

CINCINNATI FINANCIAL CORP

Form 10-Q

August 06, 2008

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q**

(Mark one)

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

For the quarterly period ended June 30, 2008.

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

For the transition period from _____ to _____.

**Commission file number 0-4604
CINCINNATI FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)**

Ohio

31-0746871

(State or other jurisdiction of incorporation or organization)

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

6200 S. Gilmore Road, Fairfield, Ohio

45014-5141

(Address of principal executive offices)

(Zip code)

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

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

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in

Rule 12b-2 of the Exchange Act. (Check one):

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 No

As of July 30, 2008, there were 162,381,212 shares of common stock outstanding.

**CINCINNATI FINANCIAL CORPORATION
FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2008
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Table of Contents**Part I Financial Information****Item 1. Financial Statements (unaudited)
Cincinnati Financial Corporation And Subsidiaries
Condensed Consolidated Balance Sheets**

(Dollars in millions except per share data)	June 30, 2008	December 31, 2007
ASSETS		
Investments		
Fixed maturities, at fair value (amortized cost: 2008 \$5,994; 2007 \$5,783) (includes securities pledged to creditors: 2008 \$520; 2007 \$745)	\$ 5,926	\$ 5,848
Equity securities, at fair value (cost: 2008 \$2,565; 2007 \$2,975)	4,453	6,249
Short-term investments, at fair value (amortized cost: 2008 \$0; 2007 \$101)	0	101
Other invested assets	81	63
Total investments	10,460	12,261
Cash and cash equivalents	333	226
Securities lending collateral invested	510	760
Investment income receivable	109	124
Finance receivable	80	92
Premiums receivable	1,150	1,107
Reinsurance receivable	777	754
Prepaid reinsurance premiums	12	13
Deferred policy acquisition costs	487	461
Land, building and equipment, net, for company use (accumulated depreciation: 2008 \$285; 2007 \$276)	234	239
Other assets	126	72
Separate accounts	533	528
Total assets	\$ 14,811	\$ 16,637
LIABILITIES		
Insurance reserves		
Loss and loss expense reserves	\$ 4,136	\$ 3,967
Life policy reserves	1,523	1,478
Unearned premiums	1,609	1,564
Securities lending payable	529	760
Other liabilities	534	574
Deferred income tax	380	977
Note payable	69	69
6.125% senior notes due 2034	371	371
6.9% senior debentures due 2028	28	28
6.92% senior debentures due 2028	392	392
Separate accounts	533	528

Total liabilities	10,104	10,708
Commitments and contingent liabilities (Note 6)		
SHAREHOLDERS' EQUITY		
Common stock, par value \$2 per share; (authorized: 2008 500 million shares, 2007 500 million shares; issued: 2008 196 million shares, 2007 196 million shares)	393	393
Paid-in capital	1,059	1,049
Retained earnings	3,298	3,404
Accumulated other comprehensive income	1,163	2,151
Treasury stock at cost (2008 34 million shares, 2007 30 million shares)	(1,206)	(1,068)
Total shareholders' equity	4,707	5,929
Total liabilities and shareholders' equity	\$ 14,811	\$ 16,637

Accompanying notes are an integral part of these statements.

Cincinnati Financial Corporation
Form 10-Q for the quarterly period ended June 30,
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Table of Contents**Cincinnati Financial Corporation And Subsidiaries
Condensed Consolidated Statements Of Income**

(In millions except per share data)	Three months ended June		Six months ended June	
	2008	30, 2007	2008	30, 2007
REVENUES				
Earned premiums				
Property casualty	\$ 761	\$ 787	\$ 1,512	\$ 1,571
Life	33	35	63	66
Investment income, net of expenses	130	150	282	298
Realized investment gains and losses	(11)	293	(244)	355
Other income	4	5	8	11
Total revenues	917	1,270	1,621	2,301
BENEFITS AND EXPENSES				
Insurance losses and policyholder benefits	595	490	1,131	974
Commissions	148	160	298	330
Other operating expenses	93	87	184	176
Taxes, licenses and fees	15	19	36	39
Increase in deferred policy acquisition costs	(11)	(7)	(17)	(23)
Interest expense	13	13	25	26
Total benefits and expenses	853	762	1,657	1,522
INCOME (LOSS) BEFORE INCOME TAXES	64	508	(36)	779
PROVISION (BENEFIT) FOR INCOME TAXES				
Current	(16)	156	6	233
Deferred	17	1	(63)	1
Total provision (benefit) for income taxes	1	157	(57)	234
NET INCOME	\$ 63	\$ 351	\$ 21	\$ 545
PER COMMON SHARE				
Net income basic	\$ 0.38	\$ 2.04	\$ 0.13	\$ 3.16
Net income diluted	0.38	2.02	0.13	3.13

Accompanying notes are an integral part of this statement.

Cincinnati Financial Corporation

Table of Contents**Cincinnati Financial Corporation And Subsidiaries
Condensed Consolidated Statements Of Shareholders Equity**

(In millions)	Six months ended June 30,	
	2008	2007
COMMON STOCK		
Beginning of year	\$ 393	\$ 391
Stock options exercised	0	1
End of period	393	392
PAID-IN CAPITAL		
Beginning of year	1,049	1,015
Stock options exercised	3	10
Share-based compensation	6	8
Other	1	2
End of period	1,059	1,035
RETAINED EARNINGS		
Beginning of year	3,404	2,786
Cumulative effect of change in accounting for hybrid financial securities	0	5
Cumulative effect of change in accounting for uncertain tax positions	0	(1)
Adjusted beginning of year	3,404	2,790
Net income	21	545
Dividends declared	(127)	(122)
End of period	3,298	3,213
ACCUMULATED OTHER COMPREHENSIVE INCOME		
Beginning of year	2,151	3,379
Cumulative effect of change in accounting for hybrid financial securities	0	(5)
Adjusted beginning of year	2,151	3,374
Other comprehensive income (loss), net	(988)	(361)
End of period	1,163	3,013
TREASURY STOCK		
Beginning of year	(1,068)	(763)
Purchases	(139)	(64)
Reissued	1	0

End of period	(1,206)	(827)
Total shareholders' equity	\$ 4,707	\$ 6,826
COMMON STOCK - NUMBER OF SHARES OUTSTANDING		
Beginning of year	166	173
Purchase of treasury shares	(4)	(1)
End of period	162	172
COMPREHENSIVE INCOME (LOSS)		
Net income	\$ 21	\$ 545
Unrealized investment gains and losses during the period	(1,523)	(561)
Other	0	4
Taxes on other comprehensive income	535	196
Total comprehensive income (loss)	\$ (967)	\$ 184

Accompanying notes are an integral part of this statement.

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Condensed Consolidated Statements Of Cash Flows**

(In millions)	Six months ended June 30,	
	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 21	\$ 545
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and other non-cash items	19	16
Realized investment losses (gains)	244	(355)
Share-based compensation	6	8
Interest credited to contract holders	18	16
Changes in:		
Investment income receivable	15	(3)
Premiums and reinsurance receivable	(66)	(156)
Deferred policy acquisition costs	(17)	(23)
Other assets	0	(8)
Loss and loss expense reserves	169	57
Life policy reserves	43	47
Unearned premiums	45	83
Other liabilities	(51)	19
Deferred income tax	(63)	1
Current income tax	(49)	88
Net cash provided by operating activities	334	335
CASH FLOWS FROM INVESTING ACTIVITIES		
Sale of fixed maturities	72	103
Call or maturity of fixed maturities	829	193
Sale of equity securities	438	565
Collection of finance receivables	19	20
Purchase of fixed maturities	(1,126)	(492)
Purchase of equity securities	(245)	(550)
Change in short-term investments, net	101	(5)
Investment in buildings and equipment, net	(20)	(34)
Investment in finance receivables	(7)	(12)
Change in other invested assets, net	(8)	(3)
Change in securities lending collateral invested	231	(976)
Net cash provided by (used in) investing activities	284	(1,191)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payment of cash dividends to shareholders	(123)	(119)
Purchase of treasury shares	(139)	(64)
Proceeds from stock options exercised	3	11
Contract holder funds deposited	9	11
Contract holder funds withdrawn	(29)	(37)
Change in securities lending payable	(231)	976

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Other	(1)	(2)
Net cash provided by (used in) financing activities	(511)	776
Net increase (decrease) in cash and cash equivalents	107	(80)
Cash and cash equivalents at beginning of year	226	202
Cash and cash equivalents at end of period	\$ 333	\$ 122
Supplemental disclosures of cash flow information:		
Interest paid (net of capitalized interest: 2008 \$3; 2007 \$2)	\$ 25	\$ 26
Income taxes paid	55	143
Non-cash activities:		
Conversion of securities	\$ 3	\$ 17
Equipment acquired under capital lease obligations	1	0
Accompanying notes are an integral part of these statements.		

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

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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, 2007, consolidated balance sheet amounts are derived from the audited financial statements but do not include all disclosures required by accounting principles generally accepted in the United States of America.

Our June 30, 2008, 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 2007 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.

Recent Accounting Pronouncements**SFAS No. 157, Fair Value Measurements**

In February 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. 157-2, Fair Value Measurement. FSP No. 157-2 is an amendment of Statements of Financial Accounting Standard (SFAS) No. 157, issued in September 2006. SFAS No. 157 defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs used to measure fair value and enhances disclosure about fair value measurements.

SFAS No. 157 was effective for fiscal years beginning after November 15, 2007, with early adoption permitted provided that the entity has not yet issued financial statements for that fiscal year, including any interim periods. The provisions of SFAS No. 157 are to be applied prospectively, except that provisions related to block discounts and existing derivative financial instruments measured under EITF 02-3 are to be applied as a one-time cumulative effect adjustment to opening retained earnings in the year of adoption.

We partially adopted SFAS No. 157 in the first quarter of 2008. We elected to defer SFAS No. 157, Fair Value Measurements, for nonfinancial assets and nonfinancial liabilities until January 1, 2009, as permitted under FSP No. 157-2. We did not have a cumulative-effect adjustment to beginning retained earnings as a result of the adoption of SFAS No. 157.

SFAS No. 159, Fair Value Option for Financial Assets and Financial Liabilities including an amendment of SFAS No. 115

In February 2007, the FASB issued SFAS No. 159, Fair Value Option for Financial Assets and Financial Liabilities including an amendment of SFAS No. 115. SFAS No. 159 permits an entity to choose to measure many financial instruments and certain other items at fair value (on an instrument-by-instrument basis) at specified election dates. The objective is to improve financial reporting by providing an entity with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. We have not elected to value any assets or liabilities (not otherwise measured at fair value) under SFAS No. 159. We continue to evaluate the impact of adopting SFAS No. 159 in the future.

SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of SFAS No. 133

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of SFAS No. 133. SFAS No. 161 requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. SFAS No. 161 also requires cross-referencing within the footnotes to assist the users of financial statements in identifying significant information about derivative instruments. The effective date of SFAS No. 161 is the company's fiscal year beginning January 1, 2009. Management has not yet

completed an assessment of the impact of SFAS No. 161.

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Fifth Third Bancorp sale On July 22, 2008, Cincinnati Financial Corporation diversified its equity portfolio by reducing its stake in Fifth Third Bancorp (NASDAQ:FITB) through a block sale of common stock held by The Cincinnati Insurance Company, a wholly owned subsidiary of Cincinnati Financial Corporation. The Cincinnati Insurance Company entered into an arrangement with Lehman Brothers Inc., in which The Cincinnati Insurance Company agreed to sell, and Lehman Brothers, Inc. agreed to buy the block of 35 million shares of Fifth Third common stock at a price of \$13.75875 per share, for total proceeds of \$482 million, which will be reduced by capital gains taxes of \$121 million. The net after tax gain of approximately \$225 million, or about \$1.35 per share, will be included in third-quarter 2008 net income.

As a condition of the sale, Cincinnati Financial, and its subsidiaries and affiliates agreed not to sell additional shares of Fifth Third for 45 days. On June 30, 2008, the market price of Fifth Third was \$10.18 per share.

NOTE 2 Investments

Fixed maturities (bonds and redeemable preferred stocks), equity securities (common and non-redeemable preferred stocks) and short-term investments have been classified as available for sale and are stated at fair values at June 30, 2008, and December 31, 2007.

At June 30, 2008, unrealized investment gains before taxes totaled \$2.034 billion and unrealized investment losses in the investment portfolio amounted to \$214 million. The unrealized gains largely were due to long term gains from our holdings of Fifth Third common stock, which contributed 24.6 percent of those gains, and from our other common stock holdings, including Exxon Mobil Corporation (NYSE:XOM), PNC Financial Services Group, Inc. (NYSE:PNC), The Procter & Gamble Company (NYSE:PG) and Wyeth (NYSE:WYE), which each contributed more than 5 percent of those gains.

The change in unrealized gains and losses on investments, net of taxes, described in the following table, is included in other comprehensive income and shareholders' equity. During the three and six months ended June 30, 2008, we recognized \$3 million and \$6 million in realized investment losses related to current period changes in valuation of our hybrid securities. At June 30, 2008, we had \$128 million of hybrid securities included in fixed maturities that now are accounted for under SFAS No. 155.

The change in fixed maturities unrealized gains and losses for the three and six months ended June 30, 2008 and 2007, was due primarily to interest-rate driven fair value fluctuations in the fixed maturity portfolio.

Equity securities unrealized gains declined for the three and six months ended June 30, 2008, primarily because of equity security market value fluctuations. Equity securities unrealized gains declined for the three and six months ended June 30, 2007, primarily because of the sale of common stock holdings.

(In millions)	Three months ended June		Six months ended June	
	2008	30, 2007	2008	30, 2007
Change in unrealized investment gains and losses and other summary:				
Fixed maturities	\$ (109)	\$ (100)	\$ (134)	\$ (90)
Equity securities	(992)	(178)	(1,385)	(471)
Adjustment to deferred acquisition costs and life policy reserves	5	3	6	2
Pension obligations	0	1	1	1
Other	(8)	(4)	(10)	1
Income taxes on above	387	98	534	196
Total	\$ (717)	\$ (180)	\$ (988)	\$ (361)

Realized gains and losses on investments are recognized in net income on a specific identification basis. See our 2007 Annual Report on Form 10-K, Item 1, Investments Segment, Page 15, for additional discussion of the investment portfolio. Other-than-temporary declines in the fair value of investments are recognized in net income as realized investment losses at the time when facts and circumstances indicate such write-downs are warranted.

Securities Lending Program

In 2006, we began actively participating in a securities lending program under which certain fixed-maturity securities from our investment portfolio are loaned to other institutions for short periods of time. We require cash collateral in excess of the market value of the loaned securities. The collateral received is invested in accordance with our guidelines in high-quality, short-duration instruments to generate additional investment income. The market value of the loaned securities is monitored on a daily basis and additional collateral is added or refunded as the market value of the loaned securities changes. As this program is accounted for as a secured borrowing, the collateral is recognized as an asset, and classified as securities lending collateral invested, with a corresponding liability for the obligation to return the collateral.

We maintain the right and ability to redeem the securities loaned on short notice and continue to earn interest on the collateral securities. Although the securities loaned have been pledged and effectively secure the cash

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collateral we receive, we maintain effective control over our securities, which we continue to classify as invested assets on our consolidated balance sheets. At June 30, 2008, we had \$520 million in securities on loan. Interest income on collateral, net of fees, was \$391,000 and \$769,000 for the three and six months ended June 30, 2008, compared with \$301,000 and \$543,000 for the three and six months ended June 30, 2007.

While the majority of the collateral held in the securities lending program currently resides in overnight funds, approximately \$69 million is invested in collateralized mortgage obligations, which had an approximate market value of \$50 million at June 30, 2008. In addition to the \$16 million written down in the first quarter of 2008, these CMOs were written down by \$3 million in the second quarter of 2008. The write downs were in conjunction with the dissolution of a short-term fund. We continue to examine our options in regard to these securities and to a broader extent our participation in the securities lending market.

NOTE 3 Reinsurance

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

(In millions)	Three months ended June		Six months ended June	
	2008	2007	2008	2007
Direct earned premiums	\$ 800	\$ 825	\$ 1,591	\$ 1,646
Assumed earned premiums	3	5	5	11
Ceded earned premiums	(42)	(43)	(84)	(86)
Net earned premiums	\$ 761	\$ 787	\$ 1,512	\$ 1,571

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

(In millions)	Three months ended June		Six months ended June	
	2008	2007	2008	2007
Direct incurred loss and loss expenses	\$ 594	\$ 501	\$ 1,119	\$ 978
Assumed incurred loss and loss expenses	1	2	0	4
Ceded incurred loss and loss expenses	(37)	(48)	(60)	(69)
Net incurred loss and loss expenses	\$ 558	\$ 455	\$ 1,059	\$ 913

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

(In millions)	Three months ended June		Six months ended June	
	2008	2007	2008	2007
Direct earned premiums	\$ 46	\$ 45	\$ 88	\$ 86
Assumed earned premiums	0	0	0	0
Ceded earned premiums	(13)	(10)	(25)	(20)
Net earned premiums	\$ 33	\$ 35	\$ 63	\$ 66

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Our statements of income include life insurance contract holder benefits incurred on assumed and ceded business:

(In millions)	Three months ended June		Six months ended June	
	2008	30, 2007	2008	30, 2007
Direct contract holders benefits incurred	\$ 54	\$ 44	\$ 94	\$ 82
Assumed contract holders benefits incurred	0	0	0	0
Ceded contract holders benefits incurred	(16)	(10)	(20)	(20)
Net contract holders benefits incurred	\$ 38	\$ 34	\$ 74	\$ 62

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The measurement date for our pension plans is December 31. The following summarizes the components of net periodic costs for our qualified and supplemental pension plans:

(In millions)	Three months ended June		Six months ended June	
	2008	30, 2007	2008	30, 2007
Service cost	\$ 4	\$ 4	\$ 8	\$ 8
Interest cost	5	4	9	8
Expected return on plan assets	(4)	(4)	(8)	(7)
Amortization of actuarial loss (gain), prior service cost and transition asset	0	1	1	1
Net periodic benefit cost	\$ 5	\$ 5	\$ 10	\$ 10

Effective June 30, 2008, we froze entry into the qualified pension plan. Current participants in the plan who are 40 years of age or older on August 31, 2008, may choose to continue to participate in the plan or to participate in our company sponsored 401(k) plan. Current participants who are under 40 years of age on August 31, 2008, and new associates will participate in our 401(k) plan. Except for those participants over the age of 40 who elect to remain in the plan, we intend to freeze benefit accruals under the plan effective August 31, 2008. Participants of any age who leave the plan may receive a distribution of their accrued pension benefit, which they may elect to receive or to rollover to tax qualified plans such as our 401(k) plan.

We made no contribution to the pension plans in the second quarter of 2008. We continue to anticipate contributing \$10 million during the third quarter of 2008 to our qualified pension plan as indicated in our 2007 Annual Report on Form 10-K. Future funding requirements may be affected by reduced participation in the pension plan, which will not be measurable until September 2008.

NOTE 5 Equity Compensation Plans

We currently have five equity compensation plans that together permit us to grant incentive stock options, non-qualified stock options, restricted stock, restricted stock units, stock appreciation rights and other stock-based awards. The Cincinnati Financial Corporation 2006 Stock Compensation Plan also gives us the flexibility to make grants to associates of any type of stock-based awards subject to performance-based criteria to directly link compensation to performance. We currently grant incentive stock options, non-qualified stock options, service-based restricted stock units and performance-based restricted stock units under our plans. One of our equity compensation plans permits us to grant common stock to our outside directors as discussed in our 2008 Proxy Statement.

A total of 22,237,750 shares are authorized to be granted under the shareholder-approved plans. At June 30, 2008, 9,068,151 shares were available for future issuance under the plans. We currently issue new shares for option exercises.

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

(In millions)	Three months ended June		Six months ended June	
	2008	30, 2007	2008	30, 2007
Share-based compensation cost	\$ 2	\$ 3	\$ 6	\$ 8
Income tax benefit	1	1	2	2
Share-based compensation cost after tax	\$ 1	\$ 2	\$ 4	\$ 6

Stock Options

Stock options are granted to associates at an exercise price that is not less than fair market value on the date of grant and are exercisable over 10 year periods. The stock options generally vest ratably over a three-year period. In determining the share-based compensation amounts for 2008, the fair value of each option granted in 2008 was estimated on the date of grant using the binomial option-pricing model with the following weighted average assumptions used for grants in 2008:

	Six months ended June 30,	
	2008	2007
Weighted average expected term	7-8 years	5-7 years
Expected volatility	20.58- 24.67%	18.29 - 24.14%
Dividend yield	3.99-4.15%	3.33%
Risk-free rates	3.29-3.66%	4.8-4.81%

As of June 30, 2008, there was \$18 million of unrecognized compensation cost related to non-vested awards that is expected to be recognized over a weighted-average period of two years.

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Here is a summary of option information:

(Shares in thousands)	Shares	Weighted-average exercise price	Aggregate intrinsic value
2008			
Outstanding at beginning of year	10,480	\$36.86	
Granted	767	38.79	
Exercised	(113)	31.44	
Forfeited	(667)	39.72	
Outstanding at end of period	10,467	36.88	\$ 0
Options exercisable at end of period	8,912	\$35.99	\$ 0
Weighted-average fair value of options granted during the period		7.44	
(Shares in thousands)	Options outstanding Weighted-average contractual life	Weighted-average exercise price	Options exercisable Weighted-average exercise price
Range of exercise prices	Shares	price	Shares
\$25.00 to \$29.99	817	1.58 yrs	\$ 26.97
\$30.00 to \$34.99	4,170	2.78 yrs	32.73
\$35.00 to \$39.99	2,263	6.44 yrs	38.53
\$40.00 to \$44.99	1,933	7.11 yrs	42.55
\$45.00 to \$49.99	1,284	7.54 yrs	45.26
Total	10,467	4.86 yrs	36.88
			8,912
			35.99

Restricted Stock Units

Service-based and performance-based restricted stock units are granted to associates at fair market value on the date of grant. Service-based restricted stock units cliff vest at the end of three years, while performance-based restricted stock units vest on the first day of March after a three-calendar year performance period, if certain performance targets are attained. As of June 30, 2008, management assumed for accounting purposes that performance targets used for the restricted stock unit awards would not be met. Share based compensation was decreased by \$1 million at June 30, 2008, due to the reversal of a portion of the performance-based restricted stock units.

The fair value of the restricted stock unit awards was determined based on the fair value on the date of grant less the present value of the dividends that holders of restricted stock units will not receive on the shares underlying the restricted stock units during the vesting period.

Here is a summary of restricted stock unit information:

Service - based	Weighted-average grant-	Performance-based	Weighted-average grant-
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(Shares in thousands)	nonvested shares	date fair value	nonvested shares	date fair value
Nonvested at January 1, 2008	162	\$ 40.74	35	\$ 40.74
Granted	227	34.70	44	33.21
Vested	(1)	37.86	0	0.00
Forfeited	(5)	37.63	0	0.00
Nonvested at June 30, 2008	383	37.20	79	36.52

NOTE 6 Commitments And Contingent Liabilities

Legal issues are part of the normal course of business for all companies. As such, we have various litigation and claims against us in process and pending. Having analyzed those claims with our legal counsel, we believe the outcomes of normal insurance matters will not have a material effect on our consolidated financial position, results of operations or cash flows. We further believe that the outcomes of non-insurance matters will be covered by insurance coverage or will not have a material effect on our consolidated financial position, results of operations or cash flows.

NOTE 7 Income Taxes

On January 1, 2007, we adopted the provisions of FIN 48. As of December 31, 2007, we had a gross unrecognized tax benefit (FIN 48 liability) of \$14.2 million. Details about our FIN 48 liability are found in our 2007 Annual Report on Form 10-K, Item 8, Note 10 of the Consolidated Financial Statements, Page 98.

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As of June 30, 2008, our unrecognized tax benefits as a result of tax positions taken during prior years increased \$2.9 million and our unrecognized tax benefits as a result of tax positions taken in the current year increased \$2.1 million for a total unrecognized tax benefit (FIN 48 liability) of \$19.2 million. In May 2008, the IRS presented us with preliminary adjustments related to the valuation of our loss reserves for tax years 2005 and 2006. Upon evaluation of the IRS preliminary adjustments, management refined certain assumptions used to calculate the unrecognized tax benefit associated with this issue, resulting in a revised measurement of the unrecognized tax benefit for both current and prior years. During the three and six months ended June 30, 2008, there have been no changes to any assumptions about the amount of our FIN 48 liability that may be settled with the IRS in the next 12 months related to tax years 2002 to 2006.

NOTE 8 SFAS No. 157, Fair Value Measurements

We adopted SFAS No. 157 in the first quarter of 2008. Our investment portfolio will be subject to SFAS No. 157 disclosure for interim reporting. Our year-end 2008 reporting will include disclosure for the investment portfolio as well as the fair value measurement framework for all SFAS No. 107 disclosures.

Fair Value Hierarchy

In accordance with SFAS No. 157, we categorized our financial instruments, based on the priority of the observable and market-based data for valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices with readily available independent data in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable market inputs (Level 3).

When various inputs for measurement fall within different levels of the fair value hierarchy, the lowest observable input that has a significant impact on fair value measurement is used.

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

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

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

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

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

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

The following table illustrates the fair value hierarchy for those assets measured at fair value on a recurring basis as of June 30, 2008. We do not have any material liabilities carried at fair value.

Asset fair value measurements at reporting date using		
Quoted	Significant	Significant
prices	other	

(In millions)	in active markets for identical assets (Level 1)	observable inputs (Level 2)	unobservable inputs (Level 3)	Total
Available for sale securities:				
Taxable fixed maturities	\$ 476	\$ 2,784	\$ 57	\$ 3,317
Taxable fixed maturities separate accounts	29	479	3	511
Tax-exempt fixed maturities	0	2,604	5	2,609
Common equities	4,068	0	63	4,131
Preferred equities	0	275	47	322
Top hat plan	5	1	0	6
CMO s Securities lending collateral	0	50	0	50
Total	\$ 4,578	\$ 6,193	\$ 175	\$ 10,946

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Each financial instrument that was deemed to have significant unobservable inputs when determining valuation is identified in the table below by security type with a summary of changes in fair value for the three months ended June 30, 2008.

(In millions)	Asset fair value measurements using significant unobservable inputs (Level 3)					
	Taxable fixed maturities	Taxable fixed maturities- separate accounts	Tax- exempt fixed maturities	Common equities	Preferred equities	Total
Beginning balance, March 31, 2008	\$ 54	\$ 3	\$ 5	\$ 59	\$ 60	\$ 181
Total gains or losses (realized/unrealized):						
Included in earnings (or changes in net assets)	0	0	0	0	0	0
Included in other comprehensive income	(2)	0	0	4	(4)	(2)
Purchases, sales, issuances, and settlements	4	0	0	0	0	4
Transfers in and/or out of Level 3	1	0	0	0	(9)	(8)
Ending balance, June 30, 2008	\$ 57	\$ 3	\$ 5	\$ 63	\$ 47	\$ 175

The amount of total gains or losses for the period included in realized investment gains and losses attributable to the change in unrealized gains or losses relating to assets still held at the reporting date

\$ (2)	\$ 0	\$ 0	\$ 4	\$ (4)	\$ (2)
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Level 3 taxable fixed-maturity securities increased primarily because of purchases and the transfer of a security from Level 2 hierarchy to Level 3 hierarchy. The transfer was the result of the use of observable inputs at March 31, 2008, compared with unobservable inputs at June 30, 2008. In addition, a \$9 million private equity investment has been recorded as an other invested asset at June 30, 2008. At March 31, 2008, that investment was included in preferred equities. The amount was transferred out of the preferred equities column on the Level 3 Reconciliation Table. Below is a summary of changes in fair value for the six months ended June 30, 2008.

(In millions)	Asset fair value measurements using significant unobservable inputs (Level 3)					
	Taxable fixed maturities	Taxable fixed maturities- separate accounts	Tax- exempt fixed maturities	Common equities	Preferred equities	Total

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Beginning balance, January 1, 2008	\$ 85	\$ 3	\$ 5	\$ 59	\$ 58	\$ 210
Total gains or losses (realized/unrealized):						
Included in earnings (or changes in net assets)	0	0	0	0	(6)	(6)
Included in other comprehensive income	(4)	0	0	4	(1)	(1)
Purchases, sales, issuances, and settlements	(11)	0	0	0	5	(6)
Transfers in and/or out of Level 3	(13)	0	0	0	(9)	(22)
Ending balance, June 30, 2008	\$ 57	\$ 3	\$ 5	\$ 63	\$ 47	\$ 175

The amount of total gains or losses for the period included in realized investment gains and losses attributable to the change in unrealized gains or losses relating to assets still held at the reporting date

	\$ (4)	\$ 0	\$ 0	\$ 4	\$ (7)	\$ (7)
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NOTE 9 Segment Information

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

Commercial lines property casualty insurance

Personal lines property casualty insurance

Life insurance

Investment operations

We report as **Other** the non-investment operations of the parent company and its subsidiaries CFC Investment Company and CinFin Capital Management Company (excluding client investment activities), as

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well as other income of our insurance subsidiary. Beginning in the first quarter of 2008, we also are including results of The Cincinnati Specialty Underwriters Insurance Company and CSU Producer Resources Inc. in Other. See our 2007 Annual Report on Form 10-K, Item 8, Note 17, Segment Information, Page 105, for a description of revenue, income or loss before income taxes and identifiable assets for each segment. Segment information is summarized in the following table:

(In millions)	Three months ended June		Six months ended June	
	2008	30, 2007	2008	30, 2007
Revenues:				
Commercial lines insurance				
Commercial casualty	\$ 194	\$ 209	\$ 384	\$ 418
Commercial property	123	125	244	248
Commercial auto	104	110	205	223
Workers compensation	94	95	189	187
Specialty packages	36	37	72	73
Surety and executive risk	28	24	53	47
Machinery and equipment	7	7	14	14
Total commercial lines insurance	586	607	1,161	1,210
Personal lines insurance				
Personal auto	82	86	164	174
Homeowner	71	72	143	143
Other personal lines	21	22	44	44
Total personal lines insurance	174	180	351	361
Life insurance	34	36	64	68
Investment operations	119	443	38	653
Other	4	4	7	9
Total	\$ 917	\$ 1,270	\$ 1,621	\$ 2,301
Income (loss) before income taxes:				
Insurance underwriting results:				
Commercial lines insurance	\$ 1	\$ 90	\$ 30	\$ 157
Personal lines insurance	(27)	0	(45)	14
Life insurance	2	0	0	5
Investment operations	103	429	7	625
Other	(15)	(11)	(28)	(22)
Total	\$ 64	\$ 508	\$ (36)	\$ 779
Identifiable assets:				

	June 30, 2008	December 31, 2007
Property casualty insurance	\$ 2,288	\$ 2,281
Life insurance	983	938
Investment operations	10,489	12,322
Other	1,051	1,096
Total	\$ 14,811	\$ 16,637

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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 2007 Annual Report on Form 10-K. Unless otherwise noted, the industry data is prepared by A.M. Best Co., a leading insurance industry statistical, analytical and financial strength rating organization. Information from A.M. Best is presented on a statutory basis. When we provide our results on a comparable statutory basis, we label it as such; all other company data is presented in accordance with accounting principles generally accepted in the United States of America (GAAP).

We present per share data on a diluted basis unless otherwise noted, adjusting those amounts for all stock splits and dividends. Dollar amounts are rounded to millions; calculations of percent changes are based on whole dollar amounts or dollar amounts rounded to the nearest thousand. 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 2007 Annual Report on Form 10-K, Item 1A, Risk Factors, Page 21. Although we often review and update our forward-looking statements when events warrant, we caution our readers that we undertake no obligation to do so.

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

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

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

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

Further decline in overall stock market values negatively affecting the company's equity portfolio and book value; in particular further declines in the market value of financial sector stocks, including Fifth Third Bancorp (NASDAQ:FITB)

Securities laws that could limit the manner, timing and volume of our investment transactions

Events, such as the credit crisis triggered by subprime mortgage lending practices, that lead to:

- o Significant decline in the value of a particular security or group of securities, such as our financial sector holdings, and impairment of the asset(s)
 - o Significant decline in investment income due to reduced or eliminated dividend payouts from a particular security or group of securities
 - o Significant rise in losses from surety and director and officer policies written for financial institutions
- Recession or other economic conditions or regulatory, accounting or tax changes resulting in lower demand for insurance products

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

Inaccurate estimates or assumptions used for critical accounting estimates

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

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

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

Ability 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

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

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

Personal lines pricing and loss trends that lead management to conclude that this segment could not attain sustainable profitability, which could prevent the capitalization of policy acquisition costs

Actions of insurance departments, state attorneys general or other regulatory agencies that:

- o Restrict our ability to exit or reduce writings of unprofitable coverages or lines of business
 - o Place the insurance industry under greater regulatory scrutiny or result in new statutes, rules and regulations
 - o Increase our expenses
 - o 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
 - o Limit our ability to set fair, adequate and reasonable rates
 - o Place us at a disadvantage in the marketplace or
 - o Restrict our ability to execute our business model, including the way we compensate agents
- Adverse outcomes from litigation or administrative proceedings

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

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

Events, such as an epidemic, natural catastrophe, terrorism or construction delays, 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 recent measures affecting corporate financial reporting and governance. The ultimate changes and eventual effects, if any, of these initiatives are uncertain.

Introduction

Corporate Financial Highlights
Income Statement and Per Share Data

(Dollars in millions except share data) 	Three months ended June 30,			Six months ended June 30,		
	2008	2007	Change %	2008	2007	Change %
Income statement data						
Earned premiums	\$ 794	\$ 822	(3.3)	\$ 1,575	\$ 1,637	(3.8)
Investment income, net of expenses	130	150	(13.4)	282	298	(5.5)
Realized investment gains and losses (pretax)	(11)	293	(103.8)	(244)	355	(168.8)
Total revenues	917	1,270	(27.8)	1,621	2,301	(29.6)
Net income	63	351	(82.0)	21	545	(96.2)
Per share data (diluted)						
Net income	0.38	2.02	(81.2)	0.13	3.13	(95.8)
Cash dividends declared	0.39	0.355	9.9	0.78	0.71	9.9
Weighted average shares outstanding	165,044,463	173,423,572	(4.8)	164,601,462	173,871,612	(5.3)

Revenues for the three and six months ended June 30, 2008, declined significantly from the year-ago periods, largely because of unfavorable comparisons between realized investment gains in 2007 and realized investment losses in 2008. Another component of revenues - earned premiums - was lower for the three and six months, but generally was in line with expectations described in our 2007 Annual Report on Form 10-K. The third component of revenues investment income was below our original projections for the three and

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six months, primarily because of a \$20 million reduction in second-quarter dividend income from our Fifth Third Bancorp common stock holding. Fifth Third announced a 66 percent reduction in its quarterly cash dividend on June 18, 2008. Along with significantly higher catastrophe losses, as discussed below, these factors led to significantly lower **net income** for the three and six months ended June 30, 2008.

Realized investment gains and losses are recognized on the sales of investments or as otherwise required by GAAP, including non-cash charges to lower the carrying value of securities. We have substantial discretion in the timing of investment sales, and that timing generally is independent of the insurance underwriting process. GAAP accounting standards also require us to recognize in income the gains or losses from certain changes in market (fair) values of securities without actual realization of those gains or losses.

During the three months ended June 30, 2008, we repurchased 821,003 shares of our common stock at a cost of \$29 million, bringing year-to-date repurchases to 3.8 million at a cost of \$139 million. Largely as a result of repurchases, average weighted shares outstanding declined 4.8 percent compared with a year ago.

The board of directors is committed to steadily increasing cash dividends and periodically authorizing stock dividends and splits. Cash dividends declared per share rose 9.9 percent in the three months and six months ended June 30, 2008.

Balance Sheet Data and Performance Measures

(Dollars in millions except share data)	At June 30, 2008	At December 31, 2007		
Balance sheet data				
Invested assets	\$10,460	\$ 12,261		
Total assets	14,811	16,637		
Short-term debt	69	69		
Long-term debt	791	791		
Shareholders' equity	4,707	5,929		
Book value per share	28.99	35.70		
Debt-to-capital ratio	15.4%	12.7%		
	Three months ended June			
	30,	Six months ended June 30,		
	2008	2008		
	2007	2007		
Performance measures				
Comprehensive income (loss)	\$ (653)	\$ 171	\$ (967)	\$ 184
Return on equity, annualized	5.0%	20.7%	0.8%	16.0%
Return on equity, annualized, based on comprehensive income (loss)	(51.5)	9.8	(36.4)	5.3

Invested assets, total assets and shareholders' equity were less than year-end 2007 primarily because of continued declines in the market value of our equity portfolio. As a result, our total debt-to-capital ratio (total debt plus shareholders' equity) rose.

Comprehensive income is net income plus the year-over-year change in accumulated other comprehensive income. In the three and six months ended June 30, 2008, we recorded a comprehensive loss because of continued market value declines for holdings in the investment portfolio. In the three and six months ended June 30, 2007, we recorded comprehensive net income as net income offset unrealized losses in the investment portfolio.

Consolidated Property Casualty Insurance Highlights

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2008	2007	Change %	2008	2007	Change %
Consolidated property casualty highlights						
Written premiums	\$ 790	\$ 810	(2.5)	\$1,566	\$1,656	(5.4)
Earned premiums	761	787	(3.3)	1,512	1,571	(3.8)
Underwriting profit	(27)	90	(129.7)	(16)	171	(109.5)
GAAP combined ratio	103.5%	88.6%		101.1%	89.1%	
Statutory combined ratio	101.5	87.7		99.4	87.7	

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

The trends in **written and earned premiums** reflect the heightened competition as well as the competitive strategies we discussed in our 2007 Annual Report on Form 10-K, Item 1, Commercial Lines and Personal Lines Property Casualty Insurance Segments, Page 14 and Page 16. Growth in new commercial and personal lines business written directly by agencies rebounded in the second quarter. New business was \$175 million in the first six months of 2008 compared with \$161 million in the first six months of 2007.

New business levels reflected market conditions for commercial and personal lines as well as the advantages of our agency relationship strategy. Our new excess and surplus lines business did not materially influence

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consolidated premiums in the first six months of 2008, contributing \$4 million in net written premiums and \$1 million in net earned premiums.

Our consolidated property casualty insurance **underwriting profit** declined substantially for the three and six months ended June 30, 2008. While premium levels, competitive market conditions, higher savings from favorable development of prior period reserves, lower commission expense and higher other underwriting expenses influenced results, the most significant factor was an atypically high level of catastrophe losses as discussed below.

Our **combined ratio** reflected the factors influencing underwriting profit. (The combined ratio is the percentage of each premium dollar incurred for losses plus all expenses – the lower the ratio, the better the performance. An underwriting profit results when the combined ratio is under 100 percent. A combined ratio above 100 percent indicates that a carrier's losses and expenses are greater than premiums.)

Savings from favorable development on prior period reserves improved the combined ratio by 11.4 and 6.6 percentage points in the three and six months ended June 30, 2008 compared with 5.6 and 4.8 percentage points in the same three and six months of 2007. These amounts include development on prior period catastrophe loss reserves as discussed below.

Catastrophe losses contributed 14.9 and 10.3 percentage points to the combined ratio in the three and six months ended June 30, 2008, compared with an unusually low 1.4 and 0.9 percentage points in the same three and six months of 2007. Catastrophe losses in the first six months of 2008 included \$4 million of savings from favorable development on 2007 and prior catastrophe loss reserves compared with \$17 million of savings in the first six months of 2007 from favorable development on 2006 and prior catastrophe loss reserves.

The following table shows catastrophe losses incurred, net of reinsurance, as well as the effect of loss development on prior period catastrophe events. We individually list catastrophe events for which incurred losses exceed \$5 million.

(In millions, net of reinsurance) Dates	Cause of loss	Region	Three months ended June 30,			Six months ended June 30,		
			Commercial lines	Personal lines	Total	Commercial lines	Personal lines	Total
2008								
Jan. 4-9	Wind, hail, flood, freezing	South, Midwest	\$ 0	\$ 0	\$ 0	\$ 3	\$ 3	\$ 6
Jan. 29-30	Wind, hail	Midwest	0	0	0	6	4	10
Feb. 5-6	Wind, hail, flood	Midwest	(2)	(1)	(3)	6	8	14
	Tornadoes, wind, hail, flood	South	0	0	0	5	1	6
Mar. 14	Wind, hail	South	(2)	1	(1)	2	5	7
Mar. 15-16	Wind, hail, flood	South	19	2	21	19	2	21
May 10-12	Wind, hail, flood	South, Mid-Atlantic	4	3	7	4	3	7
	Wind, hail	Midwest	7	2	9	7	2	9
May 22-26	Wind, hail, flood, water, hydrostatic	Midwest	6	6	12	6	6	12
	Wind, hail, flood, water, hydrostatic	Midwest	6	7	13	6	7	13
Jun. 2-4	Wind, hail, flood	Midwest	13	11	24	13	11	24
Jun. 5-8	Wind, hail, flood, water, hydrostatic	Midwest	11	12	23	11	12	23
	Wind, hail, flood, water, hydrostatic							
Jun. 11-12	hydrostatic							
All Other			4	4	8	4	4	8
Development on 2007 and prior catastrophes			0	0	0	(3)	(1)	(4)
Calendar year incurred total			\$ 66	\$ 47	\$ 113	\$ 89	\$ 67	\$ 156

2007									
Mar. 1-2	Wind, hail, flood	South	\$ 0	\$ (1)	\$ (1)	\$ 6	\$ 1	\$ 7	
Jun. 7-9	Wind, hail, flood	Midwest	2	3	5	2	3	5	
	All Other		6	5	11	14	6	20	
	Development on 2006 and prior catastrophes		(3)	(1)	(4)	(6)	(11)	(17)	
Calendar year incurred total			\$ 5	\$ 6	\$ 11	\$ 16	\$ (1)	\$ 15	

Measuring Our Success In 2008 And Beyond

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

Maintaining our strong relationships with our established agencies, writing a significant portion of each agency's business and attracting new agencies In 2008, we expect to continue to rank No. 1 or No. 2 by premium volume in approximately 75 percent or more of the locations that have marketed our products for more than five years, not taking into account any contribution from our excess and surplus lines business. In our current operating areas, we expect to improve service to our agencies by subdividing two or three field territories in the second half of 2008. We also expect to appoint a total of 65 agencies over the course of the year throughout the markets we serve.

We made 37 new appointments in first six months of 2008, of which 28 were new relationships. As a result, at June 30, 2008, our 1,110 agency relationships had 1,354 reporting agency locations marketing

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our standard market insurance products. At year-end 2007, our 1,092 agency relationships had 1,327 reporting agency locations.

In 2007, we appointed our first agencies in eastern Washington and New Mexico, our 33rd and 34th states of operation. We continually study the regulatory and competitive environment in states where we could decide to actively market our property casualty products.

On July 17, 2008, we announced our plans to appoint agencies and launch commercial lines and excess and surplus lines operations in selected Texas markets, possibly before the end of the year. We will evaluate the timing for entry for personal lines over the coming months. Texas would be our 35th state of operation. New field territories and agency appointments in Texas are not included in our current targets for 2008. We have not announced plans to enter any additional states but continue to study other potential markets for future expansion.

In 2008, we are making further progress in our efforts to improve service to and communication with our agencies through our expanding portfolio of software. We discuss our technology plans for 2008 in our 2007 Annual Report on Form 10-K, Item 1, Technology Solutions, Page 4.

Highlights of the 2008 plans include:

- o Introduce WinCPP, our commercial lines policy rating system, in our newest states Washington and New Mexico. This largely has been completed.
- o Make a direct bill option available for commercial lines policies. We have completed this for e-CLAS, our commercial lines policy processing system, which presently processes Businessowners Policies and Dentist Package Policies. We are working to make a direct bill option available for selected commercial policies not issued through e-CLAS with the intent to offer this capability for all policies as soon as practical.
- o Deploy Diamond, our personal lines policy processing system, to agencies in eight additional states. Diamond now is available in 20 of our personal lines states; by year-end it will be available in 25 of 28 personal lines states, reflecting entry into three new states.
- o Give agencies access to selected policyholder claims information.

Over the years, we have been able to increase our share of our agencies business by making available insurance products that meet the needs of the individuals and businesses in their communities. In recent years, our agents had indicated their interest in having Cincinnati available as a market for commercial accounts that require the flexibility of excess and surplus lines coverage.

Our 2008 objective was to introduce our excess and surplus lines capabilities to agencies in all of our active states except Delaware, Cincinnati Specialty Underwriters state of incorporation. During the first six months of the year, we have begun marketing in 10 of those states and remain on track to market in the planned 33 of our 34 active states before year end. In addition, we have introduced the property line of business in five states and will continue to introduce new lines of business throughout the remainder of the year; including miscellaneous professional and excess casualty. The availability of our new offerings has enhanced our ability to write new standard market property casualty business as a means for rounding out accounts that require both admitted and non-admitted market solutions.

Achieving above-industry-average growth in property casualty statutory net written premiums and maintaining industry-leading profitability over the long-term by leveraging our regional franchise and proven agency-centered business strategy As we indicated in our 2007 Annual Report on Form 10-K, if current commercial lines pricing trends continue into 2008, we believe our net written premiums could decline as

much as 5 percent compared with the 1.9 percent decline in 2007. A slower rate of decline for the second quarter of 2008 led to a 5.4 percent decline in six-month net written premiums. While pricing in our industry continues to be very competitive, we feel our current pace is consistent with our agents' practice of selecting and retaining accounts with manageable risk characteristics that support the lower prevailing prices.

In early 2008, A.M. Best believed overall industry premiums would decline 0.6 percent in 2008. Net written premiums for the commercial lines sector are expected to be down 2.3 percent in 2008 while the personal lines sector is expected to grow 1.4 percent.

In a difficult market, our agents have continued to bring the company quality business that has let us absorb high catastrophe losses at a near breakeven level for the first six months of 2008, with the combined ratio at 101.1 percent. We believe the high storm activity might lead to a full-year 2008 combined ratio that also is above 100 percent. That is above our preliminary 2008 estimate of 96 percent to 98 percent, which compared with 90.3 percent in 2007. In early 2008, the projected industry average combined ratio for the full year was 98.6 percent.

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The anticipated year-over-year increase in the combined ratio reflects three assumptions:

- o Current accident year loss and loss expense ratio excluding catastrophe losses We believe the market trends that contributed to an increase in this ratio in 2007 are continuing and may put the ratio under further pressure in 2008.

Our current assumptions for the accident year loss ratio could be compromised by economic factors, including inflation, which could cause unanticipated changes in our claims and settlement expenses related to medical care, litigation and construction. We also could see higher than anticipated loss costs related to workers compensation and lines of business that provide protection against bodily injury claims. Similarly, higher legal expenses could raise the loss expenses we incur to defend our policyholders and settle complex or disputed claims. Moving forward, we would be able to factor any such higher losses and loss expenses into our pricing and reserve calculations, potentially increasing reserves and adjusting rates.

- o Catastrophe loss ratio We now believe catastrophe losses could contribute as much as 9 percentage points to the full-year 2008 combined ratio, assuming a typical level of storm activity in the second half of the year, compared with our original estimate of 4.5 points. In total, record 2008 second-quarter and six-month catastrophe losses were more than twice what we would normally expect.

We are aware of the unpredictability of catastrophic events in any given year. Catastrophe losses contributed an average of 3.7 percentage points to our full-year combined ratio in the past 10 years, ranging from 2007's low of 0.8 points to 1998's high of 6.1 points.

- o Savings from favorable development on prior period reserves To establish the 2008 combined ratio estimate, management made the assumption based on current trends that prior period reserves would develop favorably and made the assumption that the development would affect the ratio by approximately 4 percentage points. The level of development on prior period reserves will be based on actual loss experience over the next six months and on sound actuarial estimation techniques.

As discussed in our 2007 Annual Report on Form 10-K, Property Casualty Insurance Loss And Loss Expense Reserves, Page 37, our actuarial estimate of ultimate loss experience could prove better or worse than our carried reserves reflect. To the extent that reserves are inadequate and increased, the amount of the increase is a charge in the period that the deficiency is recognized, raising our loss and loss expense ratio and reducing earnings. To the extent that reserves are redundant and released, the amount of the release is a credit in the period that the redundancy is recognized, reducing our loss and loss expense ratio and increasing earnings. Historically, management has targeted loss and loss expense reserves in the upper half of the actuarially established range.

Pursuing a total return investment strategy that generates both strong investment income growth and capital appreciation We now believe that full-year 2008 investment income could decline as much as 10 percent below the level of 2007. Our original target for the year presumed a growth rate below that of 2007. The primary reasons we lowered our investment income estimate were Fifth Third's 66 percent reduction in its quarterly cash dividend in June 2008 and our sale of 35 million shares of that holding in July 2008. We discuss these actions in Investments Results of Operation, Page 32. Our revised outlook also considers other changes in the equity portfolio in the past 12 months, the anticipated level of dividend income from other equity holdings, the investment of insurance operations cash flow and the current portfolio attributes. Preliminarily, we do not anticipate a return to growth of investment income in 2009.

We continue to focus on portfolio strategies to balance near-term income generation and the potential for long-term book value growth. Our board and investment department currently are in the process of adopting guidelines to place additional parameters around our portfolio. These parameters will address, among other

issues, security and sector concentrations and could lead to actions such as rebalancing the portfolio by trimming or selling off positions. The new parameters came out of our enterprise risk management (ERM) program, with the goal of more closely defining our risk tolerance, aligning our operating plan accordingly and improving management's ability to identify and respond to changing conditions.

We do not establish annual capital appreciation targets. Over the long term, our target is to have the equity portfolio outperform the Standard & Poor's 500 Index. In the first six months of 2008, our equity portfolio return was a negative 24.7 percent, compared with a negative return of 11.9 percent for the Index. Over the five years ended June 30, 2008, our compound annual equity portfolio return was a negative 6.2 percent compared with a compound annual total return of 7.6 percent for the Index. Our equity portfolio underperformed the market for these periods primarily because of the decline in value of our Fifth Third common stock holding.

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Increasing the total return to shareholders through a combination of higher earnings per share, growth in book value, increasing dividends and share repurchase We do not announce annual targets for earnings per share or book value. Over the long term, we look for our earnings per share and book value growth to outpace that of a peer group of national and regional property casualty insurance companies.

The board of directors is committed to steadily increasing cash dividends, periodically authorizing stock dividends and splits and authorizing share repurchase. In February 2008, the board increased the indicated annual cash dividend rate 9.9 percent, marking the 48th consecutive year of increase in the dividend rate. We believe our record of dividend increases is matched by only 11 other publicly traded corporations. Management believes the company's capital position and cash flow support the current cash dividend payout and would provide the board with the flexibility to consider future increases for shareholders.

Over the long-term, we seek to increase earnings per share, book value and dividends at a rate that would allow long-term total return to our shareholders to exceed that of the Standard & Poor's Composite 1500 Property Casualty Insurance Index. Over the five years ended December 31, 2007, our total return to shareholders of 34.0 percent was below the 62.3 percent return for that Index. For the first six months of 2008, that Index group had a negative total return to shareholders of 17.7 percent, largely reflecting overall insurance market conditions and concerns related to the ongoing credit crisis. We underperformed the group for the same period, returning a negative 34.1 percent.

Maintaining financial strength by keeping the ratio of debt to capital below 15 percent and purchasing reinsurance to provide investment flexibility Market fluctuations during the first six months of 2008 led to lower shareholders' equity and reduced capital. As a result, our debt-to-capital ratio rose slightly above our target level to 15.4 percent at June 30, 2008. Debt levels were unchanged from year-end.

Management believes it is taking the appropriate actions to preserve capital, in part to stabilize this ratio. In particular, our ERM program has contributed to the development of new investment parameters as discussed above. In conjunction with that effort, the company diversified the equity portfolio with the sale of 35 million shares of its Fifth Third common stock holding in July 2008.

We view this diversifying action to be consistent with our view of prudent ERM. Going forward, we will evaluate our remaining Fifth Third position, along with that of all of our common stocks, using our company's investment parameters and risk tolerances. Over the coming months, we anticipate systematically reinvesting the \$361 million net proceeds of the sale in fixed maturity and equity investments.

Our property casualty reinsurance seeks to maintain the balance between the cost of the program and the level of risk we retain. Our 2008 reinsurance costs are slightly below last year's level due to higher retention levels and moderating rates for certain lines of business. We provide more detail on our reinsurance programs in our 2007 Annual Report on Form 10-K, Item 7, 2008 Reinsurance Programs, Page 70.

In addition to the ratings of our parent company senior debt, independent ratings firms award our property casualty and life operations insurer financial strength ratings based on their quantitative and qualitative analyses. These ratings assess an insurer's ability to meet its financial obligations to policyholders and do not necessarily address all of the matters that may be important to shareholders.

We believe that our strong surplus position and superior insurer financial strength ratings are clear, competitive advantages in the segment of the insurance marketplace that our agents serve. Our financial strength supports the consistent, predictable performance that our policyholders, agents, associates and shareholders have always

expected and received, and it must be able to withstand significant challenges. We seek to ensure that our performance remains consistent and predictable by aligning agents' interests with those of the company, giving them outstanding service and compensation and earning their best business by enhancing their ability to serve the businesses and individuals in their communities.

During the second quarter of 2008, each of the four organizations that rate our companies placed the ratings of our standard market property casualty and life companies on watch or review following our June announcement of significant catastrophe losses and declines in value of our investment assets, particularly our large Fifth Third holding. Fitch Ratings Ltd. and Standard & Poor's Ratings Services subsequently lowered their ratings.

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As of August 5, 2008, our credit and financial strength ratings were:

Rating Agency	Parent Company Senior Debt Rating	Standard Market Property Casualty Insurance Subsidiaries Financial Strength Ratings		Life Insurance Subsidiary Financial Strength Ratings		Excess and Surplus Subsidiary Financial Strength Ratings		Status (date)			
		Rating	Tier	Rating	Tier	Rating	Tier				
A. M. Best Co.	aa-	A++	Superior	1 of 16	A+	Superior	2 of 16	A	Excellent	3 of 16	Under review with negative implications (07/03/08)
Fitch Ratings	A-	AA-	Very Strong	4 of 21	AA-	Very Strong	4 of 21				Negative outlook (07/17/08)
Moody s Investors Services	A2	Aa3	Excellent	4 of 21							Under review for possible downgrade (07/02/08)
Standard & Poor s Ratings Services	BBB+	A+	Strong	5 of 21	A+	Strong	5 of 21				Negative outlook (06/30/08)

A.M. Best Co. On July 3, 2008, A.M. Best placed under review with negative implications its financial strength and issuer credit ratings for our standard market property casualty insurance group and member companies and for The Cincinnati Life Insurance Company. A.M. Best cited the rapid decline in the value of our equity portfolio, along with an associated decline in future dividend income, significant catastrophic losses and susceptibility to competitive pricing pressures. A.M. Best noted that despite these factors, risk-adjusted capitalization, as measured by A.M. Best's Capital Adequacy Ratio, remains well supportive of the current A++ (Superior) rating for the standard market property casualty companies and the current A+ (Superior) rating for The Cincinnati Life Insurance Company. A.M. Best commented that we maintain a large and diversified fixed income portfolio that covers our insurance liabilities.

Our new excess and surplus lines subsidiary maintained its financial strength rating, an A (Excellent) with a stable outlook, from A.M. Best.

Fitch Ratings On July 17, 2008, Fitch Ratings removed our three standard market property casualty insurance companies and The Cincinnati Life Insurance Company from rating watch negative, lowering the insurer financial strength ratings to AA- (Very Strong) with a negative outlook. Fitch said its action was primarily driven by the significant decrease in shareholders' equity in 2008 as a result of a decline in the value of CFC's investment portfolio, the high level of catastrophe losses, lower investment income and less favorable market conditions. Fitch noted our historically strong operating profitability, which has been better than peers and is derived in part by a competitive advantage from a successful single-channel distribution system that emphasizes building

long-term relationships with select independent agents, low non-commission expense structure, and excellent claims service and conservative reserving practices demonstrated by favorable reserve development.

Moody's Investors Service On July 2, 2008, Moody's Investors Service placed on review for possible downgrade the Aa3 insurance financial strength ratings of the standard market property casualty insurance companies. Moody's said its review was prompted by the substantial reduction in CINF's shareholders' equity over the last 12 months, largely reflecting declines in our equity portfolio, led by our largest common stock holding, Fifth Third. Moody's is reviewing risk-adjusted capitalization of our insurance operations, potential revisions to our investment guidelines, our catastrophe risk profile and prospective operating profitability. Moody's noted that our ratings have historically contemplated some potential for significant volatility posed by our equity portfolio. Moody's believes our regional business franchise and long-standing relationships with our independent agency force remain strong.

Standard & Poor's Ratings Services On June 30, 2008, Standard & Poor's Ratings Services removed our three standard market property casualty insurance companies and The Cincinnati Life Insurance Company from credit watch, lowering the insurer financial strength ratings to A+ (Strong) with a negative outlook. Standard & Poor's said its actions reflected our weakened capitalization and current and prospective operating performance, increased market competition and reduced liquidity. Standard & Poor's noted support for operating company ratings in view of our capital at the A level, extremely strong and loyal agency force, strong competitive position, improved technological efficiencies, and improved and adequate enterprise risk management.

Statutory surplus for our property casualty insurance subsidiary was \$3.650 billion at June 30, 2008, compared with \$4.307 billion at December 31, 2007, due to lower values for financial stocks held in the insurance subsidiaries' investment portfolios. The ratio of the property casualty subsidiary's common stock to statutory surplus was 71.6 percent at June 30, 2008, compared with 86.0 percent at year-end. Life statutory surplus was \$420 million at June 30, 2008, compared with \$477 million at December 31, 2007. The ratio of the life insurance subsidiary's common stock to statutory adjusted capital and surplus was 58.5 percent at June 30, 2008, compared with 70.6 percent at year-end.

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Factors supporting our outlook for 2008 are discussed below in the Results of Operations for each of the four business segments.

Results Of Operations

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

Commercial lines property casualty insurance

Personal lines property casualty insurance

Life insurance

Investments operations

We report as Other the non-investment operations of the parent company and its subsidiaries CFC Investment Company and CinFin Capital Management Company (excluding client investment activities), as well as other income of our insurance subsidiary. Beginning in the first quarter of 2008, we also are including results of The Cincinnati Specialty Underwriters Insurance Company and CSU Producer Resources in Other.

See Item 1, Note 9 of the Condensed Consolidated Financial Statements, Page 13 for discussion of the calculations of segment data. The following sections review results of operations for each of the four segments.

Commercial Lines Insurance Results Of Operations

Overview

Performance highlights for the commercial lines segment include:

Premiums The rate of decline in commercial lines 2008 written premiums slowed in the second quarter from the first quarter. While pricing in our industry continues to be very competitive, we feel our current pace for new and renewal business is consistent with our agents' practice of selecting and retaining accounts with manageable risk characteristics that support the lower prevailing prices. The slower rate of decline in the quarter reflected healthy new business activity in the second quarter as well as the benefits of our strong agency relationships and policyholder retention.

New commercial lines business written directly by agencies rose 21.2 percent for the three months ended June 30, 2008, to \$87 million from \$71 million and rose 6.4 percent for the six months ended June 30, 2008, to \$152 million from \$143 million. New business growth was bolstered by a number of factors, including:

- o **New appointments** The 36 agencies appointed this year contributed \$2 million in new commercial lines business.
- o **Excess and surplus lines** Additional standard market business was written for policyholders who selected Cincinnati Specialty Underwriters to provide certain excess and surplus lines coverages.
- o **Carrier consolidation** We benefited from efforts to make it easier for our agencies to consolidate their books of business as they manage expenses by reducing the number of carriers they represent.

We continue to make case-by-case decisions not to write or renew certain business. In this environment, we have been careful to maintain our underwriting discipline.

We used rate credits more frequently than we did last year to retain renewals of quality business and earn new business. Our experience remains that the larger the account, the higher the credits, with variations by geographic region and class of business. Pricing pressure on new business remains high as many carriers appear to be managing the soft market by working aggressively to protect their renewal portfolios. Mid-single-digit premium declines in pricing on renewal business are typical, although higher declines are not uncommon.

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In April 2008, A.M. Best estimated that industry commercial lines net written premiums would decline 2.3 percent in 2008, after declining 0.4 percent in 2007 and 0.7 percent in 2006.

Combined ratio Our commercial lines combined ratio rose in the three and six months ended June 30, 2008, primarily because of higher catastrophe losses and normal volatility in larger losses, particularly those greater than \$2 million. Other contributing factors were lower pricing, normal loss cost inflation and higher underwriting expenses. Lower commission expenses partially offset these increases.

Our commercial lines statutory combined ratio was 97.5 percent and 95.5 percent in the three and six months ended June 30, 2008, compared with 84.4 percent and 85.4 percent in the comparable 2007 periods. In April 2008, A.M. Best estimated the industry commercial lines combined ratio would be approximately 97.5 percent in 2008, rising from approximately 93.7 percent in 2007 and 91.3 percent in 2006.

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(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2008	2007	Change %	2008	2007	Change %
Written premiums	\$ 597	\$ 613	(2.7)	\$ 1,222	\$ 1,306	(6.5)
Earned premiums	\$ 586	\$ 607	(3.3)	\$ 1,161	\$ 1,210	(4.1)
Loss and loss expenses excluding catastrophes	342	330	3.7	685	673	1.7
Catastrophe loss and loss expenses	66	5	1,220.0	89	16	465.2
Commission expenses	105	112	(6.1)	214	235	(9.2)
Underwriting expenses	68	68	1.4	136	123	10.7
Policyholder dividends	4	2	67.9	7	6	28.9
Underwriting profit	\$ 1	\$ 90	(99.3)	\$ 30	\$ 157	(81.1)
Ratios as a percent of earned premiums:						
Loss and loss expenses excluding catastrophes	58.4%	54.5%		59.1%	55.7%	
Catastrophe loss and loss expenses	11.3	0.8		7.6	1.3	
Loss and loss expenses	69.7%	55.3%		66.7%	57.0%	
Commission expenses	17.9	18.5		18.4	19.4	
Underwriting expenses	11.6	11.0		11.7	10.2	
Policyholder dividends	0.7	0.4		0.6	0.4	
Combined ratio	99.9%	85.2%		97.4%	87.0%	

Loss and Loss Expenses

Commercial lines loss and loss expenses include both net paid losses and reserve changes for unpaid losses as well as the associated loss expenses. On an ongoing basis, we monitor loss patterns and structure our products and our pricing accordingly. The change in the commercial lines loss and loss expense ratio in the three and six months ended June 30, 2008, was due to:

Market conditions and related decline in premiums During the first six months of 2008, agents again reported that pricing pressure continued to increase on renewal business and that new business pricing was requiring more flexibility and more careful risk selection. In addition to pricing pressures, premiums confirmed by audits of policyholder sales and payrolls declined for the first half of 2008.

Economy We believe the weaker economy is tempering current market conditions by holding back exposure growth.

Catastrophe losses Catastrophe losses were significantly higher than the unusually low year-ago levels. The catastrophe losses largely affected our commercial property and specialty package lines of business. In the second quarter of 2008, we also had approximately \$15 million of commercial lines losses, primarily larger losses, from weather events that were not classified as catastrophes by Property Claims Service. In the comparable 2007 period, we had \$7 million of similar, generally smaller, non-catastrophe weather losses.

Large losses 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 settlement expenses. In the second quarter of 2008, these losses and case reserve increases rose to 26.3 percent of earned premiums from 19.1 percent. We believe the increase largely reflected normal fluctuations in loss patterns, normal variability in the large case reserves for our workers' compensation claims, several unusually large losses related to non-catastrophe weather and a higher number of executive risk losses between \$250,000 and \$1 million.

Our analysis continues to indicate no unexpected concentration of these losses and reserve increases by risk category, geographic region, policy inception, agency or field marketing territory.

Savings from favorable development on prior period reserves Savings from favorable development reduced the loss and loss expense ratio by 12.6 and 7.6 percentage points in the three and six months ended June 30, 2008. Savings reduced the ratio by 7.1 and 4.8 percentage points in the three and six months ended June 30, 2007.

Fluctuations in prior period reserve development for the commercial lines segment largely were due to quarterly fluctuations in savings for the commercial casualty line of business. The commercial casualty line continued to benefit from an initiative, begun in 2001, to use a claims mediation process that promotes earlier liability settlement resolution. The line also has begun to benefit from revised expectations for loss expense inflation.

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(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2008	2007	Change %	2008	2007	Change %
New losses greater than \$4,000,000	\$ 18	\$ 0	nm	\$ 26	\$ 0	nm
New losses \$2,000,000-\$4,000,000	25	13	99.2	39	35	14.3
New losses \$1,000,000-\$2,000,000	15	23	(35.7)	33	46	(27.7)
New losses \$750,000-\$1,000,000	11	6	82.0	19	15	22.9
New losses \$500,000-\$750,000	12	11	4.0	20	22	(9.9)
New losses \$250,000-\$500,000	22	17	35.0	45	35	29.5
Case reserve development above \$250,000	51	46	11.1	96	95	0.6
Total large losses incurred	154	116	33.4	278	248	12.2
Other losses excluding catastrophes	127	137	(7.7)	279	278	0.3
Catastrophe losses	66	5	1,220.0	89	16	465.2
Total losses incurred	\$ 347	\$ 258	34.6	\$ 646	\$ 542	19.2
Ratios as a percent of earned premiums:						
New losses greater than \$4,000,000	3.1%	0.0%		2.2%	0.1%	
New losses \$2,000,000-\$4,000,000	4.3	2.1		3.4	3.0	
New losses \$1,000,000-\$2,000,000	2.5	3.8		2.9	3.8	
New losses \$750,000-\$1,000,000	1.9	1.0		1.6	1.3	
New losses \$500,000-\$750,000	2.0	1.8		1.7	1.9	
New losses \$250,000-\$500,000	3.8	2.7		3.9	2.9	
Case reserve development above \$250,000	8.7	7.6		8.3	7.9	
Total large loss ratio	26.3	19.1		24.0	20.5	
Other losses excluding catastrophes	21.6	22.7		24.0	22.9	
Catastrophe losses	11.3	0.8		7.6	1.3	
Total loss ratio	59.2%	42.6%		55.6%	44.7%	

Commission Expenses

Commercial lines commission expenses as a percent of earned premiums declined for the three and six months ended June 30, 2008, due to lower premiums and lower profit-sharing commissions compared with the year-ago periods. Profit-sharing, or contingent, commissions reward the agency's effort, reflecting the profitability of an agency's aggregate property casualty book of Cincinnati business, taking into account longer-term profit and premium volume, with a percentage for prompt payment of premiums and other criteria. These profit-based commissions generally fluctuate with our loss and loss expense ratio.

Underwriting Expenses

Non-commission underwriting and policyholder dividend expenses rose 0.6 and 1.5 percentage points for the three and six months ended June 30, 2008, largely because of a higher staffing cost allocation. The decline in written premiums also caused unfavorable year-over-year comparisons of deferred acquisition costs for the six-month period.

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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 growth and profitability trends separately for each line.

(Dollars in millions)	Three months ended June 30,			Six months ended June 30,		
	2008	2007	Change %	2008	2007	Change %
Commercial casualty:						
Written premiums	\$ 199	\$ 218	(8.4)	\$ 410	\$ 462	(11.2)
Earned premiums	194	209	(7.2)	384	418	(8.2)
Loss and loss expenses incurred	77	115	(32.3)	188	227	(17.2)
Loss and loss expense ratio	39.8%	55.0%		48.9%	54.2%	
Loss and loss expense ratio excluding catastrophes	39.8	55.0		48.9	54.2	
Reserve development impact on loss and loss expense ratio	(31.0)	(12.9)		(19.5)	(18.1)	
Commercial property:						
Written premiums	\$ 124	\$ 125	(1.6)	\$ 247	\$ 263	(6.1)
Earned premiums	123	125	(1.5)	244	248	(1.4)
Loss and loss expenses incurred	120	57	109.4	212	123	71.7
Loss and loss expense ratio	97.6%	45.9%		86.6%	49.7%	
Loss and loss expense ratio excluding catastrophes	59.6	42.7		59.3	44.7	
Reserve development impact on loss and loss expense ratio	0.0	(3.8)		1.2	(3.9)	
Commercial auto:						
Written premiums	\$ 108	\$ 112	(3.8)	\$ 215	\$ 236	(8.9)
Earned premiums	104	110	(5.6)	205	223	(8.0)
Loss and loss expenses incurred	70	68	2.7	134	141	(5.0)
Loss and loss expense ratio	67.5%	62.0%		65.5%	63.4%	
Loss and loss expense ratio excluding catastrophes	64.1	62.0		64.0	63.4	
Reserve development impact on loss and loss expense ratio	(4.5)	(4.0)		(3.8)	(5.8)	
Workers compensation:						
Written premiums	\$ 95	\$ 92	3.4	\$ 209	\$ 206	1.5
Earned premiums	94	95	(0.4)	189	187	1.0
	74	63	16.8	135	134	0.9

Loss and loss expenses incurred						
Loss and loss expense ratio	78.3%	66.8%		71.5%	71.5%	
Loss and loss expense ratio excluding catastrophes	78.3	66.8		71.5	71.5	
Reserve development impact on loss and loss expense ratio	(9.3)	(6.9)		(7.6)	(6.9)	
Specialty packages:						
Written premiums	\$ 36	\$ 36	(1.2)	\$ 73	\$ 77	(5.2)
Earned premiums	36	37	(1.9)	72	73	(1.8)
Loss and loss expenses incurred	40	19	115.9	62	44	43.1
Loss and loss expense ratio	109.7%	49.9%		86.8%	59.6%	
Loss and loss expense ratio excluding catastrophes	65.8	47.3		60.6	54.9	
Reserve development impact on loss and loss expense ratio	(3.3)	(2.7)		1.5	0.5	
Surety and executive risk:						
Written premiums	\$ 28	\$ 23	20.5	\$ 54	\$ 48	11.1
Earned premiums	28	24	15.3	53	47	10.9
Loss and loss expenses incurred	25	12	115.6	37	17	111.6
Loss and loss expense ratio	92.0%	49.2%		70.1%	36.7%	
Loss and loss expense ratio excluding catastrophes	92.0	49.2		70.1	36.7	
Reserve development impact on loss and loss expense ratio	5.4	3.0		7.6	1.2	
Machinery and equipment:						
Written premiums	\$ 7	\$ 7	3.5	\$ 14	\$ 14	(1.6)
Earned premiums	7	7	4.4	14	14	2.4
Loss and loss expenses incurred	2	1	74.2	6	3	83.5
Loss and loss expense ratio	34.1%	20.5%		43.6%	24.3%	
Loss and loss expense ratio excluding catastrophes	33.1	20.5		43.0	25.1	
Reserve development impact on loss and loss expense ratio	(6.4)	(4.2)		5.6	(5.8)	

Commercial Lines Insurance Outlook

Industrywide commercial lines written premiums are expected to decline approximately 2.3 percent in 2008 with the industry combined ratio estimated at 97.5 percent. As discussed in our 2007 Annual Report on Form 10-K, Item 1, Commercial Lines Insurance Marketplace, Page 12, over the past several years, agents have reported that renewal and new business pricing have come under steadily increasing pressure, reinforcing the need for more flexibility and careful risk selection. We believe that commercial lines pricing trends observed in 2007 and the first half of 2008 will persist at least throughout the remainder of the year.

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We intend to continue to market our products to a broad range of business classes, price our products appropriately and take a package approach. We intend to maintain our underwriting selectivity and carefully

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manage our rate levels as well as our programs that seek to accurately match exposures with appropriate premiums. We will continue to evaluate each risk individually and to make decisions about rates, the use of three-year commercial policies, policy term extensions and other policy conditions on a case-by-case basis, even in lines and classes of business that are under competitive pressure. We also expect new marketing territories created over the past several years and new agency appointments to make a growing contribution to commercial lines premium growth and underwriting profit in 2008.

We believe our approach should allow us to continue to underwrite commercial lines business profitably in 2008 although we anticipate another year of both lower premiums and a higher commercial lines combined ratio, as softening market conditions lead to lower premium per exposure. In addition, we do not believe favorable reserve development will continue to contribute to underwriting profits to the extent seen over the past four years. Further, underwriting expenses are rising. We discuss our overall outlook for our property casualty insurance operations in *Measuring Our Success in 2008 and Beyond*, Page 18.

Personal Lines Insurance Results Of Operations

Overview

Performance highlights for the personal lines segment include:

Premiums Personal lines written premiums declined slightly for the three and six months ended June 30, 2008. A return to new business growth and premium increases related to rising insured values were not able to offset lower policy counts and pricing changes that reduced premiums per policy. Pricing changes included the ongoing rollout of a program of policy credits that incorporate insurance scores and are intended to improve our ability to compete for our agents' highest quality personal lines accounts.

Personal lines new business premiums written directly by our agencies were up 7.7 percent to \$10 million for the three months ended June 30, 2008, and 3.9 percent to \$19 million for the six months ended June 30, 2008. Agencies that initiated or expanded their use of Cincinnati's personal lines products in the past 18 months were an important contributor to the growth in new personal lines business for the six months ended June 30, 2008.

We continue to implement strategies discussed in our 2007 Annual Report on Form 10-K, Item 1, *Our Business and Our Strategies*, Page 1, to enhance our response to marketplace changes and help us achieve our long-term objectives. We continue to encourage availability of our personal insurance policies through agencies that previously marketed only commercial lines for us. We are supporting agency customer service representatives by strengthening relationships with our field marketing representatives and offering educational opportunities. We are locating personal lines field marketing representatives or field underwriters in states where our personal lines automation now allows us to broaden our product line offerings, also helping to diversify our premiums geographically.

In April 2008, A.M. Best estimated that industry personal lines net written premiums would rise approximately 1.4 percent in 2008 after remaining stable in 2007 and rising 2.9 percent in 2006.

Combined ratio The combined ratio for the three and six months ended June 30, 2008, rose because of higher catastrophe losses. The loss and loss expense ratio excluding catastrophe losses declined over the same periods. Lower pricing and normal loss cost inflation continued to weigh on personal lines results. However, the quarterly personal auto loss and loss expense ratio moved below 60 percent for the first time since the third quarter 2006. Commission and other underwriting expenses declined in both periods.

Our personal lines statutory combined ratio was 114.3 percent and 112.2 percent in the three and six months ended June 30, 2008, versus 98.6 percent and 95.8 percent in the comparable 2007 periods, when catastrophe losses were atypically low. In April 2008, A.M. Best estimated the industry personal lines combined ratio would be approximately 99.5 percent in 2008, rising from approximately 96.1 percent in 2007 and 92.7 percent in 2006.

Cincinnati Financial Corporation
Form 10-Q for the quarterly period ended June 30,
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Personal Lines Results

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