CINCINNATI FINANCIAL CORP
Form 10-Q
July 25, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark one)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the quarterly period ended June 30, 2013.

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the transition period from ______________________ to ______________________.
Commission file number 0-4604

CINCINNATI FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Ohio (State or other jurisdiction of incorporation or organization)	31-0746871 (I.R.S. Employer Identification No.)
6200 S. Gilmore Road, Fairfield, Ohio (Address of principal executive offices)	45014-5141 (Zip code)

Registrant’s telephone number, including area code: (513) 870-2000

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.
þYes ¨ No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a nonaccelerated filer or a smaller reporting company. See definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company" in Rule 12b-2 of the Exchange Act.

þ Large accelerated filer ¨ Accelerated filer ¨ Nonaccelerated filer ¨ Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

¨Yes þ No

As of July 22, 2013, there were 163,668,282 shares of common stock outstanding.

CINCINNATI FINANCIAL CORPORATION
FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2013

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Item 1. Financial Statements (unaudited)

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions except per share data)	June 30, 2013	December 31, 2012
ASSETS		
Investments		
Fixed maturities, at fair value (amortized cost: 2013—$8,428; 2012—$8,222)	$8,992	$9,093
Equity securities, at fair value (cost: 2013—$2,452; 2012—$2,369)	3,875	3,373
Other invested assets	66	68
Total investments	12,933	12,534
Cash and cash equivalents	382	487
Investment income receivable	116	115
Finance receivable	79	75
Premiums receivable	1,350	1,214
Reinsurance recoverable	582	615
Prepaid reinsurance premiums	26	26
Deferred policy acquisition costs	546	470
Land, building and equipment, net, for company use (accumulated depreciation: 2013—$405; 2012—$397)	213	217
Other assets	94	61
Separate accounts	713	734
Total assets	$17,034	$16,548
LIABILITIES		
Insurance reserves		
Loss and loss expense reserves	$4,284	$4,230
Life policy and investment contract reserves	2,345	2,295
Unearned premiums	1,947	1,792
Other liabilities	597	660
Deferred income tax	512	453
Note payable	104	104
Long-term debt and capital lease obligations	833	827
Separate accounts	713	734
Total liabilities	11,335	11,095
Commitments and contingent liabilities (Note 12)	—	—
SHAREHOLDERS' EQUITY		
Common stock, par value—$2 per share; (authorized: 2013 and 2012—500 million shares; issued and outstanding: 2013—198 million shares and 2012—197 million shares)	396	394
Paid-in capital	1,162	1,134
Retained earnings	4,152	4,021
Accumulated other comprehensive income	1,221	1,129
Treasury stock at cost (2013 and 2012—34 million shares)	(1,232)	(1,225)
Total shareholders' equity	5,699	5,453
Total liabilities and shareholders' equity	$17,034	$16,548

Accompanying notes are an integral part of these condensed consolidated financial statements.

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Three months ended June 30,		Six months ended June 30,	
(In millions except per share data)	2013	2012	2013	2012
REVENUES				
Earned premiums	$954	$877	$1,885	$1,716
Investment income, net of expenses	131	132	259	263
Total realized investment gains, net	14	6	55	19
Fee revenues	3	2	4	3
Other revenues	2	3	4	5
Total revenues	1,104	1,020	2,207	2,006
BENEFITS AND EXPENSES				
Insurance losses and policyholder benefits	631	687	1,199	1,269
Underwriting, acquisition and insurance expenses	307	287	607	561
Interest expense	14	13	27	27
Other operating expenses	4	4	9	8
Total benefits and expenses	956	991	1,842	1,865
INCOME BEFORE INCOME TAXES	148	29	365	141
PROVISION (BENEFIT) FOR INCOME TAXES				
Current	37	6	91	26
Deferred	1	(9)	10	(3)
Total provision (benefit) for income taxes	38	(3)	101	23
NET INCOME	$110	$32	$264	$118
PER COMMON SHARE				
Net income—basic	$0.67	$0.20	$1.62	$0.73
Net income—diluted	0.66	0.20	1.60	0.72

Accompanying notes are an integral part of these condensed consolidated financial statements.

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three months ended June 30,		Six months ended June 30,	
(In millions)	2013	2012	2013	2012
NET INCOME	$110	$32	$264	$118
OTHER COMPREHENSIVE INCOME				
Unrealized gains (losses) on investments available-for-sale, net of tax of ($85), ($19), $39 and $61, respectively	(159)	(34)	73	114
Amortization of pension actuarial loss and prior service cost, net of tax of $1, $0, $2 and $1, respectively	2	1	3	2
Change in life deferred acquisition costs, life policy reserves and other, net of tax of $8, $(1), $8 and $(3), respectively	16	(4)	16	(7)
Other comprehensive income (loss), net of tax	(141)	(37)	92	109
COMPREHENSIVE INCOME (LOSS)	$(31)	$(5)	$356	$227

Accompanying notes are an integral part of these condensed consolidated financial statements.

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In millions)	Common Stock Outstanding Shares	Common Stock Amount	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Share-holders' Equity
Balance as reported December 31, 2011	162	$393	$1,096	$3,885	$901	$(1,220)	$5,055
Cumulative effect of a change in accounting for deferred policy acquisition costs, net of tax	—	—	—	(22)	—	—	(22)
Balance as adjusted December 31, 2011	162	393	1,096	3,863	901	(1,220)	5,033
Net income	—	—	—	118	—	—	118
Other comprehensive income, net	—	—	—	—	109	—	109
Dividends declared	—	—	—	(130)	—	—	(130)
Stock-based awards exercised and vested	—	—	1	—	—	1	2
Stock-based compensation	—	—	8	—	—	—	8
Purchases	—	—	—	—	—	—	—
Other	—	—	1	—	—	3	4
Balance June 30, 2012	162	$393	$1,106	$3,851	$1,010	$(1,216)	$5,144
Balance December 31, 2012	163	$394	$1,134	$4,021	$1,129	$(1,225)	$5,453
Net income	—	—	—	264	—	—	264
Other comprehensive income, net	—	—	—	—	92	—	92
Dividends declared	—	—	—	(133)	—	—	(133)
Stock-based awards exercised and vested	1	2	17	—	—	5	24
Stock-based compensation	—	—	10	—	—	—	10
Purchases	—	—	—	—	—	(15)	(15)
Other	—	—	1	—	—	3	4
Balance June 30, 2013	164	$396	$1,162	$4,152	$1,221	$(1,232)	$5,699

Accompanying notes are an integral part of these condensed consolidated financial statements.

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)	Six months ended June 30, 2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$264	$118
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	20	22
Realized gains on investments, net	(55)	(19)
Stock-based compensation	10	8
Interest credited to contract holders	22	18
Deferred income tax expense (benefit)	10	(3)
Changes in:		
Investment income receivable	(1)	1
Premiums and reinsurance receivable	(103)	(76)
Deferred policy acquisition costs	(39)	(26)
Other assets	(10)	(11)
Loss and loss expense reserves	54	57
Life policy reserves	33	33
Unearned premiums	155	129
Other liabilities	(39)	7
Current income tax receivable	(70)	7
Net cash provided by operating activities	251	265
CASH FLOWS FROM INVESTING ACTIVITIES		
Sale of fixed maturities	14	28
Call or maturity of fixed maturities	459	360
Sale of equity securities	157	124
Purchase of fixed maturities	(666)	(603)
Purchase of equity securities	(190)	(210)
Investment in buildings and equipment, net	(3)	(4)
Investment in finance receivables	(18)	(18)
Collection of finance receivables	14	16
Change in other invested assets, net	3	3
Net cash used in investing activities	(230)	(304)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payment of cash dividends to shareholders	(130)	(128)
Proceeds from stock options exercised	12	3
Contract holders' funds deposited	45	56
Contract holders' funds withdrawn	(55)	(62)
Excess tax benefits on stock-based compensation	9	1
Other	(7)	(6)
Net cash used in financing activities	(126)	(136)
Net change in cash and cash equivalents	(105)	(175)
Cash and cash equivalents at beginning of year	487	438
Cash and cash equivalents at end of period	$382	$263
Supplemental disclosures of cash flow information:		
Interest paid	$27	$27
Income taxes paid	158	19

Non-cash activities:		
Conversion of securities	$54	$13
Equipment acquired under capital lease obligations	17	9
Cashless exercise of stock options	15	—

Accompanying notes are an integral part of these condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 — ACCOUNTING POLICIES

The condensed consolidated financial statements include the accounts of Cincinnati Financial Corporation and its consolidated subsidiaries, each of which is wholly owned. These statements are presented in conformity with accounting principles generally accepted in the United States of America (GAAP). All intercompany balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Our actual results could differ from those estimates. Our December 31, 2012, condensed consolidated balance sheet amounts are derived from the audited financial statements but do not include all disclosures required by GAAP.

Our June 30, 2013, condensed consolidated financial statements are unaudited. Certain financial information that is included in annual financial statements prepared in accordance with GAAP is not required for interim reporting and has been condensed or omitted. We believe that we have made all adjustments, consisting only of normal recurring accruals, that are necessary for fair presentation. These condensed consolidated financial statements should be read in conjunction with our consolidated financial statements included in our 2012 Annual Report on Form 10-K. The results of operations for interim periods do not necessarily indicate results to be expected for the full year.

Adopted Accounting Updates

ASU 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. ASU 2013-02 requires entities to present in either a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line items affected by the reclassification. The company adopted this ASU during the first quarter of 2013, and it did not have a material impact on our company’s financial position, cash flows or results of operations. See Note 7, Accumulated Other Comprehensive Income, for further details.

NOTE 2 – INVESTMENTS

The following table provides cost or amortized cost, gross unrealized gains, gross unrealized losses and fair value for our invested assets:

(In millions)	Cost or amortized cost	Gross unrealized gains	losses	Fair value
At June 30, 2013				
Fixed maturities:				
States, municipalities and political subdivisions	$3,044	$162	$18	$3,188
Convertibles and bonds with warrants attached	16	—	—	16
United States government	7	—	—	7
Government-sponsored enterprises	208	—	13	195
Foreign government	10	—	—	10
Commercial mortgage-backed securities	63	—	3	60
Corporate securities	5,080	459	23	5,516
Subtotal	8,428	621	57	8,992
Equity securities:				
Common equities	2,375	1,398	12	3,761
Preferred equities	77	37	—	114
Subtotal	2,452	1,435	12	3,875
Total	$10,880	$2,056	$69	$12,867
At December 31, 2012				
Fixed maturities:				
States, municipalities and political subdivisions	$3,040	$250	$1	$3,289
Convertibles and bonds with warrants attached	31	—	—	31
United States government	7	1	—	8
Government-sponsored enterprises	164	—	—	164
Foreign government	3	—	—	3
Commercial mortgage-backed securities	27	1	—	28
Corporate securities	4,950	622	2	5,570
Subtotal	8,222	874	3	9,093
Equity securities:				
Common equities	2,270	977	9	3,238
Preferred equities	99	37	1	135
Subtotal	2,369	1,014	10	3,373
Total	$10,591	$1,888	$13	$12,466

The net unrealized investment gains in our fixed-maturity portfolio are primarily the result of the current low interest rate environment that increased the fair value of our fixed-maturity portfolio. The three largest net unrealized investment gains in our common stock portfolio are from Exxon Mobil Corporation (NYSE:XOM), Chevron Corporation (NYSE:CVX) and The Procter & Gamble Company (NYSE:PG), which had a combined net gain position of $283 million. At At June 30, 2013, we had $16 million fair value of hybrid securities included in fixed maturities that follow Accounting Standards Codification (ASC) 815-15-25, Accounting for Certain Hybrid Financial Instruments, compared with $31 million fair value of hybrid securities at December 31, 2012. The hybrid securities are carried at fair value, and the changes in fair value are included in realized investment gains and losses.

The table below provides fair values and unrealized losses by investment category and by the duration of the securities' continuous unrealized loss position:

(In millions)	Less than 12 months		12 months or more		Total	
At June 30, 2013	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Fixed maturities:						
States, municipalities and political subdivisions	$377	$18	$—	$—	$377	$18
United States government	1	—	—	—	1	—
Foreign government	10	—	—	—	10	—
Government-sponsored enterprises	185	13	—	—	185	13
Commercial mortgage-backed securities	51	3	—	—	51	3
Corporate securities	580	22	13	1	593	23
Subtotal	1,204	56	13	1	1,217	57
Equity securities:						
Common equities	202	12	—	—	202	12
Preferred equities	4	—	—	—	4	—
Subtotal	206	12	—	—	206	12
Total	$1,410	$68	$13	$1	$1,423	$69
At December 31, 2012						
Fixed maturities:						
States, municipalities and political subdivisions	$53	$1	$—	$—	$53	$1
Government-sponsored enterprises	1	—	—	—	1	—
Corporate securities	58	1	17	1	75	2
Subtotal	112	2	17	1	129	3
Equity securities:						
Common equities	107	9	—	—	107	9
Preferred equities	4	1	—	—	4	1
Subtotal	111	10	—	—	111	10
Total	$223	$12	$17	$1	$240	$13

The following table provides investment income, realized investment gains and losses and the change in unrealized investment gains and losses and other items:

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Investment income summary:				
Interest on fixed maturities	$103	$106	$205	$212
Dividends on equity securities	30	27	57	53
Other investment income	—	1	1	2
Total	133	134	263	267
Less investment expenses	2	2	4	4
Total	$131	$132	$259	$263
Realized investment gains and losses summary:				
Fixed maturities:				
Gross realized gains	$2	$13	$4	$16
Gross realized losses	—	—	—	—
Other-than-temporary impairments	—	—	(2)	—
Equity securities:				
Gross realized gains	12	6	49	29
Gross realized losses	—	(1)	—	(1)
Other-than-temporary impairments	—	(14)	—	(30)
Securities with embedded derivatives	—	1	1	5
Other	—	1	3	—
Total	$14	$6	$55	$19
Change in unrealized gains and losses summary:				
Fixed maturities	$(282)	$29	$(307)	$78
Equity securities	38	(82)	419	97
Adjustment to deferred acquisition costs and life policy reserves	26	(8)	29	(15)
Amortization of pension actuarial loss and prior service cost	3	1	5	3
Other	(2)	3	(5)	5
Income taxes on above	76	20	(49)	(59)
Total	$(141)	$(37)	$92	$109

During the three and six months ended June 30, 2013 and 2012, there were no credit losses on fixed-maturity securities for which a portion of other-than-temporary impairment (OTTI) has been recognized in other comprehensive income.

During the quarter ended June 30, 2013, there were no other-than-temporarily impaired securities. At June 30, 2013, four fixed-maturity investments with a total unrealized loss of $1 million had been in an unrealized loss position for 12 months or more. Of that total, no fixed-maturity investments had fair values below 70 percent of amortized cost. There were no equity investments in an unrealized loss position for 12 months or more as of June 30, 2013.

At December 31, 2012, four fixed-maturity investments with a total unrealized loss of $1 million had been in an unrealized loss position for 12 months or more. Of that total, no fixed-maturity investments had fair values below

70 percent of amortized cost. There were no equity investments in an unrealized loss position for 12 months or more as of December 31, 2012.

NOTE 3 – FAIR VALUE MEASUREMENTS

Fair Value Hierarchy

In accordance with accounting guidance for fair value measurements and disclosures, we categorized our financial instruments, based on the priority of the observable and market-based data for the valuation technique used, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices with readily available independent data in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable market inputs (Level 3). When various inputs for measurement fall within different levels of the fair value hierarchy, the lowest observable input that has a significant impact on fair value measurement is used. Our valuation techniques have not changed from those used at December 31, 2012, and ultimately management determines fair value. See our 2012 Annual Report on Form 10-K, Item 8, Note 3, Fair Value Measurements, Page 121, for information on characteristics and valuation techniques used in determining fair value.

Fair Value Disclosures for Assets

The following tables illustrate the fair value hierarchy for those assets measured at fair value on a recurring basis at June 30, 2013, and December 31, 2012. We do not have any material liabilities carried at fair value. There were no transfers between Level 1 and Level 2.

(In millions) At June 30, 2013	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Fixed maturities, available for sale:				
States, municipalities and political subdivisions	$—	$3,187	$1	$3,188
Convertibles and bonds with warrants attached	—	16	—	16
United States government	7	—	—	7
Government-sponsored enterprises	—	195	—	195
Foreign government	—	10	—	10
Commercial mortgage-backed securities	—	60	—	60
Corporate securities	—	5,513	3	5,516
Subtotal	7	8,981	4	8,992
Common equities, available for sale	3,761	—	—	3,761
Preferred equities, available for sale	—	112	2	114
Taxable fixed maturities separate accounts	—	693	—	693
Top Hat Savings Plan (included in Other assets)	11	—	—	11
Total	$3,779	$9,786	$6	$13,571
At December 31, 2012				
Fixed maturities, available for sale:				
States, municipalities and political subdivisions	$—	$3,288	$1	$3,289
Convertibles and bonds with warrants attached	—	31	—	31
United States government	8	—	—	8
Government-sponsored enterprises	—	164	—	164
Foreign government	—	3	—	3
Commercial mortgage-backed securities	—	28	—	28
Corporate securities	—	5,567	3	5,570
Subtotal	8	9,081	4	9,093
Common equities, available for sale	3,238	—	—	3,238
Preferred equities, available for sale	—	134	1	135
Taxable fixed-maturities separate accounts	—	689	—	689

Top Hat Savings Plan (included in Other assets)	9	—	—	9
Total	$3,255	$9,904	$5	$13,164

Each financial instrument that was deemed to have significant unobservable inputs when determining valuation is identified in the following tables by security type with a summary of changes in fair value as of June 30, 2013. Total Level 3 assets continue to be less than 1 percent of financial assets measured at fair value in the condensed consolidated balance sheets. Assets presented in the table below were valued based primarily on broker/dealer quotes for which there is a lack of transparency as to inputs used to develop the valuations. The quantitative detail of these unobservable inputs is neither provided nor reasonably available to us.

The following tables provide the change in Level 3 assets for the three months ended June 30:

(In millions)	Corporate fixed maturities	States, municipalities and political subdivisions fixed maturities	Preferred equities	Total
Beginning balance, March 31, 2013	$3	$1	$2	$6
Total gains or losses (realized/unrealized):				
Included in earnings	—	—	—	—
Included in other comprehensive income	—	—	—	—
Purchases	—	—	—	—
Sales	—	—	—	—
Transfers into Level 3	—	—	—	—
Transfers out of Level 3	—	—	—	—
Ending balance, June 30, 2013	$3	$1	$2	$6
Beginning balance, March 31, 2012	$16	$2	$7	$25
Total gains or losses (realized/unrealized):				
Included in earnings	—	—	—	—
Included in other comprehensive income	—	—	—	—
Purchases	—	—	—	—
Sales	(1)	—	—	(1)
Transfers into Level 3	—	—	—	—
Transfers out of Level 3	(11)	—	—	(11)
Ending balance, June 30, 2012	$4	$2	$7	$13

The following tables provide the change in Level 3 assets for the six months ended June 30:

(In millions)	Corporate fixed maturities	States, municipalities and political subdivisions fixed maturities	Preferred equities	Total
Beginning balance, December 31, 2012	$3	$1	$1	$5
Total gains or losses (realized/unrealized):				
Included in earnings	—	—	—	—
Included in other comprehensive income	—	—	—	—
Purchases	—	—	1	1
Sales	—	—	—	—
Transfers into Level 3	—	—	—	—
Transfers out of Level 3	—	—	—	—
Ending balance, June 30, 2013	$3	$1	$2	$6
Beginning balance, December 31, 2011	$18	$3	$4	$25
Total gains or losses (realized/unrealized):				
Included in earnings	—	—	—	—
Included in other comprehensive income	3	—	2	5
Purchases	—	—	1	1
Sales	(4)	(1)	—	(5)
Transfers into Level 3	1	—	—	1
Transfers out of Level 3	(14)	—	—	(14)
Ending balance, June 30, 2012	$4	$2	$7	$13

With the exception of the Level 3 reconciliation table, additional disclosure for the Level 3 category is not material.

Fair Value Disclosure for Assets and Liabilities Not Carried at Fair Value

The disclosures below are presented to provide timely information about the effects of current market conditions on financial instruments that are not reported at fair value in our condensed consolidated financial statements.

This table summarizes the book value and principal amounts of our long-term debt:

(In millions)			Book value		Principal amount	
Interest rate	Year of issue		June 30, 2013	December 31, 2012	June 30, 2013	December 31, 2012
6.900 %	1998	Senior debentures, due 2028	$28	$28	$28	$28
6.920 %	2005	Senior debentures, due 2028	391	391	391	391
6.125 %	2004	Senior notes, due 2034	371	371	374	374
		Total	$790	$790	$793	$793

The following table shows fair values of our note payable and long-term debt subject to fair value disclosure requirements:

(In millions) At June 30, 2013	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Note payable	$—	$104	$—	$104
6.900% senior debentures, due 2028	—	33	—	33
6.920% senior debentures, due 2028	—	469	—	469
6.125% senior notes, due 2034	—	402	—	402
Total	$—	$1,008	$—	$1,008
At December 31, 2012				
Note payable	$—	$104	$—	$104
6.900% senior debentures, due 2028	—	31	—	31
6.920% senior debentures, due 2028	—	479	—	479
6.125% senior notes, due 2034	—	431	—	431
Total	$—	$1,045	$—	$1,045

The following table shows the fair value of our life policy loans, included in other invested assets, subject to fair value disclosure requirements:

(In millions) At June 30, 2013	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Life policy loans	$—	$—	$46	$46
At December 31, 2012				
Life policy loans	$—	$—	$50	$50

Outstanding principal and interest for these life policy loans was $35 million and $37 million at June 30, 2013, and December 31, 2012, respectively.

The following table shows fair values of our deferred annuities and structured settlements, included in life policy and investment contract reserves, subject to fair value disclosure requirements:

(In millions) At June 30, 2013	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Deferred annuities	$—	$—	$887	$887
Structured settlements	—	227	—	227
Total	$—	$227	$887	$1,114
At December 31, 2012				
Deferred annuities	$—	$—	$898	$898

Structured settlements	—	240	—	240
Total	$—	$240	$898	$1,138

Recorded reserves for the deferred annuities and structured settlements were $1.049 billion and $1.043 billion at June 30, 2013, and December 31, 2012, respectively.

NOTE 4 – PROPERTY CASUALTY LOSS AND LOSS EXPENSES

This table summarizes activity for our consolidated property casualty loss and loss expense reserves:

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Gross loss and loss expense reserves, beginning of period	$4,173	$4,289	$4,169	$4,280
Less reinsurance receivable	349	352	356	375
Net loss and loss expense reserves, beginning of period	3,824	3,937	3,813	3,905
Net incurred loss and loss expenses related to:				
Current accident year	675	725	1,209	1,380
Prior accident years	(92)	(85)	(102)	(201)
Total incurred	583	640	1,107	1,179
Net paid loss and loss expenses related to:				
Current accident year	249	282	370	414
Prior accident years	272	290	664	665
Total paid	521	572	1,034	1,079
Net loss and loss expense reserves, end of period	3,886	4,005	3,886	4,005
Plus reinsurance receivable	333	332	333	332
Gross loss and loss expense reserves, end of period	$4,219	$4,337	$4,219	$4,337

We use actuarial methods, models and judgment to estimate, as of a financial statement date, the property casualty loss and loss expense reserves required to pay for and settle all outstanding insured claims, including incurred but not reported (IBNR) claims, as of that date. The actuarial estimate is subject to review and adjustment by an inter-departmental committee that includes actuarial management that is familiar with relevant company and industry business, claims and underwriting trends, as well as general economic and legal trends that could affect future loss and loss expense payments. The amount we will actually have to pay for claims can be highly uncertain. This uncertainty, together with the size of our reserves, makes the loss and loss expense reserves our most significant estimate. The reserve for loss and loss expenses in the condensed consolidated balance sheets also included $65 million at June 30, 2013, and $59 million at June 30, 2012, for certain life and health loss and loss expense reserves.

For the three months ended June 30, 2013, we experienced $92 million of favorable development on prior accident years, including $66 million of favorable development in commercial lines and $26 million of favorable development in personal lines. There was $8 million from favorable development of catastrophe losses for the three months ended June 30, 2013, compared with $5 million of favorable development of catastrophe losses that occurred for the three months ended June 30, 2012.

For the six months ended June 30, 2013, we experienced $102 million of favorable development on prior accident years, including $78 million of favorable development in commercial lines, $22 million of favorable development in personal lines and $2 million favorable development in excess and surplus lines. There was $15 million from favorable development of catastrophe losses for the six months ended June 30, 2013, compared with $27 million of favorable development of catastrophe losses that occurred for the six months ended June 30, 2012.

NOTE 5 – LIFE POLICY AND INVESTMENT CONTRACT RESERVES

We establish the reserves for traditional life insurance policies based on expected expenses, mortality, morbidity, withdrawal rates, timing of claim presentation and investment yields, including a provision for uncertainty. Once these assumptions are established, they generally are maintained throughout the lives of the contracts. We use both our own experience and industry experience, adjusted for historical trends, in arriving at our assumptions for expected mortality, morbidity and withdrawal rates as well as for expected expenses. We base our assumptions for expected investment income on our own experience adjusted for current economic conditions.

We establish reserves for the company's universal life, deferred annuity and structured settlement policies equal to the cumulative account balances, which include premium deposits plus credited interest less charges and withdrawals. Some of our universal life policies contain no-lapse guarantee provisions. For these policies, we establish a reserve in addition to the account balance, based on expected no-lapse guarantee benefits and expected policy assessments.

This table summarizes our life policy and investment contract reserves:

(In millions)	June 30, 2013	December 31, 2012
Ordinary/traditional life	$778	$752
Universal life	501	483
Deferred annuities	858	850
Structured settlements	192	193
Other	16	17
Total life policy and investment contract reserves	$2,345	$2,295

NOTE 6 – DEFERRED ACQUISITION COSTS

Expenses directly related to successfully acquiring insurance policies – primarily commissions, premium taxes and underwriting costs – are deferred and amortized over the terms of the policies. We update our acquisition cost assumptions periodically to reflect actual experience, and we evaluate the costs for recoverability. The table below shows the deferred policy acquisition costs and asset reconciliation.

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Deferred policy acquisition costs asset at beginning of period	$491	$483	$470	$477
Capitalized deferred policy acquisition costs	203	192	401	362
Amortized deferred policy acquisition costs	(183)	(181)	(362)	(337)
Amortized shadow deferred policy acquisition costs	35	(10)	37	(18)
Deferred policy acquisition costs asset at end of period	$546	$484	$546	$484

No premium deficiencies were recorded in the condensed consolidated statements of income, as the sum of the anticipated loss and loss adjustment expenses, policyholder dividends and unamortized deferred acquisition expenses did not exceed the related unearned premiums and anticipated investment income.

NOTE 7 – ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income includes changes in unrealized gains and losses on available for sale investments and other invested assets, changes in pension obligations and changes in life deferred acquisition costs, life policy reserves and other as follows:

(In millions)	Three months ended June 30,					
	2013			2012		
	Before tax	Income tax	Net	Before tax	Income tax	Net
Accumulated unrealized gains, net, on investments available for sale, beginning of period	$2,231	$771	$1,460	$1,717	$592	$1,125
Other comprehensive income before reclassification	(230)	(81)	(149)	(47)	(17)	(30)
Reclassification adjustment for realized investment gains, net, included in net income	(14)	(4)	(10)	(6)	(2)	(4)
Effect on other comprehensive income	(244)	(85)	(159)	(53)	(19)	(34)
Accumulated unrealized gains, net, on investments available for sale, end of period	$1,987	$686	$1,301	$1,664	$573	$1,091
Accumulated unrealized losses, net, for pension obligations, beginning of period	$(99)	$(34)	$(65)	$(86)	$(30)	$(56)
Other comprehensive income before reclassification	—	—	—	—	—	—
Reclassification adjustment for amortization of actuarial loss and prior service cost, net, included in net income	3	1	2	1	—	1
Effect on other comprehensive income	3	1	2	1	—	1
Accumulated unrealized losses, net, for pension obligations, end of period	$(96)	$(33)	$(63)	$(85)	$(30)	$(55)
Accumulated unrealized losses, net, on life deferred acquisition costs, life policy reserves and other, beginning of period	$(50)	$(17)	$(33)	$(34)	$(12)	$(22)
Effect on other comprehensive income	24	8	16	(5)	(1)	(4)
Accumulated unrealized losses, net, on life deferred acquisition costs, life policy reserves and other, end of period	$(26)	$(9)	$(17)	$(39)	$(13)	$(26)
Accumulated other comprehensive income, beginning of period	$2,082	$720	$1,362	$1,597	$550	$1,047
Change in unrealized gains, net, on investments available for sale	(244)	(85)	(159)	(53)	(19)	(34)
Change in pension obligations	3	1	2	1	—	1
Change in life deferred acquisition costs, life policy reserves and other	24	8	16	(5)	(1)	(4)
Effect on other comprehensive income	(217)	(76)	(141)	(57)	(20)	(37)

Accumulated other comprehensive income, end of period	$1,865	$644	$1,221	$1,540	$530	$1,010

(In millions)	Six months ended June 30,					
	2013			2012		
	Before tax	Income tax	Net	Before tax	Income tax	Net
Accumulated unrealized gains, net, on investments available for sale, beginning of period	$1,875	$647	$1,228	$1,489	$512	$977
Other comprehensive income before reclassification	164	56	108	194	67	127
Reclassification adjustment for realized investment gains, net, included in net income	(52)	(17)	(35)	(19)	(6)	(13)
Effect on other comprehensive income	112	39	73	175	61	114
Accumulated unrealized gains, net, on investments available for sale, end of period	$1,987	$686	$1,301	$1,664	$573	$1,091
Accumulated unrealized losses, net, for pension obligations, beginning of period	$(101)	$(35)	$(66)	$(88)	$(31)	$(57)
Other comprehensive income before reclassification	—	—	—	—	—	—
Reclassification adjustment for amortization of actuarial loss and prior service cost, net, included in net income	5	2	3	3	1	2
Effect on other comprehensive income	5	2	3	3	1	2
Accumulated unrealized losses, net, for pension obligations, end of period	$(96)	$(33)	$(63)	$(85)	$(30)	$(55)
Accumulated unrealized losses, net, on life deferred acquisition costs, life policy reserves and other, beginning of period	$(50)	$(17)	$(33)	$(29)	$(10)	$(19)
Other comprehensive income before reclassification	27	10	17	(10)	(3)	(7)
Reclassification adjustment for life deferred acquisition costs, life policy reserves and other, net, included in net income	(3)	(2)	(1)	—	—	—
Effect on other comprehensive income	24	8	16	(10)	(3)	(7)
Accumulated unrealized losses, net, on life deferred acquisition costs, life policy reserves and other, end of period	$(26)	$(9)	$(17)	$(39)	$(13)	$(26)
Accumulated other comprehensive income, beginning of period	$1,724	$595	$1,129	$1,372	$471	$901
Change in unrealized gains, net, on investments available for sale	112	39	73	175	61	114
Change in pension obligations	5	2	3	3	1	2
Change in life deferred acquisition costs, life policy reserves and other	24	8	16	(10)	(3)	(7)
Effect on other comprehensive income	141	49	92	168	59	109
Accumulated other comprehensive income, end of period	$1,865	$644	$1,221	$1,540	$530	$1,010

The reclassification adjustment for realized gains on investments available for sale are recorded in the total realized investment gains, net, line item of the condensed consolidated statements of income. The reclassification adjustment for amortization of actuarial loss and prior service cost, net, are recorded in the insurance losses and policyholder benefits, underwriting, acquisition and insurance expenses and the other operating expenses line items of the condensed consolidated statements of income.

NOTE 8 – REINSURANCE

Reinsurance mitigates the risk of highly uncertain exposures and limits the maximum net loss that can arise from large risks or risks concentrated in areas of exposure. Management's decisions about the appropriate level of risk retention are affected by various factors, including changes in our underwriting practices, capacity to retain risks and reinsurance market conditions. Primary components of our property and casualty reinsurance program include a property per risk treaty, property excess treaty, casualty per occurrence treaty, casualty excess treaty, property catastrophe treaty and catastrophe bonds.

Our condensed consolidated statements of income include earned consolidated property casualty insurance premiums on assumed and ceded business:

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Direct earned premiums	$958	$868	$1,893	$1,707
Assumed earned premiums	3	3	5	6
Ceded earned premiums	(51)	(45)	(99)	(89)
Net earned premiums	$910	$826	$1,799	$1,624

Our condensed consolidated statements of income include incurred consolidated property casualty insurance loss and loss expenses on assumed and ceded business:

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Direct incurred loss and loss expenses	$593	$647	$1,128	$1,183
Assumed incurred loss and loss expenses	5	1	7	6
Ceded incurred loss and loss expenses	(15)	(8)	(28)	(10)
Net incurred loss and loss expenses	$583	$640	$1,107	$1,179

Our life insurance company purchases reinsurance for protection of a portion of the risk that is written. Primary components of our life reinsurance program include individual mortality coverage and aggregate catastrophe and accidental death coverage in excess of certain deductibles.

Our condensed consolidated statements of income include earned life insurance premiums on ceded business:

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Direct earned premiums	$58	$64	$114	$118
Assumed earned premiums	—	—	—	—
Ceded earned premiums	(14)	(13)	(28)	(26)
Net earned premiums	$44	$51	$86	$92

Our condensed consolidated statements of income include life insurance policyholders’ benefits incurred on ceded business:

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Direct policyholders' benefits incurred	$62	$57	$126	$110
Assumed policyholders' benefits incurred	—	—	—	—
Ceded policyholders' benefits incurred	(14)	(10)	(34)	(20)
Net policyholders' benefits incurred	$48	$47	$92	$90

The ceded benefits incurred can vary depending on the type of life insurance policy held and the year the policy was sold.

NOTE 9 – INCOME TAXES

As of June 30, 2013, and December 31, 2012, we had no liability for unrecognized tax benefits. Details about our liability for unrecognized tax benefits are found in our 2012 Annual Report on Form 10-K, Item 8, Note 11, Income Taxes, Page 129.

The differences between the 35 percent statutory income tax rate and our effective income tax rate were as follows:

(Dollars in millions)	Three months ended June 30,								Six months ended June 30,							
	2013				2012				2013				2012			
Tax at statutory rate	$52		35.0	%	$10		35.0	%	$128		35.0	%	$49		35.0	%
Increase (decrease) resulting from:																
Tax-exempt income from municipal bonds	(9	)	(6.1	)	(8	)	(27.6	)	(16	)	(4.4	)	(17	)	(12.1	)
Dividend received exclusion	(6	)	(4.2	)	(6	)	(20.7	)	(12	)	(3.3	)	(11	)	(7.8	)
Other	1		1.0		1		3.0		1		0.4		2		1.2	
Provision (benefit) for income taxes	$38		25.7	%	$(3	)	(10.3	)%	$101		27.7	%	$23		16.3	%

The change in our effective tax rate was primarily due to changes in pretax income from underwriting results and realized investment gains and losses, compared with unchanged levels of permanent book-tax differences.

NOTE 10 – NET INCOME PER COMMON SHARE

Basic earnings per share are computed based on the weighted average number of shares outstanding. Diluted earnings per share are computed based on the weighted average number of common and dilutive potential common shares outstanding using the treasury stock method.

The table shows calculations for basic and diluted earnings per share:

(Dollars in millions except share data in thousands)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Numerator:				
Net income—basic and diluted	$110	$32	$264	$118
Denominator:				
Weighted-average common shares outstanding	163,512	162,425	163,323	162,351
Effect of stock-based awards:				
Stock options	1,239	419	1,098	375
Nonvested shares	691	670	730	602
Adjusted weighted-average shares	165,442	163,514	165,151	163,328
Earnings per share:				
Basic	$0.67	$0.20	$1.62	$0.73
Diluted	0.66	0.20	1.60	0.72
Number of anti-dilutive stock-based awards	340	6,059	393	6,072

The current sources of dilution of our common shares are certain equity-based awards as discussed in our 2012 Annual Report on Form 10-K, Item 8, Note 17, Stock-Based Associate Compensation Plans, Page 135. The above table shows the number of anti-dilutive stock-based awards for the three and six months ended June 30, 2013 and 2012. We did not include these stock-based awards in the computation of net income per common share (diluted) because their exercise would have anti-dilutive effects.

NOTE 11 – EMPLOYEE RETIREMENT BENEFITS

The following summarizes the components of net periodic costs for our qualified and supplemental pension plans:

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Service cost	$3	$3	$6	$6
Interest cost	3	4	6	7
Expected return on plan assets	(4)	(4)	(8)	(8)
Amortization of actuarial loss and prior service cost	3	1	5	3
Net periodic benefit cost	$5	$4	$9	$8

See our 2012 Annual Report on Form 10-K, Item 8, Note 13, Employee Retirement Benefits, Page 130, for information on our retirement benefits. We made matching contributions of $2 million and $3 million to our 401(k) and Top Hat savings plans during the second quarter of 2013 and 2012 and contributions of $5 million for the first six months of 2013 and 2012, respectively.

We contributed $15 million to our qualified pension plan during the first quarter of 2013. We do not anticipate further contributions to our qualified pension plan during the remainder of 2013.

NOTE 12 – COMMITMENTS AND CONTINGENT LIABILITIES

In the ordinary course of conducting business, the company and its subsidiaries are named as defendants in various legal proceedings. Most of these proceedings are claims litigation involving the company's insurance subsidiaries in which the company is either defending or providing indemnity for third-party claims brought against insureds or litigating first-party coverage claims. The company accounts for such activity through the establishment of unpaid loss and loss adjustment expense reserves. We believe that the ultimate liability, if any, with respect to such ordinary-course claims litigation, after consideration of provisions made for potential losses and costs of defense, is immaterial to our consolidated financial condition, results of operations and cash flows.

The company and its subsidiaries also are occasionally involved in other legal and regulatory proceedings, some of which assert claims for substantial amounts. These actions include, among others, putative class actions seeking certification of a state or national class. Such proceedings have alleged, for example, breach of an alleged duty to search national data bases to ascertain unreported deaths of insureds under life insurance policies. The company's insurance subsidiaries also are occasionally parties to individual actions in which extra-contractual damages, punitive damages or penalties are sought, such as claims alleging bad faith handling of insurance claims or writing unauthorized coverage and claims alleging discrimination by former associates.

On a quarterly basis, we review these outstanding matters. Under current accounting guidance, we establish accruals when it is probable that a loss has been incurred and we can reasonably estimate its potential exposure. The company accounts for such probable and estimable losses, if any, through the establishment of legal expense reserves. Based on our quarterly review, we believe that our accruals for probable and estimable losses are reasonable and that the amounts accrued do not have a material effect on our consolidated financial condition or results of operations. However, if any one or more of these matters results in a judgment against us or settlement for an amount that is significantly greater than the amount accrued, the resulting liability could have a material effect on the company's consolidated results of operations or cash flows. Based on our most recent review, our estimate for any other matters for which the risk of loss is not probable, but more than remote is less than $2 million.

NOTE 13 – SEGMENT INFORMATION

We operate primarily in two industries, property casualty insurance and life insurance. We regularly review our reporting segments to make decisions about allocating resources and assessing performance:

- Commercial lines property casualty insurance
- Personal lines property casualty insurance
- Excess and surplus lines property casualty insurance
- Life insurance
- Investments

We report as Other the noninvestment operations of the parent company and its noninsurer subsidiary, CFC Investment Company. See our 2012 Annual Report on Form 10-K, Item 8, Note 18, Segment Information, Page 137, for a description of revenue, income or loss before income taxes and identifiable assets for each of the five segments.

Segment information is summarized in the following table:

(In millions)	Three months ended June 30, 2013	2012	Six months ended June 30, 2013	2012
Revenues:				
Commercial lines insurance				
Commercial casualty	$211	$191	$415	$372
Commercial property	152	134	299	265
Commercial auto	117	106	231	207
Workers' compensation	87	85	175	166
Specialty packages	37	37	76	75
Surety and executive risk	30	27	59	54
Machinery and equipment	11	10	21	19
Commercial lines insurance premiums	645	590	1,276	1,158
Fee revenue	1	1	1	2
Total commercial lines insurance	646	591	1,277	1,160
Personal lines insurance				
Personal auto	109	100	216	198
Homeowner	99	87	195	171
Other personal lines	29	27	57	54
Personal lines insurance premiums	237	214	468	423
Fee revenue	1	1	1	1
Total personal lines insurance	238	215	469	424
Excess and surplus lines insurance	28	22	55	43
Life insurance	44	51	86	92
Separate account investment management fees	1	—	2	—
Total life insurance	45	51	88	92
Investment operations				
Investment income, net of expenses	131	132	259	263
Realized investment gains, net	14	6	55	19
Total investment revenue	145	138	314	282
Other	2	3	4	5
Total revenues	$1,104	$1,020	$2,207	$2,006
Income (loss) before income taxes:				
Insurance underwriting results				
Commercial lines insurance	$34	$(20)	$92	$14
Personal lines insurance	(1)	(55)	19	(77)
Excess and surplus lines insurance	1	(2)	1	(5)
Life insurance	3	2	10	(1)
Investment operations	127	118	275	241
Other	(16)	(14)	(32)	(31)
Total	$148	$29	$365	$141

Identifiable assets:	June 30, 2013	December 31, 2012
Property casualty insurance	$2,489	$2,395
Life insurance	1,254	1,201

Investment operations	12,983	12,599
Other	308	353
Total	$17,034	$16,548

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion highlights significant factors influencing the consolidated results of operations and financial position of Cincinnati Financial Corporation (CFC). It should be read in conjunction with the consolidated financial statements and related notes included in our 2012 Annual Report on Form 10-K. Unless otherwise noted, the industry data is prepared by A.M. Best Co., a leading insurance industry statistical, analytical and financial strength rating organization. Information from A.M. Best is presented on a statutory basis. When we provide our results on a comparable statutory basis, we label it as such; all other company data is presented in accordance with accounting principles generally accepted in the United States of America (GAAP).

We present per share data on a diluted basis unless otherwise noted, adjusting those amounts for all stock splits and dividends. Dollar amounts are rounded to millions; calculations of percent changes are based on dollar amounts rounded to the nearest million. Certain percentage changes are identified as not meaningful (nm).

SAFE HARBOR STATEMENT

This is our "Safe Harbor" statement under the Private Securities Litigation Reform Act of 1995. Our business is subject to certain risks and uncertainties that may cause actual results to differ materially from those suggested by the forward-looking statements in this report. Some of those risks and uncertainties are discussed in our 2012 Annual Report on Form 10-K, Item 1A, Risk Factors, Page 26.

Factors that could cause or contribute to such differences include, but are not limited to:

- Unusually high levels of catastrophe losses due to risk concentrations, changes in weather patterns, environmental events, terrorism incidents or other causes
- Increased frequency and/or severity of claims
- Inadequate estimates or assumptions used for critical accounting estimates
- Recession or other economic conditions resulting in lower demand for insurance products or increased payment delinquencies
- Declines in overall stock market values negatively affecting the company's equity portfolio and book value
- Events resulting in capital market or credit market uncertainty, followed by prolonged periods of economic instability or recession, that lead to:
  - Significant or prolonged decline in the value of a particular security or group of securities and impairment of the asset(s)
  - Significant decline in investment income due to reduced or eliminated dividend payouts from a particular security or group of securities
  - Significant rise in losses from surety and director and officer policies written for financial institutions or other insured entities
- Prolonged low interest rate environment or other factors that limit the company's ability to generate growth in investment income or interest rate fluctuations that result in declining values of fixed-maturity investments, including declines in accounts in which we hold bank-owned life insurance contract assets
- Increased competition that could result in a significant reduction in the company's premium volume
- Delays or performance inadequacies from ongoing development and implementation of underwriting and pricing methods or technology projects and enhancements expected to increase our pricing accuracy, underwriting profit and competitiveness
- Changing consumer insurance-buying habits and consolidation of independent insurance agencies that could alter our competitive advantages

- Inability to obtain adequate reinsurance on acceptable terms, amount of reinsurance purchased, financial strength of reinsurers and the potential for nonpayment or delay in payment by reinsurers
- Difficulties with technology or data security breaches, including cyber attacks, that could negatively affect our ability to conduct business and our relationships with agents, policyholders and others

- Inability to defer policy acquisition costs for any business segment if pricing and loss trends would lead management to conclude that segment could not achieve sustainable profitability
- Events or conditions that could weaken or harm the company's relationships with its independent agencies and hamper opportunities to add new agencies, resulting in limitations on the company's opportunities for growth, such as:
Downgrades of the company's financial strength ratings
Concerns that doing business with the company is too difficult
Perceptions that the company's level of service, particularly claims service, is no longer a distinguishing characteristic in the marketplace
- Actions of insurance departments, state attorneys general or other regulatory agencies, including a change to a federal system of regulation from a state-based system, that:
Impose new obligations on us that increase our expenses or change the assumptions underlying our critical accounting estimates
Place the insurance industry under greater regulatory scrutiny or result in new statutes, rules and regulations
Restrict our ability to exit or reduce writings of unprofitable coverages or lines of business
Add assessments for guaranty funds, other insurance related assessments or mandatory reinsurance arrangements; or that impair our ability to recover such assessments through future surcharges or other rate changes
Increase our provision for federal income taxes due to changes in tax law
Increase our other expenses
Limit our ability to set fair, adequate and reasonable rates
Place us at a disadvantage in the marketplace
Restrict our ability to execute our business model, including the way we compensate agents
- Adverse outcomes from litigation or administrative proceedings
- Events or actions, including unauthorized intentional circumvention of controls, that reduce the company's future ability to maintain effective internal control over financial reporting under the Sarbanes-Oxley Act of 2002
- Unforeseen departure of certain executive officers or other key employees due to retirement, health or other causes that could interrupt progress toward important strategic goals or diminish the effectiveness of certain longstanding relationships with insurance agents and others
- Events, such as an epidemic, natural catastrophe or terrorism, that could hamper our ability to assemble our workforce at our headquarters location

Further, the company's insurance businesses are subject to the effects of changing social, economic and regulatory environments. Public and regulatory initiatives have included efforts to adversely influence and restrict premium rates, restrict the ability to cancel policies, impose underwriting standards and expand overall regulation. The company also is subject to public and regulatory initiatives that can affect the market value for its common stock, such as measures affecting corporate financial reporting and governance. The ultimate changes and eventual effects, if any, of these initiatives are uncertain.

INTRODUCTION

CORPORATE FINANCIAL HIGHLIGHTS

Statements of Income and Comprehensive Income and Per Share Data

(Dollars in millions except share data in thousands)	Three months ended June 30,			Six months ended June 30,		
	2013	2012	Change %	2013	2012	Change %
Statement of income and comprehensive income data:						
Earned premiums	$954	$877	9	$1,885	$1,716	10
Investment income, net of expenses (pretax)	131	132	(1)	259	263	(2)
Realized investment gains and losses, net (pretax)	14	6	133	55	19	189
Total revenues	1,104	1,020	8	2,207	2,006	10
Net income	110	32	244	264	118	124
Comprehensive income (loss)	(31)	(5)	(520)	356	227	57
Per share data						
Net income - diluted	$0.66	$0.20	230	$1.60	$0.72	122
Cash dividends declared	0.4075	0.4025	1	0.815	0.805	1
Weighted average shares outstanding	165,442	163,514	1	165,151	163,328	1

Revenues rose for the second quarter and the first six months of 2013 compared with the same periods of 2012, primarily due to growth in earned premiums. Premium and investment revenue trends are discussed further in the respective sections of Results of Operations.

Realized investment gains and losses are recognized on the sales of investments or as otherwise required by GAAP. We have substantial discretion in the timing of investment sales, and that timing generally is independent of the insurance underwriting process. GAAP also requires us to recognize in net income the gains or losses from certain changes in fair values of securities even though we continue to hold the securities.

Net income for the second quarter of 2013 compared with the second quarter of 2012 rose $78 million, primarily due to stronger property casualty underwriting income that rose $72 million after taxes. Lower catastrophe losses, mostly weather related, improved after-tax property casualty underwriting results by $47 million compared with the second quarter of 2012. After-tax investment income in our investment segment results for the second quarter of 2013 declined $1 million compared with the second quarter of 2012, while life insurance segment results on a pretax basis rose by $1 million. Second-quarter 2013 after-tax net realized investment gains and losses were $6 million higher than the same quarter a year ago.

For the six-month period ended June 30, 2013, net income increased $146 million compared with the same period of 2012, also primarily due to higher property casualty underwriting results that rose $117 million after taxes, including $98 million from lower catastrophe losses. After-tax investment income decreased by $3 million while after-tax net realized investment gains and losses were $23 million higher. Life insurance segment results on a pretax basis were $11 million higher.

Performance by segment is discussed below in Results of Operations. As discussed in our 2012 Annual Report on Form 10-K, Item 7, Factors Influencing Our Future Performance, Page 42, there are several reasons that our performance during 2013 may be below our long-term targets. In that annual report, as part of Results of Operations, we also discussed the full-year 2013 outlook for each reporting segment.

The board of directors is committed to rewarding shareholders directly through cash dividends and through share repurchase authorizations. Through 2012, the company had increased the indicated annual cash dividend rate for 52 consecutive years, a record we believe was matched by only nine other publicly traded companies. During the first six months of 2013, cash dividends declared by the company increased approximately 1 percent compared with the same period of 2012. Our board regularly evaluates relevant factors in decisions related to dividends and share repurchases. Increasing the dividend in 2012 signaled management's and the board's confidence in our strong capital, liquidity and financial flexibility, as well as progress on our initiatives to improve earnings performance.

Balance Sheet Data and Performance Measures

(Dollars in millions except share data)	At June 30, 2013	At December 31, 2012
Balance sheet data:		
Invested assets	$12,933	$12,534
Total assets	17,034	16,548
Short-term debt	104	104
Long-term debt	790	790
Shareholders' equity	5,699	5,453
Book value per share	34.83	33.48
Debt-to-total-capital ratio	13.6 %	14.1 %

Total assets at June 30, 2013, increased 3 percent compared with year-end 2012, primarily due to growth in invested assets that was driven by additional purchases of securities. Shareholders' equity rose 5 percent, and book value per share was up 4 percent during the first six months of 2013. Our debt-to-total-capital ratio (capital is the sum of debt plus shareholders' equity) decreased compared with year-end 2012. The value creation ratio, a non-GAAP measure defined below, improved for the first six months of 2013 compared with 2012, reflecting higher unrealized investment gains and net income. The $1.35 increase in book value per share during the first six months of 2013 contributed 4.0 percentage points to the value creation ratio, while dividends declared at $0.815 per share contributed 2.4 points. Value creation ratio trends in total and by major components, along with a reconciliation of the non-GAAP measure to comparable GAAP measures, are shown in the tables below.

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Value creation ratio major components:				
Net income before realized gains	1.8 %	0.5 %	4.2 %	2.1 %
Change in realized and unrealized gains, fixed-maturity securities	(3.2)	0.6	(3.6)	1.3
Change in realized and unrealized gains, equity securities	0.6	(1.1)	5.6	1.2
Other	0.4	0.0	0.2	(0.4)
Value creation ratio	(0.4)%	0.0 %	6.4 %	4.2 %

(Dollars are per outstanding share)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Book value change per share:				
End of period book value	$34.83	$31.66	$34.83	$31.66
Less beginning of period book value	35.41	32.07	33.48	31.03
Change in book value	$(0.58)	$(0.41)	$1.35	$0.63
Change in book value:				
Net income before realized gains	$0.62	$0.17	$1.40	$0.65
Change in realized and unrealized gains, fixed-maturity securities	(1.12)	0.18	(1.21)	0.39
Change in realized and unrealized gains, equity securities	0.20	(0.36)	1.86	0.38
Dividend declared to shareholders	(0.41)	(0.40)	(0.82)	(0.81)
Other	0.13	0.00	0.12	0.02
Total change in book value	$(0.58)	$(0.41)	$1.35	$0.63

(Dollars are per outstanding share)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Book value change per share:				
Book value as originally reported December 31, 2011				$31.16
Cumulative effect of a change in accounting for deferred policy acquisition costs, net of tax				(0.13)
Book value as adjusted December 31, 2011				$31.03
Value creation ratio:				
End of period book value	$34.83	$31.66	$34.83	$31.66
Less beginning of period book value - as originally reported	35.41	32.07	33.48	31.16
Change in book value	(0.58)	(0.41)	$1.35	$0.50
Dividend declared to shareholders	0.4075	0.4025	0.815	0.805
Total contribution to value creation ratio	$(0.1725)	$(0.0075)	$2.165	$1.305
Contribution to value creation ratio from change in book value*	(1.6)%	(1.3)%	4.0%	1.6%
Contribution to value creation ratio from dividends declared to shareholders**	1.2	1.3	2.4	2.6
Value creation ratio	(0.4)%	0.0%	6.4%	4.2%

*Change in book value divided by the beginning of period book value as originally reported
**Dividend declared to shareholders divided by beginning of period book value as originally reported

The cumulative effect of a change in accounting for deferred policy acquisition costs, net of tax, in the above book value reconciliation is the result of our adoption of Accounting Standards Update (ASU) 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts. We retrospectively adopted this ASU on January 1, 2012. See our 2012 Annual Report on Form 10-K, Item 8, Note 1, Summary of Significant Accounting Policies, Page 112, for information on our adopted accounting standards.

PROGRESS TOWARD LONG-TERM VALUE CREATION

Operating through The Cincinnati Insurance Company, Cincinnati Financial Corporation is one of the 25 largest property casualty insurers in the nation, based on 2012 net written premium volume for approximately 2,000 U.S. stock and mutual insurer groups. We market our insurance products through a select group of independent insurance agencies in 39 states as discussed in our 2012 Annual Report on Form 10-K, Item 1, Our Business and Our Strategy, Page 3.

We maintain a long-term perspective that guides us in addressing immediate challenges or opportunities while focusing on the major decisions that best position our company for success through all market cycles. We believe that this forward-looking view has consistently benefited our policyholders, agents, shareholders and associates.

To measure our long-term progress in creating shareholder value, we have defined a value creation metric that we believe captures the contribution of our insurance operations, the success of our investment strategy and the importance we place on paying cash dividends to shareholders. This measure, our value creation ratio or VCR, is made up of two primary components: (1) our rate of growth in book value per share plus (2) the ratio of dividends declared per share to beginning book value per share. As discussed in our 2012 Annual Report on Form 10-K, Item 7, Executive Summary, Page 38, for the period 2013 through 2017, an annual value creation ratio averaging 10 percent to 13 percent is our primary performance target. Management believes this non-GAAP measure is a meaningful indicator of our long-term progress in creating shareholder value and is a useful supplement to GAAP information.

Performance Drivers

When looking at our long-term objectives, we see three performance drivers:

- Premium growth - We believe over any five-year period our agency relationships and initiatives can lead to a property casualty written premium growth rate that exceeds the industry average. For the first six months of 2013, our total property casualty net written premiums' year-over-year growth was 12 percent, comparing favorably with A.M. Best's February 2013 projection of approximately 5 percent full-year 2013 growth for the industry excluding its mortgage and financial guaranty lines of business. Our premium growth initiatives are discussed below in Highlights of Our Strategies and Supporting Initiatives.

- Combined ratio - We believe our underwriting philosophy and initiatives can generate a GAAP combined ratio over any five-year period that is consistently within the range of 95 percent to 100 percent. For the first six months of 2013, our GAAP combined ratio was 93.9 percent and our statutory combined ratio was 91.8 percent, both including 5.6 percentage points of current accident year catastrophe losses offset by 5.6 percentage points of favorable loss reserve development on prior accident years. As of February 2013, A.M. Best forecast the industry's full-year 2013 statutory combined ratio at approximately 101 percent, including approximately 5 percentage points of catastrophe losses and a favorable impact of approximately 3 percentage points from prior accident year reserve releases. The industry's ratio again excludes its mortgage and financial guaranty lines of business.

- Investment contribution - We believe our investment philosophy and initiatives can drive investment income growth and lead to a total return on our equity investment portfolio over a five-year period that exceeds the five-year return of the Standard & Poor's 500 Index. For the first six months of 2013, pretax investment income was $259 million, down 2 percent compared with the same period in 2012. We believe our investment portfolio mix provides an appropriate balance of income stability and growth with capital appreciation potential.

Highlights of Our Strategy and Supporting Initiatives

Management has worked to identify a strategy that can lead to long-term success, with concurrence by the board of directors. Our strategy is intended to position us to compete successfully in the markets we have targeted while appropriately managing risk. Further description of our long-term, proven strategy can be found in our 2012 Annual Report on Form 10-K, Item 1, Our Business and Our Strategy, Page 3. We believe successful implementation of initiatives that support our strategy, summarized below, will help us better serve our agent customers and reduce variability in our financial results while we also grow earnings and book value over the long term, successfully navigating challenging economic, market or industry pricing cycles.

- Improve insurance profitability - Implementation of these initiatives is intended to enhance underwriting expertise and knowledge, thereby increasing our ability to manage our business while also gaining efficiency. Additional information and more focused action on underperforming product lines, plus expanding pricing capabilities through the use of technology and analytics, can lead to better profit margins. Improved internal processes with additional performance metrics can help us be more efficient and effective. These initiatives also support the ability of the independent agencies that represent us to grow profitably by allowing them to serve clients faster and to more efficiently manage agency expenses.

- Drive premium growth - Implementation of these initiatives is intended to further penetrate each market we serve through our independent agency network. Strategies aimed at specific market opportunities, along with service enhancements, can help our agents grow and increase our share of their business. Diversified growth also may reduce variability of losses from weather-related catastrophes.

Below we discuss key initiatives supporting these strategies, along with an assessment of our progress.

Improve Insurance Profitability

The main initiatives to improve our insurance profitability include:

- Enhance underwriting expertise and knowledge - We continue efforts to increase our use of information and to develop our skills for improved underwriting performance, such as expanding our pricing capabilities by using predictive analytics. Expanded capabilities include streamlining and optimizing data to improve accuracy, timeliness and ease of use. We also continue to develop additional business data and tools to support more accurate underwriting, including more granular pricing, by further developing our data warehouse used in our property casualty and life insurance operations.

Work continues on initiatives to more profitably underwrite property coverages, including more staff specialization, increased insured property inspections to provide enhanced underwriting knowledge and greater use of deductibles or other policy terms and conditions as policies renew. Progress on initiatives during the first six months of 2013 included conducting over 30,000 inspections or applying loss control activities on a significant number of commercial properties and homes across several states, allowing us to increase our emphasis on roof conditions or other policy underwriting attributes. As expected, the inspections are resulting in underwriting or pricing actions – in some cases minor and in some cases significant – for a substantial portion of the inspected properties. We are also increasing our use of higher minimum loss deductible amounts and per-building deductibles for commercial risks, along with more use of wind and hail deductibles in areas subject to severe convective storm activity. We are expanding use of actual cash value coverage for older roofs and cosmetic damage exclusions for certain roof types. We expect these actions, along with others such as the use of hail-mapping technology to identify possible roof damage from prior hailstorms, to improve underwriting profitability over time for our property-related lines of business.

Similar initiatives are underway to more profitably underwrite our commercial auto line of business. A multi-department, multi-disciplinary taskforce has been working to determine ways to improve profitability, similar to the approach we used to improve workers' compensation results. Initiatives in process during the first half of 2013 included continuing education for underwriters and field marketing representatives and more focus on factors to improve pricing precision. These factors include proper classification of insured commercial autos, information about their cost-new, and improvements in the collection and use of accurate commercial vehicle identification numbers. We also are carefully managing limits when we provide umbrella liability coverage over commercial auto liability coverage.

We continue to refine our pricing precision during 2013, including use in additional states of predictive modeling tools for small business policies written through our CinciPak™ product. Progress during the first six months of 2013 included implementing CinciPak in four additional states, bringing the total number of states where that product was available to 12 at midyear. We are also making progress with predictive modeling for dwelling fire policies and development of a by-peril rating plan for homeowners. We plan to introduce both in select states in 2014. By-peril rating will improve pricing precision by separately pricing for the risk of losses from distinct perils, such as wind versus fire.

- Improve internal processes - Improved processes support our strategic goals, reducing internal costs and allowing us to focus more resources on providing agency services. Related efforts include additional streamlining of processes to issue qualified personal lines or small commercial lines business without intervention by an underwriter. Progress during the first six months of 2013 included expanding streamlined processing of small commercial property and general liability policies to additional states, and it is now available in 36 states. Audits of policies processed without an underwriter continue to indicate that those automated policies are being underwritten appropriately and issued as intended.

We measure the overall success of our strategy to improve property casualty insurance profitability primarily through our GAAP combined ratio, which we believe can be consistently within the range of 95 percent to 100 percent for any five-year period. We also compare our statutory combined ratio to the industry average to gauge our progress, as discussed in the Performance Drivers section above.

In addition, we expect these initiatives to contribute to our rank as the No. 1 or No. 2 carrier based on premium volume in agencies that have represented us for at least five years. In 2012, we again earned that rank in nearly 75 percent of the agencies that have represented Cincinnati Insurance for more than five years, based on 2012 premiums. We are working to increase the percentage of agencies where we achieve that rank.

Drive Premium Growth

Primary initiatives to drive premium growth include:

- Expansion of our marketing and service capabilities - We continue to enhance our generalist approach to allow our appointed agencies to better compete in the marketplace by providing services an agent's clients want and need. Expansion initiatives include ongoing development of targeted marketing programs, adding field marketing representatives for additional agency support in selected areas and piloting additional services to select agencies to develop our new customer care center for small commercial business policies. Progress during the first six months of 2013 included launching two of the four additional target market programs we plan to offer by the end of the year. We also completed the initial implementation in selected markets of a small consumer advertising campaign to test this mode of support for our independent agents. We expanded our excess and surplus lines field underwriting presence by adding four field marketing representatives. In addition, we added two field marketing representatives to support agencies in new marketing territories for commercial lines operations.

- New agency appointments - We continue to appoint new agencies to develop additional points of distribution, focusing on areas where our market share is less than 1 percent while also considering economic and catastrophe risk factors. In 2013, we initially targeted approximately 65 appointments of independent agencies and now intend to exceed that target by approximately 15 appointments. During the first six months of 2013, we appointed 63 new agencies that write in aggregate approximately $1.1 billion in property casualty premiums annually with various insurance carriers for an average of approximately $17 million per agency. As of June 30, 2013, a total of 1,437 agency relationships market our standard market insurance products from 1,804 reporting locations.

We seek to build a close, long-term relationship with each agency we appoint. We carefully evaluate the marketing reach of each new appointment to ensure the territory can support both current and new agencies. Our 130 commercial lines field marketing territories are staffed by marketing representatives averaging 20 years of industry experience and 10 years as a Cincinnati Insurance field marketing representative. Teams of field associates for each territory work together, providing local expertise with support from headquarters associates. This agent-centered business model helps us better understand the accounts we underwrite and creates marketing advantages for our agents. Unique Cincinnati-style service supports our agents as they grow their business and attract more clients in their communities. As a result, we generally have earned a 10 percent share of an agency's business within 10 years of its appointment.

We measure the overall success of our strategy to drive premium growth primarily through changes in net written premiums, as discussed in the Performance Drivers section above. In addition to tracking our progress toward our year-end 2015 annual direct written premiums target of $5 billion, we believe we can grow faster than the industry average over any five-year period.

Financial Strength

An important part of our long-term strategy is financial strength, which is described in our 2012 Annual Report on Form 10-K, Item 1, Our Business and Our Strategy, Financial Strength, Page 5. One aspect of our financial strength is prudent use of reinsurance to help manage financial performance variability due to catastrophe loss experience. A description of how we use reinsurance is included in our 2012 Annual Report on Form 10-K, Item 7, Liquidity and Capital Resources, 2013 Reinsurance Programs, Page 95. Another aspect is our investment portfolios, which remain well-diversified as discussed in this quarterly report Item 3, Quantitative and Qualitative Disclosures about Market Risk. We continue to maintain strong parent-company liquidity and financial strength that increases our flexibility through all periods to maintain our cash dividend and to continue to invest in and expand our insurance operations. At June 30, 2013, we held $1.369 billion of our cash and invested assets at the parent company level, of which $1.196 billion, or 87.4 percent, was invested in common stocks, and $50 million, or 3.7 percent, was cash or cash equivalents. Our debt-to-total-capital ratio at 13.6 percent remains well below our target limit. Another important indicator of financial strength is our ratio of property casualty net written premiums to statutory surplus, which was 0.9 to 1 for the 12 months ended June 30, 2013, unchanged from year-end 2012.

Our financial strength ratings assigned by independent ratings firms also are important. In addition to rating our parent company's senior debt, four firms award insurer financial strength ratings to one or more of our insurance subsidiary companies based on their quantitative and qualitative analyses. These ratings primarily assess an insurer's ability to meet financial obligations to policyholders and do not necessarily address all of the matters that may be important to investors. Ratings may be subject to revision or withdrawal at any time by the rating agency, and each rating should be evaluated independently of any other rating.

As of July 24, 2013, our insurer financial strength ratings were:

Insurer Financial Strength Ratings

Rating Agency	Standard Market Property Casualty Insurance Subsidiary			Life Insurance Subsidiary			Excess and Surplus Insurance Subsidiary			Date of Most Recent Affirmation or Action
			Rating Tier			Rating Tier			Rating Tier	
A.M. Best Co.	A+	Superior	2 of 16	A	Excellent	3 of 16	A	Excellent	3 of 16	Stable outlook (12/19/12)
Fitch Ratings	A+	Strong	5 of 21	A+	Strong	5 of 21	-	-	-	Stable outlook (5/01/13)
Moody's Investors Service	A1	Good	5 of 21	-	-	-	-	-	-	Stable outlook (04/30/13)
Standard & Poor's Ratings Services	A	Strong	6 of 21	A	Strong	6 of 21	-	-	-	Stable outlook (6/24/13)

All of our insurance subsidiaries continue to be highly rated.

On April 30, 2013, Moody's Investors Service affirmed our insurance financial strength ratings that it had assigned in September 2008, revising its outlook to stable from negative. Moody's reported that its rating is based on our entrenched regional franchise from our strong relationships with agents, our focus on small- and middle-market commercial lines risks and our good risk-adjusted capital position. Moody's said other strengths include consistent reserve strength with strong financial flexibility and substantial holding company liquidity. Moody's added that our strengths are tempered by factors such as exposure to Midwest weather-related catastrophes, potential investment volatility due to a sizeable position in common equities relative to peers and competition from well-capitalized nationwide commercial lines carriers.

On May 1, 2013, Fitch Ratings affirmed our ratings that it had assigned in September 2010, continuing its stable outlook. Fitch noted that ratings strengths include conservative capitalization, our sizeable holding company cash and marketable securities position and a moderate financial leverage ratio. Fitch noted our reserve adequacy and benefits from our implementation of underwriting and pricing actions. Fitch said its rating could be unfavorably affected by a combined ratio exceeding 105 percent on a sustained basis or by deterioration in current balance sheet strengths.

On June 24, 2013, Standard & Poor's Ratings Services affirmed our ratings that it had assigned in August 2011, continuing its stable outlook. S&P said its rating reflected our strong competitive position and extremely strong capital and earnings, and also noted our geographic diversity and diversification benefits from our life insurance business. S&P stated that our risk position is moderate despite potential earnings volatility stemming from exposure to weather-related catastrophe losses, and that its rating could be unfavorably affected if capital adequacy deteriorated for a prolonged period of time or if earnings weakened substantially.

RESULTS OF OPERATIONS

Consolidated results reflect the operating results of each of our five segments along with the parent company and other activities reported as “Other.” The five segments are:

- Commercial lines property casualty insurance
- Personal lines property casualty insurance
- Excess and surplus lines property casualty insurance
- Life insurance
- Investments

We report as Other the noninvestment operations of the parent company and its noninsurer subsidiary, CFC Investment Company. See Item 1, Note 13, Segment Information, for discussion of the calculations of segment data. Results of operations for each of the five segments are discussed below.

CONSOLIDATED PROPERTY CASUALTY INSURANCE RESULTS OF OPERATIONS

Consolidated property casualty insurance results include premiums and expenses for our standard market insurance (commercial lines and personal lines segments) as well as our surplus lines operations.

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2013	2012	Change %	2013	2012	Change %
Earned premiums	$910	$826	10	$1,799	$1,624	11
Fee revenues	2	2	0	2	3	(33)
Total revenues	912	828	10	1,801	1,627	11
Loss and loss expenses from:						
Current accident year before catastrophe losses	591	573	3	1,107	1,117	(1)
Current accident year catastrophe losses	84	152	(45)	102	263	(61)
Prior accident years before catastrophe losses	(84)	(80)	(5)	(87)	(174)	50
Prior accident years catastrophe losses	(8)	(5)	(60)	(15)	(27)	44
Loss and loss expenses	583	640	(9)	1,107	1,179	(6)
Underwriting expenses	295	265	11	582	516	13
Underwriting profit (loss)	$34	$(77)	nm	$112	$(68)	nm

Ratios as a percent of earned premiums:			Pt. Change			Pt. Change
Current accident year before catastrophe losses	64.9 %	69.5 %	(4.6)	61.5 %	68.8 %	(7.3)
Current accident year catastrophe losses	9.2	18.4	(9.2)	5.6	16.2	(10.6)
Prior accident years before catastrophe losses	(9.2)	(9.8)	0.6	(4.8)	(10.8)	6.0
Prior accident years catastrophe losses	(0.9)	(0.6)	(0.3)	(0.8)	(1.6)	0.8
Loss and loss expenses	64.0	77.5	(13.5)	61.5	72.6	(11.1)
Underwriting expenses	32.4	32.0	0.4	32.4	31.8	0.6
Combined ratio	96.4 %	109.5 %	(13.1)	93.9	104.4	(10.5)

Combined ratio:	96.4 %	109.5 %	(13.1)	93.9 %	104.4 %	(10.5)
Contribution from catastrophe losses and prior years reserve development	(0.9)	8.0	(8.9)	0.0	3.8	(3.8)
Combined ratio before catastrophe losses and prior years reserve development	97.3 %	101.5 %	(4.2)	93.9 %	100.6 %	(6.7)

Our consolidated property casualty insurance operations generated underwriting profits of $34 million and $112 million for the three and six months ended June 30, 2013, compared with underwriting losses of $77 million and $68 million for the three and six months ended June 30, 2012. The primary driver of the improved underwriting results was lower losses from natural catastrophes. Current accident year loss experience before catastrophes also improved, along with related ratios, reflecting higher pricing in addition to the effects of our initiatives to improve pricing precision and loss experience related to claims and loss control practices. Prior accident year loss experience before catastrophes during the second quarter of 2013 was slightly more favorable, compared with the second quarter of 2012, and the first six months of 2013 was less favorable than the same period in 2012. The less favorable six-month 2013 experience was primarily due to re-estimates of losses incurred but not reported (IBNR). Details of property casualty insurance results are discussed below, including our commercial lines, personal lines and excess and surplus lines segments.

We measure and analyze property casualty underwriting results primarily by the combined ratio and its component ratios. The GAAP-basis combined ratio is the percentage of incurred losses plus all expenses per each earned premium dollar – the lower the ratio, the better the performance. An underwriting profit results when the combined ratio is below 100 percent. A combined ratio above 100 percent indicates that an insurance company's losses and expenses exceeded premiums.

Our consolidated property casualty combined ratio for the second quarter improved 13.1 percentage points, and for the first six months of 2013 it improved 10.5 points, both compared with the same periods of 2012. In addition to catastrophe losses that were 9.5 and 9.8 percentage points lower, the loss and loss expenses ratios before catastrophe losses were 4.0 and 1.3 points lower, together accounting for most of the improvement.

The combined ratio can be affected significantly by natural catastrophe losses and other large losses as discussed in detail below. The combined ratio can also be affected by updated estimates of loss and loss expense reserves established for claims that occurred in prior periods, referred to as prior accident years. Net favorable development on prior accident year reserves, including reserves for catastrophe losses, lowered the combined ratio by 5.6 percentage points in the first six months of 2013, compared with 12.4 percentage points in the same period of 2012. Net favorable development is discussed in further detail in results of operations by property casualty insurance segment.

The ratio for current accident year loss and loss expenses before catastrophe losses also improved. The 61.5 percent ratio for the first six months of 2013 improved 7.3 percentage points compared with the 68.8 percent accident year 2012 ratio measured as of June 30, 2012, largely reflecting recent-year initiatives to improve pricing precision and loss experience related to claims and loss control practices, along with improving market conditions. Improving market conditions included overall higher pricing, somewhat offset by normal loss cost inflation. Higher new large losses incurred, shown on the table below, Consolidated Property Casualty Insurance Losses by Size, increased the 2013 ratio by 0.3 percentage points, partially offsetting overall improvement in the ratio for current accident year loss and loss expenses before catastrophe losses.

The underwriting expense ratio rose for the second quarter and first six months of 2013, compared with the same periods of 2012, primarily due to higher commissions.

Consolidated Property Casualty Insurance Premiums

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2013	2012	Change %	2013	2012	Change %
Agency renewal written premiums	$879	$798	10	$1,724	$1,560	11
Agency new business written premiums	139	131	6	274	239	15
Other written premiums	(34)	(26)	(31)	(44)	(53)	17
Net written premiums	984	903	9	1,954	1,746	12
Unearned premium change	(74)	(77)	4	(155)	(122)	(27)
Earned premiums	$910	$826	10	$1,799	$1,624	11

The trends in net written premiums and earned premiums summarized in the table above largely reflect the effects of our premium growth strategies and better pricing.

Consolidated property casualty net written premiums for the three and six months ended June 30, 2013, grew $81 million and $208 million compared with the same periods of 2012. Each of our property casualty segments grew during the second quarter and first six months of 2013. Our premium growth initiatives from prior years continue to favorably affect current year growth, particularly as newer agency relationships mature over time. We discuss current initiatives in the Highlights of Our Strategy and Supporting Initiatives section of this quarterly report. The main drivers of trends for 2013 are discussed by segment below in Results of Operations.

Consolidated property casualty agency new business written premiums for the three and six months ended June 30, 2013, increased $8 million and $35 million compared with the same periods of 2012. We continued to experience new business growth related to initiatives for geographic expansion into new and underserved areas. New agency appointments during 2012 and 2013 produced an $18 million increase in standard lines new business for the first six months of 2013 compared with the same period in 2012. As we appoint new agencies that choose to move accounts to us, we report these accounts as new business. While this business is new to us, in many cases it is not new to the agent. We believe these seasoned accounts tend to be priced more accurately than business that may be less familiar to our agent upon obtaining it from a competing agent.

Other written premiums include premiums ceded to our reinsurers as part of our reinsurance program. Ceded premiums reduced net written premium growth by $7 million and $11 million for the three and six months ended June 30, 2013, compared with the same periods of 2012.

Catastrophe losses typically have a meaningful effect on property casualty results and can vary significantly from period to period. Losses from natural catastrophes contributed 8.3 and 4.8 percentage points to the combined ratio in the second quarter and first six months of 2013, compared with 17.8 and 14.6 percentage points in the same periods of 2012. Some of those losses were applicable to loss deductible provisions of collateralized reinsurance funded through catastrophe bonds. Aggregate losses for the first six months of 2013, for the 75 counties included in the severe convective storm portion of that catastrophe reinsurance coverage, were approximately $2 million in excess of the $5 million per-event deductible. If aggregate losses after deductibles exceed $125 million during 2013, we can recover the excess through funds that collateralize the catastrophe bonds. The following table shows catastrophe losses and loss expenses incurred, net of reinsurance, as well as the effect of loss development on prior period catastrophe events. We individually list declared catastrophe events for which our incurred losses reached or exceeded $5 million.

Catastrophe Losses Incurred

(In millions, net of reinsurance)			Three months ended June 30,				Six months ended June 30,			
Dates	Event	Region	Comm. lines	Pers. lines	E&S lines	Total	Comm. lines	Pers. lines	E&S lines	Total
2013										
Jan. 29-31	Lightning, wind	South, Northeast	$—	$—	$—	$—	$3	$2	$—	$5
Mar. 18 -19	Hail, wind	South	2	(2)	—	—	4	7	—	11
Apr. 7-11	Hail, lightning, wind	West, Midwest	14	9	—	23	14	9	—	23
Apr. 16-19	Hail, lightning, wind	Midwest	5	7	—	12	5	7	—	12
May 18-20	Hail, lightning, wind	South, Midwest, Northeast	9	1	—	10	9	1	—	10
May 28-29	Hail, lightning, wind	South	6	3	—	9	6	3	—	9
Jun. 12-14	Hail, lightning, wind	South, Midwest	2	6	—	8	2	6	—	8
Jun. 24-26	Hail, lightning, wind	Midwest, Northeast	2	6	—	8	2	6	—	8
All other 2013 catastrophes			11	3	—	14	13	3	—	15
Development on 2012 and prior catastrophes			(6)	(2)	—	(8)	(10)	(5)	—	(15)
Calendar year incurred total			$45	$31	$—	$76	$48	$39	$—	$87
2012										
Feb. 28-29	Hail, wind, tornado	Midwest	$(2)	$—	$—	$(2)	$20	$8	$—	$28
Mar. 2-3	Hail, wind, tornado	Midwest, South	1	—	—	1	29	45	1	75
Mar. 18-25	Hail, lightning, wind	Midwest, South	2	4	—	6	2	4	—	6
Apr. 28-29	Hail, lightning, wind	Midwest, South	54	22	—	76	54	22	—	76
May 2-6	Hail, lightning, wind	Midwest	5	1	—	6	5	1	—	6
Jun. 11-13	Hail, lightning, wind	West, South	6	—	—	6	6	—	—	6
Jun. 24-28	Fire	West	8	—	—	8	8	—	—	8
Jun. 28-30	Hail, lightning, wind	Midwest, Northeast, South	3	32	—	35	3	32	—	35
All other 2012 catastrophes			11	5	—	16	13	10	—	23
Development on 2011 and prior catastrophes			2	(7)	—	(5)	(11)	(16)	—	(27)
Calendar year incurred total			$90	$57	$—	$147	$129	$106	$1	$236

The following table includes data for losses incurred of $250,000 or more per claim, net of reinsurance.

Consolidated Property Casualty Insurance Losses by Size

(Dollars in millions, net of reinsurance)	Three months ended June 30,			Six months ended June 30,		
	2013	2012	Change %	2013	2012	Change %
New losses greater than $4,000,000	$13	$4	225	$47	$15	213
New losses $1,000,000-$4,000,000	33	47	(30)	68	78	(13)
New losses $250,000-$1,000,000	48	58	(17)	104	102	2
Case reserve development above $250,000	75	55	36	123	122	1
Total large losses incurred	169	164	3	342	317	8
Other losses excluding catastrophe losses	270	241	12	522	447	17
Catastrophe losses	74	146	(49)	84	233	(64)
Total losses incurred	$513	$551	(7)	$948	$997	(5)
Ratios as a percent of earned premiums:			Pt. Change			Pt. Change
New losses greater than $4,000,000	1.4 %	0.5 %	0.9	2.6 %	0.9 %	1.7
New losses $1,000,000-$4,000,000	3.7	5.7	(2.0)	3.8	4.8	(1.0)
New losses $250,000-$1,000,000	5.3	7.1	(1.8)	5.8	6.2	(0.4)
Case reserve development above $250,000	8.2	6.7	1.5	6.8	7.5	(0.7)
Total large loss ratio	18.6	20.0	(1.4)	19.0	19.4	(0.4)
Other losses excluding catastrophe losses	29.5	29.1	0.4	29.0	27.5	1.5
Catastrophe losses	8.2	17.6	(9.4)	4.7	14.5	(9.8)
Total loss ratio	56.3 %	66.7 %	(10.4)	52.7 %	61.4 %	(8.7)

We believe the inherent variability of aggregate loss experience for our portfolio of larger policies is greater than that of our portfolio of smaller policies, and we continue to monitor the variability in addition to general inflationary trends in loss costs. Our analysis continues to indicate no unexpected concentration of these large losses and case reserve increases by risk category, geographic region, policy inception, agency or field marketing territory. The second-quarter 2013 property casualty total large losses incurred of $169 million, net of reinsurance, were slightly lower than the $171 million quarterly average during 2012 and were higher than the $164 million for the second quarter of 2012. The ratio for these large losses and case reserve increases was 1.4 percentage points lower compared with last year’s second quarter, with new losses down 2.9 points and case reserve development up 1.5 points. Second-quarter large losses added to the ratio for total large losses incurred for the first six months of 2013, which also included a first-quarter 2013 ratio that was 0.4 points higher than the first quarter of 2012. We believe results for the three-month and six-month periods largely reflected normal fluctuations in loss patterns and normal variability in large case reserves for claims above $250,000. Losses by size are discussed in further detail in results of operations by property casualty insurance segment.

COMMERCIAL LINES INSURANCE RESULTS OF OPERATIONS

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2013	2012	Change %	2013	2012	Change %
Earned premiums	$645	$590	9	$1,276	$1,158	10
Fee revenues	1	1	0	1	2	(50)
Total revenues	646	591	9	1,277	1,160	10
Loss and loss expenses from:						
Current accident year before catastrophe losses	414	396	5	784	782	0
Current accident year catastrophe losses	51	89	(43)	58	141	(59)
Prior accident years before catastrophe losses	(60)	(73)	18	(68)	(150)	55
Prior accident years catastrophe losses	(6)	1	nm	(10)	(12)	17
Loss and loss expenses	399	413	(3)	764	761	0
Underwriting expenses	213	198	8	421	385	9
Underwriting profit (loss)	$34	$(20)	nm	$92	$14	557
Ratios as a percent of earned premiums:			Pt. Change			Pt. Change
Current accident year before catastrophe losses	64.2 %	67.2 %	(3.0)	61.4 %	67.5 %	(6.1)
Current accident year catastrophe losses	7.9	15.0	(7.1)	4.6	12.2	(7.6)
Prior accident years before catastrophe losses	(9.4)	(12.3)	2.9	(5.3)	(13.0)	7.7
Prior accident years catastrophe losses	(0.8)	0.2	(1.0)	(0.8)	(1.0)	0.2
Loss and loss expenses	61.9 %	70.1 %	(8.2)	59.9 %	65.7 %	(5.8)
Underwriting expenses	33.0	33.4	(0.4)	33.0	33.2	(0.2)
Combined ratio	94.9 %	103.5 %	(8.6)	92.9 %	98.9 %	(6.0)
Combined ratio:	94.9 %	103.5 %	(8.6)	92.9 %	98.9 %	(6.0)
Contribution from catastrophe losses and prior years reserve development	(2.3)	2.9	(5.2)	(1.5)	(1.8)	0.3
Combined ratio before catastrophe losses and prior years reserve development	97.2 %	100.6 %	(3.4)	94.4 %	100.7 %	(6.3)

Overview

Performance highlights for the commercial lines segment include:

- Premiums – Commercial lines earned premiums and net written premiums rose during the second quarter and first six months of 2013 primarily due to higher renewal premiums that continued to reflect improved pricing. Higher new business written premiums also contributed to premium growth, reflecting better pricing as well as our premium growth initiatives. The premiums table below analyzes the primary components of earned premiums. We continue to use predictive analytics tools to improve pricing precision while also leveraging our local relationships with agents through the efforts of our teams that work closely with them. We seek to maintain appropriate pricing discipline for both new and renewal business as our agents and underwriters assess account quality to make careful decisions on a case-by-case basis whether to write or renew a policy.

Agency renewal written premiums rose 9 percent and 10 percent for the second quarter and first half of 2013, reflecting higher pricing and improving economic conditions. We measure average changes in commercial lines renewal pricing as the rate of change in renewal premium for the new policy period compared with the premium for the expiring policy period, assuming no change in the level of insured exposures or policy coverage between those periods for respective policies. During the second quarter of 2013, our standard commercial lines policies averaged estimated price increases in a mid-single-digit range, essentially in line with average increases in the first quarter. Our average commercial lines pricing change includes the flat pricing effect of certain coverages within package policies written for a three-year term that were in force but did not expire during the period being measured. Therefore, the average commercial lines pricing change we report reflects a blend of three year policies that did not expire and other policies that did expire during the measurement period. For only those commercial lines policies that did expire and were subsequently renewed during the second quarter of 2013, we estimate that the average price increase was again near the upper end of the mid-single-digit range, with smaller commercial property policies again experiencing average renewal price increases at a low-double-digit rate.

Renewal premiums for our commercial casualty and workers' compensation lines include the result of policy audits that adjust initial premium amounts based on differences between estimated and actual sales or payroll related to a specific policy. Net written premiums from audits during the second quarter and first six months of 2013 netted a positive $11 million and $21 million, respectively. Audits contributed $2 million to the $52 million net increase in net written premiums for the second quarter of 2013 and $7 million to the $154 million net increase in net written premiums for the first six months of 2013, both compared with the same periods a year ago. The $118 million increase in earned premiums during the first six months of 2013, compared with 2012, included a decrease from audit premiums of less than $1 million.

New business written premiums for commercial lines increased 10 percent and 19 percent during the second quarter and first six months of 2013, compared with the same periods last year. In 24 of the 39 states where we offer standard market commercial lines policies, new business written premiums grew at a double-digit rate or higher for the first half of 2013 compared with the same period of 2012.

Other written premiums – which primarily include premiums ceded to our reinsurers as part of our reinsurance program – included ceded commercial lines premiums for the second quarter of 2013 that totaled $2 million more than the second quarter of 2012. For the first six months of 2013, ceded premiums totaled $3 million more than the same period of 2012. Other written premiums also included a less favorable adjustment for the second quarter and a more favorable adjustment for the first six months of 2013, compared with the same periods last year, for estimated direct written premiums of policies in effect but not yet processed. The adjustments had an immaterial effect on earned premiums.

Commercial Lines Insurance Premiums

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2013	2012	Change %	2013	2012	Change %