CINCINNATI FINANCIAL CORP
Form 10-Q
April 28, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended March 31, 2010.

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

þ Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

¨ Yes ¨ No

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

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

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

¨ Yes þ No

As of April 26, 2010, there were 162,984,380 shares of common stock outstanding.

CINCINNATI FINANCIAL CORPORATION
FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2010

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Part I – Financial Information

Item 1. Financial Statements (unaudited)

Cincinnati Financial Corporation and Subsidiaries
Condensed Consolidated Balance Sheets

(In millions except per share data)	March 31, 2010	December 31, 2009
ASSETS		
Investments		
Fixed maturities, at fair value (amortized cost: 2010—$7,655; 2009—$7,514)	$ 8,081	$ 7,855
Equity securities, at fair value (cost: 2010—$2,089; 2009—$2,016)	2,838	2,701
Short-term investments, at fair value (amortized cost; 2010—$0; 2009—$6)	—	6
Other invested assets	83	81
Total investments	11,002	10,643
Cash and cash equivalents	402	557
Investment income receivable	116	118
Finance receivable	75	75
Premiums receivable	1,031	995
Reinsurance receivable	570	675
Prepaid reinsurance premiums	16	15
Deferred policy acquisition costs	485	481
Land, building and equipment, net, for company use (accumulated depreciation: 2010—$344; 2009—$335)	249	251
Other assets	55	45
Separate accounts	615	585
Total assets	$ 14,616	$ 14,440
LIABILITIES		
Insurance reserves		
Loss and loss expense reserves	$ 4,119	$ 4,142
Life policy reserves	1,862	1,783
Unearned premiums	1,549	1,509
Other liabilities	561	670
Deferred income tax	206	152
Note payable	49	49
6.125% senior notes due 2034	371	371
6.9% senior debentures due 2028	28	28
6.92% senior debentures due 2028	391	391
Separate accounts	615	585
Total liabilities	9,751	9,680
Commitments and contingent liabilities (Note 9)	—	—
SHAREHOLDERS' EQUITY		
Common stock, par value—$2 per share; (authorized: 2010—500 million shares, 2009—500 million shares; issued: 2010—196 million shares, 2009—196 million shares)	393	393
Paid-in capital	1,081	1,081

Retained earnings		3,865		3,862
Accumulated other comprehensive income		722		624
Treasury stock at cost (2010—33 million shares, 2009—34 million shares)		(1,196)		(1,200)
Total shareholders' equity		4,865		4,760
Total liabilities and shareholders' equity	$	14,616	$	14,440

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

Cincinnati Financial Corporation and Subsidiaries
Condensed Consolidated Statements Of Income

(In millions except per share data)	Three months ended March 31, 2010	2009
REVENUES		
Earned premiums	$ 746	$ 765
Investment income, net of expenses	130	124
Other income	3	3
Realized investment gains (losses), net		
Other-than-temporary impairments on fixed maturity securities	(1)	(40)
Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income	—	—
Other realized investment gains, net	9	38
Total realized investment gains (losses), net	8	(2)
Total revenues	887	890
BENEFITS AND EXPENSES		
Insurance losses and policyholder benefits	516	581
Underwriting, acquisition and insurance expenses	268	255
Other operating expenses	4	6
Interest expense	14	14
Total benefits and expenses	802	856
INCOME BEFORE INCOME TAXES	85	34
PROVISION (BENEFIT) FOR INCOME TAXES		
Current	15	(2)
Deferred	2	1
Total provision (benefit) for income taxes	17	(1)
NET INCOME	$ 68	$ 35
PER COMMON SHARE		
Net income—basic	$ 0.42	$ 0.22
Net income—diluted	0.42	0.22

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

Cincinnati Financial Corporation and Subsidiaries
Condensed Consolidated Statements Of Shareholders' Equity

(In millions)	Common Stock Outstanding Shares	Common Stock Amount	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Share-holders' Equity
Balance December 31, 2008	162	$ 393	$ 1,069	$ 3,579	$ 347	$ (1,206)	$ 4,182
Net income	—	—	—	35	—	—	35
Other comprehensive income (loss), net	—	—	—	—	(278)	—	(278)
Total comprehensive income							(243)
Dividends declared	—	—	—	(63)	—	—	(63)
Stock-based compensation	—	—	3	—	—	—	3
Reissued	—	—	—	—	—	2	2
Balance March 31, 2009	162	$ 393	$ 1,072	$ 3,551	$ 69	$ (1,204)	$ 3,881
Balance December 31, 2009	162	$ 393	$ 1,081	$ 3,862	$ 624	$ (1,200)	$ 4,760
Net income	—	—	—	68	—	—	68
Other comprehensive income (loss), net	—	—	—	—	98	—	98
Total comprehensive income							166
Dividends declared	—	—	—	(65)	—	—	(65)
Stock options exercised	1	—	(2)	—	—	3	1
Stock-based compensation	—	—	3	—	—	—	3
Other	—	—	(1)	—	—	1	—
Balance March 31, 2010	163	$ 393	$ 1,081	$ 3,865	$ 722	$ (1,196)	$ 4,865

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

Cincinnati Financial Corporation and Subsidiaries
Condensed Consolidated Statements Of Cash Flows

(In millions)	Three months ended March 31,			
	2010		2009	
CASH FLOWS FROM OPERATING ACTIVITIES				
Net income	$	68	$	35
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation, amortization and other non-cash items		10		8
Realized (gains) losses on investments		(8)		2
Stock-based compensation		3		3
Interest credited to contract holders		13		9
Deferred income tax expense		2		1
Changes in:				
Investment income receivable		2		—
Premiums and reinsurance receivable		69		(2)
Deferred policy acquisition costs		(10)		(7)
Other assets		(4)		(4)
Loss and loss expense reserves		(23)		7
Life policy reserves		28		25
Unearned premiums		40		38
Other liabilities		(29)		(23)
Current income tax receivable/payable		(51)		(52)
Net cash provided by operating activities		110		40
CASH FLOWS FROM INVESTING ACTIVITIES				
Sale of fixed maturities		74		62
Call or maturity of fixed maturities		176		215
Sale of equity securities		31		423
Collection of finance receivables		7		6
Purchase of fixed maturities		(431)		(873)
Purchase of equity securities		(88)		(345)
Change in short-term investments, net		6		71
Investment in buildings and equipment, net		(8)		(8)
Investment in finance receivables		(7)		(6)
Change in other invested assets, net		1		(3)
Net cash used in investing activities		(239)		(458)
CASH FLOWS FROM FINANCING ACTIVITIES				
Payment of cash dividends to shareholders		(63)		(63)
Contract holder funds deposited		58		9
Contract holder funds withdrawn		(17)		(19)
Excess tax benefits on share-based compensation		(2)		—
Other		(2)		(3)
Net cash used in financing activities		(26)		(76)
Net decrease in cash and cash equivalents		(155)		(494)
Cash and cash equivalents at beginning of year		557		1,009
Cash and cash equivalents at end of period	$	402	$	515
Supplemental disclosures of cash flow information:				
Interest paid (net of capitalized interest: 2010—$0; 2009—$0)	$	—	$	1
Income taxes paid		67		50

Non-cash activities:		
Equipment acquired under capital lease obligations	$ —	$ 2

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

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Notes To Condensed Consolidated Financial Statements (Unaudited)

NOTE 1 — Accounting Policies

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

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Our actual results could differ from those estimates. The December 31, 2009, consolidated balance sheet amounts are derived from the audited financial statements but do not include all disclosures required by GAAP.

Our March 31, 2010, condensed consolidated financial statements are unaudited. Certain financial information that is included in annual financial statements prepared in accordance with GAAP is not required for interim reporting and has been condensed or omitted. We believe that we have made all adjustments, consisting only of normal recurring accruals that are necessary for fair presentation. These condensed consolidated financial statements should be read in conjunction with our consolidated financial statements included in our 2009 Annual Report on Form 10-K. The results of operations for interim periods do not necessarily indicate results to be expected for the full year.

We have changed our presentation of earned premiums in our condensed consolidated statements of income effective the first quarter 2010. We have summarized property casualty and life earned premiums to a single caption, "Earned premiums." See Note 6, Reinsurance. Page 13, for further detail on property casualty and life earned premiums.

With the adoption of Accounting Standards Codification (ASC) 320, Recognition and Presentation of Other-Than-Temporary Impairments, in the second quarter of 2009, we recognized a cumulative effect adjustment of $106 million, net of tax, to reclassify the non-credit component of previously recognized impairments by increasing retained earnings and reducing accumulated other comprehensive income. ASC 320 does not allow retrospective application of the new other-than-temporary impairment (OTTI) model. Our Condensed Consolidated Statements of Income for the three months ended March 31, 2010, are not measured on the same basis as prior period amounts and, accordingly, these amounts are not comparable.

Adopted Accounting Updates

ASU 2010-08, Technical Corrections to Various Topics

In February 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-08, Technical Corrections to Various Topics. ASU 2010-08 does not change any of the fundamentals of U.S. GAAP, but it does explain certain clarifications made to the guidance on embedded derivatives and hedging. We have adopted ASU 2010-08, and it is effective for the first reporting period after issuance and for fiscal years beginning after December 15, 2009. It did not have a material impact on our company's financial position, cash flows or results of operations.

ASU 2010-09, Subsequent Events

In February 2010, the FASB issued ASU 2010-09, Subsequent Events. ASU 2010-09 removes the requirement for SEC filers to disclose the date through which subsequent events have been evaluated in both issued and revised financial statements. We have adopted ASU 2010-09, and it is effective for the first reporting period after issuance. It did not have a material impact on our company's financial position, cash flows or results of operations.

Pending Accounting Updates

ASU 2010-06, Fair Value Measurements and Disclosures

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

NOTE 2 – Investments

Fixed maturities (bonds and redeemable preferred stocks), equity securities (common and non-redeemable preferred stocks) and short-term investments have been classified as available for sale and are stated at fair values at March 31, 2010, and December 31, 2009.

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

(In millions)	Three month ended March 31,			
		2010		2009
Change in unrealized investment gains and losses and other summary:				
Fixed maturities	$	85	$	97
Equity securities		64		(510)
Adjustment to deferred acquisition costs and life policy reserves		(3)		(4)
Pension obligations		1		1
Other		3		(12)
Income taxes on above		(52)		150
Total	$	98	$	(278)

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

(In millions)											
			Cost or amortized		Gross unrealized				Fair value		OTTI in AOCI
At March 31, 2010			cost		gains		losses				
Fixed maturities:											
	States, municipalities and political subdivisions	$	2,992	$	122	$	4	$	3,110	$	—
	Convertibles and bonds with warrants attached		81		—		—		81		—
	United States government		4		1		—		5		—
	Government-sponsored enterprises		329		—		—		329		—
	Foreign government		3		—		—		3		—
	Short-term investments		—		—		—		—		—
	Collateralized mortgage obligations		—		—		—		—		—
	Corporate bonds		4,246		323		16		4,553		—
	Total	$	7,655	$	446	$	20	$	8,081	$	—
Equity securities		$	2,089	$	774	$	25	$	2,838		NA
At December 31, 2009											
Fixed maturities:											

States, municipalities and political subdivisions	$ 3,007	$ 128	6	$ 3,129	$ —
Convertibles and bonds with warrants attached	91	—	—	91	—
United States government	4	—	—	4	—
Government-sponsored enterprises	354	—	7	347	—
Foreign government	3	—	—	3	—
Short-term investments	6	—	—	6	—
Collateralized mortgage obligations	37	—	6	31	—
Corporate bonds	4,018	268	36	4,250	—
Total	$ 7,520	$ 396	$ 55	$ 7,861	$ —
Equity securities	$ 2,016	$ 714	$ 29	$ 2,701	NA

The unrealized investment gains at March 31, 2010, were largely due to a long-term net gain position of $725 million for our common stock portfolio. Contributing 10 percent or more of that net gain position were two publicly-traded holdings totaling $225 million: The Procter & Gamble Company (NYSE:PG) and Exxon Mobil Corporation (NYSE:XOM). At March 31, 2010, we had $82 million fair value of hybrid securities included in fixed maturities that follow ASC 815-15-25, Accounting for Certain Hybrid Financial Instruments.

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

(In millions)	Less than 12 months		12 months or more		Total	
At March 31, 2010	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Fixed maturities:						
States, municipalities and political subdivisions	$ 153	$ 2	$ 30	$ 2	$ 183	$ 4
Government-sponsored enterprises	61	—	2	—	63	—
Corporate bonds	316	8	161	8	477	16
Total	530	10	193	10	723	20
Equity securities	78	3	226	22	304	25
Total	$ 608	$ 13	$ 419	$ 32	$ 1,027	$ 45
At December 31, 2009						
Fixed maturities:						
States, municipalities and political subdivisions	$ 196	$ 4	$ 29	$ 2	$ 225	$ 6
Government-sponsored enterprises	347	7	—	—	347	7
Short-term investments	1	—	—	—	1	—
Collateralized mortgage obligations	—	—	27	6	27	6
Corporate bonds	397	19	309	17	706	36
Total	941	30	365	25	1,306	55
Equity securities	65	3	415	26	480	29
Total	$ 1,006	$ 33	$ 780	$ 51	$ 1,786	$ 84

Other-than-temporary Impairment Charges

For the three months ended March 31, 2010, there were no credit losses on fixed-maturity securities for which a portion of OTTI has been recognized in other comprehensive income. The following table provides the amount of OTTI charges:

(In millions)	Three months ended March 31,	
	2010	2009
Other-than-temporary impairment charges:		
Fixed maturities	$ 1	$ 50
Equity securities	—	—
Total	$ 1	$ 50

During the quarter ended March 31, 2010, we impaired two fixed-maturity securities for a total of $1 million. At March 31, 2010, 69 fixed-maturity investments with a total unrealized loss of $10 million had been in an unrealized loss position for 12 months or more. Of that total, one fixed-maturity security with a total unrealized loss of $1 million was trading below 70 percent of book value. Eight equity securities with a total unrealized loss of $22 million had been in an unrealized loss position for 12 months or more, but none were trading below 70 percent of book value.

At December 31, 2009, 121 fixed-maturity investments with a total unrealized loss of $25 million had been in an unrealized loss position for 12 months or more. Of that total, eight fixed maturity investments were trading below 70 percent of book value with a total unrealized loss of $2 million. Ten equity investments with a total unrealized loss of $26 million had been in an unrealized loss position for 12 months or more as of December 31, 2009. Of that total, no equity investments were trading below 70 percent of book value.

NOTE 3 –Fair Value Measurements

Fair Value Hierarchy

In accordance with fair value measurements and disclosures, we categorized our financial instruments, based on the priority of the observable and market-based data for valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices with readily available independent data in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable market inputs (Level 3). When various inputs for measurement fall within different levels of the fair value hierarchy, the lowest observable input that has a significant impact on fair value measurement is used. Our valuation techniques have not changed from December 31, 2009, and ultimately management determines fair value.

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

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

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

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

  - o Quotes from brokers or other external sources that are not considered binding;
  - o Quotes from brokers or other external sources where it cannot be determined that market participants would in fact transact for the asset or liability at the quoted price;
  - o Quotes from brokers or other external sources where the inputs are not deemed observable.

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

The following tables illustrate the fair value hierarchy for those assets measured at fair value on a recurring basis for the three months ended March 31, 2010, and December 31, 2009. We do not have any material liabilities carried at fair value. There were no significant transfers between Level 1 and Level 2.

Fair Value Disclosures for Assets

(In millions)	Asset fair value measurements at March 31, 2010 using:			
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Fixed maturities, available for sale:				
Corporate securities	$ —	$ 4,606	$ 28	$ 4,634
Foreign government	—	3	—	3
U.S. Treasury and U.S. government agencies	5	329	—	334
States, municipalities and political subdivisions	—	3,106	4	3,110
Total	5	8,044	32	8,081
Common equities, available for sale	2,614	124	—	2,738
Preferred equities, available for sale	—	94	6	100
Taxable fixed maturities separate accounts	—	582	—	582
Top Hat Savings Plan	8	—	—	8
Total	$ 2,627	$ 8,844	$ 38	$ 11,509

(In millions) Asset fair value measurements at December 31, 2009 using:

	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Fixed maturities, available for sale:				
Corporate securities	$ —	$ 4,314	$ 27	$ 4,341
Foreign government	—	3	—	3
U.S. Treasury and U.S. government agencies	4	347	—	351
Collateralized mortgage obligations	—	31	—	31
States, municipalities and political subdivisions	—	3,125	4	3,129
Total	4	7,820	31	7,855
Common equities, available for sale	2,474	134	—	2,608
Preferred equities, available for sale	—	88	5	93
Short-term investments	—	6	—	6
Taxable fixed maturities separate accounts	—	555	—	555
Top Hat Savings Plan	7	—	—	7
Total	$ 2,485	$ 8,603	$ 36	$ 11,124

Each financial instrument that was deemed to have significant unobservable inputs when determining valuation is identified in the tables below by security type with a summary of changes in fair value as of March 31, 2010. Total Level 3 assets were less than 1 percent of financial assets measured at fair value for the three months ended March 31, 2010, and December 31, 2009.

(In millions)	Asset fair value measurements using significant unobservable inputs (Level 3)					
	Corporate fixed maturities	Taxable fixed maturities-separate accounts	States, municipalities and political subdivisions fixed maturities	Common equities	Preferred equities	Total
Beginning balance, December 31, 2009	$ 27	$ —	$ 4	$ —	$ 5	$ 36
Total gains or losses (realized/unrealized):						
Included in earnings (or changes in net assets)	—	—	—	—	—	—
Included in other comprehensive income	—	—	—	—	1	1
Purchases, sales, issuances, and settlements	5	—	—	—	—	5
Transfers in and/or out of Level 3	(4)	—	—	—	—	(4)
Ending balance, March 31, 2010	$ 28	$ —	$ 4	$ —	$ 6	$ 38

(In millions)	Asset fair value measurements using significant unobservable inputs (Level 3)					
	Taxable fixed maturities	Taxable fixed maturities-separate accounts	Tax-exempt fixed maturities	Common equities	Preferred equities	Total
Beginning balance, December 31, 2008	$ 50	$ 6	$ 5	$ 64	$ 22	$ 147
Total gains or losses (realized/unrealized):						
Included in earnings (or changes in net assets)	—	—	—	—	(3)	(3)
Included in other comprehensive income	(1)	—	—	—	2	1
Purchases, sales, issuances, and settlements	—	—	—	—	—	—
Transfers in and/or out of Level 3	(11)	(6)	—	—	(15)	(32)
Ending balance, March 31, 2009	$ 38	$ —	$ 5	$ 64	$ 6	$ 113

For the three months ended March 31, 2010, one Level 3 corporate fixed-maturity security was purchased for $5 million. As a result of the change in use of observable or unobservable inputs throughout the first quarter of 2010, Level 3 corporate fixed-maturity securities decreased $4 million as one security totaling $7 million transferred from Level 3 to Level 2 and one security totaling $3 million transferred from Level 2 to Level 3. At March 31, 2010, total fair value of assets priced with broker quotes and other non-observable market inputs for the fair value measurements and disclosures was $38 million.

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

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

This table summarizes the principal amounts of our long-term debt excluding unamortized discounts:

(In millions) Interest rate	Year of issue		March 31, 2010	December 31, 2009
6.900%	1998	Senior debentures, due 2028	$ 28	$ 28
6.920%	2005	Senior debentures, due 2028	391	391
6.125%	2004	Senior notes, due 2034	374	374
		Total	$ 793	$ 793

The fair value of our senior debt approximated $761 million at March 31, 2010, compared with $740 million at year-end 2009. Fair value was determined under the fair value measurements and disclosures accounting rules based on market pricing of these or similar debt instruments that are actively trading. Fair value can vary with macro-economic concerns. Regardless of the fluctuations in fair value, the outstanding principal amount of our long-term debt is $793 million. None of the notes are encumbered by rating triggers. Also, we have a note payable with outstanding principal amount of $49 million which approximates fair value.

The fair value of life policy loans outstanding principal and interest approximated $44 million, compared with book value of $40 million reported in the condensed consolidated balance sheets as of March 31, 2010.

Life reserves and liabilities for deferred annuities and other investment contracts were $800 million and $736 million for March 31, 2010, and December 31, 2009, respectively. Fair value for these deferred annuities and investment contracts was $774 million and $737 million for March 31, 2010, and December 31, 2009, respectively. Fair values of liabilities associated with certain investment contracts are calculated based upon internally developed models because active, observable markets do not exist for those items. To determine the fair value, we make the following significant assumptions: (1) the discount rates used to calculate the present value of expected payments are the risk-free spot rates plus an A3 rated bond spread for financial issuers as of March 31, 2010, to account for non-performance risk; (2) the rate of interest credited to policyholders is the portfolio net earned interest rate less a spread for expenses and profit; and

(3) additional lapses occur when the credited interest rate is exceeded by an assumed competitor credited rate, which is a function of the risk-free rate of the economic scenario being modeled.

NOTE 4 – Deferred Acquisition Costs

The expenses associated with issuing insurance policies – primarily commissions, premium taxes and underwriting costs – are deferred and amortized over the terms of the policies. We update our acquisition cost assumptions periodically to reflect actual experience, and we evaluate our deferred acquisition cost for recoverability. Other underwriting operating expenses were $113 million and $98 million in the three months ended March 31, 2010 and 2009, respectively. The table below shows the deferred policy acquisition costs and asset reconciliation, including the amortized deferred policy acquisition costs.

(In millions)	Three months ended March 31,			
	2010		2009	
Deferred policy acquisition costs asset at beginning of the period	$	481	$	509
Capitalized deferred policy acquisition costs		171		166
Amortized deferred policy acquisition costs		(161)		(159)
Amortized shadow deferred policy acquisition costs		(6)		(6)
Deferred policy acquisition costs asset at end of the period	$	485	$	510

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

NOTE 5 – Property Casualty Loss And Loss Expenses

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

(In millions)	Three months ended March 31,			
	2010		2009	
Gross loss and loss expense reserves, beginning of period	$	4,096	$	4,040
Less reinsurance receivable		435		542
Net loss and loss expense reserves, beginning of period		3,661		3,498
Net incurred loss and loss expenses related to:				
Current accident year		514		537
Prior accident years		(39)		7
Total incurred		475		544
Net paid loss and loss expenses related to:				
Current accident year		113		142
Prior accident years		301		337
Total paid		414		479
Net loss and loss expense reserves, end of period		3,722		3,563
Plus reinsurance receivable		343		483
Gross loss and loss expense reserves, end of period	$	4,065	$	4,046

We use actuarial methods, models, and judgment to estimate, as of a financial statement date, the property casualty loss and loss expense reserves required to pay for and settle all outstanding insured claims, including incurred but not reported (IBNR) claims, as of that date. The actuarial estimate is subject to review and adjustment by an inter-departmental committee that includes actuarial management and is familiar with relevant company and industry business, claims and underwriting trends, as well as general economic and legal trends, that could affect future loss and loss expense payments.

Because of changes in estimates of insured events in prior years, we decreased the provision for loss and loss expenses by $39 million and increased the provision for loss and loss expenses by $7 million for the three months ended March 31, 2010 and 2009, respectively. The reserve for loss and loss expenses in the condensed consolidated balance sheets also includes $53 million as of March 31, 2010, and $47 million as of March 31, 2009, for certain life and health loss and loss expense reserves.

NOTE 6 – Reinsurance

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

(In millions)	Three months ended March 31, 2010		Three months ended March 31, 2009	
Direct earned premiums	$	744	$	771
Assumed earned premiums		3		3
Ceded earned premiums		(40)		(42)
Net earned premiums	$	707	$	732

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

(In millions)	Three months ended March 31, 2010		Three months ended March 31, 2009	
Direct incurred loss and loss expenses	$	449	$	526
Assumed incurred loss and loss expenses		2		4
Ceded incurred loss and loss expenses		23		12
Net incurred loss and loss expenses	$	474	$	542

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

(In millions)	Three months ended March 31, 2010		Three months ended March 31, 2009	
Direct earned premiums	$	50	$	45
Assumed earned premiums		0		0
Ceded earned premiums		(11)		(12)
Net earned premiums	$	39	$	33

Our condensed consolidated statements of income include life insurance contract holders’ benefits incurred on assumed and ceded business:

(In millions)	Three months ended March 31, 2010		Three months ended March 31, 2009	
Direct contract holders' benefits incurred	$	57	$	50
Assumed contract holders' benefits incurred		0		0
Ceded contract holders' benefits incurred		(15)		(11)
Net incurred loss and loss expenses	$	42	$	39

NOTE 7 – Employee Retirement Benefits

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

(In millions)	Three months ended March 31	
	2010	2009
Service cost	$ 2	$ 2
Interest cost	3	3
Expected return on plan assets	(3)	(3)
Amortization of actuarial loss and prior service cost	1	—
Net periodic benefit cost	$ 3	$ 2

See our 2009 Annual Report on Form 10-K, Item 8, Note 13, Employee Retirement Benefits, Page 109 for information on our retirement benefits. We made matching contributions of $2 million to our 401(k) savings plan during both the first quarter of 2010 and 2009.

We made no contribution to the pension plan during the first quarter of 2010. We anticipate contributing $25 million during 2010 to our qualified pension plan as indicated in our 2009 Annual Report on Form 10-K

NOTE 8 – Stock-Based Associate Compensation Plans

We currently have four equity compensation plans that permit us to grant various types of equity awards. We currently grant incentive stock options, non-qualified stock options, service-based restricted stock units and performance-based restricted stock units under our shareholder-approved plans. We also have a Holiday Stock Plan that permits annual awards of one share of common stock to each full-time associate for each year of service up to a maximum of 10 shares. One of our equity compensation plans permits us to grant stock to our outside directors as a component of their annual compensation. For additional information about our equity compensation plans, see our 2009 Annual Report on Form 10-K, Item 8, Note 17, Stock-Based Associate Compensation Plans, Page 113.

A total of 17 million shares are authorized to be granted under the shareholder-approved plans. At March 31, 2010, six million shares were available for future issuance under the plans.

Our pretax and after-tax stock-based compensation costs are summarized below:

(In millions)	Three months ended March 31, 2010		Three months ended March 31, 2009	
Stock-based compensation cost	$	3	$	3
Income tax benefit		1		1
Stock-based compensation cost after tax	$	2	$	2

Stock-Based Awards

During the first quarter of 2010, we granted 31,310 shares of common stock to our directors for 2009 board service fees. Stock-based awards were granted to associates during the first quarter of 2010 and are summarized in the tables below.

As of March 31, 2010, $20 million of unrecognized compensation costs related to non-vested awards are expected to be recognized over a weighted-average period of 2.2 years.

Here is a summary of option information:

(Shares in thousands)	Shares		Weighted-average exercise price
2010			
Outstanding at January 1, 2010	9,875	$	36.67
Granted	902		26.60
Exercised	(1)		26.59
Forfeited	(841)		27.33
Outstanding at March 31, 2010	9,935		36.54

Here is a summary of restricted stock unit information:

(Shares in thousands)	Service-based nonvested shares		Weighted-average grant-date fair value	Performance-based nonvested shares		Weighted-average grant-date fair value
Nonvested at January 1, 2010	597	$	31.60	121	$	29.75
Granted	290		22.27	52		22.41
Exercised	(154)		40.68	0		0.00
Forfeited	(2)		27.24	0		0.00
Cancelled	0		0.00	(24)		40.74
Nonvested at March 31, 2010	731		26.00	149		25.38

NOTE 9 – Commitments And Contingent Liabilities

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

The company and its subsidiaries also are occasionally involved in other legal actions, some of which assert claims for substantial amounts. These actions include, among others, putative class actions seeking certification of a state or national class. Such putative class actions have alleged, for example, improper reimbursement of medical providers paid under workers' compensation insurance policies, erroneous coding of municipal tax locations and excessive premium charges for uninsured motorist coverage. The company's insurance subsidiaries also are occasionally parties to individual actions in which extra-contractual damages, punitive damage or penalties are sought, such as claims alleging bad faith in the handling of insurance claims. The company accounts for such activity, if any, through the establishment of legal expense reserves included in underwriting expenses.

On a quarterly basis, we review the outstanding lawsuits seeking such recourse. Based on our quarterly review, we believe we have valid defenses to each. We believe the ultimate liability, if any, with respect to these lawsuits, after consideration of provisions made for estimated losses, is immaterial to our consolidated financial position.

Nonetheless, given the potential for large awards in certain of these actions and the inherent unpredictability of litigation, an adverse outcome could have a material adverse effect on the company’s consolidated results of operations or cash flows.

NOTE 10 – Income Taxes

As of December 31, 2009, we had no liability for unrecognized tax benefits. Details about our liability for unrecognized tax benefits are found in our 2009 Annual Report on Form 10-K, Item 8, Note 11, Income Taxes, Pages 108 and 109.

During the current quarter, there was no material change in our liability for unrecognized tax benefits. For the three months ended March 31, 2010, there have been no changes to any assumptions regarding our liability for unrecognized tax benefits that may be settled with the IRS in the next 12 months related to tax years 2007 and 2008.

NOTE 11 – Segment Information

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

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

We report as Other the non-investment operations of the parent company and its non-insurer subsidiaries, CFC Investment Company and CSU Producer Resources Inc. We also report as Other the results of The Cincinnati Specialty Underwriters Insurance Company, as well as other income of our standard market property casualty insurance subsidiary. Also included in 2009 results for this segment are the operations of a former subsidiary, CinFin Capital Management. See our 2009 Annual Report on Form 10-K, Item 8, Note 18, Segment Information, Page 115 for a description of revenue, income or loss before income taxes and identifiable assets for each of the four segments.

Segment information is summarized in the following table:

(In millions)	Three months ended March 31, 2010	2009
Revenues:		
Commercial lines insurance		
Commercial casualty	$ 164	$ 187
Commercial property	121	121
Commercial auto	95	99
Workers' compensation	74	83
Specialty packages	37	35
Surety and executive risk	24	25
Machinery and equipment	8	7
Total commercial lines insurance	523	557
Personal lines insurance		
Personal auto	81	79
Homeowner	70	70
Other personal lines	23	22
Total personal lines insurance	174	171
Life insurance	39	34
Investment operations	138	122
Other	13	6
Total	$ 887	$ 890
Income (loss) before income taxes:		
Insurance underwriting results:		
Commercial lines insurance	$ (11)	$ (12)
Personal lines insurance	(5)	(35)
Life insurance	—	(1)
Investment operations	119	106
Other	(18)	(24)
Total	$ 85	$ 34

Identifiable assets:

	March 31, 2010	December 31, 2009
Property casualty insurance	$ 1,995	$ 2,202
Life insurance	1,196	1,176
Investment operations	11,040	10,684