CINCINNATI FINANCIAL CORP
Form 10-Q
July 27, 2011

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, 2011.

¨ 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.
þ Yes ¨ 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).
þ Yes ¨ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See 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 ¨ Non-accelerated filer ¨ Smaller reporting company
(Do not check if a smaller reporting company)

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

¨ Yes þ No

As of July 22, 2011, there were 163,146,137 shares of common stock outstanding.

CINCINNATI FINANCIAL CORPORATION
FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2011

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Part I – Financial Information

Item 1. Financial Statements (unaudited)

Cincinnati Financial Corporation and Subsidiaries

Condensed Consolidated Balance Sheets

(In millions except per share data)	June 30, 2011	December 31, 2010
ASSETS		
Investments		
Fixed maturities, at fair value (amortized cost: 2011—$8,118; 2010—$7,888)	$8,717	$ 8,383
Equity securities, at fair value (cost: 2011—$2,115; 2010—$2,286)	2,971	3,041
Other invested assets	69	84
Total investments	11,757	11,508
Cash and cash equivalents	313	385
Investment income receivable	120	119
Finance receivable	75	73
Premiums receivable	1,106	1,015
Reinsurance receivable	753	572
Prepaid reinsurance premiums	15	18
Deferred policy acquisition costs	511	488
Land, building and equipment, net, for company use (accumulated depreciation: 2011—$377; 2010—$352)	234	229
Other assets	161	67
Separate accounts	657	621
Total assets	$15,702	$ 15,095
LIABILITIES		
Insurance reserves		
Loss and loss expense reserves	$4,535	$ 4,200
Life policy reserves	2,148	2,034
Unearned premiums	1,630	1,553
Other liabilities	512	556
Deferred income tax	324	260
Note payable	49	49
Long-term debt	790	790
Separate accounts	657	621
Total liabilities	10,645	10,063
Commitments and contingent liabilities (Note 10)	—	—
SHAREHOLDERS' EQUITY		
Common stock, par value—$2 per share; (authorized: 2011 and 2010—500 million shares; issued: 2011 and 2010—196 million shares)	393	393
Paid-in capital	1,094	1,091
Retained earnings	3,862	3,980
Accumulated other comprehensive income	903	769

Treasury stock at cost (2011—33 million shares and 2010—34 million shares)	(1,195)	(1,201)
Total shareholders' equity	5,057	5,032
Total liabilities and shareholders' equity	$15,702	$ 15,095

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

Cincinnati Financial Corporation and Subsidiaries

Condensed Consolidated Statements of Operations

(In millions except per share data)	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
REVENUES				
Earned premiums	$ 773	$ 768	$ 1,555	$ 1,515
Investment income, net of expenses	132	130	263	260
Fee revenues	1	1	2	2
Other revenues	2	2	5	3
Realized investment gains (losses), net:				
Other-than-temporary impairments on fixed maturity securities	-	(1)	-	(2)
Other-than-temporary impairments on fixed maturity securities transferred to other comprehensive income	-	-	-	-
Other realized investment gains (losses), net	67	(22)	79	(13)
Total realized investment gains (losses), net	67	(23)	79	(15)
Total revenues	975	878	1,904	1,765
BENEFITS AND EXPENSES				
Insurance losses and policyholder benefits	801	595	1,376	1,111
Underwriting, acquisition and insurance expenses	251	246	512	514
Other operating expenses	6	3	10	7
Interest expense	14	13	27	27
Total benefits and expenses	1,072	857	1,925	1,659
INCOME (LOSS) BEFORE INCOME TAXES	(97)	21	(21)	106
PROVISION (BENEFIT) FOR INCOME TAXES				
Current	(50)	10	(26)	25
Deferred	2	(16)	(8)	(14)
Total provision (benefit) for income taxes	(48)	(6)	(34)	11
NET INCOME (LOSS)	$ (49)	$ 27	$ 13	$ 95
PER COMMON SHARE				
Net income (loss)—basic	$ (0.30)	$ 0.17	$ 0.08	$ 0.59
Net income (loss)—diluted	(0.30)	0.17	0.08	0.58

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 December 31, 2009	162	$ 393	$ 1,081	$ 3,862	$ 624	$ (1,200)	$ 4,760
Net income	-	-	-	95	-	-	95
Other comprehensive income, net	-	-	-	-	12	-	12
Total comprehensive income							107
Dividends declared	-	-	-	(129)	-	-	(129)
Stock options exercised	1	-	(2)	-	-	3	1
Stock-based compensation	-	-	6	-	-	-	6
Purchases	-	-	-	-	-	(10)	(10)
Other	-	-	(1)	-	-	3	2
Balance June 30, 2010	163	$ 393	$ 1,084	$ 3,828	$ 636	$ (1,204)	$ 4,737
Balance December 31, 2010	163	$ 393	$ 1,091	$ 3,980	$ 769	$ (1,201)	$ 5,032
Net income	-	-	-	13	-	-	13
Other comprehensive income, net	-	-	-	-	134	-	134
Total comprehensive income							147
Dividends declared	-	-	-	(131)	-	-	(131)
Stock options exercised	-	-	(5)	-	-	3	(2)
Stock-based compensation	-	-	7	-	-	-	7
Other	-	-	1	-	-	3	4
Balance June 30, 2011	163	$ 393	$ 1,094	$ 3,862	$ 903	$ (1,195)	$ 5,057

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, 2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 13	$ 95
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and other non-cash items	23	17
Realized (gains) losses on investments	(79)	15
Stock-based compensation	7	6
Interest credited to contract holders	27	22
Deferred income tax benefit	(8)	(14)
Changes in:		
Investment income receivable	(1)	(2)
Premiums and reinsurance receivable	(269)	72
Deferred policy acquisition costs	(28)	(18)
Other assets	(7)	(4)
Loss and loss expense reserves	335	42
Life policy reserves	60	58
Unearned premiums	77	63
Other liabilities	(66)	(12)
Current income tax receivable/payable	(80)	(87)
Net cash provided by operating activities	4	253
CASH FLOWS FROM INVESTING ACTIVITIES		
Sale of fixed maturities	42	99
Call or maturity of fixed maturities	391	340
Sale of equity securities	342	60
Collection of finance receivables	14	15
Purchase of fixed maturities	(645)	(756)
Purchase of equity securities	(100)	(158)
Change in short-term investments, net	-	6
Investment in buildings and equipment, net	(4)	(11)
Investment in finance receivables	(16)	(12)
Change in other invested assets, net	2	2
Net cash provided by (used in) investing activities	26	(415)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payment of cash dividends to shareholders	(127)	(126)
Purchase of treasury shares	-	(10)
Proceeds from stock options exercised	1	-
Contract holders' funds deposited	73	103
Contract holders' funds withdrawn	(44)	(34)
Excess tax benefits on share-based compensation	2	2
Other	(7)	(5)
Net cash used in financing activities	(102)	(70)
Net change in cash and cash equivalents	(72)	(232)
Cash and cash equivalents at beginning of year	385	557
Cash and cash equivalents at end of period	$ 313	$ 325

Supplemental disclosures of cash flow information:		
Interest paid	$ 27	$ 27
Income taxes paid	55	112
Non-cash activities:		
Conversion of securities	$ -	$ 1
Equipment acquired under capital lease obligations	20	-

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, and are presented in conformity with accounting principles generally accepted in the United States of America (GAAP). All significant 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. The December 31, 2010, condensed consolidated balance sheet amounts are derived from the audited financial statements but do not include all disclosures required by GAAP.

Our June 30, 2011, 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 2010 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 2010-06, Fair Value Measurements and Disclosures

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-06, Fair Value Measurements and Disclosures. ASU 2010-06 applies to all entities that are required to make disclosures about recurring or nonrecurring fair value measurements. ASU 2010-06 requires separate disclosures of the activity in the Level 3 category related to any purchases, sales, issuances and settlements on a gross basis. The effective date of these separate disclosures is for interim and annual periods beginning after December 15, 2010. This portion of ASU 2010-06 does not have a material impact on our company's financial position, cash flows or results of operations as it focuses on additional disclosures.

ASU 2010-15, How Investments Held through Separate Accounts Affect an Insurer's Consolidation Analysis of Those Investments

In April 2010, the FASB issued ASU 2010-15, How Investments Held through Separate Accounts Affect an Insurer's Consolidation Analysis of Those Investments. ASU 2010-15 applies to all insurance entities that have separate accounts that meet the definition and requirements set forth in the Accounting Standards Codification Manual. ASU 2010-15 clarifies that an insurance entity should not consider any separate account interests held for the benefit of contract holders in an investment to be the insurer's interests. The insurance entity should not combine those interests with its general account interest in the same investment when assessing the investment for consolidation. The insurance entity may combine those interests when the separate account interests are held for the benefit of a related-party policyholder as defined in the Variable Interest Subsections of the Consolidation topic in the Codification Manual. The effective date of the amendments in this update is for interim and annual periods beginning after December 15, 2010, with early adoption permitted. The amendments in this update do not modify the disclosures currently required by GAAP and do not have a material impact on our company's financial position, cash flows or results of operations.

Pending Accounting Updates

ASU 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts

In October 2010, the FASB issued ASU 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts. ASU 2010-26 modifies the definitions of the type of costs incurred by insurance entities that can be capitalized in the successful acquisition of new and renewal contracts. ASU 2010-26 requires incremental direct costs of successful contract acquisition as well as certain costs related to underwriting, policy issuance and processing, medical and inspection and sales force contract selling for successful contract acquisition to be capitalized.
These incremental direct costs and other costs are those that are essential to the contract transaction and would not have been incurred had the contract transaction not occurred. The effective date of ASU 2010-26 is for interim and annual reporting periods beginning after December 15, 2011. The ASU has not yet been adopted, and we are currently evaluating the impact it will have on our company’s financial position, cash flows or results of operations.

ASU 2011-04, Fair Value Measurements, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurements, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRS). The ASU converges fair value measurement and disclosures among U.S. GAAP and IFRS. ASU 2011-04 changes certain fair value measurement principles and expands disclosure requirements, particularly for Level 3 inputs. The ASU is effective for interim and annual periods beginning after December 15, 2011, and should be applied prospectively. The ASU has not yet been adopted and will not have a material impact on our company's financial position, cash flows or results of operations.

ASU 2011-05, Presentation of Comprehensive Income

In June 2011, the FASB issued ASU 2011-05, Presentation of Comprehensive Income. ASU 2011-05 requires entities to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The ASU is effective for interim and annual reporting periods beginning after December 15, 2011, and should be applied prospectively. The ASU has not yet been adopted and will not have a material impact on our company's financial position, cash flows or results of operations.

NOTE 2 – Investments

Fixed maturities (bonds and redeemable preferred stocks) and equity securities (common and non-redeemable preferred stocks) have been classified as available for sale and are stated at fair values at June 30, 2011, and December 31, 2010. Realized gains and losses on investments are recognized in earnings on a specific identification basis.

The change in unrealized gains and losses, net of taxes, described in the following table, is included in other comprehensive income and shareholders' equity.

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Change in unrealized investment gains and losses and other summary:				
Fixed maturities	$ 96	$ 123	$ 104	$ 209
Equity securities	(21)	(254)	101	(190)
Adjustment to deferred acquisition costs and life policy reserves	(4)	(4)	(4)	(7)
Pension obligations	1	-	2	1
Other	2	3	3	5
Income taxes on above	(26)	46	(72)	(6)
Total	$ 48	$ (86)	$ 134	$ 12

The following table analyzes cost or amortized cost, gross unrealized gains, gross unrealized losses and fair value for our investments, along with the amount of cumulative non-credit other-than-temporary impairment (OTTI) losses transferred to accumulated other comprehensive income (AOCI) in accordance with ASC 320-10-65, Recognition and Presentation of Other-Than-Temporary Impairments, for securities that also had a credit impairment:

(In millions)	Cost or				
	amortized	Gross unrealized		Fair	OTTI in
At June 30, 2011	cost	gains	losses	value	AOCI
Fixed maturities:					
States, municipalities and political subdivisions	$3,077	$157	$3	$3,231	$-
Convertibles and bonds with warrants attached	73	-	-	73	-
United States government	5	1	-	6	-
Government-sponsored enterprises	163	-	1	162	-
Foreign government	3	-	-	3	-
Corporate securities	4,797	449	4	5,242	-
Subtotal	8,118	607	8	8,717	$-
Equity securities:					
Common equities	2,040	845	21	2,864	
Preferred equities	75	33	1	107	
Subtotal	2,115	878	22	2,971	NA
Total	$10,233	$1,485	$30	$11,688	
At December 31, 2010					
Fixed maturities:					
States, municipalities and political subdivisions	$3,043	$110	$10	$3,143	$-
Convertibles and bonds with warrants attached	69	-	-	69	-
United States government	4	1	-	5	-
Government-sponsored enterprises	201	-	1	200	-
Foreign government	3	-	-	3	-
Corporate securities	4,568	404	9	4,963	-
Subtotal	7,888	515	20	8,383	$-
Equity securities:					
Common equities	2,211	757	28	2,940	
Preferred equities	75	27	1	101	
Subtotal	2,286	784	29	3,041	NA
Total	$10,174	$1,299	$49	$11,424	

The unrealized investment gains at June 30, 2011, were largely due to a net gain position in our fixed maturity portfolio of $599 million and a net gain position in our common stock portfolio of $824 million. The unrealized investment gains in our fixed maturity portfolio are primarily composed of $445 million in unrealized gains from the corporate bond portfolio and $154 million in unrealized gains from the municipal bond portfolio.
The primary contributors to the net gain position in the common stock portfolio were The Procter & Gamble Company (NYSE:PG), Exxon Mobil Corporation (NYSE:XOM) and Chevron Corporation (NYSE:CVX) common stock, which had a combined net gain position of $283 million. At June 30, 2011, we had $73 million fair value of hybrid securities included in fixed maturities that follow ASC 815-15-25, Accounting for Certain Hybrid Financial Instruments. 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, 2011	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Fixed maturities:						
States, municipalities and political subdivisions	$ 123	$ 2	$ 9	$ 1	$ 132	$ 3
Government-sponsored enterprises	77	1	-	-	77	1
Corporate securities	256	2	28	2	284	4
Subtotal	456	5	37	3	493	8
Equity securities:						
Common equities	197	21	-	-	197	21
Preferred equities	5	-	18	1	23	1
Subtotal	202	21	18	1	220	22
Total	$ 658	$ 26	$ 55	$ 4	$ 713	$ 30
At December 31, 2010						
Fixed maturities:						
States, municipalities and political subdivisions	$ 325	$ 9	$ 9	$ 1	$ 334	$ 10
Government-sponsored enterprises	133	1	-	-	133	1
Corporate securities	354	6	39	3	393	9
Subtotal	812	16	48	4	860	20
Equity securities:						
Common equities	337	28	-	-	337	28
Preferred equities	5	-	23	1	28	1
Subtotal	342	28	23	1	365	29
Total	$ 1,154	$ 44	$ 71	$ 5	$ 1,225	$ 49

Net realized gains were $67 million and $79 million for the three and six months ended June 30, 2011, compared with net realized losses of $23 million and $15 million for the three and six months ended June 30, 2010. The realized gains for the three months ended June 30, 2011 were $67 million, offset by less than a $1 million impairment charge. The realized gains for the six months ended June 30, 2011, were $109 million, offset by a $30 million impairment charge in the first six months of 2011. The realized gains for the three and six months ended June 30, 2010, were $11 million and $20 million, offset by an impairment charge of less than $1 million in the first quarter of 2010 and $34 million in the second quarter of 2010.

Other-than-temporary Impairment Charges

During the three and six months ended June 30, 2011, there were no credit losses on fixed-maturity securities for which a portion of OTTI has been recognized in other comprehensive income. The following table provides the amount of OTTI charges for the three and six months ended June 30, 2011:

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010

Fixed maturities	$ -	$ 1	$ -	$ 2
Equity securities	-	33	30	33
Total	$ -	$ 34	$ 30	$ 35

During the quarter ended June 30, 2011, we impaired one fixed-maturity security for less than $1 million. At June 30, 2011, 14 fixed-maturity investments with a total unrealized loss of $3 million had been in an unrealized loss position for 12 months or more, but none were trading below 70 percent of amortized cost. At June 30, 2011, two equity securities with a total unrealized loss of $1 million had been in an unrealized loss position for 12 months or more, but none were trading below 70 percent of amortized cost.

At December 31, 2010, 17 fixed-maturity investments with a total unrealized loss of $4 million had been in an unrealized loss position for 12 months or more. Of that total, no fixed maturity investments were trading below 70 percent of amortized cost. Three equity investments with a total unrealized loss of $1 million had been in an unrealized loss position for 12 months or more as of December 31, 2010. Of that total, no equity investments were trading below 70 percent of amortized cost.

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, 2010, and ultimately management determines fair value.

Financial instruments are categorized based upon the following characteristics or inputs to the valuation techniques:

- Level 1 – Financial assets and liabilities for which inputs are observable and are obtained from reliable quoted prices for identical assets or liabilities in active markets. This is the most reliable fair value measurement and includes, for example, active exchange-traded equity securities.

- Level 2 – Financial assets and liabilities for which values are based on quoted prices in markets that are not active or for which values are based on similar assets and liabilities that are actively traded. This also includes pricing models for which the inputs are corroborated by market data.

- Level 3 – Financial assets and liabilities for which values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. Level 3 inputs include the following:

  - Quotes from brokers or other external sources that are not considered binding;

  - Quotes from brokers or other external sources where it cannot be determined that market participants would in fact transact for the asset or liability at the quoted price; or

  - Quotes from brokers or other external sources where the inputs are not deemed observable.

We conduct a thorough review of fair value hierarchy classifications on a quarterly basis. Reclassification of certain financial instruments may occur when input observability changes. As noted below in the Level 3 disclosure table, reclassifications are reported as transfers in or out of the Level 3 category as of the beginning of the quarter in which the reclassification occurred.

The following tables illustrate the fair value hierarchy for those assets measured at fair value on a recurring basis at June 30, 2011, and December 31, 2010. We do not have any material liabilities carried at fair value. There were no significant transfers between Level 1 and Level 2.

Fair Value Disclosures for Assets

(In millions)	Asset fair value measurements at June 30, 2011 using:			
	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	$ -	$ 3,227	$ 4	$ 3,231
Convertibles and bonds with warrants attached	-	73	-	73
United States government	6	-	-	6
Government-sponsored enterprises	-	162	-	162
Foreign government	-	3	-	3
Corporate securities	-	5,227	15	5,242
Subtotal	6	8,692	19	8,717
Common equities, available for sale	2,864	-	-	2,864
Preferred equities, available for sale	-	100	7	107
Taxable fixed maturities separate accounts	-	626	-	626
Top Hat Savings Plan	8	-	-	8
Total	$ 2,878	$ 9,418	$ 26	$ 12,322

(In millions)	Asset fair value measurements at December 31, 2010 using:			
	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	$ -	$ 3,139	$ 4	$ 3,143
Convertibles and bonds with warrants attached	-	69	-	69
United States government	5	-	-	5
Government-sponsored enterprises	-	200	-	200
Foreign government	-	3	-	3
Corporate securities	-	4,943	20	4,963
Subtotal	5	8,354	24	8,383
Common equities, available for sale	2,940	-	-	2,940
Preferred equities, available for sale	-	96	5	101
Taxable fixed maturities separate accounts	-	606	2	608
Top Hat Savings Plan	9	-	-	9
Total	$ 2,954	$ 9,056	$ 31	$ 12,041

Each financial instrument that was deemed to have significant unobservable inputs when determining valuation is identified in the tables below by security type with a summary of changes in fair value as of June 30, 2011. Total Level 3 assets continue to be less than 1 percent of financial assets measured at fair value. At June 30, 2011, total fair value of assets priced with broker quotes and other non-observable market inputs for the fair value measurements and disclosures was $26 million.

The following table provides the change in Level 3 assets for the three months ended June 30, 2011. Level 3 corporate fixed-maturity securities increased by $4 million as one security was purchased for $7 million and two securities totaling $3 million were transferred into Level 2. There were no other significant changes to Level 3 assets during this period.

(In millions)	Asset fair value measurements using significant unobservable inputs (Level 3)			
	Corporate fixed maturities	States, municipalities and political subdivisions fixed maturities	Preferred equities	Total
Beginning balance, March 31, 2011	$ 11	$ 4	$ 6	$ 21
Total gains or losses (realized/unrealized):				
Included in earnings (or changes in net assets)	-	-	-	-
Included in other comprehensive income	-	-	1	1
Purchases	7	-	-	7
Transfers into Level 3	-	-	-	-
Transfers out of Level 3	(3)	-	-	(3)
Ending balance, June 30, 2011	$ 15	$ 4	$ 7	$ 26

(In millions)	Asset fair value measurements using significant unobservable inputs (Level 3)			
	Taxable fixed maturities	Tax-exempt fixed maturities	Preferred equities	Total
Beginning balance, March 31, 2010	$ 28	$ 4	$ 6	$ 38
Total gains or losses (realized/unrealized):				
Included in earnings (or changes in net assets)	-	-	-	-
Included in other comprehensive income	-	-	(1)	(1)
Purchases, sales, issuances, and settlements	(3)	-	-	(3)
Transfers in and/or out of Level 3	(2)	-	-	(2)
Ending balance, June 30, 2010	$ 23	$ 4	$ 5	$ 32

The following table provides the change in Level 3 assets for the six months ended June 30, 2011. As a result of available observable inputs, four Level 3 corporate fixed-maturity securities transferred into Level 2 resulting in a $12 million decrease. There were no other significant changes to Level 3 assets during this period.

(In millions)	Asset fair value measurements using significant unobservable inputs (Level 3)				
	Corporate fixed maturities	Taxable fixed maturities-separate accounts	States, municipalities and political subdivisions fixed maturities	Preferred equities	Total
Beginning balance, December 31, 2010	$ 20	$ 2	$ 4	$ 5	$ 31
Total gains or losses (realized/unrealized):					
Included in earnings (or changes in net assets)	-	-	-	-	-
Included in other comprehensive income	-	-	-	1	1
Purchases	7	-	-	-	7
Transfers into Level 3	-	-	-	1	1
Transfers out of Level 3	(12)	(2)	-	-	(14)

Ending balance, June 30, 2011	$ 15	$ -	$ 4	$ 7	$ 26

(In millions)	Asset fair value measurements using significant unobservable inputs (Level 3)				
	Taxable fixed maturities	Taxable fixed maturities- separate accounts	Tax-exempt fixed maturities	Preferred equities	Total
Beginning balance, December 31, 2009	$ 27	$ -	$ 4	$ 5	$ 36
Total gains or losses (realized/unrealized):					
Included in earnings (or changes in net assets)	-	-	-	-	-
Included in other comprehensive income	-	-	-	-	-
Purchases, sales, issuances, and settlements	2	-	-	-	2
Transfers in and/or out of Level 3	(6)	-	-	-	(6)
Ending balance, June 30, 2010	$ 23	$ -	$ 4	$ 5	$ 32

Fair Value Disclosure for Senior Debt and Life Insurance Assets and Liabilities

The disclosures below are not affected by the fair value hierarchy but 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 financial statements.

This table summarizes the amortized cost and principal amounts of our long-term debt:

(In millions)			Book value		Principal amount	
Interest rate	Year of issue		June 30, 2011	December 31, 2010	June 30, 2011	December 31, 2010
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 fair value of our senior debt approximated $799 million at June 30, 2011, compared with $783 million at year-end 2010. Fair value was determined under the fair value measurements and disclosure accounting rules based on market pricing of these or similar debt instruments that are actively trading. Fair value can vary with macro-economic conditions. Regardless of the fluctuations in fair value, the outstanding principal amount of our long-term debt is $793 million. None of the long-term debt is encumbered by rating triggers. Also, we have one note payable with outstanding principal amount of $49 million, which approximates fair value.

The fair value of life policy loans outstanding principal and interest approximated $45 million, compared with amortized cost of $38 million reported in the condensed consolidated balance sheets at June 30, 2011.

Life reserves and liabilities for deferred annuities and other investment contracts were $1.005 billion and $930 million at June 30, 2011, and December 31, 2010, respectively. Fair value for these deferred annuities and investment contracts was $968 million and $933 million at June 30, 2011, and December 31, 2010, respectively. Fair values of liabilities associated with certain investment contracts are calculated based upon internally developed models because active, observable markets do not exist for those items. To determine the fair value, we make the following significant assumptions: (1) the discount rates used to calculate the present value of expected payments are the risk-free spot rates plus an A3 rated bond spread for financial issuers at June 30, 2011, to account for non-performance risk; (2) the rate of interest credited to policyholders is the portfolio net earned interest rate less a spread for expenses and profit; and (3) additional lapses occur when the credited interest rate is exceeded by an assumed competitor credited rate, which is a function of the risk-free rate of the economic scenario being modeled.

NOTE 4 – Deferred Acquisition Costs

The expenses associated with issuing 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 our deferred acquisition costs for recoverability. The table below shows the deferred policy acquisition costs and asset reconciliation, including the amortized deferred policy acquisition costs.

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010

Deferred policy acquisition costs asset, beginning of period	$ 503	$ 485	$ 488	$ 481
Capitalized deferred policy acquisition costs	183	171	361	342
Amortized deferred policy acquisition costs	(170)	(164)	(333)	(325)
Amortized shadow deferred policy acquisition costs	(5)	(7)	(5)	(13)
Deferred policy acquisition costs asset, end of period	$ 511	$ 485	$ 511	$ 485

There were no premium deficiencies recorded in the reported condensed consolidated statements of operations, as the sum of the anticipated loss and loss adjustment expenses, policyholder dividends, maintenance expenses and underwriting expenses did not exceed the related unearned premiums and anticipated investment income.

NOTE 5 – 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,	
	2011	2010	2011	2010
Gross loss and loss expense reserves, beginning of period	$ 4,179	$ 4,065	$ 4,137	$ 4,096
Less reinsurance receivable	326	343	326	435
Net loss and loss expense reserves, beginning of period	3,853	3,722	3,811	3,661
Net incurred loss and loss expenses related to:				
Current accident year	853	625	1,442	1,139
Prior accident years	(96)	(73)	(155)	(113)
Total incurred	757	552	1,287	1,026
Net paid loss and loss expenses related to:				
Current accident year	391	221	522	333
Prior accident years	248	233	608	534
Total paid	639	454	1,130	867
Net loss and loss expense reserves, end of period	3,971	3,820	3,971	3,820
Plus reinsurance receivable	508	311	508	311
Gross loss and loss expense reserves, end of period	$ 4,479	$ 4,131	$ 4,479	$ 4,131

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. The actuarial estimate is subject to review and adjustment by an inter-departmental committee that includes actuarial management, who 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.

We decreased the provision for prior accident years' incurred loss and loss expenses primarily due to reduced volatility in paid losses and reduced volatility in projections of future calendar year trends and favorable case reserve development. The reserve for loss and loss expenses in the condensed consolidated balance sheets also includes $56 million at June 30, 2011, and $53 million at June 30, 2010, for certain life and health loss and loss expense reserves.

NOTE 6 – Life Policy Reserves

We establish the reserves for traditional life insurance policies based on expected expenses, mortality, morbidity, withdrawal rates 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 investment contracts 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.

(In millions)	June 30, 2011	December 31, 2010
Ordinary/traditional life	$657	$ 628
Universal life	470	459
Deferred annuities	806	730
Investment contracts	198	200
Other	17	17
Total gross reserves	$2,148	$ 2,034

NOTE 7 – Reinsurance

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

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Direct earned premiums	$ 807	$ 769	$ 1,587	$ 1,513
Assumed earned premiums	2	2	7	5
Ceded earned premiums	(79)	(43)	(119)	(82)
Net earned premiums	$ 730	$ 728	$ 1,475	$ 1,436

Changes in 2011 ceded earned premiums compared with prior periods are related to earned reinstatement premiums as a result of the increase in catastrophe losses for the second quarter of 2011.

Our condensed consolidated statements of operations 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,	
	2011	2010	2011	2010
Direct incurred loss and loss expenses	$ 981	$ 528	$ 1,508	$ 977
Assumed incurred loss and loss expenses	5	3	20	5
Ceded incurred loss and loss expenses	(229)	21	(241)	44
Net incurred loss and loss expenses	$ 757	$ 552	$ 1,287	$ 1,026

Changes in 2011 ceded loss and loss expenses compared with prior periods are related to our increase in catastrophe losses for the second quarter of 2011.

Because of a $33 million reduction in ceded reserves, total ceded incurred loss and loss expenses for the three months ended June 30, 2010, increased net incurred loss and loss expenses by $21 million. This reserve reduction occurred in our USAIG pool, as discussed in our Annual Report on Form 10-K, Item 1A, Risk Factors, Page 28. Direct reserves were correspondingly reduced by $33 million, so there was no effect on net incurred loss and loss adjustment expenses. A reduction of $7 million in ceded IBNR reserves in the first quarter 2010 is included in the $44 million ceded incurred loss and loss expenses for the six months ended June 30, 2010.

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

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Direct earned premiums	$ 55	$ 54	$ 105	$ 104
Assumed earned premiums	0	0	0	0
Ceded earned premiums	(12)	(14)	(25)	(25)
Net earned premiums	$ 43	$ 40	$ 80	$ 79

Our condensed consolidated statements of operations include life insurance contract holders' benefits incurred on ceded business:

(In millions)	Three months ended June 30,	Six months ended June 30,

	2011	2010	2011	2010
Direct contract holders' benefits incurred	$ 56	$ 57	$ 109	$ 114
Assumed contract holders' benefits incurred	0	0	0	0
Ceded contract holders' benefits incurred	(12)	(14)	(20)	(29)
Net incurred loss and loss expenses	$ 44	$ 43	$ 89	$ 85

NOTE 8 – 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,	
	2011	2010	2011	2010
Service cost	$ 2	$ 3	$ 5	$ 5
Interest cost	4	4	7	7
Expected return on plan assets	(4)	(4)	(8)	(7)
Amortization of actuarial loss and prior service cost	1	0	2	1
Net periodic benefit cost	$ 3	$ 3	$ 6	$ 6

See our 2010 Annual Report on Form 10-K, Item 8, Note 13, Employee Retirement Benefits, Page 121 for information on our retirement benefits. We made matching contributions of $2 million to our 401(k) savings plan during the second quarter of both 2011 and 2010 and contributions of $4 million for the first half of both 2011 and 2010, respectively.

We contributed $35 million to our qualified pension plan during the first quarter of 2011. We do not anticipate further contributions to our qualified pension plan during the remainder of 2011.

NOTE 9 – Stock-Based Associate Compensation Plans

We currently have four equity compensation plans that permit us to grant various types of equity awards. We currently grant incentive stock options, non-qualified stock options, service-based restricted stock units and performance-based restricted stock units, including some with market-based performance objectives, under our shareholder-approved plans. We also have a Holiday Stock Plan that permits annual awards of one share of common stock to each full-time associate for each full calendar year of service up to a maximum of 10 shares. One of our equity compensation plans permits us to grant stock to our outside directors as a component of their annual compensation. For additional information about our equity compensation plans, see our 2010 Annual Report on Form 10-K, Item 8, Note 17, Stock-Based Associate Compensation Plans, Page 125.

A total of 16.9 million shares are authorized to be granted under the shareholder-approved plans. At June 30, 2011, 4.3 million shares were available for future issuance under the plans.

Stock-Based Awards

During the first quarter of 2011, we granted 24,492 shares of common stock to our directors for 2010 board service fees. Stock-based awards were granted to associates during the first quarter of 2011 and are summarized in the tables below. Stock-based compensation cost after tax was $3 million and $2 million for the three months ended June 30, 2011 and 2010 and $5 million and $4 million for the six months ended June 30, 2011 and 2010, respectively.

As of June 30, 2011, $21 million of unrecognized compensation costs related to non-vested awards is expected to be recognized over a weighted-average period of 2.2 years.

Here is a summary of option information:

(Shares in thousands)	Shares	Weighted-average exercise price
Outstanding at January 1, 2011	9,690	$ 36.59
Granted	891	33.98
Exercised	(23)	26.89
Forfeited or expired	(1,076)	33.60
Outstanding at June 30, 2011	9,482	36.71

Here is a summary of restricted stock unit information:

(Shares in thousands)	Service-based nonvested shares	Weighted-average grant-date fair value	Performance-based nonvested shares	Weighted-average grant-date fair value
Nonvested at January 1, 2011	716	$ 26.00	149	$ 26.08
Granted	298	29.59	51	30.96
Vested	(216)	34.45	(35)	32.42
Forfeited or canceled	(10)	24.62	(8)	33.21
Nonvested at June 30, 2011	788	25.06	157	25.86

NOTE 10 – 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 who are 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 actions, 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 putative class actions have alleged, for example, improper reimbursement of medical providers paid under workers' compensation insurance policies, erroneous coding of municipal tax locations and excessive premium charges for uninsured motorist coverage. 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 in the handling of insurance claims.

On a quarterly basis, we review the outstanding lawsuits. Under current accounting guidance, we establish accruals for lawsuits 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 lawsuits 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 cases 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 quarterly review, for any other matter for which the risk of loss is more than remote, we are unable to reasonably estimate the potential loss or establish a reasonable range of loss because each such matter is in the initial stage of its respective proceeding.

NOTE 11 – Income Taxes

As of June 30, 2011, we had no liability for unrecognized tax benefits.

As of December 31, 2010, we had no liability for unrecognized tax benefits. Details about our liability for unrecognized tax benefits are found in our 2010 Annual Report on Form 10-K, Item 8, Note 11, Income Taxes, Page 120.

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

	Three months ended June 30,				Six months ended June 30,			
	2011		2010		2011		2010	
Tax at statutory rate	35.0	%	35.0	%	35.0	%	35.0	%
Increase (decrease) resulting from:								
Tax-exempt income from municipal bonds	9.0		(41.9	)	83.7		(17.1	)
Dividend received exclusion	5.2		(21.4	)	48.4		(8.5	)
Other	0.3		2.6		(5.2	)	1.1	
Effective rate	49.5	%	(25.7	) %	161.9	%	10.5	%

NOTE 12 – 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 and casualty insurance
- Life insurance
- Investments

As discussed in our 2010 Annual Report on Form 10-K, Item 8, Note 18, Segment Information, we revised our reportable segments during the fourth quarter of 2010 to establish a separate reportable segment for excess and surplus lines. This new segment includes results of The Cincinnati Specialty Underwriters Insurance Company and CSU Producer Resources. Historically, the excess and surplus lines results were reflected in Other. Prior period data included in this quarterly report has been adjusted to represent this new segment.

We report as Other the non-investment operations of the parent company and its non-insurer subsidiary, CFC Investment Company. See our 2010 Annual Report on Form 10-K, Item 8, Note 18, Segment Information, Page 115 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,		Six months ended June 30,	
	2011	2010	2011	2010
Revenues:				
Commercial lines insurance				
Commercial casualty	$ 180	$ 172	$ 352	$ 336
Commercial property	115	121	241	242
Commercial auto	96	96	192	191
Workers' compensation	81	79	157	153
Specialty packages	27	37	64	74
Surety and executive risk	25	25	50	49
Machinery and equipment	9	8	17	16
Commercial lines insurance premiums	533	538	1,073	1,061
Fee revenue	-	-	1	1
Total commercial lines insurance	533	538	1,074	1,062
Personal lines insurance				
Personal auto	90	83	179	164
Homeowner	66	72	142	142
Other personal lines	24	24	49	47
Personal lines insurance premiums	180	179	370	353
Fee revenue	1	1	1	1
Total personal lines insurance	181	180	371	354
Excess and surplus lines insurance	17	11	32	22
Life insurance	43	41	81	80
Investment operations	199	107	342	245
Other	2	1	4	2
Total revenues	$ 975	$ 878	$ 1,904	$ 1,765
Income (loss) before income taxes:				
Insurance underwriting results:				
Commercial lines insurance	$ (128)	$ (10)	$ (149)	$ (19)
Personal lines insurance	(142)	(40)	(145)	(45)
Excess and surplus lines insurance	5	(4)	-	(8)
Life insurance	5	2	2	2
Investment operations	179	87	302	206
Other	(16)	(14)	(31)	(30)
Total	$ (97)	$ 21	$ (21)	$ 106

Identifiable assets:	June 30, 2011	December 31, 2010
Property casualty insurance	$ 2,336	$ 2,008
Life insurance	1,252	1,214
Investment operations	11,814	11,543
Other	300	330

Total	$ 15,702	$ 15,095

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 2010 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 2010 Annual Report on Form 10-K, Item 1A, Risk Factors, Page 24.

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
- Delays in adoption and implementation of underwriting and pricing methods that could increase our pricing accuracy, underwriting profit and competitiveness
- 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
- Declines in overall stock market values negatively affecting the company's equity portfolio and book value
- Events, such as the credit crisis, 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

- o Significant rise in losses from surety and director and officer policies written for financial institutions

- 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

- 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 non-payment or delay in payment by reinsurers

- 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:

  - o Downgrades of the company's financial strength ratings

  - o Concerns that doing business with the company is too difficult

  - o Perceptions that the company's level of service, particularly claims service, is no longer a distinguishing characteristic in the marketplace

- o Delays or inadequacies in the development, implementation, performance and benefits of technology projects and enhancements

- 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:

  - o Restrict our ability to exit or reduce writings of unprofitable coverages or lines of business
  - o Place the insurance industry under greater regulatory scrutiny or result in new statutes, rules and regulations
  - o 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
  - o Increase our provision for federal income taxes due to changes in tax law
  - o Increase our other expenses
  - o Limit our ability to set fair, adequate and reasonable rates
  - o Place us at a disadvantage in the marketplace
  - o 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

- Difficulties with technology or data security breaches that could negatively affect our ability to conduct business and our relationships with agents, policyholders and others

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

Statement of Operations and Per Share Data

(Dollars in millions except share data)	Three months ended June 30, 2011	2010	Change %	Six months ended June 30, 2011	2010	Change %
Statement of operations data						
Earned premiums	$ 773	$ 768	1	$ 1,555	$ 1,515	3
Investment income, net of expenses (pretax)	132	130	2	263	260	1
Realized investment gains and (losses) (pretax)	67	(23)	nm	79	(15)	nm
Total revenues	975	878	11	1,904	1,765	8
Net income (loss)	(49)	27	nm	13	95	(86)
Per share data						
Net income (loss) - diluted	(0.30)	0.17	nm	0.08	0.58	(86)
Cash dividends declared	0.40	0.395	1	0.80	0.79	1
Weighted average shares outstanding	163,068,516	163,284,013	0	163,684,903	163,293,335	0

Revenues increased for the second quarter and the six months ended June 30, 2011, compared with the same periods of 2010, primarily due to higher net realized investment gains and losses. Revenues from earned premiums and investment income also improved for both periods. Premium and investment revenue trends are discussed further in the respective sections of Results of Operations, Page 28.

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 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 2011 compared with the 2010 second quarter decreased primarily due to lower property casualty underwriting results that declined $137 million after taxes. Higher catastrophe losses, mostly weather related, were responsible for $124 million of that decline, and higher weather-related losses that were not identified as part of designated catastrophe events for the property casualty industry also lowered property casualty underwriting results. Life insurance segment results were up $2 million while investment segment results were up $60 million, including a $1 million increase from investment income and a $59 million increase from net realized investment gains and losses, all on an after-tax basis. For the six-month period ended June 30, 2011, net income decreased compared with the same period of 2010, also primarily due to lower property casualty underwriting results that declined $144 million after taxes, including $141 million from higher catastrophe losses. After-tax investment income increased $2 million and net realized investment gains and losses improved by $61 million. Performance by segment is discussed below in Results of Operations, beginning on Page 28. As discussed in our 2010 Annual Report on Form 10-K, Item 7, Factors Influencing Our Future Performance, Page 37, there are several reasons that our performance during 2011 may be below our long-term targets. In that annual report, as part of Results of Operations, we also discussed the full-year 2011 outlook for each reporting segment.

The board of directors is committed to rewarding shareholders directly through cash dividends and through share repurchase authorizations. Through 2010, the company had increased the indicated annual cash dividend rate for 50 consecutive years, a record we believe was matched by only 10 other publicly traded companies. Cash dividends declared during the first six months of 2011 increased approximately 1 percent compared with the same period of 2010. Our board regularly evaluates relevant factors in dividend-related decisions, and the 2010 dividend increase reflected confidence in our strong capital, liquidity and financial flexibility, as well as progress through our initiatives to improve earnings performance.

Balance Sheet Data and Performance Measures

(Dollars in millions except share data)	At June 30, 2011	At December 31, 2010
Balance sheet data		
Invested assets	$ 11,757	$ 11,508
Total assets	15,702	15,095
Short-term debt	49	49
Long-term debt	790	790
Shareholders' equity	5,057	5,032
Book value per share	31.01	30.91
Debt-to-total-capital ratio	14.2 %	14.3 %

	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
Performance measure				
Value creation ratio	0.1 %	(1.1)%	2.9 %	2.3 %

Total assets increased 4 percent compared with year-end 2010, including invested assets growth of 2 percent, largely due to growth in unrealized investment gains. Higher reinsurance receivable, primarily payments due from reinsurers because of higher catastrophe losses, increased total assets by 1 percent. Shareholders' equity and book value per share rose less than 1 percent during the first six months of 2011. Our debt-to-total-capital ratio (capital is the sum of debt plus shareholders' equity) improved compared with the December 31, 2010, level. The value creation ratio, defined below, was higher for the first six months of 2011 compared with 2010, primarily due to higher growth in unrealized investment gains. The $0.10 increase in book value per share during the first six months of 2011 added 0.3 percentage points to the value creation ratio while dividends declared at $0.80 per share during the first six months of 2011 contributed 2.6 points.

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 2010 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 2010 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. For the period 2010 through 2014, an annual value creation ratio averaging 12 percent to 15 percent is our primary performance target. Management believes this non-GAAP measure is a useful supplement to GAAP information.

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. The compound annual growth rate of our net written premiums was negative 0.7 percent over the five-year period 2006 through 2010, slightly worse than the negative 0.5 percent estimated growth rate for the property casualty insurance industry. Our premium mix, relative to the industry, is more heavily weighted in the commercial lines segment of the industry, where growth has lagged the personal lines segment in recent years.

For the first six months of 2011, our total property casualty net written premiums' year-over-year growth was 3 percent overall with our largest segment, commercial lines, up less than 1 percent. In early 2011, A.M. Best forecasted growth in net written premiums of approximately 1 percent for the U.S. property casualty industry for the year 2011, with the industry's commercial lines segment growing less than 1 percent. A.M. Best also expected a sluggish economic recovery and forecasted that commercial lines premium rates would continue to deteriorate in 2011. Given the ongoing weak pricing in parts of the commercial insurance marketplace, we continue to exercise discipline in risk selection and pricing. Our premium growth initiatives are discussed below in Highlights of Our Strategies and Supporting Initiatives, Page 24.

- Combined ratio — We believe our underwriting philosophy and initiatives can generate a GAAP combined ratio over any five-year period that is consistently below 100 percent. Our GAAP combined ratio averaged 98.3 percent over the five-year period 2006 through 2010. It was below 100 percent in 2006 and 2007, but was above 100 percent for 2008 through 2010, when we averaged 102.3 percent, including an average catastrophe loss ratio that was 2.1 percentage points higher than our average for the 10-year period prior to 2008. Our statutory combined ratio averaged 98.2 percent over the five-year period 2006 through 2010 compared with an estimated 99.5 percent for the property casualty industry.

For the first six months of 2011, our GAAP combined ratio was 120.1 percent and our statutory combined ratio was 119.2 percent, both including 22.5 percentage points of current accident year catastrophe losses partially offset by 10.3 percentage points of favorable loss reserve development on prior accident years. In early 2011, A.M. Best forecasted the industry's full-year 2011 statutory combined ratio at 103.5 percent, including 4.5 percentage points of catastrophe losses and a favorable impact of 2.3 percentage points from prior accident year reserve releases. For the commercial lines industry segment, A.M. Best forecasted a full-year 2011 statutory combined ratio at approximately 110 percent, including approximately 4 percentage points of catastrophe losses and a favorable impact of less than 1 percentage point from prior accident year reserve releases.

- 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. The compound annual return for our equity portfolio over the five-year period 2006 through 2010 was negative 3.0 percent compared with positive 2.3 percent for the Index. Our equity portfolio underperformed the market for the five-year period primarily because of the 2008 decline in the market value of our previously large equity holdings in the financial services sector.

Investment income, on a before-tax basis, grew at a compound annual rate of 0.3 percent over the five-year period 2006 through 2010. It grew in each year except 2008 and 2009, when we experienced a dramatic reduction in dividend payouts by financial services companies previously held in our equity portfolio.

For the first six months of 2011, pretax investment income was $263 million, up 1 percent from $260 million for the same period in 2010. The increase reflected higher dividends that somewhat offset declining interest income due to declining yields from lower interest rates. 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 2010 Annual Report on Form 10-K, Item 1, Our Business and Our Strategy, Page 3. We believe successful implementation of two groups of initiatives that support our strategy, summarized below, will help us better serve our agent customers and reduce volatility 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 this group of initiatives is intended to improve pricing capabilities for our property casualty business, increasing our ability to manage our business while also enhancing our efficiency. Improved pricing capabilities through the use of technology and analytics can lead to better profit margins. Improved planning for growth and profitability can enhance our ability to achieve objectives at all levels in the organization. Improved internal processes with additional performance metrics can help us be more efficient and effective. These initiatives support the ability of the 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 this group of 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.

We discuss initiatives supporting each of these strategies below, along with metrics we use to assess our progress.

Improve Insurance Profitability

The main initiatives to improve our insurance profitability include:

- Improve pricing precision using predictive analytics – We continue efforts to expand our pricing and underwriting capabilities by using predictive analytics and expect cumulative benefits of these efforts to improve loss ratios over time. Development of additional business data to support accurate underwriting, pricing and other business decisions also continues. A project that will continue in phases over the next several years will deploy a full data management program, including a data warehouse for our property casualty and life insurance operations, providing enhanced granularity of pricing data. Progress to date during 2011 and future plans for key initiatives are summarized below.

  - Commercial lines – In the second half of 2009, we began to use predictive modeling tools that align individual insurance policy pricing to risk attributes for our workers' compensation line of business. By late 2010, we had completed development of predictive models for our commercial auto line of business and also for general liability and commercial property coverages in commercial package accounts. A pilot version for production use of tools for these three business lines began early in the second quarter of 2011, and we plan a full-production release during the third quarter of 2011. Underwriters using these tools have enhanced abilities to target profitability and to discuss pricing impacts with agency personnel. Development of similar tools for our specialty packages line of business is planned for the fourth quarter of 2011.

  - Personal lines – Prior to 2010, we began to use predictive modeling tools for our homeowner line of business, and in late 2010 we began using similar analytics for personal auto. We believe we are successfully attracting more of our agents' preferred business, based on trends indicating the average quality of our book of business as measured by the insurance score profile. Personal lines new business written premiums continue to increase at a strong pace, growing 14 percent during the first six months of 2011. We are continuing to develop model attributes and expand our pricing points to add more precision. This includes an update to the modeling of our homeowner book for pricing changes targeted for implementation beginning the fourth quarter of 2011.

- Improve agency-level planning for profitability and growth – Additional use of analytics tools helps us to better understand our business in greater detail and to communicate additional quantitative and qualitative information to agents and associates. To predict profitability, we are developing models at an agency level and in aggregate. Enhanced reporting of related metrics should facilitate coordination and consistent decision-making. During 2011, we are developing enhanced agency planning processes to develop multi-year profitability and growth plans. In addition to determining planned premium growth from existing agencies, this process will help project the number of additional agencies needed to achieve premium targets.

- Improve internal processes and further deploy performance metrics – Process improvement supports our strategic goals and can reduce internal costs. Use of additional measurements to track progress and accountability for results will improve our overall effectiveness. Our commercial lines operation is developing additional performance metrics for underwriting associates that we plan to pilot in 2011. Completion of system development for additional coverages in our commercial lines policy administration system is expected to facilitate important internal process improvement initiatives for 2011. Progress during 2011 has included implementing capabilities to process professional and employment practices liability insurance in several states. In addition, we deployed in two additional states all commercial lines coverages currently available for processing through the system.

Another important initiative aims to develop business rules and parameters for personal lines accounts that will allow processing of risks that meet qualifying underwriting criteria without intervention by an underwriter. The objective is to streamline processing for our agents and associates, permitting more time for risks that need additional service or attention. The initiative includes developing technology to integrate automated steps into the current process plus changes in workflow, including auditing for compliance with eligibility requirements. Progress during the first six months of 2011 included implementing a new rules engine for new business in selected states.

We measure the overall success of our strategy to improve insurance profitability primarily through our GAAP combined ratio, which we believe can be consistently below 100 percent over any five-year period.

In addition, we expect these initiatives to contribute to our rank as the No. 1 or No. 2 insurance carrier based on premium volume in agencies that have represented us for at least five years. We earned that rank in approximately 75 percent of these agencies, based on premiums for 2010, the most recent year for which full agency data is available. We are working to increase the percentage of agencies with this premium share ranking.

Drive Premium Growth

Primary initiatives to drive premium growth include:

- Gain a larger share of agency business – We continue to execute on prior year growth initiatives and add new initiatives to improve our penetration in each market we serve through our independent agencies. Our focus remains on the key components of agent satisfaction based on factors agents tell us are most important.

  - Innovate our small business strategy – Additional focus on attributes that agencies weigh heavily in carrier selection for their clients is a key component of this initiative. Those attributes include technology ease of use and integration with agency management systems, flexible billing, product breadth and pricing, and service and marketing support for new business. The initiative includes refining workflows for the entire policy process, including more streamlined underwriting and claims processes, and providing additional policyholder services. In addition to growing premiums, our small business strategy is expected to improve profitability due to lower expenses through more automation of data gathering and use of predictive analytics.

We also are developing and coordinating small business targeted marketing, including cross-selling opportunities for our agencies, through our Target Markets department. This area focuses on new commercial product development, including identification and promotional support for promising classes of business. We plan to roll out new programs for three additional classes in the last half of 2011. Our target markets programs aim to attract larger business accounts in addition to small business accounts, contributing to growth for our agencies and helping to drive our premium growth.

  - 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 2011, we are targeting approximately 120 appointments of independent agencies, with a significant portion in the five states we entered since late 2008. During the first six months of 2011, we appointed 71 new agencies that write an aggregate of approximately $1.1 billion in property casualty premiums annually with various insurance carriers for an average of approximately $16 million per agency. As of June 30, 2011, a total of 1,281 agency relationships market our standard market insurance products from 1,593 reporting locations.

We seek to build a close, long-term relationship with each agency we appoint, carefully evaluating the marketing reach of each new appointment to ensure the territory can support both current and new agencies. Our 120 field marketing territories are staffed by marketing representatives averaging 20 years of industry experience and 10 years as a Cincinnati Insurance field marketing representative. The team of field associates in each territory works together with headquarters support associates to form our agent-centered business model, providing local expertise, helping us better understand the accounts we underwrite and creating market advantages for our agents. We generally earn a 10 percent share of an agency's business within 10 years of its appointment. We also help our agents grow their business by attracting more clients in their communities through unique, Cincinnati-style service.

- Improve consumer relationships we undertake on behalf of our agencies – Improved interactions with consumers who are clients and prospects of our agents can drive more business to agents and help them grow. Through this initiative, we expect to identify the various ways we interact with consumers on behalf of our agencies and ensure that we do so in a manner that reinforces the value of the independent agent while establishing the value and service of a Cincinnati policy. By understanding and monitoring trends that drive consumer purchasing decisions, we can create positive interactions. We expect online policyholder services to continue evolving and will continue to work with agencies to meet the needs of their clients. During the first quarter of 2011, we completed research that included agent and consumer surveys. Analysis of survey data yielded significant insights on consumer preferences and perceptions that we will use to make informed decisions and set priorities as we work to create positive consumer experiences that support the agent's consumer relationships.

We measure the overall success of this strategy to drive premium growth primarily through changes in net written premiums, which we believe can grow faster than the industry average over any five-year period. For the first six months of 2011, our property casualty net written premiums increased 3 percent, compared with a full-year 2011 estimated increase of approximately 1 percent for the industry based on an early 2011 forecast.

Despite near-term challenges in insurance and financial markets that are reflected in year-to-date 2011 financial performance, we have made significant progress on our initiatives and remain confident that our overall strategy can deliver long-term value for shareholders.

A vital part of our long-term strategy is financial strength, which is described in our 2010 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 2010 Annual Report on Form 10-K, Item 7, Liquidity and Capital Resources, 2011 Reinsurance Programs, Page 90, and is updated below in Consolidated Property Casualty Insurance Results of Operations, beginning on Page 28. Another aspect is our investment portfolios, which remain well-diversified as discussed in Item 3, Quantitative and Qualitative Disclosures about Market Risk, Page 47. 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, 2011, we held $1.116 billion of our cash and invested assets at the parent company level, of which $821 million, or 73.6 percent, was invested in common stocks, and $30 million, or 2.7 percent, was cash or cash equivalents. Our ratio of debt-to-total-capital at 14.2 percent remains well below our target limit of 20 percent. Another important indicator of financial strength is our ratio of property casualty net written premiums to statutory surplus, which was 0.8-to-1 for the 12 months ended June 30, 2011, unchanged from 0.8-to-1 at year-end 2010.

Our financial strength ratings 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 our property casualty and life 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 26, 2011, 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 (12/13/10)
Fitch Ratings	A +	Strong	5 of 21	A +	Strong	5 of 21	-	-	-	Stable outlook (5/2/11)
Moody's Investors Service	A1	Good	5 of 21	-	-	-	-	-	-	Stable outlook (9/25/08)
Standard & Poor's Ratings Services	A	Strong	6 of 21	A	Strong	6 of 21	-	-	-	Stable outlook (7/19/10)

All of our insurance subsidiaries continue to be highly rated.

On May 2, 2011, Fitch Ratings affirmed our ratings that it had assigned in September 2010, continuing its stable outlook. Fitch noted that ratings strengths include conservative capitalization, moderate holding company leverage, ample liquidity and competitive advantages from our distribution system. Fitch said the ratings recognize our steps taken to rebalance our common stock portfolio to reduce capital and earnings volatility. Fitch noted ratings concerns principally related to challenges from competitive market conditions and exposure to regional natural catastrophes and weather-related losses.

Results of Operations

The consolidated results of operations 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 non-investment operations of the parent company and its non-insurer subsidiary, CFC Investment Company. See Item 1, Note 12, Segment Information, Page 18, 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,		
	2011	2010	Change %	2011	2010	Change %
Earned premiums	$730	$728	0	$1,475	$1,436	3
Fee revenues	1	1	0	2	2	0
Total revenues	731	729	0	1,477	1,438	3
Loss and loss expenses from:						
Current accident year before catastrophe losses	564	522	8	1,110	1,014	9
Current accident year catastrophe losses	290	104	179	332	126	163
Prior accident years before catastrophe losses	(95)	(68)	(40)	(152)	(100)	(52)
Prior accident years catastrophe losses	-	(5)	nm	(1)	(12)	92
Total loss and loss expenses	759	553	37	1,289	1,028	25
Underwriting expenses	237	230	3	482	482	0
Underwriting loss	$(265)	$(54)	(391)	$(294)	$(72)	(308)
Ratios as a percent of earned premiums:			Pt. Change			Pt. Change
Current accident year before catastrophe losses	77.3 %	71.7 %	5.6	75.2 %	70.6 %	4.6
Current accident year catastrophe losses	39.7	14.3	25.4	22.5	8.8	13.7
	(13.0)	(9.3)	(3.7)	(10.3)	(7.0)	(3.3)

Prior accident years before catastrophe losses						
Prior accident years catastrophe losses	0.1	(0.7)	0.8	0.0	(0.8)	0.8
Total loss and loss expenses	104.1	76.0	28.1	87.4	71.6	15.8
Underwriting expenses	32.5	31.6	0.9	32.7	33.6	(0.9)
Combined ratio	136.6 %	107.6 %	29.0	120.1 %	105.2 %	14.9
Combined ratio:	136.6 %	107.6 %	29.0	120.1 %	105.2 %	14.9
Contribution from catastrophe losses and prior years reserve development	26.8	4.3	22.5	12.2	1.0	11.2
Combined ratio before catastrophe losses and prior years reserve development	109.8 %	103.3 %	6.5	107.9 %	104.2 %	3.7

Our consolidated property casualty insurance operations generated an underwriting loss of $265 million and $294 million for the three and six months ended June 30, 2011, compared with an underwriting loss of $54 million and $72 million for the three and six months ended June 30, 2010. The primary causes of the higher underwriting losses were increases of $191 million and $217 million, for the three- and six-month periods, in losses caused by natural catastrophes that were primarily weather-related. Ceded premiums to reinstate coverage layers of our property catastrophe reinsurance treaty lowered 2011 earned premiums by $38 million and increased the underwriting loss by a corresponding amount. Weather-related losses not linked to specific catastrophe events also increased the underwriting loss. More details of property casualty insurance results are discussed below, including discussion of 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.

The combined ratio can be affected significantly by 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, improved the combined ratio by 10.3 percentage points in the first half of 2011 compared with 7.8 percentage points in the same period of 2010. Net favorable development for the first six months of 2011 occurred primarily in our commercial casualty line of business as discussed in Commercial Lines Results of Operations on Page 31.

The underwriting expense ratio was higher for the second quarter of 2011 compared with the same period a year ago, primarily due to earned premiums that were lowered by $38 million of ceded premiums to reinstate coverage layers of our property catastrophe reinsurance treaty, contributing 1.6 and 0.9 percentage points to the 2011 second-quarter and six-month underwriting expense ratio. The ratio was lower for the first six months of 2011 compared with the same period of 2010, primarily due to first-quarter 2010 provisions for matters involving prior years and related to Note 10, Commitments and Contingent Liabilities, Page 17.

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2011	2010	Change %	2011	2010	Change %
Agency renewal written premiums	$ 717	$ 685	5	$ 1,425	$ 1,367	4
Agency new business written premiums	117	106	10	219	198	11
Other written premiums	(66)	(42)	(57)	(97)	(60)	(62)
Net written premiums	768	749	3	1,547	1,505	3
Unearned premium change	(38)	(21)	(81)	(72)	(69)	(4)
Earned premiums	$ 730	$ 728	0	$ 1,475	$ 1,436	3

The trends in net written premiums and earned premiums summarized in the table above reflect the effects of our premium growth strategies and slowly improving economic conditions, partially offset by higher ceded premiums to reinstate coverage layers of our property catastrophe reinsurance treaty and by ongoing strong competition in our markets. Consolidated property casualty net written premiums for the three and six months ended June 30, 2011, increased $19 million and $42 million compared with the same periods of 2010. Each of our property casualty segments registered growth for both the three-month and six-month periods ended June 30, 2011. Our premium growth initiatives from prior years continue to favorably affect current year growth, particularly as newer agency relationships mature over time. Improving insured exposure-level comparatives from the slow economic recovery also favorably affected premium growth. We discuss current initiatives in Highlights of Our Strategy and Supporting Initiatives, Page 24. The main drivers of trends for 2011 are discussed by segment on Pages 31 and 35.

Consolidated property casualty agency new business written premiums for the three and six months ended June 30, 2011, increased $11 million and $21 million compared with the same periods of 2010. New business premiums grew for each of our property casualty segments for both periods. We continued to experience new business growth related to initiatives for product line or geographic expansion into new and underserved areas. Agents appointed during 2010 or 2011 produced an increase in standard lines new business of $18 million for the first six months of 2011 compared with the same period in 2010. 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 is less familiar to our agent due to it being recently obtained from a competing agent.

Other written premiums – primarily including premiums ceded to our reinsurers as part of our reinsurance program – decreased $24 million and $37 million for the three and six months ended June 30, 2011, compared with the same periods of 2010. The decrease was primarily due to $38 million of ceded premiums recorded during the second quarter to reinstate coverage layers of our property catastrophe reinsurance treaty. As described in our 2010 Annual Report on

Form 10-K, Item 7, Liquidity and Capital Resources, 2011 Reinsurance Programs, Page 90, we originally estimated that ceded premiums from that treaty would cost approximately $12 million for an average quarter during 2011.

Near the end of the second quarter of 2011, we purchased reinsurance to replenish coverage for certain layers of our property catastrophe treaty that were used by the catastrophe events discussed below. This coverage, also known as 3rd and 4th Event cover, includes one automatic reinstatement provision. It provides reinsurance coverage for any single catastrophe event during the remainder of 2011 that causes losses between $70 million and $200 million. Coverage for 2011 single-event catastrophe losses above $200 million and up to $500 million remains in place under the original terms of our property catastrophe treaty effective January 1, 2011, and includes one automatic reinstatement provision. The estimated ceded premiums during the third and fourth quarters of 2011 for our property catastrophe reinsurance treaty in total are expected to increase approximately 50 percent from the $12 million quarterly average amount estimated for the treaty that was in place as of January 1, 2011, assuming no additional reinstatement premiums.

Our property catastrophe treaty is an important capital management tool that helps reduce financial performance variability due to catastrophe loss experience as discussed below. Among other factors that can influence our reinsurance program decisions, we consider third-party catastrophe models that estimate potential losses from catastrophe events. During the first quarter of 2011, one of the modeling vendors we use released an updated model that indicates significantly higher modeled losses from a hurricane event. We continue to study potential loss estimates from the updated model and have not yet determined how it may affect our 2012 reinsurance program.

Catastrophe losses contributed 39.8 and 22.5 percentage points to the combined ratio in the three and six months ended June 30, 2011, compared with 13.6 and 8.0 percentage points in the same periods of 2010. The three- and six-month ratios for 2011 included 0.6 and 0.9 percentage points from estimated losses of $4 million and $13 million for our participation in assumed reinsurance treaties that spread the risk of very high catastrophe losses among many insurers. The majority of the assumed reinsurance losses were from the March 2011 Japan earthquake event, and most of the remainder were from the September 2010 earthquake event in New Zealand. The only assumed reinsurance treaty for which we have material exposure has been reserved at policy limits for the Japan event and at approximately half of the policy limit for the New Zealand event.

The following table shows catastrophe losses incurred, net of reinsurance, as well as the effect of loss development on prior period catastrophe events. We individually list catastrophe events for which our incurred losses reached or exceeded $5 million. Incurred losses from the April 22-28 tornado outbreak affecting several southern states, including the Tuscaloosa, Alabama area, are shown net of amounts expected to be recovered through our property catastrophe reinsurance treaty. The gross amount is estimated at $194 million, exceeding the previous single largest catastrophe event in our company's history. Incurred losses shown from the May 20-27 storm system that included Joplin, Missouri are also net of reinsurance. The gross amount for that event is estimated at $192 million, and it includes significant losses from hail in the Dayton, Ohio, area. The total gross amount of our losses incurred for all catastrophe events during the three months ended June 30, 2011, is estimated at $512 million.

(In millions, net of reinsurance)			Three months ended June 30,				Six months ended June 30,			
Dates	Cause of loss	Region	Comm. lines	Pers. lines	E&S lines	Total	Comm. lines	Pers. lines	E&S lines	Total
2011										
Jan. 31-Feb. 3	Flood, freezing, ice, snow, wind	South, Midwest	$ -	$ -	$ -	$ -	$ 5	$ 5	$ -	$ 10
Feb. 27-28	Flood, hail, tornado, wind	Midwest	-	(1)	-	(1)	5	7	-	12
Mar. 11	Earthquake	Japan	-	-	-	-	8	-	-	8
Apr. 3-5	Flood, hail, tornado, wind	South, Midwest	16	22	-	38	16	22	-	38
Apr. 8-11	Flood, hail, tornado, wind	South, Midwest	11	9	-	20	11	9	-	20
Apr. 14-16	Flood, hail, tornado, wind	South, Midwest	10	4	-	14	10	4	-	14
Apr. 19-20	Hail, wind	South, Midwest	13	13	-	26	13	13	-	26
Apr. 22-28	Flood, hail, tornado, wind	South, Midwest	47	31	-	78	47	31	-	78
May 20-27	Flood, hail, tornado, wind	South, Midwest	45	37	-	82	45	37	-	82
May 29-Jun. 1	Flood, hail, tornado, wind	East, Midwest	4	2	-	6	4	2	-	6
Jun. 16-22	Flood, hail, tornado, wind	South, Midwest	7	10	-	17	7	10	-	17
All other 2011 catastrophes			4	5	1	10	9	11	1	21
Development on 2010 and prior catastrophes			-	-	-	-	4	(5)	-	(1)

Calendar year incurred total			$ 157	$ 132	$ 1	$ 290	$ 184	$ 146	$ 1	$ 331
2010										
Jan. 7-12	Freezing, wind	South, Midwest	$ (1)	$ -	$ -	$ (1)	$ 3	$ 2	$ -	$ 5
Feb. 9-11	Ice, snow, wind	East, Midwest	(1)	-	-	(1)	5	2	-	7
Apr. 4-6	Flood, hail, tornado, wind	South, Midwest	5	6	-	11	5	6	-	11
Apr. 30-May 3	Flood, hail, tornado, wind	South	28	6	-	34	28	6	-	34
May 7-8	Hail, tornado, wind	East, Midwest	2	10	-	12	2	10	-	12
May 12-16	Flood, hail, tornado, wind	South, Midwest	3	2	-	5	3	2	-	5
Jun. 4-6	Flood, hail, tornado, wind	Midwest	3	3	-	6	3	3	-	6
Jun. 17-20	Flood, hail, tornado, wind	Midwest, West	5	4	-	9	5	4	-	9
Jun. 21-24	Flood, hail, tornado, wind	Midwest	4	5	-	9	4	5	-	9
Jun. 25-28	Flood, hail, tornado, wind	Midwest	1	4	-	5	1	4	-	5
All other 2010 catastrophes			11	4	-	15	17	6	-	23
Development on 2009 and prior catastrophes			(4)	(1)	-	(5)	(10)	(2)	-	(12)
Calendar year incurred total			$ 56	$ 43	$ -	$ 99	$ 66	$ 48	$ -	$ 114

Commercial Lines Insurance Results of Operations

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2011	2010	Change %	2011	2010	Change %
Earned premiums	$ 533	$ 538	(1)	$ 1,073	$ 1,061	1
Fee revenues	-	-	nm	1	1	0
Total revenues	533	538	(1)	1,074	1,062	1
Loss and loss expenses from:						
Current accident year before catastrophe losses	405	386	5	807	757	7
Current accident year catastrophe losses	157	60	162	180	76	137
Prior accident years before catastrophe losses	(79)	(63)	(25)	(134)	(92)	(46)
Prior accident years catastrophe losses	-	(4)	nm	4	(10)	nm
Total loss and loss expenses	483	379	27	857	731	17
Underwriting expenses	178	169	5	366	350	5
Underwriting loss	$ (128)	$ (10)	nm	$ (149)	$ (19)	nm
Ratios as a percent of earned premiums:			Pt. Change			Pt. Change
Current accident year before catastrophe losses	75.9 %	71.7 %	4.2	75.2 %	71.4 %	3.8
Current accident year catastrophe losses	29.5	11.2	18.3	16.8	7.2	9.6
Prior accident years before catastrophe losses	(14.8)	(11.7)	(3.1)	(12.5)	(8.7)	(3.8)
Prior accident years catastrophe losses	0.2	(0.8)	1.0	0.4	(1.0)	1.4
Total loss and loss expenses	90.8	70.4	20.4	79.9	68.9	11.0
Underwriting expenses	33.4	31.3	2.1	34.1	33.0	1.1
Combined ratio	124.2 %	101.7 %	22.5	114.0 %	101.9 %	12.1
Combined ratio:	124.2 %	101.7 %	22.5	114.0 %	101.9 %	12.1
Contribution from catastrophe losses and prior years reserve development	14.9	(1.3)	16.2	4.7	(2.5)	7.2
Combined ratio before catastrophe losses and prior years reserve development	109.3 %	103.0 %	6.3	109.3 %	104.4 %	4.9

Overview

Performance highlights for the commercial lines segment include:

- Premiums – Commercial lines earned premiums and net written premiums both grew during the first half of 2011, at a rate of 1 percent or less. For the second quarter of 2011, earned premiums declined 1 percent while net written premiums rose 1 percent. Premiums for our commercial casualty and workers' compensation business 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. Audits contributed $34 million to the $12 million net increase in earned premiums for the first half of 2011 compared with the same period a year ago. The $5 million decrease in earned premiums during the second quarter of 2011, compared with the 2010 quarter, included a $16 million increase from audit premiums as a component. Earned premiums for both periods of 2011 also included $23 million of ceded premiums to reinstate coverage layers of our property catastrophe reinsurance treaty, contributing to the $5 million net decrease in earned premiums and partially offsetting net growth for the six-month period. The premiums table below analyzes other components of earned premiums.

Agency renewal written premiums that rose 2 percent for both the first three and six months of 2011 also largely reflected improving economic conditions that were partly offset by lower pricing. Net written premiums from audits during the second quarter of 2011 were positive $2 million and the year-over-year change from audits was favorable by $11 million during the second quarter and $19 million for the six-month period, in part reflecting improving insured exposure-level comparatives from the slow economic recovery. We work with our agents to retain accounts with manageable risk characteristics that support the lower average prices prevailing in the marketplace. Our agents, assisted by our field associates who handle underwriting, claims, loss control or premium audit responsibilities, provide us with insights on local market conditions. We use such insights in making decisions intended to adequately price business to achieve target profit margins. 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. Our commercial lines policies averaged an estimated price decline of approximately 1 percent during the second quarter of 2011, improving somewhat compared with the low-single-digit rate for both the first quarter of 2011 and the full-year 2010 average. More significant declines sometimes occur, particularly for larger accounts.

New business written premiums for commercial lines increased 11 percent and 9 percent during the second quarter and first six months of 2011 compared with the same periods last year. Our five newest states for our commercial lines operation – Texas, Colorado, Wyoming, Connecticut and Oregon – generated an increase in new business of approximately $2 million for the first six months of 2011, while the increase from other states in total was $11 million or 10 percent.

Other written premiums included higher amounts ceded to reinsurers for both the three- and six-month periods of 2011, with $23 million ceded to reinstate coverage layers of our property catastrophe reinsurance treaty. For the second quarter of 2011, the higher ceded premiums were partially offset by a more favorable adjustment, compared with the second quarter of last year, for estimated direct written premiums of policies in effect but not yet processed. The adjustment for estimated premiums had an immaterial effect on earned premiums.

Commercial Lines Insurance Premiums

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2011	2010	Change %	2011	2010	Change %
Agency renewal written premiums	$500	$492	2	$1,042	$1,025	2
Agency new business written premiums	81	73	11	152	139	9
Other written premiums	(44)	(33)	(33)	(69)	(44)	(57)
Net written premiums	537	532	1	1,125	1,120	0
Unearned premium change	(4)	6	nm	(52)	(59)	12
Earned premiums	$533	$538	(1)	$1,073	$1,061	1

- Combined ratio – The commercial lines combined ratio for the three and six months ended June 30, 2011, increased compared with the same periods of 2010 , driven by catastrophe losses that were 19.3 and 11.0 percentage points higher. The ratio for current accident year loss and loss expenses before catastrophe losses of 75.2 percent for the first six months of 2011 rose 0.7 percentage points above the 74.5 percent accident year 2010 ratio measured as of December 31, 2010. The effect of the $23 million ceded to reinstate coverage layers of our property catastrophe reinsurance treaty increased the 2011 ratio by 1.5 percentage points.

The net effect of reserve development on prior accident years during the second quarter and first six months of 2011 was favorable for commercial lines overall by $79 million and $130 million compared with net favorable development of $67 million and $102 million for the same periods in 2010. For the three and six months ended June 30, 2011, most of the commercial lines favorable reserve development on prior accident years occurred in the commercial casualty line of business, which represented 80 percent of the six-month commercial lines favorable development. The favorable reserve development recognized during the first six months of 2011 for commercial casualty was approximately half for accident year 2010 and slightly under one-third for accident years 2008 through 2009, and was primarily due to reduced volatility in paid losses, reduced volatility in projections of future calendar year trends and favorable case reserve development. Reserve estimates are inherently uncertain as described in our 2010 Annual Report on Form 10-K, Item 7, Property Casualty Insurance Loss and Loss Expense Obligations and Reserves, Page 82.

Our loss and loss expense ratio for workers' compensation remained high at 85.4 percent for the first six months of 2011, but improved 5.2 percentage points compared with the first six months of 2010 and 8.5 points compared with full-year 2010. As discussed in our 2010 Annual Report on Form 10-K, Item 7, Commercial Lines of Business Analysis, Page 58, predictive modeling for workers' compensation is expected to increase pricing accuracy, therefore improving profitability and the related ratios over time. In addition to continued use and refinement of predictive analytics, we use specialists who have extensive experience in underwriting workers' compensation exposures, and claims associates who specialize in workers' compensation claims, and we are increasing our use of loss control risk evaluation services for these accounts. Specialization and timely handling of claims through direct reporting of workers' compensation claims, implemented in early 2010, should enable our claims representatives to more effectively manage and contain the costs of claims that have already occurred, as well as future claims. Loss control services should help prevent worker-related accidents or lessen the severity of injuries when accidents occur.

The commercial lines underwriting expense ratio for the second quarter and the first six months of 2011 increased compared with the same periods of 2010, primarily due to earned premiums that were lowered by $23 million of ceded premiums to reinstate coverage layers of our property catastrophe reinsurance treaty.

Underwriting results and related measures for the combined ratio are summarized in the first table of Commercial Lines Insurance Results of Operations. The tables and discussion below provide additional details for certain primary drivers of underwriting results.

Commercial Lines Insurance Losses by Size

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2011	2010	Change %	2011	2010	Change %
New losses greater than $4,000,000	$6	$11	(45)	$16	$17	(6)
New losses $1,000,000-$4,000,000	30	22	36	70	54	30
New losses $250,000-$1,000,000	39	40	(3)	77	80	(4)
Case reserve development above $250,000	46	29	59	77	61	26
Total large losses incurred	121	102	19	240	212	13
Other losses excluding catastrophe losses	135	159	(15)	290	321	(10)
Catastrophe losses	157	57	175	183	66	177
Total losses incurred	$413	$318	30	$713	$599	19

Ratios as a percent of earned premiums:			Pt. Change			Pt. Change
New losses greater than $4,000,000	1.1 %	2.0 %	(0.9)	1.5 %	1.6 %	(0.1)
New losses $1,000,000-$4,000,000	5.5	4.1	1.4	6.5	5.1	1.4
New losses $250,000-$1,000,000	7.4	7.4	0.0	7.1	7.5	(0.4)
Case reserve development above $250,000	8.7	5.4	3.3	7.2	5.8	1.4
Total large loss ratio	22.7	18.9	3.8	22.3	20.0	2.3
Other losses excluding catastrophe losses	25.3	29.6	(4.3)	27.0	30.2	(3.2)
Catastrophe losses	29.6	10.5	19.1	17.1	6.2	10.9
Total loss ratio	77.6 %	59.0 %	18.6	66.4 %	56.4 %	10.0

We continue to monitor new losses and case reserve increases greater than $250,000 for trends in factors such as initial reserve levels, loss cost inflation and claim settlement expenses. 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 commercial lines total large losses incurred of $121 million is roughly in line with the $119 million quarterly average during 2010, while the $102 million for the 2010 second quarter was unusually low. In the second quarter of 2011, the ratio for these large losses and case reserve increases was 3.8 percentage points higher compared with last year’s second quarter, primarily due to a higher incurred losses for weather-related claims and general liability and director and officer liability coverages. The second-quarter increase in losses added to the ratio for total large losses incurred for the first six months of 2011, which also includes higher number of claims and incurred losses for our commercial property line of business during the first quarter. 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.

Commercial Lines of Business Analysis

Approximately 95 percent of our commercial lines premiums relate to accounts with coverages from more than one of our business lines. As a result, we believe that the commercial lines segment is best measured and evaluated on a segment basis. However, we provide line of business data to summarize premium and loss trends separately for each line. The ratios shown in the table below are components of loss and loss expenses as a percentage of earned premiums.

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2011	2010	Change %	2011	2010	Change %
Commercial casualty:						
Written premiums	$ 177	$ 168	5	$ 366	$ 359	2
Earned premiums	180	172	5	352	336	5
Current accident year before catastrophe losses	66.0 %	73.6 %		72.3 %	72.3 %	
Current accident year catastrophe losses	0.0	0.0		0.0	0.0	
Prior accident years before catastrophe losses	(27.2)	(25.3)		(29.7)	(19.2)	
Prior accident years catastrophe losses	0.0	0.0		0.0	0.0	
Total loss and loss expenses ratio	38.8 %	48.3 %		42.6 %	53.1 %	
Commercial property:						
Written premiums	$ 123	$ 124	(1)	$ 255	$ 253	1
Earned premiums	115	121	(5)	241	242	0
Current accident year before catastrophe losses	76.8 %	56.6 %		70.5 %	59.4 %	
Current accident year catastrophe losses	78.8	39.1		45.6	24.8	
Prior accident years before catastrophe losses	(1.7)	(3.1)		3.4	(1.4)	
Prior accident years catastrophe losses	1.1	(2.4)		2.3	(2.3)	
Total loss and loss expenses ratio	155.0 %	90.2 %		121.8 %	80.5 %	
Commercial auto:						
Written premiums	$ 102	$ 99	3	$ 209	$ 202	3
Earned premiums	96	96	0	192	191	1
Current accident year before catastrophe losses	72.6 %	69.5 %		74.5 %	68.8 %	
Current accident year catastrophe losses	6.2	4.4		3.3		