

CINCINNATI FINANCIAL CORP

Form 10-K/A

March 16, 2006

United States Securities and Exchange Commission  
Washington, D.C. 20549  
Form 10-K/A  
Amendment No. 1

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934.

For the fiscal year ended December 31, 2005.

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 of incorporation)

31-0746871

(I.R.S. Employer Identification No.)

6200 S. Gilmore Road

Fairfield, Ohio 45014-5141

(Address of principal executive offices) (Zip Code)

(513) 870-2000

(Registrant's telephone number, including area code)

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

None

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

\$2.00 par, common stock

(Title of Class)

6.125% Senior Notes due 2034

(Title of Class)

6.9% Senior Debentures due 2028

(Title of Class)

6.92% Senior Debentures due 2028

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes  No

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

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

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

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(Check one): Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The aggregate market value of voting stock held by nonaffiliates of the Registrant was \$6,181,583,530 as of June 30, 2005. As of February 28, 2006, there were 174,106,280 shares of common stock outstanding.

Document Incorporated by Reference

Portions of the definitive Proxy Statement for Cincinnati Financial Corporation's Annual Meeting of Shareholders to be held on May 6, 2006, are incorporated by reference into Parts II and III of this Form 10-K.

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**Amendment No. 1 to Cincinnati Financial Corporation's Annual Report  
on Form 10-K for the Year Ended December 31, 2005**

The purpose of this Amendment No. 1 on Form 10-K/A is solely to amend Part II, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the year ended December 31, 2005 (Original Filing), which was originally filed with the Securities and Exchange Commission (SEC) on March 10, 2006. The only change is to correct the 10 year table on Page 63 showing the development of loss and loss expense reserves. Some cumulative net paid data did not appropriately shift to the left when the new 2005 column was added on the right. As a result, the re-estimated amounts for 2003 and prior on the table now have been updated. As required by SEC rules, this Amendment sets forth the complete text of Part II, Item 7, which has been revised solely as indicated above.

Additionally, pursuant to Rule 12b-15 of the Act, this Amendment contains new certifications pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act of 2002. This Amendment contains only the sections of the Original Filing that are being amended and does not affect other sections of the Original Filing not discussed herein. This Amendment continues to speak as of the date of the Original Filing and we have not updated the disclosure contained herein to reflect events that have occurred since the filing of the Original Filing. Accordingly, this Amendment should be read in conjunction with the company's other filings, if any, made with the SEC subsequent to the filing of the Original Filing, including any amendments to those filings, if any.

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

### **Introduction**

The purpose of Management's Discussion and Analysis is to provide an understanding of Cincinnati Financial Corporation's consolidated results of operations and financial position. Management's Discussion and Analysis should be read in conjunction with Item 6, Selected Financial Data, Pages 28 and 29, and Item 8, Consolidated Financial Statements and related Notes, beginning on Page 77. We present per share data on a diluted basis unless otherwise noted and we have adjusted those amounts for all stock splits and dividends, including the 5 percent stock dividend paid on April 26, 2005.

We begin with an executive summary of our results of operations and outlook, as well as details on critical accounting policies and estimates. Periodically, we refer to estimated industry data so that we can give information on our performance versus the overall insurance industry. Unless otherwise noted, the industry data is prepared by A.M. Best, 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 on a GAAP basis.

### **Executive Summary**

Cincinnati Financial Corporation is the parent company of the nation's 19 largest publicly traded property casualty insurer, based on statutory net written premium volume through the first nine months of 2005. We primarily market commercial lines and personal lines property casualty insurance products through a select group of independent insurance agencies in 32 states. As we discussed in the business description in Item 1, we believe three characteristics distinguish our company and allow us to build shareholder value:

- We cultivate relationships with the independent insurance agents who market our policies and we make our decisions at the local level

- We achieve claims excellence, covering the spectrum from our response to reported claims to our approach to establishing reserves for not-yet-paid claims

- We invest for long-term total return, using available cash flow to purchase equity securities after covering insurance liabilities by purchasing fixed-maturity securities

We provide additional detail on these subjects in the Results of Operations and Liquidity and Capital Resources sections of this discussion.

Among the factors that influence the consolidated results of operations and financial position of the company, we consider our relationships with independent insurance agents to be the most significant. We seek to be an indispensable partner in each agency's success. To continue to achieve our performance targets, we must maintain these strong relationships, write a significant portion of each agency's business and attract new agencies.

Conditions in the property casualty markets were challenging in 2005, as we discuss in the business description in Item 1, Our Business and Our Strategy, Page 1. In the commercial lines marketplace, competition continues to accelerate, resulting in a lower premium growth rate. In the personal lines marketplace, our personal lines rates in some territories have not been in a competitive range that would allow our agents to market the benefits of our products, resulting in declining policy retention and lower new business.

We believe consistently applying our long-term strategies rather than taking short-term actions will allow us to address these challenges. We seek to meet our agents' needs, with an eye toward solutions and approaches that will give us an advantage for five, 10 or even more years. As we appoint new agencies, we are looking to build relationships that will grow as successfully as those we have had for 40 or 50 years.

In 2005, we achieved most of our objectives for creating shareholder value, as we discuss on Page 33. Although unrealized gains have been down in the past several years because of the decline in the market value of our Fifth Third investment, we believe our portfolio continues to have the potential to increase investment income and provide capital appreciation over the long term.

Below we review highlights of our financial results for the past three years and measures of the success of our efforts to create shareholder value.

## Corporate Financial Highlights

### Income Statement and Per Share Data

(Dollars in millions except share data)

	2005	2004	2003	2005-2004 Change %	2004-2003 Change %
<b>Income statement data</b>					
Earned premiums	\$ 3,164	\$ 3,020	\$ 2,748	4.8	9.9
Investment income, net of expenses	526	492	465	6.9	5.7
Net realized gains and losses (pretax)	61	91	(41)	(33.1)	321.7
Total revenues	3,767	3,614	3,181	4.2	13.6
Net income	602	584	374	3.1	56.0
<b>Per share data (diluted)</b>					
Net income	3.40	3.28	2.10	3.7	56.4
Cash dividends declared	1.205	1.04	0.90	16.1	14.4
Weighted average shares outstanding	177,116,126	178,376,848	178,292,248	(0.7)	0.0

In 2005, we reported record results, as described in detail in the results of operations.

**Revenue** growth was slower in 2005 than in 2004 because of slowing consolidated property casualty **earned premium** growth due to market conditions. Pretax **investment income** growth accelerated over the three years. Realized gains made a positive contribution in 2005 and 2004 although we recorded a realized loss in 2003.

**Net income** and **net income per share** reached record levels in 2005 although the growth rates were substantially lower in 2005 than in 2004. A number of factors affected the annual growth rates, including:

The consolidated property casualty **underwriting profit** improved substantially in 2004 and we sustained healthy profitability in 2005. The factors behind the improvement are discussed in the Results of Operations.

**Realized investment gains and losses** are integral to our financial results over the long term. We have substantial discretion in the timing of investment sales and, therefore, the gains or losses that will be recognized in any period. That discretion generally is independent of the insurance underwriting process. Also, applicable accounting standards require us to recognize gains and losses from certain changes in fair values of securities and embedded derivatives without actual realization of those gains and losses. Security sales led to realized gains in 2005 and 2004 while write-downs of impaired assets led to realized losses in 2003.

o 2005 Realized investment gains raised net income by \$40 million, or 23 cents per share, after tax

o 2004 Realized investment gains raised net income by \$60 million, or 34 cents per share, after tax

o 2003 Realized investment losses reduced net income by \$27 million, or 15 cents per share, after tax

**Weighted average shares outstanding** may fluctuate from period to period because we regularly repurchase shares under board authorizations and we issue shares when associates exercise stock options. At year-end 2005, weighted average shares outstanding on a diluted basis had declined 1.3 million from year-end 2004.

In 2003, we recovered \$23 million pretax from a settlement negotiated with a vendor. The recovery added \$15 million, or 8 cents per share, to net income. The negotiated settlement related to the \$39 million one-time, pretax charge incurred in 2000 to write off previously capitalized software development costs.

The board of directors is committed to steadily increasing cash dividends and periodically authorizing stock dividends and splits. **Cash dividends declared** per share rose 16.1 percent and 14.4 percent in 2005 and 2004.

### Balance Sheet Data and Performance Measures

(Dollars in millions except per share data)

	2005	2004	2003	2005-2004 Change %	2004-2003 Change %
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**Balance Sheet Data**

Invested assets	<b>\$12,702</b>	\$12,677	\$12,485	<b>0.2</b>	1.5
Total assets	<b>16,003</b>	16,107	15,509	<b>(0.6)</b>	3.9
Long-term debt	<b>791</b>	791	420	<b>0.0</b>	88.4
Shareholders' equity	<b>6,086</b>	6,249	6,204	<b>(2.6)</b>	0.7
Book value per share	<b>34.88</b>	35.60	35.10	<b>(2.0)</b>	1.4

**Performance measures**

Comprehensive income	<b>\$ 99</b>	\$ 287	\$ 815	<b>(65.8)</b>	(64.8)
Return on equity	<b>9.8%</b>	9.4%	6.3%		
Return on equity, based on comprehensive income	<b>1.6</b>	4.6	13.8		
Debt-to-capital ratio	<b>11.5</b>	11.2	8.9		

2005 10-K Page 32

**Invested assets** and **total assets** have been relatively flat over the past two years as strong cash flow has been offset by lower unrealized investment gains. This led to a modest decline in **shareholders equity** and **book value** in 2005. Comprehensive income is net income plus the change in net other accumulated comprehensive income. Change in net other accumulated comprehensive income is the year-over-year difference in unrealized gains on investments. In 2005 and 2004, **comprehensive income** declined because lower unrealized gains more than offset the increase in net income. Unrealized gains were down primarily because of a decline in the market value of our Fifth Third investment. With net income growing and shareholders equity declining, **return on equity** rose over the past three years. **Return on equity based on comprehensive income**, however, declined in line with total comprehensive income. We issued \$375 million of long-term debt in 2004, raising total **long-term debt** to \$791 million at year-end 2005 and 2004. Our ratio of long-term **debt to capital** (long-term debt plus shareholders equity) rose in 2004 following the new debt issue and remained stable in 2005.

### Property Casualty Highlights

(Dollars in millions)

				2005-2004 Change	2004-2003 Change %
	2005	2004	2003	%	
<b>Property casualty highlights</b>					
Written premiums	\$3,076	\$2,997	\$2,815	2.6	6.5
Underwriting profit	330	298	140	10.8	113.3
GAAP combined ratio	89.2%	89.8%	94.7%		
Statutory combined ratio	89.0	89.4	94.2		

The declining trend in overall **written premium** growth reflected the market factors discussed in Item 1, Commercial Lines and Personal Lines Property Casualty Insurance Segments, Page 10 and Page 11. In each of the past three years, our overall written premium growth rate has exceeded that of the industry. The estimated industry growth rate was 0.7 percent, 4.7 percent and 9.6 percent in 2005, 2004 and 2003, respectively. The 2005 overall industry premium growth rate included an estimated 33.9 percent decline in reinsurance sector premiums.

Our consolidated property casualty insurance **underwriting profit** rose in 2005 and 2004, and our **combined ratio** improved each year. (The combined ratio is the percentage of each premium dollar spent on claims plus all expenses the lower the ratio, the better the performance.) The 2005 improvement reflected lower catastrophe losses, continued strong commercial lines underwriting results, a return to underwriting profitability for personal lines and above-average savings from favorable loss reserve development from prior accident years. The 2004 improvement reflected growth in premiums, in particular more adequate premium per policy, the benefits of other underwriting efforts and above-average savings from favorable loss reserve development from prior accident years.

The estimated industry average statutory combined ratios were 102.0 percent, 98.1 percent and 100.2 percent for 2005, 2004 and 2003, respectively. The 2005 overall industry combined ratio included an estimated 150.7 percent reinsurance sector ratio.

We also measure a variety of non-financial metrics for our property casualty operations. For example, we monitor our rank within our reporting agency locations. In 2004, we ranked No. 1 or No. 2 by premium volume in 74 percent of the locations that have marketed our products for more than five years. Other measures include subdivision of territories and new agency appointments. In 2005, we subdivided eight field territories, raising the total to 100, and appointed 41 new agency relationships. These new appointments and other changes in agency structures led to a net increase in reporting agency locations of 40 in 2005.

Agent satisfaction with our technology solutions is, and will continue to be, a requirement for maintaining our strong relationships with these agencies. In 2005, we made additional progress in implementing technology solutions that we believe should make it easier for agencies to do business with us. Among other milestones, we deployed our new commercial lines policy processing system to all of our agencies in Ohio for use in processing new and renewal businessowners policies. We also deployed our personal lines policy processing system in two additional states and made important upgrades and enhancements.



**Measuring Our Success in 2006 and Beyond**

We use a variety of metrics to measure the success of our strategies:

**Maintaining our strong relationships with our established agencies, writing a significant portion of each agency's business and attracting new agencies** In 2006, we expect to continue to rank No. 1 or No. 2 by premium volume in at least 74 percent or more of the locations that have marketed our products for more than five years. We expect to subdivide three field territories in 2006 and we are targeting 50 new agency appointments.

2005 10-K Page 33

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In 2006, we expect to make further progress in our efforts to improve service to and communication with our agencies through our expanding portfolio of software. In particular, we will continue to deploy our commercial lines and personal lines quoting and policy processing systems that allow our agencies and our field and headquarters associates to collaborate on new and renewal business more efficiently and give our agencies choice and control. We discuss our technology plans for 2006 in Item 1, Technology Solutions, Page 4.

**Achieving above-industry-average growth in property casualty statutory net written premiums and maintaining industry-leading profitability by leveraging our regional franchise and proven agency-centered business strategy** We believe our consolidated property casualty written premiums will be flat to slightly up in 2006 compared with the 2.6 percent increase in 2005. We may not achieve our objective of above-industry-average growth in 2006 because the modest growth we anticipate in commercial lines written premiums, despite increasing competition, may be offsetting the rate-driven declines we anticipate in personal lines written premiums. In addition, the overall industry premium growth is estimated at 3.3 percent in 2006, which includes an estimated 18.6 percent reinsurance sector growth rate. The 2006 industry growth rate for the commercial lines sector is estimated at 2.3 percent and the personal lines sector is estimated at 2.9 percent. Our combined ratio estimate for 2006 is 92 percent to 94 percent on either a GAAP or statutory basis compared with 89.2 percent on a GAAP basis in 2005. We believe the most significant difference will be a lower level of savings from favorable loss reserve development from prior accident years. In 2006, we believe that savings is likely to reduce the combined ratio in the range of 2 to 3 percentage points. Higher-than-normal savings, particularly for liability coverages, reduced the 2005 combined ratio by 5.2 percentage points and the 2004 combined ratio by 6.7 percentage points.

We also have raised slightly our estimate of the impact to the 2006 combined ratio from catastrophe losses to the range of 4.0 and 4.5 percentage points from our historic range of 3.0 to 3.5 percentage points. We are taking into account the potential for severe weather, as we've seen in the past two years, and the higher retention on our new catastrophe reinsurance treaty. Both the loss and loss expense ratio and underwriting expense ratio trends could affect the combined ratios for our commercial lines and personal lines segments:

- o The degree of price softening in the commercial lines marketplace will affect the 2006 loss and loss expense ratio for that business area, as that ratio may move up slightly as pricing becomes more competitive.
- o The personal lines 2006 loss and loss expense ratio primarily will reflect our ability to offer competitive prices for our personal lines products in that changing marketplace. We believe we have taken the appropriate actions to maintain that ratio near the improved level we achieved in 2005.
- o For both commercial lines and personal lines, lower growth rates could lead to further unfavorable year-over-year comparisons in the ratios of deferred acquisition costs and other underwriting expenses to earned premiums. Continued investment in technology also may contribute to an increase in other underwriting expenses.

The estimated industry average 2006 combined ratio is 98.7 percent.

**Pursuing a total return investment strategy that generates both strong investment income growth and capital appreciation** - In 2006, we are estimating pretax investment income growth to again be in the range of 6.5 percent to 7.0 percent. This outlook is based on the higher anticipated level of dividend income from equity holdings, the investment of insurance operations cash flow and the higher-than-historical allocation of new cash flow to fixed-maturity securities over the past 18 months.

We do not establish annual capital appreciation targets. Over the long term, our target is to have the equity portfolio outperform the Standard & Poor's 500 Index. Over the five years ended December 31, 2005, our compound annual equity portfolio return was a negative 0.8 percent compared with a compound annual total return of 0.5 percent for the Index. In 2005, our compound annual equity portfolio was a negative 4.2 percent, compared with a compound annual total return of 4.9 percent for the Index. Our equity portfolio underperformed the market for these periods because of the decline in the market value of our holdings of Fifth Third common stock over the past five years.

**Increasing the total return to shareholders through a combination of higher earnings per share, growth in book value and increasing dividends** - We do not announce annual targets for earnings per share or book value. Earnings results in 2006 will be tempered by the first quarter adoption of Statement of Financial Accounting Standards (SFAS) No. 123(R) Share-Based Payments, which requires expensing the cost of associate options on our income statement. Our estimate of pro forma option expense, as detailed in Item 8, Note 1 to the Consolidated Financial Statements, Page 84, would have reduced earnings per share by 7 cents to 8 cents in each of the past three years.

2005 10-K Page 34

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Over the long term, we look for our earnings per share growth to outpace that of a peer group of national and regional property casualty insurance companies. Long-term book value growth should approximate that of our equity portfolio.

The board of directors is committed to steadily increasing cash dividends and periodically authorizing stock dividends and splits. In February 2006, the board increased the indicated annual dividend rate 9.8 percent, marking the 46<sup>th</sup> consecutive year of increases in our indicated dividend rate. We believe our record of dividend increases is matched by only 11 other publicly traded corporations.

Over the long-term, we seek to increase earnings per share, book value and dividends at a rate that would allow long-term total return to our shareholders to exceed that of the Standard & Poor's Composite 1500 Property Casualty Insurance Index. Over the past five years, our total return to shareholders of 40.9 percent matched the return on that Index.

**Maintaining financial strength by keeping the ratio of debt to capital below 15 percent and purchasing reinsurance to provide investment flexibility** - Based on our present capital requirements, we do not anticipate a material increase in debt levels during 2006. As a result, we believe our debt-to-capital ratio will remain in the range of 11 percent to 12 percent.

In December 2005, we finalized our reinsurance program for 2006, updating it to maintain the balance between the cost of the program and the level of risk we retain. Under the new program, our 2006 reinsurance premiums are expected to be \$7 million lower than 2005, without taking into account the reinstatement premium incurred in 2005. We provide more detail on our reinsurance programs in 2006 Reinsurance Programs, Page 68.

Factors supporting our outlook for 2006 are discussed below in the Results of Operations for each of the four business segments.

### **Critical Accounting Estimates**

Cincinnati Financial Corporation's financial statements are prepared using GAAP. These principles require management to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and accompanying Notes. Actual results could differ materially from those estimates.

The significant accounting policies used in the preparation of the financial statements are discussed in Item 8, Note 1 to the Consolidated Financial Statements, Page 84. In conjunction with that discussion, material implications of uncertainties associated with the methods, assumptions and estimates underlying the company's critical accounting policies are discussed below. The audit committee of the board of directors reviews the annual financial statements with management and the independent registered public accounting firm. These discussions cover the quality of earnings, review of reserves and accruals, reconsideration of the suitability of accounting principles, review of highly judgmental areas including critical accounting policies, audit adjustments and such other inquiries as may be appropriate.

### **Property Casualty Insurance Loss and Loss Expense Reserves**

#### **Overview**

Our most significant estimates relate to our reserves for property casualty loss and loss expenses. We believe that the stability of our business makes our historical data the most important source for establishing adequate reserve levels. We base reserve estimates on company experience and information from internal analyses and obtain additional information from the appointed actuary. When reviewing reserves, we analyze historical data and estimate the effect of various loss factors. We believe that the following represent the primary risks to our ability to estimate loss reserves accurately:

- Court decisions or legislation that result in unanticipated coverage expansions on past and existing policies
- Changes in medical inflation and mortality rates that affect workers compensation claims
- Changes in claim cost trends, including the effects of general economic and tort cost inflation, not reflected in the historical data used to estimate loss reserves
- Changes in reinsurance coverage, not reflected in reserving data, that affect the company's net payments and net case reserves

Payment and reporting pattern changes attributable to the implementation of a new claims management system  
Reporting pattern changes attributable to changes in case reserving practices, particularly with respect to umbrella liability claims

Absence of cost-effective methods for accurately assessing asbestos and environmental claim liabilities (see Property Casualty Insurance Reserves, Asbestos and Environmental Reserves, Page 63, for discussion of related reserve levels and trends)

2005 10-K Page 35

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Any of these factors could cause our ultimate loss experience to be better or worse than reserves held, and the difference could be material. To the extent that reserves are inadequate and strengthened, the amount of such increase is treated as a charge in the period that the deficiency is recognized, raising the loss and loss expense ratio and reducing earnings. To the extent that reserves are redundant and released, the amount of the release is a credit in the period that the redundancy is recognized, reducing the loss and loss expense ratio and increasing earnings.

A reserve change of \$31 million would have a 1 percentage point effect on the loss and loss expense ratio, based on 2005 earned premiums, a \$20 million effect on income and an 11 cent effect on net income per share.

### **Establishing Reserves**

Reserves are established for the total of unpaid loss and loss expenses, including estimates for claims that have been reported, estimates for claims that have been incurred but not yet reported (IBNR) and estimates of loss expenses associated with processing and settling those claims. Reserves are determined for the various lines of business. Loss reserves are reduced by salvage and subrogation reserves.

We establish case reserves for claims that have been reported within the parameters of coverage provided in the policy. Individual case reserves greater than \$35,000 established by field claims representatives are reviewed by experienced headquarters claims supervisors while case reserves greater than \$100,000 also are reviewed by headquarters claims managers. The estimates reflect informed judgment and experience of our claims associates based on general insurance reserving practices and their experience with the company. Case reserves are reviewed on a 90-day cycle, or more frequently if specific circumstances require, based on events such as the status of ongoing negotiations.

The anticipated effect of inflation is implicitly considered when estimating reserves for loss and loss expenses. While anticipated cost increases due to inflation are considered in estimating ultimate claim costs, increases in average severity of claims are caused by a number of factors that vary by individual type of policy. Average severity projections are based on historical trends adjusted for anticipated changes in underwriting standards, policy provisions and general economic trends. We do not discount any of our property casualty loss and loss expense reserves.

In 2001, we began to establish higher initial case reserves on serious injury claims to reflect recent experience indicating the likelihood that juries would ignore significant liability issues in cases involving seriously injured claimants.

To establish IBNR reserves on an annual basis, we use a variety of tools, including actuarial and statistical methods. These may include but are not limited to:

- The Case Incurred Development Method

- The Paid Development Method

- The Bornhuetter-Ferguson Method

- Probability Trend Family Methods

Supplemental statistical information is compiled and reviewed to aid in the application of the actuarial methods. The supplemental data also is used to evaluate the reasonableness of estimates derived from the actuarial methods. This information includes:

- Industry loss frequency and severity and premium trends

- Past, present and anticipated product pricing

- Anticipated premium growth

- Other quantifiable trends

- Projected ultimate loss ratios

We conduct our thorough evaluation of the adequacy of reserves as of the end of the third quarter of each year. As a result, the most significant refinements in reserves historically have been implemented in the fourth quarter.

Beginning in 2006, we are conducting a detailed supplemental review as of the end of the fourth quarter of each year in parallel with the outside actuarial review. Less detailed, periodic reviews of reserve adequacy are made at the other quarter ends. A loss review committee, including internal actuaries and representatives from management of multiple operating departments, is responsible for the quarterly review process.

The internal actuaries provide a point estimate and a range to summarize their analysis. At year-end 2005 and 2004, IBNR reserves differed from the internal actuarial point estimate by less than 1 percent of our loss and loss expense reserve.



### **Adjusting Reserves**

While we believe that reported reserves provide for all unpaid loss and loss expense obligations, the estimation processes involve a number of variables and assumptions. We believe this uncertainty is mitigated by the historical stability of our book of business and by our periodic reviews of estimates. As loss experience develops and new information becomes known, the reserves are reviewed and adjusted as appropriate. In this process, we monitor trends in the industry, cost trends, relevant court cases, legislative activity and other current events in an effort to ascertain new or additional exposures to loss. If we determine that reserves established in prior years were not sufficient or were excessive, the change is reflected in current-year results.

### **Actuarial Review**

As part of our internal processes, we utilize an appointed actuary to provide management with an opinion regarding an acceptable range for adequate statutory reserves based on generally accepted actuarial guidelines.

Historically, we have established adequate reserves that have fallen in the upper half of the appointed actuary's range. This approach has resulted in recognition of reserve redundancies for the past 10 years, as we discuss in Development of Loss and Loss Expenses, Page 62. Modestly redundant reserves support our business strategy to retain high financial strength ratings and remain a market for agencies' business in all market conditions.

The appointed actuary conducts a thorough evaluation of the adequacy of reserves as of the end of the third quarter of each year and conduct a supplemental review of full-year data at year-end.

### **Asset Impairment**

Fixed-maturity and equity investments are our largest assets. Certain estimates and assumptions made by management relative to investment portfolio assets are critical. The company's asset impairment committee continually monitors investments and all other assets for signs of other-than-temporary and/or permanent impairment. Among other signs, the committee monitors significant decreases in the market value of the assets, changes in legal factors or in the business climate, an accumulation of costs in excess of the amount originally expected to acquire or construct an asset, uncollectability of all other assets, or other factors such as bankruptcy, deterioration of creditworthiness, failure to pay interest or dividends or signs indicating that the carrying amount may not be recoverable.

The application of our impairment policy resulted in other-than-temporary impairment charges and write-offs of investments that reduced our income before income taxes by \$1 million, \$6 million and \$80 million in 2005, 2004 and 2003, respectively.

Other-than-temporary impairment in the value of securities is defined by the company as declines in valuation that meet specific criteria established in the asset impairment policy. Such declines often occur in conjunction with events taking place in the overall economy and market, combined with events specific to the industry or operations of the issuing corporation. These specific criteria include a declining trend in market value, the extent of the market value decline and the length of time the value of the security has been depressed, as well as subjective measures such as pending events and issuer liquidity. Generally, these declines in valuation are greater than might be anticipated when viewed in the context of overall economic and market conditions. We provide information regarding valuation of our invested assets in Item 8, Note 2 to the Consolidated Financial Statements, Page 88.

Our portfolio managers constantly monitor the status of their assigned portfolios for indications of potential problems or issues that may be possible impairment issues. If an impairment indicator is noted, the portfolio managers even more closely scrutinize the security.

Impairment charges are recorded for other-than-temporary declines in value, if, in the asset impairment committee's judgment, there is little expectation that the value will be recouped in the foreseeable future. The impairment policy defines a security as distressed when it is trading below 70 percent of book value or has a Moody's or Standard & Poor's credit rating below B3/B-. Distressed securities receive additional scrutiny. In 2005 and earlier, a security would have been written down in the event of a declining market value for four consecutive quarters with quarter-end market value below 50 percent of book value, or when a security's market value is 50 percent below book value for three consecutive quarters. Effective January 1, 2006, a security may be written down in the event of a declining market value for four consecutive quarters with quarter-end market value below 70 percent of book value, or when a security's market value is 70 percent below book value for three consecutive quarters. A sudden and severe drop in market value that does not otherwise meet the above criteria is reviewed for possible immediate impairment.



When evaluating other-than-temporary impairments, the committee considers the company's ability to retain a security for a period adequate to recover a significant percentage of cost. Because of the company's investment philosophy and strong capitalization, it can hold securities that have the potential to recover value until their scheduled redemption, when they might otherwise be deemed impaired. Investment assets that

2005 10-K Page 37

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have already been impaired are evaluated based on their adjusted book value and further written down, if deemed appropriate. The decision to sell or write down an asset with impairment indications reflects, at least in part, management's opinion that the security no longer meets the company's investment objectives. We provide detailed information about securities trading in a continuous loss position at year-end 2005 in Item 7A, Unrealized Investment Gains and Losses, Page 74. Other-than-temporary declines in the fair value of investments are recognized in net income as realized losses at the time when facts and circumstances indicate such write-downs are warranted. Permanent impairment charges (write-offs) are defined as those for which management believes there is little potential for future recovery, for example, following the bankruptcy of the issuing corporation. These permanent declines in the fair value of investments are written off at the time when facts and circumstances indicate such write-downs are warranted, and they are reflected in realized losses.

Other-than-temporary and permanent impairments are distinct from the ordinary fluctuations seen in the value of a security when considered in the context of overall economic and market conditions. Securities considered to have a temporary decline would be expected to recover their market value, which may be at maturity. Under the same accounting treatment as market value gains, temporary declines (changes in the fair value of these securities) are reflected on our balance sheet in other comprehensive income, net of tax, and have no impact on reported net income.

#### **Life Insurance 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. We use our own experience and historical trends for setting our assumptions for expected expenses. We base our assumptions for expected investment income on our own experience adjusted for current economic conditions.

We establish reserves for our universal life, deferred annuity and investment contracts equal to the cumulative account balances, which include premium deposits plus credited interest less charges and withdrawals.

#### **Employee Benefit Pension Plan**

We have a defined benefit pension plan covering substantially all employees. Contributions and pension costs are developed from annual actuarial valuations. These valuations involve key assumptions including discount rates and expected return on plan assets, which are updated each year. Any adjustments to these assumptions are based on considerations of current market conditions. Therefore, changes in the related pension costs or credits may occur in the future due to changes in assumptions.

The key assumptions used in developing the 2005 net pension expense were a 5.75 percent discount rate, an 8.0 percent expected return on plan assets and rates of compensation increases ranging from 5 percent to 7 percent. The 8.0 percent return on plan assets assumption is based partially on the fact that substantially all of the investments held by the pension plan are common stocks that pay annual dividends. We believe this rate is representative of the expected long-term rate of return on these assets. These assumptions were consistent with the prior year except that the discount rate was reduced by one fourth of one percent due to current market conditions. In 2005, the net pension expense was \$13 million. In 2006, we expect a net pension expense of \$17 million, primarily as a result of a 0.25 percent reduction in the discount rate and increased service costs.

Holding all other assumptions constant, a 0.5 percentage point decline in the discount rate would lower our 2006 net income before income taxes by \$2 million. Likewise, a 0.5 percentage point decline in the expected return on plan assets would lower our 2005 income before income taxes by \$1 million.

In addition, the fair value of the plan assets exceeded the accumulated benefit obligation by \$8 million at year-end 2005 and \$16 million at year-end 2004. The fair value of the plan assets was less than the projected plan benefit obligation by \$62 million at year-end 2005 and \$41 million at year-end 2004. Market conditions and interest rates significantly affect future assets and liabilities of the pension plan. We expect to contribute approximately \$10 million to the pension plan in 2006.

#### **Deferred Acquisition Costs**

We establish a deferred asset for costs that vary with, and are primarily related to, acquiring property casualty and life business. These costs are principally agent commissions, premium taxes and certain underwriting costs, which are deferred and amortized into income as premiums are earned. Deferred acquisition costs track with the change in premiums. Underlying assumptions are updated periodically to reflect actual experience. Changes in the amounts or timing of estimated future profits could result in adjustments to the accumulated amortization of these costs.

For property casualty policies, deferred acquisition costs are amortized over the terms of the policies. For life policies, acquisition costs are amortized into income either over the premium-paying period of the policies or the life of the policy, depending on the policy type.

#### **Contingent Commission Accrual**

Another significant estimate relates to our accrual for contingent (profit-sharing) commissions. We base the contingent commission accrual estimates on property casualty underwriting results and on supplemental property casualty information. Contingent commissions are paid to agencies using a formula that takes into account agency profitability and other factors, such as prompt monthly payment of amounts due to the company. Due to the complexity of the calculation and the variety of factors that can affect contingent commissions for an individual agency, the amount accrued can differ from the actual contingent commissions paid. The contingent commission accrual of \$108 million in 2005 contributed 3.5 percentage points to the property casualty combined ratio. If commissions paid were to vary from that amount by 5 percent, it would affect 2006 net income by \$4 million, or 2 cents per share, and the combined ratio by approximately 0.2 percentage points.

#### **Separate Accounts**

We issue life contracts, referred to as bank-owned life insurance policies (BOLI). Based on the specific contract provisions, the assets and liabilities for some BOLIs are legally segregated and recorded as assets and liabilities of the separate accounts. Other BOLIs are included in the general account. For separate account BOLIs, minimum investment returns and account values are guaranteed by the company and also include death benefits to beneficiaries of the contract holders.

Separate account assets are carried at fair value. Separate account liabilities primarily represent the contract holders claims to the related assets and also are carried at the fair value of the assets. Generally, investment income and realized investment gains and losses of the separate accounts accrue directly to the contract holders and, therefore, are not included in our Consolidated Statements of Income. However, each separate account contract includes a negotiated realized gain and loss sharing arrangement with the company. This share is transferred from the separate account to our general account and is recognized as revenue or expense. In the event that the asset value of contract holders' accounts is projected below the value guaranteed by the company, a liability is established through a charge to our earnings.

For our most significant separate account, written in 1999, realized gains and losses are retained in the separate account and are deferred and amortized to the contract holder over a five-year period, subject to certain limitations. Upon termination or maturity of this separate account contract, any unamortized deferred gains and/or losses will revert to the general account. In the event this separate account holder were to exchange the contract for the policy of another carrier, there would be a surrender charge equal to 10 percent of the contract's account value during the first five years. Beginning in year six, the surrender charge decreases 2 percent a year to 0 percent in year 11. At year-end 2005, net unamortized realized gains amounted to \$1 million. In accordance with this separate account agreement, the investment assets must meet certain criteria established by the regulatory authorities to whose jurisdiction the group contract holder is subject. Therefore, sales of investments may be mandated to maintain compliance with these regulations, possibly requiring gains or losses to be recorded, and charged to the general account. Potentially, losses could be material; however, unrealized losses in the separate account portfolio were less than \$4 million at year-end 2005.

#### **Recent Accounting Pronouncements**

Information regarding recent accounting pronouncements is provided in Item 8, Note 1 to the Consolidated Financial Statements, Page 84. We have determined that recent accounting pronouncements have not had nor are they expected to have any material impact on our consolidated financial statements.

#### **Results of Operations**

The consolidated results of operations reflect the operating results of each of our four segments along with the parent company and other non-insurance activities. The four segments are:

- Commercial lines property casualty insurance
- Personal lines property casualty insurance
- Life insurance

Investments operations

We measure profit or loss for our property casualty and life segments based upon underwriting results. Insurance underwriting results (profit or loss) represent net earned premium less loss and loss expenses and underwriting expenses on a pretax basis. We also measure aspects of the performance of our commercial lines

2005 10-K Page 39

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and personal lines segments on a combined property casualty insurance operations basis. Underwriting results and segment pretax operating income are not a substitute for net income determined in accordance with GAAP.

For the combined property casualty insurance operations as well as the commercial lines and personal lines segments, statutory accounting data and ratios are key performance indicators that we use to assess business trends and to make comparisons to industry results, since GAAP-based industry data generally is not readily available. We also use statutory accounting data and ratios as key performance indicators for our life insurance operations. We do not believe that inflation has had a material effect on consolidated results of operations, except to the extent that inflation may affect interest rates and claim costs.

Investments held by the parent company and the investment portfolios for the property casualty and life insurance subsidiaries are managed and reported as the investments segment, separate from the underwriting businesses. Net investment income and net realized investment gains and losses for our investment portfolios are discussed in the Investments Results of Operations.

The calculations of segment data are described in more detail in Item 8, Note 17 of the Consolidated Financial Statements, Page 98. The following sections review results of operations for each of the four segments. Commercial Lines Insurance Results of Operations begins on Page 41, Personal Lines Insurance Results of Operations begins on Page 47, Life Insurance Results of Operations begins on Page 52, and Investments Results of Operations begins on Page 54. We begin with an overview of our consolidated property casualty operations, which is the total of our commercial lines and personal lines segments. Our consolidated property casualty operations generated 81.2 percent of our revenues in 2005, and certain factors affected both of our property casualty segments.

#### Consolidated Property Casualty Insurance Results of Operations

(Dollars in millions)

	2005	2004	2003	2005-2004 Change %	2004-2003 Change %
Written premiums	\$ 3,076	\$ 2,997	\$ 2,815	2.6	6.5
Earned premiums	\$ 3,058	\$ 2,919	\$ 2,653	4.8	10.0
Loss and loss expenses excluding catastrophes	1,685	1,605	1,700	5.0	(5.6)
Catastrophe loss and loss expenses	127	148	97	(14.8)	53.4
Commission expenses	592	583	507	1.6	15.0
Underwriting expenses	319	274	194	16.3	40.6
Policyholder dividends	5	11	15	(52.3)	(25.0)
Underwriting profit	\$ 330	\$ 298	\$ 140	10.8	113.3
Ratios as a percent of earned premiums:					
Loss and loss expenses excluding catastrophes	55.1%	55.0%	64.1%		
Catastrophe loss and loss expenses	4.1	5.1	3.6		
Loss and loss expenses	59.2	60.1	67.7		
Commission expenses	19.4	20.0	19.1		
Underwriting expenses	10.4	9.4	7.3		
Policyholder dividends	0.2	0.3	0.6		

Combined ratio	<b>89.2%</b>	89.8%	94.7%
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Factors that affected written premiums for property casualty insurance operations included:

New business written directly by agencies New business written directly by agencies was \$314 million, \$330 million and \$328 million in 2005, 2004 and 2003, respectively. New business levels reflect market conditions for commercial and personal lines.

Reinsurance reinstatement premiums To restore affected layers of property catastrophe reinsurance programs, we incurred \$8 million and \$11 million in reinsurance reinstatement premiums in 2005 and 2004.

Favorable development of loss reserves from prior accident years affected the combined ratio for property casualty insurance operations. The 2005 and 2004 ratios benefited from higher than normal savings. The 2004 and 2003 ratios benefited from uninsured motorist/underinsured motorist (UM/UIM) reserve releases. Following an Ohio Supreme Court decision in late 2003 to limit its 1999 *Scott-Pontzer vs. Liberty Mutual* decision, we released UM/UIM reserves as follows:

2003 We released \$38 million pretax of previously established UM/UIM reserves, adding \$25 million, or 14 cents per share, to net income in 2003.

2004 In 2004, we reviewed outstanding UM/UIM claims for which litigation was pending. Those claims represented approximately \$37 million in previously established case reserves. During the first quarter of 2004, we filed motions for dismissal in various jurisdictions for specific claims and released an additional \$32 million in related case reserves. The reserve releases in 2004 added \$21 million, or 12 cents per share, to net income.

2005 In 2005, we stopped separately reporting on UM/UIM-related reserve actions.

The discussions of property casualty segments provide additional detail regarding these factors.

## **Commercial Lines Insurance Results of Operations**

### **Overview Three-year Highlights**

Performance highlights for the commercial lines segment include:

**Premiums** As competition in our commercial markets continues to increase, our written premium growth rate has slowed because of the more competitive pricing environment and the underwriting discipline we have maintained for both renewal and new business. The primary source of growth in the past three years has been higher pricing on new and renewal commercial business aided by property insurance-to-value initiatives and more accurate risk classification. These more than offset our deliberate decisions not to write or renew certain business and the loss of some smaller accounts due to competition. We believe that our written premium growth rate continues to exceed the average for the overall commercial lines industry, which was estimated at 2.7 percent for 2005 and 2.3 percent for 2004. Earned premium growth has slowed because of the declining growth rate of written premiums. Reinsurance reinstatement premiums allocated to commercial lines reduced earned premium growth by 0.2 and 0.3 percentage points in 2005 and 2004, respectively.

**Combined ratio** Our commercial lines combined ratio was very strong in 2005 and 2004 largely due to our programs to obtain more adequate premiums per policy and our underwriting efforts. The 3.3 percentage point increase in the 2005 ratio primarily was due to a rise in the loss and loss expense ratio. The increase reflected a single large loss in 2005 that increased the ratio by 1.1 percentage points and savings from favorable loss reserve development below the 2004 level. We discuss large losses and other factors affecting the combined ratio beginning on Page 42. We discuss the savings from favorable loss reserve development by commercial lines of business on Page 45.

Our commercial lines statutory combined ratio was 87.1 percent in 2005 compared with 83.7 percent in 2004 and 91.6 percent in 2003. By comparison, the estimated industry commercial lines combined ratio was 99.1 percent in 2005, 102.5 percent in 2004 and 100.2 percent in 2003.

### **Growth and Profitability**

As competition in the commercial markets has increased, we have maintained our pricing discipline for both renewal and new business. Our independent agents reported steady pressure on pricing during 2005 and communicated that winning new business and retaining renewals required more pricing flexibility and careful risk selection. With the commercial lines pricing environment growing more competitive, we continue to rely on factors other than price to drive sales. Our agents look for the best insurance program for their clients, not just the best price. They serve policyholders well by presenting our value proposition — customized coverage packages, personal claims service and high financial strength ratings — all wrapped up in a convenient three-year commercial policy. We intend to remain a stable market for our agencies — best business, and believe that our case-by-case approach gives us a clear advantage. Our field marketing associates and our independent agents work together to select risks and respond appropriately to local pricing trends. Historically, they have proven capable of balancing risk and price to achieve growth in new business over the longer term.

Staying abreast of evolving market conditions is a critical function, accomplished in both an informal and a formal manner. Informally, our field marketing representatives and underwriters are in constant receipt of market intelligence from the agencies with which they work. Formally, our commercial lines product management group and field marketing associates complete periodic market surveys to obtain competitive intelligence. This market information helps to identify the top competitors by line of business or specialty program and also identifies our market strengths and weaknesses. The analysis encompasses pricing, breadth of coverage and underwriting/eligibility issues. In addition to reviewing our competitive position, our product management group and our underwriting audit group review compliance with our underwriting standards as well as the pricing adequacy of our commercial insurance programs and coverages. Further, our research and development department analyzes opportunities and develops new products, new coverage options and improvements to existing insurance products.

In 2003 and 2004, all lines of business grew because of higher premiums per policy. In 2005, growth largely was driven by commercial multi-peril and other liability coverages with commercial auto premiums declining.

Commercial auto is one of the first lines to experience pricing pressure because it often represents the largest portion



of insurance costs for commercial policyholders. Commercial auto also is one of the larger, annually priced components of our three-year policies.

We have more aggressively identified and measured exposures to match coverage amounts and premiums to the risk. Where this matching is not possible, accounts are not renewed unless there are mitigating factors. As a result, we experienced no growth in overall commercial lines policy counts from 2003 to 2005. Agents tell us they agree with the need to carefully select risks and assure pricing adequacy. They appreciate the time our associates invest in creating solutions for their clients while protecting profitability, whether that means working on an individual case or developing modified policy terms and conditions that preserve flexibility, choice and other sales advantages.

2005 10-K Page 41

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For new business, our field marketing associates and agents are working together to select risks and respond appropriately to local pricing trends. New commercial lines business was \$282 million in 2005, unchanged from 2004. New business was \$268 million in 2003.

We discuss growth by commercial lines of business on Page 45.

### Commercial Lines Results

(Dollars in millions)	<b>2005</b>	2004	2003	<b>2005-2004 Change %</b>	2004-2003 Change %
Written premiums	<b>\$ 2,290</b>	\$ 2,186	\$ 2,031	<b>4.7</b>	7.6
Earned premiums	<b>\$ 2,254</b>	\$ 2,126	\$ 1,908	<b>6.0</b>	11.4
Loss and loss expenses excluding catastrophes	<b>1,222</b>	1,083	1,176	<b>12.9</b>	(7.9)
Catastrophe loss and loss expenses	<b>76</b>	71	42	<b>6.0</b>	68.9
Commission expenses	<b>438</b>	423	361	<b>3.6</b>	17.1
Underwriting expenses	<b>228</b>	200	147	<b>13.5</b>	36.8
Policyholder dividends	<b>5</b>	11	15	<b>(52.3)</b>	(25.0)
Underwriting profit	<b>\$ 285</b>	\$ 338	\$ 167	<b>(15.6)</b>	102.3
Ratios as a percent of earned premiums:					
Loss and loss expenses excluding catastrophes	<b>54.2%</b>	50.9%	61.6%		
Catastrophe loss and loss expenses	<b>3.4</b>	3.4	2.2		
Loss and loss expenses	<b>57.6</b>	54.3	63.8		
Commission expenses	<b>19.5</b>	19.9	18.9		
Underwriting expenses	<b>10.1</b>	9.4	7.7		
Policyholder dividends	<b>0.2</b>	0.5	0.8		
Combined ratio	<b>87.4%</b>	84.1%	91.2%		

Over the past three years, we have continued to focus on seeking and maintaining adequate premium per exposure as well as pursuing non-pricing means of enhancing longer-term profitability. These have included identifying the exposures we have for each risk and making sure we offer appropriate coverages, terms and conditions and limits of insurance. We continue to adhere to our underwriting guidelines, to re-underwrite books of business with selected agencies and to update policy terms and conditions, where necessary. In addition, we continue to leverage our strong local presence. Our field marketing representatives have met with every agency to reaffirm agreements on the extent of frontline renewal underwriting to be performed by local agencies. Loss control, machinery and equipment and field claims representatives continue to conduct on-site inspections. Field claims representatives prepare full risk reports on every account reporting a loss above \$100,000 or on any risk of concern. Multi-departmental task forces have implemented programs to address concerns for specific areas such as contractor and commercial auto risks. These actions have helped to mitigate rising loss severity.

We describe the significant costs components for the commercial lines segment below.

**Loss and Loss Expenses (excluding catastrophe losses)**

Loss and loss expenses include both net paid losses and reserve additions for unpaid losses as well as the associated loss expenses. We believe more competitive market conditions were one factor in the 3.3 percentage point rise in the loss and loss expense ratio excluding catastrophes between 2005 and 2004. In addition, 2005 results include a single large loss that was insufficiently covered through our facultative reinsurance programs, which increased the 2005 loss and loss expenses by \$24 million, net of reinsurance, or 1.1 percentage points. Savings from favorable loss reserve development was lower in 2005 than 2004, which we discuss by commercial lines of business on Page 45.

Underwriting actions that led to higher premiums on a relatively stable level of exposures contributed to the 10.7 percentage point decline in the loss and loss expense ratio excluding catastrophes between 2004 and 2003. In addition, savings from favorable loss reserve development was significantly higher in 2004 than 2003.

Re-underwriting our commercial lines book of business in the early 2000s has had an impact on reserve development patterns because we are seeing lower frequency of losses. The favorable development in 2005 and 2004 was also due to the headquarters claims department's initiative, begun in 2001. Since 2001, we have been establishing higher initial case reserves on severe injury claims because our experience indicated that juries often ignore significant liability issues in cases involving seriously injured claimants. These higher initial amounts produce case reserves that reflect our full exposure more accurately. But some claims settle before reaching a jury and some juries make awards that are less than the worst-case scenario. As a result, some change in our case reserve development patterns allowed us to also reduce IBNR in 2005.

We monitor incurred losses by size of loss, business line, risk category, geographic region, agency, field marketing territory and duration of policyholder relationship, addressing concentrations or trends as needed. Our 2005 analysis indicated no significant concentrations other than trends in business lines that we address as part of our ongoing business operations. We also measure new losses and case reserve increases greater than \$250,000 to track frequency and severity.

These commercial lines large losses and case reserve increases have been in the range of 15 percent to 17 percent of annual earned premiums since 2003. The primary reason the contribution of these losses to the loss and loss expense ratio rose in 2005 was higher total new losses greater than \$1 million. New losses greater than \$1 million rose because of a rise in the number of these losses and the single large loss noted above. Total development and case reserve increases of \$250,000 or more rose primarily because of two verdicts that exceeded the reserves we had established.

### Commercial Lines Losses by Size

(Dollars in millions)

	2005	2004	2003	2005-2004 Change %	2004-2003 Change %
Losses \$1 million or more	\$ 124	\$ 80	\$ 89	54.3	(9.5)
Losses \$250 thousand to \$1 million	105	103	117	1.2	(11.9)
Development and case reserve increases of \$250 thousand or more	149	133	121	12.7	9.9
Other losses	596	536	608	11.1	(11.8)
Total losses incurred excluding catastrophe losses	974	852	935	14.2	(8.8)
Catastrophe losses	76	71	42	6.0	68.9
Total losses incurred	\$ 1,050	\$ 923	\$ 977	13.6	(5.4)
As a percent of earned premiums:					
Losses \$1 million or more	5.5%	3.8%	4.6%		
Losses \$250 thousand to \$1 million	4.7	4.9	6.2		
Development and case reserve increases of \$250 thousand or more	6.6	6.2	6.3		
Other losses	26.4	25.1	31.9		
Loss ratio excluding catastrophe losses	43.2	40.0	49.0		
Catastrophe loss ratio	3.4	3.4	2.2		
Total loss ratio	46.6%	43.4%	51.2%		

### Catastrophe Loss and Loss Expenses

Commercial lines catastrophe losses, net of reinsurance and before taxes, were \$76 million in 2005 compared with \$71 million in 2004 and \$42 million in 2003. The following table shows losses incurred, net of reinsurance, and subsequent development, for catastrophe losses in each of the past three years.

The Cincinnati Insurance Companies do not appoint agencies to actively market property casualty insurance in Louisiana, Mississippi or Texas. Our Hurricane Katrina and Rita losses included losses associated with commercial accounts written by agents in other states to cover locations and vehicles in multiple states, including Louisiana, Mississippi and Texas.

Hurricane Katrina losses also included \$18 million in assumed losses. The Cincinnati Insurance Company participates in three assumed reinsurance treaties with two reinsurers that spread the risk of very high catastrophe losses among many insurers. The assumed losses from Hurricane Katrina included \$16 million under a treaty with the Munich Re Group to assume 2 percent of property losses between \$400 million and \$1.2 billion from a single event. Munich Re has reserved its Hurricane Katrina losses above \$1.2 billion. We reduced our participation in the Munich Re assumed

reinsurance treaty to 1 percent in 2006.

2005 10-K Page 43

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(In millions, net of reinsurance)			Incurred in calendar year ended December 31,		
Occurrence year	Cause of loss	Region	2005	2004	2003
<b>2005</b>					
May	Wind, hail	Midwest	\$ 4		
July	Hurricane Dennis	South	5		
August	Hurricane Katrina	South	36		
September	Hurricane Rita	South	3		
October	Hurricane Wilma	South	13		
November	Wind, hail	Midwest	2		
November	Wind	Midwest, South	2		
Total			65		
2004					
May	Wind, hail	Midwest, Mid-Atlantic	0	\$ 1	
May	Wind, hail	Midwest, Mid-Atlantic, South	0	11	
July	Wind, hail	Midwest, Mid-Atlantic, South	8	7	
August	Hurricane Charley	South	0	16	
September	Hurricane Frances	South	1	4	
September	Hurricane Jeanne	Mid-Atlantic, South	1	4	
September	Hurricane Ivan	Midwest, Mid-Atlantic, South	1	21	
December	Wind, ice, snow	Midwest, South	0	5	
Others			0	3	
Total			11	72	
2003 and prior					
April	Wind, hail	Midwest, South	0	(2)	\$ 5
May	Wind, hail	Midwest, South	1	0	17
July	Wind, hail	Midwest, Mid-Atlantic, South	0	2	2
July	Wind, hail	Midwest, Mid-Atlantic, South	(1)	0	6
September	Wind	Mid-Atlantic, South	0	0	5
November	Wind	Midwest, Mid-Atlantic, South	0	(1)	6
Others			0	0	1
Total			0	(1)	42
Calendar year total			\$ 76	\$ 71	\$ 42

**Commission Expenses**

Commercial lines commission expense as a percent of earned premium declined by 0.4 percentage points in 2005 after rising by 1.0 percentage points in 2004. Profit-sharing, or contingent, commissions are calculated on the profitability of an agency's aggregate book of business, taking into account longer-term profit, with a percentage for prompt payment of premiums and other criteria, and reward our agents' efforts. These profit-based commissions generally fluctuate with our loss and loss expenses.

A refinement and subsequent release of a contingent commission over accrual from 2004 in the first three months of 2005 was responsible for 0.3 percentage points of the decline in 2005. The refinement reflected the use of final 2004 financial data to calculate the contingent commissions paid in 2005. Our 2005 contingent commission accrual reflected our estimate of the profit-sharing commissions that will be paid to our agencies in early 2006.

**Underwriting Expenses**

Non commission expenses rose to 10.1 percent of earned premium in 2005 from 9.4 percent in 2004 and 7.7 percent in 2003. The three-year rise in the ratio largely was due to unfavorable deferred acquisition cost comparisons resulting from slower premium growth, higher staffing expenses and increased taxes and fees that were partially due to a state guaranty fund refund in 2003. The software recovery discussed in Corporate Financial Highlights, Page 32, reduced the 2003 ratio by 0.8 percentage points.

**Policyholder Dividends**

Policyholder dividend expense was 0.2 percent of earned premium in 2005 compared with 0.5 percent in 2004 and 0.8 percent in 2003.

**Line of Business Analysis**

(Dollars in millions)

Calendar year	2005	2004	2003	2005-2004 Change %	2004-2003 Change %
Commercial multi-peril:					
Written premium	\$ 809	\$ 767	\$ 713	5.4	7.6
Earned premium	796	751	673	5.9	11.6
Loss and loss expenses incurred	443	469	442	(5.5)	6.1
Loss and loss expenses ratio	55.7%	62.4%	65.6%		
Loss and loss expense ratio excluding catastrophes	47.5	54.9	59.9		
Workers compensation:					
Written premium	\$ 338	\$ 320	\$ 304	5.5	5.2
Earned premium	328	313	293	5.1	6.8
Loss and loss expenses incurred	300	251	235	19.4	6.6
Loss and loss expenses ratio	91.3%	80.3%	80.5%		
Loss and loss expense ratio excluding catastrophes	91.3	80.3	80.5		
Commercial auto:					
Written premium	\$ 447	\$ 458	\$ 434	(2.4)	5.5
Earned premium	456	450	419	1.4	7.4
Loss and loss expenses incurred	273	236	240	15.7	(1.8)
Loss and loss expenses ratio	59.8%	52.4%	57.3%		
Loss and loss expense ratio excluding catastrophes	59.7	52.1	56.5		
Other liability:					
Written premium	\$ 458	\$ 424	\$ 377	7.9	12.5
Earned premium	442	402	342	9.8	17.6
Loss and loss expenses incurred	187	116	183	61.7	(36.8)
Loss and loss expenses ratio	42.4%	28.8%	53.6%		
Loss and loss expense ratio excluding catastrophes	42.4	28.8	53.6		
Accident year	2005	2004	2003	2002	2001
Loss and loss expenses incurred:					
Commercial multi-peril	\$ 504	\$ 459	\$ 411	\$ 408	\$ 403
Workers compensation	256	245	231	236	230
Commercial auto	297	268	261	251	242
Other liability	269	210	193	156	123
Loss and loss expenses ratio:					
Commercial multi-peril	63.4%	61.2%	61.1%	67.2%	75.3%
Workers compensation	78.0	78.3	78.9	80.2	91.2
Commercial auto	65.1	59.6	62.3	65.4	75.6
Other liability	60.8	52.3	56.5	56.8	57.1

In total, the commercial multi-peril, workers compensation, commercial auto and other liability lines of business accounted for 89.7 percent of total commercial lines earned premium compared with 90.1 percent in 2004 and



90.5 percent in 2003. Approximately 95 percent of our commercial lines premiums are written as packages, providing accounts with coverages from more than one business line. We believe that our commercial lines segment is best measured and evaluated on a segment basis. We have provided the table above and the discussion below to summarize growth and profitability trends separately for each of the four primary business lines.

The accident year loss data provides current estimates of incurred loss and loss expenses for the past five accident years. Accident year data classifies losses according to the year in which the corresponding loss event occurred, regardless of when the losses are actually reported, booked or paid.

Over the past three years, results for the business lines within the commercial lines segment have reflected our emphasis on underwriting and obtaining adequate pricing for covered risks, as discussed above.

#### **Commercial Multi-peril**

In 2005 and 2004, commercial multi-peril written premiums rose more rapidly than the total for commercial lines as a higher proportion of liability coverages were written in discounted packages because of competitive pricing pressures. Commercial multi-peril written premiums were lower in 2003 when some liability coverages were moved to nondiscounted policies. Nondiscounted policies are included in our other liability line of business.

Commercial multi-peril is our single largest business line. We believe this business line's loss data provides the best indicator of the success of the growth and underwriting actions that we have implemented during the past five years. The higher general liability base rates that were effective in most states beginning in 2003 helped to offset a trend toward higher construction costs for 2005 and 2004 property claims.

In each of the last three calendar years, reserve changes for prior periods have contributed to results.

2005 Favorable development lowered the loss and loss expense ratio by 7.7 percentage points. The favorable development largely was due to lower commercial multi-peril exposures because of

prior-year transfers of business to non-discounted policies and to the benefits of changes made in 2002 to our general liability terms and conditions.

2004 Reserve strengthening added 0.6 percentage points to the loss and loss expense ratio. Additions to reserves for environment claims were offset by favorable development of case reserves for non-environmental claims due to our headquarters claims department's initiative to establish higher initial case reserves on severe injury claims.

2003 Reserve strengthening added 2.0 percentage points to the loss and loss expense ratio because we added to our reserves for environmental claims.

In addition, the large loss discussed above added 2.9 percentage points to the 2005 ratio.

### **Workers Compensation**

Conditions within the workers compensation market remained stable in 2005 and 2004 after improving between 1999 and 2003 as market pricing rose in most states, albeit offset by continued rising trends in loss severity. In 2005, workers compensation written premiums rose more rapidly than our total commercial lines written premiums as this business line appeared to experience less competitive pricing pressures than the overall commercial lines market in the second half of the year. As the commercial lines market has softened, however, insurers have displayed a greater willingness to write more desirable risks, and growth in the premium volume of state pools for workers compensation is declining.

Since 2002, we have chosen not to renew selected policies where we believed the aggregate exposure risk was excessive. Any new or renewal policy covering 200 or more employees at any one location receives added scrutiny as we seek to manage risk aggregation. We make workers compensation available as part of package policies for commercial lines policyholders in selected states as a competitive tool. We pay a lower commission rate on workers compensation business, which means this line has a higher loss and loss expense breakeven point than our other commercial business lines. In Ohio, our largest state, workers compensation coverage is a state monopoly, provided solely by the state instead of by private insurers.

The workers compensation loss and loss expense ratio rose in 2005 after remaining steady for several years, largely because of a higher level of reserve strengthening for older accident years.

2005 Reserve strengthening added 13.3 percentage points to the loss and loss expense ratio. The reserve strengthening primarily was due to medical cost inflation and longer estimated payout periods compared with our original projections.

2004 Reserve strengthening added 4.9 percentage points to the loss and loss expense ratio, which also was due to longer estimated payout periods.

2003 Reserve strengthening added 4.3 percentage points to the loss and loss expense ratio, which also was due to medical cost inflation.

### **Commercial Auto**

Written premiums declined 2.4 percent in 2005 after rising 5.5 percent in 2004, below the overall commercial lines growth rate. Commercial auto is one of the package policy components for which we calculate pricing annually. This line tends to be highly sensitive to competitive pressures.

In the past several years, we accelerated efforts to improve commercial auto underwriting and rate levels, making certain that vehicle use was properly classified. As a result of those actions and moderating industrywide severity and frequency trends, the loss and loss expense ratio for commercial auto remained at an acceptable level in 2005 despite pricing pressures, after improving from 2001 through 2004. Further, we continue to adhere to our underwriting guidelines to assure accurate classification and pricing.

A significant factor in the calendar year-over-year changes has been savings from favorable loss reserve development for prior years.

2005 Favorable development lowered the loss and loss expense ratio by 5.3 percentage points. The savings largely were due to moderating frequency and severity trends.

2004 Favorable development lowered the loss and loss expense ratio by 10.5 percentage points, including 4.6 percentage points due to the release of UM/UIM reserves. The remainder of the savings largely was due to moderating frequency and severity trends.

2003 Favorable development lowered the loss and loss expense ratio by 8.8 percentage points, including 6.9 percentage points due to the release of UM/UIM case reserves. The release of UM/UIM-related IBNR reserves

also contributed.

**Other Liability**

Other liability (commercial umbrella, commercial general liability and most executive risk policies) written premiums also grew more rapidly than our total commercial lines written premiums because of the growing number of policies written in non-discounted programs and the continuing rise in liability pricing. The growth

2005 10-K Page 46

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rate is decelerating, however, because a higher proportion of accounts are being written in discounted packages because of competitive pricing pressures. Discounted policies are included in our commercial multi-peril line of business.

Director and officer coverage accounted for approximately 11 percent of other liability premium in 2005 compared with approximately 13 percent in 2004 and approximately 12 percent in 2003. Our director and officer policies are offered primarily to nonprofit organizations, reducing the risk associated with this line of business. As of December 31, 2005, three of our in-force director and officer policies were for Fortune 500 companies, 38 were for publicly traded companies (excluding banks and savings and loans) and 59 were for banks and savings and loans with more than \$500 million in assets.

In large part because this business line also includes umbrella coverages, the calendar year loss and loss expense ratio tends to fluctuate significantly on a year-over-year basis. Our headquarters claims department's initiative to establish higher initial case reserves on severe injury claims has the greatest effect on this business line:

2005 Favorable development lowered the loss and loss expense ratio by 18.4 percentage points. Enforcement of stricter underwriting standards and a preference for lower limit policies contributed to favorable development for our commercial umbrella coverages.

2004 Favorable development lowered the loss and loss expense ratio by 32.5 percentage points, including 2.0 percentage points due to the release of UM/UIM reserves.

2003 Favorable development lowered the loss and loss expense ratio by 23.0 percentage points, including 2.6 percentage points due to the release of UM/UIM reserves.

### **Commercial Lines Insurance Outlook**

Industrywide commercial lines written premiums are expected to rise approximately 2.3 percent in 2006. During 2005, agents reported that renewal pricing pressure had risen since the end of 2004 and new business pricing was requiring even more flexibility and more careful risk selection. During 2005, we needed to use credits more frequently to retain renewals of quality business—the larger the account, the higher the credits, with variations by geographic region and class of business. At the end of 2005, renewal rates on property coverages were generally flat to modestly down, exclusive of any changes in an account's exposure. Renewal pricing on liability coverages was less affected by competitive pricing pressures, with some increases possible.

We intend to continue to market our products to a broad range of business classes, price our products adequately and take a package approach. We intend to maintain our underwriting selectivity and carefully manage our rate levels, as well as our programs that seek to accurately match exposures with appropriate premiums. We will continue to evaluate each risk individually and to make decisions regarding rates, the use of three-year commercial policies and other policy terms on a case-by-case basis, even in lines and classes of business that are under competitive pressure. New marketing territories created over the past several years and new agency appointments will contribute to commercial lines growth.

Prior to Hurricanes Katrina, Rita and Wilma, we anticipated 2006 commercial lines insurance market trends would reflect accelerated competition with pressure on pricing from the industry's increasing surplus and improving profitability. We are uncertain what the effect of the hurricanes will be on commercial lines pricing going forward. We believe their effect on pricing largely will be limited to coastal markets and business lines directly affected by the storms.

We believe our approach should allow us to maintain most of the positive underlying improvements in profitability that have occurred over the past several years, but we do not believe favorable reserve development will contribute to underwriting profits as much in 2006 as in 2005 and 2004. In addition, underwriting expenses are rising. We discuss our overall outlook for the property casualty insurance operations in *Measuring Our Success in 2006 and Beyond*, Page 33,.

### **Personal Lines Insurance Results of Operations**

#### **Overview Three-year Highlights**

Performance highlights for the personal lines segment include:

Premiums During the past three years, we have been working to address personal lines profitability. Because of our actions, the 2005 personal lines combined ratio was below 100 percent for the first time since 1999. However, as

other carriers refined their pricing models , our pricing was less competitive and written premiums declined in 2005 after slowing in 2004. Industry average written premium growth was estimated at 3.5 percent for 2005 and 6.6 percent for 2004. Our earned premium growth has slowed as a result of the written premium trend. Reinsurance reinstatement premiums allocated to personal lines reduced our premium growth by 0.3 and 0.8 percentage points for 2005 and 2004, respectively.

Combined ratio The substantial improvement in the 2005 combined ratio reflected our progress in lowering the homeowner loss and loss expense ratio and our lower catastrophe losses offset by higher

2005 10-K Page 47

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noncommission underwriting expenses. The 2004 personal lines combined ratio was slightly above the prior year's level. Higher catastrophe losses and underwriting expenses offset the improvement in the homeowner and personal auto loss and loss expense ratios excluding catastrophe losses.

Our personal lines statutory combined ratio was 94.3 percent in 2005 compared with 104.6 percent in 2004 and 102.9 percent in 2003. By comparison, the estimated industry personal lines combined ratio was 97.3 percent in 2005, 94.9 percent in 2004 and 98.4 percent in 2003.

### Growth and Profitability

Personal lines insurance is a strategic component of our overall relationship with many of our agencies and an important component of agency relationships with their clients. We believe agents recommend Cincinnati personal insurance products for their value-oriented clients who seek to balance quality and price and are attracted by Cincinnati's superior claims service and the benefits of our package approach. In the past 12 to 18 months, our personal lines rates in some territories did not allow our agents to market these benefits, resulting in a slight decline in our policy retention rate from its historical level above 90 percent.

The same factors that reduced policy retention have had an impact on new personal lines business. Personal lines new business premiums written directly by agencies declined 33.9 percent to \$32 million in 2005 and declined 19.9 percent to \$48 million in 2004.

We discuss premium trends by personal lines of business on Page 51.

### Personal Lines Results

(Dollars in millions)	2005	2004	2003	2005-2004 Change %	2004-2003 Change %
Written premiums	\$ 786	\$ 811	\$ 784	(3.0)	3.4
Earned premiums	\$ 804	\$ 793	\$ 745	1.4	6.4
Loss and loss expenses excluding catastrophes	463	522	524	(11.3)	(0.4)
Catastrophe loss and loss expenses	51	77	55	(34.2)	41.4
Commission expenses	154	160	146	(3.6)	9.7
Underwriting expenses	91	74	47	24.0	52.1
Underwriting profit(loss)	\$ 45	\$ (40)	\$ (27)	214.0	45.8
Ratios as a percent of earned premiums:					
Loss and loss expenses excluding catastrophes	57.6%	65.9%	70.3%		
Catastrophe loss and loss expenses	6.3	9.7	7.3		
Loss and loss expenses	63.9	75.6	77.6		
Commission expenses	19.2	20.1	19.5		
Underwriting expenses	11.3	9.3	6.5		
Combined ratio	94.4%	105.0%	103.6%		

Between 2000 and 2003, the industry implemented higher homeowner rates and imposed stricter enforcement of underwriting standards. In late 2004, price competition returned as insurers leveraged their higher profitability and stronger financial positions. The marketplace continued to become more competitive throughout 2005.

We began a strategic shift in 2004 from our traditional three-year to one-year homeowner policy terms. We are transitioning to one-year policies in conjunction with the state-by-state deployment of Diamond, our personal lines policy processing system. One-year policies allow us to promptly modify rates, terms and conditions in response to market changes. In mid-2004, we also began modifying policy terms to change homeowner policy earthquake deductibles to 10 percent from 5 percent in selected Midwestern states, reducing the company's exposure to a single significant catastrophic event.

In 2004, as price competition began to emerge, we were in the early stages of our program to improve profitability for our homeowner line by raising rates and making changes to our policy terms and conditions.

From mid-2004 to mid-2005, we opted to delay rate changes because we felt it was important to fully commit our programming resources to completing necessary modifications and upgrades to our then-new Diamond policy processing system. During that time period, other carriers began making more aggressive use of segmented pricing models, generating lower rates for higher quality accounts. When some important system modifications were completed in mid-2005, we began filing rate and credit changes to better position our products in the market.

The introduction of Diamond in our higher volume states may also have contributed to lower growth rates. The focus required by our agencies to convert to the newer technology and adapt to new work flows may have diverted their resources from new business efforts. Diamond gives agencies additional choices to consider for their business operations and for policyholders. Agents are growing more familiar with the new options and workflow, and many now are seeing benefits from efficiencies as they renew business through the system.

During 2005, we increased the system's processing power and availability and offered additional functionality requested by agency staff. For example, we began offering convenient account billing to direct bill customers,

invoicing for multiple policies at one time, and electronic fund transfer, which accommodates new monthly payment plans. We continue to respond to agency requests for enhancements as we prepare Diamond for additional states. Although our homeowner profitability lagged the industry, our actions resulted in substantial improvement in our personal lines combined ratio over the past three years. Our 2005 statutory combined ratio improved to 94.3 percent while the estimated industry combined ratio deteriorated 2.4 points to 97.3 percent. Moreover, we expect to realize additional profit improvements in 2006 as we continue the conversion to one-year policies written with updated rates, terms and conditions.

In mid-2006, we will introduce a limited program of rate segments incorporating insurance scores into pricing for our personal auto and homeowner products in states using Diamond and make other changes to our credits in states not yet using Diamond. This step should further improve our ability to compete for our agents' highest quality personal lines accounts. We believe it will increase the opportunity to work with our agents on marketing the advantages of our personal lines products and services to their clients, which would help us resume growing in this business area. We describe the significant costs components for the personal lines segment below.

#### **Loss and Loss Expenses (excluding catastrophe losses)**

Loss and loss expenses include both net paid losses and reserve additions for unpaid losses as well as the associated loss expenses. The improvement in the loss and loss expense ratio excluding catastrophes over the past three years was due to a 14.4 percentage point improvement in the homeowner ratio excluding catastrophe losses between 2005 and 2003 and a 10.4 percentage point improvement in the personal auto ratio excluding catastrophe losses over the same period. Savings from favorable loss reserve development, including the release of UM/UIM reserves, influenced those improvements. We discuss homeowner and personal auto trends separately beginning on Page 51.

We monitor incurred losses by size of loss, business line, risk category, geographic region, agency, field marketing territory and duration of policyholder relationship, addressing concentrations or trends as needed. Our 2005 analysis indicated no significant concentrations other than trends in business lines that we address as part of our ongoing business operations. We also measure new losses and case reserve adjustments greater than \$250,000 to track frequency and severity. These personal lines large losses and case reserve increases declined as a percent of earned premiums in 2005 because of higher rates per exposure.

#### **Personal Lines Losses by Size**

(Dollars in millions)	2005	2004	2003	2005-2004 Change %	2004-2003 Change %
Losses \$1 million or more	\$ 13	\$ 17	\$ 15	(26.0)	14.6
Losses \$250 thousand to \$1 million	34	43	41	(19.9)	4.9
Development and case reserve increases of \$250 thousand or more	19	21	11	(7.7)	83.7
Other losses	339	371	391	(8.5)	(5.2)
Total losses incurred excluding catastrophe losses	405	452	458	(10.2)	(1.4)
Catastrophe losses	51	77	55	(34.2)	41.4
Total losses incurred	\$ 456	\$ 529	\$ 513	(13.7)	3.1
As a percent of earned premiums:					
Losses \$1 million or more	1.5%	2.2%	2.0%		
Losses \$250 thousand to \$1 million	4.3	5.4	5.5		
	2.4	2.6	1.5		



Development and case reserve increases of \$250 thousand or more			
Other losses	<b>42.2</b>	46.8	52.5
Loss ratio excluding catastrophe losses	<b>50.4</b>	57.0	61.5
Catastrophe loss ratio	<b>6.3</b>	9.7	7.3
Total loss ratio	<b>56.7%</b>	66.7%	68.8%

2005 10-K Page 49

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**Catastrophe Loss and Loss Expenses**

Personal lines catastrophe losses, net of reinsurance and before taxes, were \$51 million in 2005 compared with \$77 million in 2004 and \$55 million in 2003. The following table shows losses incurred, net of reinsurance, and subsequent development, for catastrophe losses in each of the past three years.

(In millions, net of reinsurance)			Incurred in calendar year ended December 31,		
Occurrence year	Cause of loss	Region	2005	2004	2003
<b>2005</b>					
January	Wind, ice snow, freezing	Midwest, Mid-Atlantic	\$ 1		
May	Wind, hail	Midwest	8		
July	Hurricane Dennis	South	2		
August	Hurricane Katrina	South	11		
October	Hurricane Wilma	South	12		
November	Wind, hail	Midwest	9		
November	Wind	Midwest, South	10		
Total			53		
<b>2004</b>					
May	Wind, hail	Midwest, Mid-Atlantic	0	\$ 9	
May	Wind, hail	Midwest, Mid-Atlantic, South	0	20	
July	Wind, hail	Midwest, Mid-Atlantic, South	(1)	5	
August	Hurricane Charley	South	0	10	
September	Hurricane Frances	South	1	7	
September	Hurricane Jeanne	Mid-Atlantic, South	0	2	
September	Hurricane Ivan	Midwest, Mid-Atlantic, South	1	18	
December	Wind, ice, snow	Midwest, South	(3)	8	
Others			0	2	
Total			(2)	81	
<b>2003 and prior</b>					
April	Wind, hail	Midwest, South	0	(2)	\$ 31
May	Wind, hail	Midwest, South	0	0	17
July	Wind, hail	Midwest, Mid-Atlantic, South	0	(1)	5
July	Wind, hail	Midwest, Mid-Atlantic, South	0	0	1
September	Wind	Mid-Atlantic, South	0	(1)	4
November	Wind	Midwest, Mid-Atlantic, South	0	0	1
Others			0	0	(4)
Total			0	(4)	55

Calendar year total	\$	51	\$	77	\$	55
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**Commission Expenses**

Commission expense as a percent of earned premium declined by 0.9 percentage points in 2005, largely paralleling the decline in written premiums, after rising 0.6 percentage points in 2004. Profit-sharing, or contingent, commissions are calculated on the profitability of an agency's aggregate book of business, taking into account longer-term profit, with a percentage for prompt payment of premiums and other criteria. A refinement and subsequent release of a contingent commission over accrual from 2004 in the first three months of 2005 was responsible for 0.2 percentage points of the decline in 2005.

**Underwriting Expenses**

Noncommission expenses rose to 11.3 percent of earned premium in 2005 from 9.3 percent in 2004 and 6.5 percent in 2003. The three-year rise in the ratio largely was due to higher technology expenses, unfavorable deferred acquisition cost comparisons resulting from slower premium growth, higher staffing expenses and increased taxes and fees that were partially due to a state guaranty fund refund in 2003. The software recovery discussed in Corporate Financial Highlights Page 32, reduced the 2003 ratio by 1.1 percentage points.

2005 10-K Page 50

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**Line of Business Analysis**

(Dollars in millions)

Calendar year	2005	2004	2003	2005-2004 Change %	2004-2003 Change %
Personal auto:					
Written premium	\$ 410	\$ 453	\$ 447	(9.4)	1.2
Earned premium	433	451	428	(4.0)	5.4
Loss and loss expenses incurred	261	298	304	(12.5)	(2.1)
Loss and loss expenses ratio	60.2%	66.1%	71.1%		
Loss and loss expense ratio excluding catastrophes	59.7	65.1	70.1		
Homeowner:					
Written premium	\$ 290	\$ 273	\$ 254	6.3	7.3
Earned premium	285	259	239	10.2	8.2
Loss and loss expenses incurred	212	249	222	(14.6)	12.2
Loss and loss expenses ratio	74.5%	96.1%	92.7%		
Loss and loss expense ratio excluding catastrophes	58.4	69.3	72.8		
Accident year	2005	2004	2003	2002	2001
Loss and loss expenses incurred:					
Personal auto	\$ 267	\$ 297	\$ 305	\$ 289	\$ 259
Homeowner	215	254	227	207	193
Loss and loss expenses ratio:					
Personal auto	61.8%	66.0%	71.2%	74.3%	71.9%
Homeowner	75.4	98.1	95.0	98.6	101.4

The personal auto and homeowner business lines together accounted for 89.2 percent, 89.5 percent and 89.5 percent of total personal lines earned premiums in 2005, 2004 and 2003, respectively. Our intent is to write personal auto and homeowner coverages in personal lines packages that may also include personal umbrella liability, watercraft and other coverages. As a result, we believe that the personal lines segment is best measured and evaluated on a segment basis. We have provided the table above and the discussion below to summarize growth and profitability trends separately for the two primary business lines.

The accident year loss data provides current estimates of incurred loss and loss expenses for the past five accident years. Accident year data classifies losses according to the year in which the corresponding loss event occurred, regardless of when the losses are actually reported, booked or paid.

**Personal Auto**

Written and earned premiums for the personal auto line declined in 2005 after rising in 2004. As noted above, the decline in 2005 primarily was due to price competition in some states and territories, which has resulted in lower policy renewal retention and significantly lower new business levels. We are continuing to modify selected rates and credits to address our competitive position.

The loss and loss expense ratio for personal auto improved from an already strong level over the three years because of higher pricing. For selected agencies, we use re-underwriting programs to review and to strengthen underwriting standards, requiring motor vehicle reports for insured drivers, and to develop strategies to increase the company's penetration of the agency's personal lines business.

Calendar year-over-year changes in the loss and loss expense ratio have included loss reserve development. In 2005, savings from favorable loss reserve development from prior accident years lowered the loss and loss expense ratio by

1.6 percentage points. In 2004 and 2003, reserve strengthening added 0.2 percentage points and 2.1 percentage points, respectively, to the loss and loss expense ratio.

**Homeowner**

Written and earned premiums for the homeowner line rose in 2005 and 2004. Written premiums rose because of the effect of rate increases, which served to offset lower policy renewal retention and significantly lower new business levels. Earned premiums continued to benefit from written premium growth in earlier periods.

At year-end 2005, approximately 56 percent of all homeowner policies had been converted to a one-year term, up from approximately 27 percent at year-end 2004. We are continuing to renew homeowner policies for three-year terms in nine states until the Diamond roll out is planned for those states. Renewal rates on those three-year policies reflect all rate changes enacted over the past several years. This can cause those policies to renew at a significantly higher cost for the policyholders, even if the price is competitive.

The loss and loss expense ratio for the homeowner line excluding catastrophe losses improved in 2005 and 2004. Unusually high catastrophe losses in 2004 interrupted two years of improvement in the loss and loss expense ratio including catastrophe losses. Favorable loss reserve development from prior accident years lowered the loss and loss expense ratio by 1.0 percentage points in 2005, 2.2 percentage points in 2004 and 3.1 percentage points in 2003.

We continue to seek to improve homeowner results so that this line achieves profitability. Since we generally do not allocate noncommission expenses to individual business lines, to measure homeowner profitability, we

assume total commission and underwriting expenses would contribute approximately 30 percentage points to our homeowner combined ratio. Lower levels of premium growth could affect our ability to attain that level in 2006 and beyond.

We also assume catastrophe losses as a percent of homeowner earned premium would be in the range of 17 percent. Over the past three years, catastrophe losses have averaged approximately 21 percent of homeowner earned premiums. We believe it will take until 2007 for the full benefit of our pricing and underwriting actions to be reflected in homeowner results.

### **Personal Lines Insurance Outlook**

Industry experts currently anticipate industrywide personal lines written premiums will rise approximately 2.9 percent in 2006, with personal auto premiums expected to rise about 2.5 percent and homeowner premiums expected to rise 4.2 percent.

A number of factors contribute to our assessment of the potential for personal lines growth:

**Competitive rates** We are working on a number of rate setting initiatives to make our personal auto and homeowner rates competitive in all of our territories. We work with our agents to establish rates that are attractive to our agencies' quality accounts. In mid-2006, we will introduce a limited program of rate segments incorporating insurance scores into rates for our personal auto and homeowner policies to further improve our pricing for our agents' quality accounts. We believe the opportunity exists to work with our agents to market the advantages of our personal lines products to their clients, which would help us resume growing in this business area.

**Policy characteristics** In keeping with industry practices, most of our homeowner products no longer automatically cover guaranteed replacement costs. We add specific charges for some optional coverages previously included at no charge, such as limited replacement cost and water damage coverages. Policyholders who need the water damage protection now can select the amount of coverage that meets their needs. However, these changes and our transition to one-year homeowner policies may have diminished the factors that distinguished our products.

**Diamond introduction** The use of the Diamond system by agencies writing approximately 70 percent of personal lines volume is a significant accomplishment. We believe the system ultimately will make it easier for agents to place personal auto, homeowner and other personal lines business with us, while greatly increasing policy-issuance and policy-renewal efficiencies and providing direct-bill capabilities. Agents using Diamond chose direct bill for 37 percent and headquarters printing for 75 percent of policy transactions in 2005, options that generally were not available on our previous system.

**New agencies** The availability of Diamond should help us increase the number of agencies that offer our personal lines products, which also should contribute to personal lines growth. We currently market both homeowner and personal auto insurance products through 773 of our 1,253 reporting agency locations in 22 of the 32 states in which we market commercial lines insurance. We market homeowner products through 22 locations in three additional states (Maryland, North Carolina and West Virginia.)

In addition to the rate modifications currently underway, we identify several other factors that may affect the personal lines combined ratio in 2006 and beyond. Personal lines underwriters continue to focus on insurance-to-value initiatives to verify that policyholders are buying the correct level of coverage for the value of the insured risk, and we are carefully maintaining underwriting standards. However, if premiums decline more than we expect, the personal lines expense ratio may be higher than the 2005 level, because some of our costs are relatively fixed, such as our planned investments in technology. We discuss our overall outlook for the property casualty insurance operations in *Measuring Our Success in 2006 and Beyond*, Page 33.

### **Life Insurance Results of Operations**

#### **Overview Three-year Highlights**

Performance highlights for the life insurance segment include:

**Revenues** Revenue growth has accelerated over the past three years as gross in-force policy face amounts increased to \$51.493 billion at year-end 2005 from \$44.921 billion at year-end 2004 and \$38.492 billion at year-end 2003.

**Profitability** The life insurance segment reports a small GAAP profit because investment income is included in investment segment results, except investment income credited to contract holders (interest assumed in life insurance policy reserve calculations). Results improved in 2005 and 2004 because operating expenses remained

level and mortality experience remained within pricing guidelines as premiums continued to rise.

At the same time, we recognize assets under management, capital appreciation and investment income are integral to evaluation of the success of the life insurance segment because of the long duration of life

2005 10-K Page 52

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products. For that reason, we also evaluate GAAP data including all investment activities on life insurance-related assets.

GAAP net income on that basis grew 23.8 percent in 2005 to \$47 million and 74.1 percent in 2004 to \$38 million. The life insurance portfolio had pretax realized investment gains of \$17 million in 2005 compared with \$9 million of gains in 2004 and \$10 million of pretax realized investment losses in 2003.

### Life Insurance Results

(In millions)	2005	2004	2003	2005-2004 Change %	2004-2003 Change %
Written premiums	\$ 205	\$ 193	\$ 143	6.5	34.7
Earned premiums	\$ 106	\$ 101	\$ 95	5.7	5.5
Separate account investment management fees	4	3	2	18.5	31.9
Total revenues	110	104	97	6.0	6.1
Contract holders benefits incurred	102	95	91	7.2	3.5
Investment interest credited to contract holders	(51)	(46)	(43)	12.9	5.7
Expenses incurred	52	53	52	(0.3)	0.2
Total expenses	103	102	100	0.8	0.9
Life insurance segment profit (loss)	\$ 7	\$ 2	\$ (3)	334.2	147.5

### Growth

We offer term, whole life and universal life products, fixed annuities and disability income products. Revenues in 2005 were derived principally from:

Premiums from traditional products, principally term insurance, which contributed 71.3 percent

Fee income from interest-sensitive products, principally universal life insurance, which contributed 25.5 percent

Separate account investment management fee income, which contributed 3.2 percent

Our life insurance subsidiary reported total statutory written premiums of \$205 million in 2005 compared with \$193 million in 2004, which included premiums for two general account BOLI policies totaling \$10 million, and \$143 million in 2003. Written premiums for life insurance operations for all periods include life insurance, annuity and accident and health premiums.

In 2005, our life insurance segment experienced a 2.0 percent rise in applications submitted and a 4.9 percent increase in gross face amounts issued, primarily due to continued strong sales of term insurance marketed through the company's property casualty agency force.

Over the past several years, we have worked to maintain a portfolio of straightforward and up-to-date products, primarily under the LifeHorizons name. Our product development efforts emphasize death benefit protection and guarantees.

For example, a new term series that includes a return-of-premium feature replaced the existing term portfolio in 2005. Reaction to the new portfolio has been favorable with approximately 25 percent of applications requesting the return-of-premium feature. In 2006, we are introducing a new universal life product that offers a secondary guarantee that keeps the death benefit in force provided a competitive minimum premium requirement is met.



Distribution expansion remains a high priority. In the past several years, we have added life field marketing representatives for the western and northeastern states.

**Profitability**

Life segment expenses consist principally of:

Insurance benefits paid and reserve increases related to traditional life and interest-sensitive products, which accounted for 66.0 percent of 2005 expenses and 64.3 percent of 2004 expenses

Commissions, general and other business expenses, net of deferred acquisition costs, which accounted for 34.0 percent of 2005 expenses and 35.7 percent of 2004 expenses

Life segment profitability depends largely on premium levels, the adequacy of product pricing, underwriting skill and operating efficiencies. Life segment results include only investment interest credited to contract holders (interest assumed in life insurance policy reserve calculations). The remaining investment income is reported in the investment segment results. The life investment portfolio is managed to earn target spreads between earned investment rates on general account assets and rates credited to policyholders. We consider the amount of assets under management and investment income for the life investment portfolio as key performance indicators for the life insurance segment. We seek to maintain a competitive advantage with respect to benefits paid and reserve increases by consistently achieving better than average claims experience due to skilled underwriting. Commissions paid by

2005 10-K Page 53

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the life insurance operation are on par with industry averages. During the past several years, we have invested in imaging and workflow technology and have significantly improved application processing. We have achieved efficiencies while maintaining our service standards.

### Life Insurance Outlook

As the life insurance company seeks to improve penetration of our property casualty agencies, our objective is to increase premiums and contain expenses. We continue to emphasize the cross-serving opportunities afforded by worksite marketing of life insurance products. In 2006, we are exploring additional programs to simplify the worksite marketing sales process, including electronic enrollment software. We also intend to enhance our worksite product portfolio to make it more attractive to agents. We believe these strategies will allow us to continue to increase our worksite marketing business area.

Term insurance is our largest life insurance product line. We continue to introduce new term products with features our agents indicate are important. In addition to the changes in our term life insurance portfolio, we are implementing our new universal life products.

Marketplace and regulatory changes during 2004 have affected the cost and availability of reinsurance for term life insurance issued since the beginning of 2005. We are addressing this situation by retaining no more than a \$500,000 exposure, ceding the balance using excess over retention mortality coverage and retaining the policy reserve.

Retaining the policy reserve has no direct impact on GAAP results. However, because of the conservative nature of statutory reserving principles, retaining the policy reserve unduly depresses our statutory earnings and requires a large commitment of capital. We anticipate favorable regulatory changes as we discuss in Item 1, Life Insurance Segment, Page 13. We believe we will be able to continue to grow in the term life insurance marketplace while appropriately managing risk, at a cost that allows the life insurance company to achieve its internal performance targets.

### Investments Results of Operations

#### Overview Three-year Highlights

The investment segment contributes investment income and realized gains and losses to results of operations.

Investments provide our primary source of pretax and after-tax profits.

**Investment income** Pretax investment income reached a new record in 2005, rising 6.9 percent from the prior record in 2004. Growth in investment income over the past two years has been driven by strong cash flow for new investments, higher interest income from the growing fixed-maturity portfolio and increased dividend income from the common stock portfolio.

**Realized gains and losses** We reported realized gains in 2005 and 2004 largely due to investment sales. The realized loss in 2003 was due to other-than-temporary impairment charges.

#### Investment Results

(In millions)	2005	2004	2003	2005-2004 Change %	2004-2003 Change %
Investment income:					
Interest	\$ 280	\$ 252	\$ 235	11.2	7.2
Dividends	244	239	227	2.1	5.0
Other	8	6	8	29.4	(23.0)
Investment expenses	(6)	(5)	(5)	(22.3)	(13.0)
Total net investment income	526	492	465	6.9	5.6
Investment interest credited to contract holders	(51)	(46)	(43)	12.9	5.7
Net realized investment gains and losses:					

Realized investment gains and losses	<b>69</b>	87	30	<b>(20.7)</b>	189.9
Change in valuation of embedded derivatives	<b>(7)</b>	10	9	<b>(167.2)</b>	7.9
Other-than-temporary impairment charges	<b>(1)</b>	(6)	(80)	<b>78.5</b>	92.0
Net realized investment gains (losses)	<b>61</b>	91	(41)	<b>(33.1)</b>	321.7
Investment operations income	<b>\$ 536</b>	\$ 537	\$ 381	<b>(0.4)</b>	40.6

### Investment Income

The advantages of strong cash flow in the past three years have been somewhat offset by the challenge of investing in a low interest rate environment. The allocation of new investment dollars to fixed-maturity securities during most of 2005 and 2004 added to investment income growth.

Overall, common stock dividends contributed 43.7 percent of pretax investment income in 2005 compared with 43.9 percent in 2004 and 42.3 percent in 2003. Fifth Third, our largest equity holding, contributed 43.6 percent of total dividend income in 2005. We discuss our Fifth Third investment in Item 7A, Quantitative and Qualitative Disclosures About Market Risk, Page 70. In 2005, 36 of the 49 common stock holdings in the portfolio raised their indicated annual dividend payout, as did 33 of the 51 in 2004 and 29 of 51 in 2003.

2005 10-K Page 54

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### **Net Realized Investment Gains and Losses**

Net realized investment gains and losses are made up of realized investment gains and losses on the sale of securities, changes in the valuation of embedded derivatives within certain convertible securities and other-than-temporary impairment charges. These three areas are discussed below.

#### **Realized Investment Gains and Losses**

Realized investment gains in 2005 and 2004 largely were due to the sale of equity holdings. We buy and sell both fixed-maturity and equity securities on an ongoing basis to help achieve our portfolio objectives.

In 2005 and 2003, we had gains from the sale of equity holdings that no longer met our investment parameters or were obtained from convertible securities whose underlying common stock was never intended to be a long-term holding. Included in 2005 were the initial sales of a portion of our ALLTEL holding. We completed the sale of our entire ALLTEL position in January 2006. We discuss this sale in Item 1, Investments Segment, Page 15, and Item 8, Note 2 to the Consolidated Financial Statements, Page 88.

In 2004, we sold \$356 million in equity holdings as part of a program to support the financial strength ratings of our property casualty insurance operations. We selected holdings to sell primarily based on the belief of the investment committee and management that these securities would have a lower dividend growth rate over the next several years when compared with other holdings in the portfolio. We also considered the potential tax effect of any unrealized gains. Partial sales of holdings in which we held over \$100 million in fair value at year-end 2003 contributed \$311 million.

We sold fixed-maturity investments during the past three years as part of our portfolio management strategies. The majority of these were bonds disposed of due to rating or credit concerns, including several in the airline and auto related industries. Although we prefer to hold fixed-maturity investments until they mature, a decision to sell reflects our perception of a change in the underlying fundamentals of the security and preference to allocate those funds to investments that more closely meet the established parameters for long-term stability and growth. Our opinion that a security fundamentally no longer meets our investment parameters may reflect a loss of confidence in the issuer's management, a change in underlying risk factors (such as political risk, regulatory risk, sector risk or credit risk), or a recovery from a previously impaired value.

Realized gains in the past three years also have included gains from the sale of previously impaired securities.

#### **Change in the Valuation of Embedded Derivatives**

In 2005, we recorded \$7 million in fair value declines compared with \$10 million in fair value increases in 2004 and \$9 million in fair value increases in 2003. These changes in fair value are due to the application of SFAS No. 133, which requires measurement of the fluctuations in the value of the embedded derivative features in selected convertible securities. The changes in fair values are recognized in net income in the period they occur. See Item 8, Note 1 to the Consolidated Financial Statements, Page 84, for details on the accounting for convertible security embedded options.

#### **Other-than-temporary Impairment Charges**

In 2005, we recorded \$1 million in write-downs of investments that we deemed had experienced an other-than-temporary decline in market value versus \$6 million in 2004 and \$80 million in 2003. The factors we consider when evaluating impairments are discussed in Critical Accounting Estimates, Asset Impairment, Page 37. The other-than-temporary impairment charges represented less than 0.1 percent of our total invested assets at year-end 2005 and 2004 and 0.6 percent of our total invested assets at year-end 2003. Other-than-temporary impairment charges also include unrealized losses of holdings that we have identified for sale but not yet completed a transaction. The significant decline in other-than-temporary impairment in 2005 and 2004 was due to prior impairments in the portfolio, disposition of certain securities in prior years and an improvement in the general financial climate. The majority of the other-than-temporary write-downs in the past three years were due to:

- 2005 one auto-related convertible preferred security for \$1 million
- 2004 two airline-related tax-exempt municipal bonds totaling \$5 million
- 2003 31 high-yield corporate bonds written down \$39 million and 10 convertible securities written down \$26 million. Market value declines in 2003 largely related to events specific to the issuer rather than industry issues, although \$58 million of the \$80 million write-downs were concentrated in the utility/merchant energy trading,

airline and healthcare industries.

2005 10-K Page 55

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Other-than temporary impairment charges from the investment portfolio by the asset class we described in Item 1, Investments Segment, Page 15, are summarized below:

(Dollars in millions)	Years ended December 31,		
	2005	2004	2003
<b>Taxable fixed maturities:</b>			
Number of securities impaired	2	1	42
Percent to total owned	0%	1%	6%
Impairment amount	\$ (1)	\$ 0	\$ (66)
New book value	1	2	36
Percent to total owned	0%	1%	1%
<b>Tax-exempt fixed maturities:</b>			
Number of securities impaired	0	2	5
Percent to total owned	0%	0%	1%
Impairment amount	\$ 0	\$ (5)	\$ (6)
New book value	0	9	3
Percent to total owned	0%	1%	0%
<b>Common equities:</b>			
Number of securities impaired	0	1	2
Percent to total owned	0%	2%	4%
Impairment amount	\$ 0	\$ (1)	\$ (8)
New book value	0	0	5
Percent to total owned	0%	0%	0%
<b>Preferred equities:</b>			
Number of securities impaired	0	0	0
Percent to total owned	0%	0%	0%
Impairment amount	\$ 0	\$ 0	\$ 0
New book value	0	0	0
Percent to total owned	0%	0%	0%
<b>Short-term investments:</b>			
Number of securities impaired	0	0	0
Percent to total owned	0%	0%	0%
Impairment amount	\$ 0	\$ 0	\$ 0
New book value	0	0	0
Percent to total owned	0%	0%	0%
<b>Total:</b>			
Number of securities impaired	2	4	49
Percent to total owned	0%	0%	3%
Impairment amount	\$ (1)	\$ (6)	\$ (80)
New book value	\$ 1	\$ 11	\$ 44

Percent to total owned 0% 0% 1%  
 Other-than temporary impairment charges from the investment portfolio by industry are summarized as follows:

(Dollars in millions)	Years ended December 31,		
	2005	2004	2003
Automotive	\$ (1)	\$ 0	\$ (1)
Airline	0	(5)	(18)
Utility/merchant energy/trading	0	0	(30)
Healthcare	0	0	(10)
Other	0	(1)	(21)
Total	\$ (1)	\$ (6)	\$ (80)

### Investments Outlook

We believe investment income growth for 2006 could be in the range of 6.5 percent to 7.0 percent. Our outlook is based on the anticipated level of dividend income, the strong cash flow from insurance operations and the higher-than-normal allocation of new cash flow to fixed-maturity securities over the past 18 months. Dividend increases within the last 12 months by Fifth Third and another 35 of the 49 common stock holdings in the equity portfolio should add \$15 million to annualized investment income. In 2006, our investment department will allocate the after-tax proceeds of the ALLTEL common stock sale in line with our overall investment philosophy, with a focus on replacing the approximately \$20 million in ALLTEL dividend income received in 2005.

2005 10-K Page 56

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We believe impairments in 2006 should be limited to securities that have been identified for sale or that have experienced a sharp decline in fair value with little or no warning because of issuer-specific events. All but two securities in the portfolio were trading at or above 70 percent of book value at December 31, 2005. Our asset impairment committee continues to monitor the investment portfolio. The current asset impairment policy is in Critical Accounting Estimates, Asset Impairment, Page 37.

#### **Other**

In 2005, other income of the insurance subsidiaries, parent company operations and non-investment operations of CFC Investment Company and CinFin Capital Management Company resulted in \$12 million in revenues compared with \$8 million in 2004 and \$7 million in 2003. Losses before income taxes of \$50 million in 2005 were primarily due to \$52 million in interest expense from debt of the parent company. Losses before income taxes were \$37 million in 2004 and \$38 million in 2003, when interest expense was \$36 million and \$33 million, respectively.

#### **Taxes**

Income tax expense was \$221 million in 2005 compared with \$216 million in 2004 and \$106 million in 2003. The effective tax rate for 2005 was 26.8 percent compared with 27.0 percent in 2004 and 22.0 percent in 2003. In addition to higher underwriting profits, the higher tax rate in 2005 and 2004 reflected a higher level of capital gains, compared with capital losses in 2003.

We pursue a strategy of investing some portion of cash flow in tax-advantaged fixed-maturity and equity securities to minimize our overall tax liability and maximize after-tax earnings. Details regarding our effective tax rate are found in Item 8, Note 10 to the Consolidated Financial Statements, Page 93.

#### **Liquidity and Capital Resources**

Liquidity and capital resources represent the overall financial strength of our company and our ability to generate cash flows to meet the short- and long-term cash requirements of business obligations and growth needs. We seek to maintain prudent levels of liquidity and financial strength for the protection of our policyholders, creditors and shareholders.

The parent company's primary means of meeting liquidity requirements are dividends from our insurance subsidiary and income from investments held at the parent-company level supported by our capital resources. At year-end 2005, we had shareholders' equity of \$6.086 billion and total debt of \$791 million. Our ability to access the capital markets and short-term bank borrowing provide other potential sources of liquidity. One way we seek to maintain financial strength is by keeping our ratio of debt to capital below 15 percent. Our parent company's cash requirements include dividends to shareholders, interest payments on our long-term debt, common stock repurchases and general operating expenses.

Our insurance subsidiary's primary sources of liquidity are premiums and investment income. Its cash needs primarily consist of paying property casualty and life insurance loss and loss expenses as well as ongoing operating expenses and payments of dividends to the parent company. Although we have never sold investments to pay claims, the sale of investments would provide an additional source of liquidity, if required. After satisfying operating cash requirements, excess cash flows are invested in fixed-maturity and equity securities, leading to the potential for increases in future investment income and unrealized appreciation.

#### **Sources of Liquidity**

##### **Subsidiary Dividends**

Our insurance subsidiary declared dividends to the parent company of \$275 million in 2005, \$175 million in 2004 and \$50 million in 2003. State of Ohio regulatory requirements restrict the dividends insurance subsidiaries can pay.

Generally, the most Ohio-domiciled insurance subsidiaries can pay without prior regulatory approval is the greater of 10 percent of statutory surplus or 100 percent of statutory net income for the prior calendar year up to the amount of statutory unassigned surplus as of the end of the prior calendar year. Dividends exceeding these limitations may be paid only with approval of the Ohio Department of Insurance. During 2006, total dividends that our lead insurance subsidiary can pay to our parent company without regulatory approval are approximately \$517 million.

##### **Insurance Underwriting**

Our property casualty and life insurance operations provide liquidity because premiums generally are received before losses are paid under the policies purchased with those premiums. After satisfying our cash requirements, excess cash



flows are used for investment, increasing future investment income.

2005 10-K Page 57

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This table shows a summary of cash flow of the insurance subsidiary (direct method):

(In millions)	Years ended December 31,		
	2005	2004	2003
Written premiums	\$ 3,187	\$ 3,055	\$ 2,771
Loss and loss expenses paid	1,752	1,694	1,617
Commissions and other underwriting expenses paid	951	889	774
Insurance subsidiary cash flow from underwriting	484	472	380
Investment income received	427	362	332
Insurance subsidiary operating cash flow	\$ 911	\$ 834	\$ 712

Historically, cash receipts from property casualty and life insurance premiums, along with investment income, have been more than sufficient to pay claims, operating expenses and dividends to the parent company. While first-year life insurance expenses normally exceed the premiums, subsequent premiums are used to generate investment income until the time the policy benefits are paid.

After paying claims and operating expenses, cash flows from underwriting were essentially unchanged in 2005 after rising 21.5 percent in 2004. We discuss our future obligations for claims payments in Contractual Obligations, Page 59, and our future obligations for underwriting expenses in Commissions and Other Underwriting Expenses, Page 60. Based on our outlook for commercial lines, personal lines and life insurance, we believe that cash flows from underwriting could decline in 2006. A lower level of cash flow available for investment could lead to reduced potential for increases in future investment income and capital gains.

### Investing Activities

Investment income is a primary source of liquidity for both the parent company and insurance subsidiary. The transfer of equity holdings to our insurance subsidiary from the parent company in 2004 increased the amount of investment income generated at the subsidiary level but had no effect on consolidated investment income. As we discuss under Investments Results of Operations, Page 54, investment income rose in each of the past three years, and we expect investment income to grow 6.5 percent to 7.0 percent in 2006.

Realized gains also can provide liquidity, although we follow a buy-and-hold investment philosophy seeking to compound cash flows over the long-term. When we dispose of investments, we generally reinvest the gains in new investment securities. Disposition of investments occurs for a number of reasons:

**Sales of fixed-maturity investments** We prefer to hold fixed-maturity securities until maturity. Any decision to sell or to reduce a holding reflects our perception of a change in the underlying fundamentals of the security and our preference to allocate those funds to investments that more closely meet our established parameters for long-term stability and growth.

**Call or maturity of fixed-maturity investments** Calls and maturities of fixed-maturity investments are a function of the yield curve. The pace of calls of fixed maturities declined in 2005 because of a stabilization of interest rates. In the past several years, we have purchased U.S. agency paper with higher coupons and shorter call protection features.

**Sales of equity securities investments** In 2005, we continued to sell equity positions previously identified. We also recorded the initial ALLTEL sales in 2005. Sales of equity securities rose in 2004 due to the sale of \$356 million in equity holdings as part of our program to support the financial strength ratings of our property casualty insurance operations. Holdings to be sold were selected primarily based on the investment committee's and management's belief that these securities would have a lower dividend growth rate over the next several years when compared with other holdings in the portfolio. We also considered the potential tax effect of any unrealized gains.

We generally have substantial discretion in the timing of investment sales and, therefore, the resulting gains or losses that are recognized in any period. That discretion generally is independent of the insurance underwriting process. In

2006, we expect to continue to limit the disposition of investments to those that no longer meet our investment parameters or those that reach maturity or are called by the issuer. The sale of equity investments that no longer meet our investment criteria can provide cash for investment in common stocks that we perceive to have greater potential for capital appreciation and income growth.

**Capital Resources**

At year-end 2005, our debt-to-capital ratio was 11.5 percent. We had \$791 million of long-term debt and no borrowings on our short-term lines of credit. We generally have minimized our reliance on debt financing although we may utilize lines of credit to fund short-term cash needs.

We provide details of our three long-term notes in Item 8, Note 7 to the Consolidated Financial Statements, Page 91. None of the notes are encumbered by rating triggers.

2005 10-K Page 58

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We issued \$375 million aggregate principal amount of 6.125% senior notes in 2004. The \$368 million net proceeds from the offering:

Paid off \$183 million in short-term debt.

Are financing the construction of an estimated \$100 million office building and parking garage to be situated at the headquarters located in Fairfield beginning in 2005, as announced in August 2004.

Are available for general corporate purposes.

As of March 3, 2006, our senior debt issues were rated aa- by A.M. Best, A+ by Fitch, A2 by Moody's and A by Standard & Poor's.

At year-end 2005, we had two lines of credit totaling \$125 million with no outstanding balance. One line of credit for \$75 million was established more than five years ago and has no financial covenants. The second line of credit is an unsecured \$50 million line of credit from Fifth Third Bank established in 2005. It is available for general corporate purposes and contains customary financial covenants.

Based on our present capital requirements, we do not anticipate a material increase in debt levels during 2006. As a result, we believe our debt-to-capital ratio will remain in the range of 11 percent to 12 percent.

As a long-term investor, we historically have followed a buy-and-hold investing strategy. This policy has generated a significant amount of unrealized appreciation on equity investments. Unrealized appreciation, before deferred income taxes, was \$5.067 billion and \$5.840 billion at year-end 2005 and 2004, respectively. On an after-tax basis, it constituted 54.0 percent of total shareholders' equity at year-end 2005.

#### **Off-balance Sheet Arrangements**

We do not utilize any special-purpose financing vehicles or have any undisclosed off-balance sheet arrangements (as that term is defined in applicable SEC rules) that are reasonably likely to have a current or future material effect on the company's financial condition, results of operation, liquidity, capital expenditures or capital resources. Similarly, the company holds no fair-value contracts for which a lack of marketplace quotations would necessitate the use of fair-value techniques.

#### **Uses of Liquidity**

Our parent company and insurance subsidiary have contractual and other obligations. In addition, one of our primary uses of cash is to enhance shareholder return.

#### **Contractual Obligations**

At December 31, 2005, we estimated our future contractual obligations as follows:

(In millions)	Payment due by period				Total
	Within 1 year	Years 2-3	Years 4-5	More than 5 years	
Contractual obligations:					
Net property casualty claims payments	\$ 1,009	\$ 1,054	\$ 474	\$ 574	\$ 3,111
Net life claims payments	6	0	0	0	6
Interest on long-term debt	52	104	104	1,048	1,308
Long-term debt	0	0	0	795	795
Annuity obligations	15	45	30	104	194
Headquarters building expansion	20	63	0	0	83
Computer hardware and software	10	2	1	1	14
Other invested assets	9	10	1	0	20
<b>Total</b>	<b>\$ 1,121</b>	<b>\$ 1,278</b>	<b>\$ 610</b>	<b>\$ 2,522</b>	<b>\$ 5,531</b>

#### **Claims Payments**

Our estimate of material commitments for net property casualty claims payments was approximately 56.2 percent of the estimated contractual obligations at year-end 2005.

We direct our associates to settle claims and pay losses as quickly as practical and made \$1.752 billion in net claim payments during 2005. At year-end 2005, we had net property casualty reserves of \$3.111 billion, reflecting \$1.605 billion in unpaid amounts on reported claims (case reserves), \$669 million in loss expense reserves and \$837 million in estimates of IBNR claims. The specific amounts and timing of obligations related to case reserves and associated loss expenses are not set contractually. The amounts and timing of obligations for IBNR claims and related loss expenses are unknown. We discuss the adequacy of our property casualty and life insurance loss and loss expense reserves in Property Casualty Insurance Reserves, Page 61.

The historic pattern of using premium receipts for the payment of loss and loss expenses has enabled us to extend slightly the maturities of our investment portfolio beyond the estimated settlement date of the loss reserves. The modified duration of our fixed-maturity portfolio was 7.1 years at year-end 2005. By contrast, the duration of our loss and loss expense reserves was 3.1 years and the duration of all liabilities was 2.8 years. We believe this difference in duration does not affect our ability to meet current obligations because cash flow

from operations is sufficient to meet these obligations. In addition, our investment strategy has led to substantial unrealized gains from holdings in equity securities. These equity holdings could be liquidated to meet higher than anticipated loss and loss expenses.

We believe that our insurance subsidiaries maintain sufficient liquidity to pay claims and operating expenses, as well as meet commitments in the event of unforeseen circumstances such as catastrophe losses, reinsurer insolvencies, changes in the timing of claims payments, increases in claims severity, reserve deficiencies or inadequate premium rates. We believe catastrophic events are the most likely cause of an unexpected rise in claims severity or frequency. Our reinsurance program mitigates the liquidity risk of a single large loss or an unexpected rise in claims severity or frequency due to a catastrophic event. Reinsurance does not relieve us of our obligation to pay covered claims. The financial strength of our reinsurers is important because our ability to recover for losses under one of our reinsurance agreements depends on the financial viability of the reinsurer.

While we believe that historical performance of property casualty and life loss payment patterns is a reasonable source for projecting future claims payments, there is inherent uncertainty in this estimate of contractual obligations. We believe that we could meet our obligations under a significant and unexpected change in the timing of these payments because of the liquidity of our invested assets, strong financial position and access to lines of credit.

#### **Long-term Debt and Interest on Long-Term Debt**

Our estimate of material commitments for long-term debt was approximately 14.4 percent and our estimate of material commitments for interest on long-term debt was approximately 23.6 percent of the estimated contractual obligations at year-end 2005.

Our interest expense rose in 2005 to an annual rate of approximately \$52 million due to our 2004 issuance of \$375 million aggregate principal amount of 6.125% senior notes due 2034. We generally have tried to minimize our reliance on debt financing and do not expect a material increase in interest expense in the near future.

#### **Annuitization Obligations**

Our estimate of material commitments for obligations due under annuities written by our life insurance subsidiary was approximately 3.5 percent of the estimated contractual obligations at year-end 2005.

#### **Headquarters Building Expansion**

The construction of our new office building and parking garage to be situated at our headquarters located in Fairfield is expected to require approximately \$83 million over the next three years. The construction project is on schedule and on budget. As of December 31, 2005, construction costs totaled \$18 million. We expect construction to be completed by September 2008.

We invested \$100 million of the proceeds from our 2004 issuance of \$375 million aggregate principal amount of 6.125% senior notes due 2034 in short-term investments to fund this obligation.

#### **Computer Hardware and Software**

We expect to need approximately \$14 million over the next five years for material commitments for computer hardware and software, including maintenance contracts on hardware and other known obligations. We discuss below the non-contractual expenses we anticipate for computer hardware and software in 2006.

#### **Commissions and Other Underwriting Expenses**

In addition to our contractual obligations, our insurance operations use cash for commission and other underwriting expenses.

As discussed above, commissions and other underwriting expenses paid rose in each the past two years, reflecting the operating expense trends we discuss in the Commercial Lines and Personal Lines Insurance Results of Operations, Page 41 and Page 47. Commission payments also include contingent, or profit-sharing, commissions, which are paid to agencies using a formula that takes into account agency profitability and other factors, such as prompt monthly payment of amounts due to the company. Commission payments generally track with written premiums. Contingent commission payments in 2006 will be influenced by the excellent profitability we generated in 2005 and 2004.

Many of our operating expenses are not contractual obligations, but reflect the ongoing expenses of our business. Staffing is the largest component of our operating expenses and is expected to rise again in 2006, reflecting the 4.3 percent average annual growth in our associate base over the past three years. Our associate base has grown as we focus on enhancing service to our agencies and staffing additional field territories. Other expenses should rise in line

with our growth.

2005 10-K Page 60

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In addition to contractual obligations for hardware and software, we anticipate investing approximately \$16 million in key technology initiatives in 2006, including spending for the development and rollout of our commercial lines policy processing systems that we discuss in Item 1, Technology Solutions, Page 4. Capitalized development costs related to key technology initiatives totaled \$11 million in 2005. These activities are conducted at our discretion and we have no material contractual obligations for activities planned as part of these projects.

### **Investing Activities**

Excess cash flows from underwriting, investment and other corporate activities are invested in fixed-maturity and equity securities on an ongoing basis to help achieve our portfolio objectives. See Item 1, Investments Segment, Page 15, for a discussion of our investment strategy, portfolio allocation and quality. Since the second quarter of 2004, virtually all of our available cash flow has been used to purchase fixed-maturity investments to reduce our property casualty subsidiary's ratio of common stock to statutory surplus.

Purchases of fixed-maturity securities rose significantly in 2005 and 2004. Due to the allocation of a higher percentage of new investment dollars to fixed-maturity investments, equity securities purchases in 2005 and 2004 were below the level of 2003. Purchases in 2005 included \$144 million of nonredeemable preferred stock. We evaluate nonredeemable preferred stocks similar to the evaluation we make for fixed-maturity investments, seeking attractive relative yields.

In 2006, we anticipate continuing to use the majority of available cash flow to purchase fixed-maturity investments and preferred stock. Common stock purchases primarily will be funded with proceeds of common stock sales. The trend of ratios we monitor could permit some common stock purchases with cash flow from operations.

### **Uses of Capital**

Uses of cash to enhance shareholder return include:

**Dividends to shareholders** Over the past 10 years, the company has paid an average of 42 percent of net income as dividends, with the remaining 58 percent available to reinvest for future growth and for share repurchases. The ability of the company to continue paying cash dividends is subject to factors the board of directors may deem relevant.

In February 2006, the board of directors authorized a 9.8 percent increase in the regular quarterly cash dividend to an indicated annual rate of \$1.34 per share. In 2005, 2004 and 2003, we paid cash dividends of \$204 million, \$177 million and \$156 million.

**Common stock repurchase** Our board believes that stock repurchases can help fulfill our commitment to enhancing shareholder value. Consequently, the board has authorized the repurchase of outstanding shares. Common stock repurchases for treasury have continued at a steady pace over the last several years and occur when we believe that stock prices on the open market are favorable for such repurchases. At a minimum, we would expect the repurchase to offset dilution of option exercises. In 2005, 2004 and 2003, we used \$63 million, \$66 million and \$55 million for share repurchase.

In 2005, the board authorized a 10 million share repurchase program to replace a program authorized in 1999. At year-end 2005, 9.5 million shares remained authorized for repurchase under the 2005 program.

The details of the repurchase activity are described in Item 5, Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities, Page 27. Between February 1999 and year-end 2005, we have repurchased 14.8 million shares at a total cost to the company of \$543 million. We do not adjust number of shares repurchased and average price per repurchased share for stock dividends.

### **Property Casualty Insurance Reserves**

At year-end 2005, the total reserve balance, net of reinsurance, was \$3.111 billion, compared with \$2.977 billion at year-end 2004 and \$2.845 billion at year-end 2003. We provide a reconciliation of the property casualty reserve balances with the loss and loss expense liability on the balance sheet in Item 8, Note 4 to the Consolidated Financial Statements, Page 90. The reserves reflected in the financial statements are management's best estimate.



The appointed actuary's range for adequate statutory reserves, net of reinsurance, was \$2.921 billion to \$3.153 billion for 2005; \$2.794 billion to \$3.032 billion for 2004; and \$2.696 billion to \$2.906 billion for 2003. The assumptions used to establish the recommended ranges were consistent with the actuary's practices. Historically, we have established reserves in the upper half of the actuary's range, as discussed in Critical Accounting Estimates, Property Casualty Loss and Loss Expense Reserves, Page 35.

2005 10-K Page 61

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In addition to our conclusions regarding adequate reserve levels, other factors that have affected reserve levels over the past three years included:

- Increases in coverage in force in selected business lines
- New business
- Higher initial case reserves on liability claims
- Judicial decisions and mass tort claims
- Loss cost inflation in selected lines

The types of coverages we offer and the risk levels retained have a direct influence on the development of claims. Specifically, claims that develop quickly and have lower risk retention levels generally are more predictable.

As we discuss in Commercial Lines Insurance Segment Reserves, Page 64, re-underwriting the commercial lines book of business beginning in 2000, including decisions to non-renew certain policyholders due to risk levels and to increase rates to better reflect exposure levels, has resulted in improved profitability. We believe the program has led to a lower risk profile for the overall commercial lines segment, which has contributed to favorable loss reserve trends.

As we discuss in Personal Lines Insurance Segment Reserves, Page 66, we are seeking to improve our personal lines segment performance, in particular the homeowner business line, partially by reducing risk exposure through changes in policy terms and conditions. We do not expect our actions in personal lines to have a material impact on loss reserve trends, largely due to the relatively short-tail nature of homeowner claims.

In 2003 and 2004, \$70 million in reserves were released following the November 2003 Ohio Supreme Court's limiting of its 1999 *Scott-Pontzer v. Liberty Mutual* decision. The reserve releases were primarily made in the commercial auto and other liability business lines. Following the fourth-quarter 2003 reserve review, reserve levels were modified to reflect management's assessment that mold claims behaved similar to asbestos and environmental claims, and reserves for these claims should be estimated using similar methods. These changes have been seen predominately in the commercial multi-peril business line. We expect that mold exclusions added to our commercial policies beginning in 2003 will mitigate this issue after 2006.

Further, beginning in 2003, reserve levels reflected the need to establish higher expense reserves because of the rise in litigation costs due to larger and more complex claims. These changes have been seen predominately in commercial multi-peril and other liability business lines. Beginning in 2002, our conclusions regarding reserve levels for all business lines reflected refinement of the manner in which the value of future salvage and subrogation for claims already incurred were estimated.

#### **Development of Loss and Loss Expenses**

We reconcile the beginning and ending balances of our reserve for loss and loss expenses at December 31, 2005, 2004 and 2003, in Item 8, Note 4 to the Consolidated Financial Statements, Page 90. The reconciliation of our year-end 2004 reserve balance to net incurred losses one year later recognizes approximately \$160 million in redundant reserves.

The table below shows the development of the estimated reserves for loss and loss expenses the past 10 years.

**Section A** shows our total property casualty loss and loss expense reserves recorded at the balance sheet date for each of the indicated calendar years on a gross and net basis. Those reserves represent the estimated amount of loss and loss expenses for claims arising in all prior years that are unpaid at the balance sheet date, including losses that have been incurred but not yet reported to the company.

**Section B** shows the cumulative net amount paid with respect to the previously recorded reserve as of the end of each succeeding year. For example, as of December 31, 2005, we had paid \$1.053 billion of loss and loss expenses in calendar years 1996 through 2005, for losses that occurred in accident years 1995 and prior. An estimated \$130 million of losses remain unpaid as of year-end 2005 (net re-estimated reserves of \$1.183 billion less cumulative paid loss and loss expenses of \$1.053 billion).

**Section C** shows the re-estimated amount of the previously reported reserves based on experience as of the end of each succeeding year. The estimate is increased or decreased as we learn more about the frequency and severity of claims.

**Section D**, cumulative net redundancy, represents the aggregate change in the estimates for all years subsequent to the year the reserves were initially established. For example, reserves established at December 31, 1995, had developed a \$398 million redundancy over 10 years, net of reinsurance, which has been reflected in income over the 10 years. The effects on income in 2005, 2004 and 2003 of changes in estimates of the reserves for loss and loss expenses for all accident years are shown in the reconciliation below.

2005 10-K Page 62

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(In millions)	Calendar year ended December 31,										
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
A. Originally reported reserves for unpaid loss and loss expenses:											
Gross of reinsurance	\$ 1,690	\$ 1,824	\$ 1,889	\$ 1,978	\$ 2,093	\$ 2,401	\$ 2,865	\$ 3,150	\$ 3,386	\$ 3,514	\$ <b>3,629</b>
Reinsurance recoverable	109	122	112	138	161	219	513	542	541	537	<b>518</b>
Net of reinsurance	\$ 1,581	\$ 1,702	\$ 1,777	\$ 1,840	\$ 1,932	\$ 2,182	\$ 2,352	\$ 2,608	\$ 2,845	\$ 2,977	\$ <b>3,111</b>
B. Cumulative net paid as of:											
One year later	\$ 395	\$ 453	\$ 499	\$ 522	\$ 591	\$ 697	\$ 758	\$ 799	\$ 817	\$ <b>907</b>	
Two years later	630	732	761	853	943	1,116	1,194	1,235	<b>1,293</b>		
Three years later	801	884	965	1,067	1,195	1,378	1,455	<b>1,519</b>			
Four years later	881	992	1,075	1,207	1,327	1,526	<b>1,614</b>				
Five years later	946	1,049	1,152	1,283	1,412	<b>1,623</b>					
Six years later	977	1,093	1,205	1,333	<b>1,464</b>						
Seven years later	1,009	1,123	1,239	<b>1,366</b>							
Eight years later	1,031	1,146	<b>1,260</b>								
Nine years later	1,045	<b>1,159</b>									
Ten years later	<b>1,053</b>										
C. Net reserves re-estimated as of:											
One year later	\$ 1,429	\$ 1,582	\$ 1,623	\$ 1,724	\$ 1,912	\$ 2,120	\$ 2,307	\$ 2,528	\$ 2,649	\$ <b>2,817</b>	
Two years later	1,380	1,470	1,551	1,728	1,833	2,083	2,263	2,377	<b>2,546</b>		
Three years later	1,279	1,405	1,520	1,636	1,802	2,052	2,178	<b>2,336</b>			
Four years later	1,236	1,380	1,465	1,615	1,771	2,010	<b>2,153</b>				
Five years later	1,227	1,326	1,466	1,608	1,757	<b>1,999</b>					
Six years later	1,189	1,333	1,463	1,602	<b>1,733</b>						
Seven years later	1,205	1,333	1,460	<b>1,577</b>							
Eight years later	1,210	1,332	<b>1,435</b>								
Nine years later	1,208	<b>1,305</b>									
Ten years later	<b>1,183</b>										
D. Cumulative net redundancy as of:											
One year later	\$ 152	\$ 120	\$ 154	\$ 116	\$ 20	\$ 62	\$ 45	\$ 80	\$ 196	\$ <b>160</b>	
Two years later	201	232	226	112	99	99	89	231	<b>299</b>		
Three years later	302	297	257	204	130	130	174	<b>272</b>			
Four years later	345	322	312	225	161	172	<b>199</b>				
Five years later	354	376	311	232	175	<b>183</b>					

Six years later	392	369	314	238	<b>199</b>
Seven years later	376	369	317	<b>263</b>	
Eight years later	371	370	<b>342</b>		
Nine years later	373	<b>397</b>			
Ten years later	<b>398</b>				

## Net liability

re-estimated latest	\$ 1,183	\$ 1,305	\$ 1,435	\$ 1,577	\$ 1,733	\$ 1,999	\$ 2,153	\$ 2,336	\$ 2,546	<b>\$ 2,817</b>
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## Re-estimated

recoverable latest	179	174	189	214	222	248	513	548	526	<b>539</b>
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## Gross liability

re-estimated latest	\$ 1,362	\$ 1,479	\$ 1,624	\$ 1,791	\$ 1,955	\$ 2,247	\$ 2,666	\$ 2,884	\$ 3,072	<b>\$ 3,356</b>
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## Cummulative

gross redundancy	\$ 328	\$ 345	\$ 265	\$ 187	\$ 138	\$ 154	\$ 199	\$ 266	\$ 314	<b>\$ 158</b>
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In evaluating the development of our estimated reserves for loss and loss expenses for the past 10 years, note that each amount includes the effects of all changes in amounts for prior periods. For example, payments or reserve adjustments related to losses settled in 2005 but incurred in 1999 are included in the cumulative deficiency or redundancy amount for 2000 and each subsequent year. In addition, this table presents calendar year data, not accident or policy year development data, which readers may be more accustomed to analyzing. Conditions and trends that have affected development of the reserves in the past may not necessarily occur in the future. Accordingly, it may not be appropriate to extrapolate future redundancies or deficiencies based on this data.

Differences between the property casualty reserves reported in the accompanying consolidated balance sheets (prepared in accordance with GAAP) and those same reserves reported in the annual statements (filed with state insurance departments in accordance with statutory accounting practices - SAP), relate principally to the reporting of reinsurance recoverables, which are recognized as receivables for GAAP and as an offset to reserves for SAP.

**Asbestos and Environmental Reserves**

We believe that our asbestos and environmental reserves, including mold reserves, are adequate at this time and that these coverage areas are immaterial to our financial position due to the types of accounts we have insured in the past. Loss and loss expenses incurred for all asbestos and environmental claims were \$12 million, or 0.7 percent of total loss and loss expenses in 2005, compared with \$41 million, or 2.4 percent in 2004, and \$28 million, or 1.6 percent, in 2003. The increase in 2004 was primarily due to mold claims prior to the introduction of the mold exclusion to our policy forms.

Net reserves for all asbestos and environmental claims were \$132 million in 2005 compared with \$135 million in 2004 and \$105 million in 2003. Net reserves for all asbestos and environmental claims were 4.2 percent, 4.5 percent and 3.7 percent of total reserves, in 2005, 2004 and 2003, respectively.

We generally wrote commercial accounts after the development of coverage forms that exclude asbestos cleanup costs. We believe our exposure to risks associated with past production and/or installation of asbestos materials is minimal because we primarily were a personal lines company when most of the asbestos exposure occurred. The commercial coverage we did offer was predominantly related to local-market construction activity rather than asbestos manufacturing. Further, over the past four years, to limit our exposure to mold and other environmental risks going forward, we have revised policy terms where permitted by state regulation. We continue to evaluate our exposure to silicosis and welding claims, but believe our exposure is minimal.

#### **Commercial Lines Insurance Segment Reserves**

For the business lines in the commercial lines insurance segment, the following table shows the breakout of gross reserves among case, IBNR and loss expense reserves. The rise in total gross reserves for our commercial business lines was related to our growth. Commercial multi-peril reserve growth also was related to the higher proportion of commercial lines catastrophe losses in 2005 compared with 2004. Workers compensation reserve growth also was related to medical cost inflation and longer estimated payout periods as we discussed in Commercial Lines Insurance Results of Operations, Page 41.

(In millions)	Loss reserves Case reserves	Loss reserves IBNR reserves	Loss expense reserves	Total gross reserves	Percent of total
<b>At December 31, 2005</b>					
Commercial multi-peril	\$ 505	\$ 101	\$ 228	\$ 834	26.3%
Workers compensation	283	333	79	695	21.9
Commercial auto	267	56	65	388	12.2
Other liability	312	368	140	820	25.9
All other lines of business	277	24	135	436	13.7
<b>Total</b>	<b>\$ 1,644</b>	<b>\$ 882</b>	<b>\$ 647</b>	<b>\$ 3,173</b>	<b>100.0%</b>
<b>At December 31, 2004</b>					
Commercial multi-peril	\$ 465	\$ 123	\$ 227	\$ 815	27.0%
Workers compensation	258	278	75	611	20.3
Commercial auto	254	58	64	376	12.5
Other liability	288	377	111	776	25.7
All other lines of business	289	19	130	438	14.5
<b>Total</b>	<b>\$ 1,554</b>	<b>\$ 855</b>	<b>\$ 607</b>	<b>\$ 3,016</b>	<b>100.0%</b>

As a result of underwriting actions taken since 2000 and a generally favorable insurance marketplace, the commercial lines segment has been able to obtain higher premium per exposure. As a result, profitability has improved due to higher revenue on stable loss and loss expenses.

The following table provides the amounts of net reserve changes made over the past three years by commercial line of business and accident year:

(Dollars in millions)	Commercial multi-peril	Workers compensation	Commercial auto	Other liability
<b>As of December 31, 2005</b>				
2004 accident year	\$ 5	\$ (9)	\$ 16	\$ 36
2003 accident year	22	(13)	5	32
2002 accident year	9	(8)	2	6
2001 accident year	7	(3)	1	1
2000 accident year	0	(3)	0	(8)
1999 accident year	2	(3)	0	0
1998 and prior accident years	16	(4)	10	(17)
Redundancy/(deficiency)	\$ 61	\$ (43)	\$ 34	\$ 50
Reserves as originally estimated	\$ 760	\$ 557	\$ 372	\$ 599
Reserves re-estimated as of December 31, 2005	699	600	338	549
Redundancy/(deficiency)	\$ 61	\$ (43)	\$ 34	\$ 50
Impact on loss and loss expense ratio	7.7%	(13.3)%	7.4%	11.2%
<b>As of December 31, 2004</b>				
2003 accident year	\$ (5)	\$ 5	\$ 11	\$ 36
2002 accident year	2	(1)	10	41
2001 accident year	5	(6)	4	27
2000 accident year	4	(3)	4	13
1999 accident year	0	(2)	7	2
1998 accident year	1	(1)	3	0
1997 and prior accident years	(11)	(7)	8	12
Redundancy/(deficiency)	\$ (4)	\$ (15)	\$ 47	\$ 131
Reserves as originally estimated	\$ 691	\$ 514	\$ 381	\$ 635
Reserves re-estimated as of December 31, 2004	695	529	334	504
Redundancy/(deficiency)	\$ (4)	\$ (15)	\$ 47	\$ 131
Impact on loss and loss expense ratio	(0.6)%	(4.9)%	10.5%	32.5%
<b>As of December 31, 2003</b>				
2002 accident year	\$ (3)	\$ (1)	\$ 11	\$ 36
2001 accident year	2	(3)	2	15
2000 accident year	(10)	(2)	7	5
1999 accident year	5	(1)	11	6
1998 accident year	(2)	0	2	3
1997 accident year	(2)	(1)	1	5

1996 and prior accident years	(3)	(5)	3	9
Redundancy/(deficiency)	\$ (13)	\$ (13)	\$ 37	\$ 79
Reserves as originally estimated	\$ 609	\$ 477	\$ 383	\$ 580
Reserves re-estimated as of December 31, 2003	622	490	346	501
Redundancy/(deficiency)	\$ (13)	\$ (13)	\$ 37	\$ 79
Impact on loss and loss expense ratio	(2.0)%	(4.3)%	8.8%	23.0%

The overall favorable development recorded in the commercial lines reserves illustrates the potential for revisions inherent in estimating reserves, especially in long-tail lines such as other liability. With the exception of the UM/UIM reserve releases and other significant changes in assumptions discussed above, commercial lines reserve development over the past three years was consistent with:

The initiative, begun in 2001, to establish higher initial case reserves on liability claims in the period in which the claim is reported.

Higher than expected medical inflation affecting the workers compensation line

Settlements that differed from the established case reserves

Changes in case reserves based on new information for specific claims or classes of claims

Differences in the timing of actual settlements compared with the payout patterns assumed in the accident year

IBNR reductions

Lower risk profile after 2001 due to commercial lines underwriting initiatives



**Personal Lines Insurance Segment Reserves**

For the business lines in the personal lines insurance segment, the following table shows the breakout of gross reserves among case, IBNR and loss expense reserves. Total gross reserves were down slightly from year-end 2004 due to normal claims activity on a lower policy count and lower personal lines catastrophe reserves in 2005 than in 2004.

(In millions)	Loss reserves		Loss expense reserves	Total gross reserves	Percent of total
	Case reserves	IBNR reserves			
<b>At December 31, 2005</b>					
Personal auto	\$ 175	\$ 4	\$ 34	\$ 213	46.9%
Homeowners	70	21	18	109	23.8
All other lines of business	55	67	12	134	29.3
<b>Total</b>	<b>\$ 300</b>	<b>\$ 92</b>	<b>\$ 64</b>	<b>\$ 456</b>	<b>100.0%</b>
<b>At December 31, 2004</b>					
Personal auto	\$ 181	\$ 15	\$ 35	\$ 231	46.4%
Homeowners	81	21	23	125	25.1
All other lines of business	57	73	12	142	28.5
<b>Total</b>	<b>\$ 319</b>	<b>\$ 109</b>	<b>\$ 70</b>	<b>\$ 498</b>	<b>100.0%</b>

Over the past three years, higher-than-normal catastrophe losses have contributed to the personal lines loss and loss expenses.

The following table provides the amounts of net reserve changes made over the past three years by personal line of business and accident year:

(Dollars in millions)	Personal auto	Homeowners
<b>As of December 31, 2005</b>		
2004 accident year	\$ 2	\$ 1
2003 accident year	0	2
2002 accident year	2	0
2001 accident year	4	1
2000 accident year	1	0
1999 accident year	1	(1)
1998 and prior accident years	2	0
Redundancy/(deficiency)	\$ 12	\$ 3
Reserves as originally estimated	\$ 231	\$ 114
Reserves re-estimated as of December 31, 2005	219	111
Redundancy/(deficiency)	\$ 12	\$ 3
Impact on loss and loss expense ratio	2.7%	1.0%
<b>As of December 31, 2004</b>		
2003 accident year	\$ (9)	\$ 0
2002 accident year	(1)	1
2001 accident year	3	4
2000 accident year	3	1
1999 accident year	1	0
1998 accident year	1	0
1997 and prior accident years	1	0
Redundancy/(deficiency)	\$ (1)	\$ 6
Reserves as originally estimated	\$ 224	\$ 89
Reserves re-estimated as of December 31, 2004	225	83
Redundancy/(deficiency)	\$ (1)	\$ 6
Impact on loss and loss expense ratio	(0.2)%	2.2%
<b>As of December 31, 2003</b>		
2002 accident year	\$ (8)	\$ 2
2001 accident year	(4)	5
2000 accident year	0	0
1999 accident year	2	1

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1998 accident year	0	0
1997 accident year	1	0
1996 and prior accident years	0	0
Redundancy/(deficiency)	\$ (9)	\$ 8
Reserves as originally estimated	\$ 201	\$ 96
Reserves re-estimated as of December 31, 2003	210	88
Redundancy/(deficiency)	\$ (9)	\$ 8
Impact on loss and loss expense ratio	(2.1)%	3.1%

The overall favorable development recorded in the personal lines segment reserves illustrates the potential for revisions inherent in estimating reserves. Personal lines reserve development over the past three years was consistent with:

- Settlements that differed from the established case reserves
- Changes in case reserves based on new information for specific claims or classes of claims
- Differences in the timing of actual settlements compared with the payout patterns assumed in the accident year
- IBNR reductions
- Recognition of favorable case reserve development

**Life Insurance Reserves**

Gross life policy reserves were \$1.343 billion at year-end 2005, compared with \$1.194 billion at year-end 2004. We establish 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. We use our own experience and historical trends for setting

our assumptions for expected expenses. We base our assumptions for expected investment income on our own experience adjusted for current economic conditions.

We establish reserves for our universal life, deferred annuity and investment contracts equal to the cumulative account balances, which include premium deposits plus credited interest less charges and withdrawals.

We regularly review our life insurance business to ensure that any deferred acquisition cost associated with the business is recoverable and that our actuarial liabilities (life insurance segment reserves) make sufficient provision for future benefits and related expenses.

### **2006 Reinsurance Programs**

A single large loss or an unexpected rise in claims severity or frequency due to a catastrophic event could present us with a liquidity risk. In an effort to control such losses, we forego marketing property casualty insurance in specific geographic areas, monitor our exposure in certain coastal regions, review aggregate exposures to huge disasters and purchase reinsurance. We use the Risk Management Solutions and Applied Insurance Research models to evaluate exposures to a once-in-250-year event in determining appropriate reinsurance coverage programs. In conjunction with these activities, we also continue to evaluate information provided by our reinsurance broker. These various sources explore and analyze credible scientific evidence, including the impact of global climate change, which may affect our exposure under insurance policies.

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 regarding the appropriate level of property casualty risk retention are affected by various factors, including changes in our underwriting practices, capacity to retain risks and reinsurance market conditions. Reinsurance does not relieve us of our obligation to pay covered claims. The financial strength of our reinsurers is important because our ability to recover for losses covered under one of our reinsurance agreements depends on the financial viability of the reinsurer.

Currently participating on our property and casualty per-occurrence programs are American Reinsurance Company, GE Insurance Solutions, Partner Reinsurance Company of the U.S. and Swiss Reinsurance America Corporation, all of which have A.M. Best insurer financial strength ratings of A (Excellent) or A+ (Superior). Our property catastrophe program is subscribed through a broker by reinsurers from the United States, Bermuda, London and Europe markets. The estimated incremental premium savings is \$7 million for the 2006 property casualty reinsurance agreements, without taking into account the reinstatement premium incurred in 2005. The savings primarily is due to higher retention levels and to lower rates for the casualty per occurrence program, which offset higher rates for the property per occurrence and property catastrophe programs.

Primary components of the 2006 property and casualty reinsurance program include:

**Property per risk treaty** The primary purpose of the property treaty is to provide excess limits capacity up to \$25 million, supplying adequate capacity for the majority of the risks we write and also includes protection for extra-contractual liability coverage losses. The ceded premium is estimated to be \$30 million for 2006, compared with \$29 million in 2005 and \$27 million in 2004. In 2006, we are retaining the first \$4 million of each loss. Losses between \$4 million and \$25 million are reinsured at 100 percent. The \$4 million base retention is new for 2006. Last year, we retained the first \$3 million of every property loss. Losses in excess of \$3 million were reinsured at 100 percent up to \$25 million in 2005.

**Casualty per occurrence treaty** The casualty treaty provides excess limits capacity up to \$25 million. Similar to the property treaty, this provides sufficient capacity to cover the vast majority of casualty accounts we insure and also includes protection for extra-contractual liability coverage losses. The ceded premium is estimated to be \$47 million in 2006, compared with \$64 million in 2005 and \$61 million in 2004. In 2006, we are changing to a flat \$4 million retention. Previously, we retained the first \$2 million of each casualty loss, and 60 percent of the next \$2 million of loss. Losses in excess of \$4 million are reinsured at 100 percent up to \$25 million.

In mid-2005, we modified our casualty per occurrence treaty for director and officer policies for five Fortune 1000 companies and one financial services company. For three of the six companies, our retention per policy could be as high as \$15 million rather than the \$4 million for a typical policy; for one of the other companies, our

retention per policy could be as high as \$14 million; for the other two companies, our retention per policy could be as high as \$5 million. We believe the additional risk undertaken with these selected policies remains at an acceptable level based on our financial strength. We arranged for this exception for this small group of companies to maintain business relationships with key agencies and insureds. We intend to review this element of our working treaties on an ongoing basis.

**Casualty excess treaties** We purchase a casualty reinsurance treaty that provides an additional \$25 million in protection for certain casualty losses. This treaty, along with the casualty per occurrence treaty, provides a total of \$50 million of protection for workers compensation, extra-contractual liability coverage and clash coverage losses, which is used when there is a single occurrence involving multiple

2005 10-K Page 68

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policyholders of The Cincinnati Insurance Companies or multiple coverages for one insured. The ceded premium is estimated to be \$2 million in 2006 up only slightly from 2005 and 2004.

We purchase another casualty excess treaty, which provides an additional \$20 million in casualty loss coverage. This treaty also provides catastrophic coverage for workers compensation and extra-contractual liability coverage losses. The ceded premium is estimated to be \$1 million for 2006, similar to the premium paid in 2005.

**Property catastrophe treaty** To protect against catastrophic events such as wind and hail, hurricanes or earthquakes, we purchase property catastrophe reinsurance, with a limit up to \$500 million. For the 2006 treaty, ceded premiums are estimated to be \$38 million, up from \$29 million in 2005, excluding the reinstatement premium, and \$27 million in 2004, excluding the reinstatement premium. The premium increase for 2006 primarily is due to the difficult market conditions brought on in part by the record catastrophe losses experienced by reinsurance companies in 2005. We increased our retention on this program to \$45 million and we will retain 5 percent of losses between \$45 million and \$500 million. In 2005, we retained the first \$25 million of losses arising out of a single event, 40 percent of losses from \$25 million to \$45 million and 5 percent of all losses in excess of \$45 million, up to \$500 million.

Individual risks with insured values in excess of \$25 million as identified in the policy are handled through a different reinsurance mechanism. We reinsure property coverage for individual risks with insured values between \$25 million and \$50 million under an automatic facultative treaty. For those risks with property values exceeding \$50 million, we negotiate the purchase of facultative coverage on an individual certificate basis. For casualty coverage on individual risks with limits exceeding \$25 million, facultative reinsurance coverage is placed on an individual certificate basis. Responding to the challenges presented by terrorism has become a very important issue for the insurance industry over the last three years. Terrorism coverage at various levels has been secured in all of our reinsurance agreements. The broadest coverage for this peril is found in the property and casualty working treaties, which provide coverage for commercial and personal risks. Our property catastrophe treaty provides coverage for personal risks and the majority of its reinsurers provide limited coverage for commercial risks with total insured values of \$10 million or less. For insured values between \$10 million and \$25 million, there also may be coverage in the property working treaty. Reinsurance protection for the company's surety business is covered under separate treaties with many of the same reinsurers that write the property casualty working treaties.

Reinsurance protection for our life insurance business is covered under separate treaties with many of the same reinsurers that write the property casualty working treaties. In 2005, we modified our reinsurance protection for our term life insurance business due to changes in the marketplace that affected the cost and availability of reinsurance for term life insurance. We are retaining no more than a \$500,000 exposure, ceding the balance using excess over retention mortality coverage, and retaining the policy reserve. Retaining the policy reserve has no direct impact on GAAP results. However, because of the conservative nature of statutory reserving principles, retaining the policy reserve unduly depresses our statutory earnings and requires a large commitment of our capital. We also have catastrophe reinsurance coverage on our life insurance operations that reimburses us up to \$20 million for covered net losses in excess of \$5 million. The treaty contains a reinstatement provision, provided the covered losses were not due to terrorism.

The NAIC has asked for comments on proposals to modify statutory accounting procedures to reduce the negative effect on statutory life insurance income. We expect the NAIC proposals will be adopted. If they are not, we believe we will be able to structure a reinsurance program to provide the life insurance company with the ability to continue to grow in the term life insurance marketplace while appropriately managing risk, at a cost that allows us to achieve our life insurance company profit targets.

#### **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 Item 1A, Risk Factors, Page 21. Although we often review or update our forward-looking statements when events warrant, we caution our readers that we undertake no obligation to do so.

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

Ability to obtain adequate reinsurance on acceptable terms, amount of reinsurance purchased and financial strength of reinsurers

Increased frequency and/or severity of claims

2005 10-K Page 69

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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 Downgrade of the company's financial strength ratings,
- o Concerns that doing business with the company is too difficult or
- o Perceptions that the company's level of service, particularly claims service, is no longer a distinguishing characteristic in the marketplace

Increased competition that could result in a significant reduction in the company's premium growth rate

Underwriting and pricing methods adopted by competitors that could allow them to identify and flexibly price risks, which could decrease our competitive advantages

Insurance regulatory actions, legislation or court decisions or legal actions that increase expenses or place us at a disadvantage in the marketplace

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

Inaccurate estimates or assumptions used for critical accounting estimates, including loss reserves

Events that reduce the company's ability to maintain effective internal control over financial reporting under the Sarbanes-Oxley Act of 2002 in the future

Recession or other economic conditions or regulatory, accounting or tax changes resulting in lower demand for insurance products

Sustained decline in overall stock market values negatively affecting the company's equity portfolio; in particular a sustained decline in the market value of Fifth Third shares, a significant equity holding

Events that lead to a significant decline in the value of a particular security and impairment of the asset

Prolonged low interest rate environment or other factors that limit the company's ability to generate growth in investment income

Adverse outcomes from litigation or administrative proceedings

Effect on the insurance industry as a whole, and thus on the company's business, of the actions undertaken by the Attorney General of the State of New York and other regulators against participants in the insurance industry, as well as any increased regulatory oversight that might result

Investment activities or market value fluctuations that trigger restrictions applicable to the parent company under the Investment Company Act of 1940

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 recent measures affecting corporate financial reporting and governance. The ultimate changes and eventual effects, if any, of these initiatives are uncertain.



Readers are cautioned that the company undertakes no obligation to review or update the forward-looking statements included herein.

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

**Introduction**

Market risk is the potential for a decrease in securities value resulting from broad yet uncontrollable forces such as: inflation, economic growth, interest rates, world political conditions or other widespread unpredictable events. It is comprised of many individual risks that, when combined, create a macroeconomic impact. The company accepts and manages risks in the investment portfolio as part of the means of achieving portfolio objectives. Some of the risks are:

Political the potential for a decrease in market value due to the real or perceived impact of governmental policies or conditions

Regulatory the potential for a decrease in market value due to the impact of legislative proposals or changes in laws or regulations

Economic the potential for a decrease in value due to changes in general economic factors (recession, inflation, deflation, etc.)

**Revaluation** the potential for a decrease in market value due to a change in relative value (change in market multiple) of the market brought on by general economic factors

**Interest-rate** the potential for a decrease in market value of a security or portfolio due to its sensitivity to changes (increases or decreases) in the general level of interest rates

**Company-specific risk** is the potential for a particular issuer to experience a decline in valuation due to the impact of sector or market risk on the holding or because of issues specific to the firm:

**Fraud** the potential for a negative impact on an issuer's performance due to actual or alleged illegal or improper activity of individuals it employs

**Credit** the potential for deterioration in an issuer's financial profile due to specific company issues, problems it faces in the course of its operations or industry-related issues

**Default** the possibility that an issuer will not make a required payment (interest payment or return of principal) on its debt. Generally this occurs after its financial profile has deteriorated (credit risk) and it no longer has the means to make its payments

The investment committee of the board of directors monitors the investment risk management process primarily through its executive oversight of our investment activities. We take an active approach to managing market and other investment risks, including the accountabilities and controls over these activities. Actively managing these market risks is integral to our operations and could require us to change the character of future investments purchased or sold or require us to shift the existing asset portfolios to manage exposure to market risk within acceptable ranges.

**Sector risk** is the potential for a negative impact on a particular industry due to its sensitivity to factors that make up market risk. Market risk affects general supply/demand factors for an industry and will affect companies within that industry to varying degrees.

Risks associated with the five asset classes described in Item 1, Investments Segment, Page 15, can be summarized as follows (H = high, A = average, L = low):

	Taxable fixed maturities	Tax-exempt fixed maturities	Common equities	Preferred equities	Short-term investments
Political	A	H	A	A	L
Regulatory	A	A	A	A	L
Economic	A	A	H	A	L
Revaluation	A	A	H	A	L
Interest rate	H	H	A	H	L
Fraud	A	L	A	A	L
Credit	A	L	A	A	L
Default	A	L	A	A	L

#### **Fixed-maturity Investments**

For investment-grade corporate bonds, the inverse relationship between interest rates and bond prices leads to falling bond values during periods of increasing interest rates. Although the potential for a worsening financial condition, and ultimately default, does exist with investment-grade corporate bonds, their higher-quality financial profiles make credit risk less of a concern than for lower-quality investments. We address this risk by consistently investing within a particular maturity range, which has, over the years, provided the portfolio with a laddered maturity schedule, which we believe is less subject to large swings in value due to interest rate changes. While a single maturity range may see values drop due to general interest rate levels, other maturity ranges will be less affected by those changes.

Additionally, purchases are spread across a wide spectrum of industries and companies, diversifying our holdings and minimizing the impact of specific industries or companies with greater sensitivities to interest rate fluctuations.

The primary risk related to high-yield corporate bonds is credit risk or the potential for a deteriorating financial structure. A weak financial profile can lead to rating downgrades from the credit rating agencies, which can put further downward pressure on bond prices. Interest rate risk is less of a factor with high-yield corporate bonds, as valuation is related more directly to underlying operating performance than to general interest rates. This puts more emphasis on the financial results achieved by the issuer rather than general economic trends or statistics within the marketplace. We address this concern by analyzing issuer- and industry-specific financial results and by closely monitoring holdings within this asset class.

The primary risks related to tax-exempt bonds are interest rate risk and political risk associated with the specific economic environment within the political boundaries of the issuing municipal entity. We address these concerns by focusing on municipalities' general-obligation debt and on essential-service bonds. Essential-service bonds derive a revenue stream from the services provided by the municipality, which are vital to the people living in the area (water service, sewer service, etc.). Another risk related to tax-exempt bonds is regulatory risk or the potential for legislative changes that would negate the benefit of owning tax-exempt

bonds. We monitor regulatory activity for situations that may negatively affect current holdings and its ongoing strategy for investing in these securities.

The final, less significant risk is a small exposure to credit risk for a portion of the tax-exempt portfolio that has support from corporate entities. Examples are bonds insured by corporate bond insurers or bonds with interest payments made by a corporate entity through a municipal conduit/authority. While decisions regarding these investments primarily consider the underlying municipal situation, the existence of third-party insurance reduces risk in the event of default. In circumstances in which the municipality is unable to meet its obligations, risk would be increased if the insuring entity were experiencing financial duress. Because of our diverse exposure and selection of higher-rated entities with strong financial profiles, we do not believe this is a material concern.

### Interest Rate Sensitivity Analysis

Because of our strong surplus, long-term investment horizon and ability to hold most fixed-maturity investments until maturity, we believe the company is well positioned if interest rates were to rise. A higher rate environment would provide the opportunity to invest cash flow in higher-yielding securities, while reducing the likelihood of calls of the higher-yielding U.S. agency paper purchased over the past year. While higher interest rates would be expected to continue to increase the number of fixed-maturity holdings trading below 100 percent of book value, we believe lower fixed-maturity security values due solely to interest rate changes would not signal a decline in credit quality.

A dynamic financial planning model developed during 2002 uses analytical tools to assess market risks. As part of this model, the modified duration of the fixed-maturity portfolio is continually monitored by our investment department to evaluate the theoretical impact of interest rate movements.

We measure modified duration and duration to worst. The table below summarizes the effect of hypothetical changes in interest rates on the fixed-maturity portfolio under both duration scenarios:

(In millions)	Fair value of fixed maturity portfolio	Modified duration		Duration to worst	
		100 basis point spread decrease	100 basis point spread increase	100 basis point spread decrease	100 basis point spread increase
<b>At December 31, 2005</b>	<b>\$5,476</b>	<b>\$5,868</b>	<b>\$5,084</b>	<b>\$5,779</b>	<b>\$5,173</b>
At December 31, 2004	5,070	5,445	4,695	5,326	4,814

The modified duration of our portfolio is currently 7.1 years and the modified duration of the redeemable preferred portfolio is currently 10.4 years. A 100 basis-point movement in interest rates would result in an approximately 7.2 percent change in the market value of the combined portfolios. Generally speaking, the higher a bond's rating, the more directly correlated movements in its market value will be to changes in the general level of interest rates.

Therefore, the municipal bond portfolio is more likely to respond to a changing interest rate scenario. Our U.S. agency paper portfolio, because it generally has very little call protection, has a low duration and would not be expected to be as responsive to rate movements. Lower investment grade and high-yield corporate bond values are driven by credit spreads, as well as their durations, in response to interest rate movements.

In the dynamic financial planning model, the selected interest rate change of 100 basis points represents our views of a shift in rates that is quite possible over a one-year period. The rates modeled should not be considered a prediction of future events as interest rates may be much more volatile in the future. The analysis is not intended to provide a precise forecast of the effect of changes in rates on our results or financial condition, nor does it take into account any actions that we might take to reduce exposure to such risks.

### Short-term Investments

Our short-term investments present minimal risk as we generally purchase the highest quality commercial paper.

### Equity Investments

Common stocks are subject to a variety of risk factors encompassed under the umbrella of market risk. General economic swings influence the performance of the underlying industries and companies within those industries. A downturn in the economy will have a negative impact on an equity portfolio. Industry- and company-specific risks

have the potential to substantially affect the market value of the company's equity portfolio. We address these risks by maintaining investments in a small group of holdings that we can analyze closely, better understanding their business and the related risk factors.

At December 31, 2005, the company held 14 individual equity positions valued at approximately \$100 million or above, see Item 1, Investments Segment, Page 15, for additional details on these holdings. These equity positions accounted for approximately 93.8 percent of the unrealized appreciation of the entire portfolio.

2005 10-K Page 72

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We believe our equity investment style centered on companies that pay and increase dividends to shareholders is an appropriate long-term strategy. While our long-term financial position would be affected by prolonged changes in the market valuation of our investments, we believe our strong surplus position and cash flow provide a cushion against short-term fluctuations in valuation. We believe that the continued payment of cash dividends by the issuers of the common equities we hold also should provide a floor to their valuation.

Our investments are heavily weighted toward the financials sector, which represented 63.4 percent of the total fair value of the common stock portfolio at December 31, 2005. Financials sector investments typically underperform the overall market during periods when interest rates are expected to rise. We historically have seen these types of short-term fluctuations in market value of its holdings as potential buying opportunities but are cognizant that a prolonged downturn in this sector could create a long-term negative effect on the portfolio.

Over the longer term, our objective is for the performance of our equity portfolio to exceed that of the broader market. Over the five years ended December 31, 2005, our compound annual equity portfolio return was a negative 0.8 percent compared with a compound annual total return of 0.5 percent for the Standard & Poor's 500 Index, a common benchmark of market performance. In 2005, our compound annual equity portfolio was a negative 4.2 percent, compared with a compound annual total return of 4.9 percent for that Index. Our equity portfolio underperformed the market for these periods because of the decline in the market value of our holdings of Fifth Third common stock over the past five years.

The primary risk related to preferred stock is similar to those related to investment grade corporate bonds. Falling interest rates will adversely impact market values due the normal inverse relationship between rates and yields. Credit risk exists due to their subordinate position in the capital structure. We minimize this risk by primarily purchasing investment grade preferred stocks of issuers with a strong history of paying a common stock dividend.

#### **Fifth Third Bancorp Holding**

One of our common stock holdings, Fifth Third, accounted for 26.3 percent of our shareholders' equity at year-end 2005 and dividends earned from our Fifth Third investment were 20.2 percent of our investment income in 2005.

(In Millions except market price data)	Years ended December 31,		
	2005	2004	2003
Fifth Third Bancorp common stock holding:			
Dividends earned	\$ 106	\$ 95	\$ 82
Percent of total investment income	20.2%	19.4%	17.7%
	At December 31,		
	2005	2004	
Shares held	73	73	
Closing market price of Fifth Third	\$37.72	\$47.30	
Book value of holding	283	283	
Fair value of holding	2,745	3,443	
After-tax unrealized gain	1,600	2,054	
Market value as a percent of total equity investments	38.6%	45.9%	
Market value as a percent of invested assets	21.6	27.2	
Market value as a percent of total shareholders' equity	45.1	55.1	
After-tax unrealized gain as a percent of total shareholders' equity	26.3	32.9	

Based on 2005 results, a 10 percent change in dividends earned from our Fifth Third holding would result in an \$11 million change in pretax investment income and a \$9 million change in after-tax earnings.

Every \$1.00 change in the market price of Fifth Third's common stock has approximately a 27 cent impact on our book value per share. A 20 percent change in the market price of Fifth Third's common stock from its year-end 2005 closing price would result in a \$549 million change in assets and a \$357 million change in after-tax unrealized gains.

Fifth Third's market value over the past three years has been impacted by a difficult interest rate environment and the residual effects of a regulatory review that was concluded in early 2004. We believe that they have come out of the process a stronger bank operationally and we believe the management team can execute on the strategy for growth they have defined. During this challenging period for the bank, we have continued to benefit from their superior dividend growth. In September 2005, Fifth Third increased its indicated annual dividend by 8.6 percent, which is expected to contribute an additional \$9 million to investment income on an annualized basis.

2005 10-K Page 73

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### **Unrealized Investment Gains and Losses**

At December 31, 2005, unrealized investment gains before taxes totaled \$5.145 billion and unrealized investment losses in the investment portfolio amounted to \$78 million.

#### **Unrealized Investment Gains**

The unrealized gains at year-end 2005 were primarily due to long-term gains from the company's holdings in the common stock of Fifth Third (Nasdaq: FITB) and Alltel Corporation (NYSE: AT). Reflecting the company's long-term investment philosophy, of the 1,082 securities trading at or above book value, 767, or 70.9 percent, have shown unrealized gains for more than 24 months.

#### **Unrealized Investment Losses Potential Other-than-temporary Impairments**

The asset impairment policy evaluates significant decreases in the market value of the assets; changes in legal factors or in the business climate; or other such factors indicating whether or not the carrying amount may be recoverable. A declining trend in market value, the extent of the market value decline and the length of time in which the value has been depressed are objective measures that can be outweighed by subjective measures such as impending events and issuer liquidity. In 2005 and earlier, impairment is evaluated in the event of a declining market value for four consecutive quarters with quarter-end market value below 50 percent of book value, or when a security's market value is 50 percent below book value for three consecutive quarters. Effective January 1, 2006, impairment may be evaluated in the event a declining market value for four consecutive quarters with quarter-end market value below 70 percent of book value, or when a security's market value is 70 percent below book value for three consecutive quarters. In addition to applying the impairment policy, the status of the portfolio is constantly monitored by the company's portfolio managers for indications of potential problems or issues that may be possible impairment issues. If an impairment indicator is noted, the portfolio managers even more closely scrutinize the security. During 2005 and 2004, a total of six securities were written down as other-than-temporarily impaired.

We expect the number of securities trading below 100 percent of book value to fluctuate as interest rates rise or fall. Further, book values for some securities have been revised due to impairment charges recognized during 2003 and 2002. At December 31, 2005, 732 of the 1,814 securities we owned were trading below 100 percent of book value compared with 208 of the 1,593 securities we owned at December 31, 2004. Of the 732 holdings trading below book value at December 31, 2005, 714 were trading between 90 percent and 100 percent of book value.

The 732 holdings trading below book value at December 31, 2005, represented 22.3 percent of invested assets and \$78 million in unrealized losses. We deem the risk related to securities trading between 70 percent and 100 percent of book value to be relatively minor and at least partially offset by the earned income potential of these investments.

714 of these holdings were trading between 90 percent and 100 percent of book value. The value of these securities fluctuates primarily because of changes in interest rates. The fair value of these 714 securities was \$2.717 billion at December 31, 2005, and they accounted for \$57 million in unrealized losses.

18 of these holdings were trading below 90 percent of book value at December 31, 2005. The fair value of these holdings was \$111 million, and they accounted for the remaining \$21 million in unrealized losses. These holdings are being monitored for credit- and industry-related risk factors. Of these securities, seven are bonds or convertible preferred stocks of auto industry-related issuers and one is a common stock of a pharmaceutical company. These eight securities account for \$69 million of the fair value of holdings trading below 90 percent of book value. The remaining ten are smaller positions in a variety of industries.

Holdings trading below 70 percent of book value are monitored more closely for potential other-than-temporary impairment. At December 31, 2005, two auto-related holdings with a fair value of \$8 million were trading below 70 percent of book value. At year-end 2004, no securities were trading below 70 percent of book value.

As discussed in Critical Accounting Estimates, Asset Impairment, Page 37, when evaluating other-than-temporary impairments, we consider our ability to retain a security for a period adequate to recover a substantial portion of its cost. Because of our investment philosophy and strong capitalization, we can hold securities until their scheduled redemption that might otherwise be deemed impaired as we evaluate their potential for recovery based economic, industry or company factors.





The following table summarizes the investment portfolio by period of time:

(Dollars in millions)	6 Months or less		> 6-12 Months		> 12-24 Months		> 24-36 Months	
	Number of issues	Gross unrealized gain/loss	Number of issues	Gross unrealized gain/loss	Number of issues	Gross unrealized gain/loss	Number of issues	Gross unrealized gain/loss
<b>Taxable fixed maturities:</b>								
Trading below 70% of book value	2	\$ (4)	0	\$ 0	0	\$ 0	0	\$ 0
Trading at 70% to less than 100% of book value	185	(22)	57	(17)	46	(12)	5	(1)
Trading at 100% and above of book value	37	3	14	1	35	5	346	102
<b>Total</b>	<b>224</b>	<b>(23)</b>	<b>71</b>	<b>(16)</b>	<b>81</b>	<b>(7)</b>	<b>351</b>	<b>101</b>
<b>Tax-exempt fixed maturities:</b>								
Trading below 70% of book value	0	0	0	0	0	0	0	0
Trading at 70% to less than 100% of book value	357	(8)	32	(3)	32	(3)	3	0
Trading at 100% and above of book value	51	1	43	1	105	3	384	43
<b>Total</b>	<b>408</b>	<b>(7)</b>	<b>75</b>	<b>(2)</b>	<b>137</b>	<b>0</b>	<b>387</b>	<b>43</b>
<b>Common equities:</b>								
Trading below 70% of book value	0	0	0	0	0	0	0	0
Trading at 70% to less than 100% of book value	1	0	1	0	2	(5)	0	0
Trading at 100% and above of book value	5	3	1	1	4	8	35	4,968
<b>Total</b>	<b>6</b>	<b>3</b>	<b>2</b>	<b>1</b>	<b>6</b>	<b>3</b>	<b>35</b>	<b>4,968</b>
<b>Preferred equities:</b>								
Trading below 70% of book value	0	0	0	0	0	0	0	0
Trading at 70% to less than 100% of book value	8	(2)	0	0	0	0	1	(1)
Trading at 100% and above of book value	11	1	4	1	3	0	2	4

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Total	19	(1)	4	1	3	0	3	3
Short-term investments:								
Trading below 70% of book value	0	0	0	0	0	0	0	0
Trading at 70% to less than 100% of book value	0	0	0	0	0	0	0	0
Trading at 100% and above of book value	2	0	0	0	0	0	0	0
Total	2	0	0	0	0	0	0	0
Summary:								
Trading below 70% of book value	2	(4)	0	0	0	0	0	0
Trading at 70% to less than 100% of book value	551	(32)	90	(20)	80	(20)	9	(2)
Trading at 100% and above of book value	106	8	62	4	147	16	767	5,117
Total	659	\$ (28)	152	\$ (16)	227	\$ (4)	776	\$ 5,115

2005 10-K Page 75

The following table summarizes the investment portfolio:

(Dollars in millions)	Number of issues	Book value	Fair value	Gross unrealized gain/loss	Gross investment income
<b>At December 31, 2005</b>					
Taxable fixed maturities:					
Trading below 70% of book value	2	\$ 12	\$ 8	\$ (4)	\$ 1
Trading at 70% to less than 100% of book value	293	1,839	1,787	(52)	84
Trading at 100% and above of book value	432	1,453	1,564	111	99
Securities sold in current year	0	0	0	0	15
<b>Total</b>	<b>727</b>	<b>3,304</b>	<b>3,359</b>	<b>55</b>	<b>199</b>
Tax-exempt fixed maturities:					
Trading below 70% of book value	0	0	0	0	0
Trading at 70% to less than 100% of book value	424	941	927	(14)	32
Trading at 100% and above of book value	583	1,142	1,190	48	55
Securities sold in current year	0	0	0	0	3
<b>Total</b>	<b>1,007</b>	<b>2,083</b>	<b>2,117</b>	<b>34</b>	<b>90</b>
Common equities:					
Trading below 70% of book value	0	0	0	0	0
Trading at 70% to less than 100% of book value	4	51	46	(5)	1
Trading at 100% and above of book value	45	1,910	6,890	4,980	229
Securities sold in current year	0	0	0	0	0
<b>Total</b>	<b>49</b>	<b>1,961</b>	<b>6,936</b>	<b>4,975</b>	<b>230</b>
Preferred equities:					
Trading below 70% of book value	0	0	0	0	0
Trading at 70% to less than 100% of book value	9	63	60	(3)	1
Trading at 100% and above of book value	20	104	110	6	3
Securities sold in current year	0	0	0	0	0

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Total	29	167	170	3	4
Short-term investments:					
Trading below 70% of book value	0	0	0	0	0
Trading at 70% to less than 100% of book value	0	0	0	0	0
Trading at 100% and above of book value	2	75	75	0	1
Securities sold in current year	0	0	0	0	0
Total	2	75	75	0	1
Portfolio summary:					
Trading below 70% of book value	2	12	8	(4)	1
Trading at 70% to less than 100% of book value	730	2,894	2,820	(74)	118
Trading at 100% and above of book value	1,082	4,684	9,829	5,145	387
Securities sold in current year	0	0	0	0	18
Total	1,814	\$ 7,590	\$ 12,657	\$ 5,067	\$ 524
At December 31, 2004					
Portfolio summary:					
Trading below 70% of book value	0	\$ 0	\$ 0	\$ 0	\$ 0
Trading at 70% to less than 100% of book value	208	900	883	(17)	32
Trading at 100% and above of book value	1,385	5,899	11,756	5,857	427
Securities sold in current year	0	0	0	0	32
Total	1,593	\$ 6,799	\$ 12,639	\$ 5,840	\$ 491

2005 10-K Page 76

**Signatures**

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Cincinnati Financial Corporation

/S/ Kenneth W. Stecher

By: Kenneth W. Stecher  
Title: Chief Financial Officer, Senior Vice President, Secretary and  
Treasurer  
Date: March 15, 2006

2005 10-K Page 112

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## Index of Exhibits

Exhibit No.	Exhibit Description
3.1A	Amended Articles of Incorporation of Cincinnati Financial Corporation <sup>(1)</sup>
3.1B	Amendment to Article Fourth of Amended Articles of Incorporation of Cincinnati Financial Corporation <sup>(2)</sup>
3.2	Regulations of Cincinnati Financial Corporation <sup>(3)</sup>
4.1	Indenture with The Bank of New York Trust Company <sup>(4)</sup>
4.2	Supplemental Indenture with The Bank of New York Trust Company <sup>(4)</sup>
4.3	Second Supplemental Indenture with The Bank of New York Trust Company <sup>(5)</sup>
4.4	Form of 6.125% Exchange Note Due 2034 (included in Exhibit 4.2)
4.5	Form of 6.92% Debentures Due 2028 (included in Exhibit 4.3)
4.6	Indenture with the First National Bank of Chicago (subsequently assigned to The Bank of New York Trust Company) <sup>(6)</sup>
4.7	Form of 6.90% Debentures Due 2028 (included in Exhibit 4.6)
10.1	Agreement with Messer Construction <sup>(7)</sup>
10.2	Stock Repurchase Agreement dated November 12, 2004 with Robert C. Schiff, Trustee, Robert C. Schiff Revocable Trust <sup>(7)</sup>
10.3	Purchase Agreement with J.P. Morgan Securities Inc. and UBS Securities LLC <sup>(8)</sup>
10.4	2003 Non-Employee Directors Stock Plan <sup>9)</sup>
10.5	Cincinnati Financial Corporation Stock Option Plan No. V <sup>(10)</sup>
10.6	Cincinnati Financial Corporation Stock Option Plan No. VI <sup>(11)</sup>
10.7	Cincinnati Financial Corporation Stock Option Plan No. VII <sup>(12)</sup>
10.8	Standard Form of Nonqualified and Incentive Option Agreements for Stock Option Plan No. V <sup>(7)</sup>
10.9	Standard Form of Nonqualified and Incentive Option Agreements for Stock Option Plan No. VI <sup>(7)</sup>
10.10	Standard Form of Nonqualified and Incentive Option Agreements for Stock Option Plan No. VII <sup>(7)</sup>
10.11	Cincinnati Financial Corporation Stock Option Plan No. VIII <sup>(9)</sup>
10.12	Registration Rights Agreement with J.P. Morgan Securities Inc. and UBS Securities LLC <sup>(4)</sup>

- 10.13 Form of Dealer Manager Agreement between Cincinnati Financial and UBS Securities LLC <sup>(13)</sup>
- 10.14 Standard Form of Incentive Stock Option Agreement for Stock Option Plan VIII <sup>(14)</sup>
- 10.15 Standard Form of Nonqualified Stock Option Agreement for Stock Option Plan VIII <sup>(15)</sup>
- 10.16 Standard Form of Combined Incentive/Nonqualified Stock Option for Stock Option Plan VI <sup>(16)</sup>
- 10.17 364-Day Credit Agreement by and among Cincinnati Financial Corporation and CFC Investment Company, as Borrowers, and Fifth Third Bank, as Lender <sup>(17)</sup>
- 10.18 Director and Named Executive Officer Compensation Summary <sup>(18)</sup>
- 10.19 Executive Compensation Plan <sup>(19)</sup>
- 11 Statement re: Computation of per share earnings for the years ended December 31, 2005, 2004 and 2003, contained in Note 11 to the Consolidated Financial Statements included in Part II, Item 8 of this report, Page 93
- 14 Cincinnati Financial Corporation Code of Ethics for Senior Financial Officers <sup>(20)</sup>
- 21 Cincinnati Financial Corporation Subsidiaries contained in Part I, Item 1 of this report, Page 1
- 23 Consent of Independent Registered Public Accounting Firm, Page 114
- 31.1 Certification pursuant to Section 302 of the Sarbanes Oxley Act of 2002 Chief Executive Officer
- 31.2 Certification pursuant to Section 302 of the Sarbanes Oxley Act of 2002 Chief Financial Officer
- 32 Certification pursuant to Section 906 of the Sarbanes Oxley Act of 2002

<sup>1</sup> Incorporated by reference to the company's 1999 Annual Report on Form 10-K dated March 23, 2000 (File No. 000-04604).

<sup>2</sup> Incorporated by reference to Exhibit 3(i) filed with the company's Current Report on Form 8-K dated July 15, 2005.

<sup>3</sup> Incorporated by reference to the company's Definitive Proxy Statement dated March 2, 1992, Exhibit 2 (File No. 000-04604).

<sup>4</sup> Incorporated by reference to the company's Current Report on Form 8-K dated November 2, 2004, filed with respect to the issuance of the company's 6.125% Senior Notes due November 1, 2034.

<sup>5</sup> Incorporated by reference to the company's Current Report on Form 8-K dated May 9, 2005, filed with respect to the completion of the company's exchange offer and rescission offer for its 6.90% senior debentures due 2028.

<sup>6</sup> Incorporated by reference to the company's registration statement on Form S-3 effective May 22, 1998 (File No. 333-51677).

<sup>7</sup> Incorporated by reference to the company's 2004 Annual Report on Form 10-K dated March 11, 2005.



- 8 Incorporated by reference to the company's Current Report on Form 8-K dated November 1, 2004, filed with respect to the issuance of the company's 6.125% Senior Notes due November 1, 2034.
- 9 Incorporated by reference to the company's Definitive Proxy Statement dated March 21, 2005.
- 10 Incorporated by reference to the company's Definitive Proxy Statement dated March 2, 1996 (File No. 000-04604).
- 11 Incorporated by reference to the company's Definitive Proxy Statement dated March 1, 1999 (File No. 000-04604).
- 12 Incorporated by reference to the company's Definitive Proxy Statement dated March 8, 2002.
- 13 Incorporated by reference to the company's Registration Statement on Form S-4 filed March 21, 2005 (File No. 333-123471).
- 14 Incorporated by reference to Exhibit 10.1 filed with the company's Current Report on Form 8-K dated July 15, 2005.
- 15 Incorporated by reference to Exhibit 10.2 filed with the company's Current Report on Form 8-K dated July 15, 2005.
- 16 Incorporated by reference to Exhibit 10.3 filed with the company's Current Report on Form 8-K dated July 15, 2005.
- 17 Incorporated by reference to Exhibit 10.1 filed with the company's Current Report on Form 8-K dated May 31, 2005.
- 18 Incorporated by reference to the company's Definitive Proxy Statement to be filed no later than April 14, 2006.
- 19 Incorporated by reference to Exhibit 10.2 filed with the company's Current Report on Form 8-K dated November 23, 2005.
- 20 Incorporated by reference to the company's Definitive Proxy Statement dated March 18, 2004.