

# Cincinnati Financial Corporation

## Full Rating Report

### Ratings

Security Class	Rating
Long-Term Issuer Default Rating	A-
Senior Unsecured	BBB+
IFS	A+

The Cincinnati Insurance Co.

The Cincinnati Casualty Co.

The Cincinnati Indemnity Co.

The Cincinnati Life Ins. Co.

Insurer Financial Strength (IFS) A+

### Rating Outlook

Stable

### Financial Data

(\$ Mil.)	2010	9/30/11 <sup>a</sup>
Net Income	377	32
S/H Equity	5,032	4,786
Total Debt	839	894
ROAE (%)	7.7	0.9
Combined Ratio	101.7	116.8

<sup>a</sup>Net income is nine months ending Sept. 30, 2011; ROAE is annualized. S/H – Shareholders'. Note: GAAP.

### Related Research

[Fitch Affirms Cincinnati Financial's Ratings; Outlook Stable, Nov. 14, 2011](#)

[Property/Casualty Insurers' Midyear 2011 Financial Results, Sept. 19, 2011](#)

[Property/Casualty Insurers' Financial Leverage and Debt Servicing Capacity, April 15, 2011](#)

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### Key Rating Drivers

**Conservative Operating Company Capitalization:** Cincinnati Financial Corporation's (CINF) rating strengths include conservative operating subsidiary capitalization supported by a strong holding company cash and marketable securities position, and moderate holding company financial leverage. Property/casualty (P/C) operations are conservatively capitalized, with operating leverage that averaged 0.77x and net leverage that averaged 2.22x from 2006–2010 and an NAIC RBC materially higher than industry averages at 415% at year-end 2010.

**Deteriorating P/C Underwriting Results:** Rating concerns are principally related to the challenges posed by competitive market conditions and CINF's exposure to regional natural catastrophes and other weather-related losses. The P/C segment has reported underwriting losses since 2007, with catastrophe losses continuing to exceed the company's 10-year average of 4.4 points. However, after adjusting for catastrophe losses, Fitch Ratings believes underwriting performance has also deteriorated relative to the industry and regional peers.

**Investment Risk Driven by Equities:** CINF's investment risk is driven by its higher than average allocation to common equities. However, Fitch believes the company has ample liquidity to cover its insurance reserves through its high-quality liquid bond portfolio, the value of which exceeded total insurance reserves by almost 35% at year-end 2010.

**Reserve Risk Well Managed:** Fitch believes CINF's P/C reserves are adequate and well managed. The company has reported favorable prior-year reserve development in each of the last 22 years. Adverse development in the workers' compensation segment was reported in two of the last five years and remains more exposed to potential future adverse development, in Fitch's view. Notably, commercial casualty reserves have been a source of material favorable reserve development over the five years ending 2010, as well as in 2011.

### What Could Trigger a Rating Action

**Rating Expectations:** Fitch's rating rationale anticipates P/C statutory operating leverage to remain below 1.0x, financial leverage to remain below 20%, the lead P/C subsidiary's NAIC RBC ratio to remain greater than 375%, and the life company's RBC ratio to remain greater than 350%. Fitch also assumes that CINF will continue to maintain holding company cash and marketable securities, at least while underwriting performance is weak, to exceed annual shareholder dividends and interest expense of approximately \$300 million.

**Downgrade Triggers:** The key rating trigger that could lead to a downgrade is continuing poor underwriting performance. Deterioration in current balance sheet strength, as defined in the previous paragraph, could also lead to a downgrade.

**Upgrade Triggers:** Fitch considers a rating upgrade to be unlikely in the near term due to CINF's regional footprint and regulatory, economic, and concentrated Midwest catastrophe exposures. Key rating triggers that could lead to an upgrade over the longer term include a material and sustained improvement on recent underwriting performance that causes Fitch to view CINF as comparable from a ratings perspective with higher-rated companies, and improved catastrophe and overall risk management through difficult underwriting and economic conditions.

**Market Position and Size/Scale**

**Market Position and Management Strategy Support Ratings**

- Competitive advantages through successful independent agency system.
- Regional footprint drives exposure to catastrophe and weather events.

**Competitive Advantages through Successful Independent Agency System**

Fitch views CINF's competitive positioning as solid, and the company consistently ranks among the top 25 insurers in the P/C industry in the U.S. in terms of net written premium. CINF's strategy is centered on the commitment to its network of professional independent insurance agencies. Fitch believes the company's strong agency system is a core strength contributing to CINF's success in a highly competitive P/C industry.

CINF is focused on building long-term relationships and increasing its penetration of each existing agency's business. The company maintains a competitive and effective commission structure, paying among the highest commissions in the industry. A significant portion of the commission is based on the profitability of the agent's book of business.

CINF has developed additional businesses to expand product offerings available to its agency force. These include surety business and excess and surplus (E&S) lines, as well as life insurance, disability income policies, and annuities.

**Regional Footprint Drives Exposure to Catastrophe and Weather Events**

In commercial lines, CINF is focused on products that agents can market to small and mid-sized businesses in their communities. Approximately 95% of commercial lines premiums are written to provide accounts with more than one product coverage. Commercial lines are actively marketed in 39 states, with recent entries into Texas, Colorado, Wyoming, Oregon and Connecticut. In 2010, the 10 largest states generated 64% of earned premiums.

In personal lines, CINF seeks healthy regulatory environments and control of exposure to catastrophe losses. Marketing is focused on accounts that include both auto and homeowner's coverages. Personal lines business is concentrated in 10 states that made up 82% of earned premiums in 2010. Six states, including Ohio, Georgia, Indiana, Illinois, Alabama, and Kentucky, made up 70% of personal lines earned premium.

CINF has a material exposure to regional natural catastrophes and weather-related events, including hurricanes, wind, hail, floods, and winter storms. An expanding geographic footprint should facilitate some reduction in exposures, but Fitch cautions this may be offset by the risk of underpricing in new markets where local knowledge and expertise are lacking.

**Ratings Range Based on Market Position and Size/Scale**

IFS:	AAA	AA	A	BBB	<BBB
Debt:	AA	A	BBB	BB	<BB
Major Positions and Scale	←		→		
Modest Position and Scale		←		→	
Small, Narrow Focus			←		

**Related Criteria**

Insurance Rating Methodology, Sept. 22, 2011

**Corporate Governance**

No material issues to the rating are noted. The board appears to have an appropriate amount of independence from management and seems reasonably involved in establishing the company's strategic direction. Standard board subcommittees are in place.

**Organizational Structure**

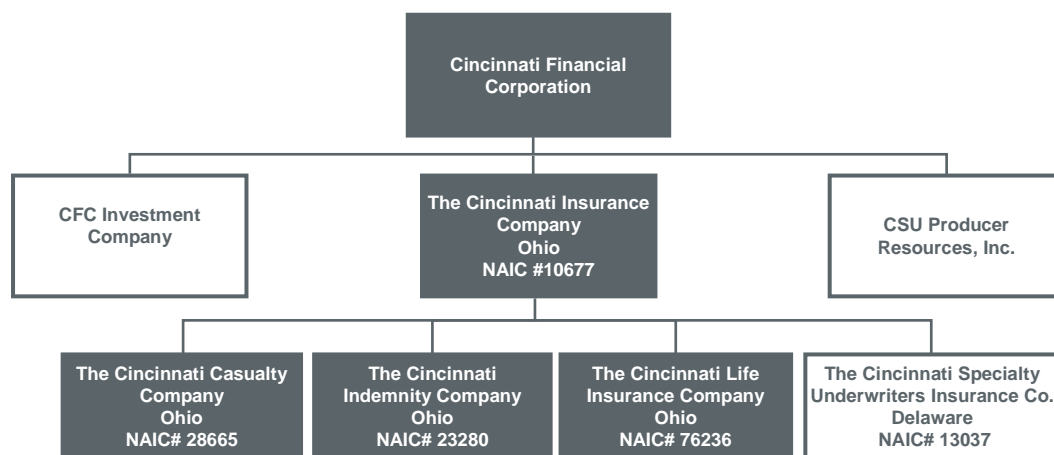
**Ownership Is Neutral to Rating**

CINF is a publicly traded holding company formed in 1968. The Cincinnati Insurance Company, founded in 1950, is 100% owned by CINF. Public ownership is viewed as neutral to the rating.

CINF formed various insurance operating subsidiaries to expand its product offerings. These include The Cincinnati Casualty Company in 1973, The Cincinnati Life Insurance Company in 1987, The Cincinnati Indemnity Company in 1989, and The Cincinnati Specialty Underwriters Insurance Company in 2007.

Two non-insurance subsidiaries complement CINF's insurance operations. CSU Producer Resources, Inc. offers E&S brokerage services to the same local independent agencies that offer CINF's standard insurance market policies. CFC Investment Company offers commercial leasing and financing services to the company's agents, their clients, and other customers and had \$73 million in receivables at year-end 2010.

**Organization Chart**



Rated by Fitch Ratings.  
Source: Cincinnati Financial Corporation.

**Industry Profile and Operating Environment**

A majority of U.S. life and nonlife (re)insurers in Fitch's rated universe have insurer financial strength (IFS) ratings in the 'AA' and 'A' categories.

**Nonlife Industry Has Relatively Low Risk Profile**

Key nonlife industry risk factors include cyclical pricing, intense market competition, pricing and reserving uncertainty, investment risk tied to fixed income and equity holdings, catastrophe loss exposures, and regulatory issues. The industry withstood the 2008–2009 financial crisis reasonably well, and industry capital levels returned to record levels in 2010 due to earnings retention and investment gains. Operating leverage ratios are currently at historical lows. This capital strength balances with near-term expectations for weaker profitability and returns on

**Sovereign- and Country-Related Constraints**

Fitch rates the sovereign obligations of the United States of America at 'AAA' with a Stable Outlook, and the country ceiling is similarly rated at 'AAA'. Therefore, the ratings of U.S. insurance organizations and other corporate issuers are not constrained by sovereign or macroeconomic risks.

capital, as premium rates are not likely to improve materially in the current economic and insurance market environment, and yields on invested asset remain low.

**Life Industry Has Strong Balance Sheet Fundamentals**

Key life industry risk factors include fixed income and equity investment risks, macroeconomic uncertainty, low interest rates, and intense price competition, as well as regulatory and accounting uncertainty. The industry withstood the 2008–2009 financial crisis reasonably well, with capital largely rebounding due to earnings, investment gains, and capital raises. Balance sheet strengths reflect very strong liquidity, reasonable financial leverage, and improved asset quality. Improved earnings continue to lag precrisis levels due to low interest rates and increased hedging costs. The industry's large in-force book of variable annuity business will continue to be a drag on profitability over the near term and could cause a material hit to industry earnings and capital in an unexpected, but still plausible, severe stress scenario.

**Ratings Range Based on Industry Profile/Operating Environment**

	IFS:	AAA	AA	A	BBB	<BBB
	Debt:	AA	A	BBB	BB	<BB
Non-Life Commercial		←	██████████	██████████	██████████	→
Non-Life Personal		←	██████████	██████████	██████████	→
Life Insurance		←	██████████	██████████	██████████	→

**Peer Analysis**

**CINF Regional Peer Comparison Supports Rating Level**

CINF's primary regional peer competitors include Harleysville Group Inc., The Hanover Insurance Group, and Selective Insurance Group, Inc. While CINF's historical combined ratio was several points better than its regional peers, Fitch believes the differential has narrowed with poorer operating performance over the last three years. CINF's growth in net premiums earned has been lower than peers, which Fitch generally views favorably, considering current market conditions. Fitch views the company's capital as stronger, but subject to more volatility than peers due to its significantly greater equity concentration.

**Regional Peer Comparison**

	IFS	Five-Year CAGR NPE (%)	Five-Year Average CR (%)	Standard Deviation (%)	2010 Operating Leverage (x)	2010 RBC Ratio (%)
Cincinnati Financial	A+	(0.9)	98.3	5.8	0.8	415
Selective Insurance Group	A+	0.0	99.1	2.1	1.3	251
Hanover Insurance Group	A–	5.6	97.7	2.5	1.8	306
Harleysville Insurance	NR	0.6	99.8	2.3	0.9	341

IFS – Insurer financial strength. CAGR – Compound annual growth rate. NPE – Property/casualty (P/C) net premium earned. CR – P/C combined ratio. RBC – Risk-based capital ratio (applies to largest P/C operating company only). NR – Not rated. Note: U.S. GAAP. Operating leverage is on statutory basis and is for P/C operations. Source: Highline Data, Fitch Ratings.

## Capitalization and Leverage

(\$ Mil.)	2006	2007	2008	2009	2010	Fitch's Expectation
Statutory Surplus <sup>a</sup>	4,750	4,307	3,360	3,648	3,777	Fitch's rating rationale anticipates P/C operating leverage to remain well below 1.0x, ECA financial leverage to remain below 20%, the lead P/C subsidiary's NAIC RBC ratio to remain greater than 375%, and the life company's RBC ratio to remain greater than 350%.
NPW/Surplus (x) <sup>a</sup>	0.67	0.72	0.90	0.80	0.78	
Net Leverage (x) <sup>a</sup>	1.97	2.06	2.47	2.31	2.28	
NAIC Risk-Based Capital Ratio (%) <sup>b</sup>	333	352	416	419	415	
ECA Leverage (%) — GAAP	11.0	12.7	16.2	15.6	15.1	

<sup>a</sup>Cincinnati Insurance Group (P/C only). <sup>b</sup>Largest P/C operating subsidiary only. ECA – Equity-credit-adjusted (shareholders' equity excludes FAS 115 bond gains and losses). Note: Statutory accounting principles except where noted.

Source: Highline Data, Fitch Ratings

### Solid but Volatile Capitalization with Moderate Financial Leverage

- Conservative P/C statutory capitalization.
- Small but solid life statutory capitalization.
- Moderate financial leverage employed.

Equity valuation has been a key driver of volatility in statutory capitalization of both CINF's P/C and life operating subsidiaries and in shareholders' equity. At year-end 2010, 26% of equities were held at the parent company level.

### Conservative P/C Statutory Capitalization

P/C operations are conservatively capitalized. Operating leverage averaged 0.77x and net leverage averaged 2.22x from 2006–2010, which compared to the industry at 0.85x and 2.70x respectively. With an adjustment to exclude the investment in Cincinnati Life, operating leverage remains conservative at 0.84x at year-end 2010. The NAIC RBC of the largest P/C operating subsidiary was materially higher than industry averages at 415% at year-end 2010.

### Small but Solid Life Statutory Capitalization

Cincinnati Life's capitalization solidly supports the company's profile. However, total adjusted capital at \$318 million was modest at year-end 2010. NAIC RBC was very strong at 452%, and the risky assets ratio of 62% compared with the industry average of 92% at Dec. 31, 2010.

### Moderate Financial Leverage Employed

CINF targets financial leverage below 20% and has not used hybrid securities in its capital structure or long-term debt to fund its relatively modest share repurchase program. At Sept. 30, 2011, CINF's ECA financial leverage, excluding FAS 115 bond gains and losses, was moderate at 17.1%. The company discontinued its securities lending program in 2008 and its TFC ratio was low at 0.18x at year-end 2010. CINF has no goodwill.

## GAAP Capitalization and Change in Shareholders' Equity

(\$ Mil.)	2006	2007	2008	2009	2010
<b>S/H Equity — Beginning of Year</b>	<b>6,086</b>	<b>6,808</b>	<b>5,929</b>	<b>4,182</b>	<b>4,760</b>
Net Income	930	855	429	432	377
Other Comprehensive Income	127	(1,223)	(1,804)	383	145
Issuance/Repurchase of Stock	(119)	(305)	(138)	6	(1)
Dividends to Shareholders	(232)	(241)	(254)	(255)	(259)
Other	16	35	20	12	10
<b>Change During Year</b>	<b>722</b>	<b>(879)</b>	<b>(1,747)</b>	<b>578</b>	<b>272</b>
<b>S/H Equity — End of Year</b>	<b>6,808</b>	<b>5,929</b>	<b>4,182</b>	<b>4,760</b>	<b>5,032</b>

S/H – Shareholders'.

Source: Cincinnati Financial Corporation, Fitch Ratings.

## Debt Service Capabilities and Financial Flexibility

(\$ Mil.)	2006	2007	2008	2009	2010	Fitch's Expectation
Pretax Financing Charges	53	52	53	55	54	Statutory interest coverage is forecast to exceed 7x in 2011, while GAAP EBIT coverage is expected to be negative to breakeven.
Operating EBIT/Financing Charges (x)	13.2	16.6	8.6	5.5	7.5	
Statutory Interest Coverage (x)	9.7	11.0	12.9	6.6	7.0	
Operating Cash Flow	615	705	484	525	531	
Holdco Cash and Investments	2,675	2,096	1,316	1,040	1,086	

EBIT – Earnings before interest and taxes. Statutory Interest Coverage – Maximum statutory dividend divided by adjusted interest expense. Note: U.S. GAAP unless otherwise noted.

Source: Highline Data, Fitch Ratings.

## Debt Maturities

(\$ Mil., As of Sept. 30, 2011)	
2011 (Remaining)	—
2012	—
2013	—
2014	—
2015	—
2016 or Later	790

Note: GAAP.

Source: Cincinnati Financial Corporation.

## Outstanding Debt

(As of Sept. 30, 2011)	Amount (\$ Mil.)
6.9% Senior Notes due 2028	28
6.9% Senior Notes due 2028	391
6.125% Senior Notes due 2034	371
<b>Total</b>	<b>790</b>

Note: GAAP.

Source: Cincinnati Financial Corporation.

## Ample Debt Servicing Capacity and Liquidity

- Deterioration in GAAP EBIT coverage but strong statutory interest coverage.
- Financial flexibility derived from significant holding company liquidity.
- Modest use of back-up liquidity.

### ***Deterioration in GAAP EBIT Coverage but Strong Statutory Interest Coverage***

CINF's GAAP EBIT coverage remains consistent with the industry and similarly rated peers, despite declines in GAAP earnings in recent years. The company's GAAP EBIT coverage was 7.5x for 2010, compared with 7.5x for the P/C industry and 7.1x for P/C companies with senior debt rated 'BBB+'. GAAP EBIT coverage for the nine months to Sept. 30, 2011, was negative 1.2x, but given weak underwriting results and catastrophe losses for the industry, remains within rating expectations.

Fitch also notes the sizable burden of CINF's shareholder dividend, relative to GAAP earnings in recent periods. The company recently increased its dividend for the 51st consecutive year upon review of several key metrics, including holding company liquidity (see also *GAAP Capitalization and Changes in Shareholders' Equity* on page 5).

Funding for debt service and holding company obligations is primarily from operating company dividends. Operating company maximum dividend capacity (statutory interest coverage) was solid at 7.5x in 2010 and is forecast to exceed 7.0x in 2011. Statutory interest coverage should remain solid despite the weak underwriting performance of the P/C operations. Ohio is a "greater of" state (the maximum dividend is the greater of 10% of statutory surplus or 100% of statutory net income for the prior calendar year), and P/C statutory surplus has remained strong.

### ***Financial Flexibility Derived from Significant Holding Company Liquidity***

CINF has consistently maintained significant levels of cash and marketable securities at the holding company. This liquidity is available to support debt service, shareholder dividend increases, and operating company capitalization, if needed.

### ***Modest Use of Back-Up Liquidity***

Other liquidity sources include CINF's two bank lines of credit totaling \$225 million that mature in 2012. Access to these lines of credit requires compliance with various covenants, and the company was well within compliance of all covenants under the credit agreements at year-end 2010.

CINF had \$104 million under its revolving credit lines at Sept. 30, 2011. The company increased its borrowings under one line by \$55 million in the third quarter, primarily to fund share repurchases. CFC Investment Company is also a borrower under both lines of credit.

## Financial Performance and Earnings

(\$ Mil.)	2007	2008	2009	2010	9M2011	Fitch's Expectation
Total Premiums (Life and P/C)	3,250	3,136	3,054	3,082	2,367	Fitch believes mid- to high-single-digit ROEs are more representative of CINF's near-term profit capabilities, given market conditions in commercial lines and personal lines and following investment portfolio restructuring.
Net Operating Income	610	344	215	274	(18)	
Realized Gains (Losses)	245	85	217	103	50	
Net Income	855	429	432	377	32	
Net Income ROE (%)	13.4	8.5	9.7	7.7	0.9	

P/C – Property/casualty. ROE – Return on average shareholders' equity. Note: U.S. GAAP.

Source: Highline Data, Fitch Ratings.

### Profitability Expected to Continue to Deteriorate Over Near Term

- Catastrophe losses and market conditions drive P/C underwriting losses.
- Stable though modest operating earnings from life segment.

### Catastrophe Losses and Market Conditions Drive P/C Underwriting Losses

CINF has reported underwriting losses totaling \$565 million over the last 15 quarters. Even after adjusting for catastrophe losses that have been greater than the company's long-term average, Fitch expects CINF and the industry to report unfavorable underwriting performance over the near term as the P/C industry is in the soft phase of the market cycle (see table below and Appendix A for further details on underwriting results).

CINF has implemented a number of technology initiatives including the use of predictive modeling tools, initially for workers' compensation and homeowner's insurance and recently for commercial package products that are anticipated to improve underwriting expertise and loss ratios over time. CINF's expense ratio has been consistently stable. However, it remains almost five points higher than industry aggregates, similar to other regional insurers.

### Stable Though Modest Operating Earnings from Life Segment

The life segment continues to contribute stable but modest operating earnings to CINF's overall results. Universal life and level term life products are the primary contributors, though Cincinnati Life has expanded its worksite product portfolio. Profitability drivers include generally favorable mortality and persistency, as well as stable investment yield. Fitch believes the company has also effectively focused on managing expenses while growing the business.

## Profitability and Underwriting Performance

(\$ Mil.)	2007	2008	2009	2010	9M2011
P/C Net Premiums Earned	3,125	3,010	2,911	2,924	2,244
<b>P/C Net Underwriting Gain (Loss)</b>	<b>304</b>	<b>(16)</b>	<b>(128)</b>	<b>(47)</b>	<b>(374)</b>
P/C Net Investment Income	393	350	336	348	262
<b>P/C Segment Earnings</b>	<b>697</b>	<b>334</b>	<b>208</b>	<b>301</b>	<b>(112)</b>
Life Segment Earnings	59	61	55	57	39
Other	54	7	(17)	(6)	14
<b>Pretax Operating Earnings</b>	<b>810</b>	<b>402</b>	<b>246</b>	<b>352</b>	<b>(87)</b>
Loss Ratio (%)	58.6	68.3	71.7	68.9	84.6
Expense Ratio (%)	31.6	32.3	32.8	32.8	32.2
<b>CY Combined Ratio (%)</b>	<b>90.3</b>	<b>100.6</b>	<b>104.5</b>	<b>101.7</b>	<b>116.8</b>
Prior-Year Reserve Development (%)	(7.2)	(10.5)	(6.2)	(9.8)	(9.9)
Catastrophe Losses (%)	0.8	6.7	5.7	5.1	18.9
<b>AY Combined Ratio, Ex. Catastrophes</b>	<b>96.6</b>	<b>104.4</b>	<b>105.0</b>	<b>106.4</b>	<b>107.8</b>

P/C – Property/casualty. CY – Calendar year. AY – Accident year. Note: U.S. GAAP.

Source: Cincinnati Financial Corporation, Fitch Ratings.

## Investments and Asset Risk

(%)	2007	2008	2009	2010	9/30/11	Fitch's Expectation
Cash and Invested Assets (Mil.)	12,487	9,899	11,200	11,893	11,837	Fitch expects CINF to maintain equity allocation below management's tolerances and previous highs.
Fixed Income	47	59	70	70	75	
Equities	50	29	24	26	22	
Cash, Short-Term, and Other	3	12	6	4	3	
Investment Yield	4.6	4.8	4.7	4.5	4.4	

Note: U.S. GAAP.

Source: Highline Data, Fitch Ratings.

### Investment Risk Driven by Equities

- Concentrations reduced after equity portfolio rebalancing.
- Insurance reserves backed by high-quality, fixed-income portfolio.

Fitch favorably views the steps CINF has taken to rebalance its investment portfolio to reduce capital and earnings volatility. Importantly, the current investment portfolio and capitalization remain supportive of the company's ratings under stress test scenarios in which Fitch assumes credit-related losses on fixed-income securities and asset valuation losses on equities.

### Concentrations Reduced After Equity Portfolio Rebalancing

Historically, CINF employed a total return investment philosophy for common stocks that resulted in a significant concentration in a relatively small number of names, particularly in the financial services sector. In 2008, the company adopted new investment guidelines to address the overall allocation to equities, as well as security and sector concentrations.

One holding, Pepsico Inc., was CINF's single-largest holding at 4.7% of the equity portfolio and 1.1% of the investment portfolio at Sept. 30, 2011. The composition by sector was well diversified, and the financial services sector composed 11.3% of the portfolio. At Sept. 30, 2011, the equity portfolio was in a net unrealized gain position of \$477 million.

### Insurance Reserves Backed by High-Quality, Fixed-Income Portfolio

Fitch believes CINF has ample liquidity to cover its insurance reserves through its high-quality, fixed-income portfolio. The effective duration of the fixed-maturity portfolio was 5.0 years at year-end 2010, compared with the duration of P/C loss and LAE reserves of approximately 3.5 years. Fitch does not believe this duration mismatch materially affects the ability of P/C operations to meet current obligations, because operating cash flow generation remains solid.

Cincinnati Life's fixed-annuity portfolio of approximately \$800 million is duration matched within a tolerance range of 0.5 years. The company is exposed to moderate disintermediation risk, with 35% of the fixed annuity liabilities out of the surrender charged period at year-end 2010.

At Sept. 30, 2010, the fixed-maturity portfolio had an average rating of 'A', and the value of the portfolio exceeded total insurance reserves by almost 32%. Below investment-grade (BIG) and nonrated securities were 6.1% of the portfolio. At Sept. 30, 2011, the net unrealized gain for the fixed-maturity portfolio was \$675 million and the gross unrealized loss was \$18 million.

Tax-exempt securities represented 33% of the fixed-maturity portfolio at Sept. 30, 2010. CINF traditionally has purchased municipal bonds focusing on general obligation and essential services, such as sewer and water. The gross unrealized gains and gross unrealized losses on tax-exempt securities were \$190 million and \$1 million, respectively, at Sept. 30, 2011.

**Reserve Adequacy**

(\$ Mil.)	2006	2007	2008	2009	2010	Fitch's Expectation
Loss and Loss Expense Reserves	3,356	3,398	3,498	3,661	3,811	Fitch expects CINF's prior-year reserve development to remain favorable but decline somewhat going forward, adding pressure to run rate profitability.
Prior-Year Reserve Development	(109)	(212)	(290)	(155)	(260)	
Reserve Development/NPE (%)	(3.4)	(6.8)	(9.6)	(5.3)	(8.9)	
Reserve Development/P/H Surplus (%)	(2.6)	(4.5)	(6.7)	(4.6)	(7.1)	

**Reserve Position Is Relatively Strong**

- Reserves appear generally adequate.
- Consistent favorable reserve development.
- Workers' compensation reserves more exposed to potential adverse development.
- Limited asbestos and environmental (A&E) exposures.

**Reserves Appear Generally Adequate**

Fitch believes that CINF's P/C reserves are within the range of adequacy in the aggregate and that the company uses reasonable methods to estimate its reserves. Fitch estimates a modest loss reserve redundancy based on Fitch's analysis of Schedule P reserves at year-end 2010.

**Consistent Favorable Reserve Development**

Conservative reserving practices are indicated by favorable loss reserve development in each of the last 22 years. Favorable development over the last five years totaled more than \$1.0 billion across product segments and averaged 6.8% of net statutory premiums earned and 5.1% of policyholders' surplus.

**Workers' Compensation Reserves More Exposed to Potential Adverse Development**

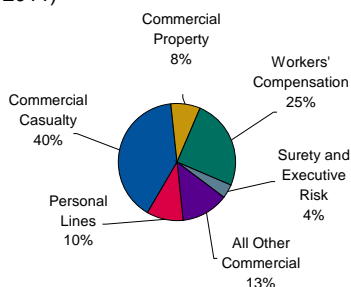
CINF's exposure to potential adverse development is primarily through its long-tail workers' compensation business. Prior-year workers' compensation reserves developed adversely in 2006 and 2009 at 2.6% and 14.7% of GAAP net earned premium (NPE), respectively. CINF undertook an extensive review of its workers' compensation business in 2009, which included underwriting and pricing actions on the worst performing policies. A number of technology initiatives, including predictive modeling, have been focused on this business and are expected to improve underwriting results over time.

Notably, CINF has reported favorable prior-year reserve development in its commercial casualty segment in each of the last years over the period 2006–2010 that averages 22.5% of NPE and was 28.7% of NPE through nine months of 2011. Fitch believes this is evidence of conservative reserving practices. CINF also reported moderating loss cost trends, notably for umbrella coverages.

**Limited A&E Exposures**

Fitch believes CINF's A&E exposures are limited. This is because the company's reinsurance retention was \$0.5 million or below prior to 1987 and CINF was predominantly a personal lines company in the 1960s and 1970s when asbestos and pollution exclusions were not widely used. A&E loss reserves totaled \$134 million at year-end 2010 or 3.5% of net loss and loss expense reserves.

**P/C Gross Loss and Loss Expense Reserves**  
(Totalled \$4.5 Bil., as of Sept. 30, 2011)



Note: GAAP.  
Source: Cincinnati Financial Corp.

## Reinsurance, Risk Mitigation, and Catastrophe Risk

(\$ Mil.)	2006	2007	2008	2009	2010	Fitch's Expectation
Net Reinsurance Recoverable	251	284	312	221	204	Fitch expects CINF's reinsurance recoverable exposure to remain modest.
Net Recoverable/PH Surplus (%)	5.3	6.6	9.3	6.0	9.5	

PH – Policyholders'. Note: Statutory accounting principles, P/C segment only.

Source: Cincinnati Insurance Group.

### Reasonable Reinsurance Protection Limits Large Losses

- Significant natural catastrophe exposures.
- 2011 reinsurance program bolstered to protect against additional events.
- Challenge of storms below retention layer continues.
- Good quality reinsurers.

### Significant Natural Catastrophe Exposures

Fitch views CINF's modeled exposure to potential losses from catastrophes as generally comparable to those of regional peer companies. On a gross basis, the company's catastrophe exposure is sizable, due to its exposure to a New Madrid earthquake or an East Coast hurricane, and reflects its concentration in Midwestern states but avoidance of California. While the company has reduced coastal exposure in catastrophe-prone states, such as Florida, recent events have revealed CINF's exposure to inland storm losses. Also, recent changes in methodology by catastrophe modeling firms have led to higher catastrophe probable maximum losses (PMLs). However, on a net basis, Fitch believes the company's exposure is manageable relative to its surplus position.

### 2011 Reinsurance Program Bolstered to Protect Against Additional Events

CINF purchases property catastrophe reinsurance with a limit up to \$500 million to protect against catastrophic events. Under the 2011 treaty, the company retained the first \$45 million of catastrophe losses and varying shares of losses up to \$500 million. CINF purchased reinsurance in the second quarter of 2011 to replenish coverage for certain layers of the property catastrophe treaty that were used up by 2011 storms, also known as 3<sup>rd</sup> and 4<sup>th</sup> Event Cover. After the revision, the company's maximum exposure to a catastrophic event that caused \$500 million in covered losses would be \$112 million after reinsurance compared with \$88 million under the earlier program. The revised 2011 program includes one full reinstatement of limits and a \$70 million retention.

### Challenge of Storms Below Retention Layer Continues

CINF's reinsurance retention of \$45 million as a percentage of policyholder surplus is lower than many of its peers. However, many of CINF's catastrophe loss events in the last several years have not reached its reinsurance retention layer and were not hurricanes. The previous record for catastrophe losses, \$203 million, was reported in 2008 and included 17 individual storm events that generated losses, net of reinsurance, exceeding \$5 million, as well as Hurricane Ike, which generated \$142 million and \$59 million in losses, gross and net of reinsurance, respectively.

Catastrophe losses of \$682 million and \$424 million gross and net of reinsurance, respectively, were recorded through nine months ended Sept. 30, 2011, and included 17 individual storm events that generated losses reaching or exceeding \$5 million. The 2011 Tuscaloosa, AL, tornado and the storm that caused tornadoes in Joplin, MO, and hail in Dayton, OH, became

CINF's largest catastrophe losses. The gross amounts for these events were \$189 million and \$238 million, respectively (\$75 million and \$92 million net of reinsurance, respectively).

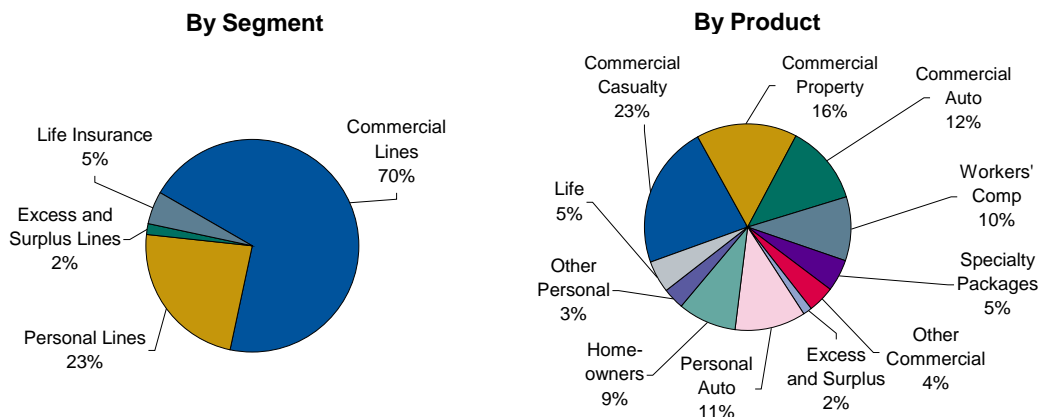
***Good Quality Reinsurers***

Fitch believes CINF's modest reinsurance recoverable exposure is manageable. The credit quality of the company's reinsurers is generally good as reinsurers are rated 'A-' or higher.

Appendix A: Additional Financial Exhibits

Net Earned Premium

(\$3.1 Bil. in 2010)



Source: Cincinnati Financial Corp.'s 2009 10-K.

Segment Operating Performance

(%)	2007	2008	2009	2010	9M2011
<b>Commercial Lines</b>					
Net Premiums Earned (\$ Mil.)	2,411	2,316	2,199	2,154	1,630
Change in Net Premiums Earned	0.4	(3.9)	(5.1)	(2.0)	1.4
Loss Ratio	57.8	64.9	68.9	66.7	78.9
Expense Ratio	31.4	32.0	32.7	32.7	33.1
<b>CY Combined Ratio</b>	<b>89.2</b>	<b>97.0</b>	<b>101.6</b>	<b>99.4</b>	<b>112.0</b>
Effect of Prior-Year Reserve Development	(8.0)	(11.7)	(6.1)	(11.9)	(11.8)
Effect of Catastrophe Losses	0.7	4.4	2.5	4.1	15.0
<b>AY Combined Ratio, Exc. Catastrophes</b>	<b>96.6</b>	<b>104.2</b>	<b>105.3</b>	<b>107.2</b>	<b>108.8</b>
<b>Personal Lines</b>					
Net Premiums Earned (\$ Mil.)	714	689	685	721	563
Change in Net Premiums Earned	(6.3)	(3.5)	(0.6)	5.3	5.2
Loss Ratio	61.3	79.4	80.4	74.5	102.7
Expense Ratio	32.6	32.5	31.4	33.3	29.8
<b>CY Combined Ratio</b>	<b>94.0</b>	<b>111.9</b>	<b>111.8</b>	<b>107.8</b>	<b>132.5</b>
Prior Year Reserve Development	(4.2)	(7.4)	(6.6)	(4.0)	(4.3)
Catastrophe Losses	1.3	14.5	16.2	8.0	31.8
<b>AY Combined Ratio, Exc. Catastrophes</b>	<b>96.9</b>	<b>104.8</b>	<b>102.2</b>	<b>103.7</b>	<b>105.0</b>

CY – Calendar year. AY – Accident year. Note: U.S. GAAP.  
Source: Cincinnati Financial Corporation, Fitch Ratings.

## Appendix B: Other Ratings Considerations

Below is a summary of additional ratings considerations of a “technical” nature, that are also part of Fitch’s ratings criteria.

### Group IFS Rating Approach

CINF’s first three rated P/C subsidiaries in the chart to the left are all “Core” and receive the group rating.

Fitch has revised the strategic category of Cincinnati Life to “Core” from “Important”, and it also receives the group rating. The change in strategic category reflects Fitch’s recognition of the high degree of operational integration between Cincinnati Life and its P/C parent, The Cincinnati Insurance Company. The life and property/casualty businesses share common management, including marketing and distribution, as well as investment and expense management. Because of the level of distribution integration, Fitch believes it would be difficult to divest the life operation and that CINF remains strategically committed to this segment.

### Notching

Per Fitch notching criteria, CINF’s country of domicile, the U.S, is a “strong” regulatory environment with restrictions on payments from the operating companies to holding company and priority afforded policyholder obligations.

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## Notching Summary

### Holding Company

Standard notching was applied between the implied operating company and holding company IDRs, with no adjustments made for unusual leverage, coverage, or diversification of cash flow.

### IFS Ratings

Due to the existence of policyholder priority, a baseline recovery assumption of “good” was applied to the IFS rating and standard notching was used.

### Debt

Senior unsecured – Notching of unsecured senior debt was based on a standard baseline recovery assumption of “below average” for a holding company issuer and standard notching was used.

IDR – Issuer default rating. IFS – Insurer financial strength.

Source: Fitch Ratings.

## Exceptions to Criteria/Ratings Limitations

None.

### Core Subsidiaries

The Cincinnati Insurance Co.

The Cincinnati Casualty Co.

The Cincinnati Indemnity Co.

The Cincinnati Life Insurance Co.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

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