CINCINNATI FINANCIAL CORP
Form 10-Q
July 26, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended June 30, 2012.

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

For the transition period from _____________________ to _____________________.

Commission file number 0-4604

CINCINNATI FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

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

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

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

þ Yes ¨ No

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

þ Yes ¨ No

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

þ Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company

(Do not check if a smaller reporting company)

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

¨ Yes þ No

As of July 23, 2012, there were 162,521,638 shares of common stock outstanding.

CINCINNATI FINANCIAL CORPORATION

FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2012

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Part I – Financial Information

Item 1. Financial Statements (unaudited)

Cincinnati Financial Corporation and Subsidiaries

Condensed Consolidated Balance Sheets

(In millions except per share data)	June 30, 2012	December 31, 2011
ASSETS		
Investments		
Fixed maturities, at fair value (amortized cost: 2012—$8,252; 2011—$8,084)	$9,025	$ 8,779
Equity securities, at fair value (cost: 2012—$2,248; 2011—$2,162)	3,139	2,956
Other invested assets	67	66
Total investments	12,231	11,801
Cash and cash equivalents	263	438
Investment income receivable	118	119
Finance receivable	78	76
Premiums receivable	1,210	1,087
Reinsurance receivable	575	622
Prepaid reinsurance premiums	24	24
Deferred policy acquisition costs	484	477
Land, building and equipment, net, for company use (accumulated depreciation: 2012—$390; 2011—$376)	229	227
Other assets	179	93
Separate accounts	698	671
Total assets	$16,089	$ 15,635
LIABILITIES		
Insurance reserves		
Loss and loss expense reserves	$4,396	$ 4,339
Life policy and investment contract reserves	2,256	2,214
Unearned premiums	1,762	1,633
Other liabilities	539	517
Deferred income tax	359	303
Note payable	104	104
Long-term debt and capital lease obligations	831	821
Separate accounts	698	671
Total liabilities	10,945	10,602

Commitments and contingent liabilities (Note 13)	—	—
SHAREHOLDERS' EQUITY		
Common stock, par value—$2 per share; (authorized: 2012 and 2011—500 million shares; issued and outstanding: 2012—197 million shares and 2011—196 million shares)	393	393
Paid-in capital	1,106	1,096
Retained earnings	3,851	3,863
Accumulated other comprehensive income	1,010	901
Treasury stock at cost (2012—34 million shares and 2011—34 million shares)	(1,216)	(1,220)
Total shareholders' equity	5,144	5,033
Total liabilities and shareholders' equity	$ 16,089	$ 15,635

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

Cincinnati Financial Corporation and Subsidiaries

Condensed Consolidated Statements of Comprehensive Operations

(In millions except per share data)	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
REVENUES				
Earned premiums	$ 877	$ 773	$ 1,716	$ 1,555
Investment income, net of expenses	132	132	263	263
Total realized investment gains, net	6	67	19	79
Fee revenues	2	1	3	2
Other revenues	3	2	5	5
Total revenues	1,020	975	2,006	1,904
BENEFITS AND EXPENSES				
Insurance losses and policyholder benefits	687	801	1,269	1,376
Underwriting, acquisition and insurance expenses	287	253	561	515
Interest expense	13	14	27	27
Other operating expenses	4	6	8	10
Total benefits and expenses	991	1,074	1,865	1,928
INCOME (LOSS) BEFORE INCOME TAXES	29	(99)	141	(24)
PROVISION (BENEFIT) FOR INCOME TAXES				
Current	6	(50)	26	(26)
Deferred	(9)	1	(3)	(9)
Total provision (benefit) for income taxes	(3)	(49)	23	(35)
NET INCOME (LOSS)	$ 32	$ (50)	$ 118	$ 11
PER COMMON SHARE				
Net income (loss)—basic	$ 0.20	$ (0.31)	$ 0.73	$ 0.07
Net income (loss)—diluted	0.20	(0.31)	0.72	0.07
NET INCOME (LOSS)	$ 32	$ (50)	$ 118	$ 11
OTHER COMPREHENSIVE INCOME (LOSS), BEFORE TAX				
Unrealized gains (losses) on investments available-for-sale	(47)	142	194	284
Reclassification adjustment for (gains) included in net income	(6)	(67)	(19)	(79)
Unrealized (losses) on other	(5)	(2)	(10)	(1)
Unrealized gains (losses) on investments available-for-sale and other	(58)	73	165	204
Amortization of pension actuarial loss and prior service cost	1	1	3	2

Less: amortization of pension prior service cost included in net income	-	-	-	-
Defined benefit pension plan	1	1	3	2
Other comprehensive income (loss) before tax	(57)	74	168	206
Income tax expense (benefit) related to items of other comprehensive income	(20)	26	59	72
Other comprehensive income (loss), net of tax	(37)	48	109	134
COMPREHENSIVE INCOME (LOSS)	$ (5)	$ (2)	$ 227	$ 145

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	Amount	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Share-holders' Equity
Balance as reported December 31, 2010	163	$ 393	$ 1,091	$ 3,980	$ 769	$ (1,201)	$ 5,032
Cumulative effect of a change in accounting for deferred policy acquisition costs, net of tax	-	-	-	(20)	-	-	(20)
Balance as adjusted December 31, 2010	163	393	1,091	3,960	769	(1,201)	5,012
Net income	-	-	-	11	-	-	11
Other comprehensive income, net	-	-	-	-	134	-	134
Dividends declared	-	-	-	(131)	-	-	(131)
Stock-based awards exercised and vested	-	-	(5)	-	-	3	(2)
Stock-based compensation	-	-	7	-	-	-	7
Other	-	-	1	-	-	3	4
Balance June 30, 2011	163	$ 393	$ 1,094	$ 3,840	$ 903	$ (1,195)	$ 5,035
Balance December 31, 2011	162	$ 393	$ 1,096	$ 3,863	$ 901	$ (1,220)	$ 5,033
Net income	-	-	-	118	-	-	118
Other comprehensive income, net	-	-	-	-	109	-	109
Dividends declared	-	-	-	(130)	-	-	(130)
Stock-based awards exercised and vested	-	-	1	-	-	1	2
Stock-based compensation	-	-	8	-	-	-	8
Other	-	-	1	-	-	3	4
Balance June 30, 2012	162	$ 393	$ 1,106	$ 3,851	$ 1,010	$ (1,216)	$ 5,144

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

Cincinnati Financial Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(In millions)	Six months ended June 30,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 118	$ 11
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and other non-cash items	22	23
Realized gains on investments, net	(19)	(79)
Stock-based compensation	8	7
Interest credited to contract holders	18	27
Deferred income tax (benefit) expense	(3)	(9)
Changes in:		
Investment income receivable	1	(1)
Premiums and reinsurance receivable	(76)	(269)
Deferred policy acquisition costs	(26)	(26)
Other assets	(11)	(6)
Loss and loss expense reserves	57	335
Life policy reserves	33	60
Unearned premiums	129	77
Other liabilities	7	(66)
Current income tax receivable/payable	7	(80)
Net cash provided by operating activities	265	4
CASH FLOWS FROM INVESTING ACTIVITIES		
Sale of fixed maturities	28	42
Call or maturity of fixed maturities	360	391
Sale of equity securities	124	342
Purchase of fixed maturities	(603)	(645)
Purchase of equity securities	(210)	(100)
Investment in buildings and equipment, net	(4)	(4)
Investment in finance receivables	(18)	(16)
Collection of finance receivables	16	14
Change in other invested assets, net	3	2
Net cash (used in) provided by investing activities	(304)	26
CASH FLOWS FROM FINANCING ACTIVITIES		
Payment of cash dividends to shareholders	(128)	(127)
Proceeds from stock options exercised	3	1
Contract holders' funds deposited	56	73
Contract holders' funds withdrawn	(62)	(44)
Excess tax benefits on share-based compensation	1	2
Other	(6)	(7)
Net cash used in financing activities	(136)	(102)

Net change in cash and cash equivalents	(175)	(72)
Cash and cash equivalents at beginning of year	438	385
Cash and cash equivalents at end of period	$ 263	$ 313
Supplemental disclosures of cash flow information:		
Interest paid	$ 27	$ 27
Income taxes paid	19	55
Non-cash activities:		
Conversion of securities	$ 13	$ -
Equipment acquired under capital lease obligations	9	20

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

Notes to Condensed Consolidated Financial Statements (unaudited)

Note 1 — Accounting Policies

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

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Our actual results could differ from those estimates. The December 31, 2011, condensed consolidated balance sheet amounts are derived from the audited financial statements but do not include all disclosures required by GAAP.

Our June 30, 2012, 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 2011 Annual Report on Form 10-K. The results of operations for interim periods do not necessarily indicate results to be expected for the full year.

Adopted Accounting Updates

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

In October 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*. ASU 2010-26 modified the definitions of the type of costs incurred by insurance entities that can be capitalized in the successful acquisition of new and renewal contracts. ASU 2010-26 requires incremental direct costs of successful contract acquisition as well as certain costs related to underwriting, policy issuance and processing, medical and inspection and sales force contract selling for successful contract acquisition to be capitalized. These incremental direct costs and other costs are those that are essential to the contract transaction and would not have been incurred had the contract transaction not occurred. We retrospectively adopted ASU 2010-26 on January 1, 2012.

The following table illustrates the effect of adopting ASU 2010-26 in the condensed consolidated balance sheets:

(In millions, except per share amounts)	June 30, 2012	December 31, 2011		
		As Reported	As Adjusted	Difference
Deferred policy acquisition costs	$484	$510	$ 477	$ (33)
Total assets	16,089	15,668	15,635	(33)
Deferred income tax	359	314	303	(11)
Shareholders' equity	5,144	5,055	5,033	(22)
Book value per share	31.66	31.16	31.03	(0.13)

The following table illustrates the effect of adopting ASU 2010-26 in the condensed consolidated statements of comprehensive operations:

(In millions, except per share amounts)	Three months ended June 30,			
	2012	2011		
		As Reported	As Adjusted	Difference
Underwriting, acquisition and insurance expenses	$287	$251	$ 253	$ 2
Net income	32	(49)	(50)	(1)
Net income per share:				
Basic	$0.20	$(0.30)	$ (0.31)	$ (0.01)
Diluted	0.20	(0.30)	(0.31)	(0.01)

	Six months ended June 30,			
	2012	2011		
		As Reported	As Adjusted	Difference
Underwriting, acquisition and insurance expenses	$561	$512	$ 515	$ 3
Net income	118	13	11	(2)
Net income per share:				
Basic	$0.73	$0.08	$ 0.07	$ (0.01)
Diluted	0.72	0.08	0.07	(0.01)

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

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurements, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRS)*. The ASU converges fair value measurement and disclosures among U.S. GAAP and IFRS. ASU 2011-04 changes certain fair value measurement principles and expands disclosure requirements. The company adopted ASU 2011-04 during the first quarter of 2012, and it did not have a material impact on our company's financial position, cash flows or results of operations.

ASU 2011-05, Presentation of Comprehensive Income

In December 2011, the FASB issued ASU 2011-12*, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update 2011-05, Presentation of Comprehensive Income*. ASU 2011-05 requires entities to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single, continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-12 defers the changes in ASU 2011-05 that relate to the presentation of reclassification adjustments. The deferral of those changes allows the FASB time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income for all periods presented. The company adopted ASU 2011-12 and ASU 2011-05 during the first quarter of 2012, and it did not have a material impact on our company's financial position, cash flows or results of operations.

Note 2 – Segment Information

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

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

We report as Other the non-investment operations of the parent company and its non-insurer subsidiary, CFC Investment Company. See our 2011 Annual Report on Form 10-K, Item 8, Note 18, Segment Information, Page 136, for a description of revenue, income or loss before income taxes and identifiable assets for each of the five segments.

Segment information is summarized in the following table:

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Revenues:				
Commercial lines insurance				
Commercial casualty	**$ 191**	$ 180	$ 372	$ 352
Commercial property	134	115	265	241
Commercial auto	106	96	207	192
Workers' compensation	85	81	166	157
Specialty packages	37	27	75	64
Surety and executive risk	27	25	54	50
Machinery and equipment	10	9	19	17
Commercial lines insurance premiums	590	533	1,158	1,073
Fee revenue	1	-	2	1
Total commercial lines insurance	591	533	1,160	1,074
Personal lines insurance				
Personal auto	100	90	198	179
Homeowner	87	66	171	142
Other personal lines	27	24	54	49
Personal lines insurance premiums	214	180	423	370
Fee revenue	1	1	1	1
Total personal lines insurance	215	181	424	371
Excess and surplus lines insurance	22	17	43	32
Life insurance	51	43	92	81
Investment operations	138	199	282	342
Other	3	2	5	4
Total revenues	**$ 1,020**	$ 975	$ 2,006	$ 1,904
Income (loss) before income taxes:				
Insurance underwriting results:				
Commercial lines insurance	**$ (20)**	$ (129)	$ 14	$ (151)
Personal lines insurance	(55)	(142)	(77)	(145)
Excess and surplus lines insurance	(2)	4	(5)	(1)
Life insurance	2	5	(1)	2
Investment operations	118	179	241	302
Other	(14)	(16)	(31)	(31)
Total	**$ 29**	$ (99)	$ 141	$ (24)

Identifiable assets:	June 30, 2012	December 31, 2011

Property casualty insurance	$2,274	$ 2,272
Life insurance	1,177	1,237
Investment operations	12,364	11,883
Other	274	243
Total	$16,089	$ 15,635

Note 3 – Investments

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

(In millions)	Cost or amortized	Gross unrealized		Fair
At June 30, 2012	cost	gains	losses	value
Fixed maturities:				
States, municipalities and political subdivisions	$ 3,033	$ 250	$ -	$ 3,283
Convertibles and bonds with warrants attached	51	-	-	51
United States government	7	1	-	8
Government-sponsored enterprises	86	-	-	86
Foreign government	3	-	-	3
Corporate securities	5,072	529	7	5,594
Subtotal	8,252	780	7	9,025
Equity securities:				
Common equities	2,149	860	2	3,007
Preferred equities	99	33	-	132
Subtotal	2,248	893	2	3,139
Total	$ 10,500	$ 1,673	$ 9	$ 12,164
At December 31, 2011				
Fixed maturities:				
States, municipalities and political subdivisions	$ 3,006	$ 246	$ -	$ 3,252
Convertibles and bonds with warrants attached	59	-	-	59
United States government	6	1	-	7
Government-sponsored enterprises	159	1	-	160
Foreign government	3	-	-	3
Corporate securities	4,851	465	18	5,298
Subtotal	8,084	713	18	8,779
Equity securities:				
Common equities	2,088	801	35	2,854
Preferred equities	74	28	-	102
Subtotal	2,162	829	35	2,956
Total	$ 10,246	$ 1,542	$ 53	$ 11,735

The net unrealized investment gains in our fixed-maturity portfolio are primarily the result of the current low interest rate environment that increased the fair value of our fixed-maturity portfolio. Included in corporate fixed maturities

are $13 million of AAA rated commercial mortgage-backed securities. The three largest net unrealized investment gains in our common stock portfolio are from Exxon Mobil Corporation (NYSE:XOM), The Procter & Gamble Company (NYSE:PG) and Chevron Corporation (NYSE:CVX), which had a combined net gain position of $269 million. At June 30, 2012, we had $51 million fair value of hybrid securities included in fixed maturities that follow Accounting Standards Codification (ASC) 815-15-25, Accounting for Certain Hybrid Financial Instruments. The hybrid securities are carried at fair value, and the changes in fair value are included in realized investment gains and losses. At June 30, 2012, and December 31, 2011, there were no other-than-temporary impairments included within accumulated other comprehensive income (AOCI).

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

(In millions)	Less than 12 months		12 months or more		Total	
At June 30, 2012	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Fixed maturities:						
States, municipalities and political subdivisions	$ 35	$ -	$ 1	$ -	$ 36	$ -
United States government	1	-	-	-	1	-
Government-sponsored enterprises	25	-	-	-	25	-
Corporate securities	193	3	59	4	252	7
Subtotal	254	3	60	4	314	7
Equity securities:						
Common equities	67	2	3	-	70	2
Preferred equities	5	-	4	-	9	-
Subtotal	72	2	7	-	79	2
Total	$ 326	$ 5	$ 67	$ 4	$ 393	$ 9
At December 31, 2011						
Fixed maturities:						
States, municipalities and political subdivisions	$ -	$ -	$ 12	$ -	$ 12	$ -
United States government	1	-	-	-	1	-
Government-sponsored enterprises	10	-	-	-	10	-
Corporate securities	380	13	57	5	437	18
Subtotal	391	13	69	5	460	18
Equity securities:						
Common equities	333	35	-	-	333	35
Preferred equities	5	-	19	-	24	-
Subtotal	338	35	19	-	357	35
Total	$ 729	$ 48	$ 88	$ 5	$ 817	$ 53

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

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Realized investment gains and losses summary:				

Fixed maturities:				
Gross realized gains	$ 13	$ 4	$ 16	$ 7
Gross realized losses	-	-	-	-
Other-than-temporary impairments	-	-	-	-
Equity securities:				
Gross realized gains	6	79	29	114
Gross realized losses	(1)	(18)	(1)	(18)
Other-than-temporary impairments	(14)	-	(30)	(30)
Securities with embedded derivatives	1	-	5	4
Other	1	2	-	2
Total	$ 6	$ 67	$ 19	$ 79
Change in unrealized gains and losses summary:				
Fixed maturities	$ 29	$ 96	$ 78	$ 104
Equity securities	(82)	(21)	97	101
Adjustment to deferred acquisition costs and life policy reserves	(8)	(4)	(15)	(4)
Amortization of pension actuarial loss and prior service cost	1	1	3	2
Other	3	2	5	3
Income taxes on above	20	(26)	(59)	(72)
Total	$ (37)	$ 48	$ 109	$ 134

During the three and six months ended June 30, 2012 and 2011, there were no credit losses on fixed-maturity securities for which a portion of other-than-temporary impairment (OTTI) has been recognized in other comprehensive income.

During the quarter ended June 30, 2012, we other-than-temporarily impaired four securities. At June 30, 2012, 16 fixed-maturity investments with a total unrealized loss of $4 million had been in an unrealized loss position for 12 months or more. Of that total, no fixed-maturity investments had fair values below 70 percent of amortized cost. Three equity investments with a total unrealized loss of less than $1 million had been in an unrealized loss position for 12 months or more as of June 30, 2012. Of that total, no equity investments were trading below 70 percent of cost.

At December 31, 2011, 20 fixed-maturity investments with a total unrealized loss of $5 million had been in an unrealized loss position for 12 months or more. Of that total, no fixed-maturity investments had fair values below 70 percent of amortized cost. Two equity investments with a total unrealized loss of less than $1 million had been in an unrealized loss position for 12 months or more as of December 31, 2011. Of that total, no equity investments were trading below 70 percent of cost.

Note 4 – Fair Value Measurements

Fair Value Hierarchy

In accordance with accounting guidance for fair value measurements and disclosures, we categorized our financial instruments, based on the priority of the observable and market-based data for the valuation technique used, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices with readily available independent data in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable market inputs (Level 3). When various inputs for measurement fall within different levels of the fair value hierarchy, the lowest observable input that has a significant impact on fair value measurement is used. Our valuation techniques have not changed from those used at December 31, 2011, and ultimately management determines fair value.

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

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

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

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

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

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

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

We conduct a thorough review of fair value hierarchy classifications on a quarterly basis. We primarily base fair value for investments in equity and fixed-maturity securities (including redeemable preferred stock and assets held in separate accounts) on quoted market prices or on prices from a nationally recognized pricing vendor, an outside resource that supplies global securities pricing, dividend, corporate action and descriptive information to support fund pricing, securities operations, research and portfolio management. The company obtains and reviews the pricing service's valuation methodologies and related inputs and validates these prices by replicating a sample across each asset class using a discounted cash flow model. When a price is not available from these sources, as in the case of securities that are not publicly traded, we determine the fair value using various inputs including quotes from independent brokers. We have generally obtained and evaluated two non-binding quotes from brokers, our investment professionals determine our best estimate of fair value. The fair value of investments not priced by a pricing vendor is less than 1 percent of the fair value of our total investment portfolio. Reclassification of certain financial instruments may occur when input observability changes. All 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 technique used for the Level 2 fixed-maturity securities and taxable fixed maturities in separate accounts is the application of matrix pricing. The inputs used include relevant market information by asset class, trade activity of like securities, yield to maturity and economic events. All of the Level 2 fixed-maturity securities are priced by a nationally recognized pricing vendor.

The Level 2 preferred equities technique used is the application of matrix pricing. The inputs used, similar to those used by the pricing vendor for our fixed-maturity securities, include relevant market information, trade activity of like securities, yield to maturity, corporate action notices and economic events. All of the Level 2 preferred equities are priced by a nationally recognized pricing vendor.

Fair Value Disclosures for Assets

The following tables illustrate the fair value hierarchy for those assets measured at fair value on a recurring basis at June 30, 2012, and December 31, 2011. We do not have any material liabilities carried at fair value. There were no transfers between Level 1 and Level 2.

(In millions)	Asset fair value measurements at June 30, 2012 using:			
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Fixed maturities, available for sale:				
States, municipalities and political subdivisions	$ -	$ 3,281	$ 2	$ 3,283
Convertibles and bonds with warrants attached	-	51	-	51
United States government	8	-	-	8
Government-sponsored enterprises	-	86	-	86
Foreign government	-	3	-	3
Corporate securities	-	5,590	4	5,594
Subtotal	8	9,011	6	9,025
Common equities, available for sale	3,007	-	-	3,007
Preferred equities, available for sale	-	125	7	132
Taxable fixed maturities separate accounts	-	657	-	657
Top Hat Savings Plan	9	-	-	9
Total	$ 3,024	$ 9,793	$ 13	$ 12,830

(In millions)	Asset fair value measurements at December 31, 2011 using:			
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total

Fixed maturities, available for sale:				
States, municipalities and political subdivisions	$-	$ 3,249	$ 3	$3,252
Convertibles and bonds with warrants attached	-	59	-	59
United States government	7	-	-	7
Government-sponsored enterprises	-	160	-	160
Foreign government	-	3	-	3
Corporate securities	-	5,280	18	5,298
Subtotal	7	8,751	21	8,779
Common equities, available for sale	2,854	-	-	2,854
Preferred equities, available for sale	-	98	4	102
Taxable fixed-maturities separate accounts	-	628	-	628
Top Hat Savings Plan	8	-	-	8
Total	$2,869	$ 9,477	$ 25	$12,371

Each financial instrument that was deemed to have significant unobservable inputs when determining valuation is identified in the tables below by security type with a summary of changes in fair value as of June 30, 2012. Total Level 3 assets continue to be less than 1 percent of financial assets measured at fair value in the condensed consolidated balance sheets. Assets presented in the table below were valued based primarily on broker/dealer quotes for which there is a lack of transparency as to inputs used to develop the valuations. The quantitative detail of these unobservable inputs is neither provided nor reasonably available to us.

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

(In millions)	Asset fair value measurements using significant unobservable inputs (Level 3)			
	Corporate fixed maturities	States, municipalities and political subdivisions fixed maturities	Preferred equities	Total
Beginning balance, March 31, 2012	$ 16	$ 2	$ 7	$ 25
Total gains or losses (realized/unrealized):				
Included in earnings	-	-	-	-
Included in other comprehensive income	-	-	-	-
Purchases	-	-	-	-
Sales	(1)	-	-	(1)
Transfers into Level 3	-	-	-	-
Transfers out of Level 3	(11)	-	-	(11)
Ending balance, June 30, 2012	$ 4	$ 2	$ 7	$ 13
Beginning balance, March 31, 2011	$ 11	$ 4	$ 6	$ 21
Total gains or losses (realized/unrealized):				
Included in earnings	-	-	-	-
Included in other comprehensive income	-	-	1	1
Purchases	7	-	-	7
Sales	-	-	-	-
Transfers into Level 3	-	-	-	-
Transfers out of Level 3	(3)	-	-	(3)
Ending balance, June 30, 2011	$ 15	$ 4	$ 7	$ 26

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

(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	Preferred equities	Total

			fixed maturities		
Beginning balance, December 31, 2011	$ 18	$ -	$ 3	$ 4	$ 25
Total gains or losses (realized/unrealized):					
Included in earnings	-	-	-	-	-
Included in other comprehensive income	3	-	-	2	5
Purchases	-	-	-	1	1
Sales	(4)	-	(1)	-	(5)
Transfers into Level 3	1	-	-	-	1
Transfers out of Level 3	(14)	-	-	-	(14)
Ending balance, June 30, 2012	$ 4	$ -	$ 2	$ 7	$ 13
Beginning balance, December 31, 2010	$ 20	$ 2	$ 4	$ 5	$ 31
Total gains or losses (realized/unrealized):					
Included in earnings	-	-	-	-	-
Included in other comprehensive income	-	-	-	1	1
Purchases	7	-	-	-	7
Sales					-
Transfers into Level 3	-	-	-	1	1
Transfers out of Level 3	(12)	(2)	-	-	(14)
Ending balance, June 30, 2011	$ 15	$ -	$ 4	$ 7	$ 26

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

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

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

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

(In millions)				Book value		Principal amount	
				June 30,	December 31,	June 30,	December 31,
Interest rate		Year of issue		2012	2011	2012	2011
6.900	%	1998	Senior debentures, due 2028	$ 28	$ 28	$ 28	$ 28
6.920	%	2005	Senior debentures, due 2028	391	391	391	391
6.125	%	2004	Senior notes, due 2034	371	371	374	374
			Total	$ 790	$ 790	$ 793	$ 793

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

(In millions)	Note payable and long-term debt fair value disclosures at June 30, 2012 using:			
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Note payable	$ -	$ 104	$ -	$ 104
6.9% senior debentures, due 2028	-	32	-	32
6.92% senior debentures, due 2028	-	457	-	457
6.125% senior notes, due 2034	-	410	-	410
Total	$ -	$ 1,003	$ -	$ 1,003

Fair value of the note payable is determined based upon the outstanding balance at June 30, 2012, because it is short term and tied to a variable interest rate. The note payable was classified as Level 2 as a market does not exist.

The fair value of our long-term debt approximated $814 million at year-end 2011. Fair value was determined under the fair value measurements and disclosure accounting rules based on market pricing of similar debt instruments that are actively trading. We determine fair value for our debt the same way that corporate fixed-maturities are valued in our investment portfolio. Fair value can vary with macroeconomic conditions. Regardless of the fluctuations in fair value, the outstanding principal amount of our long-term debt is $793 million. None of the long-term debt is encumbered by rating triggers.

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

(In millions)	Life insurance assets fair value disclosures at June 30, 2012 using:			
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Life policy loans	$ -	$ -	$ 46	$ 46

The fair value of life policy loans outstanding principal and interest approximated $43 million at December 31, 2011. Outstanding principal and interest for these life policy loans was $36 million and $37 million at June 30, 2012, and December 31, 2011, respectively. 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 as non-performance risk is minimal; and (2) the loan repayment rate by which policyholders pay off their loan balances is in line with past experience.

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

(In millions)	Life insurance liabilities fair value disclosures at June 30, 2012 using:			
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Deferred annuities	$ -	$ -	$ 834	$ 834
Structured settlements	-	214	-	214
Total	$ -	$ 214	$ 834	$ 1,048

The fair value for deferred annuities and structured settlements were $794 million and $208 million, respectively, at December 31, 2011. Recorded reserves for the deferred annuities and structured settlements were $1.039 billion and $1.025 billion at June 30, 2012, and December 31, 2011, respectively.

Fair values for deferred annuities are calculated based upon internally developed models because active, observable markets do not exist for those items. To determine the fair value, we make the following significant assumptions: (1) the discount rates used to calculate the present value of expected payments are the risk-free spot rates plus an A3 rated bond spread for financial issuers at June 30, 2012, 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.

Determination of fair value for structured settlements assumes the discount rates used to calculate the present value of expected payments are the risk-free spot rates plus an A3 rated bond spread for financial issuers at June 30, 2012, to account for non-performance risk.

Note 5 – Property Casualty Loss and Loss Expenses

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

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Gross loss and loss expense reserves, beginning of period	$ 4,289	$ 4,179	$ 4,280	$ 4,137
Less reinsurance receivable	352	326	375	326
Net loss and loss expense reserves, beginning of period	3,937	3,853	3,905	3,811
Net incurred loss and loss expenses related to:				
Current accident year	725	853	1,380	1,442
Prior accident years	(85)	(96)	(201)	(155)
Total incurred	640	757	1,179	1,287
Net paid loss and loss expenses related to:				
Current accident year	282	391	414	522
Prior accident years	290	248	665	608
Total paid	572	639	1,079	1,130
Net loss and loss expense reserves, end of period	4,005	3,971	4,005	3,971
Plus reinsurance receivable	332	508	332	508
Gross loss and loss expense reserves, end of period	$ 4,337	$ 4,479	$ 4,337	$ 4,479

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. The amount we will actually have to pay for claims can be highly uncertain. This uncertainty, together with the size of our reserves, makes the loss and loss expense reserves our most significant estimate. The reserve for loss and loss expenses in the condensed consolidated balance sheets also includes $59 million at June 30, 2012, and $56 million at June 30, 2011, for certain life and health loss and loss expense reserves.

During the second quarter of 2012, we experienced $85 million of favorable development on prior accident years. There was $5 million from favorable development of catastrophe losses compared with no favorable development of catastrophe losses at June 30, 2011. Overall favorable development for commercial lines reserves illustrated the potential for revisions inherent in estimating reserves, especially for long-tailed lines such as commercial casualty and workers' compensation. We recognized favorable reserve development of $56 million for the commercial casualty line and favorable development of $12 million for the workers' compensation line due to reduced uncertainty of prior accident year loss and loss adjustment expense for these lines.

During the first half of 2012, we experienced $201 million of favorable development on prior accident years. There was $27 million from favorable development of catastrophe losses compared with $1 million at June 30, 2011. We recognized favorable reserve development of $104 million for the commercial casualty line and favorable development of $28 million for the workers' compensation line due to reduced uncertainty of prior accident year loss and loss adjustment expense for these lines.

Note 6 – Deferred Acquisition Costs

The expenses associated with issuing insurance policies – primarily commissions, premium taxes and underwriting costs – are deferred and amortized over the terms of the policies. We update our acquisition cost assumptions periodically to reflect actual experience, and we evaluate our deferred acquisition costs for recoverability. All acquisition costs reflect ASU 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*, which we adopted on January 1, 2012. The table below shows the deferred policy acquisition costs and asset reconciliation, including the amortized deferred policy acquisition costs.

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Deferred policy acquisition costs asset at beginning of period	$ 483	$ 472	$ 477	$ 458
Capitalized deferred policy acquisition costs	192	168	362	332
Amortized deferred policy acquisition costs	(181)	(156)	(337)	(306)
Amortized shadow deferred policy acquisition costs	(10)	(5)	(18)	(5)
Deferred policy acquisition costs asset at end of period	484	$ 479	$ 484	$ 479

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

Note 7 – Life Policy and Investment Contract Reserves

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

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

(In millions)	June 30, 2012	December 31, 2011
Ordinary/traditional life	$ 719	$ 691
Universal life	481	481
Deferred annuities	842	827
Structured settlements	197	198
Other	17	17
Total gross reserves	$ 2,256	$ 2,214

Note 8 – Reinsurance

Reinsurance mitigates the risk of highly uncertain exposures and limits the maximum net loss that can arise from large risks or risks concentrated in areas of exposure. Primary components of our property and casualty reinsurance program include a property risk treaty, casualty per occurrence treaty and property catastrophe treaty.

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

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Direct earned premiums	$ 868	$ 807	$ 1,707	$ 1,587
Assumed earned premiums	3	2	6	7
Ceded earned premiums	(45)	(79)	(89)	(119)
Net earned premiums	$ 826	$ 730	$ 1,624	$ 1,475

The decrease in ceded earned premiums for 2012 compared with 2011 is related to earned reinstatement premiums as a result of the increase in catastrophe losses in the second quarter of 2011.

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

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Direct incurred loss and loss expenses	$ 647	$ 981	$ 1,183	$ 1,508
Assumed incurred loss and loss expenses	1	5	6	20
Ceded incurred loss and loss expenses	(8)	(229)	(10)	(241)
Net incurred loss and loss expenses	$ 640	$ 757	$ 1,179	$ 1,287

The decrease in ceded loss and loss expenses for 2012 compared with 2011 is related to the higher catastrophe losses in the second quarter of 2011.

Our life insurance company purchases reinsurance for protection of a portion of the risk that is written. Primary components of our life reinsurance program include individual mortality coverage and aggregate catastrophe and accidental death coverage in excess of certain deductibles. Our condensed consolidated statements of comprehensive operations include earned life insurance premiums on ceded business:

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Direct earned premiums	$ 64	$ 55	$ 118	$ 105
Assumed earned premiums	-	-	-	-
Ceded earned premiums	(13)	(12)	(26)	(25)
Net earned premiums	$ 51	$ 43	$ 92	$ 80

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

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Direct contract holders' benefits incurred	$ 57	$ 56	$ 110	$ 109
Assumed contract holders' benefits incurred	-	-	-	-
Ceded contract holders' benefits incurred	(10)	(12)	(20)	(20)
Net incurred loss and loss expenses	$ 47	$ 44	$ 90	$ 89

Note 9 – Net Income Per Common Share

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

Here are calculations for basic and diluted earnings per share:

(Dollars in millions except share data in thousands)	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Numerator:				
Net income (loss)—basic and diluted	$ 32	$ (50)	$ 118	$ 11
Denominator:				
Weighted-average common shares outstanding	162,425	163,069	162,351	163,005
Effect of stock-based awards:				
Nonvested shares	670	-	602	512
Stock options	419	-	375	168
Adjusted weighted-average shares	163,514	163,069	163,328	163,685
Earnings (loss) per share:				
Basic	$ 0.20	$ (0.31)	$ 0.73	$ 0.07
Diluted	0.20	(0.31)	0.72	0.07
Number of anti-dilutive stock-based awards	6,059	7,858	6,072	7,853

The current sources of dilution of our common shares are certain equity-based awards as discussed in our 2011 Annual Report on Form 10-K, Item 8, Note 17, Stock-Based Associate Compensation Plans, Page 134. The above table shows the number of anti-dilutive stock-based awards for the three and six months ended June 30, 2012 and 2011. We did not include these stock-based awards in the computation of net income per common share (diluted) because their exercise would have anti-dilutive effects. Due to the net loss in the second quarter of 2011, the assumed exercise of certain stock options and nonvested shares were excluded from the computation of diluted loss per share.

Note 10 – Employee Retirement Benefits

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

(In millions)	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Service cost	$ 3	$ 2	$ 6	$ 5
Interest cost	4	4	7	7
Expected return on plan assets	(4)	(4)	(8)	(8)
Amortization of actuarial loss and prior service cost	1	1	3	2
Net periodic benefit cost	$ 4	$ 3	$ 8	$ 6

See our 2011 Annual Report on Form 10-K, Item 8, Note 13, Employee Retirement Benefits, Page 130, for information on our retirement benefits. We made matching contributions of $3 million and $2 million to our 401(k) and Top Hat savings plans during the second quarter of 2012 and 2011 and contributions of $5 million and $4 million for the first halves of 2012 and 2011, respectively.

We made no contribution to the pension plan during the first half of 2012. We anticipate contributing $14 million in the third quarter of 2012 to our qualified pension plan as indicated in our 2011 Annual Report on Form 10-K.

Note 11 – Stock-Based Compensation Plans

We currently have four equity compensation plans that permit us to grant various types of equity awards. We currently grant incentive stock options, non-qualified stock options, service-based restricted stock units and performance-based restricted stock units, including some with market-based performance objectives, under our shareholder-approved plans to associates. We also have a Holiday Stock Plan that permits annual awards of one share of common stock to each full-time associate for each full calendar year of service up to a maximum of 10 shares. One of our equity compensation plans permits us to grant stock to our outside directors as a component of their annual compensation. For additional information about our equity compensation plans, see our 2011 Annual Report on Form 10-K, Item 8, Note 17, Stock-Based Associate Compensation Plans, Page 134.

A total of 17.3 million shares are authorized to be granted under the shareholder-approved plans. At June 30, 2012, 9.3 million shares were available for future issuance under the plans.

Stock-Based Awards

Stock-based awards were granted to associates during 2012 and are summarized in the tables below. Stock-based compensation cost after tax was $3 million for both the three months ended June 30, 2012 and 2011 and $5 million for both the six months ended June 30, 2012 and 2011, respectively. As of June 30, 2012, $27 million of unrecognized compensation costs related to non-vested awards is expected to be recognized over a weighted-average period of 2.2 years.

Here is a summary of option information:

(Shares in thousands)	Shares	Weighted-average exercise price
Outstanding at January 1, 2012	9,357	$ 36.71
Granted	536	35.63
Exercised	(100)	28.73
Forfeited or expired	(1,148)	35.50
Outstanding at June 30, 2012	8,645	36.90

Here is a summary of restricted stock unit information:

(Shares in thousands)	Service-based shares	Weighted-average grant-date fair value	Performance-based shares	Weighted-average grant-date fair value
Nonvested at January 1, 2012	563	$ 26.05	156	$ 25.86
Granted	403	31.14	110	34.89
Vested	(4)	27.23	(53)	22.88
Forfeited or canceled	(16)	27.76	(4)	30.97
Nonvested at June 30, 2012	946	28.18	209	31.26

Note 12 – Income Taxes

As of June 30, 2012, and December 31, 2011, we had no liability for unrecognized tax benefits. Details about our liability for unrecognized tax benefits are found in our 2011 Annual Report on Form 10-K, Item 8, Note 11, Income Taxes, Pages 129 and 130.

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

(Dollars in millions)	Three months ended June 30,				Six months ended June 30,			
	2012		2011		2012		2011	
Tax at statutory rate	$ 10	35.0 %	$ (35)	35.0 %	$ 49	35.0 %	$ (8)	35.0 %
Increase (decrease) resulting from:								
Tax-exempt income from municipal bonds	(8)	(27.6)	(9)	9.1	(17)	(12.1)	(17)	70.8
Dividend received exclusion	(6)	(20.7)	(5)	5.1	(11)	(7.8)	(10)	41.7
Other	1	3.0	-	0.3	2	1.2	-	(1.7)
Provision (benefit) for income taxes	$ (3)	(10.3)%	$ (49)	49.5 %	$ 23	16.3 %	$ (35)	145.8 %

The change in our effective tax rate was primarily due to changes in pretax income from underwriting results and realized investment gains and losses.

Note 13 – 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, breach of an alleged duty to search national data bases to ascertain unreported deaths of insureds under life insurance policies. The company's insurance subsidiaries also are occasionally parties to individual actions in which extra-contractual damages, punitive damages or penalties are sought, such as claims alleging bad faith in the handling of insurance claims or claims alleging discrimination by former associates.

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

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

The following discussion highlights significant factors influencing the consolidated results of operations and financial position of Cincinnati Financial Corporation (CFC). It should be read in conjunction with the consolidated financial statements and related notes included in our 2011 Annual Report on Form 10-K. Unless otherwise noted, the industry data is prepared by A.M. Best Co., a leading insurance industry statistical, analytical and financial strength rating organization. Information from A.M. Best is presented on a statutory basis. When we provide our results on a comparable statutory basis, we label it as such; all other company data is presented in accordance with accounting principles generally accepted in the United States of America (GAAP).

As discussed in Item 1, Note 1, Accounting Policies, Page 7, effective January 1, 2012, we adopted ASU 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts. We adjusted applicable financial statements. Related financial data shown in Management's Discussion and Analysis of Financial Condition and Results of Operations also have been adjusted.

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

Safe Harbor Statement

This is our "Safe Harbor" statement under the Private Securities Litigation Reform Act of 1995. Our business is subject to certain risks and uncertainties that may cause actual results to differ materially from those suggested by the forward-looking statements in this report. Some of those risks and uncertainties are discussed in our 2011 Annual Report on Form 10-K, Item 1A, Risk Factors, Page 26.

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

- Unusually high levels of catastrophe losses due to risk concentrations, changes in weather patterns, environmental events, terrorism incidents or other causes

- Increased frequency and/or severity of claims

- Inadequate estimates or assumptions used for critical accounting estimates

- Recession or other economic conditions resulting in lower demand for insurance products or increased payment delinquencies

- Declines in overall stock market values negatively affecting the company's equity portfolio and book value

- Events resulting in capital market or credit market uncertainty, followed by prolonged periods of economic instability or recession, that lead to:

  - Significant or prolonged decline in the value of a particular security or group of securities and impairment of the asset(s)

  - Significant decline in investment income due to reduced or eliminated dividend payouts from a particular security or group of securities

  - Significant rise in losses from surety and director and officer policies written for financial institutions or other insured entities

- Prolonged low interest rate environment or other factors that limit the company's ability to generate growth in investment income or interest rate fluctuations that result in declining values of fixed-maturity investments, including declines in accounts in which we hold bank-owned life insurance contract assets

- Increased competition that could result in a significant reduction in the company's premium volume

- Delays or performance inadequacies from ongoing development and implementation of underwriting and pricing methods or technology projects and enhancements expected to increase our pricing accuracy, underwriting profit and competitiveness

- Changing consumer insurance-buying habits and consolidation of independent insurance agencies that could alter our competitive advantages

- Inability to obtain adequate reinsurance on acceptable terms, amount of reinsurance purchased, financial strength of reinsurers and the potential for non-payment or delay in payment by reinsurers

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

- Inability to defer policy acquisition costs for any business segment if pricing and loss trends would lead management to conclude that segment could not achieve sustainable profitability

- Events or conditions that could weaken or harm the company's relationships with its independent agencies and hamper opportunities to add new agencies, resulting in limitations on the company's opportunities for growth, such as:

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

- Actions of insurance departments, state attorneys general or other regulatory agencies, including a change to a federal system of regulation from a state-based system, that:

  - Impose new obligations on us that increase our expenses or change the assumptions underlying our critical accounting estimates
  - Place the insurance industry under greater regulatory scrutiny or result in new statutes, rules and regulations
  - Restrict our ability to exit or reduce writings of unprofitable coverages or lines of business
  - Add assessments for guaranty funds, other insurance related assessments or mandatory reinsurance arrangements; or that impair our ability to recover such assessments through future surcharges or other rate changes
  - Increase our provision for federal income taxes due to changes in tax law
  - Increase our other expenses
  - Limit our ability to set fair, adequate and reasonable rates
  - Place us at a disadvantage in the marketplace
  - Restrict our ability to execute our business model, including the way we compensate agents

- Adverse outcomes from litigation or administrative proceedings

- Events or actions, including unauthorized intentional circumvention of controls, that reduce the company's future ability to maintain effective internal control over financial reporting under the Sarbanes-Oxley Act of 2002

- Unforeseen departure of certain executive officers or other key employees due to retirement, health or other causes that could interrupt progress toward important strategic goals or diminish the effectiveness of certain longstanding relationships with insurance agents and others

- Events, such as an epidemic, natural catastrophe or terrorism, that could hamper our ability to assemble our workforce at our headquarters location

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

Introduction

Corporate Financial Highlights

Statements of Comprehensive Income and Per Share Data

(Dollars in millions except share data in thousands)	Three months ended June 30,			Six months ended June 30,		
	2012	2011	Change %	2012	2011	Change %
Statement of operations data						
Earned premiums	$877	$773	13	$1,716	$1,555	10
Investment income, net of expenses (pretax)	132	132	0	263	263	0
Realized investment gains and losses (pretax)	6	67	(91)	19	79	(76)
Total revenues	1,020	975	5	2,006	1,904	5
Net income (loss)	32	(50)	nm	118	11	973
Comprehensive income (loss)	(5)	(2)	(150)	227	145	57
Per share data						
Net income (loss) - diluted	$0.20	$(0.31)	nm	$0.72	$0.07	929
Cash dividends declared	0.4025	0.40	1	0.805	0.80	1
Weighted average shares outstanding	163,514	163,069	0	163,328	163,685	0

Revenues rose for the second quarter and the first six months of 2012 compared with the same periods of 2011, primarily due to growth in earned premiums. Premium and investment revenue trends are discussed further in the respective sections of Results of Operations, Page 30.

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

Net income for the second quarter of 2012 compared with the 2011 second quarter increased $82 million, reflecting stronger property casualty underwriting income that rose $124 million after taxes. Lower catastrophe losses, mostly

weather related, reduced net-of-taxes property casualty underwriting results by $93 million less than the second quarter of 2011, in addition to better underwriting results before catastrophes. After-tax investment income in our investment segment results for the second quarter of 2012 rose $1 million compared with the second quarter of 2011, while life insurance segment results on a pretax basis declined by $3 million. Second-quarter 2012 after-tax net realized investment gains and losses were $40 million lower than a year earlier.

For the six-month period ended June 30, 2012, net income increased compared with the same period of 2011, also primarily due to higher property casualty underwriting results that rose $149 million after taxes, including $62 million from lower catastrophe losses. After-tax investment income rose by $1 million while after-tax net realized investment gains and losses were $38 million lower. Life insurance segment results on a pretax basis were $3 million lower.

Performance by segment is discussed below in Results of Operations, beginning on Page 30. As discussed in our 2011 Annual Report on Form 10-K, Item 7, Factors Influencing Our Future Performance, Page 41, there are several reasons that our performance during 2012 may be below our long-term targets. In that annual report, as part of Results of Operations, we also discussed the full-year 2012 outlook for each reporting segment.

The board of directors is committed to rewarding shareholders directly through cash dividends and through share repurchase authorizations. Through 2011, the company had increased the indicated annual cash dividend rate for 51 consecutive years, a record we believe was matched by only nine other publicly traded companies. Cash dividends declared during the first six months of 2012 increased approximately 1 percent compared with the same period of 2011. Our board regularly evaluates relevant factors in share repurchase- and dividend-related decisions, and the 2011 dividend increase signaled confidence in our strong capital, liquidity and financial flexibility, as well as progress through our initiatives to improve earnings performance.

Balance Sheet Data and Performance Measures

(Dollars in millions except share data)	At June 30, 2012	At December 31, 2011
Balance sheet data		
Invested assets	$ 12,231	$ 11,801
Total assets	16,089	15,635
Short-term debt	104	104
Long-term debt	790	790
Shareholders' equity	5,144	5,033
Book value per share	31.66	31.03
Debt-to-total-capital ratio	14.8 %	15.1 %

Total assets increased 3 percent compared with year-end 2011, largely due to growth in invested assets that was driven by additional purchases of securities and to a lesser extent by higher market valuation. Shareholders' equity rose 2 percent and book value per share was up 2 percent during the first six months of 2012. Our debt-to-total-capital ratio (capital is the sum of debt plus shareholders' equity) decreased compared with year-end 2011. The value creation ratio, a non-GAAP measure defined below, was higher for the first six months of 2012 compared with 2011, primarily due to growth in unrealized investment gains and net income. The $0.63 increase in book value per share during the first six months of 2012 contributed 2.0 percentage points to the value creation ratio while dividends declared at $0.805 per share during the first six months of 2012 contributed 2.6 points. Value creation ratio trends and a reconciliation of the non-GAAP measure to comparable GAAP measures are shown in the tables below.

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Performance measure				
Value creation ratio	0.0 %	0.1 %	4.6 %	2.9 %

(Dollars are per share)	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Value creation ratio				
End of period book value	$ 31.66	$ 30.88	$ 31.66	$ 30.88
Less beginning of period book value	32.07	31.27	31.03	30.79
Change in book value	(0.41)	(0.39)	0.63	0.09

Dividend declared to shareholders	0.40	0.40	0.81	0.80
Total contribution to value creation ratio	$ (0.01)	$ 0.01	$ 1.44	$ 0.89
Contribution to value creation ratio from change in book value	(1.3)%	(1.2)%	2.0%	0.3%
Contribution to value creation ratio from dividends declared to shareholders	1.3	1.3	2.6	2.6
Value creation ratio	0.0%	0.1%	4.6%	2.9%

Progress Toward Long-Term Value Creation

Operating through The Cincinnati Insurance Company, Cincinnati Financial Corporation is one of the 25 largest property casualty insurers in the nation, based on 2011 direct written premium volume for approximately 2,000 U.S. stock and mutual insurer groups. We market our insurance products through a select group of independent insurance agencies in 39 states as discussed in our 2011 Annual Report on Form 10-K, Item 1, Our Business and Our Strategy, Page 3.

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

To measure our long-term progress in creating shareholder value, we have defined a value creation metric that we believe captures the contribution of our insurance operations, the success of our investment strategy and the importance we place on paying cash dividends to shareholders. This measure, our value creation ratio or VCR, is made up of two primary components: (1) our rate of growth in book value per share plus (2) the ratio of dividends declared per share to beginning book value per share. For the period 2010 through 2014, an annual value creation ratio averaging 12 percent to 15 percent is our primary performance target. Management believes this non-GAAP measure is a useful supplement to GAAP information.

Performance Drivers

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

- Premium growth – We believe over any five-year period our agency relationships and initiatives can lead to a property casualty written premium growth rate that exceeds the industry average. For the first six months of 2012, year-over-year growth of our total property casualty net written premiums was 13 percent. This growth rate compared favorably with A.M. Best's projection, as of February 2012, of 4 percent full-year growth for the industry excluding the mortgage and financial guaranty lines of business. Our premium growth initiatives are discussed below in Highlights of Our Strategies and Supporting Initiatives, Page 26.

- Combined ratio – We believe our underwriting philosophy and initiatives can generate a GAAP combined ratio over any five-year period that is consistently within the range of 95 percent to 100 percent. For the first six months of 2012, our GAAP combined ratio was 104.4 percent and our statutory combined ratio was 103.4 percent, both including 16.2 percentage points of current accident year catastrophe losses partially offset by 12.4 percentage points of favorable loss reserve development on prior accident years. As of February 2012, A.M. Best forecasted the industry's 2012 statutory combined ratio, excluding the mortgage and financial guaranty lines of business, at approximately 102 percent. Best's projection included approximately 5 percentage points of catastrophe losses and a favorable impact of approximately 3 percentage points from prior accident year reserve releases. For the commercial lines industry segment, excluding the mortgage and financial guaranty lines of business, A.M. Best projected a full-year 2012 statutory combined ratio at approximately 104 percent, including approximately 4 percentage points of catastrophe losses and a favorable impact of approximately 2 percentage points from prior accident year reserve releases.

- Investment contribution – We believe our investment philosophy and initiatives can drive investment income growth and lead to a total return on our equity investment portfolio over a five-year period that exceeds the five-year return of the Standard & Poor's 500 Index. For the first six months of 2012, pretax investment income was $263 million, flat compared with the same period in 2011. We believe our investment portfolio mix provides an appropriate balance of income stability and growth with capital appreciation potential.

Highlights of Our Strategy and Supporting Initiatives

Management has worked to identify a strategy that can lead to long-term success, with concurrence by the board of directors. Our strategy is intended to position us to compete successfully in the markets we have targeted while appropriately managing risk. Further description of our long-term, proven strategy can be found in our 2011 Annual Report on Form 10-K, Item 1, Our Business and Our Strategy, Page 3. We believe successful implementation of initiatives that support our strategy, summarized below, will help us better serve our agent customers and reduce variability in our financial results while we also grow earnings and book value over the long term, successfully navigating challenging economic, market or industry pricing cycles.

- Improve insurance profitability – Implementation of these initiatives is intended to improve pricing capabilities for our property casualty business and increase our ability to manage our business while also enhancing our efficiency. Improved pricing capabilities through the use of technology and analytics can lead to better profit margins. Improved internal processes with additional performance metrics can help us be more efficient and effective. These initiatives also support the ability of the agencies that represent us to grow profitably by allowing them to serve clients faster and to more efficiently manage agency expenses.

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

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

Improve Insurance Profitability

The main initiatives to improve our insurance profitability include:

- Improve pricing precision using predictive analytics – We continue efforts to expand our pricing capabilities by using predictive analytics and expect cumulative benefits of these efforts to improve loss ratios over time. Expanded capabilities include streamlining and optimizing data to improve accuracy, timeliness and ease of use. Development of additional business data to support accurate underwriting, pricing and other business decisions also continues. A phased project that will continue over the next several years will deploy a full data management program, including a data warehouse for our property casualty and life insurance operations, providing enhanced granularity of pricing data.

During the second quarter of 2012, development for our second generation workers' compensation predictive model was completed. Once further integration with our policy administration systems is complete, all of our commercial lines predictive models will operate on the same platform. Additional integration should enhance the ability of underwriters to target profitability and to discuss pricing impacts with agency personnel. The updated version of the workers' compensation predictive modeling tool is expected to be deployed to our underwriters for new business and renewal policy processing during the third quarter.

In late 2011, we developed tools to improve pricing precision for small business policies written through our new product known as CinciPak™. Plans to implement these tools for underwriters' use include rolling them out to eight states by the end of 2012. During the first quarter we began to pilot CinciPak for a few dozen agencies in one state, as scheduled. Progress during the second quarter included introducing CinciPak in two additional states, and introduction in two more states is planned for the third quarter.

For our personal lines business, we will continue to enhance our pricing model attributes and expand our pricing points to add more precision during 2012. These enhancements should help us continue to be competitive on the most desirable business and to adapt more rapidly to changes in market conditions. During the first quarter, we completed a homeowner policy rate proposal based on our most recent modeled results. Rate changes based on the proposal will be filed in the majority of our states with effective dates in the fourth quarter of 2012. Progress during the second quarter included completion of a personal auto rate proposal based on recent modeled results. Rate changes based on this proposal will be filed in the majority of our states with effective dates in early 2013.

- Improve internal processes – Improved processes support our strategic goals, reducing internal costs and allowing us to focus more resources on providing agency services. Important process improvement efforts include ongoing simplification of new business processing between company and agency management systems, and future processing of some small commercial lines business without intervention by an underwriter. We also are developing additional

talent management capabilities to further improve the effectiveness of all associates.

Continued development for additional coverages in our commercial lines policy administration system is expected to facilitate important internal process improvement initiatives. Progress during the second quarter included completion of requirements for these coverages and initiation of their development. Delivery of the first iteration to 10 states is expected by the end of 2012, followed by additional states in 2013. In addition, at the beginning of the third quarter of 2012, we launched the system, known as e-CLAS® CPP, in an additional state, the 35th in our 39-state operating territory for commercial lines.

For our personal lines business, we have also been developing business rules and parameters to allow future processing of some policies without intervention by an underwriter, for risks that meet qualifying underwriting criteria. The objective is to streamline processing for our agents and associates, permitting more time for risks that need additional service or attention while also reducing internal costs. During the first quarter, we expanded our pilot to automate renewal underwriting into three additional states, for a total of four states. Progress during the second quarter included expansion into two additional states for a total of six states. We also introduced automated processing of certain endorsements.

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

In addition, we expect these initiatives to contribute to our rank as the No. 1 or No. 2 carrier based on premium volume in agencies that have represented us for at least five years. In 2011, we again earned that rank in approximately 75 percent of the agencies that have represented Cincinnati Insurance for more than five years, based on 2010 premiums. We are working to increase the percentage of agencies where we achieve that rank.

Drive Premium Growth

Primary initiatives to drive premium growth include:

- Expansion of our marketing capabilities – We continue to enhance our generalist approach to allow our appointed agencies to better compete in the marketplace by providing services agents' clients want and need. Expansion initiatives include adding field associates for additional agency support in targeted areas, entering new states of operation for personal lines, and further development of targeted marketing activities.

During the first quarter we placed two new personal lines field marketing representatives to provide service to additional agencies located in the Northeast and Mid-Atlantic areas, for a total of 10 in various parts of our personal lines operating territory.

For our excess and surplus lines operation, we have been approved as a non-admitted carrier and brokerage in Delaware and Rhode Island. During the first half of 2012, we expanded our field underwriting presence and now have 10 field underwriting territories. During the first half of 2012, we also introduced a new quick-issue offering for special event policies and began more broadly marketing our expertise in large accounts.

Expansion of our personal lines operation is planned for additional states where we currently offer commercial lines products but do not offer personal lines products. We entered the state of New York during the first quarter of 2012. We plan to expand to one additional state by the end of 2012 and another state in the first half of 2013.

We also continue to develop and coordinate targeted marketing, including cross-selling opportunities, through our Target Markets department. This area focuses on commercial product development, including identification and promotional support for promising classes of business. We offered nine target markets programs to our agencies by the end of 2011. During the first quarter of 2012, we completed one of the four additional target market programs we plan to launch by the end of the year, with plans to launch our second program early in the third quarter. In each of the first two quarters, we also rolled out additional coverage forms for our existing programs.

- New agency appointments – We continue to appoint new agencies to develop additional points of distribution, focusing on areas where our market share is less than 1 percent while also considering economic and catastrophe risk factors. In 2012, we are targeting approximately 130 appointments of independent agencies. During the first six months of 2012, we appointed 93 new agencies that write in aggregate approximately $1.3 billion in property casualty premiums annually with various insurance carriers for an average of nearly $15 million per agency. As of June 30, 2012, a total of 1,375 agency relationships market our standard market insurance products from 1,717 reporting locations.

We seek to build a close, long-term relationship with each agency we appoint. We carefully evaluate the marketing reach of each new appointment to ensure the territory can support both current and new agencies. During April 2012, we staffed two new marketing territories for commercial lines. Our 127 commercial lines field marketing territories are staffed by marketing representatives averaging 19 years of industry experience and nearly 10 years as a Cincinnati Insurance field marketing representative. The team of field associates in each territory works together with headquarters support associates to form our agent-centered business model, providing local expertise, helping us better understand the accounts we underwrite and creating market advantages for our agents. We help our agents grow their business by attracting more clients in their communities through unique Cincinnati-style service, and generally have earned a 10 percent share of an agency's business within 10 years of its appointment.

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

An important part of our long-term strategy is financial strength, which is described in our 2011 Annual Report on Form 10-K, Item 1, Our Business and Our Strategy, Financial Strength, Page 5. One aspect of our financial strength is prudent use of reinsurance to help manage financial performance variability due to catastrophe loss experience. A description of how we use reinsurance is included in our 2011 Annual Report on Form 10-K, Item 7, Liquidity and Capital Resources, 2012 Reinsurance Programs, Page 98.

Another aspect is our investment portfolios, which remain well-diversified as discussed in Item 3, Quantitative and Qualitative Disclosures about Market Risk, Page 51. We continue to maintain strong parent company liquidity and financial strength that increases our flexibility through all periods to maintain our cash dividend and to continue to invest in and expand our insurance operations. At June 30, 2012, we held $1.025 billion of our cash and invested assets at the parent company level, of which $872 million, or 85.1 percent, was invested in common stocks, and $23 million, or 2.3 percent, was cash or cash equivalents. Our debt-to-total-capital ratio at 14.8 percent remains well below our target limit of 20 percent. Another important indicator of financial strength is our ratio of property casualty net written premiums to statutory surplus, which was 0.9-to-1 for the 12 months ended June 30, 2012, up from 0.8-to-1 at year-end 2011.

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

As of July 25, 2012, our insurer financial strength ratings were:

Rating Agency	Insurer Financial Strength Ratings Standard Market Property Casualty Insurance Subsidiary			Life Insurance Subsidiary			Excess and Surplus Insurance Subsidiary			Date of Most Recent Affirmation or Action
			Rating Tier			Rating Tier			Rating Tier	
A. M. Best Co.	A+	Superior	2 of 16	A	Excellent	3 of 16	A	Excellent	3 of 16	Stable outlook (12/23/11)
Fitch Ratings	A+	Strong	5 of 21	A+	Strong	5 of 21	-	-	-	Stable outlook (5/3/12)
Moody's Investors Service	A1	Good	5 of 21	-	-	-	-	-	-	Negative outlook (10/21/11)
Standard & Poor's Ratings Services	A	Strong	6 of 21	A	Strong	6 of 21	-	-	-	Stable outlook (8/4/11)

All of our insurance subsidiaries continue to be highly rated.

On May 3, 2012, Fitch Ratings affirmed our ratings that it had assigned in September 2010, continuing its stable outlook. Fitch noted that ratings strengths include conservative capitalization, moderate holding company leverage and strong liquidity. Fitch noted our reserve adequacy and implementation of initiatives anticipated to improve

underwriting results. Fitch said rating concerns include challenges from a competitive market and exposure to regional natural catastrophes and weather-related losses.

Results of Operations

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

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

We report as Other the non-investment operations of the parent company and its non-insurer subsidiary, CFC Investment Company. See Item 1, Note 12, Segment Information, Page 20, for discussion of the calculations of segment data. Results of operations for each of the five segments are discussed below.

Consolidated Property Casualty Insurance Results of Operations

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

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2012	2011	Change %	2012	2011	Change %
Earned premiums	$ 826	$ 730	13	$ 1,624	$ 1,475	10
Fee revenues	2	1	100	3	2	50
Total revenues	828	731	13	1,627	1,477	10

Loss and loss expenses from:						
Current accident year before catastrophe losses	573	564	2	1,117	1,110	1
Current accident year catastrophe losses	152	290	(48)	263	332	(21)
Prior accident years before catastrophe losses	(80)	(95)	16	(174)	(152)	(14)
Prior accident years catastrophe losses	(5)	-	nm	(27)	(1)	nm
Total loss and loss expenses	640	759	(16)	1,179	1,289	(9)
Underwriting expenses	265	239	11	516	485	6
Underwriting loss	$(77)	$(267)	71	$(68)	$(297)	77
Ratios as a percent of earned premiums:			Pt. Change			Pt. Change
Current accident year before catastrophe losses	69.5 %	77.3 %	(7.8)	68.8 %	75.2 %	(6.4)
Current accident year catastrophe losses	18.4	39.7	(21.3)	16.2	22.5	(6.3)
Prior accident years before catastrophe losses	(9.8)	(13.0)	3.2	(10.8)	(10.3)	(0.5)
Prior accident years catastrophe losses	(0.6)	0.1	(0.7)	(1.6)	0.0	(1.6)
Total loss and loss expenses	77.5	104.1	(26.6)	72.6	87.4	(14.8)
Underwriting expenses	32.0	32.6	(0.6)	31.8	32.8	(1.0)
Combined ratio	109.5 %	136.7 %	(27.2)	104.4 %	120.2 %	(15.8)
Combined ratio:	109.5 %	136.7 %	(27.2)	104.4 %	120.2 %	(15.8)
Contribution from catastrophe losses and prior years reserve development	8.0	26.8	(18.8)	3.8	12.2	(8.4)
Combined ratio before catastrophe losses and prior years reserve development	101.5 %	109.9 %	(8.4)	100.6 %	108.0 %	(7.4)

Our consolidated property casualty insurance operations generated an underwriting loss of $77 million and $68 million for the three and six months ended June 30, 2012, compared with an underwriting loss of $267 million and $297 million for the three and six months ended June 30, 2011. The primary causes of the improved underwriting results were lower losses from natural catastrophes and improving trends in pricing relative to loss costs. We believe the favorable trends for loss experience before catastrophes are in part due to our initiatives to improve pricing precision and loss experience related to claims and to loss control practices. Details of property casualty insurance results are discussed below, including our commercial lines, personal lines and excess and surplus lines segments.

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

The combined ratio can be affected significantly by natural catastrophe losses and other large losses as discussed in detail below. The combined ratio can also be affected by updated estimates of loss and loss expense reserves established for claims that occurred in prior periods, referred to as prior accident years. Net favorable development on prior accident year reserves, including reserves for catastrophe losses, improved the combined ratio by 12.4 percentage points in the first six months of 2012, or 2.1 percentage

points more compared with 10.3 percentage points in the same period of 2011. On a before-catastrophe losses basis, net favorable development on prior accident year reserves for the first six months of 2012 was 0.5 percentage points more. Net favorable development for the first six months of 2012 is discussed in further detail in results of operations by property casualty insurance segment, Pages 34 through 44.

Our consolidated property casualty combined ratio for the second quarter improved 27.2 percentage points, and for the first six months of 2012 it improved 15.8 points, both compared with the same periods of 2011. In addition to catastrophe losses that were 22.0 and 7.9 percentage points lower, the loss and loss expenses ratio before catastrophe losses were 4.6 and 6.9 points lower, together accounting for most of the improvement.

The ratio for current accident year loss and loss expenses before catastrophe losses improved. The 68.8 percent ratio for the first six months of 2012 improved 6.4 percentage points compared with the 75.2 percent accident year 2011 ratio measured as of June 30, 2011, in part reflecting recent-year initiatives to improve pricing precision and loss experience related to claims and to loss control practices and improving market conditions. Lower new large losses incurred, shown on the table on Page 32, decreased the 2012 ratio by 2.0 percentage points and were partly responsible for the ratio's improvement. The effect of the $38 million ceded in 2011 to reinstate coverage layers of our property catastrophe reinsurance treaty increased the 2011 ratio by 1.9 percentage points. We believe the remaining reduction of 2.5 percentage points is largely due to initiatives to improve pricing precision and loss experience related to claims and loss control practices, somewhat offset by normal loss cost inflation.

The underwriting expense ratio improved for the second quarter and first six months of 2012 compared with the same periods a year ago, primarily due to higher earned premiums.

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2012	2011	Change %	2012	2011	Change %
Agency renewal written premiums	$ 798	$ 717	11	$ 1,560	$ 1,425	9
Agency new business written premiums	131	117	12	239	219	9
Other written premiums	(26)	(66)	61	(53)	(97)	45
Net written premiums	903	768	18	1,746	1,547	13
Unearned premium change	(77)	(38)	(103)	(122)	(72)	(69)
Earned premiums	$ 826	$ 730	13	$ 1,624	$ 1,475	10

The trends in net written premiums and earned premiums summarized in the table above largely reflect the effects of our premium growth strategies, better pricing and the unfavorable effect on 2011 premiums due to additional ceded premiums to reinstate coverage layers of our property catastrophe reinsurance treaty. Reinsurance reinstatement

premiums lowered net written and earned premiums by $38 million during the second quarter and first six months of 2011.

Consolidated property casualty net written premiums for the three and six months ended June 30, 2012, grew $135 million and $199 million compared with the same periods of 2011. Ceded premiums to reinstate coverage layers of our property catastrophe reinsurance treaty lowered net written and earned premiums by $38 million during the second quarter and first six months of 2011. On a percentage basis, 2011 reinsurance reinstatement premiums accounted for 6 percent and 3 percent of net written premium growth for the three and six months ended June 30, 2012, respectively. Each of our property casualty segments grew during the second quarter and first six months of 2012. Our premium growth initiatives from prior years continue to favorably affect current year growth, particularly as newer agency relationships mature over time. Improving insured exposure-level comparatives reflecting some improving areas of the economy also favorably affected premium growth. We discuss current initiatives in Highlights of Our Strategy and Supporting Initiatives, Page 26. The main drivers of trends for 2012 are discussed by segment on Pages 34, 39 and 43.

Consolidated property casualty agency new business written premiums for the three and six months ended June 30, 2012, increased $14 million and $20 million compared with the same periods of 2011. We continued to experience new business growth related to initiatives for geographic expansion into new and underserved areas. Agents appointed during 2011 or 2012 produced an increase in standard lines new business of $18 million for the first six months of 2012 compared with the same period in 2011. As we appoint new agencies that choose to move accounts to us, we report these accounts as new business. While this business is new to us, in many cases it is not new to the agent. We believe these seasoned accounts tend to be priced more accurately than business that may be less familiar to our agent upon obtaining it from a competing agent.

Other written premiums – primarily including premiums ceded to our reinsurers as part of our reinsurance program – contributed $40 million and $44 million to net written premium growth for the three and six months ended June 30, 2012, compared with the same periods of 2011. The $38 million unfavorable effect on 2011 premiums from additional ceded premiums to reinstate coverage layers of our

property catastrophe reinsurance treaty accounted for much of the contribution. In addition to lower total ceded written premiums, other written premiums also benefited from a more favorable adjustment, compared with the second quarter of last year, for estimated direct written premiums of policies in effect but not yet processed. The adjustment had an immaterial effect on earned premiums.

Catastrophe losses typically have a meaningful effect on property casualty results and can vary significantly from period to period. Losses from natural catastrophes contributed 17.8 and 14.6 percentage points to the combined ratio in the three and six months ended June 30, 2012, compared with 39.8 and 22.5 percentage points in the same periods of 2011. The following table shows catastrophe losses and loss expenses incurred, net of reinsurance, as well as the effect of loss development on prior period catastrophe events. One of the second-quarter 2012 catastrophe events had losses estimated at June 30, 2012, that exceeded our $75 million loss retention for our property catastrophe reinsurance treaty. Terms of the treaty include one automatic reinstatement by layer of reinsurance. The first layer provides recovery of 48.3 percent of per-event losses between $75 million and $100 million. Amounts recovered and reinstatement premiums related to the second quarter of 2012 were immaterial. We individually list catastrophe events for which our incurred losses reached or exceeded $5 million.

(In millions, net of reinsurance)			Three months ended June 30,				Six months ended June 30,			
Dates	Event	Region	Comm. lines	Pers. lines	E&S lines	Total	Comm. lines	Pers. lines	E&S lines	Total
2012										
Feb. 28 - 29	Hail, wind, tornado	Midwest	$ (2)	$ -	$ -	$ (2)	$ 20	$ 8	$ -	$ 28
Mar. 2 – 3	Hail, wind, tornado	Midwest, South	1	-	-	1	29	45	1	75
Mar. 18 - 25	Hail, lightning, wind	Midwest, South	2	4	-	6	2	4	-	6
Apr. 28 - 29	Hail, lightning, wind	Midwest, South	54	22	-	76	54	22	-	76
May 2 - 6	Hail, lightning, wind	Midwest	5	1	-	6	5	1	-	6
Jun. 11 - 13	Hail, lightning, wind	West, South	6	-	-	6	6	-	-	6
Jun. 24 - 28	Fire	West	8	-	-	8	8	-	-	8
Jun. 28 - Jun. 30	Hail, lightning, wind	Midwest, Northeast, South	3	32	-	35	3	32	-	35
All other 2012 catastrophes			11	5	-	16	13	10	-	23

Development on 2011 and prior catastrophes			2	(7)	-	(5)	(11)	(16)	-	(27)
Calendar year incurred total			$ 90	$ 57	$ -	$ 147	$ 129	$ 106	$ 1	$ 236
2011										
Jan. 31-Feb. 3	Freezing, wind	South, Midwest	$ -	$ -	$ -	$ -	$ 5	$ 5	$ -	$ 10
Feb. 27-28	Hail, wind, tornado	Midwest	-	(1)	-	(1)	5	7	-	12
Mar. 11	Earthquake	Japan	-	-	-	-	8	-	-	8
Apr. 3-5	Hail, wind, tornado	South, Midwest	16	22	-	38	16	22	-	38
Apr. 8-11	Hail, wind, tornado	South, Midwest	11	9	-	20	11	9	-	20
Apr. 14-16	Hail, wind, tornado	South, Midwest	10	4	-	14	10	4	-	14
Apr. 19-20	Hail, wind	South, Midwest	13	13	-	26	13	13	-	26
Apr. 22-28	Hail, wind, tornado	South, Midwest	47	31	-	78	47	31	-	78
May 20-27	Hail, wind, tornado	South, Midwest	45	37	-	82	45	37	-	82
May 29-Jun. 1	Hail, wind, tornado	Northeast, Midwest	4	2	-	6	4	2	-	6
Jun. 16-22	Hail, wind, tornado	South, Midwest	7	10	-	17	7	10	-	17
All other 2011 catastrophes			4	5	1	10	9	11	1	21
Development on 2010 and prior catastrophes			-	-	-	-	4	(5)	-	(1)
Calendar year incurred total			$ 157	$ 132	$ 1	$ 290	$ 184	$ 146	$ 1	$ 331

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

Consolidated Property Casualty Insurance Losses by Size

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2012	2011	Change %	2012	2011	Change %
New losses greater than $4,000,000	$ 4	$ 5	(20)	$ 15	$ 16	(6)
New losses $1,000,000-$4,000,000	47	33	42	78	83	(6)
New losses $250,000-$1,000,000	58	52	12	102	106	(4)
Case reserve development above $250,000	55	51	8	122	85	44
Total large losses incurred	164	141	16	317	290	9
Other losses excluding catastrophe losses	241	236	2	447	481	(7)
Catastrophe losses	146	289	(49)	233	329	(29)
Total losses incurred	$ 551	$ 666	(17)	$ 997	$ 1,100	(9)
Ratios as a percent of earned premiums:			Pt. Change			Pt. Change
New losses greater than $4,000,000	0.5 %	0.8 %	(0.3)	0.9 %	1.1 %	(0.2)
New losses $1,000,000-$4,000,000	5.7	4.6	1.1	4.8	5.6	(0.8)
New losses $250,000-$1,000,000	7.1	7.0	0.1	6.2	7.2	(1.0)
Case reserve development above $250,000	6.7	6.9	(0.2)	7.5	5.8	1.7
Total large loss ratio	20.0	19.3	0.7	19.4	19.7	(0.3)
Other losses excluding catastrophe losses	29.1	32.3	(3.2)	27.5	32.6	(5.1)
Catastrophe losses	17.6	39.6	(22.0)	14.5	22.3	(7.8)
Total loss ratio	66.7 %	91.2 %	(24.5)	61.4 %	74.6 %	(13.2)

We believe the inherent variability of aggregate loss experience for our portfolio of larger policies is greater than that of our portfolio of smaller policies, and we continue to monitor the variability in addition to general inflationary trends in loss costs. Our analysis continues to indicate no unexpected concentration of these large losses and case reserve increases by risk category, geographic region, policy inception, agency or field marketing territory. The second-quarter 2012 property casualty total large losses incurred of $164 million, net of reinsurance, matched the $164 million quarterly average during 2011 and higher than the $141 million for the second quarter of 2011. The ratio for these large losses and case reserve increases was 0.7 percentage points higher compared with last year's second quarter, with new losses up 0.9 points and case reserve development down 0.2 points. The second-quarter increase in losses added to the ratio for total large losses incurred for the first six months of 2012, which also included a first-quarter 2012 ratio that was 1.0 point lower than the first quarter of 2011. We believe results for the three-month and six-month periods largely reflected normal fluctuations in loss patterns and normal variability in large case reserves for claims above $250,000. Losses by size are discussed in further detail in results of operations by property casualty insurance segment, Pages 34 through 44.

Commercial Lines Insurance Results of Operations

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2012	2011	Change %	2012	2011	Change %
Earned premiums	$590	$533	11	$1,158	$1,073	8
Fee revenues	1	-	nm	2	1	100
Total revenues	591	533	11	1,160	1,074	8
Loss and loss expenses from:						
Current accident year before catastrophe losses	396	405	(2)	782	807	(3)
Current accident year catastrophe losses	89	157	(43)	141	180	(22)
Prior accident years before catastrophe losses	(73)	(79)	8	(150)	(134)	(12)
Prior accident years catastrophe losses	1	-	nm	(12)	4	nm
Total loss and loss expenses	413	483	(14)	761	857	(11)
Underwriting expenses	198	179	11	385	368	5
Underwriting profit (loss)	$(20)	$(129)	84	$14	$(151)	nm
Ratios as a percent of earned premiums:			Pt. Change			Pt. Change
Current accident year before catastrophe losses	67.2 %	75.9 %	(8.7)	67.5 %	75.2 %	(7.7)
Current accident year catastrophe losses	15.0	29.5	(14.5)	12.2	16.8	(4.6)
Prior accident years before catastrophe losses	(12.3)	(14.8)	2.5	(13.0)	(12.5)	(0.5)
Prior accident years catastrophe losses	0.2	0.2	0.0	(1.0)	0.4	(1.4)
Total loss and loss expenses	70.1	90.8	(20.7)	65.7	79.9	(14.2)
Underwriting expenses	33.4	33.4	0.0	33.2	34.3	(1.1)
Combined ratio	103.5%	124.2%	(20.7)	98.9 %	114.2%	(15.3)
Combined ratio:	103.5%	124.2%	(20.7)	98.9 %	114.2%	(15.3)
Contribution from catastrophe losses and prior years reserve development	2.9	14.9	(12.0)	(1.8)	4.7	(6.5)
Combined ratio before catastrophe losses and prior years reserve development	100.6%	109.3%	(8.7)	100.7%	109.5%	(8.8)

Overview

Performance highlights for the commercial lines segment include:

- Premiums – Commercial lines earned premiums and net written premiums grew during the second quarter and first half of 2012 primarily due to higher renewal premiums that continued to reflect improved pricing. Ceded premiums to reinstate coverage layers of our property catastrophe reinsurance treaty lowered net written and earned premiums by $23 million during the second quarter and first six months of 2011. Higher new business written premiums reflected better pricing in addition to our premium growth initiatives, also contributing to premium growth. The premiums table below analyzes the primary components of earned premiums.

Agency renewal written premiums rose 10 percent and 8 percent for the second quarter and the first six months of 2012, reflecting higher pricing and improving economic conditions. To better manage our business in the highly competitive commercial lines marketplace, we continue to increase our use of predictive analytics tools to improve pricing precision while also leveraging our local relationships with agents through the efforts of our teams that work closely with them. We believe our field focus is unique and has several advantages, including providing us with high-quality intelligence on local market conditions. We seek to maintain appropriate pricing discipline for both new and renewal business as management emphasizes the importance of our agencies and underwriters assessing account quality to make careful decisions on a case-by-case basis whether to write or renew a policy. Rate credits may be used to retain renewals of high-quality business and to earn new business, but we do so selectively in order to avoid commercial accounts that we believe have insufficient profit margins.

We measure average changes in commercial lines renewal pricing as the rate of change in renewal premium for the new policy period compared with the premium for the expiring policy period, assuming no change in the level of insured exposures or policy coverage between those periods for respective policies. During the second quarter of 2012, our standard commercial lines policies averaged estimated price change increases in a mid-single-digit range, improving somewhat compared with the first quarter of 2012. Our average commercial lines pricing change includes the flat pricing effect of certain coverages within package policies written for a three-year term that were in force but did not expire during the period being measured. Therefore, the average commercial lines pricing change we report reflects a blend of three-year policies that did not expire and other policies that did expire during the measurement period. For the commercial lines policies that expired and were subsequently renewed during the second quarter of 2012, we estimate that the average pricing

change was solidly in a mid-single-digit range, with workers' compensation and commercial property policies experiencing higher than average renewal price increases.

Renewal premiums for our commercial casualty and workers' compensation business include the result of policy audits that adjust initial premium amounts based on differences between estimated and actual sales or payroll related to a specific policy. Net written premiums from audits during the second quarter and the first six months of 2012 netted to positive $9 million and $15 million, respectively. Audits contributed $7 million to the $89 million net increase in net written premiums for the second quarter of 2012 and $16 million to the $127 million net increase in net written premiums for the first six months of 2012, both compared with the same periods a year ago. The $85 million increase in earned premiums during the first six months of 2012, compared with 2011, included a $14 million increase from audit premiums.

New business written premiums for commercial lines increased 12 percent and 9 percent during the second quarter and first six months of 2012 compared with the same period last year. The increase was broad-based as nearly two-thirds of the 39 states where we offer standard market commercial lines policies had higher new business written premiums for the first half of 2012 compared with the same period of 2011.

Other written premiums included a lower total amount ceded to reinsurers for the first half of 2012 compared with the same period of 2011, because 2011 premiums were reduced by $23 million of additional ceded premiums to reinstate coverage layers of our property catastrophe reinsurance treaty. Other written premiums also included a more favorable adjustment, compared with the first six months of last year, for estimated direct written premiums of policies in effect but not yet processed. The adjustment had an immaterial effect on earned premiums.

Commercial Lines Insurance Premiums

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2012	2011	Change %	2012	2011	Change %
Agency renewal written premiums	$ 552	$ 500	10	$ 1,123	$ 1,042	8
Agency new business written premiums	91	81	12	166	152	9
Other written premiums	(17)	(44)	61	(37)	(69)	46
Net written premiums	626	537	17	1,252	1,125	11
Unearned premium change	(36)	(4)	nm	(94)	(52)	(81)
Earned premiums	$ 590	$ 533	11	$ 1,158	$ 1,073	8

- Combined ratio – The commercial lines combined ratio for the three and six months ended June 30, 2012, improved compared with the same periods of 2011, primarily due to catastrophe losses that were 14.5 and 6.0 percentage points lower. In addition, the 2012 periods benefited from lower ratios for loss and loss expenses before catastrophes.

Catastrophe losses accounted for 15.2 and 11.2 percentage points of the combined ratio for the three and six months ended June 30, 2012, compared with 29.7 and 17.2 percentage points for the same periods last year. The 10-year annual average through 2011 for the commercial lines segment was 3.7 percentage points, and the five-year annual average was 4.3 percentage points.

The ratio for current accident year loss and loss expenses before catastrophe losses improved. The 67.5 percent ratio for the first six months of 2012 improved 7.7 percentage points compared with the 75.2 percent accident year 2011 ratio measured as of June 30, 2011, in part reflecting recent-year initiatives to improve pricing precision and loss experience related to claims and to loss control practices and improving market conditions. Lower new large losses incurred, shown on the table on Page 33, decreased the 2012 ratio by 3.0 percentage points and were responsible for some of the ratio's improvement. The effect of the $23 million ceded to reinstate coverage layers of our property catastrophe reinsurance treaty increased the 2011 ratio by 1.5 percentage points. We believe the remaining reduction of 3.2 percentage points in the first half of 2012 is largely due to initiatives to improve pricing precision and loss experience related to claims and loss control practices, somewhat offset by normal loss cost inflation.

The net effect of reserve development on prior accident years during the second quarter and first six months of 2012 was favorable for commercial lines overall by $72 million and $162 million compared with net favorable development of $79 million and $130 million for the same periods in 2011. For the six months ended June 30, 2012, favorable reserve development on prior accident years in the commercial casualty line of business represented 64 percent of the commercial lines favorable development. Workers' compensation accounted for 17 percent of the favorable development, while most of the remaining commercial lines favorable reserve development for the first six months of 2012 was almost evenly split between the commercial property and commercial auto lines of business. The favorable reserve development recognized during the first six months of

2012 for commercial lines included approximately 11 percent for accident year 2011 and nearly 50 percent for combined accident years 2009 and 2010, and was primarily due to reduced volatility in paid losses, reduced volatility in projections of future calendar year trends and lower than anticipated loss emergence on known claims. Reserve estimates are inherently uncertain as described in our 2011 Annual Report on Form 10-K, Item 7, Critical Accounting Estimates, Property Casualty Insurance Loss and Loss Expense Reserves, Page 42.

The commercial lines underwriting expense ratio for the second quarter of 2012 matches the second quarter of 2011 and the first six months of 2012 improved primarily due to higher earned premiums.

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

Commercial Lines Insurance Losses by Size

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2012	2011	Change %	2012	2011	Change %
New losses greater than $4,000,000	$ 4	$ 6	(33)	$ 15	$ 16	(6)
New losses $1,000,000-$4,000,000	33	30	10	56	70	(20)
New losses $250,000-$1,000,000	36	39	(8)	68	77	(12)
Case reserve development above $250,000	51	46	11	115	77	49
Total large losses incurred	124	121	2	254	240	6
Other losses excluding catastrophe losses	138	135	2	243	290	(16)
Catastrophe losses	89	157	(43)	127	183	(31)
Total losses incurred	$ 351	$ 413	(15)	$ 624	$ 713	(12)
Ratios as a percent of earned premiums:			Pt. Change			Pt. Change
New losses greater than $4,000,000	0.7 %	1.1 %	(0.4)	1.3 %	1.5 %	(0.2)
New losses $1,000,000-$4,000,000	5.5	5.5	0.0	4.9	6.5	(1.6)
New losses $250,000-$1,000,000	6.2	7.4	(1.2)	5.9	7.1	(1.2)
Case reserve development above $250,000	8.7	8.7	0.0	9.9	7.2	2.7
Total large loss ratio	21.1	22.7	(1.6)	22.0	22.3	(0.3)
Other losses excluding catastrophe losses	23.4	25.3	(1.9)	21.0	27.0	(6.0)
Catastrophe losses	15.1	29.6	(14.5)	11.0	17.1	(6.1)
Total loss ratio	59.6 %	77.6 %	(18.0)	54.0 %	66.4 %	(12.4)

We continue to monitor new losses and case reserve increases greater than $250,000 for trends in factors such as initial reserve levels, loss cost inflation and claim settlement expenses. Our analysis continues to indicate no unexpected concentration of these large losses and case reserve increases by risk category, geographic region, policy inception, agency or field marketing territory. The second-quarter 2012 commercial lines total large losses incurred of $124 million, net of reinsurance, was lower than the $137 million quarterly average during 2011 and higher than the $121 million for the second quarter of 2011. The ratio for these large losses and case reserve increases was 1.6 percentage points lower compared with last year's second quarter, as higher earned premiums more than offset higher incurred losses for our commercial auto line of business. The second-quarter increase in losses added to the ratio for total large losses incurred for the first six months of 2012, which also included a higher number of claims and higher incurred losses for our general liability line of business during the first quarter. We believe results for the three-month and six-month periods largely reflected normal fluctuations in loss patterns and normal variability in large case reserves for claims above $250,000.

Commercial Lines of Business Analysis

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

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2012	2011	Change %	2012	2011	Change %
Commercial casualty:						
Written premiums	$ 202	$ 177	14	$ 404	$ 366	10
Earned premiums	191	180	6	372	352	6
Current accident year before catastrophe losses	67.2 %	66.0 %		68.7 %	72.3 %	
Current accident year catastrophe losses	0.0	0.0		0.0	0.0	
Prior accident years before catastrophe losses	(29.2)	(27.2)		(28.0)	(29.7)	
Prior accident years catastrophe losses	0.0	0.0		0.0	0.0	
Total loss and loss expenses ratio	38.0 %	38.8 %		40.7 %	42.6 %	
Commercial property:						
Written premiums	$ 146	$ 123	19	$ 287	$ 255	13
Earned premiums	134	115	17	265	241	10
Current accident year before catastrophe losses	55.3 %	76.8 %		56.2 %	70.5 %	
Current accident year catastrophe losses	56.7	78.8		44.3	45.6	
Prior accident years before catastrophe losses	(3.4)	(1.7)		(4.0)	3.4	
Prior accident years catastrophe losses	1.3	1.1		(2.2)	2.3	
Total loss and loss expenses ratio	109.9 %	155.0 %		94.3 %	121.8 %	
Commercial auto:						
Written premiums	$ 115	$ 102	13	$ 229	$ 209	10
Earned premiums	106	96	10	207	192	8
Current accident year before catastrophe losses	71.8 %	72.6 %		72.8 %	74.5 %	
Current accident year catastrophe losses	3.2	6.2		2.4	3.3	
Prior accident years before catastrophe losses	(1.8)	(11.0)		(6.8)	(17.6)	
Prior accident years catastrophe losses	(0.3)	(0.1)		(0.4)	(0.2)	
Total loss and loss expenses ratio	72.9 %	67.7 %		68.0 %	60.0 %	
Workers' compensation:						
Written premiums	$ 86	$ 73	18	$ 179	$ 163	10
Earned premiums	85	81	5	166	157	6
Current accident year before catastrophe losses	80.8 %	108.5 %		81.7 %	102.3 %	
Current accident year catastrophe losses	0.0	0.0		0.0	0.0	
Prior accident years before catastrophe losses	(14.3)	(28.9)		(16.6)	(16.9)	
Prior accident years catastrophe losses	0.0	0.0		0.0	0.0	
Total loss and loss expenses ratio	66.5 %	79.6 %		65.1 %	85.4 %	

Specialty packages:						
Written premiums	$ 38	$ 27	41	$ 78	$ 64	22
Earned premiums	37	27	37	75	64	17
Current accident year before catastrophe losses	72.8 %	93.8 %		69.6 %	75.7 %	
Current accident year catastrophe losses	23.9	223.8		24.4	99.4	
Prior accident years before catastrophe losses	(3.0)	1.8		(8.5)	9.5	
Prior accident years catastrophe losses	(0.2)	(0.7)		(6.5)	(1.1)	
Total loss and loss expenses ratio	93.5 %	318.7 %		79.0 %	183.5 %	
Surety and executive risk:						
Written premiums	$ 29	$ 26	12	$ 56	$ 50	12
Earned premiums	27	25	8	54	50	8
Current accident year before catastrophe losses	72.1 %	47.9 %		60.9 %	51.3 %	
Current accident year catastrophe losses	0.0	0.0		0.0	0.0	
Prior accident years before catastrophe losses	10.3	19.4		22.3	30.2	
Prior accident years catastrophe losses	0.0	0.0		0.0	0.0	
Total loss and loss expenses ratio	82.4 %	67.3 %		83.2 %	81.5 %	
Machinery and equipment:						
Written premiums	$ 10	$ 9	11	$ 19	$ 18	6
Earned premiums	10	9	11	19	17	12
Current accident year before catastrophe losses	23.8 %	32.0 %		29.8 %	30.1 %	
Current accident year catastrophe losses	0.0	0.2		0.0	0.2	
Prior accident years before catastrophe losses	(2.5)	6.9		0.4	7.7	
Prior accident years catastrophe losses	0.0	0.0		0.0	0.0	
Total loss and loss expenses ratio	21.3 %	39.1 %		30.2 %	38.0 %	

As discussed above, the loss and loss expenses ratio component of the combined ratio is an important measure of underwriting profit and performance. Catastrophe losses are volatile and can distort short-term profitability trends, particularly for certain lines of business. Development of loss and loss expense reserves on prior accident years can also distort trends in measures of profitability for recently written business. To illustrate these effects, we separate their impact on the ratios shown in the table above. For the three and six months ended June 30, 2012, the commercial line of business with the most significant profitability challenge was surety and executive risk, assuming future weather-related loss experience for commercial property is at an average level that aligns with premium rates, including pricing increases of recent quarters. As discussed in Commercial Lines Insurance Results of Operations, Overview, Page 34, policies with commercial property coverages experienced higher than average renewal price increases in the second quarter of 2012, consistent with prior discussion for the first quarter. In addition, a multi-department, multi-disciplinary taskforce has been reviewing our property book of business and continues to seek ways to improve profitability, similar to the approach we used to improve workers' compensation results. Several profit improvement initiatives are already underway, such as increased specialization among selected claims and loss control associates.

Our second-quarter and first-half 2012 surety and executive risk results included unfavorable development on prior accident years reserves for director and officer liability related to financial institutions. As discussed in our 2011 Annual Report on Form 10-K, Item 7, Commercial Lines Insurance Results of Operations, Page 67, we have taken steps to actively manage the potentially high risk of writing director and officer liability.

Personal Lines Insurance Results of Operations

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2012	2011	Change %	2012	2011	Change %
Earned premiums	$ 214	$ 180	19	$ 423	$ 370	14
Fee revenues	1	1	0	1	1	0
Total revenues	215	181	19	424	371	14
Loss and loss expenses from:						
Current accident year before catastrophe losses	160	146	10	302	275	10
Current accident year catastrophe losses	63	132	(52)	121	151	(20)
Prior accident years before catastrophe losses	(7)	(9)	22	(24)	(11)	(118)
Prior accident years catastrophe losses	(6)	-	nm	(15)		