CINCINNATI FINANCIAL CORP
Form 10-Q
April 24, 2014

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 March 31, 2014.

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

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

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

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

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

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

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

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

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

¨Yes þ No

As of April 21, 2014, there were 163,519,128 shares of common stock outstanding.

CINCINNATI FINANCIAL CORPORATION
FORM 10-Q FOR THE QUARTER ENDED March 31, 2014

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Item 1. Financial Statements (unaudited)

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions except per share data)	March 31, 2014	December 31, 2013
Assets		
Investments		
Fixed maturities, at fair value (amortized cost: 2014—$8,609; 2013—$8,638)	$9,180	$9,121
Equity securities, at fair value (cost: 2014—$2,545; 2013—$2,523)	4,426	4,375
Other invested assets	72	68
Total investments	13,678	13,564
Cash and cash equivalents	521	433
Investment income receivable	116	121
Finance receivable	83	85
Premiums receivable	1,396	1,346
Reinsurance recoverable	546	547
Prepaid reinsurance premiums	27	26
Deferred policy acquisition costs	564	565
Land, building and equipment, net, for company use (accumulated depreciation: 2014—$424; 2013—$420)	207	210
Other assets	79	73
Separate accounts	725	692
Total assets	$17,942	$17,662
Liabilities		
Insurance reserves		
Loss and loss expense reserves	$4,375	$4,311
Life policy and investment contract reserves	2,435	2,390
Unearned premiums	2,035	1,976
Other liabilities	545	611
Deferred income tax	721	673
Note payable	104	104
Long-term debt and capital lease obligations	834	835
Separate accounts	725	692
Total liabilities	11,774	11,592
Commitments and contingent liabilities (Note 12)	—	—
Shareholders' Equity		
Common stock, par value—$2 per share; (authorized: 2014 and 2013—500 million shares; issued: 2014 and 2013—198 million shares)	397	397
Paid-in capital	1,191	1,191
Retained earnings	4,287	4,268
Accumulated other comprehensive income	1,578	1,504
Treasury stock at cost (2014 and 2013—35 million shares)	(1,285)	(1,290)
Total shareholders' equity	6,168	6,070
Total liabilities and shareholders' equity	$17,942	$17,662

Accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In millions except per share data)	Three months ended March 31,	
	2014	2013
Revenues		
Earned premiums	$1,027	$931
Investment income, net of expenses	135	128
Realized investment gains, net	22	41
Fee revenues	3	1
Other revenues	2	2
Total revenues	1,189	1,103
Benefits and Expenses		
Insurance losses and policyholder benefits	732	568
Underwriting, acquisition and insurance expenses	320	300
Interest expense	14	13
Other operating expenses	4	5
Total benefits and expenses	1,070	886
Income Before Income Taxes	119	217
Provision for Income Taxes		
Current	20	54
Deferred	8	9
Total provision for income taxes	28	63
Net Income	$91	$154
Per Common Share		
Net income—basic	$0.56	$0.95
Net income—diluted	0.55	0.94

Accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)	Three months ended March 31, 2014	2013
Net Income	$91	$154
Other Comprehensive Income		
Unrealized gains on investments available-for-sale, net of tax of $41 and $124, respectively	76	232
Net change in pension actuarial loss and prior service cost, net of tax of $0 and $1, respectively	(1)	1
Change in life deferred acquisition costs, life policy reserves and other, net of tax of $0 and $0, respectively	(1)	—
Other comprehensive income, net of tax	74	233
Comprehensive Income	$165	$387

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

(In millions)	Common Stock Outstanding Shares	Amount	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Share-holders' Equity
Balance December 31, 2012	163	$394	$1,134	$4,021	$1,129	$(1,225)	$5,453
Net income	—	—	—	154	—	—	154
Other comprehensive income, net	—	—	—	—	233	—	233
Dividends declared	—	—	—	(66)	—	—	(66)
Treasury stock acquired—share repurchase authorization	—	—	—	—	—	—	—
Other	—	1	12	—	—	(2)	11
Balance March 31, 2013	163	$395	$1,146	$4,109	$1,362	$(1,227)	$5,785
Balance December 31, 2013	163	$397	$1,191	$4,268	$1,504	$(1,290)	$6,070
Net income	—	—	—	91	—	—	91
Other comprehensive income, net	—	—	—	—	74	—	74
Dividends declared	—	—	—	(72)	—	—	(72)
Treasury stock acquired—share repurchase authorization	—	—	—	—	—	(7)	(7)
Other	—	—	—	—	—	12	12
Balance March 31, 2014	163	$397	$1,191	$4,287	$1,578	$(1,285)	$6,168

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)	Three months ended March 31, 2014	2013
Cash Flows From Operating Activities		
Net income	$91	$154
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	13	9
Realized gains on investments, net	(22)	(41)
Stock-based compensation	6	5
Interest credited to contract holders	10	11
Deferred income tax expense	8	9
Changes in:		
Investment income receivable	5	(2)
Premiums and reinsurance receivable	(50)	(82)
Deferred policy acquisition costs	(5)	(19)
Other assets	(5)	(2)
Loss and loss expense reserves	64	10
Life policy reserves	49	13
Unearned premiums	59	83
Other liabilities	(102)	(88)
Current income tax receivable/payable	8	(3)
Net cash provided by operating activities	129	57
Cash Flows From Investing Activities		
Sale of fixed maturities	24	12
Call or maturity of fixed maturities	252	221
Sale of equity securities	31	98
Purchase of fixed maturities	(236)	(325)
Purchase of equity securities	(33)	(108)
Investment in finance receivables	(4)	(8)
Collection of finance receivables	7	7
Investment in buildings and equipment, net	(3)	(1)
Change in other invested assets, net	1	2
Net cash provided by (used in) investing activities	39	(102)
Cash Flows From Financing Activities		
Payment of cash dividends to shareholders	(67)	(65)
Purchase of treasury shares	(7)	—
Proceeds from stock options exercised	8	6
Contract holders' funds deposited	20	24
Contract holders' funds withdrawn	(32)	(31)
Other	(2)	4
Net cash used in financing activities	(80)	(62)
Net change in cash and cash equivalents	88	(107)
Cash and cash equivalents at beginning of year	433	487
Cash and cash equivalents at end of period	$521	$380
Supplemental disclosures of cash flow information:		
Interest paid	$—	$—
Income taxes paid	11	54
Non-cash activities:		

Conversion of securities	$—	$43
Equipment acquired under capital lease obligations	5	12
Cashless exercise of stock options	4	9

Accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 — ACCOUNTING POLICIES
The condensed consolidated financial statements include the accounts of Cincinnati Financial Corporation and its consolidated subsidiaries, each of which is wholly owned. These statements are presented in conformity with accounting principles generally accepted in the United States of America (GAAP). All intercompany balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Our actual results could differ from those estimates. Our December 31, 2013, condensed consolidated balance sheet amounts are derived from the audited financial statements but do not include all disclosures required by GAAP.

Our March 31, 2014, 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 2013 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.

NOTE 2 – INVESTMENTS

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

(In millions)	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
At March 31, 2014				
Fixed maturity securities:				
States, municipalities and political subdivisions	$3,113	$143	$12	$3,244
Convertibles and bonds with warrants attached	17	—	—	17
United States government	7	—	—	7
Government-sponsored enterprises	211	—	20	191
Foreign government	10	—	—	10
Commercial mortgage-backed	206	2	2	206
Corporate	5,045	468	8	5,505
Subtotal	8,609	613	42	9,180
Equity securities:				
Common equities	2,418	1,845	6	4,257
Nonredeemable preferred equities	127	43	1	169
Subtotal	2,545	1,888	7	4,426
Total	$11,154	$2,501	$49	$13,606
At December 31, 2013				
Fixed maturity securities:				
States, municipalities and political subdivisions	$3,107	$125	$21	$3,211
Convertibles and bonds with warrants attached	17	—	—	17
United States government	7	—	—	7
Government-sponsored enterprises	227	—	27	200
Foreign government	10	—	—	10
Commercial mortgage-backed	148	—	5	143
Corporate	5,122	433	22	5,533
Subtotal	8,638	558	75	9,121
Equity securities:				
Common equities	2,396	1,818	1	4,213
Nonredeemable preferred equities	127	38	3	162
Subtotal	2,523	1,856	4	4,375
Total	$11,161	$2,414	$79	$13,496

The net unrealized investment gains in our fixed-maturity portfolio are primarily the result of the continued low interest rate environment that increased the fair value of our fixed-maturity portfolio. The five largest unrealized investment gains in our common stock portfolio are from Exxon Mobil Corporation (NYSE:XOM), The Procter & Gamble Company (NYSE:PG), Honeywell International Incorporated (NYSE:HON), Chevron Corporation (NYSE:CVX), and Dover Corporation (NYSE:DOV), which had a combined gross unrealized gain of $431 million. At March 31, 2014, we had $17 million fair value of hybrid securities included in fixed maturities that follow Accounting Standards Codification (ASC) 815-15-25, Accounting for Certain Hybrid Financial Instruments, compared with $18 million fair value of hybrid securities at December 31, 2013. 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 gross 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	Total
At March 31, 2014	Fair value	Unrealized losses	Fair value	Unrealized losses	fair value	unrealized losses
Fixed maturity securities:						
States, municipalities and political subdivisions	$289	$7	$98	$5	$387	$12
United States government	11	—	—	—	11	—
Government-sponsored enterprises	83	8	96	12	179	20
Commercial mortgage-backed	55	1	15	1	70	2
Corporate	291	7	65	1	356	8
Subtotal	729	23	274	19	1,003	42
Equity securities:						
Common equities	72	6	—	—	72	6
Nonredeemable preferred equities	39	1	—	—	39	1
Subtotal	111	7	—	—	111	7
Total	$840	$30	$274	$19	$1,114	$49
At December 31, 2013						
Fixed maturity securities:						
States, municipalities and political subdivisions	$490	$18	$42	$3	$532	$21
United States government	1	—	—	—	1	—
Government-sponsored enterprises	199	27	1	—	200	27
Foreign government	10	—	—	—	10	—
Commercial mortgage-backed	125	5	—	—	125	5
Corporate	572	20	43	2	615	22
Subtotal	1,397	70	86	5	1,483	75
Equity securities:						
Common equities	77	1	—	—	77	1
Nonredeemable preferred equities	42	3	—	—	42	3
Subtotal	119	4	—	—	119	4
Total	$1,516	$74	$86	$5	$1,602	$79

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

(In millions)	Three months ended March 31, 2014	2013
Investment income summary:		
Interest on fixed maturities	$104	$102
Dividends on equity securities	32	27
Other investment income	1	1
Total	137	130
Less investment expenses	2	2
Total	$135	$128
Realized investment gains and losses summary:		
Fixed maturities:		
Gross realized gains	$2	$2
Gross realized losses	—	—
Other-than-temporary impairments	—	(2)
Equity securities:		
Gross realized gains	18	37
Gross realized losses	—	—
Other-than-temporary impairments	(1)	—
Securities with embedded derivatives	(1)	1
Other	4	3
Total	$22	$41
Change in unrealized gains and losses summary:		
Fixed maturities	$88	$(25)
Equity securities	29	381
Net change in pension actuarial loss and prior service cost	(1)	2
Adjustment to deferred acquisition costs and life policy reserves	(3)	3
Other	2	(3)
Income taxes on above	(41)	(125)
Total	$74	$233

During the three months ended March 31, 2014 and 2013, there were no credit losses on fixed-maturity securities for which a portion of other-than-temporary impairment (OTTI) has been recognized in other comprehensive income.

During the quarter ended March 31, 2014, there were two equity securities and one fixed-maturity security other-than-temporarily impaired. At March 31, 2014, ninety-nine fixed-maturity investments with a total unrealized loss of $19 million had been in an unrealized loss position for 12 months or more. Of that total, no fixed-maturity investments had fair values below 70 percent of amortized cost. One equity investment with a total unrealized loss of less than $500,000 had been in an unrealized loss position for 12 months or more as of March 31, 2014. This equity investment was not trading below 70 percent of cost.

During 2013, we other-than-temporarily impaired seven fixed-maturity securities. At December 31, 2013, forty fixed-maturity investments with a total unrealized loss of $5 million had been in an unrealized loss position for 12 months or more. Of that total, no fixed-maturity investments had fair values below 70 percent of amortized cost. There were no equity investments in an unrealized loss position for 12 months or more as of December 31, 2013.

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, 2013, and ultimately management determines fair value. See our 2013 Annual Report on Form 10-K, Item 8, Note 3, Fair Value Measurements, Page 121, for information on characteristics and valuation techniques used in determining fair value.

Fair Value Disclosures for Assets

The following tables illustrate the fair value hierarchy for those assets measured at fair value on a recurring basis at March 31, 2014, and December 31, 2013. We do not have any material liabilities carried at fair value. There were no transfers between Level 1 and Level 2.

(In millions) At March 31, 2014	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	$—	$3,244	$—	$3,244
Convertibles and bonds with warrants attached	—	17	—	17
United States government	7	—	—	7
Government-sponsored enterprises	—	191	—	191
Foreign government	—	10	—	10
Commercial mortgage-backed	—	201	5	206
Corporate	—	5,497	8	5,505
Subtotal	7	9,160	13	9,180
Common equities, available for sale	4,257	—	—	4,257
Nonredeemable preferred equities, available for sale	—	167	2	169
Separate accounts taxable fixed maturities	—	700	—	700
Top Hat Savings Plan mutual funds and common equity (included in Other assets)	17	—	—	17
Total	$4,281	$10,027	$15	$14,323
At December 31, 2013				
Fixed maturities, available for sale:				
States, municipalities and political subdivisions	$—	$3,211	$—	$3,211
Convertibles and bonds with warrants attached	—	17	—	17
United States government	7	—	—	7
Government-sponsored enterprises	—	200	—	200
Foreign government	—	10	—	10
Commercial mortgage-backed	—	143	—	143
Corporate	—	5,531	2	5,533
Subtotal	7	9,112	2	9,121
Common equities, available for sale	4,213	—	—	4,213
	—	160	2	162

Nonredeemable preferred equities, available for sale				
Separate accounts taxable fixed-maturities	—	682	—	682
Top Hat Savings Plan mutual funds and common equity (included in Other assets)	14	—	—	14
Total	$4,234	$9,954	$4	$14,192

Each financial instrument that was deemed to have significant unobservable inputs when determining valuation is identified in the following tables by security type with a summary of changes in fair value as of March 31, 2014. Total Level 3 assets continue to be less than 1 percent of financial assets measured at fair value in the condensed consolidated balance sheets. Assets presented in the table below were valued based primarily on broker/dealer quotes for which there is a lack of transparency as to inputs used to develop the valuations. The quantitative detail of these unobservable inputs is neither provided nor reasonably available to us.

The following tables provide the change in Level 3 assets for the three months ended March 31:

(In millions)	Asset fair value measurements using significant unobservable inputs (Level 3)				
	Corporate fixed maturities	Commercial mortgage-backed fixed maturities	States, municipalities and political subdivisions fixed maturities	Nonredeemable preferred equities	Total
Beginning balance, January 1, 2014	$2	$—	$—	$2	$4
Total gains or losses (realized/unrealized):					
Included in net income	—	—	—	—	—
Included in other comprehensive income	—	—	—	—	—
Purchases	—	—	—	—	—
Sales	—	—	—	—	—
Transfers into Level 3	6	5	—	—	11
Transfers out of Level 3	—	—	—	—	—
Ending balance, March 31, 2014	$8	$5	$—	$2	$15
Beginning balance, January 1, 2013	$3	$—	$1	$1	$5
Total gains or losses (realized/unrealized):					
Included in net income	—	—	—	—	—
Included in other comprehensive income	—	—	—	—	—
Purchases	—	—	—	1	1
Sales	—	—	—	—	—
Transfers into Level 3	—	—	—	—	—
Transfers out of Level 3	—	—	—	—	—
Ending balance, March 31, 2013	$3	$—	$1	$2	$6

Additional disclosures for the Level 3 category are not material.

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

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

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

(In millions)				Book value		Principal amount	
Interest rate		Year of issue		March 31, 2014	December 31, 2013	March 31, 2014	December 31, 2013
6.900	%	1998	Senior debentures, due 2028	$28	$28	$28	$28
6.920	%	2005	Senior debentures, due 2028	391	391	391	391
6.125	%	2004	Senior notes, due 2034	371	371	374	374
			Total	$790	$790	$793	$793

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

(In millions) At March 31, 2014	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Note payable	$—	$104	$—	$104
6.900% senior debentures, due 2028	—	32	—	32
6.920% senior debentures, due 2028	—	470	—	470
6.125% senior notes, due 2034	—	419	—	419
Total	$—	$1,025	$—	$1,025
At December 31, 2013				
Note payable	$—	$104	$—	$104
6.900% senior debentures, due 2028	—	30	—	30
6.920% senior debentures, due 2028	—	458	—	458
6.125% senior notes, due 2034	—	399	—	399
Total	$—	$991	$—	$991

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

(In millions) At March 31, 2014	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Life policy loans	$—	$—	$44	$44
At December 31, 2013				
Life policy loans	$—	$—	$45	$45

Outstanding principal and interest for these life policy loans was $35 million and $36 million at March 31, 2014, and December 31, 2013, respectively.

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

(In millions) At March 31, 2014	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Deferred annuities	$—	$—	$900	$900
Structured settlements	—	212	—	212
Total	$—	$212	$900	$1,112
At December 31, 2013				
Deferred annuities	$—	$—	$911	$911
Structured settlements	—	219	—	219
Total	$—	$219	$911	$1,130

Recorded reserves for the deferred annuities and structured settlements were $1.051 billion at March 31, 2014, and December 31, 2013.

NOTE 4 – PROPERTY CASUALTY LOSS AND LOSS EXPENSES

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

(In millions)	Three months ended March 31, 2014	2013
Gross loss and loss expense reserves, beginning of period	$4,241	$4,169
Less reinsurance receivable	299	356
Net loss and loss expense reserves, beginning of period	3,942	3,813
Net incurred loss and loss expenses related to:		
Current accident year	705	534
Prior accident years	(29)	(10)
Total incurred	676	524
Net paid loss and loss expenses related to:		
Current accident year	197	121
Prior accident years	387	392
Total paid	584	513
Net loss and loss expense reserves, end of period	4,034	3,824
Plus reinsurance receivable	289	349
Gross loss and loss expense reserves, end of period	$4,323	$4,173

We use actuarial methods, models and judgment to estimate, as of a financial statement date, the property casualty loss and loss expense reserves required to pay for and settle all outstanding insured claims, including incurred but not reported (IBNR) claims, as of that date. The actuarial estimate is subject to review and adjustment by an inter-departmental committee that includes actuarial management that is familiar with relevant company and industry business, claims and underwriting trends, as well as general economic and legal trends that could affect future loss and loss expense payments. The amount we will actually have to pay for claims can be highly uncertain. This uncertainty, together with the size of our reserves, makes the loss and loss expense reserves our most significant estimate. The reserve for loss and loss expenses in the condensed consolidated balance sheets also included $52 million at March 31, 2014, and $67 million at March 31, 2013, for certain life and health loss and loss expense reserves.

For the three months ended March 31, 2014, we experienced $29 million of favorable development on prior accident years, including $3 million of favorable development in commercial lines, $17 million of favorable development in personal lines and $9 million favorable development in excess and surplus lines. This included $9 million from favorable development of catastrophe losses for the three months ended March 31, 2014, compared with $7 million of favorable development of catastrophe losses for the three months ended March 31, 2013.

NOTE 5 – LIFE POLICY AND INVESTMENT CONTRACT RESERVES

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

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

This table summarizes our life policy and investment contract reserves:

(In millions)	March 31, 2014	December 31, 2013
Ordinary/traditional life	$830	$815
Universal life	509	508
Deferred annuities	864	862
Structured settlements	187	189
Other	45	16
Total life policy and investment contract reserves	$2,435	$2,390

NOTE 6 – DEFERRED ACQUISITION COSTS

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

(In millions)	Three months ended March 31, 2014	2013
Deferred policy acquisition costs asset, beginning of period	$565	$470
Capitalized deferred policy acquisition costs	206	198
Amortized deferred policy acquisition costs	(201)	(179)
Amortized shadow deferred policy acquisition costs	(6)	2
Deferred policy acquisition costs asset, end of period	$564	$491

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

NOTE 7 – ACCUMULATED OTHER COMPREHENSIVE INCOME

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

(In millions)	Three months ended March 31,					
	2014			2013		
	Before tax	Income tax	Net	Before tax	Income tax	Net
Accumulated unrealized gains, net, on investments available for sale, beginning of period	$2,335	$808	$1,527	$1,875	$647	$1,228
Other comprehensive income before reclassification	135	48	87	397	139	258
Reclassification adjustment for realized investment gains, net, included in net income	(18)	(7)	(11)	(41)	(15)	(26)
Effect on other comprehensive income	117	41	76	356	124	232
Accumulated unrealized gains, net, on investments available for sale, end of period	$2,452	$849	$1,603	$2,231	$771	$1,460
Accumulated unrealized losses, net, for pension obligations, beginning of period	$(18)	$(6)	$(12)	$(101)	$(35)	$(66)
Effect on other comprehensive income	(1)	—	(1)	2	1	1
Accumulated unrealized losses, net, for pension obligations, end of period	$(19)	$(6)	$(13)	$(99)	$(34)	$(65)
Accumulated unrealized losses, net, on life deferred acquisition costs, life policy reserves and other, beginning of period	$(16)	$(5)	$(11)	$(50)	$(17)	$(33)
Other comprehensive income before reclassification	3	1	2	—	—	—
Reclassification adjustment for life deferred acquisition costs, life policy reserves and other, net, included in net income	(4)	(1)	(3)	—	—	—
Effect on other comprehensive income	(1)	—	(1)	—	—	—
Accumulated unrealized losses, net, on life deferred acquisition costs, life policy reserves and other, end of period	$(17)	$(5)	$(12)	$(50)	$(17)	$(33)
Accumulated other comprehensive income, beginning of period	$2,301	$797	$1,504	$1,724	$595	$1,129
Change in unrealized gains, net, on investments available for sale	117	41	76	356	124	232
Change in pension obligations	(1)	—	(1)	2	1	1
	(1)	—	(1)	—	—	—

Change in life deferred acquisition costs, life policy reserves and other						
Effect on other comprehensive income	115	41	74	358	125	233
Accumulated other comprehensive income, end of period	$2,416	$838	$1,578	$2,082	$720	$1,362

The reclassification adjustment for realized gains on investments available for sale and life deferred acquisition costs, life policy reserves and other is recorded in the total realized investment gains, net, line item of the condensed consolidated statements of income.

NOTE 8 – REINSURANCE
Reinsurance mitigates the risk of highly uncertain exposures and limits the maximum net loss that can arise from large risks or risks concentrated in areas of exposure. Management's decisions about the appropriate level of risk retention are affected by various factors, including changes in our underwriting practices, capacity to retain risks and reinsurance market conditions.

Primary components of our property casualty reinsurance program include a property per risk treaty, property excess treaty, casualty per occurrence treaty, casualty excess treaty, property catastrophe treaty and catastrophe bonds.

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

(In millions)	Three months ended March 31,	
	2014	2013
Direct earned premiums	$1,019	$935
Assumed earned premiums	3	2
Ceded earned premiums	(43)	(48)
Net earned premiums	$979	$889

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

(In millions)	Three months ended March 31,	
	2014	2013
Direct incurred loss and loss expenses	$677	$535
Assumed incurred loss and loss expenses	2	2
Ceded incurred loss and loss expenses	(3)	(13)
Net incurred loss and loss expenses	$676	$524

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

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

(In millions)	Three months ended March 31,	
	2014	2013
Direct earned premiums	$62	$56
Ceded earned premiums	(14)	(14)
Net earned premiums	$48	$42

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

(In millions)	Three months ended March 31,	
	2014	2013
Direct policyholders' benefits incurred	$80	$64
Ceded policyholders' benefits incurred	(24)	(20)
Net policyholders' benefits incurred	$56	$44

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

NOTE 9 – INCOME TAXES

As of March 31, 2014, and December 31, 2013, we had no liability for unrecognized tax benefits.

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

(In millions)	Three months ended March 31,			
	2014		2013	
Tax at statutory rate	$42	35.0 %	$76	35.0 %
Increase (decrease) resulting from:				
Tax-exempt income from municipal bonds	(8)	(6.7)	(8)	(3.7)
Dividend received exclusion	(7)	(5.9)	(6)	(2.6)
Other	1	1.1	1	0.3
Provision for income taxes	$28	23.5 %	$63	29.0 %

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

NOTE 10 – NET INCOME PER COMMON SHARE

Basic earnings per share are computed based on the weighted average number of common shares outstanding. Diluted earnings per share are computed based on the weighted average number of common and dilutive potential common shares outstanding using the treasury stock method. The table shows calculations for basic and diluted earnings per share:

(In millions except per share data)	Three months ended March 31,	
	2014	2013
Numerator:		
Net income—basic and diluted	$91	$154
Denominator:		
Basic weighted-average common shares outstanding	163.4	163.1
Effect of stock-based awards:		
Stock options	1.0	1.0
Nonvested shares	0.6	0.8
Adjusted diluted weighted-average shares	165.0	164.9
Earnings per share:		
Basic	$0.56	$0.95
Diluted	0.55	0.94
Number of anti-dilutive stock-based awards	0.7	2.1

The sources of dilution of our common shares are certain equity-based awards. See our 2013 Annual Report on Form 10-K, Item 8, Note 17, Share-Based Associate Compensation Plans, Page 154, for information about equity-based awards. The above table shows the number of anti-dilutive stock-based awards for the three months ended March 31, 2014 and 2013. We did not include these stock-based awards in the computation of net income per common share (diluted) because their exercise would have anti-dilutive effects.

NOTE 11 – EMPLOYEE RETIREMENT BENEFITS

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

(In millions)	Three months ended March 31,	
	2014	2013
Service cost	$2	$3
Interest cost	4	3
Expected return on plan assets	(4)	(4)
Amortization of actuarial loss and prior service cost	1	2
Net periodic benefit cost	$3	$4

See our 2013 Annual Report on Form 10-K, Item 8, Note 13, Employee Retirement Benefits, Page 148, for information on our retirement benefits. We made matching contributions of $4 million and $3 million to our 401(k) and Top Hat savings plans during the first quarters of 2014 and 2013.

We contributed $5 million to our qualified pension plan during the first quarter of 2014. We do not anticipate further contributions to our qualified pension plan during the remainder of 2014.

NOTE 12 – COMMITMENTS AND CONTINGENT LIABILITIES

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

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

On a quarterly basis, we review these outstanding matters. Under current accounting guidance, we establish accruals when it is probable that a loss has been incurred and we can reasonably estimate its potential exposure. The company accounts for such probable and estimable losses, if any, through the establishment of legal expense reserves. Based on our quarterly review, we believe that our accruals for probable and estimable losses are reasonable and that the amounts accrued do not have a material effect on our consolidated financial condition or results of operations. However, if any one or more of these matters results in a judgment against us or settlement for an amount that is significantly greater than the amount accrued, the resulting liability could have a material effect on the company's consolidated results of operations or cash flows. Based on our most recent review, our estimate for any other matters for which the risk of loss is not probable, but more than remote, is less than $1 million.

NOTE 13 – SEGMENT INFORMATION

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

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

We report as Other the noninvestment operations of the parent company and its noninsurer subsidiary, CFC Investment Company. See our 2013 Annual Report on Form 10-K, Item 8, Note 18, Segment Information, Page 156, 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 March 31,	
	2014	2013
Revenues:		
Commercial lines insurance		
Commercial casualty	$224	$204
Commercial property	171	147
Commercial auto	126	114
Workers' compensation	92	88
Specialty packages	36	39
Management liability and surety	31	29
Machinery and equipment	12	10
Commercial lines insurance premiums	692	631
Fee revenue	1	—
Total commercial lines insurance	693	631
Personal lines insurance		
Personal auto	116	107
Homeowner	109	96
Other personal lines	29	28
Personal lines insurance premiums	254	231
Excess and surplus lines insurance	33	27
Life insurance premiums	48	42
Separate account investment management fees	2	1
Total life insurance	50	43
Investment operations		
Investment income, net of expenses	135	128
Realized investment gains, net	22	41
Total investment revenue	157	169
Other	2	2
Total revenues	$1,189	$1,103
Income (loss) before income taxes:		
Insurance underwriting results		
Commercial lines insurance	$2	$58
Personal lines insurance	(7)	20
Excess and surplus lines insurance	4	—
Life insurance	—	7
Investment operations	136	148
Other	(16)	(16)
Total income before income taxes	$119	$217
Identifiable assets:	March 31, 2014	December 31, 2013
Property casualty insurance	$2,493	$2,455
Life insurance	1,302	1,225
Investment operations	13,730	13,618
Other	417	364

Total	$17,942	$17,662

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. It should be read in conjunction with the consolidated financial statements and related notes included in our 2013 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 2013 Annual Report on Form 10-K, Item 1A, Risk Factors, Page 31.

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 or development of claims that are unforeseen at the time of policy issuance
- Inadequate estimates or assumptions used for critical accounting estimates
- Declines in overall stock market values negatively affecting the company's equity portfolio and book value
- Events resulting in capital market or credit market uncertainty, followed by prolonged periods of economic instability or recession, that lead to:
  - Significant or prolonged decline in the value of a particular security or group of securities and impairment of the asset(s)
  - Significant decline in investment income due to reduced or eliminated dividend payouts from a particular security or group of securities
  - Significant rise in losses from surety and director and officer policies written for financial institutions or other insured entities
- Prolonged low interest rate environment or other factors that limit the company's ability to generate growth in investment income or interest rate fluctuations that result in declining values of fixed-maturity investments, including declines in accounts in which we hold bank-owned life insurance contract assets
- Recession or other economic conditions resulting in lower demand for insurance products or increased payment delinquencies
- Difficulties with technology or data security breaches, including cyberattacks, that could negatively affect our ability to conduct business and our relationships with agents, policyholders and others
- Disruption of the insurance market caused by technology innovations, such as driverless cars, that could decrease consumer demand for insurance products
- Delays or performance inadequacies from ongoing development and implementation of underwriting and pricing methods, including telematics and other usage-based insurance methods, or technology projects and enhancements expected to increase our pricing accuracy, underwriting profit and competitiveness
- 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 nonpayment or delay in payment by reinsurers

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

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

CORPORATE FINANCIAL HIGHLIGHTS

Net Income and Comprehensive Income Data
(In millions except per share data)

	Three months ended March 31,		
	2014	2013	% Change
Net income and comprehensive income data:			
Earned premiums	$1,027	$931	10
Investment income, net of expenses (pretax)	135	128	5
Realized investment gains and losses, net (pretax)	22	41	(46)
Total revenues	1,189	1,103	8
Net income	91	154	(41)
Comprehensive income	165	387	(57)
Net income - diluted	$0.55	$0.94	(41)
Cash dividends declared	0.44	0.4075	8
Adjusted weighted average shares outstanding	165.0	164.9	—

Revenues rose for the first quarter of 2014 compared with first-quarter 2013, primarily due to growth in earned premiums. Premium and investment revenue trends are discussed further in the respective sections of Results of Operations.

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

Net income for the first quarter of 2014 compared with the same quarter of 2013 decreased $63 million, primarily due to a decrease in property casualty underwriting income of $51 million after taxes. Higher catastrophe losses, mostly weather related, accounted for $50 million of that decrease. After-tax investment income in our investment segment results for the first quarter of 2014 rose $6 million compared with the same quarter of 2013. First-quarter 2014 after-tax net realized investment gains and losses were $12 million lower than the same quarter a year ago.

Performance by segment is discussed below in Results of Operations. As discussed in our 2013 Annual Report on Form 10-K, Item 7, Factors Influencing Our Future Performance, Page 48, there are several reasons that our performance during 2014 may be below our long-term targets. In that annual report, as part of Results of Operations, we also discussed the full-year 2014 outlook for each reporting segment.

The board of directors is committed to rewarding shareholders directly through cash dividends and through share repurchase authorizations. Through 2013, the company had increased the indicated annual cash dividend rate for 53 consecutive years, a record we believe was matched by only nine other publicly traded companies. In January 2014, the board of directors increased the second-quarter dividend to 44 cents per share, setting the stage for our 54th consecutive year of increasing cash dividends. During the first three months of 2014, cash dividends declared by the company increased approximately 8 percent compared with the same period of 2013. That increase reflected board actions in both August 2013 and January 2014 that raised the per-share amount of regular dividends. Our board regularly evaluates relevant factors in decisions related to dividends and share repurchases. The 2014 dividend increase signaled management's and the board's confidence in our outstanding capital, liquidity and financial flexibility, in addition to strong earnings performance.

Balance Sheet Data and Performance Measures

(In millions except share data)	At March 31, 2014	At December 31, 2013
Balance sheet data:		
Invested assets	$13,678	$13,564
Total assets	17,942	17,662
Short-term debt	104	104
Long-term debt	790	790
Shareholders' equity	6,168	6,070
Book value per share	37.73	37.21
Debt-to-total-capital ratio	12.7 %	12.8 %

Total assets at March 31, 2014, increased 2 percent compared with year-end 2013, largely due to growth in invested assets that was driven by higher valuation. A higher amount of cash and cash equivalents contributed almost one-third of the increase in total assets. Shareholders' equity rose 2 percent, and book value per share rose 1 percent during the first three months of 2014. Our debt-to-total-capital ratio (capital is the sum of debt plus shareholders' equity) decreased slightly compared with year-end 2013. The value creation ratio, a non-GAAP measure defined below, was lower for the first three months of 2014 compared with 2013, primarily due to less benefit from the rise in unrealized investment gains for our equity portfolio. The $0.52 increase in book value per share during the first three months of 2014 contributed 1.4 percentage points to the value creation ratio, while dividends declared at $0.44 per share contributed 1.2 points. Value creation ratio trends in total and by major components, along with a reconciliation of the non-GAAP measure to comparable GAAP measures, are shown in the tables below.

	Three months ended March 31, 2014	2013
Value creation ratio major components:		
Net income before realized gains	1.3 %	2.3 %
Change in realized and unrealized gains, fixed-maturity securities	0.9	(0.3)
Change in realized and unrealized gains, equity securities	0.5	5.0
Other	(0.1)	0.0
Value creation ratio	2.6 %	7.0 %

(Dollars are per outstanding share)	Three months ended March 31, 2014	2013
Book value change per share:		
End of period book value	$37.73	$35.41
Less beginning of period book value	37.21	33.48
Change in book value	$0.52	$1.93

Change in book value:		
Net income before realized gains	$0.47	$0.78
Change in realized and unrealized gains, fixed-maturity securities	0.35	(0.09)
Change in realized and unrealized gains, equity securities	0.19	1.66
Dividend declared to shareholders	(0.44)	(0.41)
Other	(0.05)	(0.01)
Total change in book value	$0.52	$1.93

(Dollars are per outstanding share)	Three months ended March 31, 2014	2013
Value creation ratio:		
End of period book value	$37.73	$35.41
Less beginning of period book value	37.21	33.48
Change in book value	0.52	1.93
Dividend declared to shareholders	0.44	0.4075
Total contribution to value creation ratio	$0.96	$2.3375
Contribution to value creation ratio from change in book value*	1.4 %	5.8 %
Contribution to value creation ratio from dividends declared to shareholders**	1.2	1.2
Value creation ratio	2.6 %	7.0 %

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

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 2013 net written premium volume for approximately 2,000 U.S. stock and mutual insurer groups. We market our insurance products through a select group of independent insurance agencies in 39 states as discussed in our 2013 Annual Report on Form 10-K, Item 1, Our Business and Our Strategy, Page 5.

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

To measure our long-term progress in creating shareholder value, we have defined a value creation metric that we believe captures the contribution of our insurance operations, the success of our investment strategy and the importance we place on paying cash dividends to shareholders. This measure, our value creation ratio or VCR, is made up of two primary components: (1) our rate of growth in book value per share plus (2) the ratio of dividends declared per share to beginning book value per share. As discussed in our 2013 Annual Report on Form 10-K, Item 7, Executive Summary, Page 43, for the period 2013 through 2017, an annual value creation ratio averaging 10 percent to 13 percent is our primary performance target. Management believes this non-GAAP measure is a meaningful indicator of our long-term progress in creating shareholder value and is a useful supplement to GAAP information.

Performance Drivers

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

- Premium growth – We believe our agency relationships and initiatives can lead to a property casualty written premium growth rate over any five-year period that exceeds the industry average. For the first three months of 2014, our total property casualty net written premiums' year-over-year growth was 7 percent, comparing favorably with A.M. Best's February 2014 projection of approximately 4 percent full-year growth for the industry. The industry's growth rate excludes its mortgage and financial guaranty lines of business. Our premium growth initiatives are discussed below in Highlights of Our Strategies and Supporting Initiatives.
- Combined ratio – We believe our underwriting philosophy and initiatives can generate a GAAP combined ratio over any five-year period that is consistently within the range of 95 percent to 100 percent. For the first three months of

2014, our GAAP combined ratio was 100.3 percent and our statutory combined ratio was 98.1 percent, both including 9.9 percentage points of current accident year catastrophe losses partially offset by 3.1 percentage points of favorable loss reserve development on prior accident years. As of February 2014, A.M. Best forecasted the industry's full-year 2014 statutory combined ratio at approximately 99 percent, including approximately 5 percentage points of catastrophe losses and a favorable impact of approximately 5 percentage points from prior accident year reserve releases. The industry's ratio again excludes its mortgage and financial guaranty lines of business.

- Investment contribution – We believe our investment philosophy and initiatives can drive investment income growth and lead to a total return on our equity investment portfolio over a five-year period that exceeds the five-year return of the Standard & Poor's 500 Index. For the three months of 2014, pretax investment income was $135 million, up 5 percent compared with the same period in 2013. 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 2013 Annual Report on Form 10-K, Item 1, Our Business and Our Strategy, Page 5. We believe successful implementation of initiatives that support our strategy, summarized below, will help us better serve our agent customers and reduce variability in our financial results while we also grow earnings and book value over the long term, successfully navigating challenging economic, market or industry pricing cycles.

- Improve insurance profitability – Implementation of these initiatives is intended to enhance underwriting expertise and knowledge, thereby increasing our ability to manage our business while also gaining efficiency. Better profit margins can arise from additional information and more focused action on underperforming product lines, plus pricing capabilities we are expanding through the use of technology and analytics. Improved internal processes with additional performance metrics can help us be more efficient and effective. These initiatives also support the ability of the independent agencies that represent us to grow profitably by allowing them to serve clients faster and to more efficiently manage agency expenses.
- Drive premium growth – Implementation of these initiatives is intended to further penetrate each market we serve through our independent agencies. Strategies aimed at specific market opportunities, along with service enhancements, can help our agencies grow and increase our share of their business. Diversified growth also may reduce variability of losses from weather-related catastrophes.

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

Improve Insurance Profitability

The main initiatives to improve our insurance profitability include:

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

Ongoing efforts to expand our pricing precision include enhancement of analytics and predictive modeling tools to better align individual insurance policy pricing to risk attributes. Further integration of such tools with policy administration systems is intended to better target profitability and discuss pricing impacts with agency personnel as we seek to remain competitive on the most desirable business while we rapidly adapt to changes in market conditions. Rate increases that continue to use pricing precision features for our personal auto line of business continue to be implemented, and are effective beginning second-quarter 2014 for many states where we operate. For commercial autos we insure, pricing precision is an ongoing focus through actions such as premium rate classification improvements and the collection and use of commercial vehicle identification numbers. We are also making progress with predictive modeling for dwelling fire policies and development of a by-peril rating plan for homeowner policies. We plan to introduce both in select states during 2014. By-peril rating will improve pricing precision by separately pricing for the risk of losses from distinct perils, such as wind versus fire.

Work continues on initiatives to more profitably underwrite property coverages, including more staff specialization, increased insured property inspections to provide enhanced underwriting knowledge and greater use of deductibles or other policy terms and conditions as policies renew. During the warmer-weather months of 2014, we plan to complete inspections for approximately 130,000 properties, including both homes and businesses. We are also taking other actions, such as increasing our use of higher minimum loss deductible amounts for homeowner policies and per-building deductibles for commercial risks, along with more use of wind and hail deductibles in areas subject to severe convective storm activity.

- Improve internal processes – Improved processes support our strategic goals, reducing internal costs and allowing us to focus more resources on providing agency services. Important process upgrades include continuing to streamline processing between company and agency management systems for more policies. This allows for processing of qualified personal lines or small commercial lines business without intervention by an underwriter or for routing of complex work items to the most appropriate associate for optimal service. Progress during the first quarter of 2014 included deploying this streamlined process for crime and professional coverages in commercial lines accounts. Beginning in April 2014, it was deployed for renewing personal lines policies. Audits of policies processed without an underwriter continue to indicate that the streamlined process is underwriting and issuing policies as intended.

In 2014, we are also enhancing policy processing by migrating additional types of coverages to our e-CLAS® CPP commercial lines policy administration system. During the first quarter, we began e-CLAS processing in two more states for workers' compensation policies. Work also continues for offering enhanced policy billing or payment options and for improving our workflow tools.

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

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

Drive Premium Growth

Primary initiatives to drive premium growth include:

- Expansion of our marketing and service capabilities – We continue to enhance our generalist approach to allow our appointed agencies to better compete in the marketplace by providing services an agent's clients want and need. Expansion initiatives include ongoing development of targeted marketing programs, adding field marketing representatives for additional agency support in selected areas and piloting additional services to select agencies to develop our new customer care center for small commercial business policies. Progress during the first quarter of 2014 included entering the state of Connecticut for personal lines and adding two field marketing representatives to better support agencies in recently subdivided marketing territories for commercial lines operations. We also continued efforts to develop new target market programs and to expand our pilot of a customer care center for small commercial business policies to additional agencies.
- 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 2014, we initially targeted approximately 100 appointments of independent agencies. During the first three months of 2014, we appointed 27 new agencies that write in aggregate approximately $800 million in property casualty premiums annually with various insurance carriers for an average of approximately $30 million per agency. As of March 31, 2014, a total of 1,450 agency relationships market our property casualty insurance products from 1,836 reporting locations. During the first three months of 2014, we also appointed 28 independent life agencies to offer only our life insurance products and services.

We seek to build a close, long-term relationship with each agency we appoint. We carefully evaluate the marketing reach of each new appointment to ensure the territory can support both current and new agencies. Our 132 commercial lines field marketing territories are staffed by marketing representatives averaging 20 years of industry experience and 10 years as a Cincinnati Insurance field marketing representative. Teams of field associates for each territory work together, providing local expertise with support from headquarters associates. This agent-centered business model helps us better understand the accounts we underwrite and creates marketing advantages for our agents. Unique Cincinnati-style service supports our agents as they grow their business and attract more clients in their communities. As a result, we generally have earned a 10 percent share of a property casualty agency's business within 10 years of its appointment.

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

Financial Strength

An important part of our long-term strategy is financial strength, which is described in our 2013 Annual Report on Form 10-K, Item 1, Our Business and Our Strategy, Financial Strength, Page 7. 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 2013 Annual Report on Form 10-K, Item 7, Liquidity and Capital Resources, 2014 Reinsurance Programs, Page 107. Another aspect is our investment portfolios, which remain well-diversified as discussed in this quarterly report Item 3, Quantitative and Qualitative Disclosures about Market Risk. We continue to maintain strong parent-company liquidity and financial strength that increase our flexibility to maintain our cash dividend through all periods and to continue to invest in and expand our insurance operations.

At March 31, 2014, we held $1.628 billion of our cash and invested assets at the parent-company level, of which $1.377 billion, or 84.6 percent, was invested in common stocks, and $137 million, or 8.4 percent, was cash or cash equivalents. Our debt-to-total-capital ratio at 12.7 percent remains well below our target limit. Another important indicator of financial strength is our ratio of property casualty net written premiums to statutory surplus, which was 0.9 to 1 for the 12 months ended March 31, 2014, unchanged from year-end 2013.

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

As of April 23, 2014, our insurer financial strength ratings were:
Insurer Financial Strength Ratings

Rating Agency	Standard Market Property Casualty Insurance Subsidiaries			Life Insurance Subsidiary			Excess and Surplus Lines Insurance Subsidiary			Date of Most Recent Affirmation or Action
			Rating Tier			Rating Tier			Rating Tier	
A.M. Best Co.	A+	Superior	2 of 16	A	Excellent	3 of 16	A	Excellent	3 of 16	Stable outlook (12/19/13)
Fitch Ratings	A+	Strong	5 of 21	A+	Strong	5 of 21	-	-	-	Stable outlook (11/12/13)
Moody's Investors Service	A1	Good	5 of 21	-	-	-	-	-	-	Stable outlook (04/30/13)
Standard & Poor's Ratings Services	A	Strong	6 of 21	A	Strong	6 of 21	-	-	-	Stable outlook (06/24/13)

All of our insurance subsidiaries continue to be highly rated. No ratings agency actions to our insurer financial strength ratings occurred during the first quarter of 2014.

RESULTS OF OPERATIONS

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

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

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

CONSOLIDATED PROPERTY CASUALTY INSURANCE RESULTS OF OPERATIONS

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

(In millions)	Three months ended March 31,		
	2014	2013	% Change
Earned premiums	$979	$889	10
Fee revenues	1	—	nm
Total revenues	980	889	10
Loss and loss expenses from:			
Current accident year before catastrophe losses	609	516	18
Current accident year catastrophe losses	96	18	433
Prior accident years before catastrophe losses	(20)	(3)	(567)
Prior accident years catastrophe losses	(9)	(7)	(29)
Loss and loss expenses	676	524	29
Underwriting expenses	305	287	6
Underwriting (loss) profit	$(1)	$78	nm
Ratios as a percent of earned premiums:			Pt. Change
Current accident year before catastrophe losses	62.3 %	58.1 %	4.2
Current accident year catastrophe losses	9.9	2.0	7.9
Prior accident years before catastrophe losses	(2.1)	(0.3)	(1.8)
Prior accident years catastrophe losses	(1.0)	(0.8)	(0.2)
Loss and loss expenses	69.1	59.0	10.1
Underwriting expenses	31.2	32.2	(1.0)
Combined ratio	100.3 %	91.2 %	9.1
Combined ratio	100.3 %	91.2 %	9.1
Contribution from catastrophe losses and prior years reserve development	6.8	0.9	5.9
Combined ratio before catastrophe losses and prior years reserve development	93.5 %	90.3 %	3.2

Our consolidated property casualty insurance operations generated an underwriting loss of $1 million for the first quarter of 2014, compared with an underwriting profit of $78 million for first-quarter 2013. The $79 million year-over-year change largely reflected $76 million more in losses from weather-related natural catastrophes. Weather-related losses not identified as part of designated catastrophe events for the property casualty industry, typically referred to as noncatastrophe weather losses, also contributed to the 2014 underwriting loss. Noncatastrophe weather-related losses in the first quarter of 2014 totaled $37 million more than first-quarter 2013. The unfavorable effects of higher 2014 weather-related losses in aggregate offset the benefits in the first quarter of higher pricing and our ongoing initiatives to improve pricing precision and loss experience related to claims and loss control practices.

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

Our consolidated property casualty combined ratio for the first quarter of 2014 was 9.1 percentage points higher than the ratio for first three months of 2013. Catastrophe losses were 7.7 percentage points higher, accounting for most of the increase. Noncatastrophe weather-related losses were 3.6 points higher, further contributing to the higher first-quarter 2014 combined ratio.

The combined ratio can be affected significantly by natural catastrophe losses and other large losses as discussed in detail below. The combined ratio can also be affected by updated estimates of loss and loss expense reserves established for claims that occurred in prior periods, referred to as prior accident years. Net favorable development on prior accident year reserves, including reserves for catastrophe losses, lowered the combined ratio by 3.1 percentage points in the first three months of 2014, compared with 1.1 percentage points in the same period of 2013. Net favorable development is discussed in further detail in results of operations by property casualty insurance segment.

The ratio for current accident year loss and loss expenses before catastrophe losses also rose in the first quarter of 2014. The 62.3 percent ratio for the first three months of 2014 increased 4.2 percentage points compared with the 58.1 percent accident year 2013 ratio measured as of March 31, 2013, and was 1.7 points higher than the 60.6 percent accident year 2013 ratio measured as of December 31, 2013. The effects of higher 2014 noncatastrophe weather-related losses offset the effects of overall higher pricing, net of normal loss cost inflation.

The underwriting expense ratio decreased for the first three months of 2014, compared with the same period of 2013, primarily due to higher earned premiums and ongoing expense management efforts.

Consolidated Property Casualty Insurance Premiums

(In millions)	Three months ended March 31,		
	2014	2013	% Change
Agency renewal written premiums	$956	$845	13
Agency new business written premiums	123	135	(9)
Other written premiums	(42)	(10)	(320)
Net written premiums	1,037	970	7
Unearned premium change	(58)	(81)	28
Earned premiums	$979	$889	10

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

Consolidated property casualty net written premiums for the three months ended March 31, 2014, grew $67 million compared with the same period of 2013. Each of our property casualty segments continued to grow during the first three months of 2014. Our premium growth initiatives from prior years provided an ongoing favorable effect on growth during 2014, particularly as newer agency relationships mature over time. We discuss current initiatives in the Highlights of Our Strategy and Supporting Initiatives section of this quarterly report. The main drivers of trends for 2014 are discussed by segment below in Results of Operations.

Consolidated property casualty agency new business written premiums for the three months ended March 31, 2014, decreased $12 million compared with the same period of 2013. New business written premiums were lower than the year-ago quarter for our commercial lines and personal lines insurance segments and higher for our excess and surplus lines insurance segment. New agency appointments during 2013 and 2014 produced a $4 million increase in standard lines new business for the first three months of 2014 compared with the same period in 2013. As we appoint new agencies that choose to move accounts to us, we report these accounts as new business. While this business is new to us, in many cases it is not new to the agent. We believe these seasoned accounts tend to be priced more accurately than business that may be less familiar to our agent upon obtaining it from a competing agent.

Other written premiums include premiums ceded to our reinsurers as part of our reinsurance program. A decrease in ceded premiums contributed $4 million to net written premium growth for the three months ended March 31, 2014, compared with the same period of 2013. Other written premiums also included a less favorable adjustment for the first three months of 2014, compared with the same period last year, for estimated direct written premiums of policies in effect but not yet processed in our commercial lines insurance segment. The adjustments had an immaterial effect on earned premiums.

Catastrophe losses typically have a material effect on property casualty results and can vary significantly from period to period. Losses from natural catastrophes contributed 8.9 percentage points to the combined ratio in the first three months of 2014, compared with 1.2 percentage points in the same period of 2013. Some of those losses were applicable to loss deductible provisions of our collateralized reinsurance funded through catastrophe bonds. For our collateralized reinsurance arrangement effective January 18, 2014, aggregate losses applicable through March 31, 2014, were less that $1 million for the specific geographic locations included in the severe convective storm portion of that coverage. If aggregate losses after deductibles exceed $160 million during an annual coverage period, we can recover the excess through funds that collateralize the catastrophe bonds. The following table shows catastrophe losses and loss expenses incurred, net of reinsurance, as well as the effect of loss development on prior period catastrophe events. We individually list declared catastrophe events for which our incurred losses reached or exceeded $10 million.

Catastrophe Losses and Loss Expenses Incurred
(In millions, net of reinsurance)

			Three months ended March 31,			
Dates	Event	Region	Comm. lines	Pers. lines	E&S lines	Total
2014						
Jan. 5-8	Freezing, ice and snow, wind	Midwest, Northeast, South	$51	$24	$1	$76
All other 2014 catastrophes			11	9	—	20
Development on 2013 and prior catastrophes			(3)	(6)		