve analyses, management determines the carried reserve for each class of business. In making the determination, management considers numerous factors, such as changes in actuarial indications in the period, the maturity of the accident year, trends observed over the recent past and the level of volatility within a particular class of business. Such an assessment requires considerable judgment. It is often not possible to determine whether a change in the data is an anomaly. Even if a change is determined to be permanent, it is not always possible to determine the extent of the change until sometime later. As a result, there can be a time lag between the emergence of a change and a determination that the change should be reflected in the carried loss reserves. In general, changes are made more quickly to more mature accident years and less volatile classes of business.

Among the numerous factors that contribute to the inherent uncertainty in the process of establishing loss reserves are the following:

changes in the inflation rate for goods and services related to covered damages such as medical care and home repair costs;

changes in the judicial interpretation of policy provisions relating to the determination of coverage;

changes in the general attitude of juries in the determination of liability and damages;

legislative actions including the impact of the Class Action Fairness Act of 2005;

changes in the medical condition of claimants;

changes in our estimates of the number and/or severity of claims that have been incurred but not reported as of the date of the financial statements;

changes in our underwriting standards; and

changes in our claim handling procedures.

In addition, we must consider the uncertain effects of emerging or potential claims and coverage issues that arise as legal, judicial and social conditions change. These issues can have a negative effect on our loss reserves by either extending coverage beyond the original underwriting intent or by increasing the number or size of claims. Recent examples of emerging or potential claims and coverage issues include increases in the number and size of directors and officers liability and errors and omissions liability claims arising out of investment banking practices and accounting and other corporate malfeasance, exposure to claims asserted for bodily injury as a result of long-term exposure to harmful products or substances and increases in the number and size of water damage claims related to remediation of mold conditions. As a result of issues such as these, the uncertainties inherent in estimating ultimate claim costs on the basis of past experience have grown, further complicating the already complex loss reserving process.

The future impact of the various factors described above that contribute to the uncertainty in the loss reserving process and of emerging or potential claims and coverage issues is extremely hard to predict and cannot be quantified.

**Reserves Relating to Asbestos and Toxic Waste Claims.** The estimation of loss reserves relating to asbestos and toxic waste claims on insurance policies written many years ago is subject to greater uncertainty than other types of claims due to inconsistent court decisions as well as judicial interpretations and legislative actions that in some cases have tended to broaden coverage beyond the original intent of such policies and in others have expanded theories of liability. The insurance industry as a whole is engaged in extensive litigation over coverage and liability issues and is thus confronted with a continuing uncertainty in its efforts to quantify these exposures.

Reserves for asbestos and toxic waste claims cannot be estimated with traditional actuarial loss reserving techniques that rely on historical accident year loss development factors. Instead, we rely on an exposure-based analysis that involves a detailed review of individual policy terms and exposures. Because each policyholder presents different liability and coverage issues, we generally evaluate our exposure on a policyholder-by-policyholder basis, considering a variety of factors that are unique to each policyholder. Quantitative techniques have to be supplemented by subjective considerations including management's judgment. It is therefore not possible to determine the future development of asbestos and toxic waste claims with the same degree of reliability as is the case for other types of claims. Such development will be affected by future court decisions and interpretations as well as changes in applicable legislation.

We establish case reserves and expense reserves for costs of related litigation where sufficient information has been developed to indicate the involvement of a specific insurance policy. In addition, IBNR reserves are established to cover additional exposures on both known and unasserted claims.

**Asbestos Reserves.** Asbestos remains the most significant and difficult mass tort for the insurance industry in terms of claims volume and dollar exposure. Asbestos claims relate primarily to bodily injuries asserted by those who came in contact with asbestos or products containing asbestos. Early court cases established the continuous trigger theory with respect to insurance coverage. Under this

theory, insurance coverage is deemed to be triggered from the time a claimant is first exposed to asbestos until the manifestation of any disease. This interpretation of a policy trigger can involve insurance companies over many years and increases their exposure to liability.

New asbestos claims and new exposures on existing claims have continued unabated despite the fact that usage of asbestos has declined since the mid-1970 s. Each claim filing typically names dozens of defendants to ensure that there is a solvent company left in the group to eventually pay claims. The plaintiffs bar continues to solicit new claimants through extensive advertising and through asbestos medical screenings. New asbestos cases are often filed in those jurisdictions with a reputation for judges and juries that are extremely sympathetic to plaintiffs. A vast majority of asbestos bodily injury claims are filed by claimants who do not show any signs of asbestos related disease.

There have been several recent positive events in the asbestos environment:

Various challenges to mass screening claimants have been mounted, including a June 2005 U.S. District Court decision in Texas that accused plaintiffs lawyers of filing claims for people who had not been properly diagnosed with silicosis. Among the repercussions of that ruling, several asbestos injury settlement trusts have refused new claims that were based on the diagnosis of physicians or screening companies named in the case. Further investigations of the medical screening process for asbestos claims are underway.

A number of key jurisdictions have adopted venue reform that requires plaintiffs to have a connection to the jurisdiction in order to file a complaint.

Since 2004, several states have enacted laws that set medical criteria that must be met for plaintiffs to proceed with their claims. Other states have medical criteria bills pending. While this legislation is being challenged in certain of these states, it appears that these laws are already impacting the filing of claims by unimpaired plaintiffs. A related positive development has been the implementation by several states of inactive dockets, which preserve the rights of unimpaired claimants but do not provide for payments to these claimants unless they meet medical criteria.

To date, approximately 75 manufacturers and distributors of asbestos products have filed for bankruptcy protection as a result of asbestos related liabilities. Certain of these manufacturers and distributors have utilized a practice referred to as a prepackaged bankruptcy, which involves an agreement to a plan between the debtor and its creditors, including current and future asbestos claimants. Although the debtor is negotiating in part with its insurers money, insurers are generally given only limited opportunity to be heard. In recognition that many aspects of prepackaged bankruptcy plans are unfair to certain classes of claimants and to the insurance industry, these plans are beginning to be closely scrutinized by the courts and rejected when appropriate.

Our most significant individual asbestos exposures involve products liability on the part of traditional defendants who were engaged in the manufacture, distribution or installation of asbestos products. We wrote excess liability and/or general liability coverages for these insureds. While these insureds are relatively few in number, their exposure has increased in recent years due to the increased volume of claims, the erosion of much of the underlying limits and the bankruptcies of target defendants.

Our other asbestos exposures involve products and non-products liability on the part of peripheral defendants, including a mix of manufacturers, distributors and installers of certain products that contain asbestos in small quantities and owners or operators of properties where asbestos was present. Generally, these insureds are named defendants on a regional rather than a nationwide basis. As the financial resources of traditional asbestos defendants have been depleted, plaintiffs are targeting these viable peripheral parties with greater frequency and, in many cases, for larger awards.

Asbestos claims against the major manufacturers, distributors or installers of asbestos products were presented under the products liability section of primary general liability policies as well as under excess liability policies, both of which typically had aggregate limits that capped an insurer s exposure. In recent years, a number of asbestos claims by insureds are being presented as non-products claims, such as those by installers of asbestos products and by property owners or operators



who allegedly had asbestos on their property, under the premises or operations section of primary general liability policies. Unlike products exposures, these non-products exposures typically had no aggregate limits on coverage, creating potentially greater exposure. Further, in an effort to seek additional insurance coverage, some insureds with installation activities who have substantially eroded their products coverage are presenting new asbestos claims as non-products operations claims or attempting to reclassify previously settled products claims as non-products claims to restore a portion of previously exhausted products aggregate limits. It is difficult to predict whether insureds will be successful in asserting claims under non-products coverage or whether insurers will be successful in asserting additional defenses. Therefore, the future impact of such efforts on insurers is uncertain.

In establishing our asbestos reserves, we evaluate the exposure presented by each insured. As part of this evaluation, we consider a variety of factors including: the available insurance coverage; limits and deductibles; the jurisdictions involved; past settlement values of similar claims; the potential role of other insurance, particularly underlying coverage below our excess liability policies; potential bankruptcy impact; and applicable coverage defenses, including asbestos exclusions. We have assumed a continuing unfavorable legal environment with no benefit from any federal asbestos reform legislation. Proposed legislation currently being considered by the Senate would create a \$140 billion asbestos trust fund. We are among those who oppose this bill because it provides neither certainty nor finality.

In the fourth quarter of 2003, our actuaries and claim personnel, together with our outside actuarial consultants, performed a rigorous update of a 2002 ground-up analysis of our asbestos related exposures. The review noted certain adverse trends, particularly an increase in estimates of the ultimate liabilities for several of our traditional asbestos defendants. In addition, the number of peripheral asbestos defendants for whom we established reserves and the average severity of these claims were both higher than anticipated. Upon completion of the update, we increased our net asbestos loss reserves by \$250 million.

During 2004 and 2005, our actuaries and claim personnel performed analyses of our asbestos related exposures. The 2004 analysis noted that both the number of peripheral asbestos defendants for whom we established reserves and the average severity of these claims were again somewhat higher than expected. In addition, there was an increase in our estimate of the ultimate liabilities for one of our traditional asbestos defendants. The 2005 analysis noted an increase in our estimate of the ultimate liabilities for two of our asbestos defendants. Based on these analyses, which were confirmed by our outside actuarial consultants, we increased our net asbestos loss reserves by \$75 million in 2004 and \$35 million in 2005.

The following table presents a reconciliation of the beginning and ending loss reserves related to asbestos claims.

	<b>Years Ended December 31</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	(in millions)		
Gross loss reserves, beginning of year	\$961	\$1,068	\$ 885
Reinsurance recoverable, beginning of year	55	56	51
Net loss reserves, beginning of year	906	1,012	834
Net incurred losses	35	75	250
Net losses paid	61	181	72
Net loss reserves, end of year	880	906	1,012
Reinsurance recoverable, end of year	50	55	56
Gross loss reserves, end of year	\$930	\$ 961	\$1,068

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The following table presents the number of policyholders for whom we have open asbestos case reserves and the related net loss reserves at December 31, 2005 as well as the net losses paid during 2005 by component.

	Number of Policyholders	Net Loss Reserves	Net Losses Paid
		(in millions)	
Traditional defendants	21	\$334	\$ 10
Peripheral defendants	375	378	51
Future claims from unknown policyholders		168	
		\$880	\$ 61

Significant uncertainty remains as to our ultimate liability related to asbestos related claims. This uncertainty is due to several factors including:

the long latency period between asbestos exposure and disease manifestation and the resulting potential for involvement of multiple policy periods for individual claims;

plaintiffs' increased focus on peripheral defendants;

the increase in the volume of claims by unimpaired plaintiffs and the extent to which they can be precluded from making claims;

the efforts by insureds to obtain coverage not subject to aggregate limits;

the number of insureds seeking bankruptcy protection as a result of asbestos related liabilities and the impact of prepackaged bankruptcies;

the ability of claimants to bring a claim in a state in which they have no residency or exposure;

inconsistent court decisions and diverging legal interpretations; and

the possibility, however remote, of federal legislation that would address the asbestos problem.

These significant uncertainties are not likely to be resolved definitively in the near future. While there have been some positive legislative and judicial developments in the asbestos arena over the past two years, it is too early to call it a trend.

**Toxic Waste Reserves.** Toxic waste claims relate primarily to pollution and related cleanup costs. Our insureds have two potential areas of exposure – hazardous waste dump sites and pollution at the insured site primarily from underground storage tanks and manufacturing processes.

Under the federal Superfund law and similar state statutes, when potentially responsible parties (PRPs) fail to handle the clean-up at a hazardous waste site, regulators have the work done and then attempt to establish legal liability against the PRPs. Most sites have multiple PRPs.

Most PRPs named to date are parties who have been generators, transporters, past or present landowners or past or present site operators. The PRPs disposed of toxic materials at a waste dump site or transported the materials to the site. These PRPs had proper government authorization in many instances. Insurance policies issued to PRPs were not intended to cover the clean-up costs of pollution and, in many cases, did not intend to cover the pollution itself. Pollution was not a recognized hazard at the time many of these policies were written. In more recent years, however, policies specifically excluded such exposures.

As the costs of environmental clean-up became substantial, PRPs and others increasingly filed claims with their insurance carriers. Litigation against insurers extends to issues of liability, coverage and other policy provisions.

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There is substantial uncertainty involved in estimating our liabilities related to these claims. First, the liabilities of the claimants are extremely difficult to estimate. At any given waste site, the allocation of remediation costs among governmental authorities and the PRPs varies greatly depending on a

variety of factors. Second, different courts have addressed liability and coverage issues regarding pollution claims and have reached inconsistent conclusions in their interpretation of several issues. These significant uncertainties are not likely to be resolved definitively in the near future.

Uncertainties also remain as to the Superfund law itself. Superfund's taxing authority expired on December 31, 1995 and has not been re-enacted. Federal legislation appears to be at a standstill. At this time, it is not possible to predict the direction that any reforms may take, when they may occur or the effect that any changes may have on the insurance industry.

Without federal movement on Superfund reform, the enforcement of Superfund liability is shifting to the states. States are being forced to reconsider state-level cleanup statutes and regulations. As individual states move forward, the potential for conflicting state regulation becomes greater. In a few states, we are seeing cases brought against insureds or directly against insurance companies for environmental pollution and natural resources damages. To date, only a few natural resource claims have been filed and they are being vigorously defended. Significant uncertainty remains as to the cost of remediating the state sites. Because of the large number of state sites, such sites could prove even more costly in the aggregate than Superfund sites.

In establishing our toxic waste reserves, we evaluate the exposure presented by each insured. As part of this evaluation, we consider a variety of factors including: the probable liability, available insurance coverage, judicial interpretations, past settlement values of similar exposures as well as facts that are unique to each insured.

Uncertainty remains as to our ultimate liability relating to toxic waste claims. However, toxic waste losses appear to be developing as expected due to relatively stable claim trends. In many cases, claims are being settled for less than initially anticipated due to more efficient site remediation efforts. In other cases, we have been successful at buying back our policies.

The following table presents a reconciliation of our beginning and ending loss reserves, net of reinsurance recoverable, related to toxic waste claims. There are virtually no reinsurance recoveries related to these claims.

	Years Ended December 31		
	2005	2004	2003
	(in millions)		
Reserves, beginning of year	\$208	\$226	\$249
Incurring losses			
Losses paid	17	18	23
Reserves, end of year	\$191	\$208	\$226

Of the net toxic waste loss reserves at December 31, 2005 \$64 million was for IBNR losses.

**Reinsurance Recoverable.** Reinsurance recoverable is the estimated amount recoverable from reinsurers related to the losses we have incurred. At December 31, 2005, reinsurance recoverable included \$396 million recoverable with respect to paid losses and loss expenses, which is included in other assets, and \$3.8 billion recoverable on unpaid losses and loss expenses.

Reinsurance recoverable on unpaid losses and loss expenses represents an estimate of the portion of our gross loss reserves that will be recovered from reinsurers. Such reinsurance recoverable is estimated as part of our loss reserving process using assumptions that are consistent with the assumptions used in estimating the gross loss reserves. Consequently, the estimation of reinsurance recoverable is subject to similar judgments and uncertainties as the estimation of gross loss reserves.

Ceded reinsurance contracts do not relieve our primary obligation to our policyholders. Consequently, an exposure exists with respect to reinsurance recoverable to the extent that any reinsurer is unable or unwilling to meet the obligations assumed under the reinsurance contracts. We are selective in regard to our reinsurers, placing reinsurance with only those reinsurers with strong



balance sheets and superior underwriting ability, and we monitor the financial strength of our reinsurers on an ongoing basis. Nevertheless, in recent years, certain of our reinsurers have experienced financial difficulties or exited the reinsurance business. In addition, we may become involved in coverage disputes with our reinsurers. A provision for estimated uncollectible reinsurance is recorded based on an evaluation of balances due from reinsurers, changes in the credit standing of the reinsurers, coverage disputes and other relevant factors.

### ***Prior Year Loss Development***

Because loss reserve estimates are subject to the outcome of future events, changes in estimates are unavoidable given that loss trends vary and time is required for changes in trends to be recognized and confirmed. Reserve changes that increase previous estimates of ultimate cost are referred to as unfavorable or adverse development or reserve strengthening. Reserve changes that decrease previous estimates of ultimate cost are referred to as favorable development or reserve releases.

A reconciliation of our beginning and ending loss reserves, net of reinsurance, for the three years ended December 31, 2005 is as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	(in millions)		
Net loss reserves, beginning of year	\$ 16,809	\$ 14,521	\$ 12,642
Net incurred losses and loss expenses related to			
Current year	7,651	6,994	6,470
Prior years	163	327	397
	<u>7,814</u>	<u>7,321</u>	<u>6,867</u>
Net payments for losses and loss expenses related to			
Current year	1,879	1,691	1,589
Prior years	4,031	3,342	3,399
	<u>5,910</u>	<u>5,033</u>	<u>4,988</u>
Net loss reserves, end of year	<u>\$ 18,713</u>	<u>\$ 16,809</u>	<u>\$ 14,521</u>

During 2005, we experienced overall unfavorable prior year development of \$163 million, which represented 1.0% of the net loss reserves as of December 31, 2004. This compares with unfavorable prior year development of \$327 million during 2004, which represented 2.3% of the net loss reserves at December 31, 2003, and \$397 million during 2003, which represented 3.1% of the net loss reserves at December 31, 2002. Such adverse development was reflected in operating results in these respective years.

The net unfavorable development of \$163 million in 2005 was due to various factors. The most significant were:

We experienced net adverse development of about \$200 million in the professional liability classes other than fidelity. Adverse development related to accident years 1998 through 2002, due largely to errors and omissions liability claims related to corporate failures and allegations of management misconduct and accounting irregularities, was offset in part by favorable development related to accident years 2003 and 2004.

We experienced adverse development of about \$175 million related to accident years prior to 1996, including \$35 million related to asbestos claims. The adverse development was due largely to our strengthening loss reserves for commercial excess/umbrella and other commercial liability classes. There was significant reported loss activity during 2005 related to these older accident years, which caused us to extend the expected loss emergence period for these classes.

We experienced favorable development of about \$160 million due to fewer than expected late reported homeowners and commercial property losses.

We experienced favorable development of about \$90 million in the fidelity and surety classes due to lower than expected reported loss emergence.

The net unfavorable development of \$327 million in 2004 was also the result of various factors. The most significant factors were:

We experienced adverse development of about \$415 million in the professional liability classes, principally directors and officers liability and errors and omissions liability, resulting from adverse loss trends in accident years 1998 through 2002 due in large part to claims related to corporate failures and allegations of management misconduct and accounting irregularities, especially those involving investment banks and other financial institutions.

We experienced adverse development of about \$185 million related to accident years prior to 1995, including \$75 million related to asbestos claims. We strengthened loss reserves for certain commercial liability classes.

We experienced adverse development of about \$50 million in the workers' compensation class due primarily to higher average severity of the medical portion of these claims.

We experienced favorable development of about \$270 million related to the 2003 accident year, due in large part to an unusually low amount of late reported homeowners and commercial property losses.

We experienced favorable development of \$80 million due to a reduction of loss reserves related to the September 11 attack.

The unfavorable development in 2003 was due primarily to two factors. First, we strengthened asbestos loss reserves by \$250 million in the fourth quarter. Second, we experienced unfavorable development of about \$140 million in our professional liability classes, principally directors and officers liability and errors and omissions liability, as adverse loss trends in the 2000 through 2002 accident years more than offset favorable loss experience in older accident years.

In Item 1 of this report, we present an analysis of our consolidated loss reserve development on a calendar year basis for each of the ten years prior to 2005.

Our U.S. property and casualty subsidiaries are required to file annual statements with insurance regulatory authorities prepared on an accounting basis prescribed or permitted by such authorities. These annual statements include an analysis of loss reserves, referred to as Schedule P, that presents accident year loss development information by line of business for the nine years prior to 2005. It is our intention to post the Schedule P for our combined U.S. property and casualty subsidiaries on our website as soon as it becomes available.

## **Investment Results**

Property and casualty investment income before taxes increased by 11% in 2005 compared with 2004 and by 12% in 2004 compared with 2003. Growth in both years was due to an increase in invested assets, which reflected substantial cash flow from operations over the period. Growth in 2004 also benefited from an \$800 million capital contribution to the property and casualty subsidiaries by the Corporation in the second quarter of 2003. Growth in investment income in both years was dampened by lower available reinvestment rates on fixed maturities that matured.

The effective tax rate on our investment income was 19.7% in 2005 compared with 19.8% in 2004 and 20.3% in 2003. The effective tax rate fluctuated as the result of our holding a different proportion of our investment portfolio in tax-exempt securities during each year.

On an after-tax basis, property and casualty investment income increased by 11% in 2005 and 13% in 2004. Management uses property and casualty investment income after-tax, a non-GAAP financial measure, to evaluate its investment performance because it reflects the impact of any change in the proportion of the investment portfolio invested in tax-exempt securities and is therefore more meaningful for analysis purposes than investment income before income tax.

#### **Other Charges**

Other charges include miscellaneous income and expenses of the property and casualty subsidiaries.

Other charges in 2003 included expenses of \$18 million related to the restructuring of our operations in Continental Europe. The restructuring costs consisted primarily of severance costs related to branch closings and work force reductions.

#### **CHUBB FINANCIAL SOLUTIONS**

Chubb Financial Solutions (CFS) was organized in 2000 to develop and provide customized products to address specific financial needs of corporate clients. CFS operated through both the capital and insurance markets. The insurance and reinsurance solutions were written by our property and casualty subsidiaries, and the results of such business are included within our underwriting results.

In April 2003, the Corporation announced its intention to exit CFS's non-insurance business and to run-off the existing financial products portfolio. Since that date, our objective has been to exit this business as quickly as possible while minimizing the potential of a large payment due to an unexpected credit event.

CFS's non-insurance business was primarily structured credit derivatives, principally as a counterparty in portfolio credit default swap contracts. The Corporation guaranteed all of these obligations.

In a typical portfolio credit default swap, CFS participated in the senior layer of a structure designed to replicate the performance of a portfolio of corporate or asset-backed securities. The structure of these portfolio credit default swaps generally requires CFS to make payment to counterparties to the extent cumulative losses, related to numerous credit events, exceed a specified threshold. The risk below that threshold, referred to as subordination, is assumed by other parties with the primary risk layer sometimes retained by the buyer. Credit events generally arise when one of the referenced entities within a portfolio becomes bankrupt, undergoes a debt restructuring or fails to make timely interest or principal payments.

Portfolio credit default swaps are derivatives and are carried in the financial statements at estimated fair value, which represents management's best estimate of the cost to exit our positions. Credit default swaps tend to be unique transactions and there is no market for trading such exposures. To estimate the fair value of the obligation in each credit default swap, we use internal valuation models that are similar to external valuation models.

The fair value of our credit default swaps is subject to fluctuations arising from, among other factors, changes in credit spreads, the financial ratings of referenced asset-backed securities, actual credit events reducing subordination, credit correlation within a portfolio, anticipated recovery rates related to potential defaults and changes in interest rates. Changes in fair value are included in income in the period of the change. Thus, CFS's results have been subject to volatility.

The non-insurance business of CFS produced a loss before taxes of \$6 million in 2005 compared with losses of \$17 million in 2004 and \$127 million in 2003.

The substantial loss in 2003 was due to downgrades in the financial ratings of certain referenced securities underlying two of our asset-backed portfolio credit default swaps. In the first nine months of



the year, the fair value of our obligations related to these two swaps increased by \$70 million. Then, in the fourth quarter, CFS paid \$50 million to terminate the two asset-backed portfolio credit default swaps and simultaneously entered into a new contract under which CFS guaranteed principal and interest obligations on a notional amount of referenced securities. CFS established a liability of \$186 million related to the new principal and interest contract, which represented the estimated fair value of the guarantee at its inception. At the same time, CFS eliminated the carried liability of \$140 million on the two swaps that were terminated. The aggregate loss in the fourth quarter related to the termination of the two swaps was \$96 million. The losses during 2003 related to these two asset-backed swaps were partially offset by mark-to-market gains on our corporate credit default swaps.

The loss in 2004 was primarily related to the termination during the year of CFS's obligations under several portfolio credit default swaps.

The loss in 2005 was due to the termination of the principal and interest guarantee contract. CFS paid the counterparty \$198 million to terminate the contract, at which time the \$186 million liability was eliminated. The loss related to the termination of this contract was partially offset by gains on the termination during the period of CFS's obligations under certain portfolio credit default swaps.

Revenues from the non-insurance business of CFS, primarily consisting of the change in fair value of derivatives contracts, were virtually nil in 2005 and 2004 and negative \$62 million in 2003. Revenues were negative in 2003 due to the adverse impact of changes in fair value and the impact of the agreement to terminate the two asset-backed portfolio credit default swaps and replace them with a principal and interest guarantee.

CFS's aggregate exposure, or retained risk, from each of its in-force portfolio credit default swaps is referred to as notional amount. Notional amounts are used to express the extent of involvement in swap transactions. These amounts are used to calculate the exchange of contractual cash flows and are not necessarily representative of the potential for gain or loss. The notional amounts are not recorded on the balance sheet.

During each of the past three years, CFS terminated certain portfolio credit default swaps with the original counterparties at negotiated settlement amounts. CFS also entered into credit default swaps with third parties that effectively offset existing credit default swaps. As of December 31, 2005, the notional amount of such offsetting credit default swaps was approximately \$1.5 billion.

The notional amount of CFS's credit default swaps was \$1.0 billion at December 31, 2005. Our realistic loss exposure is a very small portion of the \$1.0 billion notional amount as our position is senior to subordinated interests of \$537 million in the aggregate. In addition, using our internal ratings models, we estimate that the credit ratings of the individual portfolio credit default swaps at December 31, 2005 were AAA.

In addition to portfolio credit default swaps, CFS entered into a derivative contract linked to an equity market index that terminates in 2012 and a few other insignificant non-insurance transactions.

The notional amount and fair value of our future obligations under derivative contracts by type of risk were as follows:

	<b>December 31</b>			
	<b>Notional Amount</b>		<b>Fair Value</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	<b>(in billions)</b>		<b>(in millions)</b>	
Credit default swaps				
Corporate securities	\$ .2	\$1.3	\$ 1	\$ 5
Asset-backed securities	.8	7.4	1	9
	—	—	—	—
	1.0	8.7	2	14
Other	.3	.3	7	8
	—	—	—	—
	\$1.3	\$9.0	\$ 9	\$ 22
	—	—	—	—



## **CORPORATE AND OTHER**

Corporate and other includes investment income earned on corporate invested assets, interest expense and other expenses not allocated to the operating subsidiaries, and the results of our real estate and other non-insurance subsidiaries. It also includes income from our investment in Allied World Assurance Company, Ltd.

Corporate and other produced a loss before taxes of \$166 million in 2005 compared with losses of \$159 million and \$157 million in 2004 and 2003, respectively. Corporate and other results were similar in all three years as increases in investment income in 2004 and 2005 were substantially offset by increasingly larger losses in our real estate operations. Investment income was higher in 2005 compared with 2004 due to an increase in corporate invested assets resulting primarily from the issuance of common stock under stock-based employee compensation plans. Investment income was higher in 2004 compared with 2003 due to an increase in corporate invested assets resulting primarily from the issuance of debt and equity securities during 2003.

In 2004 and 2003, corporate and other results included a loss at The Chubb Institute, Inc., the post secondary educational subsidiary that we sold in September 2004. In both years, the effect of this loss was substantially offset by income from our investment in Allied World. Income from our investment in Allied World was significantly lower in 2005 than in the prior two years due to losses from Hurricane Katrina, our share of which was approximately \$45 million.

## **Real Estate**

Real estate operations resulted in a loss before taxes of \$41 million in 2005 compared with losses of \$25 million in 2004 and \$14 million in 2003. These amounts are included in the corporate and other results.

During 2005, we committed to a plan to sell a parcel of land in New Jersey that we had previously intended to hold and develop. The decision to sell the property was based on our assessment of the current real estate market and our concern about zoning issues. As a result of our decision to sell this property, we reassessed the recoverability of its carrying value. Based on our reassessment, we recognized an impairment loss of \$48 million during the year to reduce the carrying value of the property to its estimated fair value. The higher loss in 2004 compared with 2003 was due primarily to the recognition of impairment losses in 2004 on two commercial properties.

Real estate revenues were \$115 million in 2005, \$70 million in 2004 and \$72 million in 2003. In each year, we sold selected commercial properties as well as residential properties.

In addition to the aforementioned parcel of land that we plan to sell, we own approximately \$160 million of land that we expect will be developed in the future. Our real estate assets also include approximately \$145 million of commercial properties and land parcels under lease.

The recoverability of the carrying value of our real estate assets, other than the parcel of land that we plan to sell, is assessed based on our ability to fully recover costs through a future revenue stream. The assumptions used reflect future improvement in demand for office space, an increase in rental rates and the ability and intent to obtain financing in order to hold and develop such remaining properties and protect our interests over the long term. Management believes that it has made adequate provisions for impairment of real estate assets. However, if the assets are not sold or developed or if leased properties do not perform as presently contemplated, it is possible that additional impairment losses may be recognized that would have a material adverse effect on the Corporation's results of operations.

**REALIZED INVESTMENT GAINS AND LOSSES**

Net investment gains realized were as follows:

	<b>Years Ended December 31</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	(in millions)		
Net realized gains (losses) on sales			
Equity securities	\$237	\$225	\$ 75
Fixed maturities	(35)	24	66
Transfer of reinsurance assumed business	171		
Personal Lines Insurance Brokerage	16		
Chubb Institute		(31)	
	—	—	—
	389	218	141
	—	—	—
Other-than-temporary impairment			
Equity securities	1		14
Fixed maturities	4		42
	—	—	—
	5		56
	—	—	—
Realized investment gains before tax	\$384	\$218	\$ 85
	—	—	—
Realized investment gains after tax	\$248	\$146	\$ 55
	—	—	—

Of the net realized gains on sales of equity securities, \$162 million, \$155 million and \$35 million in 2005, 2004 and 2003, respectively, related to our share of gains recognized by limited partnerships in which we have an interest.

In December 2005, we transferred our ongoing reinsurance business and certain related assets to Harbor Point Limited. We recognized a gain of \$171 million on this transaction, which is further discussed under "Transfer of Ongoing Reinsurance Assumed Business".

In September 2005, we completed the sale of Personal Lines Insurance Brokerage, Inc. Based on the terms of the sale, we recognized a gain of \$16 million.

In 2004, we sold The Chubb Institute. Under the terms of the sale, we recognized a loss of \$31 million.

A primary reason for the sale of fixed maturities in each of the last three years has been to improve our after-tax portfolio return without sacrificing quality where market opportunities have existed to do so. In the fourth quarter of 2005, to reduce our income tax liability, we engaged in a program to sell taxable and tax-exempt fixed maturities to generate realized losses to offset a portion of the gain related to the Harbor Point transaction.

We regularly review those invested assets whose fair value is less than cost to determine if an other-than-temporary decline in value has occurred. In evaluating whether a decline in value of any investment is temporary or other-than-temporary, we consider various quantitative criteria and qualitative factors including the length of time and the extent to which the fair value has been less than the cost, the financial condition and near term prospects of the issuer, whether the issuer is current on contractually obligated interest and principal payments, our intent and ability to hold the investment for a period of time sufficient to allow us to recover our cost, general market conditions and industry or sector specific factors. If a decline in the fair value of an individual security is deemed to be other-than-temporary, the difference between cost and estimated fair value is charged to income as a realized investment loss. The fair value of the investment becomes its new cost basis.



The writedowns of fixed maturities in 2003 were primarily due to collateral deterioration of several asset-backed securities and price declines of a few corporate credits in the airline and energy sectors.

Information related to investment securities in an unrealized loss position at December 31, 2005 and 2004 is included in Note (3)(b) of the Notes to Consolidated Financial Statements.

## INCOME TAXES

We establish deferred income taxes on the undistributed earnings of foreign subsidiaries. Similarly, we establish deferred tax assets related to the expected future U.S. tax benefit of losses and foreign taxes incurred by our foreign subsidiaries. To evaluate the realization of the future tax benefit of these deferred tax assets, management must consider whether it is more likely than not that sufficient taxable income will be generated. Management's judgment is based on its assessment of business plans and related projections of future taxable income as well as available tax planning strategies. The tax loss carryforwards and foreign tax credits have no expiration. However, we are required under generally accepted accounting principles to consider a relatively near term horizon when we evaluate the likelihood of realizing future tax benefits.

During the years 2000 through 2002, Chubb Insurance Company of Europe (Chubb Europe) incurred substantial losses. During 2002, we established a valuation allowance of \$40 million for the portion of deferred income tax assets related to the expected future U.S. tax benefit of the losses and foreign taxes incurred by Chubb Europe that we could not recognize for accounting purposes due to the requirement to evaluate realization over a near term horizon. Due to profitable results in Chubb Europe during 2003, we concluded that it was more likely than not that the deferred tax assets would be realized over a near term horizon and we eliminated the valuation allowance.

In connection with the sale of a subsidiary a number of years ago, we agreed to indemnify the buyer for certain pre-closing tax liabilities. During the first quarter of 2005, we settled this obligation with the purchaser. As a result, we reduced our income tax liability, which resulted in the recognition of a benefit of \$22 million.

## CAPITAL RESOURCES AND LIQUIDITY

Capital resources and liquidity represent the overall financial strength of the Corporation and its ability to generate cash flows from its operating subsidiaries, borrow funds at competitive rates and raise new capital to meet operating and growth needs.

### Capital Resources

Capital resources provide protection for policyholders, furnish the financial strength to support the business of underwriting insurance risks and facilitate continued business growth. At December 31, 2005, the Corporation had shareholders' equity of \$12.4 billion and total debt of \$2.5 billion.

In 2002, Chubb issued \$600 million of unsecured 4% senior notes due in 2007 and 24 million mandatorily exercisable warrants to purchase its common stock. The notes and warrants were issued together in the form of 7% equity units, each of which initially represented \$25 principal amount of notes and one warrant. In August 2005, the notes were successfully remarketed as required by their terms. The interest rate on the notes was reset to 4.934%, effective August 16, 2005. The remarketed notes mature on November 16, 2007. Each warrant obligated the holder to purchase, on or before November 16, 2005, for a settlement price of \$25, a variable number of shares of Chubb's common stock. The number of shares purchased was determined based on a formula that considered the market price of Chubb's common stock immediately prior to the time of settlement in relation to the \$56.64 per share sale price of the common stock at the time the equity units were offered. Upon settlement of the warrants, Chubb issued 8,683,117 shares of common stock and received proceeds of \$600 million.

In June 2003, Chubb issued \$460 million of unsecured 2.25% senior notes due in 2008 and 18.4 million purchase contracts to purchase its common stock. The notes and purchase contracts

were issued together in the form of 7% equity units, each of which initially represents \$25 principal amount of notes and one purchase contract. The notes will be remarketed in May 2006. Each purchase contract obligates the holder to purchase, for a settlement price of \$25, a variable number of shares of Chubb's common stock on or before August 16, 2006. The number of shares to be purchased will be determined based on a formula that considers the market price of Chubb's common stock immediately prior to the time of settlement in relation to the \$59.50 per share sale price of the common stock at the time the equity units were offered. Upon settlement of the purchase contracts, Chubb will receive proceeds of approximately \$460 million and will issue between approximately 6,500,000 and 7,700,000 shares of common stock.

The equity units are further described in Notes (8) and (18) of the Notes to Consolidated Financial Statements.

Chubb also has outstanding \$225 million of unsecured 3.95% notes due in 2008, \$400 million of unsecured 6% notes due in 2011, \$275 million of unsecured 5.2% notes due in 2013, \$100 million of unsecured 6.6% debentures due in 2018 and \$200 million of unsecured 6.8% debentures due in 2031. In August 2005, \$300 million of 6.15% notes were paid when due.

Chubb Executive Risk Inc., a wholly owned subsidiary, has outstanding \$75 million of unsecured 7 1/8% notes due in 2007. Executive Risk Capital Trust, wholly owned by Chubb Executive Risk, has outstanding \$125 million of 8.675% capital securities. The sole assets of the Trust are debentures issued by Chubb Executive Risk. The capital securities are subject to mandatory redemption in 2027 upon repayment of the debentures. The capital securities are also subject to mandatory redemption under certain circumstances beginning in 2007. Chubb has guaranteed the unsecured notes and the capital securities.

Management continuously monitors the amount of capital resources that Chubb maintains both for itself and its operating subsidiaries. In connection with our long-term capital strategy, Chubb from time to time contributes capital to its property and casualty subsidiaries. In addition, in order to satisfy its capital needs as a result of any rating agency capital adequacy or other future rating issues, or in the event we were to need additional capital to make strategic investments in light of market opportunities, we may take a variety of actions, which could include the issuance of additional debt and/or equity securities.

In June 2003, a shelf registration statement that Chubb filed in March 2003 was declared effective by the Securities and Exchange Commission. Under the registration statement, up to \$2.5 billion of various types of securities may be issued. At December 31, 2005, approximately \$650 million remained under the shelf registration statement.

In December 2005, the Board of Directors authorized the repurchase of up to 14,000,000 shares of Chubb's common stock. The authorization has no expiration date. The authorization replaced an existing program authorized by the Board in July 1998 to purchase up to 12,500,000 shares, of which 3,287,100 shares had remained available. We made no share repurchases during 2003 and 2004. We repurchased 1,393,900 shares in open market transactions in 2005 at a cost of \$135 million. As of December 31, 2005, 12,606,100 shares remained under the current share repurchase authorization. Based on our outlook for 2006, we expect to repurchase all of the shares remaining under this authorization by the end of 2006.

On January 3, 2006, we repurchased 2,550,000 shares under an accelerated stock buyback program at an initial price of \$97.80 per share, for a total cost of approximately \$250 million. At the end of the program, we may receive, or be required to pay, a price adjustment based on the volume weighted average price of Chubb's common stock during the agreed upon program period, which will not exceed four months. The price adjustment may be settled, at our election, in Chubb's common stock or cash.

## Ratings

Chubb and its insurance subsidiaries are rated by major rating agencies. These ratings reflect the rating agency's opinion of our financial strength, operating performance, strategic position and ability to meet our obligations to policyholders.

Credit ratings assess a company's ability to repay its debts. The following table summarizes the Corporation's credit ratings from the major independent rating organizations as of March 10, 2006.

	<u>A.M. Best</u>	<u>Standard &amp; Poor's</u>	<u>Moody's</u>	<u>Fitch</u>
Senior unsecured debt rating	aa-	A	A2	A+
Commercial paper	AMB-1+	A-1	P-1	F-1

Financial strength ratings assess an insurer's ability to meet its financial obligations to policyholders. The following table summarizes our property and casualty subsidiaries' financial strength ratings from the major independent rating organizations as of March 10, 2006.

	<u>A.M. Best</u>	<u>Standard &amp; Poor's</u>	<u>Moody's</u>	<u>Fitch</u>
Financial strength	A++	AA	Aa2	AA

Ratings are an important factor in establishing our competitive position in the insurance markets. There can be no assurance that our ratings will continue for any given period of time or that they will not be changed.

It is possible that positive or negative ratings actions by one or more of the rating agencies may occur in the future. If our ratings were downgraded, we may incur higher borrowing costs and may have more limited means to access capital. In addition, a downgrade in our financial strength ratings could adversely affect the competitive position of our insurance operations, including a possible reduction in demand for our products in certain markets.

## Liquidity

Liquidity is a measure of our ability to generate sufficient cash flows to meet the short and long term cash requirements of our business operations.

Our property and casualty operations provide liquidity in that premiums are generally received months or even years before losses are paid under the policies purchased by such premiums. Historically, cash receipts from operations, consisting of insurance premiums and investment income, have provided more than sufficient funds to pay losses, operating expenses and dividends to Chubb. After satisfying our cash requirements, excess cash flows are used to build the investment portfolio and thereby increase future investment income.

Our strong underwriting results continued to generate substantial new cash in 2005. New cash from operations available for investment by the property and casualty subsidiaries was approximately \$3.4 billion in 2005 compared with \$3.8 billion in 2004 and \$3.1 billion in 2003. New cash available in 2005 was lower than in 2004 due to a 17% increase in paid losses in 2005 whereas premium receipts were only modestly higher compared with 2004. The increase in paid losses in 2005 was due primarily to directors and officers liability payments related to accident years 2002 and prior, payments related to Hurricane Katrina and payments related to two surety claims. New cash available in 2004 was higher than in 2003 due to growth in premium receipts in 2004 whereas paid losses were nearly flat compared with 2003.

In addition to cash from operations, the property and casualty subsidiaries received a capital contribution of \$800 million from Chubb in the second quarter of 2003.

Our property and casualty subsidiaries maintain investments in highly liquid, short-term and other marketable securities to provide for immediate cash needs.





Chubb's liquidity requirements in the past have been met by dividends from its property and casualty subsidiaries and the issuance of commercial paper and debt and equity securities. It is expected that our liquidity requirements in the future will be met by these sources of funds or borrowings from our credit facility.

The declaration and payment of future dividends to Chubb's shareholders will be at the discretion of Chubb's Board of Directors and will depend upon many factors, including our operating results, financial condition, capital requirements and any regulatory constraints.

As a holding company, Chubb's ability to continue to pay dividends to shareholders and to satisfy its obligations, including the payment of interest and principal on debt obligations, relies on the availability of liquid assets, which is dependent in large part on the dividend paying ability of its property and casualty subsidiaries. Various state insurance laws restrict our property and casualty subsidiaries as to the amount of dividends they may pay without the prior approval of regulatory authorities. The restrictions are generally based on net income and on certain levels of policyholders' surplus as determined in accordance with statutory accounting practices. Dividends in excess of such thresholds are considered extraordinary and require prior regulatory approval. During 2005, these subsidiaries paid to Chubb dividends totaling \$617 million, including \$520 million in cash and \$97 million in other assets. The maximum dividend distribution that may be made by the property and casualty subsidiaries to Chubb during 2006 without prior approval is approximately \$1.4 billion.

We believe that our strong financial position and conservative debt level provide us with the flexibility and capacity to obtain funds externally through debt or equity financings on both a short term and long term basis.

In June 2005, the Corporation entered into a revolving credit agreement with a group of banks that provides for unsecured borrowings of up to \$500 million. The revolving credit facility terminates on June 22, 2010. On the termination date of the agreement, any loans then outstanding become payable. There have been no borrowings under this agreement. Various interest rate options are available to the Corporation, all of which are based on market interest rates. The agreement contains customary restrictive covenants including a covenant to maintain a minimum consolidated shareholders' equity, as adjusted. The facility is available for general corporate purposes and to support our commercial paper borrowing arrangement. This facility replaced a \$250 million short term revolving credit facility that expired and a \$250 million medium term revolving credit facility that was terminated.

#### Contractual Obligations and Off-Balance Sheet Arrangements

The following table provides our future payments due by period under contractual obligations as of December 31, 2005, aggregated by type of obligation.

	<u>2006</u>	<u>2007 and 2008</u>	<u>2009 and 2010</u>	<u>There- after</u>	<u>Total</u>
	(in millions)				
Principal due under long-term debt	\$	\$1,360	\$	\$1,100	\$2,460
Interest and contract adjustment payments on long-term debt and equity units	137	196	134	534	1,001
Future minimum rental payments under operating leases	89	170	128	253	640
	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total	\$226	\$1,726	\$262	\$1,887	\$4,101
	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>

The above table excludes certain commitments totaling \$1.0 billion at December 31, 2005 to fund limited partnership investments. These capital commitments can be called by the partnerships during the commitment period (on average, 1 to 4 years) to fund working capital needs or the purchase of new investments.

The above table also excludes estimated future cash flows related to our carried loss reserves at December 31, 2005. There is typically no stated contractual commitment associated with property and casualty insurance loss reserves. The obligation to pay a claim arises only when a covered loss event occurs and a settlement is reached. The vast majority of our loss reserves relate to claims for which settlements have not yet been reached. Our loss reserves therefore represent estimates of future payments. These estimates are dependent on the outcome of future events. Accordingly, the payment of the loss reserves is not fixed as to either amount or timing.

Our gross liability for unpaid losses and loss expenses was \$22.5 billion at December 31, 2005. Of this \$22.5 billion liability, we estimate that approximately \$6.3 billion will be paid in 2006, an aggregate \$6.8 billion will be paid in 2007 and 2008, and an aggregate \$3.4 billion will be paid in 2009 and 2010. The estimate is based on our historical loss payment patterns. The ultimate amount and timing of loss payments will likely vary materially from our estimate. We expect that these loss payments will be funded, in large part, by future cash receipts from operations.

The Corporation does not have any material off-balance sheet arrangements, except as disclosed in Note (13) of the Notes to Consolidated Financial Statements.

## INVESTED ASSETS

The main objectives in managing our investment portfolios are to maximize after-tax investment income and total investment returns while minimizing credit risks in order to provide maximum support to the insurance underwriting operations. Investment strategies are developed based on many factors including underwriting results and our resulting tax position, regulatory requirements, fluctuations in interest rates and consideration of other market risks. Investment decisions are centrally managed by investment professionals based on guidelines established by management and approved by the boards of directors.

Our investment portfolio is primarily comprised of high quality bonds, principally tax-exempt, U.S. Treasury and government agency, mortgage-backed securities and corporate issues as well as foreign bonds that support our international operations. In addition, the portfolio includes equity securities, primarily publicly traded common stocks and private equity limited partnerships, held with the objective of capital appreciation.

In 2005, 2004 and 2003, we invested new cash in tax-exempt bonds and taxable bonds and, to a lesser extent, equity securities. In 2005, the taxable bonds we invested in were primarily mortgage-backed securities and corporate bonds. In 2004, the taxable bonds were primarily U.S. Treasury securities, foreign government bonds and corporate bonds. In 2003, the taxable bonds were primarily U.S. Treasury securities, mortgage-backed securities and foreign government bonds. Our objective is to achieve the appropriate mix of taxable and tax-exempt securities in our portfolio to balance both investment and tax strategies. At December 31, 2005, 52% of our fixed maturity portfolio was invested in tax-exempt bonds compared with 51% at December 31, 2004 and 2003.

Fixed maturity securities that we have the ability and intent to hold to maturity are classified as held-to-maturity. The remaining fixed maturities, which may be sold prior to maturity to support our investment strategies, such as in response to changes in interest rates and the yield curve or to maximize after-tax returns, are classified as available-for-sale. Fixed maturities classified as held-to-maturity are carried at amortized cost while fixed maturities classified as available-for-sale are carried at market value. At December 31, 2005 and 2004, 1% of the fixed maturity portfolio was classified as held-to-maturity compared with 2% at December 31, 2003.

Changes in the general interest rate environment affect the returns available on new fixed maturity investments. While a rising interest rate environment enhances the returns available on new investments, it reduces the market value of existing fixed maturity investments and thus the availability of gains on disposition. A decline in interest rates reduces the returns available on new investments but

increases the market value of existing investments, creating the opportunity for realized investment gains on disposition.

The unrealized appreciation before tax of investments carried at market value, which includes fixed maturities classified as available-for-sale and equity securities, was \$478 million, \$961 million and \$1,036 million at December 31, 2005, 2004 and 2003, respectively. Such unrealized appreciation is reflected in a separate component of other comprehensive income, net of applicable deferred income tax.

The unrealized market appreciation before tax of those fixed maturities carried at amortized cost was \$11 million, \$21 million and \$35 million at December 31, 2005, 2004 and 2003, respectively. Such unrealized appreciation was not reflected in the consolidated financial statements.

Changes in unrealized market appreciation or depreciation of fixed maturities were due primarily to fluctuations in interest rates.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Market risk represents the potential for loss due to adverse changes in the fair value of financial instruments. Our primary exposure to market risks relates to our investment portfolio, which is sensitive to changes in interest rates and, to a lesser extent, credit quality, prepayment, foreign currency exchange rates and equity prices. We also have exposure to market risks through our debt obligations. Analytical tools and monitoring systems are in place to assess each of these elements of market risk.

**Investment Portfolio**

Interest rate risk is the price sensitivity of a security that promises a fixed return to changes in interest rates. Changes in market interest rates directly affect the market value of our fixed income securities. We view the potential changes in price of our fixed income investments within the overall context of asset and liability management. Our actuaries estimate the payout pattern of our liabilities, primarily our property and casualty loss reserves, to determine their duration, which is the present value of the weighted average payments expressed in years. We set duration targets for our fixed income investment portfolios after consideration of the duration of these liabilities and other factors, which we believe mitigates the overall effect of interest rate risk for the Corporation.

The following table provides information about our fixed maturity investments, which are sensitive to changes in interest rates. The table presents cash flows of principal amounts and related weighted average interest rates by expected maturity dates at December 31, 2005 and 2004. The cash flows are based on the earlier of the call date or the maturity date or, for mortgage-backed securities, expected payment patterns. Actual cash flows could differ from the expected amounts.

**At December 31, 2005**

	2006	2007	2008	2009	2010	There- after	Total	
							Amortized Cost	Estimated Market Value
(in millions)								
Tax-exempt	\$ 742	\$ 715	\$ 942	\$1,031	\$1,092	\$11,131	\$15,653	\$15,965
Average interest rate	5.5%	5.3%	5.1%	5.1%	4.8%	4.1%		
Taxable other than mortgage- backed securities	912	1,261	1,415	1,659	1,257	3,662	10,166	10,267
Average interest rate	4.6%	4.5%	4.6%	4.4%	4.8%	5.0%		
Mortgage-backed securities	411	446	704	579	539	1,671	4,350	4,302
Average interest rate	4.8%	4.6%	5.2%	4.7%	4.6%	4.9%		
<b>Total</b>	<b>\$2,065</b>	<b>\$2,422</b>	<b>\$3,061</b>	<b>\$3,269</b>	<b>\$2,888</b>	<b>\$16,464</b>	<b>\$30,169</b>	<b>\$30,534</b>



At December 31, 2004

	2005	2006	2007	2008	2009	There- after	Total	
							Amortized Cost	Estimated Market Value
(in millions)								
Tax-exempt	\$ 1,020	\$ 547	\$ 756	\$ 846	\$ 1,010	\$ 9,661	\$ 13,840	\$ 14,410
Average interest rate	5.8%	5.4%	5.3%	5.0%	5.1%	4.2%		
Taxable other than mortgage- backed securities	749	1,191	909	1,550	1,620	3,633	9,652	9,866
Average interest rate	4.3%	3.7%	4.3%	4.2%	4.4%	5.1%		
Mortgage-backed securities	409	376	431	665	436	1,394	3,711	3,754
Average interest rate	4.8%	4.8%	4.6%	5.3%	4.7%	4.9%		
<b>Total</b>	<b>\$ 2,178</b>	<b>\$ 2,114</b>	<b>\$ 2,096</b>	<b>\$ 3,061</b>	<b>\$ 3,066</b>	<b>\$ 14,688</b>	<b>\$ 27,203</b>	<b>\$ 28,030</b>

Credit risk is the potential loss resulting from adverse changes in the issuer's ability to repay the debt obligation. We have consistently invested in high quality marketable securities. As a result, we believe that we have minimal credit quality risk. About 75% of the taxable bonds in our portfolio are issued by the U.S. Treasury or U.S. government agencies or rated AA or better by Moody's or Standard and Poor's. Of the tax-exempt bonds, about 95% are rated AA or better with about 70% rated AAA. About 2% of our bond portfolio is below investment grade. Our taxable bonds have an average maturity of five years, while our tax-exempt bonds mature on average in nine years.

Prepayment risk refers to the changes in prepayment patterns related to decreases and increases in interest rates that can either shorten or lengthen the expected timing of the principal repayments and thus the average life of a security, potentially reducing or increasing its effective yield. Such risk exists primarily within our portfolio of mortgage-backed securities. We monitor such risk regularly.

Mortgage-backed securities comprised 30% and 28% of our taxable bond portfolio at year-end 2005 and 2004, respectively. About 73% of our mortgage-backed securities holdings at December 31, 2005 related to residential mortgages consisting of government agency pass-through securities, government agency collateralized mortgage obligations (CMOs) and AAA rated non-agency CMOs backed by government agency collateral or single family home mortgages. The majority of the CMOs are actively traded in liquid markets and market value information is readily available from broker/dealers. An additional 20% of our mortgage-backed securities were call protected, AAA rated commercial mortgage-backed securities. The remaining mortgage-backed holdings were in investment grade commercial mortgage-backed securities.

Foreign currency risk is the sensitivity to foreign exchange rate fluctuations of the market value and investment income related to foreign currency denominated financial instruments. The functional currency of our foreign operations is generally the currency of the local operating environment since business is primarily transacted in such local currency. We reduce the risks relating to currency fluctuations by maintaining investments in those foreign currencies in which our property and casualty subsidiaries have loss reserves and other liabilities. Such investments generally have characteristics similar to our liabilities in those currencies. At December 31, 2005, the property and casualty subsidiaries held non-U.S. investments of \$4.6 billion supporting their international operations. These investments have quality and maturity characteristics similar to our domestic portfolio. The principal currencies creating foreign exchange rate risk for the property and casualty subsidiaries are the Canadian dollar, the British pound sterling and the euro.

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The following table provides information about those fixed maturity investments that are denominated in these currencies. The table presents cash flows of principal amounts in U.S. dollar equivalents by expected maturity dates at December 31, 2005. Actual cash flows could differ from the expected amounts.

At December 31, 2005

	2006	2007	2008	2009	2010	There- after	Total	
							Amortized Cost	Estimated Market Value
(in millions)								
Canadian dollar	\$ 119	\$ 136	\$ 201	\$ 149	\$ 202	\$ 446	\$ 1,253	\$ 1,279
British pound sterling	28	48	114	198	150	565	1,103	1,129
Euro	38	122	88	142	61	370	821	848

Equity price risk is the potential loss in market value of our equity securities resulting from adverse changes in stock prices. In general, equities have more year-to-year price variability than intermediate term high grade bonds. However, returns over longer time frames have been consistently higher. Our publicly traded equity securities are high quality, diversified across industries and readily marketable. Our portfolio also includes investments in private equity limited partnerships. These investments by their nature are less liquid and involve more risk than other investments. We actively manage our market risk through type of asset class and domestic and international diversification. We do extensive research and due diligence prior to investing. We review the performance of these investments on a quarterly basis and we obtain audited financial statements.

A hypothetical decrease of 10% in the market price of each of the equity securities held at December 31, 2005 and 2004 would have resulted in a decrease of \$221 million and \$184 million, respectively, in the fair value of the equity securities portfolio.

All of the above risks are monitored on an ongoing basis. A combination of in-house systems and proprietary models and externally licensed software are used to analyze individual securities as well as each portfolio. These tools provide the portfolio managers with information to assist them in the evaluation of the market risks of the portfolio.

**Debt**

We also have interest rate risk on our debt obligations. The following table provides information about our long term debt obligations and related interest rate swap at December 31, 2005. For debt obligations, the table presents expected cash flow of principal amounts and related weighted average interest rates by maturity date. For the interest rate swap, the table presents the notional amount and related average interest rates by maturity date.

At December 31, 2005

	2006	2007	2008	2009	2010	There- after	Total	Estimated Market Value
(in millions)								
Long-term debt								
Expected cash flows of principal amounts	\$	\$ 675	\$ 685	\$	\$	\$ 1,100	\$ 2,460	\$ 2,714
Average interest rate		5.2%	2.8%			6.3%		
Interest rate swap								
Notional amount	\$	\$	\$	\$	\$	\$ 125	\$ 125	\$ 7
Variable pay rate						6.6%(a)		
Fixed receive rate						8.7%		

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(a) 3 month LIBOR rate plus 204 basis points

59

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**Item 8. Consolidated Financial Statements and Supplementary Data**

Consolidated financial statements of the Corporation at December 31, 2005 and 2004 and for each of the three years in the period ended December 31, 2005 and the report thereon of our independent registered public accounting firm, and the Corporation's unaudited quarterly financial data for the two-year period ended December 31, 2005 are listed in Item 15(a) of this report.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

As of December 31, 2005, an evaluation of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures was performed under the supervision and with the participation of the Corporation's management, including the chief executive officer and chief financial officer. Based on that evaluation, Chubb's chief executive officer and chief financial officer concluded that the Corporation's disclosure controls and procedures were effective as of the evaluation date.

During the three month period ended December 31, 2005, there were no changes in internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

**Management's Report on Internal Control over Financial Reporting**

Management of the Corporation is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Securities Exchange Act of 1934. The Corporation's internal control over financial reporting was designed under the supervision of and with the participation of the Corporation's management, including Chubb's chief executive officer and chief financial officer, to provide reasonable assurance regarding the reliability of the Corporation's financial reporting and the preparation and fair presentation of published financial statements in accordance with U.S. generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect all misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management conducted an assessment of the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2005. In making this assessment, management used the framework set forth in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management has determined that, as of December 31, 2005, the Corporation's internal control over financial reporting is effective.

Management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2005 has been audited by Ernst & Young LLP, the independent registered public accounting firm who also audited the Corporation's consolidated financial statements. Their attestation report on management's assessment of the Corporation's internal control over financial reporting is shown on page 61.

**Item 9B. Other Information**

None.

**Report of Independent Registered Public Accounting Firm**

**Ernst & Young LLP**

5 Times Square  
New York, New York 10036

*The Board of Directors and Shareholders*

*The Chubb Corporation*

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that The Chubb Corporation maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Corporation'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, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, 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, management's assessment that The Chubb Corporation maintained effective internal control over financial reporting as of December 31, 2005 is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, The Chubb Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, 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 The Chubb Corporation as of December 31, 2005 and 2004, and the related consolidated statements of income, shareholders' equity, cash flows and comprehensive income for each of the three years in the period ended December 31, 2005 and our report dated March 10, 2006 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

March 10, 2006

**PART III.**

**Item 10. *Directors and Executive Officers of the Registrant***

Information regarding Chubb's directors is incorporated by reference from Chubb's definitive Proxy Statement for the 2006 Annual Meeting of Shareholders under the caption "Our Board of Directors." Information regarding Chubb's executive officers is included in Part I of this report under the caption "Executive Officers of the Registrant." Information regarding Section 16 reporting compliance of Chubb's directors, executive officers and 10% beneficial owners is incorporated by reference from Chubb's definitive Proxy Statement for the 2006 Annual Meeting of Shareholders under the caption "Section 16(a) Beneficial Ownership Reporting Compliance." Information regarding Chubb's Code of Ethics for CEO and Senior Financial Officers is included in Item 1 of this report under the caption "Business - General." Information regarding the Audit Committee of Chubb's Board of Directors and its Audit Committee financial experts is incorporated by reference from Chubb's definitive Proxy Statement for the 2006 Annual Meeting of Shareholders under the captions "Corporate Governance - Audit Committee" and "Committee Assignments."

**Item 11. *Executive Compensation***

Incorporated by reference from Chubb's definitive Proxy Statement for the 2006 Annual Meeting of Shareholders, under the captions "Corporate Governance - Directors - Compensation" and "Executive Compensation."

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Incorporated by reference from Chubb's definitive Proxy Statement for the 2006 Annual Meeting of Shareholders, under the captions "Security Ownership of Certain Beneficial Owners and Management" and "Equity Compensation Plan Information."

**Item 13. *Certain Relationships and Related Transactions***

Incorporated by reference from Chubb's definitive Proxy Statement for the 2006 Annual Meeting of Shareholders, under the caption "Certain Transactions and Other Matters."

**Item 14. *Principal Accountant Fees and Services***

Incorporated by reference from Chubb's definitive Proxy Statement for the 2006 Annual Meeting of Shareholders, under the caption "Proposal 3: Ratification of Appointment of Independent Auditor."

**PART IV.**

**Item 15. *Exhibits, Financial Statements and Schedules***

The financial statements and schedules listed in the accompanying index to financial statements and financial statement schedules are filed as part of this report.

The exhibits listed in the accompanying index to exhibits are filed as part of this report.



Signature	Title	Date
<hr/> <i>/s/ DAVID G. SCHOLEY</i> <hr/>	Director	March 3, 2006
<b>(David G. Scholey)</b>		
<hr/> <i>/s/ RAYMOND G.H. SEITZ</i> <hr/>	Director	March 3, 2006
<b>(Raymond G.H. Seitz)</b>		
<hr/> <i>/s/ LAWRENCE M. SMALL</i> <hr/>	Director	March 3, 2006
<b>(Lawrence M. Small)</b>		
<hr/> <i>/s/ DANIEL E. SOMERS</i> <hr/>	Director	March 3, 2006
<b>(Daniel E. Somers)</b>		
<hr/> <i>/s/ KAREN HASTIE WILLIAMS</i> <hr/>	Director	March 3, 2006
<b>(Karen Hastie Williams)</b>		
<hr/> <i>/s/ ALFRED W. ZOLLAR</i> <hr/>	Director	March 3, 2006
<b>(Alfred W. Zollar)</b>		
<hr/> <i>/s/ MICHAEL O REILLY</i> <hr/>	Vice Chairman and Chief Financial Officer	March 3, 2006
<b>(Michael O Reilly)</b>		
<hr/> <i>/s/ HENRY B. SCHRAM</i> <hr/>	Senior Vice President and Chief Accounting Officer	March 3, 2006
<b>(Henry B. Schram)</b>		

## THE CHUBB CORPORATION

## INDEX TO FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULES

## (Item 15(a))

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All other schedules are omitted since the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the financial statements and notes thereto.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM  
ERNST & YOUNG LLP**

5 Times Square

New York, New York 10036

*The Board of Directors and Shareholders*

*The Chubb Corporation*

We have audited the accompanying consolidated balance sheets of The Chubb Corporation as of December 31, 2005 and 2004, and the related consolidated statements of income, shareholders' equity, cash flows and comprehensive income for each of the three years in the period ended December 31, 2005. Our audits also included the financial statement schedules listed in the Index at Item 15(a). These financial statements and schedules are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements and schedules 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 The Chubb Corporation at December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present 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) the effectiveness of The Chubb Corporation's internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 10, 2006 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

March 10, 2006

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**THE CHUBB CORPORATION**  
**Consolidated Statements of Income**

	<b>In Millions, Except For Per Share Amounts Years Ended December 31</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Revenues</b>			
Premiums Earned	\$12,176.0	\$11,635.7	\$10,182.5
Investment Income	1,407.7	1,256.0	1,118.3
Other Revenues	115.1	67.3	8.8
Realized Investment Gains	383.5	218.2	84.4
<b>TOTAL REVENUES</b>	<b>14,082.3</b>	<b>13,177.2</b>	<b>11,394.0</b>
<b>Losses and Expenses</b>			
Insurance Losses and Loss Expenses	7,813.5	7,320.9	6,867.2
Amortization of Deferred Policy Acquisition Costs	2,930.4	2,843.3	2,535.6
Other Insurance Operating Costs and Expenses	512.1	630.1	704.7
Investment Expenses	29.2	24.7	29.0
Other Expenses	160.7	110.9	150.4
Corporate Expenses	189.4	179.1	173.5
<b>TOTAL LOSSES AND EXPENSES</b>	<b>11,635.3</b>	<b>11,109.0</b>	<b>10,460.4</b>
<b>INCOME BEFORE FEDERAL AND FOREIGN INCOME TAX</b>	<b>2,447.0</b>	<b>2,068.2</b>	<b>933.6</b>
<b>Federal and Foreign Income Tax</b>	<b>621.1</b>	<b>519.8</b>	<b>124.8</b>
<b>NET INCOME</b>	<b>\$ 1,825.9</b>	<b>\$ 1,548.4</b>	<b>\$ 808.8</b>
<b>Net Income Per Share</b>			
Basic	\$ 9.21	\$ 8.15	\$ 4.51
Diluted	8.94	8.01	4.46

See accompanying notes.

**THE CHUBB CORPORATION**  
**Consolidated Balance Sheets**

	In Millions December 31	
	2005	2004
<b>Assets</b>		
Invested Assets		
Short Term Investments	\$ 1,898.5	\$ 1,307.5
Fixed Maturities		
Held-to-Maturity Tax Exempt (market \$215.8 and \$338.3)	204.6	317.2
Available-for-Sale		
Tax Exempt (cost \$15,448.5 and \$13,522.6)	15,749.5	14,071.3
Taxable (cost \$14,515.8 and \$13,362.7)	14,568.4	13,620.8
Equity Securities (cost \$2,088.1 and \$1,687.3)	2,212.4	1,841.3
 TOTAL INVESTED ASSETS	 34,633.4	 31,158.1
Cash	35.6	41.7
Securities Lending Collateral	2,076.8	1,853.9
Accrued Investment Income	391.0	350.0
Premiums Receivable	2,319.2	2,336.4
Reinsurance Recoverable on Unpaid Losses and Loss Expenses	3,769.2	3,483.2
Prepaid Reinsurance Premiums	244.2	328.3
Deferred Policy Acquisition Costs	1,444.8	1,434.7
Real Estate Assets	367.4	474.2
Investment in Partially Owned Company	260.0	346.2
Deferred Income Tax	622.5	533.5
Goodwill	467.4	467.4
Other Assets	1,429.2	1,452.7
 TOTAL ASSETS	 \$48,060.7	 \$44,260.3
<b>Liabilities</b>		
Unpaid Losses and Loss Expenses	\$22,481.7	\$20,291.9
Unearned Premiums	6,360.7	6,355.9
Securities Lending Payable	2,076.8	1,853.9
Long Term Debt	2,467.3	2,813.7
Dividend Payable to Shareholders	90.2	75.0
Accrued Expenses and Other Liabilities	2,177.0	2,743.5
 TOTAL LIABILITIES	 35,653.7	 34,133.9

**Commitments and Contingent Liabilities (Notes 7 and 13)**

**Shareholders Equity**

Preferred Stock Authorized 4,000,000 Shares;  
\$1 Par Value; Issued None

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Common Stock	Authorized 600,000,000 Shares;		
\$1 Par Value; Issued 210,432,298 and 195,803,824 Shares		210.4	195.8
Paid-In Surplus		2,364.4	1,319.1
Retained Earnings		9,599.7	8,119.1
Accumulated Other Comprehensive Income			
Unrealized Appreciation of Investments, Net of Tax		310.7	624.5
Foreign Currency Translation Gains, Net of Tax		56.7	79.0
Treasury Stock, at Cost	1,393,900 and 3,127,282 Shares	(134.9)	(211.1)
TOTAL SHAREHOLDERS EQUITY		12,407.0	10,126.4
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY		\$48,060.7	\$44,260.3

See accompanying notes.

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**THE CHUBB CORPORATION**  
**Consolidated Statements of Shareholders' Equity**

	In Millions		
	Years Ended December 31		
	2005	2004	2003
<b>Preferred Stock</b>			
Balance, Beginning and End of Year	\$	\$	\$
<b>Common Stock</b>			
Balance, Beginning of Year	195.8	195.8	180.3
Shares Issued Upon Settlement of Equity Unit Warrants	8.7		
Common Stock Offering			15.5
Shares Issued Under Stock-Based Employee Compensation Plans	5.9		
Balance, End of Year	210.4	195.8	195.8
<b>Paid-In Surplus</b>			
Balance, Beginning of Year	1,319.1	1,318.8	445.4
Shares Issued Upon Settlement of Equity Unit Warrants	591.3		
Common Stock Offering			871.3
Issuance of Equity Units			(78.1)
Changes Related to Stock-Based Employee Compensation (includes tax benefit (charge) of \$84.1, \$(2.2) and \$17.5)	454.0	.3	80.2
Balance, End of Year	2,364.4	1,319.1	1,318.8
<b>Retained Earnings</b>			
Balance, Beginning of Year	8,119.1	6,868.9	6,319.0
Net Income	1,825.9	1,548.4	808.8
Dividends Declared (per share \$1.72, \$1.56 and \$1.44)	(345.3)	(298.2)	(258.9)
Balance, End of Year	9,599.7	8,119.1	6,868.9
<b>Unrealized Appreciation of Investments</b>			
Balance, Beginning of Year	624.5	673.6	585.5
Change During Year, Net of Tax	(313.8)	(49.1)	88.1
Balance, End of Year	310.7	624.5	673.6
<b>Foreign Currency Translation Gains (Losses)</b>			
Balance, Beginning of Year	79.0	12.0	(56.5)
Change During Year, Net of Tax	(22.3)	67.0	68.5
Balance, End of Year	56.7	79.0	12.0
<b>Receivable from Employee Stock Ownership Plan</b>			

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Balance, Beginning of Year		(17.9)	(34.1)
Principal Repayments		17.9	16.2
Balance, End of Year			(17.9)
<b>Treasury Stock, at Cost</b>			
Balance, Beginning of Year	(211.1)	(529.2)	(613.9)
Repurchase of Shares	(134.9)		
Shares Issued Under Stock-Based Employee Compensation Plans	211.1	318.1	84.7
Balance, End of Year	(134.9)	(211.1)	(529.2)
TOTAL SHAREHOLDERS EQUITY	\$12,407.0	\$10,126.4	\$8,522.0

See accompanying notes.

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**THE CHUBB CORPORATION**  
**Consolidated Statements of Cash Flows**

	In Millions		
	Years Ended December 31		
	2005	2004	2003
<b>Cash Flows from Operating Activities</b>			
Net Income	\$ 1,825.9	\$ 1,548.4	\$ 808.8
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities			
Increase in Unpaid Losses and Loss Expenses, Net	1,903.8	2,287.5	1,879.6
Increase in Unearned Premiums, Net	106.6	417.2	885.4
Decrease (Increase) in Premiums Receivable	17.2	(148.4)	(147.4)
Increase in Deferred Policy Acquisition Costs	(16.7)	(76.6)	(168.3)
Decrease in Liability Related to Principal and Interest Guarantee	(186.4)		
Deferred Income Tax (Credit)	83.8	85.0	(96.9)
Amortization of Premiums and Discounts on Fixed Maturities	216.8	98.0	63.2
Depreciation	90.8	105.6	108.0
Realized Investment Gains	(383.5)	(218.2)	(84.4)
Other, Net	97.2	(9.9)	115.8
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>3,755.5</b>	<b>4,088.6</b>	<b>3,363.8</b>
<b>Cash Flows from Investing Activities</b>			
Proceeds from Sales of Fixed Maturities Available-for-Sale	7,481.7	3,920.3	6,165.3
Proceeds from Maturities of Fixed Maturities	1,683.4	2,048.1	2,105.5
Proceeds from Sales of Equity Securities	697.5	779.7	501.0
Purchases of Fixed Maturities	(12,206.6)	(11,465.2)	(12,139.5)
Purchases of Equity Securities	(862.1)	(860.4)	(824.0)
Decrease (Increase) in Short Term Investments, Net	(591.0)	1,388.4	(939.2)
Increase (Decrease) in Net Payable from Security Transactions not Settled	(110.6)	126.6	(31.1)
Purchases of Property and Equipment, Net	(40.5)	(64.7)	(74.3)
Other, Net	97.4	(1.1)	3.2
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(3,850.8)</b>	<b>(4,128.3)</b>	<b>(5,233.1)</b>
<b>Cash Flows from Financing Activities</b>			
Proceeds from Issuance of Long Term Debt			960.0
Repayment of Long Term Debt	(300.7)	(.4)	(100.4)
Increase (Decrease) in Funds Held Under Deposit Contracts	(276.5)	44.2	347.2

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Proceeds from Common Stock Offering			886.8
Proceeds from Common Stock Issued Upon Settlement of Equity Unit Warrants	600.0		
Proceeds from Issuance of Common Stock Under Stock-Based Employee Compensation Plans	531.4	258.4	43.8
Repurchase of Shares	(134.9)		
Dividends Paid to Shareholders	(330.1)	(290.9)	(251.1)
Other, Net		17.9	(6.7)
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>89.2</b>	<b>29.2</b>	<b>1,879.6</b>
Net Increase (Decrease) in Cash	(6.1)	(10.5)	10.3
Cash at Beginning of Year	41.7	52.2	41.9
<b>CASH AT END OF YEAR</b>	<b>\$ 35.6</b>	<b>\$ 41.7</b>	<b>\$ 52.2</b>

**Consolidated Statements of Comprehensive Income**

Net Income	\$ 1,825.9	\$ 1,548.4	\$ 808.8
Other Comprehensive Income			
Change in Unrealized Appreciation of Investments, Net of Tax	(313.8)	(49.1)	88.1
Foreign Currency Translation Gains (Losses), Net of Tax	(22.3)	67.0	68.5
	(336.1)	17.9	156.6
<b>COMPREHENSIVE INCOME</b>	<b>\$ 1,489.8</b>	<b>\$ 1,566.3</b>	<b>\$ 965.4</b>

See accompanying notes.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### (1) Summary of Significant Accounting Policies

#### (a) *Basis of Presentation*

The Chubb Corporation (Chubb) is a holding company with subsidiaries principally engaged in the property and casualty insurance business. The property and casualty insurance subsidiaries (the P&C Group) underwrite most lines of property and casualty insurance in the United States, Canada, Europe, Australia and parts of Latin America and Asia. The geographic distribution of property and casualty business in the United States is broad with a particularly strong market presence in the Northeast.

Chubb Financial Solutions (CFS) was organized in 2000 to develop and provide customized risk-financing services through both the capital and insurance markets. CFS's non-insurance business was primarily structured credit derivatives, principally as a counterparty in portfolio credit default swaps. In the second quarter of 2003, the Corporation implemented a plan to exit the credit derivatives business and is running off the financial products portfolio of CFS.

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles and include the accounts of Chubb and its subsidiaries (collectively, the Corporation). Significant intercompany transactions have been eliminated in consolidation.

The consolidated financial statements include amounts based on informed estimates and judgments of management for those transactions that are not yet complete. Such estimates and judgments affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Certain amounts in the consolidated financial statements for prior years have been reclassified to conform with the 2005 presentation.

#### (b) *Invested Assets*

Short term investments, which have an original maturity of one year or less, are carried at amortized cost, which approximates market value.

Fixed maturities, which include bonds and redeemable preferred stocks, are purchased to support the investment strategies of the Corporation. These strategies are developed based on many factors including rate of return, maturity, credit risk, tax considerations and regulatory requirements. Fixed maturities that may be sold prior to maturity to support the investment strategies of the Corporation are classified as available-for-sale and carried at market value as of the balance sheet date. Those fixed maturities that the Corporation has the ability and positive intent to hold to maturity are classified as held-to-maturity and carried at amortized cost.

Premiums and discounts arising from the purchase of mortgage-backed securities are amortized using the interest method over the estimated remaining term of the securities, adjusted for anticipated prepayments.

Equity securities include common stocks, non-redeemable preferred stocks and private equity limited partnerships. Common and non-redeemable preferred stocks are carried at market value as of the balance sheet date. Limited partnerships are carried at the Corporation's equity in the estimated fair value of the investments held by the partnerships.

Unrealized appreciation or depreciation of investments carried at market value is excluded from net income and credited or charged, net of applicable deferred income tax, directly to a separate component of comprehensive income. Changes in the Corporation's equity in the limited partnerships are included in income as realized investment gains or losses.

Realized gains and losses on the sale of investments are determined on the basis of the cost of the specific investments sold and are credited or charged to income. When the market value of any investment is lower than its cost, an assessment is made to determine whether the decline is temporary or other-than-temporary. If the decline is deemed to be other-than-temporary, the investment is written down to market value and the amount of the writedown is charged to income as a realized investment loss. The market value of the investment becomes its new cost basis.

The Corporation engages in a securities lending program to generate additional income, whereby certain securities from its portfolios are loaned to other institutions for short periods of time. The Corporation's policy is to require



initial collateral equal to at least 102% of the market value of the loaned securities. In those instances where cash collateral is obtained from the borrower, the collateral is invested by the lending agent in accordance with the Corporation's guidelines. The cash collateral is recognized as an asset with a corresponding liability for the obligation to return the collateral. In instances where non-cash collateral is obtained from the borrower, the Corporation does not recognize the receipt of the collateral held by the lending agent or the obligation to return the collateral as there exists no right to sell or repledge the collateral. The Corporation retains a portion of the income earned from the cash collateral or receives a fee from the borrower. Under the terms of the securities lending program, the lending agent indemnifies the Corporation against borrower defaults. The Corporation maintains effective control over securities loaned and therefore continues to report such securities as invested assets. The market value of the loaned securities was \$2,801.2 million and \$1,805.5 million at December 31, 2005 and 2004, respectively. Of these amounts, \$2,511.4 million and \$1,798.0 million, respectively, comprised available-for-sale fixed maturities and the balance comprised equity securities.

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*(c) Premium Revenues and Related Expenses*

Insurance premiums are earned on a monthly pro rata basis over the terms of the policies and include estimates of audit premiums and premiums on retrospectively rated policies. Assumed reinsurance premiums are earned over the terms of the reinsurance contracts. Unearned premiums represent the portion of direct and assumed premiums written applicable to the unexpired terms of the insurance policies and reinsurance contracts in force.

Ceded reinsurance premiums are charged to income over the terms of the reinsurance contracts. Prepaid reinsurance premiums represent the portion of premiums ceded to reinsurers applicable to the unexpired terms of the reinsurance contracts in force.

Reinsurance reinstatement premiums are recognized in the same period as the loss event that gave rise to the reinstatement premiums.

Acquisition costs that vary with and are primarily related to the production of business are deferred and amortized over the period in which the related premiums are earned. Such costs include commissions, premium taxes and certain other underwriting and policy issuance costs. Commissions received related to reinsurance premiums ceded are considered in determining net acquisition costs eligible for deferral. Deferred policy acquisition costs are reviewed to determine whether they are recoverable from future income. If such costs are deemed to be unrecoverable, they are expensed. Anticipated investment income is considered in the determination of the recoverability of deferred policy acquisition costs.

*(d) Unpaid Losses and Loss Expenses*

Unpaid losses and loss expenses (also referred to as loss reserves) include the accumulation of individual case estimates for claims that have been reported and estimates of claims that have been incurred but not reported as well as estimates of the expenses associated with processing and settling all reported and unreported claims, less estimates of anticipated salvage and subrogation recoveries. Loss reserves are not discounted to present value.

Estimates are based upon past loss experience modified for current trends as well as prevailing economic, legal and social conditions. Such estimates are regularly reviewed and updated. Any changes in estimates are reflected in operating results in the period in which the estimates are changed.

Reinsurance recoverable on unpaid losses and loss expenses represents an estimate of the portion of gross loss reserves that will be recovered from reinsurers. Amounts recoverable from reinsurers are estimated in a manner consistent with the gross losses associated with the reinsured policies. A provision for estimated uncollectible reinsurance is recorded based on an evaluation of balances due from reinsurers, changes in the credit standing of the reinsurers, coverage disputes and other relevant factors.

*(e) Financial Products*

Credit derivatives, principally portfolio credit default swaps, are carried at estimated fair value as of the balance sheet date. Changes in fair value are recognized in income in the period of the change and are included in other revenues.

Assets and liabilities related to the credit derivatives are included in other assets and other liabilities.

*(f) Real Estate*

Real estate properties are carried at cost less accumulated depreciation and any writedowns for impairment. Real estate taxes, interest and other carrying costs incurred prior to completion of the assets for their intended use are capitalized. Also, costs incurred during the initial leasing of income producing properties are capitalized until the project is substantially complete, subject to a maximum time period subsequent to completion of major construction activity.

Real estate properties are reviewed for impairment whenever events or circumstances indicate that the carrying value of such properties may not be recoverable. In performing the review for recoverability of carrying value, estimates are made of the future undiscounted cash flows from each of the properties during the period the property will be held and upon its eventual disposition. If the expected future undiscounted cash flows are less than the carrying value of any property, an impairment loss is recognized, resulting in a writedown of the carrying value of the property. Measurement of such impairment is based on the fair value of the property.

Rental revenues are recognized on a straight-line basis over the term of the lease. Profits on land, residential unit and commercial building sales are recognized at closing, subject to compliance with applicable accounting guidelines.

(g) *Investment in Partially Owned Company*

Investment in partially owned company includes the Corporation's 19% interest in a corporate joint venture, Allied World Assurance Holdings, Ltd. The equity method of accounting is used for this investment.

(h) *Goodwill*

Goodwill represents the excess of the purchase price over the fair value of net assets of entities acquired. Goodwill is tested for impairment at least annually.

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(i) *Property and Equipment*

Property and equipment used in operations, including certain costs incurred to develop or obtain computer software for internal use, are capitalized and carried at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets.

(j) *Income Taxes*

Chubb and its domestic subsidiaries file a consolidated federal income tax return.

Deferred income tax assets and liabilities are recognized for the expected future tax effects attributable to temporary differences between the financial reporting and tax bases of assets and liabilities, based on enacted tax rates and other provisions of tax law. The effect on deferred tax assets and liabilities of a change in tax laws or rates is recognized in income in the period in which such change is enacted. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that all or some portion of the deferred tax assets will not be realized.

The Corporation does not consider the earnings of its foreign subsidiaries to be permanently reinvested. Accordingly, provision has been made for the expected U.S. federal income tax liabilities applicable to undistributed earnings of foreign subsidiaries.

(k) *Stock-Based Employee Compensation*

The fair value method of accounting is used for stock-based employee compensation plans. Under the fair value method, compensation cost is measured based on the fair value of the award at the grant date and recognized over the service period.

(l) *Foreign Exchange*

Assets and liabilities relating to foreign operations are translated into U.S. dollars using current exchange rates as of the balance sheet date. Revenues and expenses are translated into U.S. dollars using the average exchange rates during the year.

The functional currency of foreign operations is generally the currency of the local operating environment since business is primarily transacted in such local currency. Translation gains and losses, net of applicable income tax, are excluded from net income and are credited or charged directly to a separate component of comprehensive income.

(m) *Cash Flow Information*

In the statement of cash flows, short term investments are not considered to be cash equivalents. The effect of changes in foreign exchange rates on cash balances was immaterial.

In 2005, the Corporation transferred its ongoing reinsurance assumed business and certain related assets to Harbor Point Limited (see Note (2)). In exchange, the Corporation received from Harbor Point \$200 million of 6% convertible notes and warrants to purchase common stock of Harbor Point.

In 2005, a mortgage payable of \$41.6 million was assumed by an unaffiliated joint venture in connection with the disposition of the Corporation's interest in a variable interest entity in which it was the primary beneficiary.

These noncash transactions have been excluded from the consolidated statement of cash flows.

(n) *Accounting Pronouncements Not Yet Adopted*

In November 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) Nos. 115-1 and 124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. The FSP addresses the determination as to when an investment is considered impaired, whether that impairment is other-than-temporary, and the measurement of an impairment loss. The FSP clarifies that an investor shall recognize an impairment loss when the impairment is deemed to be other-than-temporary even if a decision to sell the impaired security has not been made. FSP Nos. 115-1 and 124-1 nullifies certain requirements and carries forward other requirements of Emerging Issues Task Force (EITF) Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. The guidance in the FSP is effective for the Corporation for the year beginning January 1, 2006. The implementation of the FSP is not expected to have a significant effect on the Corporation's financial position or results of operations.

In December 2004, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment, which revised SFAS No. 123, Accounting for Stock-Based Compensation. SFAS No. 123(R) requires companies to adopt the fair value method of accounting for stock-based employee compensation plans. In

April 2005, the Securities and Exchange Commission delayed the effective date for compliance with SFAS No. 123(R). As a result, the provisions of SFAS No. 123(R) are now effective for the Corporation for the year beginning January 1, 2006. The fair value method of accounting for stock-based employee compensation plans as defined in SFAS No. 123(R) is similar in most respects to the fair value method defined in SFAS No. 123. Since the Corporation has already adopted the fair value method of accounting for stock-based employee compensation plans, the adoption of SFAS No. 123(R) is not expected to have a significant effect on the Corporation's financial position or results of operations.

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**(2) Transfer of Ongoing Reinsurance Assumed Business**

In December 2005, the Corporation completed a transaction involving a new Bermuda based reinsurance company, Harbor Point Limited.

As part of the transaction, the Corporation transferred its ongoing reinsurance assumed business and certain related assets, including renewal rights, to Harbor Point. In exchange, the Corporation received from Harbor Point \$200 million of 6% convertible notes and warrants to purchase common stock of Harbor Point. The notes and warrants represent in the aggregate on a fully diluted basis approximately 16% of the new company.

Harbor Point generally did not assume the reinsurance liabilities relating to reinsurance contracts incepting prior to December 31, 2005. Those liabilities and the related assets were retained by the P&C Group.

Other than pursuant to certain arrangements entered into with Harbor Point, the P&C Group will generally no longer engage directly in the reinsurance assumed business. Harbor Point will have the right for a transition period of up to two years to underwrite specific reinsurance business on the P&C Group's behalf. The P&C Group will retain a portion of this business and will cede the balance to Harbor Point in return for a fronting commission.

The transaction resulted in a pre-tax gain of \$204.2 million, of which \$171.0 million was recognized in 2005 and \$33.2 million was deferred. The portion of the gain that was deferred was based on the Corporation's economic interest in Harbor Point.

The Corporation will receive additional payments over the next two years based on the amount of P&C Group business renewed by Harbor Point. The Corporation will recognize these amounts in income when earned.

**(3) Invested Assets and Related Income**

(a) The amortized cost and estimated market value of fixed maturities were as follows:

		December 31							
		2005				2004			
		Amortized Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Estimated Market Value	Amortized Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Estimated Market Value
		(in millions)							
Held-to-maturity exempt	Tax	\$ 204.6	\$ 11.2	\$	\$ 215.8	\$ 317.2	\$ 21.1	\$	\$ 338.3
Available-for-sale									
Tax exempt		15,448.5	362.0	61.0	15,749.5	13,522.6	570.2	21.5	14,071.3
Taxable									
U.S. Government and government agency and authority obligations		2,769.9	5.7	17.2	2,758.4	2,804.7	13.6	13.6	2,804.7
Corporate bonds		2,608.3	56.4	34.6	2,630.1	2,437.9	107.3	11.4	2,533.8
Foreign bonds		4,747.0	107.1	16.7	4,837.4	4,353.6	125.8	7.2	4,472.2
Mortgage-backed securities		4,350.1	33.8	81.5	4,302.4	3,711.3	71.6	28.6	3,754.3
Redeemable preferred stocks		40.5		.4	40.1	55.2	.7	.1	55.8

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	14,515.8	203.0	150.4	14,568.4	13,362.7	319.0	60.9	13,620.8
Total available-for-sale	29,964.3	565.0	211.4	30,317.9	26,885.3	889.2	82.4	27,692.1
Total fixed maturities	\$30,168.9	\$576.2	\$211.4	\$30,533.7	\$27,202.5	\$910.3	\$82.4	\$28,030.4

The amortized cost and estimated market value of fixed maturities at December 31, 2005 by contractual maturity were as follows:

	Amortized Cost	Estimated Market Value
(in millions)		
<b>Held-to-maturity</b>		
Due in one year or less	\$ 40.1	\$ 40.4
Due after one year through five years	108.7	112.4
Due after five years through ten years	46.5	52.9
Due after ten years	9.3	10.1
	\$ 204.6	\$ 215.8
<b>Available-for-sale</b>		
Due in one year or less	\$ 1,058.2	\$ 1,061.7
Due after one year through five years	6,791.6	6,845.4
Due after five years through ten years	9,273.9	9,449.5
Due after ten years	8,490.5	8,658.9
	25,614.2	26,015.5
Mortgage-backed securities	4,350.1	4,302.4
	\$29,964.3	\$30,317.9

Actual maturities could differ from contractual maturities because borrowers may have the right to call or prepay obligations.

(b) The components of unrealized appreciation or depreciation of investments carried at market value were as follows:

	December 31	
	2005	2004
(in millions)		
<b>Equity securities</b>		
Gross unrealized appreciation	\$ 162.7	\$ 162.5
Gross unrealized depreciation	38.4	8.5
	124.3	154.0
<b>Fixed maturities</b>		
Gross unrealized appreciation	565.0	889.2
Gross unrealized depreciation	211.4	82.4
	353.6	806.8
	477.9	960.8
Deferred income tax liability	167.2	336.3
	\$ 310.7	\$ 624.5

When the market value of any investment is lower than its cost, an assessment is made to determine whether the decline is temporary or other-than-temporary. The assessment is based on both quantitative criteria and qualitative information and considers a number of factors including, but not limited to, the length of time and the extent to which the market value has been less than the cost, the financial condition and near term prospects of the issuer, whether the issuer is current on contractually obligated interest and principal payments, the intent and ability of the Corporation to hold the investment for a period of time sufficient to allow for the recovery of cost, general market conditions and industry or sector specific factors. Based on a review of the securities in an unrealized loss position of December 31, 2005 and 2004, management believes that none of the declines in market value at those dates were other-than-temporary.

The following table summarizes, for all investment securities in an unrealized loss position at December 31, 2005, the aggregate market value and gross unrealized depreciation by investment category and length of time that individual securities have continuously been in an unrealized loss position.

	Less Than 12 Months		12 Months or More		Total	
	Estimated Market Value	Gross Unrealized Depreciation	Estimated Market Value	Gross Unrealized Depreciation	Estimated Market Value	Gross Unrealized Depreciation
(in millions)						
<b>Fixed maturities available-for-sale</b>						
Tax exempt	\$ 3,984.0	\$ 40.3	\$ 829.4	\$ 20.7	\$ 4,813.4	\$ 61.0



Taxable						
U.S. Government and government agency and authority obligations	977.7	6.4	437.7	10.8	1,415.4	17.2
Corporate bonds	948.2	22.6	303.3	12.0	1,251.5	34.6
Foreign bonds	1,283.7	14.3	79.5	2.4	1,363.2	16.7
Mortgage-backed securities	1,804.4	32.5	1,319.2	49.0	3,123.6	81.5
Redeemable preferred stocks			10.1	.4	10.1	.4
	5,014.0	75.8	2,149.8	74.6	7,163.8	150.4
Total fixed maturities available-for-sale	8,998.0	116.1	2,979.2	95.3	11,977.2	211.4
Equity securities	185.8	26.2	67.1	12.2	252.9	38.4
	\$9,183.8	\$142.3	\$3,046.3	\$107.5	\$12,230.1	\$249.8

The total gross unrealized depreciation amount at December 31, 2005 comprised approximately 1,425 securities, of which 1,375 were fixed maturities. Almost all of the fixed maturities in an unrealized loss position were investment grade securities depressed due to changes in interest rates from the date of purchase. There were no securities with a market value less than 80% of the security's amortized cost for six continuous months. Securities in an unrealized loss position for less than twelve months comprised approximately 1,150 securities, of which 99% were securities with a market value to amortized cost ratio at or greater than 90%. Securities in an unrealized loss position for twelve months or more comprised approximately 275 securities, of which 98% were securities with a market value to amortized cost ratio at or greater than 90%.

At December 31, 2004, fixed maturities and equity securities with an aggregate market value of \$7,512.0 million were in an unrealized loss position and the gross unrealized depreciation of such securities was \$90.9 million. Securities with a market value of \$1,685.3 million had been in an unrealized loss position for twelve months or more and the gross unrealized depreciation of such securities was \$36.2 million.

The change in unrealized appreciation or depreciation of investments carried at market value was as follows:

	Years Ended December 31		
	2005	2004	2003
	(in millions)		
Change in unrealized appreciation or depreciation of equity securities	\$ (29.7)	\$ 21.0	\$ 139.1
Change in unrealized appreciation of fixed maturities	(453.2)	(96.4)	(3.7)
	(482.9)	(75.4)	135.4
Deferred income tax (credit)	(169.1)	(26.3)	47.3
	\$ (313.8)	\$ (49.1)	\$ 88.1

The unrealized appreciation of fixed maturities carried at amortized cost is not reflected in the financial statements. The change in unrealized appreciation of fixed maturities carried at amortized cost was a decrease of \$9.9 million, \$14.1 million and \$20.6 million for the years ended December 31, 2005, 2004 and 2003, respectively.

(c) The sources of net investment income were as follows:

	Years Ended December 31		
	2005	2004	2003
	(in millions)		
Fixed maturities	\$ 1,295.7	\$ 1,155.5	\$ 1,003.0
Equity securities	50.2	50.0	36.2
Short term investments	52.8	44.3	71.3
Other	9.0	6.2	7.8
Gross investment income	1,407.7	1,256.0	1,118.3
Investment expenses	29.2	24.7	29.0
	\$ 1,378.5	\$ 1,231.3	\$ 1,089.3

(d) Realized investment gains and losses were as follows:

	Years Ended December 31		
	2005	2004	2003
	(in millions)		
Fixed maturities			
Gross realized gains	\$ 73.6	\$ 97.1	\$ 131.9
Gross realized losses	(108.9)	(72.5)	(65.5)
Other-than-temporary impairments	(4.4)	(.2)	(42.1)

	(39.7)	24.4	24.3
Equity securities			
Gross realized gains	342.6	336.2	159.8
Gross realized losses	(105.4)	(111.0)	(85.2)
Other-than-temporary impairments	(1.0)		(14.5)
	236.2	225.2	60.1
Transfer of reinsurance business	171.0		
Sale of Personal Lines Insurance Brokerage	16.0		
Sale of The Chubb Institute		(31.4)	
Realized investment gains	383.5	218.2	84.4
Income tax	135.8	72.2	29.5
	\$ 247.7	\$ 146.0	\$ 54.9

In December 2005, the Corporation transferred its ongoing reinsurance assumed business and certain related assets to Harbor Point Limited. This transaction is further described in Note (2).

In September 2005, the Corporation sold Personal Lines Insurance Brokerage, Inc., an insurance brokerage subsidiary. In September 2004, the Corporation sold The Chubb Institute, Inc., its post secondary educational subsidiary.

#### (4) Deferred Policy Acquisition Costs

Policy acquisition costs deferred and the related amortization charged against income were as follows:

	Years Ended December 31		
	2005	2004	2003
	(in millions)		
Balance, beginning of year	\$ 1,434.7	\$ 1,343.4	\$ 1,150.0
Costs deferred during year			
Commissions and brokerage	1,635.9	1,634.5	1,491.6
Premium taxes and assessments	260.1	256.3	239.1
Salaries and operating costs	1,051.1	1,029.1	973.2
	2,947.1	2,919.9	2,703.9
Increase (decrease) due to foreign exchange	(6.6)	14.7	25.1
Amortization during year	(2,930.4)	(2,843.3)	(2,535.6)
Balance, end of year	\$ 1,444.8	\$ 1,434.7	\$ 1,343.4

#### (5) Real Estate

The components of real estate assets were as follows:

December 31

	2005	2004
	(in millions)	
Mortgages and notes receivable	\$ 19.0	\$ 19.7
Income producing properties	143.8	157.9
Construction in progress	20.9	28.6
Land under development and unimproved land	183.7	268.0
	\$367.4	\$474.2

Impairment losses of \$65.7 million, \$27.3 million and \$8.4 million were recognized in 2005, 2004 and 2003, respectively, to write down the carrying value of certain properties to their estimated fair value.

Depreciation expense related to income producing properties was \$5.5 million, \$5.9 million and \$4.1 million for 2005, 2004 and 2003, respectively.

**(6) Property and Equipment**

Property and equipment included in other assets were as follows:

	December 31	
	2005	2004
	(in millions)	
Cost	\$804.0	\$840.9
Accumulated depreciation	419.1	411.6
	\$384.9	\$429.3

Depreciation expense related to property and equipment was \$85.3 million, \$99.7 million and \$103.9 million for 2005, 2004 and 2003, respectively.

## **(7) Unpaid Losses and Loss Expenses**

The process of establishing loss reserves is complex and imprecise as it must take into consideration many variables that are subject to the outcome of future events. As a result, informed subjective estimates and judgments as to the P&C Group's ultimate exposure to losses are an integral component of the loss reserving process.

Most of the P&C Group's loss reserves relate to long tail liability classes of business. For many liability claims significant periods of time, ranging up to several years or more, may elapse between the occurrence of the loss, the reporting of the loss and the settlement of the claim. The longer the time span between the incidence of a loss and the settlement of the claim, the more the ultimate settlement amount can vary.

There are numerous factors that contribute to the inherent uncertainty in the process of establishing loss reserves. Among these factors are changes in the inflation rate for goods and services related to covered damages such as medical care and home repair costs; changes in the judicial interpretation of policy provisions relating to the determination of coverage; changes in the general attitude of juries in the determination of liability and damages; legislative changes; changes in the medical condition of claimants; changes in the estimates of the number and/or severity of claims that have been incurred but not reported as of the date of the financial statements; and changes in the P&C Group's underwriting standards and/ or claim handling procedures.

In addition, the uncertain effects of emerging or potential claims and coverage issues that arise as legal, judicial and social conditions change must be taken into consideration. These issues can have a negative effect on loss reserves by either extending coverage beyond the original underwriting intent or by increasing the number or size of claims. As a result of such issues, the uncertainties inherent in estimating ultimate claim costs on the basis of past experience have grown, further complicating the already complex loss reserving process.

The future impact of the various factors that contribute to the uncertainty in the loss reserving process and of emerging or potential claims and coverage issues is extremely hard to predict and cannot be quantified.

The estimation of loss reserves relating to asbestos and toxic waste claims on insurance policies written many years ago is subject to greater uncertainty than other types of claims due to inconsistent court decisions as well as judicial interpretations and legislative actions that in some cases have tended to broaden coverage beyond the original intent of such policies and in others have expanded theories of liability. The insurance industry as a whole is engaged in extensive litigation over these coverage and liability issues and is thus confronted with a continuing uncertainty in its efforts to quantify these exposures.

Asbestos remains the most significant and difficult mass tort for the insurance industry in terms of claims volume and dollar exposure. Asbestos claims relate primarily to bodily injuries asserted by those who came in contact with asbestos or products containing asbestos. Early court cases established the continuous trigger theory with respect to insurance coverage. Under this theory, insurance coverage is deemed to be triggered from the time a claimant is first exposed to asbestos until the manifestation of any disease. This interpretation of a policy trigger can involve insurance companies over many years and increases their exposure to liability.

New asbestos claims and new exposures on existing claims have continued unabated despite the fact that usage of asbestos has declined since the mid-1970's. Each claim filing typically names dozens of defendants to ensure that there is a solvent company left in the group to eventually pay claims. The plaintiffs' bar continues to solicit new claimants through extensive advertising and through asbestos medical screenings. New asbestos cases are often filed in those jurisdictions with a reputation for judges and juries that are extremely sympathetic to plaintiffs. A vast majority of asbestos bodily injury claims are filed by claimants who do not show any signs of asbestos related disease.

There have been several positive recent developments in the asbestos environment. Various challenges to mass screening claimants have been mounted. Also, a number of key jurisdictions have adopted venue reform that requires plaintiffs to have a connection to the jurisdiction in order to file a complaint. In addition, several states have enacted laws that set medical criteria that must be met for plaintiffs to proceed with their claims and other states have medical criteria bills pending.

To date, approximately 75 manufacturers and distributors of asbestos products have filed for bankruptcy protection as a result of asbestos related liabilities. Certain of these manufacturers and distributors have utilized a practice referred to as a prepackaged bankruptcy, which involves an agreement to a plan between the debtor and its creditors, including current and future asbestos claimants. Although the debtor is negotiating in part with its insurers' money,

insurers are generally given only limited opportunity to be heard. In recognition that many aspects of prepackaged bankruptcy plans are unfair to certain classes of claimants and to the insurance industry, these plans are beginning to be closely scrutinized by the courts and rejected when appropriate.

The P&C Group's most significant individual asbestos exposures involve products liability on the part of traditional defendants who were engaged in the manufacture, distribution or installation of asbestos products. The P&C Group wrote excess liability and/or general liability coverages for these insureds. While these insureds are relatively few in number, their exposure has increased in recent years due to the increased volume of claims, the erosion of much of the underlying limits and the bankruptcies of target defendants.

The P&C Group's other asbestos exposures involve products and non-products liability on the part of peripheral defendants, including a mix of manufacturers, distributors and installers of certain products that contain asbestos in small quantities and owners or operators

of properties where asbestos was present. Generally, these insureds are named defendants on a regional rather than a nationwide basis. As the financial resources of traditional asbestos defendants have been depleted, plaintiffs are targeting these viable peripheral parties with greater frequency and, in many cases, for larger awards.

Asbestos claims against the major manufacturers, distributors or installers of asbestos products were presented under the products liability section of primary general liability policies as well as under excess liability policies, both of which typically had aggregate limits that capped an insurer's exposure. In recent years, a number of asbestos claims by insureds are being presented as non-products claims, such as those by installers of asbestos products and by property owners or operators who allegedly had asbestos on their property, under the premises or operations section of primary general liability policies. Unlike products exposures, these non-products exposures typically had no aggregate limits on coverage, creating potentially greater exposure. Further, in an effort to seek additional insurance coverage, some insureds with installation activities who have substantially eroded their products coverage are presenting new asbestos claims as non-products operations claims or attempting to reclassify previously settled products claims as non-products claims to restore a portion of previously exhausted products aggregate limits. It is difficult to predict whether insureds will be successful in asserting claims under non-products coverage or whether insurers will be successful in asserting additional defenses. Therefore, the future impact of such efforts on insurers is uncertain.

In establishing asbestos reserves, the exposure presented by each insured is evaluated. As part of this evaluation, consideration is given to a variety of factors including the available insurance coverage; limits and deductibles; the jurisdictions involved; past settlement values of similar claims; the potential role of other insurance, particularly underlying coverage below excess liability policies; potential bankruptcy impact; and applicable coverage defenses, including asbestos exclusions.

Significant uncertainty remains as to the ultimate liability of the P&C Group relating to asbestos related claims. This uncertainty is due to several factors including the long latency period between asbestos exposure and disease manifestation and the resulting potential for involvement of multiple policy periods for individual claims; plaintiffs increased focus on peripheral defendants; the increase in the volume of claims by unimpaired plaintiffs and the extent to which they can be precluded from making claims; the efforts by insureds to obtain coverage not subject to aggregate limits; the number of insureds seeking bankruptcy protection as a result of asbestos related liabilities and the impact of prepackaged bankruptcies; the ability of claimants to bring a claim in a state in which they have no residency or exposure; inconsistent court decisions and diverging legal interpretations; and the possibility, however remote, of federal legislation that would address the asbestos problem. These significant uncertainties are not likely to be resolved definitively in the near future.

Insurance losses and loss expenses of the P&C Group included \$35 million, \$75 million and \$250 million in 2005, 2004 and 2003, respectively, related to asbestos claims.

Toxic waste claims relate primarily to pollution and related cleanup costs. The P&C Group's insureds have two potential areas of exposure: hazardous waste dump sites and pollution at the insured site primarily from underground storage tanks and manufacturing processes.

Under the federal Superfund law and similar state statutes, when potentially responsible parties (PRPs) fail to handle the clean-up at a hazardous waste site, regulators have the work done and then attempt to establish legal liability against the PRPs. Most sites have multiple PRPs.

Most PRPs named to date are parties who have been generators, transporters, past or present landowners or past or present site operators. The PRPs disposed of toxic materials at a waste dump site or transported the materials to the site. Insurance policies issued to PRPs were not intended to cover the clean-up costs of pollution and, in many cases, did not intend to cover the pollution itself.

As the costs of environmental clean-up became substantial, PRPs and others increasingly filed claims with their insurance carriers. Litigation against insurers extends to issues of liability, coverage and other policy provisions.

There is substantial uncertainty involved in estimating the P&C Group's liabilities related to these claims. First, the liabilities of the claimants are extremely difficult to estimate. At any given waste site, the allocation of remediation costs among governmental authorities and the PRPs varies greatly depending on a variety of factors. Second, different courts have addressed liability and coverage issues regarding pollution claims and have reached inconsistent conclusions in their interpretation of several issues. These significant uncertainties are not likely to be resolved

definitively in the near future.

Uncertainties also remain as to the Superfund law itself. Superfund's taxing authority expired on December 31, 1995 and has not been re-enacted. Federal legislation appears to be at a standstill. At this time, it is not possible to predict the direction that any reforms may take, when they may occur or the effect that any changes may have on the insurance industry.

Without federal movement on Superfund reform, the enforcement of Superfund liability is shifting to the states. States are being forced to reconsider state-level cleanup statutes and regulations. As individual states move forward, the potential for conflicting state regulation becomes greater. In a few states, cases have been brought against insureds or directly against insurance companies for environmental pollution and natural resources damages. To date, only a few natural resources claims have been filed and they are being vigorously defended. Significant uncertainty remains as to the cost of remediating the state sites. Because of the large number of state sites, such sites could prove even more costly in the aggregate than Superfund sites.

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In establishing toxic waste reserves, the exposure presented by each insured is evaluated. As part of this evaluation, consideration is given to the probable liability, available insurance coverage, judicial interpretations, past settlement values of similar exposures as well as facts that are unique to each insured.

A reconciliation of the beginning and ending liability for unpaid losses and loss expenses, net of reinsurance recoverable, and a reconciliation of the net liability to the corresponding liability on a gross basis is as follows:

	2005	2004	2003
	(in millions)		
Gross liability, beginning of year	\$20,291.9	\$ 17,947.8	\$ 16,713.1
Reinsurance recoverable, beginning of year	3,483.2	3,426.6	4,071.5
Net liability, beginning of year	16,808.7	14,521.2	12,641.6
Net incurred losses and loss expenses related to			
Current year	7,650.8	6,994.0	6,469.9
Prior years	162.7	326.9	397.3
	7,813.5	7,320.9	6,867.2
Net payments for losses and loss expenses related to			
Current year	1,878.4	1,691.4	1,588.8
Prior years	4,031.3	3,342.0	3,398.8
	5,909.7	5,033.4	4,987.6
Net liability, end of year	18,712.5	16,808.7	14,521.2
Reinsurance recoverable, end of year	3,769.2	3,483.2	3,426.6
Gross liability, end of year	\$22,481.7	\$ 20,291.9	\$ 17,947.8

The gross liability for unpaid losses and loss expenses and reinsurance recoverable included \$966.9 million and \$755.8 million, respectively, at December 31, 2005 related to Hurricane Katrina. The gross liability for unpaid losses and loss expenses and reinsurance recoverable included \$412.9 million and \$353.8 million, respectively, at December 31, 2005, \$700.5 million and \$582.1 million, respectively, at December 31, 2004, and \$999.3 million and \$748.2 million, respectively, at December 31, 2003 related to the September 11, 2001 attack.

Because loss reserve estimates are subject to the outcome of future events, changes in estimates are unavoidable given that loss trends vary and time is required for changes in trends to be recognized and confirmed. During 2005, the P&C Group experienced overall unfavorable development of \$162.7 million on net unpaid losses and loss expenses established as of the previous year end. This compares with unfavorable prior year development of \$326.9 million in 2004 and \$397.3 million in 2003. Such adverse development was reflected in operating results in these respective years.

The net unfavorable development of \$162.7 million in 2005 was due to various factors. Unfavorable development of about \$200 million was experienced in the professional liability classes other than fidelity. Adverse development

related to accident years 1998 through 2002, due largely to errors and omissions liability claims related to corporate failures and allegations of management misconduct and accounting irregularities, was offset in part by favorable development related to accident years 2003 and 2004. Unfavorable development of about \$175 million was experienced related to accident years prior to 1996, including \$35 million related to asbestos claims. The adverse development was due largely to the strengthening of loss reserves for commercial excess umbrella and other commercial liability classes. There was significant reported loss activity during 2005 related to these older accident years, which resulted in a lengthening of the expected loss emergence period for these classes. Favorable development of about \$160 million was experienced due to fewer than expected late reported homeowners and commercial property losses. Favorable development of about \$90 million was experienced in the fidelity and surety classes due to lower than expected reported loss emergence.

The net unfavorable development of \$326.9 million in 2004 was also the result of various factors. Unfavorable development of about \$415 million was experienced in the professional liability classes, principally directors and officers liability and errors and omissions liability, resulting from adverse loss trends in accident years 1998 through 2002 due in large part to claims related to corporate failures and allegations of management misconduct and accounting irregularities, especially those involving investment banks and other financial institutions. Unfavorable development of about \$185 million was experienced related to accident years prior to 1995, including \$75 million related to asbestos claims. Loss reserves were strengthened for certain commercial liability classes. Unfavorable development of about \$50 million was experienced in the workers' compensation class due primarily to higher average severity of the medical portion of these claims. Favorable development of about \$270 million was experienced related to the 2003 accident year, due in large part to an unusually low amount of late reported homeowners and commercial property losses. Favorable development of \$80 million was experienced due to a reduction in loss reserves related to the September 11 attack.

The unfavorable development in 2003 was due primarily to two factors. First, asbestos loss reserves were strengthened by \$250 million. Second, unfavorable development of about \$140 million was experienced in the professional liability classes, principally directors and officers liability and errors and omissions liability, as adverse loss trends in the 2000 through 2002 accident years more than offset favorable loss experience in older accident years.

Management believes that the aggregate loss reserves of the P&C Group at December 31, 2005 were adequate to cover claims for losses that had occurred, including both those known and those yet to be reported. In establishing such reserves, management considers facts currently known and the present state of the law and coverage litigation. However, given the judicial decisions and legislative actions that have broadened the scope of coverage and expanded theories of liability in the past and the possibilities of similar interpretations in the future, particularly as they relate to asbestos claims and, to a lesser extent, toxic waste claims, it is possible that management's estimate of the ultimate liability for losses that occurred as of December 31, 2005 may increase in future periods. Such increases in estimates could have a material adverse effect on the Corporation's future operating results. However, management does not expect that any such increases would have a material adverse effect on the Corporation's consolidated financial condition.

**(8) Debt and Credit Arrangements**

(a) Long term debt consisted of the following:

	December 31	
	2005	2004
	(in millions)	
Mortgages	\$	\$ 42.3
6.15% notes due August 15, 2005		300.0
4.934% notes due November 16, 2007*	600.0	600.0
7 <sup>1</sup> / <sub>8</sub> % notes due December 15, 2007	75.0	75.0
3.95% notes due April 1, 2008	225.0	225.0
2.25% notes due August 16, 2008	460.0	460.0
6% notes due November 15, 2011	400.0	400.0
5.2% notes due April 1, 2013	275.0	275.0
6.6% debentures due August 15, 2018	100.0	100.0
8.675% capital securities due February 1, 2027	125.0	125.0
6.8% debentures due November 15, 2031	200.0	200.0
	2,460.0	2,802.3
Fair value of interest rate swap	7.3	11.4
	\$2,467.3	\$2,813.7

\* These notes bore an interest rate of 4% at December 31, 2004. The interest rate was reset to 4.934% in August 2005 pursuant to the remarketing of these notes as described below.

In November 2002, Chubb issued \$600 million of unsecured 4% senior notes due November 16, 2007 and 24 million mandatorily exercisable warrants to purchase Chubb's common stock. The notes and warrants were issued together in the form of 7% equity units. Each equity unit initially represented one warrant and \$25 principal amount of notes. In August 2005, the notes were successfully remarketed as required by their terms. The interest rate on the notes was reset to 4.934%, from 4%, effective August 16, 2005. The remarketed notes are due on November 16, 2007. The warrants are further described in Note (18)(b).

In June 2003, Chubb issued \$460 million of unsecured 2.25% senior notes due August 16, 2008 and 18.4 million purchase contracts to purchase Chubb's common stock. The notes and purchase contracts were issued together in the form of 7% equity units. Each equity unit initially represents one purchase contract and \$25 principal amount of notes. The notes are pledged by the holders to secure their obligations under the purchase contracts. Chubb will make quarterly interest payments to the holders of the notes initially at a rate of 2.25% per year. The 2.25% notes will be remarketed in May 2006. At that time, the remarketing agent will have the ability to reset the interest rate on the notes in order to generate sufficient remarketing proceeds to satisfy the holder's obligation under the purchase contract. If the notes are not successfully remarketed, Chubb will exercise its rights as a secured party to obtain and extinguish the notes and deliver its common stock to the holders pursuant to the purchase contracts. The purchase contracts are further described in Note (18)(c).

The 3.95% notes, the 6% notes, the 5.2% notes, the 6.6% debentures and the 6.8% debentures are all unsecured obligations of Chubb.

The 7<sup>1</sup>/<sub>8</sub>% notes are obligations of Chubb Executive Risk Inc., a wholly owned subsidiary, and are fully and unconditionally guaranteed by Chubb.

Executive Risk Capital Trust, wholly owned by Chubb Executive Risk, has outstanding \$125 million of 8.675% capital securities. The Trust in turn used the proceeds from the issuance of the capital securities to acquire \$125 million of Chubb Executive Risk 8.675% junior subordinated deferrable interest debentures due February 1, 2027. The sole assets of the Trust are the debentures. The debentures and the related income effects are eliminated in the consolidated financial statements. The capital securities are subject to mandatory redemption on February 1, 2027, upon repayment of the debentures. The capital securities are also subject to mandatory redemption in certain other specified circumstances beginning in 2007 at a redemption price that includes a make whole premium through 2017 and at par thereafter. Chubb Executive Risk has the right, at any time, to defer payments of interest on the debentures and hence distributions on the capital securities for a period not exceeding ten consecutive semi-annual periods up to the maturity dates of the respective securities. During any such period, interest will continue to accrue and Chubb Executive Risk may not declare or pay any dividends. The capital securities are unconditionally and on a subordinated basis guaranteed by Chubb.

Chubb is a party to a cancelable interest rate swap agreement with a notional amount of \$125 million that replaces the fixed rate of the capital securities with the 3-month LIBOR rate plus 204 basis points. The swap agreement provides only for the exchange of interest on the notional amount. The interest rate swap matures in February 2027. The fair value of the swap is included in other assets, offset by a corresponding increase to long term debt.

The amounts of long term debt due annually during the five years subsequent to December 31, 2005 are as follows:

Years Ending  
December 31

	(in millions)
2006	\$
2007	675.0
2008	685.0
2009	
2010	

Chubb filed a shelf registration statement which the Securities and Exchange Commission declared effective in June 2003, under which up to \$2.5 billion of various types of securities may be issued. At December 31, 2005, approximately \$650 million remained under the shelf.

(b) Interest costs of \$134.8 million, \$138.7 million and \$130.1 million were incurred in 2005, 2004 and 2003, respectively. Interest paid was \$137.9 million, \$135.6 million and \$122.2 million in 2005, 2004 and 2003, respectively.

(c) In June 2005, the Corporation entered into a revolving credit agreement with a group of banks that provides for unsecured borrowings of up to \$500 million. The revolving credit facility terminates on June 22, 2010. On the termination date of the agreement, any loans then outstanding become payable. There have been no borrowings under this agreement. Various interest rate options are available to the Corporation, all of which are based on market interest rates. The Corporation pays a fee to have this revolving credit facility available. The agreement contains customary restrictive covenants including a covenant to maintain a minimum consolidated shareholders' equity, as adjusted. The facility is available for general corporate purposes and to support the Corporation's commercial paper borrowing arrangement. This facility replaced, on substantially the same terms, a \$250 million short term revolving credit facility that expired and a \$250 million medium term revolving credit facility that was terminated.

### (9) Reinsurance

In the ordinary course of business, the P&C Group assumes and cedes reinsurance with other insurance companies. Reinsurance is ceded to provide greater diversification of risk and to limit the P&C Group's maximum net loss arising from large risks or catastrophic events.

A large portion of the P&C Group's ceded reinsurance is effected under contracts known as treaties under which all risks meeting prescribed criteria are automatically covered. Most of these arrangements consist of excess of loss and catastrophe contracts that protect against a specified part or all of certain types of losses over stipulated amounts arising from any one occurrence or event. In certain circumstances, reinsurance is also effected by negotiation on individual risks.

Ceded reinsurance contracts do not relieve the P&C Group of the primary obligation to its policyholders. Thus, an exposure exists with respect to reinsurance ceded to the extent that any reinsurer is unable or unwilling to meet the obligations assumed under the reinsurance contracts. The P&C Group monitors the financial strength of its reinsurers on an ongoing basis.

Premiums earned and insurance losses and loss expenses are reported net of reinsurance in the consolidated statements of income.

The effect of reinsurance on the premiums written and earned of the P&C Group was as follows:

	Years Ended December 31		
	2005	2004	2003
		(in millions)	
Direct premiums written	\$12,179.6	\$12,001.3	\$11,337.7
Reinsurance assumed	1,119.7	1,397.7	1,266.0
Reinsurance ceded	(1,016.7)	(1,346.1)	(1,535.8)
Net premiums written	\$12,282.6	\$12,052.9	\$11,067.9
Direct premiums earned	\$12,110.6	\$11,663.8	\$10,720.0
Reinsurance assumed	1,175.5	1,367.7	1,094.4
Reinsurance ceded	(1,110.1)	(1,395.8)	(1,631.9)
Net premiums earned	\$12,176.0	\$11,635.7	\$10,182.5

Reinsurance recoveries by the P&C Group that have been deducted from insurance losses and loss expenses were \$1,030.7 million, \$803.0 million and \$767.0 million in 2005, 2004 and 2003, respectively.



**(10) Federal and Foreign Income Tax**

(a) Income tax expense consisted of the following components:

	Years Ended December 31		
	2005	2004	2003
	(in millions)		
Current tax			
United States	\$420.7	\$337.6	\$170.7
Foreign	116.6	97.2	51.0
Deferred tax expense (credit), principally United States	83.8	85.0	(96.9)
	\$621.1	\$519.8	\$124.8

Federal and foreign income taxes paid were \$409.4 million, \$377.7 million and \$133.9 million in 2005, 2004 and 2003, respectively.

(b) The effective income tax rate is different than the statutory federal corporate tax rate. The reasons for the different effective tax rate were as follows:

	Years Ended December 31					
	2005		2004		2003	
	Amount	% of Pre-Tax Income	Amount	% of Pre-Tax Income	Amount	% of Pre-Tax Income
	(in millions)					
Income before federal and foreign income tax	\$2,447.0		\$2,068.2		\$933.6	
Tax at statutory federal income tax rate	\$856.5	35.0%	\$723.9	35.0%	\$326.7	35.0%
Tax exempt interest income	(194.9)	(8.0)	(174.0)	(8.4)	(150.1)	(16.1)
Valuation allowance					(40.0)	(4.3)
Other, net	(40.5)	(1.6)	(30.1)	(1.5)	(11.8)	(1.2)
Actual tax	\$621.1	25.4%	\$519.8	25.1%	\$124.8	13.4%

Deferred income tax assets are established related to the expected future U.S. tax benefit of losses and foreign taxes incurred by the Corporation's foreign subsidiaries. Realization of these deferred tax assets depends on the ability to generate sufficient taxable income in future periods in the appropriate taxing jurisdictions. A valuation allowance of \$40.0 million was established at December 31, 2002 to reflect management's assessment that the realization of a portion of the deferred tax assets was uncertain due to the inability of a foreign subsidiary to generate sufficient taxable income in the near term. This foreign subsidiary was profitable in 2003, which reduced the deferred tax assets related to the expected future U.S. tax benefit of losses incurred by the subsidiary. Accordingly, the valuation allowance was eliminated at December 31, 2003.

(c) The tax effects of temporary differences that gave rise to deferred income tax assets and liabilities were as follows:

	December 31	
	2005	2004
	(in millions)	
<b>Deferred income tax assets</b>		
Unpaid losses and loss expenses	\$ 734.1	\$ 670.9
Unearned premiums	364.5	361.9
Foreign tax credits	388.1	306.8
Employee compensation	134.8	123.7
Postretirement benefits	12.8	40.7
Alternative minimum tax credit carryforward		59.5
Total	1,634.3	1,563.5
<b>Deferred income tax liabilities</b>		
Deferred policy acquisition costs	429.8	435.5
Unremitted earnings of foreign subsidiaries	318.4	203.2
Unrealized appreciation of investments	167.2	336.3
Other, net	96.4	55.0
Total	1,011.8	1,030.0
Net deferred income tax asset	\$ 622.5	\$ 533.5

Although realization of deferred tax assets is not assured, management believes that it is more likely than not that the deferred tax assets will be realized. Accordingly, no valuation allowance was recorded at December 31, 2005 or 2004.



**(11) Stock-Based Employee Compensation Plans**

(a) In 2004, the Corporation adopted the Long-Term Stock Incentive Plan (2004), which succeeded the Long-Term Stock Incentive Plan (2000). The Long-Term Stock Incentive Plan (2004), which is similar to the 2000 plan, provides for the granting of restricted stock units, restricted stock, performance shares, stock options, and other stock-based awards to key employees. The maximum number of shares of Chubb's common stock in respect to which stock-based awards may be granted under the 2004 Plan is 5,800,000 newly authorized shares, plus any shares remaining available for issuance under the 2000 Plan. At December 31, 2005, 5,954,000 shares were available for grant under the 2004 Plan.

During 2004, the Corporation changed the emphasis of its equity compensation program from stock options to other equity awards.

Restricted stock unit awards are payable in cash, in shares of Chubb's common stock, or in a combination of both. Restricted stock unit awards are not considered to be outstanding shares of common stock, have no voting rights and are subject to forfeiture during the restriction period. Holders of restricted stock unit awards may receive dividend equivalents. Restricted stock awards consist of shares of Chubb's common stock granted at no cost to the employees. Shares of restricted stock become outstanding when granted, receive dividends and have voting rights. The shares are subject to forfeiture and to restrictions that prevent their sale or transfer during the restriction period. Performance share awards are based on the achievement of performance goals over performance cycle periods. Performance share awards are payable in cash, in shares of Chubb's common stock or in a combination of both.

An amount equal to the fair market value at the date of grant of restricted stock unit awards, restricted stock awards and performance share awards is expensed over the vesting period. The Corporation granted restricted stock unit awards, restricted stock awards and performance share awards with respect to 1,122,263 shares in 2005, 1,204,025 shares in 2004 and 301,037 shares in 2003. The weighted average fair market value per share of such awards was \$77.40, \$68.41 and \$48.58 in 2005, 2004 and 2003, respectively. The aggregate amount charged against income with respect to these awards was \$56.9 million, \$35.0 million and \$17.8 million in 2005, 2004 and 2003, respectively.

Stock options are granted at exercise prices not less than the fair market value of Chubb's common stock on the date of grant. The terms and conditions upon which options become exercisable may vary among grants. Options expire no later than ten years from the date of grant.

An amount equal to the fair market value of stock options at the date of grant is expensed over the period that such options become exercisable. The amount charged against income with respect to stock options was \$9.0 million, \$29.0 million and \$56.0 million in 2005, 2004 and 2003, respectively. The weighted average fair value of stock options granted during 2005, 2004 and 2003 was \$15.11, \$15.00 and \$9.71, respectively. The fair value of each stock option was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions.

	2005	2004	2003
Risk-free interest rate	4.0%	3.4%	2.9%
Expected volatility	22.1%	25.9%	28.0%
Dividend yield	2.0%	2.2%	3.1%
Expected average term (in years)	3.5	4.2	5.5

Additional information with respect to stock options is as follows:

	2005		2004		2003	
	Number of Shares	Weighted Average	Number of Shares	Weighted Average	Number of Shares	Weighted Average

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		Exercise Price		Exercise Price		Exercise Price
Outstanding, beginning of year	17,741,298	\$62.65	22,032,594	\$60.87	19,855,186	\$63.51
Granted	379,291	85.48	179,579	71.73	4,326,225	46.90
Exercised	(9,265,879)	60.17	(3,994,258)	52.60	(1,031,414)	47.65
Forfeited	(176,812)	67.85	(476,617)	68.12	(1,117,403)	65.88
Outstanding, end of year	8,677,898	66.19	17,741,298	62.65	22,032,594	60.87
Exercisable, end of year	8,555,486	66.09	15,650,019	64.57	16,176,926	63.01

December 31, 2005

Range of Option Exercise Prices		Options Outstanding			Options Exercisable	
		Number Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Number Exercisable	Weighted Average Exercise Price
\$16.21	\$48.75	2,012,144	\$46.85	5.6	2,012,144	\$46.85
54.55	71.00	3,132,720	65.19	4.3	3,074,547	65.11
71.11	98.01	3,533,034	78.09	4.2	3,468,795	78.12
		8,677,898	66.19	4.6	8,555,486	66.09

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(b) The Corporation has a Stock Purchase Plan under which substantially all employees are eligible to purchase shares of Chubb's common stock at a fixed price at the end of the offering period. The price is determined on the date the purchase rights are granted and the offering period cannot exceed 27 months. The number of shares an eligible employee may purchase is based on the employee's compensation.

An amount equal to the fair market value of purchase rights at the date of grant is expensed over the offering period. In 2002, the Corporation granted purchase rights with respect to 1,661,587 shares. The weighted average fair market value per share of such purchase rights was \$14.69. The amount charged against income with respect to such purchase rights was \$3.6 million and \$10.3 million in 2004 and 2003, respectively. No purchase rights have been granted since 2002.

(c) The Corporation had a leveraged Employee Stock Ownership Plan (ESOP) in which substantially all employees were eligible to participate. At its inception in 1989, the ESOP used the proceeds of a \$150.0 million loan from Chubb to purchase 7,792,204 newly issued shares of Chubb's common stock. The loan, which bore interest at 9%, was due in September 2004. The receivable from the ESOP, which was recorded as a separate reduction of shareholders' equity on the consolidated balance sheets, was reduced as repayments were made on the loan principal.

Chubb and its participating subsidiaries made semi-annual contributions to the ESOP. The contributions, together with the dividends on the shares of common stock in the ESOP, were used by the ESOP to make loan interest and principal payments to Chubb. As interest and principal were paid, a portion of the common stock was allocated to eligible employees. As of September 30, 2004, the loan was fully paid and all common shares held by the ESOP were allocated. During the fourth quarter of 2004, the ESOP was merged into the Corporation's Capital Accumulation Plan.

The Corporation used the cash payment method of recognizing ESOP expense. Cash contributions to the ESOP of \$13.1 million in 2004 and \$11.2 million in 2003 were charged against income. Dividends on shares of common stock in the ESOP used for debt service were \$5.9 million for 2004 and \$7.7 million for 2003.

## **(12) Employee Benefits**

(a) The Corporation has several non-contributory defined benefit pension plans covering substantially all employees. Prior to 2001, benefits were generally based on an employee's years of service and average compensation during the last five years of employment. Effective January 1, 2001, the Corporation changed the formula for providing pension benefits from the final average pay formula to a cash balance formula. Under the cash balance formula, a notional account is established for each employee, which is credited semi-annually with an amount equal to a percentage of eligible compensation based on age and years of service plus interest based on the account balance. Employees hired prior to 2001 will generally be eligible to receive vested benefits based on the higher of the final average pay or cash balance formulas.

The Corporation's funding policy is to contribute amounts that meet regulatory requirements plus additional amounts determined by management based on actuarial valuations, current market conditions and other factors. This may result in no contribution being made in a particular year.

The Corporation also provides certain other postretirement benefits, principally health care and life insurance, to retired employees and their beneficiaries and covered dependents. Substantially all employees hired before January 1, 1999 may become eligible for these benefits upon retirement if they meet minimum age and years of service requirements. Health care coverage is contributory. Retiree contributions vary based upon a retiree's age, type of coverage and years of service with the Corporation. Life insurance coverage is non-contributory.

In 2004, the Corporation began to fund a portion of the health care benefits obligation where such funding could be accomplished on a tax effective basis. Previously, the Corporation did not fund these benefits in advance. Benefits are paid as covered expenses are incurred.

The Corporation uses December 31 as the measurement date for its pension and other postretirement benefit plans.

The following table sets forth the plans' funded status and amounts recognized in the balance sheets:

	Pension Benefits		Other Postretirement Benefits	
	2005	2004	2005	2004
	(in millions)			
Benefit obligation	\$ 1,292.9	\$ 1,076.9	\$ 274.7	\$ 216.0
Plan assets at fair value	1,031.2	886.2	21.8	13.4
Benefit obligation in excess of plan assets	261.7	190.7	252.9	202.6
Unrecognized net loss from past experience different from that assumed	(390.6)	(258.2)	(54.7)	(7.5)
Unrecognized prior service cost	(12.8)	(14.5)	3.5	
Liability (asset) included in other liabilities	\$ (141.7)	\$ (82.0)	\$ 201.7	\$ 195.1

The accumulated benefit obligation for the pension plans was \$1,000.0 million and \$836.5 million at December 31, 2005 and 2004, respectively. The accumulated benefit obligation is the present value of pension benefits earned as of the measurement date based on employee service and compensation prior to that date. It differs from the pension benefit obligation in the above table in that the accumulated benefit obligation includes no assumptions about future compensation levels.

The weighted average assumptions used to determine the benefit obligations were as follows:

	Pension Benefits		Other Postretirement Benefits	
	2005	2004	2005	2004
Discount rate	5.75%	6.25%	5.75%	6.25%
Rate of compensation increase	4.5	4.5		

The Corporation made pension plan contributions of \$126.9 million and \$65.0 million during 2005 and 2004, respectively. The Corporation made other postretirement benefit plan contributions of \$8.0 million and \$12.8 million during 2005 and 2004, respectively.

The components of net pension and other postretirement benefit costs were as follows:

	Pension Benefits			Other Postretirement Benefits		
	2005	2004	2003	2005	2004	2003
	(in millions)					
Service cost	\$57.6	\$50.2	\$42.7	\$ 8.4	\$ 8.5	\$ 6.7
Interest cost	68.5	61.2	55.2	14.5	14.7	12.6

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Expected return on plan assets	(73.5)	(66.9)	(55.0)	(1.1)	(.2)	
Other costs	20.6	14.2	3.5	.4	1.4	.4
	\$73.2	\$58.7	\$46.4	\$22.2	&	