CINCINNATI FINANCIAL CORP
Form 10-K
February 27, 2009

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United States Securities and Exchange Commission
Washington, D.C. 20549
Form 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
For the fiscal year ended December 31, 2008.

o **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 of incorporation)	(I.R.S. Employer Identification No.)

6200 S. Gilmore Road
Fairfield, Ohio 45014-5141
(Address of principal executive offices) (Zip Code)
(513) 870-2000
(Registrant s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:
None
Securities registered pursuant to Section 12(g) of the Act:
$2.00 par, common stock
(Title of Class)
6.125% Senior Notes due 2034
(Title of Class)
6.9% Senior Debentures due 2028
(Title of Class)
6.92% Senior Debentures due 2028
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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 þ No o

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

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 þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o
		(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 o No þ

The aggregate market value of voting stock held by nonaffiliates of the Registrant was $3,708,499,771 as of June 30, 2008.

As of February 19, 2009, there were 162,502,547 shares of common stock outstanding.

Document Incorporated by Reference

Portions of the definitive Proxy Statement for Cincinnati Financial Corporation s Annual Meeting of Shareholders to be held on May 2, 2009, are incorporated by reference into Parts II and III of this Form 10-K.

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Part I

Item 1. Business

Cincinnati Financial Corporation   Introduction

We are an Ohio corporation formed in 1968. Our lead subsidiary, The Cincinnati Insurance Company, was founded in 1950. Our main business is marketing property casualty insurance. Our headquarters is in Fairfield, Ohio. At year-end 2008, we had 4,179 associates, with 2,984 headquarters associates providing support to 1,195 field associates.

At year-end 2008, Cincinnati Financial Corporation owned 100 percent of four subsidiaries: The Cincinnati Insurance Company, CSU Producer Resources Inc., CFC Investment Company and CinFin Capital Management Company. In addition, the parent company has an investment portfolio, owns the headquarters building and is responsible for corporate borrowings and shareholder dividends. The Cincinnati Insurance Company owns 100 percent of our four other insurance subsidiaries.

In addition to The Cincinnati Insurance Company, our standard market property casualty insurance group includes two of those subsidiaries   The Cincinnati Casualty Company and The Cincinnati Indemnity Company. This group markets a broad range of business, homeowner and auto policies in 35 states. Other subsidiaries of The Cincinnati Insurance Company include The Cincinnati Life Insurance Company, which markets life insurance, disability income policies and annuities, and The Cincinnati Specialty Underwriters Insurance Company, which began offering surplus lines insurance products in January 2008.

The three other subsidiaries of Cincinnati Financial are CSU Producer Resources, which offers insurance brokerage services to our independent agencies so their clients can access our surplus lines insurance products; CFC Investment Company, which offers commercial leasing and financing services to our agents, their clients and other customers; and CinFin Capital Management Company, which provided asset management services to internal and third-party clients. CinFin Capital Management will cease operations effective February 28, 2009.

Our filings with the Securities and Exchange Commission are available, free of charge, on our Web site, *www.cinfin.com*, as soon as possible after they have been filed with the SEC. These filings include our annual reports on Form 10-K, our quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. In the following pages we reference various Web sites. These Web sites, including our own, are not incorporated by reference in this Annual Report on Form 10-K.

Periodically, we refer to estimated industry data so that we can give information about our performance versus the overall insurance industry. Unless otherwise noted, the industry data is prepared by A.M. Best Co., a leading insurance industry statistical, analytical and insurer financial strength and credit 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).

Our Business And Our Strategy

Introduction

The Cincinnati Insurance Company was founded almost 60 years ago by independent insurance agents. They established the mission that continues to guide all of the companies in the Cincinnati Financial family   to grow profitably and enhance the ability of local independent insurance agents to deliver quality financial protection to the people and businesses they serve by:

- providing market stability through financial strength
- producing competitive up-to-date products and services and
- developing associates committed to superior service

A select group of agencies in 35 states actively markets our property casualty insurance within their communities. Standard market commercial lines policies are available in all of those states, while personal lines policies are available in 27 and surplus commercial lines policies are available in 33 of the same 35 states. Within this select group, we also seek to become the life insurance carrier of choice and to help agents and their clients   our policyholders   by offering leasing and financing services.

Three hallmarks distinguish this company, positioning us to build value and long-term success:

Commitment to our network of professional independent insurance agencies and to their continued success

- Financial strength that lets us be a consistent market for our agents business, supporting stability and confidence
- Operating structure that supports local decision making, showcasing our claims excellence and allowing us to balance growth with underwriting discipline

Independent Insurance Agency Marketplace

The U.S. property casualty insurance industry is a highly competitive marketplace with over 2,000 stock and mutual companies operating independently or in groups. No single company or group dominates across all product lines and states. Standard market insurance companies (carriers) can market a broad array of products nationally or:

- choose to sell a limited product line or only one type of insurance (monoline carrier)
- target a certain segment of the market (for example, personal insurance)
- focus on one or more states or regions (regional carrier)

Standard market property casualty insurers generally offer insurance products through one or more distribution channels:

- independent agents, who represent multiple carriers,
- captive agents, who represent one carrier exclusively, or
- direct marketing to consumers

For the most part, we compete with standard market insurance companies that market through independent insurance agents.

We are committed to this channel. The independent agencies that we choose to market our standard lines insurance products share our philosophies. They do business person to person; offer broad, value-added services; maintain sound balance sheets; and manage their agencies professionally. We develop our relationships with agencies that are active in their local communities, providing important knowledge of local market trends, opportunities and challenges.

In addition to the standard market for property casualty insurance, the surplus lines market exists due to a regulatory distinction. Generally, surplus lines insurance carriers provide insurance that is unavailable in the standard market due to market conditions or due to characteristics of the insured person or organization that are caused by nature, the insured s claim history or the characteristics of their business. Insurers operating in the surplus lines market are generally small specialty insurers or specialized divisions of larger insurance organizations. Each markets through surplus lines insurance brokers.

We opened our own surplus line insurance brokerage firm so that we could offer surplus lines products exclusively to the independent agents who market our other property casualty insurance products. We also market life insurance products through the agencies that market our property casualty products.

At year-end 2008, our 1,133 agency relationships had 1,387 reporting locations marketing our standard market insurance products. An increasing number of agencies have multiple, separately identifiable locations, reflecting their growth and consolidation of ownership within the independent agency marketplace. The number of reporting agency locations indicates our agents regional scope and the extent of our presence within our 35 active states. At year-end 2007, our 1,092 agency relationships had 1,327 reporting locations. At year-end 2006, our 1,066 agency relationships had 1,289 reporting locations.

On average, we have a 12.4 percent share of the property casualty insurance purchased through our reporting agency locations. Our share is 18.1 percent in reporting agency locations that have represented us for more than 10 years; 7.4 percent in agencies that have represented us for five to 10 years; 4.4 percent in agencies that have represented us for one to five years; and 0.6 percent in agencies that have represented us for less than one year.

Our largest single agency relationship accounted for approximately 1.3 percent of our total property casualty agency earned premiums in 2008. No aggregate of locations under a single ownership structure accounted for more than 2.3 percent of our total agency earned premiums in 2008.

Over the next decade, industry analysts predict successful agencies will have opportunities to increase their size on average almost three-fold. Agencies are expected to continue to pursue consolidation opportunities, buying or merging with other agencies to create stronger organizations and expand service. In addition to the growing networks of agency locations owned by banks and brokers, other agencies are addressing the consolidation by forming voluntary associations that may share back office and other functions to enhance economies, while maintaining their individual ownership structures.

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Financial Strength

We believe that our financial strength and strong surplus position, reflected in our insurer financial strength ratings, are clear, competitive advantages in the segment of the insurance marketplace that we serve. This strength supports the consistent, predictable performance that our policyholders, agents, associates and shareholders have always expected and received, and helps us withstand significant challenges.

While the prospect exists for volatility due to our exposures to potential catastrophes or significant capital market losses, the ratings agencies consistently have asserted that we have built appropriate financial strength and flexibility to manage that volatility. We remain committed to strategies that emphasize being a consistent, stable market for our agents business over short-term benefits that might accrue by quick reaction to changes in market conditions.

At year-end 2008 and 2007, risk-based capital (RBC) for our standard and surplus lines property casualty operations and life operations was exceptionally strong, far exceeding regulatory requirements.

- We ended 2008 with a 0.9-to-1 ratio of property casualty premiums to surplus, a key measure of property casualty insurance company capacity. Our ratio gives us the flexibility to reduce risk by expanding our operations into new geographies and product areas. The estimated industry average ratio also was 0.9 to 1 for 2008. The lower the ratio, the greater capacity an insurer has for growth.
- We ended 2008 with a 17.7 percent ratio of life statutory adjusted risk-based surplus to liabilities, a key measure of life insurance company capital strength. The estimated industry average ratio was 9.9 percent for 2008. A higher ratio indicates an insurer s stronger security for policyholders and capacity to support business growth.

	At December 31,	
	2008	2007
Standard market property casualty insurance subsidiary		
Statutory surplus	**$3,360**	$4,307
Risk-based capital (RBC)	**3,389**	4,336
Authorized control level risk-based capital	**407**	615
Ratio of risk-based capital to authorized control level risk-based capital	**8.3**	7.0
Written premium to surplus ratio	**0.9**	0.7
Life insurance subsidiary		
Statutory surplus	**$ 290**	$ 477
Risk-based capital (RBC)	**290**	506
Authorized control level risk-based capital	**37**	66
Ratio of risk-based capital to authorized control level risk-based capital	**7.8**	7.3
Total liabilities excluding separate account business	**1,640**	1,552
Life statutory risk-based adjusted surplus to liabilities ratio	**17.7%**	33.2%
Surplus lines subsidiary		
Statutory surplus	**$ 174**	$ 196
Risk-based capital (RBC)	**174**	196
Authorized control level risk-based capital	**4**	9
Ratio of risk-based capital to authorized control level risk-based capital	**39.7**	20.7
Written premium to surplus ratio	**0.1**	n/a

The consolidated property casualty insurance group s ratio of investments in common stock to statutory surplus at 53.4 percent at year-end 2008 compared with 84.5 percent at year-end 2007. The life insurance company s ratio was 39.2 percent compared with 70.6 percent a year ago.

Our parent company s senior debt is rated by four independent ratings firms. In addition, the 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 financial obligations to policyholders and do not necessarily address all of the matters that may be important to shareholders. Ratings may be subject to revision or withdrawal at any time by the rating agency, and each rating should be evaluated independently of any other rating.

All of our insurance subsidiaries continue to be highly rated. 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 in June and July 2008 and subsequently lowered them. These actions followed our June announcement of significant catastrophe losses and declines in value of our investment assets.

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As of February 26, 2009, our credit and financial strength ratings were:

		Insurance Financial Strength Ratings									
Rating Agency	Parent Company Senior Debt Rating	Standard Market Property Casualty Insurance Subsidiary		Rating Tier	Life Insurance Subsidiary		Rating Tier	Surplus Lines Subsidiary		Rating Tier	Status (date)
A. M. Best Co.	a	A+	Superior	2 of 16	A	Excellent	3 of 16	A	Excellent	3 of 16	Stable outlook (12/19/08)
Fitch Ratings	A-	AA-	Very Strong	4 of 21	AA-	Very Strong	4 of 21				Negative outlook (2/13/09)
Moody s Investors Services	A3	A1	Good	5 of 21							Stable outlook (9/25/08)
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 December 22, 2008, A.M. Best affirmed its A (Excellent) financial strength rating and its issuer credit rating of The Cincinnati Specialty Underwriters Insurance Company, our surplus lines subsidiary. A.M. Best removed from under review with negative implications its financial strength and issuer credit ratings for our other insurance companies, lowering the financial strength ratings to A+ (Superior) for the standard market property casualty insurance group and member companies and to A (Excellent) for The Cincinnati Life Insurance Company. A.M. Best cited our continued exposure to the vagaries of the capital markets, at the same time raising the outlook to stable on all of the company s ratings to acknowledge our enhanced risk management processes, sound liquidity, superior risk-adjusted capitalization for our operating entities and successful business profile within our targeted regional markets.

Fitch Ratings On February 13, 2009, Fitch Ratings affirmed our ratings it had assigned in July 2008, continuing its negative outlook due to the downside risk in our equity portfolio. Fitch stated that it viewed favorably the number of steps we have taken to rebalance our equity portfolio and reduce exposure to the financial sector. Fitch noted our strong capitalization at the current ratings level and low operating leverage. In July 2008, Fitch had removed ratings for 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).

Moody s Investors Service On September 25, 2008, Moody s Investors Service removed our standard market property casualty insurance companies from review, lowering the insurance financial strength ratings to A1. The outlook on the ratings is stable. Moody s said its action reflected reduced shareholders equity and risk-adjusted capitalization, concerns about management of investment portfolio volatility, and increasing commercial lines competition. Moody s noted our strong regional franchise and strong risk-adjusted capitalization reflecting consistent reserve strength and manageable peak-level catastrophe exposure; and an excellent financial leverage profile accompanied by significant holding company liquidity.

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.

Our debt ratings are discussed in Item 7, Additional Sources of Liquidity, Page 71.

Operating Structure

We offer our broad array of insurance products through the independent agency channel. We recognize that locally based independent agencies have relationships in their communities that can lead to policyholder satisfaction, loyalty and profitable business. We seek to be a consistent and predictable property casualty carrier that agencies can rely on to serve their clients. For our standard market business, field and headquarters underwriters make risk-specific decisions about both new business and renewals.

In our 10 highest volume states for consolidated property casualty premiums, 910 reporting agency locations wrote 68.7 percent of our 2008 consolidated property casualty earned premium volume compared with 69.1 percent in 2007.

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Property Casualty Insurance Earned Premiums by State

(Dollars in millions)	Earned premiums	% of total earned	Agency locations	Average premium per location
Year ended December 31, 2008				
Ohio	**$630**	**20.9%**	**219**	**$ 2.9**
Illinois	**270**	**9.0**	**119**	**2.3**
Indiana	**205**	**6.8**	**104**	**2.0**
Pennsylvania	**183**	**6.1**	**80**	**2.3**
Georgia	**150**	**5.0**	**68**	**2.2**
North Carolina	**150**	**5.0**	**73**	**2.1**
Michigan	**135**	**4.5**	**101**	**1.3**
Virginia	**131**	**4.4**	**58**	**2.3**
Wisconsin	**108**	**3.6**	**48**	**2.3**
Tennessee	**102**	**3.4**	**40**	**2.6**
Year ended December 31, 2007				
Ohio	$664	21.2%	218	$ 3.0
Illinois	283	9.1	116	2.4
Indiana	218	7.0	101	2.2
Pennsylvania	188	6.0	77	2.4
North Carolina	154	4.9	69	2.2
Georgia	150	4.8	66	2.3
Michigan	146	4.7	95	1.5
Virginia	140	4.5	56	2.5
Wisconsin	114	3.6	47	2.4
Tennessee	103	3.3	37	2.8

Field Focus

We rely on our field associates to provide service and be accountable to our agencies for decisions we make at the local level. These associates live in the communities they serve and work from offices in their homes, providing 24/7 availability to our agents. Headquarters associates also provide agencies with underwriting, accounting and technology assistance and training. Company executives, headquarters underwriters and special teams regularly travel to visit agencies, strengthening the personal relationships we have with these organizations. Agents have opportunities for direct, personal conversations with our senior management team, and headquarters associates have opportunities to refresh their knowledge of marketplace conditions and field activities.

The field team is coordinated by field marketing representatives responsible for new commercial lines business underwriting. They are joined by field representatives specializing in claims, loss control, personal lines, machinery and equipment, bond, premium audit, life insurance and leasing. The field team provides many services for agencies and policyholders; for example, our field machinery and equipment and loss control representatives perform inspections and recommend specific actions to improve the safety of the policyholder s operations and the quality of the agent s account.

Agents work with us to carefully select risks and assure pricing adequacy. They appreciate the time our associates invest in creating solutions for their clients while protecting profitability, whether that means working on an individual case or customizing policy terms and conditions that preserve flexibility, choice and other sales advantages. We seek to develop long-term relationships by understanding the unique needs of their customers, our policyholders.

We also are responsive to agent needs for well designed property casualty products. Our commercial lines products are structured to allow flexible combinations of property and liability coverages in a single package with a single expiration date. This approach brings policyholders convenience, discounts and a reduced risk of coverage gaps or disputes. At the same time, it increases account retention and saves time and expense for the agency and our company.

We seek to employ technology solutions and business process improvements that:

- allow our agencies and our field and headquarters associates to collaborate more efficiently,
- provide our agencies the ability to access our systems and client data to process business transactions from their offices,
- automate our internal processes so our associates can spend more time serving agents and policyholders, and
- reduce duplicated effort and make our processes more efficient to reduce company and agency costs.

Agencies access our systems and other electronic services via their agency management systems or CinciLink®, our secure agency-only Web site. CinciLink provides an array of Web-based services and content that make it easier to do business with us, such as commercial and personal lines rating and processing systems, policy loss information, sales and marketing materials, educational courses on our products and services, accounting services, and electronic libraries for property and casualty coverage forms and state rating manuals.

Superior Claims Service

Our claims philosophy reflects our belief that we will prosper as a company by responding to claims person to person, paying covered claims promptly, preventing false claims from unfairly adding to overall premiums and building financial strength to meet future obligations.

Our 748 locally based field claims representatives work from their homes, assigned to specific agencies. They respond personally to policyholders and claimants, typically within 24 hours of receiving an agency s claim report. We believe we have a competitive advantage because of the person-to-person approach and the resulting high level of service that our field claims representatives provide. We also help our agencies provide prompt service to policyholders by giving agencies authority to immediately pay most first-party claims under standard market policies up to $2,500. We believe this same local approach to handling claims is a competitive advantage for our agents providing surplus lines coverage in their communities. Our field claims representatives handle these claims under the guidance of headquarters-based surplus lines claims managers.

Our property casualty claims operation uses CMS, a claims management system, to streamline processes and achieve operational efficiencies. CMS allows field and headquarters claims associates to collaborate on reported claims through a virtual claim file. Our field claims representatives use tablet computers to view and enter information into CMS from any location, including an insured s home or agent s office, and to print claim checks using portable printers. Agencies now can access selected CMS information such as activity notes on workers compensation claims. Later in 2009, activity notes for other business lines will be available to the agencies.

Catastrophe response teams are comprised of volunteers from our experienced field claims staff. We take pride in giving our field personnel the tools and authority they need to do their jobs. In times of widespread loss, our field claims representatives confidently and quickly resolve claims, often writing checks on the same day they inspect the loss. CMS introduced new efficiencies that are especially evident during catastrophes. Electronic claim files allow for fast initial contact of policyholders and easy sharing of information and data between rotating storm teams, headquarters and local field claims representatives. When hurricanes or other weather events are predicted, we can choose to have catastrophe response team members travel to strategic locations near the expected impact area. This puts them in position to quickly get to the affected area, set up temporary offices and start calling on policyholders.

Our claims associates work to control costs where appropriate. They use vendor resources that provide negotiated pricing to our insureds and claimants. Our field claims representatives also are educated continuously on new techniques and repair trends. They can leverage their local knowledge and experience with area body shops, which helps them negotiate the right price with any facility the policyholder chooses.

We staff a Special Investigations Unit with former law enforcement and claims professionals whose qualifications make them uniquely suited to gathering facts to uncover potential fraud. While we believe it s our job to pay what is due under each policy, we also want to prevent false claims from unfairly increasing overall premiums. Our SIU also operates a computer forensic lab, using sophisticated software to recover data and mitigate the cost of computer-related claims for business interruption and loss of records.

Loss and Loss Expense Reserves

When claims are made by or against policyholders, any amounts that our property casualty operations pay or expect to pay for covered claims are losses. The costs we incur in investigating, resolving and processing these claims are loss expenses. Our consolidated financial statements include property casualty loss and loss expense reserves that estimate the costs of not-yet-paid claims incurred through December 31 of each year. The reserves include estimates for claims that have been reported to us plus our estimates for claims that have been incurred but not yet reported (IBNR), along with our estimate for loss expenses associated with processing and settling those claims. We develop the various estimates based on individual claim evaluations and statistical projections. We reduce the loss reserves by an estimate for the amount of salvage and subrogation we expect to recover. Our annual review has led us to add to earnings in each of the past 20 years savings from favorable development of loss reserves on prior accident years.

We encourage you to review several sections of the Management s Discussion and Analysis where we discuss our loss reserves in greater depth. In Item 7, Critical Accounting Estimates, Property Casualty Insurance Loss and Loss Expense Reserves, Page 41, we discuss our process for analyzing potential losses and establishing reserves. In Item 7, Property Casualty Loss and Loss Expense Obligations and Reserves, Page 74, and Life Insurance Policyholder Obligations and Reserves, Page 80, we review reserve levels, including 10 year development of our property casualty loss reserves.

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Insurance Products

We actively market property casualty insurance in 35 states through a select group of independent insurance agencies. Our standard market commercial lines products are marketed in all of those states while our standard market personal lines are marketed in 27. We discuss our commercial lines and personal lines insurance operations and products in Commercial Lines Property Casualty Insurance Segment, Page 11, and Personal Lines Property Casualty Insurance Segment, Page 14. At year-end 2008, CSU Producer Resources marketed our surplus lines products to agencies in 33 states that represent Cincinnati Insurance.

The Cincinnati Specialty Underwriters Insurance Company was formed in 2007. The company was capitalized with $200 million from its parent company, The Cincinnati Insurance Company. It began offering surplus lines insurance products in January 2008. We structured this operation to exclusively serve the needs of the independent agencies that currently market our standard market insurance policies. When all or a portion of a current or potential client s insurance program requires surplus lines coverages, those agencies now can write the whole account with Cincinnati, gaining benefits not often found in the broader surplus lines market. Agencies have access to The Cincinnati Specialty Underwriters Insurance Company s product line through CSU Producer Resources, the wholly owned insurance brokerage subsidiary of parent-company Cincinnati Financial Corporation.

Cincinnati Specialty Underwriters and CSU Producer Resources employ a Web-based policy administration system to quote, bind, issue and deliver policies electronically to agents. This system also provides integration to existing document management and data management systems, allowing for straight-through processing of policies and billing.

We also support the independent agencies affiliated with our property casualty operations in their programs to sell life insurance. The products offered by our life insurance subsidiary round out and protect accounts and improve account persistency. At the same time, our life operation increases diversification of revenue and profitability sources for both the agency and our company.

Our property casualty agencies make up the main distribution system for our life insurance products. To help build scale, we also develop life business from other independent life insurance agencies in geographic markets not served through our property casualty agencies. We are careful to solicit business from these other agencies in a manner that does not conflict with or compete with the marketing and sales efforts of our property casualty agencies. We emphasize up-to-date products, responsive underwriting, high quality service and competitive pricing.

Other Services to Agencies

We complement the insurance operations by providing products and services that help attract and retain high-quality independent insurance agencies. When we appoint agencies, we look for organizations with knowledgeable, professional staffs. In turn, we make an exceptionally strong commitment to assist them in keeping their knowledge up to date and educating new people they bring on board as they grow. Numerous activities fulfill this commitment at our headquarters, in regional and agency locations, and online.

Except travel-related expenses for courses held at our headquarters, most programs are offered at no cost to our agencies. While that approach may be extraordinary in our industry today, the result is quality service for our policyholders and increased success for our independent agencies.

In addition to broad education and training support, we make non-insurance financial services available through CFC Investment Company. CFC Investment Company offers equipment and vehicle leases and loans for independent insurance agencies, their commercial clients and other businesses. It also provides commercial real estate loans to help agencies operate and expand their businesses. We believe that providing these services enhances agency relationships with their clients, increasing loyalty while diversifying the agency s revenues.

Strategic Initiatives

Management has worked with the board of directors to identify the strategies that can position us for long-term success. We broadly group these strategies into three areas of focus preserving capital, improving insurance profitability and driving premium growth correlating with the primary ways we measure our progress toward our long-term financial objectives. Our strategies are intended to position us to compete successfully in the markets we have targeted while minimizing risk. We believe successful implementation of the initiatives that support our strategies will help us better serve our agent customers, reduce volatility in our financial results and weather difficult economic, market or pricing cycles. We describe our expectations for the results of these initiatives in Item 7, Executive Summary of the Management s Discussion and Analysis, Page 37.

Preserve Capital

Our first strategy is to preserve capital. Implementation of the initiatives below that support this strategy is intended to preserve our capital and liquidity so that we can successfully grow our insurance business. A strong capital position provides the capacity to support premium growth and provides the liquidity to sustain our investment in the people and infrastructure needed to implement our other strategic initiatives.

The four primary capital preservation initiatives are:

Maintain a diversified and stabilized investment portfolio by applying parameters and tolerances We discuss our portfolio strategies in greater depth in Investments Segment, Page 17.

- o High-quality fixed-maturity portfolio that matches or exceeds total insurance reserves At year-end 2008, the average rating of the $5.827 billion fixed maturity portfolio was Aa3/A+, and the portfolio value exceeded total insurance reserve liability. We also have reinsurance recoverables to offset a portion of insurance reserves.

- o Parent company liquidity that increases our flexibility through all periods to maintain our cash dividend and to continue to invest in and expand our insurance operations We aim to keep approximately 90 percent of parent company investments in cash and marketable securities. At year-end 2008, we held $1.3 billion of our cash and invested assets at the parent company level, of which $809 million, or 61.5 percent, was invested in common stocks and $344 million, or 26.1 percent, was cash or cash equivalents.

- o Diversified equity portfolio that has no concentrated positions in single stocks or industries At year-end 2008, no single security accounted for more than 14.5 percent of our portfolio of publicly traded common stocks and no single sector accounted for more than 21.6 percent. Because of the strength of our fixed-maturity portfolio, we have the opportunity to invest for potential capital appreciation by purchasing equity securities. We seek to achieve a total return on the equity portfolio over any five-year period that exceeds that of the Standard & Poor s 500 Index while taking equal or less risk.

Minimize reliance on debt as a source of capital, maintaining the ratio of debt-to-total capital below 20 percent This target is higher than we had identified in previous years because total capital declined in 2008 although debt levels were essentially unchanged. At year-end 2008, this ratio was 16.7 percent compared with 12.7 percent at year-end 2007 and 11.0 percent at year-end 2006. Our long-term debt consists of three non-convertible, non-callable debentures, two due in 2028 and one in 2034.

Purchase reinsurance from highly rated reinsurers to mitigate underwriting risk and to support our ability to hold investments until maturity. See Item 7, 2009 Reinsurance Programs, Page 81, for additional details on these programs.

Identify tolerances for other operational risks and calibrate management decisions accordingly For example, we are developing programs to address the concentration of production operations at our headquarters location.

We measure the overall success of our strategy to preserve capital primarily by growing investment income and by achieving over any five-year period a total return on our equity investment portfolio that exceeds the Standard & Poor s 500 s return. We also monitor other measures. One of the most significant is our ratio of property casualty net written premiums to statutory surplus, which was 0.9-to-1 at year-end 2008 compared with 0.7-to-1 at year-end 2007 and 2006. This ratio is a common measure of operating leverage used in the property casualty industry; the lower the ratio the more capacity a company has for premium growth. The estimated property casualty industry net written premium to statutory surplus ratio also was 0.9-to-1 at year-end 2008, 0.8-to-1 at year-end 2007 and 0.9-to-1 at year-end 2006.

Our second means of verifying our capital preservation strategy is our financial strength ratings as discussed in Our Business and Our Strategy, Page 1. All of our insurance subsidiaries continue to be highly rated. A third means is measurement of our risk-based capital ratios, which currently indicate that our insurance subsidiaries are operating with a level of capital far exceeding regulatory requirements.

Improve Insurance Profitability

Our second strategy is to improve insurance profitability. Implementation of the operational initiatives below is intended to support improved cash flow and profitable growth for the agencies that represent us and for our company.

These initiatives primarily seek to strengthen our relationships with agents, allowing them to serve clients faster and manage expenses better. Others may streamline our internal processes so we can devote more time to agent service.

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The three primary initiatives to improve insurance profitability are:

Implement technology projects to improve critical efficiencies and streamline processes for our agencies, allowing us to win an increasing share of their business. By the end of this year, we expect to make significant strides with deployment of technology initiatives that enhance local decision making based on the local knowledge and risk selection expertise we derive from our agents and from having a large network of field representatives who live and work in our agents communities:

- o Predictive modeling tool for our workers compensation business line The tool will increase pricing precision so that our agents can better compete for the most desirable workers compensation business. We should begin using this tool to help make risk and pricing selection decisions during 2009.

- o Commercial lines policy administration system By year-end 2009, we expect to deploy a new system for commercial package and auto to all of our appointed agencies in 10 of our larger states with additional states in 2010. The new system includes direct bill capabilities and other features we need so we can cement our spot among the go-to carriers for our agencies.

- o Personal lines policy administration system In early 2010, our personal lines policy processing system will move to a next generation platform. We expect our agents efficiency to improve with newly designed, easier to use screens that can be delivered with greater speed. We continue to focus on making it easier for our agents to do business with us.

- o Online technologies to serve agencies and policyholders During 2009, we expect to introduce online services that agents have requested for policyholders. In the first quarter of 2009, personal lines policyholders whom we bill for our agents will be able to visit our Web site to make payments.

- o Improved claims processes with options such as agent access to more detailed information on the status of pending claims These capabilities help sustain our reputation for superior claims service by helping keep the agent better informed on the details of claim status. In 2009, we will enhance our response time for new claims by adding an online system for agency submission of notices of loss.

- o Improving our business data, supporting accurate underwriting, pricing and decisions Over the next several years, we will deploy a full data management program, including a property casualty insurance data warehouse. One of the greatest advantages will be enhanced granularity of pricing data.

Continue to staff field positions to ensure that we carefully select and evaluate new business on a case-by-case basis so we can grow profitably. At year-end 2008, we had 111 field marketing territories, up from 106 at the end of 2007 and 102 at the end of 2006.

- o Personal lines field marketing representatives In 2008, we expanded the role of our personal lines marketing representative by locating associates in states newer to our personal lines offerings. In these states, our personal lines automation has allowed us to introduce or broaden our product offerings. We now have two headquarters-based and three field-based personal lines marketing representatives and will add two more in the field in 2009. These representatives have underwriting authority and visit agencies on a regular basis to promote the advantages of Cincinnati personal lines.

- o Other field associates help provide our agents with superior service and support Additions are planned to the field teams that provide the local expertise, help us better understand the accounts we underwrite and provide another market advantage for our agents. In 2009, we expect to add three new premium audit representatives and three new loss control representatives, including two who will help support our expansion into western states. In 2010, we are considering additional machinery and equipment field positions.

Improve internal efficiencies to make best use of our resources Smart spending today means we will be even better prepared with strong, local market-based relationships when external conditions improve. Projects under way

include developing an energy efficiency plan for our headquarters buildings and reviewing underwriting workflow.
We measure the overall success of our strategy to improve insurance profitability primarily through our GAAP combined ratio, which we believe can be consistently below 100 percent over any five-year period.

In addition, we expect these initiatives to contribute to our rank as the No. 1 or No. 2 carrier based on premium volume in agencies that have represented us for at least five years. In 2008, we again earned that rank in more than 75 percent of the agencies that have represented Cincinnati Insurance for more than five years. We are working to improve that rank again in 2009 and in each of the years that follow.

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Drive Premium Growth

Our third strategy is to drive premium growth. Implementation of the operational initiatives below is intended to expand our geographic footprint and diversify our premium sources to obtain profitable growth without significant infrastructure expense. Diversified growth also may reduce our catastrophe exposure risk and temper negative changes that may occur in the economic, judicial or regulatory environments in the territories we serve.

The four primary initiatives to drive premium growth are:

New agency appointments in 2009 We continue to appoint new agencies in our current operating territories, adding 76 in 2008. Our objective is to appoint additional points of distribution each year. In 2009, we are targeting 65 appointments of independent agencies writing an aggregate $1 billion in property casualty premiums annually with all carriers they represent. This target includes appointments in the recently opened state of Texas.

In measuring progress towards achieving this initiative, we include appointment of new agency relationships with Cincinnati. For those that we believe will produce a meaningful amount of new business premiums, we also include appointment of agencies that merge with a Cincinnati agency and new branch offices opened by existing Cincinnati agencies. We made 76, 66 and 55 new appointments in 2008, 2007 and 2006, respectively. Of these new appointments, 52, 50 and 42, respectively, were new relationships. These new appointments and other changes in agency structures led to a net increase in reporting agency locations of 60 in 2008, 38 in 2007 and 37 in 2006. We seek to build a close, long-term relationships with each agency we appoint. We carefully evaluate the marketing reach of each new appointment to ensure the territory can support both current and new agencies.

New states With our entry into Texas during the fourth quarter of 2008, Cincinnati Insurance now is actively marketing our policies in 35 states, expanding our opportunities beyond the Midwest and South. We now have a sizeable presence in the western states opening New Mexico and eastern Washington in 2007, Utah in 2000, Idaho in 1999 and Montana in 1998. We entered Arizona in 1971. We plan to look next at taking Cincinnati Insurance to agencies in Colorado and Wyoming. While we continually study the regulatory and competitive environment in other states where we could decide to actively market our property casualty products, we have not announced the timetable for entry into new states.

We generally are able to reach a 10 percent share of an agency s business after 10 years. In Delaware, New Mexico and Washington, our three newest states, we ve appointed agencies that write about $400 million annually with all the carriers they represent. Our writings with these new agencies were almost 2 percent of that total in 2008.

We appointed our first agencies in Texas late in 2008. Over the next 18 months, we expect to appoint agencies in that state that write about $750 million in premiums annually with all carriers they represent.

Surplus lines insurance Another source of premium growth is our new surplus lines operation, which ended the year on track with products available in 33 states. We entered this business area to better serve our agents. Today, they write about $2.5 billion annually of surplus lines business with other carriers. We want to earn an appropriate share by bringing Cincinnati-style service to those clients. In 2008, our first year, we wrote $14 million in surplus lines premiums and met our 2008 strategic plan objectives.

Personal lines We are working to position our personal lines business for profitable future growth. By late-2009, we expect to have made more advances using tiered rating, helping to further improve our rate and credit structures. Personal lines rate changes made in 2008 have started to drive additional new business.

We believe additional rate changes that became effective the beginning of 2009 can further drive new business. These changes build on our 2006 introduction of credits for homeowner and personal auto products that began to address rates that were too high, our 2007 introduction of discounts on homeowner policies in some states when an auto policy is also purchased and our 2008 introduction of further credits and debits. These pricing refinements reduced premiums for many policies we write, presenting an opportunity to market the policy advantages to our agents more quality-conscious clientele.

We also are more aggressively tapping our potential to market personal lines insurance through agencies that already represent us for commercial lines. We began offering personal lines in two more states in 2008, expanded our product offerings in two others and expect to add two additional states Idaho, and South Carolina in early 2009. We expect to make personal lines available in these six states through agencies that write approximately $600 million in personal lines premiums annually with all carriers they represent.

We measure the overall success of this strategy to drive premium growth primarily through changes in net written premiums, which we believe can grow faster than the industry average over any five-year period.

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Notably, many of our growth initiatives have been under way for a year or more and helped us achieve 13 percent new business growth for 2008 although total written premiums were down on weak market pricing, economic pressures and a reinsurance restatement premium.

Our Segments

Consolidated financial results primarily reflect the results of our four reporting segments. These segments are defined based on financial information we use to evaluate performance and to determine the allocation of assets.

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

We also evaluate results for our consolidated property casualty operations, which is the total of our commercial lines, personal lines and surplus lines results.

Revenues, income before income taxes, and identifiable assets for each segment are shown in a table in Item 8, Note 18 of the Consolidated Financial Statements, Page 119. Some of that information also is discussed in this section of this report, where we explain the business operations of each segment. The financial performance of each segment is discussed in the Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, which begins on Page 37.

Commercial Lines Property Casualty Insurance Segment

The commercial lines property casualty insurance segment contributed net earned premiums of $2.316 billion to total revenues, or 60.6 percent of that total, and $70 million to income before income taxes in 2008. Commercial lines net earned premiums declined 3.9 percent in 2008 after growing 0.4 percent in 2007 and 6.6 percent in 2006.

Approximately 95 percent of our commercial lines premiums are written to provide accounts with coverages from more than one of our business lines. As a result, we believe that our commercial lines business is best measured and evaluated on a segment basis. However, we provide line of business data to summarize growth and profitability trends separately for our business lines. The seven commercial business lines are:

- Commercial casualty Commercial casualty insurance provides coverage to businesses against third-party liability from accidents occurring on their premises or arising out of their operations, including liability coverage for injuries sustained from products sold as well as coverage for professional services, such as dentistry. Specialized casualty policies may include liability coverage for employment practices liability (EPLI), which protects businesses against claims by employees that their legal rights as employees of the company have been violated, and other acts or failures to act under specified circumstances as well as excess insurance and umbrella liability, including personal umbrella liability written as an endorsement to commercial umbrella coverages. The commercial casualty business line includes liability coverage written on both a discounted and non-discounted basis as part of commercial package policies.
- Commercial property Commercial property insurance provides coverage for loss or damage to buildings, inventory and equipment caused by covered causes of loss such as fire, wind, hail, water, theft and vandalism, as well as business interruption resulting from a covered loss. Commercial property also includes crime insurance, which provides coverage for losses such as embezzlement or misappropriation of funds by an employee, among others, and inland marine insurance, which provides coverage for a variety of mobile equipment, such as contractor s equipment, builder s risk, cargo and electronic data processing equipment. Various property coverages can be written as stand-alone policies or can be added to a package policy. The commercial property business line includes property coverage written on both a non-discounted and discounted basis as part of commercial package policies.
- Commercial auto Commercial auto coverages protect businesses against liability to others for both bodily injury and property damage, medical payments to insureds and occupants of their vehicles, physical damage to an insured s own vehicle from collision and various other perils, and damages caused by uninsured motorists.
- Workers compensation Workers compensation coverage protects employers against specified benefits payable under state or federal law for workplace injuries to employees. We write workers compensation coverage in all of our active states except North Dakota, Ohio and Washington, where coverage is provided solely by the state instead of by private insurers.

Specialty packages   Specialty packages include coverages for property, liability and business interruption tailored to meet the needs of specific industry classes, such as artisan contractors, dentists, garage operators, financial institutions, metalworkers, printers, religious institutions, or smaller, main street businesses. Businessowners policies, which combine property, liability and business interruption coverages for small businesses, are included in specialty packages.

Surety and executive risk This business line includes:

- o Contract and commercial surety bonds, which guarantee a payment or reimbursement for financial losses resulting from dishonesty, failure to perform and other acts.

- o Fidelity bonds, which cover losses that policyholders incur as a result of fraudulent acts by specified individuals or dishonest acts by employees.

- o Director and officer liability insurance, which covers liability for alleged errors in judgment, breaches of duty and wrongful acts related to activities of for-profit or nonprofit organizations. Our director and officer liability policy can optionally include EPLI coverage.

Machinery and equipment Specialized machinery and equipment coverage can provide protection for loss or damage to boilers and machinery, including production and computer equipment, from sudden and accidental mechanical breakdown, steam explosion, or artificially generated electrical current.

Our emphasis is on products that agents can market to small- to mid-size businesses in their communities. Of our 1,387 reporting agency locations, eight market only our surety and executive risk products and four market only our personal lines products. The remaining 1,375 locations, located in all states in which we actively market, offer some or all of our standard market commercial insurance products.

In 2008, our 10 highest volume commercial lines states generated 65.9 percent of our earned premiums compared with 66.7 percent in the prior year. Earned premiums in the 10 highest volume states decreased 4.4 percent in 2008 and decreased 3.1 percent in the remaining 25 states. The number of reporting agency locations in our 10 highest volume states increased to 905 in 2008 from 878 in 2007.

Commercial Lines Earned Premiums by State

(Dollars in millions)	Earned premiums	% of total earned	Agency locations	Average premium per location
Year ended December 31, 2008				
Ohio	**$377**	**16.2%**	**218**	**$ 1.7**
Illinois	**222**	**9.5**	**118**	**1.9**
Pennsylvania	**166**	**7.1**	**80**	**2.1**
Indiana	**148**	**6.4**	**103**	**1.4**
North Carolina	**143**	**6.2**	**73**	**2.0**
Virginia	**111**	**4.8**	**58**	**1.9**
Michigan	**107**	**4.6**	**99**	**1.1**
Georgia	**89**	**3.8**	**68**	**1.3**
Wisconsin	**88**	**3.8**	**48**	**1.8**
Tennessee	**82**	**3.5**	**40**	**2.1**
Year ended December 31, 2007				
Ohio	$397	16.5%	216	$ 1.8
Illinois	234	9.7	115	2.0
Pennsylvania	170	7.0	77	2.2
Indiana	158	6.6	100	1.6
North Carolina	147	6.1	69	2.1
Virginia	119	4.9	56	2.1

Michigan	115	4.8	95	1.2
Wisconsin	94	3.9	47	2.0
Georgia	88	3.7	66	1.3
Tennessee	81	3.5	37	2.2

For new commercial lines business, case-by-case underwriting and pricing is coordinated by our locally based field marketing representatives. Our agents and our field marketing, claims, loss control, premium audit, bond and machinery and equipment representatives get to know the people and businesses in their communities and can make informed decisions about each risk. These field marketing representatives also are responsible for selecting new independent agencies, coordinating field teams of specialized company representatives and promoting all of the company s products within the agencies they serve.

Commercial lines policy renewals are managed by headquarters underwriters who are assigned to specific agencies and consult with local field staff as needed. As part of our team approach, the headquarters underwriter also helps oversee agency growth and profitability. They are responsible for formal issuance of all new business and renewal policies as well as policy endorsements. Further, the headquarters underwriters provide day-to-day customer service to agencies and marketing representatives by providing product training, answering underwriting questions, helping to determine underwriting eligibility and assisting with the mechanics of premium determination.

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Our commercial lines packages are typically offered on a three-year policy term for most insurance coverages, a key competitive advantage. Although we offer three-year policy terms, premiums for some coverages within those policies are adjustable at anniversary for the next annual period, and policies may be cancelled at any time at the discretion of the policyholder. Contract terms often provide that rates for property, general liability, inland marine and crime coverages, as well as policy terms and conditions, are fixed for the term of the policy. The general liability exposure basis may be audited annually. Commercial auto, workers compensation, professional liability and most umbrella liability coverages within multi-year packages are rated at each of the policy s annual anniversaries for the next one-year period. The annual pricing could incorporate rate changes approved by state insurance regulatory authorities between the date the policy was written and its annual anniversary date, as well as changes in risk exposures and premium credits or debits relating to loss experience and other underwriting judgment factors. We estimate that approximately 75 percent of 2008 commercial premiums were subject to annual rating or were written on a one-year policy term.

In our experience, multi-year packages are somewhat less price sensitive for the quality-conscious insurance buyers who we believe are typical clients of our independent agents. Customized insurance programs on a three-year term complement the long-term relationships these policyholders typically have with their agents and with the company. By reducing annual administrative efforts, multi-year policies lower expenses for our company and for our agents. The commitment we make to policyholders encourages long-term relationships and reduces their need to annually re-evaluate their insurance carrier or agency. We believe that the advantages of three-year policies in terms of improved policyholder convenience, increased account retention and reduced administrative costs outweigh the potential disadvantage of these policies, even in periods of rising rates.

Staying abreast of evolving market conditions is a critical function, accomplished in both an informal and a formal manner. Informally, our field marketing representatives and underwriters are in constant receipt of market intelligence from the agencies with which they work. Formally, our commercial lines product management group and field marketing associates conduct periodic surveys to obtain competitive intelligence. This market information helps identify the top competitors by line of business or specialty program and also identifies our market strengths and weaknesses. The analysis encompasses pricing, breadth of coverage and underwriting/eligibility issues.

In addition to reviewing our competitive position, our product management group and our underwriting audit group review compliance with our underwriting standards as well as the pricing adequacy of our commercial insurance programs and coverages. Further, our research and development department analyzes opportunities and develops new products, new coverage options and improvements to existing insurance products.

At year-end 2008, we supported our commercial lines operations with a variety of technology tools. WinCPP® is our commercial lines premium quoting system. WinCPP is available in all of our agency locations in which we actively market commercial lines insurance and provides quoting capabilities for nearly 100 percent of our new and renewal commercial lines business. WinCPP works with our real-time agency interface, CinciBridge , which allows automated movement of key underwriting data from an agency s management system to WinCPP, reducing agents data entry and allowing seamless quoting and rating capabilities.

Many small business accounts written as Businessowners Policies (BOP) and Dentist s Package Policies (DBOP) are eligible to be issued at our agency locations through our Web-based e-CLAS® policy processing system. (A businessowners policy combines property, liability and business interruption coverages for small businesses.) e-CLAS provides full policy lifecycle transactions, including quoting, issuance, policy changes, renewal processing and policy printing at the agency location. These features make it easy and efficient for our agencies to issue and service these policies. At year-end 2008, e-CLAS for BOP and DBOP was in use in 30 states representing 98 percent of our premiums for these products, which are included in the specialty packages commercial line of business. e-CLAS also uses CinciBridge to provide real-time data transfer with agency management systems.

We have been streamlining internal processes and achieving operational efficiencies in our headquarters commercial lines operations through deployment of iView , a policy imaging and workflow system. This system provides online access to electronic copies of policy files, enabling our underwriters to respond to agent requests and inquiries more quickly and efficiently. iView also automates internal workflows through electronic routing of underwriting and processing work tasks. At year-end 2008, more than 92 percent of in-force non-workers compensation commercial lines policy files were administered and stored electronically in iView. Workers compensation policies are to be added to iView in 2009.

Commercial Lines Insurance Marketplace

Our competition for the types and sizes of commercial accounts we typically write in the standard market predominantly consists of those companies that also distribute through independent agencies. The independent agencies that market our commercial lines products typically represent six to 12 standard market insurance carriers, including both national and regional carriers, some of which may be mutual companies. Overall, the softening commercial lines marketplace of the past several years continued to intensify in 2008. Over this period, anecdotal reports of very aggressive pricing have grown in frequency. Over the course of 2008, we saw many situations where underwriting discipline appeared to slip as carriers sought to capture market share. Many carriers continued to manage the soft market conditions by working aggressively to protect their renewal portfolios. Renewal decreases in the mid-single digits were still prevalent in the fourth quarter of 2008; however, we have worked to retain our best renewal business while continuing to write new business and maintain underwriting discipline. In late 2008 and early 2009, we have begun to see preliminary indications leading us to believe that market pricing may be starting to level.

Personal Lines Property Casualty Insurance Segment

The personal lines property casualty insurance segment contributed net earned premiums of $689 million to total revenues, or 18.0 percent of the total, and reported a loss before income taxes of $82 million in 2008. Personal lines net earned premiums declined 3.4 percent in 2008, 6.3 percent in 2007 and 5.3 percent in 2006.

We prefer to write personal lines coverage in accounts that include both auto and homeowner coverages as well as coverages that are part of our other personal business line. As a result, we believe that our personal lines business is best measured and evaluated on a segment basis. However, we provide line of business data to summarize growth and profitability trends separately for three business lines:

- Personal auto This business line includes personal auto coverages that protect against liability to others for both bodily injury and property damage, medical payments to insureds and occupants of their vehicle, physical damage to an insured s own vehicle from collision and various other perils, and damages caused by uninsured motorists. In addition, many states require policies to provide first-party personal injury protection, frequently referred to as no-fault coverage.
- Homeowners This business line includes homeowner coverages that protect against losses to dwellings and contents from a wide variety of perils, as well as liability arising out of personal activities both on and off the covered premises. The company also offers coverage for condominium unit owners and renters.
- Other personal lines This includes the variety of other types of insurance products we offer to individuals such as dwelling fire, inland marine, personal umbrella liability and watercraft coverages.

At year-end, we marketed personal lines insurance products through 954 of our 1,387 reporting agency locations in 27 of the 35 states in which we offer standard market commercial lines insurance. The remaining 433 locations primarily are in states where we do not yet actively market these products; some are in locations where we have determined, in conjunction with agency management, that our personal lines products were not appropriate for their agencies at this time. As discussed in Strategic Initiatives, Page 7, introducing personal lines to these agencies is one of the ways we intend to grow profitably in the next several years. The number of reporting agency locations in our 10 highest volume states increased to 627 in 2008 from 604 in 2007.

In 2008, our 10 highest volume personal lines states generated 85.1 percent of our earned premiums compared with 84.9 percent in the prior year. Earned premiums in the 10 highest volume states declined 3.0 percent in 2008 and declined 6.4 percent in the remaining states.

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Personal Lines Earned Premiums by State

(Dollars in millions)	Earned premiums	% of total earned	Agency locations	Average premium per location
Year ended December 31, 2008				
Ohio	**$253**	**36.8%**	**199**	**$ 1.3**
Georgia	**61**	**8.9**	**60**	**1.0**
Indiana	**57**	**8.3**	**76**	**0.8**
Illinois	**48**	**7.0**	**84**	**0.6**
Alabama	**41**	**5.9**	**37**	**1.1**
Kentucky	**34**	**5.0**	**36**	**0.9**
Michigan	**28**	**4.0**	**70**	**0.4**
Florida	**24**	**3.4**	**10**	**2.4**
Virginia	**20**	**2.9**	**25**	**0.8**
Wisconsin	**20**	**2.9**	**30**	**0.7**
Year ended December 31, 2007				
Ohio	$266	37.3%	200	$ 1.3
Georgia	61	8.6	58	1.1
Indiana	59	8.3	71	0.8
Illinois	49	6.8	81	0.6
Alabama	37	5.2	33	1.1
Kentucky	37	5.2	36	1.0
Michigan	31	4.4	64	0.5
Florida	23	3.2	10	2.3
Virginia	21	3.0	22	1.0
Wisconsin	20	2.9	29	0.7

New and renewal personal lines business reflects our risk-specific underwriting philosophy. Each agency selects personal lines business primarily from within the geographic territory that it serves, based on the agent s knowledge of the risks in those communities or familiarity with the policyholder. Personal lines activities are supported by headquarters associates assigned to individual agencies. We now have five full-time personal lines marketing representatives, two headquarters based and three living in the field, and plan to add two more in 2009. These marketing representatives have underwriting authority and visit agencies on a regular basis. They reinforce the advantages of our personal lines products and offer training in the use of our processing system.

Competitive advantages of our personal lines coverages include our claims service, credit structure and customizable endorsements for both the personal auto and homeowner policies. Most of our personal lines products are processed through Diamond, our real-time personal lines policy processing system, which supports and allows once-and-done processing. Diamond incorporates features frequently requested by our agencies such as direct bill and monthly payment plans, local and headquarters policy printing options, data transfer to and from popular agency management systems and real-time integration with third-party data such as insurance scores, motor vehicle reports and address verification. At year-end 2008, Diamond was in use in 24 states representing approximately 99 percent of our personal lines premium volume, all of which is on a one-year term.

In 2006, we introduced PL-efiles, a policy imaging system, to our personal lines operations. Through year-end 2008, we had transitioned information on current Diamond personal lines policies to PL-efiles and continue to work on imaging necessary older information. The transition replaces paper format with electronic copies of policy documents. PL-efiles complements the Diamond system by giving personal lines underwriters and support staff online access to policy documents and data, enabling them to respond to agent requests and inquiries quickly and efficiently.

Personal Lines Insurance Marketplace

The independent agencies that market our personal lines products typically represent four to six standard personal lines carriers. In addition to carriers that market through independent agents, our personal lines competition also includes carriers that market through captive agents and direct writers, which our agencies clients may investigate independently.

Over the past several years, we have seen increased competition in the personal lines marketplace, driven by industrywide improvement in results and favorable frequency and severity trends. The increased competition in the past several years also reflected implementation of tiered rating systems by a growing number of carriers. Carriers that have adopted these systems rely on increasingly more data, including credit-based information, to identify multiple relevant variables to segment the market.

We expect the overall market to remain competitive, with small pricing increases in personal lines over the next 12 to 24 months. Carriers will continue to increase the sophistication of their pricing to attract more preferred customers and gain market share. Industry results should continue to improve if catastrophe losses return to a normalized level.

Life Insurance Segment

The life insurance segment contributed $126 million, or 3.3 percent, of net earned premiums and $4 million of income before income taxes in 2008. Life insurance segment profitability is discussed in detail in Item 7, Life Insurance Results of Operations, Page 64. Life insurance net earned premiums grew 0.8 percent in 2008, 9.0 percent in 2007 and 7.9 percent in 2006.

The overall mission of our company is supported by The Cincinnati Life Insurance Company. Cincinnati Life helps meet the needs of our agencies, including increasing and diversifying agency revenues. We primarily focus on life products that produce revenue growth through a steady stream of premium payments. By diversifying revenue and profitability for both the agency and our company, this strategy enhances the already strong relationship built by the combination of the property casualty and life companies.

Cincinnati Life seeks to become the life insurance carrier of choice for the independent agencies that work with our property casualty operations. We emphasize up-to-date products, responsive underwriting and high quality service as well as competitive commissions. At year-end 2008, almost 75 percent of our 1,387 property casualty reporting agency locations offered Cincinnati Life s products to their clients. We also develop life business from approximately 500 other independent life insurance agencies. We are careful to solicit business from these other agencies in a manner that does not conflict with or compete with the marketing and sales efforts of our property casualty agencies.

Life Insurance Business Lines

Four lines of business term insurance, universal life insurance, worksite products and whole life insurance account for approximately 83.7 percent of the life insurance segment s revenues:

- Term insurance policies under which a death benefit is payable only if the insured dies during a specific period of time. For policies without a return of premium provision, no benefit is payable if the insured person survives to the end of the term. For policies in-force with a return of premium provision, a benefit equal to the sum of all paid premiums is payable if the insured person survives to the end of the term. While premiums are fixed, they must be paid as scheduled. The policies are fully underwritten.
- Universal life insurance long-duration life insurance policies. Contract premiums are neither fixed nor guaranteed; however, the contract does specify a minimum interest crediting rate and a maximum cost of insurance charge and expense charge. Premiums are not fixed and may be varied by the contract owner. The cash values, available as a loan collateralized by the cash surrender value, are not guaranteed and depend on the amount and timing of actual premium payments and the amount of actual contract assessments. The policies are fully underwritten.
- Worksite products term insurance, whole life insurance, universal life and disability insurance offered to employees through their employer. Premiums are collected by the employer using payroll deduction. Polices are issued using a simplified underwriting approach and on a guaranteed issue basis. Worksite insurance products provide our property casualty agency force with excellent cross-serving opportunities for both commercial and personal accounts. Agents report that offering worksite marketing to employees of their commercial accounts provides a benefit to the employees at no cost to the employer. Worksite marketing also connects agents with new customers who may not have previously benefited from receiving the services of a professional independent insurance agent.
- Whole life insurance policies that provide life insurance for the entire lifetime of the insured; the death benefit is guaranteed never to decrease and premiums are guaranteed never to increase. While premiums are fixed, they must be paid as scheduled. These policies provide guaranteed cash values that are available as loans collateralized by the cash surrender value. The policies are fully underwritten.

In addition, Cincinnati Life markets:

- Disability income insurance provides monthly benefits to offset the loss of income when the insured person is unable to work due to accident or illness.
- Deferred annuities provide regular income payments that commence after the end of a specified period or when the annuitant attains a specified age. During the deferral period, any payments made under the contract accumulate at the crediting rate declared by the company but not less than a contract-specified guaranteed minimum interest rate. A deferred annuity may be surrendered during the deferral period for a cash value equal to the accumulated

payments plus interest less the surrender charge, if any.

Immediate annuities provide some combination of regular income and lump sum payments in exchange for a single premium. Immediate annuities also are written by our life insurance segment and purchased by our property casualty companies to settle casualty claims.

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Life Insurance Marketplace

Our property casualty agencies comprise the main distribution system for our life insurance segment. While other life insurance carriers continue to expand the use of nontraditional distribution channels, such as banks or direct sales as alternatives to the agency channel, we intend to market solely through independent agencies, with an emphasis on enhancing relationships with agencies affiliated with our property casualty insurance operations.

When marketing through our property casualty agencies, we have specific competitive advantages:

- Because our property casualty operations are held in high regard, property casualty agency management is predisposed to consider selling our life products.
- Marketing efforts for both our property casualty and life insurance businesses are directed by our field marketing department, which assures consistency of communication and operations. Life field marketing representatives are available to meet face-to-face with agency personnel and their clients as well.
- The resources of our life headquarters underwriters and other associates are available to the agents and field team to assist in the placement of business. Fewer and fewer of our competitors provide direct, personal support between the agent and the insurance carrier.

We continue to emphasize the cross-serving opportunities of our life insurance, including term and worksite products, for the property casualty agency s personal and commercial accounts. In both the property casualty and independent life agency distribution systems, we enjoy the advantages of offering competitive, up-to-date products, providing close personal attention in combination with financial strength and stability.

- We primarily offer products addressing the needs of businesses with key person and buy-sell coverages. We offer personal and commercial clients of our agencies quality, personal life insurance coverage.
- Term insurance is our largest life insurance product line. We continue to introduce new term products with features our agents indicate are important, such as a return of premium rider, and we have restructured our underwriting classifications to better meet the needs of their clients.

Because of our strong capital position, we can offer a competitive product portfolio including guaranteed products, giving our agents a marketing edge. Our life insurance company maintains strong insurer financial strength ratings: A.M. Best A (Excellent), Fitch AA- (Very Strong) and Standard & Poor s A+ (Strong), as discussed in Financial Strength, Page 3. Our life insurance company has not chosen to establish a Moody s rating.

Current statutory laws and regulations require life insurance companies to hold redundant reserves, particularly for preferred risk underwriting classes. While these redundant reserves have no effect on GAAP results, they depress statutory earnings and require a large commitment of capital. Redundant reserves are a significant issue, not just for our life insurance operations, but for all writers of term insurance and universal life with secondary guarantees.

The National Association of Insurance Commissioners recognizes the problems caused by redundant reserves and is considering a principles-based reserving system rather than the current formulaic system. While still capturing all material risks, a principles-based system would allow a company to use its own experience, subject to credibility standards and appropriate margins for uncertainty. Also, under the proposed principles-based system, the insurer would fully document and disclose all its assumptions and methods to regulatory officials.

Investments Segment

The investment segment contributed $675 million, or 17.6 percent, of our total revenues in 2008, primarily from net investment income and from realized investment gains and losses from investment portfolios managed for the holding company and each of the operating subsidiaries. After deducting $63 million in interest credited to contract holders of the life insurance segment, the investments segment contributed $612 million of income before income taxes, or more than 100 percent of our 2008 total income before income taxes.

During 2008, our board and investment department adopted internal guidelines to place additional parameters around our portfolio. These parameters address, among other issues, the overall mix of the portfolio as well as security and sector concentrations. The parameters came out of our risk management program, with the goal of more specifically defining our risk tolerances, aligning our operating plan accordingly and improving management s ability to identify and respond to changing conditions. Going forward, we will evaluate all of our fixed-maturity and equity investments using our investment parameters, as appropriate.

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The fair value (market value) of our investment portfolio was $8.807 billion and $12.198 billion at year-end 2008 and 2007, respectively. Despite the market turmoil of 2008 and our decision to realize $1.024 billion in gains on security sales during the year, the overall portfolio remained in an unrealized gain position at year-end.

The cash we generate from insurance operations historically has been invested in three broad categories of investments:

- Fixed-maturity investments Includes taxable and tax-exempt bonds and redeemable preferred stocks. During 2008 and 2007, purchases served to offset sales, calls and market value declines.
- Equity investments Includes common and nonredeemable preferred stocks. During 2008 and 2007, sales and market value declines of equity securities more than offset purchases and market value appreciation.
- Short-term investments Primarily commercial paper.

	At December 31, 2008				At December 31, 2007			
(In millions)	**Book value**	**% of BV**	**Fair value**	**% of FV**	Book value	% of BV	Fair value	% of FV
Taxable fixed maturities	**$3,354**	**40.8%**	**$3,094**	**35.1%**	$3,265	36.9%	$ 3,284	26.9%
Tax-exempt fixed maturities	**2,704**	**32.9**	**2,733**	**31.0**	2,518	28.4	2,564	21.0
Common equities	**1,889**	**23.0**	**2,721**	**30.9**	2,715	30.7	6,020	49.4
Preferred equities	**188**	**2.3**	**175**	**2.0**	260	2.9	229	1.9
Short-term investments	**84**	**1.0**	**84**	**1.0**	101	1.1	101	0.8
Total	**$8,219**	**100.0%**	**$8,807**	**100.0%**	$8,859	100.0%	$12,198	100.0%

We actively determine the portion of new cash flow to be invested in fixed-maturity and equity securities at the parent and insurance subsidiary levels. We consider internal measures, as well as insurance department regulations and ratings agency guidance. We monitor a variety of metrics, including after-tax yields, the ratio of investments in common stocks to statutory surplus for the property casualty and life insurance operations and the parent company s ratio of investment assets to total assets.

At year-end 2008, 1.6 percent of the value of our investment portfolio was made up of securities that do not actively trade on a public market and require management s judgment to develop pricing or valuation techniques (Level 3 assets). We obtain at least two outside valuations for these assets and generally use the more conservative calculation. These investments include private placements, small issues and various thinly traded securities. See Item 7, Fair Value Measurements, Page 45, and Item 8, Note 3 of the Consolidated Financial Statements Page 106, for additional discussion of our valuation techniques.

In addition to securities held in our investment portfolio, at year-end 2008, other invested assets included $37 million of life policy loans, $32 million of venture capital fund investments, $8 million of private equity investments and $6 million of investment in real estate.

Fixed-maturity and Short-term Investments

By maintaining a well diversified fixed-maturity portfolio, we attempt to reduce overall risk. We invest new money in the bond market on a continuous basis, targeting what we believe to be optimal risk-adjusted after-tax yields. Risk, in this context, includes interest rate, call, reinvestment rate, credit and liquidity risk. We do not make a concerted effort to alter duration on a portfolio basis in response to anticipated movements in interest rates. By continuously investing in the bond market, we build a broad, diversified portfolio that we believe mitigates the impact of adverse economic factors.

We place a strong emphasis on purchasing current income-producing securities for the insurance companies portfolios. Within the fixed-maturity portfolio, we invest in a blend of taxable and tax-exempt securities with an eye toward maximizing credit adjusted after-tax yields.

During the third quarter of 2008, we terminated a securities lending program under which certain fixed maturities from our investment portfolio were loaned to other institutions for short periods of time. As a result, no securities were on loan at year-end 2008 compared with $745 million at year-end 2007. We discuss the program in Item 8, Note 2 of the Consolidated Financial Statements, Page 104.

In conjunction with the program termination, we returned the collateral but chose to retain a small portfolio of collateralized mortgage obligations (CMOs) rather than sell them at what we felt were distressed prices in an illiquid market. The CMOs were an investment made by one of the short-duration funds, which subsequently dissolved and distributed the assets to its investors. All $30 million of the CMOs in the portfolio are collateralized by Alt-A mortgages that originated between 2004 and 2006. Consequently, at December 31, 2008, we owned investment-grade CMOs with a fair value and book value of $27 million and $39 million, respectively. Of the $27 million investment-grade CMOs, $21 million were rated AAA by Standard & Poor s. We also owned non-investment grade CMOs that had a fair value and book value of $3 million and $4 million, respectively. We do not intend to make additional investments in this asset category.

Fixed-maturity and Short-term Portfolio Ratings

As of year-end 2008, the portfolio was trading at 96.2 percent of its book value, in line with general market conditions. The general level of interest rates decreased over the course of 2008; however, credit spreads widened considerably due to a continued flight to quality.

The downward shift in the higher portfolio ratings during 2008 primarily was driven by significant calls of government sponsored entities (GSE) bonds, as well as rating withdrawals that occurred in response to the difficulties experienced by certain municipal bond insurers. The majority of our non-rated securities are tax-exempt municipal bonds from smaller municipalities that chose not to pursue a credit rating. Credit ratings as of December 31 for the fixed-maturity and short-term portfolio were:

	At December 31, 2008		At December 31, 2007	
(Dollars in millions)	Fair value	Percent to total	Fair value	Percent to total
Moody s Ratings and Standard & Poor s Ratings combined				
Aaa, Aa, A, AAA, AA, A	**$ 4,149**	**70.2%**	$ 4,366	73.4%
Baa, BBB	**1,258**	**21.3**	1,076	18.1
Ba, BB	**240**	**4.1**	225	3.8
B, B	**46**	**0.8**	110	1.8
Caa, CCC	**7**	**0.1**	25	0.4
Ca, CC	**3**	**0.1**	0	0.0
C, C	**0**	**0.0**	0	0.0
Non-rated	**208**	**3.4**	147	2.5
Total	**$ 5,911**	**100.0%**	$ 5,949	100.0%

We discuss the maturity of our fixed-maturity portfolio in Item 8, Note 2 of the Consolidated Financial Statements, Page 104. Attributes of the fixed-maturity portfolio include:

	Years ended December 31, **2008**	2007
Weighted average yield-to-book value	**5.6%**	5.3 %
Weighted average maturity	**8.2 yrs**	8.0 yrs
Effective duration	**5.4 yrs**	4.8 yrs

Taxable Fixed Maturities

Our taxable fixed-maturity portfolio (at fair value) at year-end 2008 included:

- $389 million in U.S. agency paper that is rated Aaa/AAA by Moody s and Standard & Poor s, respectively.
- $2.324 billion in investment-grade corporate bonds that have a Moody s rating at or above Baa3 or a Standard & Poor s rating at or above BBB-.
- $210 million in high-yield corporate bonds that have a Moody s rating below Baa3 or a Standard & Poor s rating below BBB-.
- $171 million in convertible bonds and redeemable preferred stocks.

Our strategy typically is to buy and hold fixed-maturity investments to maturity, but we monitor credit profiles and market value movements when determining holding periods for individual securities. With the exception of U.S. agency paper (government-sponsored entities), no individual issuer s securities accounted for more than 1.7 percent of the taxable fixed-maturity portfolio at year-end 2008.

The investment-grade corporate bond portfolio is most heavily concentrated in the financial-related sectors, including banks, brokerage, finance and investment and insurance companies. The financial sectors represented 34.2 percent of fair value of this portfolio at year-end 2008, compared with 42.1 percent, at year-end 2007. Although the financial-related sectors make up our largest group of investment-grade corporate bonds, we believe our concentration is below the average for the corporate bond market as a whole. Utilities are the only other sector that exceeds 10 percent of our investment-grade corporate bond portfolio, at 11.6 percent of fair value at year-end 2008.

Tax-exempt Fixed Maturities

We traditionally have purchased municipal bonds focusing on general obligation and essential services bonds, such as sewer, water or others. While no single municipal issuer accounted for more than 0.6 percent of the tax-exempt municipal bond portfolio at year-end 2008, there are higher concentrations within individual states. Holdings in Texas and Indiana accounted for a total of 35.0 percent of the municipal bond portfolio at year-end 2008.

In recent years, we have purchased insured municipal bonds because of their excellent credit-adjusted after-tax yields. At year-end 2008, bonds representing $2.290 billion, or 83.8 percent, of the fair value of our municipal portfolio were insured with an average rating of AAA. Because of our emphasis on general obligation and essential services bonds, over 90 percent of the insured municipal bonds have an underlying rating of at least A3 or A-.

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Short-term Investments

Our short-term investments consist primarily of commercial paper, demand notes or bonds purchased within one year of maturity. We make short-term investments primarily with funds to be used to make upcoming cash payments, such as taxes. At year-end 2008, we had $84 million of short-term investments compared with $101 million at year-end 2007.

Equity Investments

After covering both our intermediate and long-range insurance obligations with fixed-maturity investments, we historically used available cash flow to invest in equity securities. Investment in equity securities has played an important role in achieving our portfolio objectives and has contributed to portfolio appreciation. We remain committed to our long-term equity focus, which we believe is key to our company s long-term growth and stability.

Common Stocks

Our common stock investments generally are dividend-paying securities. In this market, we are seeking to maximize our potential return while minimizing dividend income risk by selecting securities from a variety of dividend scenarios, including those with the potential for dividend growth from a below-market current yield. Other criteria we evaluate include increasing sales and earnings, proven management and a favorable outlook. We believe our equity investment style is an appropriate long-term strategy after we have purchased fixed maturity investments to cover our insurance reserves.

In mid-2008, we began applying new investment guidelines that increased portfolio diversification, reducing single issue and sector concentrations. Our year-end 2008 portfolio has been positioned for reduced volatility going forward. As a result, despite economic and market disruptions that led to unprecedented value declines, our equity portfolio suffered less than the broader indices during 2008.

We view our diversifying actions to be consistent with our view of prudent risk management. At year-end 2008, our financial sector holdings were 12.4 percent of our $2.7 billion publicly traded common stock portfolio, below the Standard & Poor s 500 weighting, and significantly lower than our 56.2 percent financial sector weighting at year-end 2007. Among other changes, we reduced our Fifth Third Bancorp (NASDAQ:FITB) holding to approximately 12 million shares at year-end 2008. Following Fifth Third s further reduction of its dividend payout in December 2008, we sold the remainder of our holding in January 2009 for an additional capital gain. We expect to continue to make changes to the portfolio, as deemed appropriate.

Proceeds of sales are being reinvested in both fixed income and equity securities with yields that we believe are likely to be more secure. This may slow the return to growth in investment income although we believe year-over-year comparisons may turn positive in the second half of 2009.

Common Stock Portfolio Industry Sector Distribution

	Percent of Publicly Traded Common Stock Portfolio			
	At December 31, 2008		At December 31, 2007	
	Cincinnati Financial	S&P 500 Industry Weightings	Cincinnati Financial	S&P 500 Industry Weightings
Sector:				
Healthcare	**21.6%**	**14.8%**	10.2%	12.0%
Consumer staples	**19.8**	**12.8**	10.7	10.2
Energy	**16.8**	**13.3**	11.5	12.9
Financial	**12.4**	**13.3**	56.2	17.6
Utilities	**9.3**	**4.2**	4.8	3.6
Consumer discretionary	**6.6**	**8.4**	2.8	8.5
Industrials	**6.1**	**11.1**	1.9	11.5
Information technology	**4.2**	**15.3**	1.9	16.8
Materials	**1.9**	**3.0**	0.0	3.3

Telecomm services	**1.3**	**3.8**	0.0	3.6
Total	**100.0%**	**100.0%**	100.0%	100.0%

At year-end 2008, 29.7 percent of our common stock holdings (measured by fair value) were held at the parent company level.

Until June 2008, we had held more than 10 percent of Fifth Third s common stock for many years. We continue to hold more than 5 percent of Piedmont Natural Gas Company (NYSE:PNY). At year-end 2008, there were 12 holdings with a fair value equal to or greater than 2 percent of our publicly traded common stock portfolio compared with 15 similar holdings at year-end 2007. No single issue accounted for more than 14.5 percent at year-end 2008.

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Nonredeemable Preferred Stocks

We evaluate preferred stocks in a manner similar to the evaluation we make for fixed-maturity investments, seeking attractive relative yields. We generally focus on investment-grade preferred stocks issued by companies that have a strong history of paying common dividends, providing us with another layer of protection. We believe that careful application of this strategy continues to have merit, although events of 2008 indicated that preferred stocks will not receive preferential treatment in a government-sponsored restructuring. When possible, we seek out preferred stocks that offer a dividend received deduction for income tax purposes.

Additional information regarding the composition of investments is included in Item 8, Note 2 of the Consolidated Financial Statements, Page 104.

Other

We report as Other the other income of our standard market property casualty insurance subsidiary, as well as non-investment operations of the parent company and its subsidiaries, CFC Investment Company and CinFin Capital Management Company (excluding client investment activities). In 2008, we also included results of our surplus lines operations, The Cincinnati Specialty Underwriters Insurance Company and CSU Producer Resources.

CFC Investment Company

CFC Investment Company offers commercial leasing and financing services to our agents, their clients and other customers. As of year-end 2008, CFC Investment Company had 2,197 accounts and $71 million in receivables, compared with 2,590 accounts and $92 million in receivables at year-end 2007.

CinFin Capital Management

CinFin Capital Management provided asset management services to internal and third-party clients. CinFin Capital advised clients in December 2008 that it would close on February 28, 2009. During the recent financial market downturn, this business performed satisfactorily relative to the appropriate benchmarks, and it was profitable over its 10 years in operation. We determined that sufficient future growth through agency referrals or other routes would have required a substantial increase in resources even as we are seeking to increase our focus on our core insurance business with new initiatives. Many of our agencies did not see referrals for investment management services within the scope of their offerings to their clients.

As of year-end 2008, CinFin Capital had 44 institutional, corporate and individual clients. Assets under management were $817 million. We have given our unaffiliated clients ample opportunity to arrange for another financial adviser and respond to any market changes in a timely manner. We will continue to manage internally our pension plan and Cincinnati Life s separate accounts.

Surplus Lines Property Casualty Insurance

Agencies have access to The Cincinnati Specialty Underwriters Insurance Company s product line through CSU Producer Resources, the wholly owned insurance brokerage subsidiary of parent-company Cincinnati Financial Corporation. CSU Producer Resources has binding authority on all classes of business written through CSU and maintains appropriate agent and surplus lines licenses to process non-admitted business.

Producers can submit risks to CSU Producer Resources, reflecting the mix of accounts Cincinnati agencies currently write in their non-admitted surplus lines markets. CSU Producer Resources currently markets and underwrites commercial general liability, property and miscellaneous errors and omissions coverages in 33 states. It will continue to add lines of business and coverages.

Agency producers have direct access through CSU Producer Resources to our dedicated surplus lines underwriters, and they also can tap into their agencies broader Cincinnati relationships to bring their policyholders services such as experienced and responsive loss control and claims handling. Our new surplus lines policy administration system delivers electronic copies of policies to producers within minutes of underwriting approval and policy issue. CSU Producer Resources gives extra support to our producers by remitting surplus lines taxes and stamping fees and retaining admitted market affadavits, where required.

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Regulation

State Regulation

The business of insurance primarily is regulated by state law. All of our insurance company subsidiaries are domiciled in the State of Ohio, except The Cincinnati Specialty Underwriters Insurance Company, which is domiciled in the State of Delaware. Each insurance subsidiary is governed by the insurance laws and regulations in its respective state of domicile. We also are subject to state regulatory authorities of all states in which we write insurance. The state laws and regulations that have the most significant effect on our insurance operations and financial reporting are discussed below.

Insurance Holding Company Regulation We are regulated as an insurance holding company system in the respective states of domicile of our standard market property casualty company subsidiary and its surplus lines and life insurance subsidiaries. These regulations require that we annually furnish financial and other information about the operations of the individual companies within the holding company system. All transactions within a holding company affecting insurers must be fair and equitable. Notice to the state insurance commissioner is required prior to the consummation of transactions affecting the ownership or control of an insurer and prior to certain material transactions between an insurer and any person or entity in its holding company group. In addition, some of those transactions cannot be consummated without the commissioner s prior approval.

Subsidiary Dividends The Cincinnati Insurance Company is 100 percent owned by Cincinnati Financial Corporation. The dividend-paying capacity of The Cincinnati Insurance Company and its 100 percent owned subsidiaries is regulated by the laws of the applicable state of domicile. Under these laws, our insurance subsidiaries must provide a 10-day advance informational notice to the insurance commissioner for the domiciliary state prior to payment of any dividend or distribution to its shareholders. In all cases, ordinary dividends may be paid only from earned surplus, which for the Ohio subsidiaries is the amount of unassigned funds set forth in an insurance subsidiary s most recent statutory financial statement. For the Delaware subsidiary, it is the amount of available and accumulated funds derived from the subsidiary s net operating profit of its business and realized capital gains.

The insurance company subsidiaries must give 30 days notice to and obtain prior approval from the state insurance commissioner before the payment of an extraordinary dividend as defined by the state s insurance code. You can find information about the dividends paid by our insurance subsidiary in 2008 in Item 8, Note 9 of the Consolidated Financial Statements, Page 110.

Insurance Operations All of our insurance subsidiaries are subject to licensing and supervision by departments of insurance in the states in which they do business. The nature and extent of such regulations vary, but generally have their source in statutes that delegate regulatory, supervisory and administrative powers to state insurance departments. Such regulations, supervision and administration of the insurance subsidiaries include, among others, the standards of solvency that must be met and maintained; the licensing of insurers and their agents and brokers; the nature and limitations on investments; deposits of securities for the benefit of policyholders; regulation of policy forms and premium rates; policy cancellations and non-renewals; periodic examination of the affairs of insurance companies; annual and other reports required to be filed on the financial condition of insurers or for other purposes; requirements regarding reserves for unearned premiums, losses and other matters; the nature of and limitations on dividends to policyholders and shareholders; the nature and extent of required participation in insurance guaranty funds; the involuntary assumption of hard-to-place or high-risk insurance business, primarily workers compensation insurance; and the collection, remittance and reporting of certain taxes and fees.

The legislative and regulatory climate in Florida continues to create uncertainty for the insurance industry. In February 2007, we adopted a marketing stance of writing no new business relationships in Florida. This remained our stance through 2008, except in the lines of directors and officers, surety, machinery and equipment and life insurance, which we resumed writing in June 2007, subject to existing guidelines. In 2009, we intend to cautiously resume writing additional commercial lines of business, while working to more actively manage the associated catastrophe risk, carefully underwriting new commercial submissions and non-renewing commercial and personal lines policies that present the most risk of loss because of their age, construction and geographic characteristics. In

2008, our written premiums from Florida agencies were 2.9 percent of total written premiums, compared with 3.2 percent in 2007.

On August 24, 2007, the company received administrative subpoenas from the Florida Office of Insurance Regulation seeking documents and testimony concerning insurance for residential risks located in Florida and communications with reinsurers, risk modeling companies, rating agencies and insurance trade associations. We produced documents to respond to the subpoenas. The Office of Insurance Regulation cancelled and has not rescheduled the hearing noticed in the subpoena for

October 18, 2007. Although inactive, these subpoenas remain outstanding as of December 31, 2008. We continue to assess the changing insurance environment in Florida and hope to resume writing our complete portfolio of insurance products in the state as the market stabilizes.

Insurance Guaranty Associations Each state has insurance guaranty association laws under which the associations may assess life and property casualty insurers doing business in the state for certain obligations of insolvent insurance companies to policyholders and claimants. Typically, states assess each member insurer in an amount related to the insurer s proportionate share of business written by all member insurers in the state. Our insurance companies incurred a charge of less than $1 million from guaranty associations in 2008 and a charge of $2 million in 2007. We cannot predict the amount and timing of any future assessments or refunds on our insurance subsidiaries under these laws.

Shared Market and Joint Underwriting Plans State insurance regulation requires insurers to participate in assigned risk plans, reinsurance facilities and joint underwriting associations, which are mechanisms that generally provide applicants with various basic insurance coverages when they are not available in voluntary markets. Such mechanisms are most commonly instituted for automobile and workers compensation insurance, but many states also mandate participation in FAIR Plans or Windstorm Plans, which provide basic property coverages. Participation is based upon the amount of a company s voluntary market share in a particular state for the classes of insurance involved. Underwriting results related to these organizations, which tend to be adverse to our company, have been immaterial to our results of operations.

Statutory Accounting For public reporting, insurance companies prepare financial statements in accordance with GAAP. However, certain data also must be calculated according to statutory accounting rules as defined in the NAIC s Accounting Practices and Procedures Manual (SAP). While not a substitute for any GAAP measure of performance, statutory data frequently is used by industry analysts and other recognized reporting sources to facilitate comparisons of the performance of insurance companies.

Insurance Reserves State insurance laws require that property casualty and life insurance insurers analyze the adequacy of reserves annually. Our appointed actuaries must submit an opinion that reserves are adequate for policy claims-paying obligations and related expenses.

Risk-Based Capital Requirements The NAIC s risk-based capital (RBC) requirements for property casualty and life insurers serve as an early warning tool for the NAIC and state regulators to identify companies that may be undercapitalized and may merit further regulatory action. The NAIC has a standard formula for annually assessing RBC. The formula for calculating RBC for property casualty companies takes into account asset and credit risks but places more emphasis on underwriting factors for reserving and pricing. The formula for calculating RBC for life insurance companies takes into account factors relating to insurance, business, asset and interest rate risks.

Federal Regulation

Although the federal government and its regulatory agencies generally do not directly regulate the business of insurance, federal initiatives often have an impact. Some of the current and proposed federal measures that may significantly affect our business are discussed below.

The Terrorism Risk Insurance Act of 2002 (TRIA) TRIA was originally signed into law on November 26, 2002, and extended on December 22, 2005, in a revised form, and extended again on December 26, 2007. TRIA provides a temporary federal backstop for losses related to the writing of the terrorism peril in property casualty insurance policies. TRIA now is scheduled to expire December 31, 2014. Under regulations promulgated under this statute, insurers are required to offer terrorism coverage for certain lines of property casualty insurance, including property, commercial multi-peril, fire, ocean marine, inland marine, liability, aircraft and workers compensation. In the event of a terrorism event defined by TRIA, the federal government would reimburse terrorism claim payments subject to the insurer s deductible. The deductible is calculated as a percentage of subject written premiums for the preceding calendar year. Our deductible in 2008 was $395 million (20 percent of 2007 subject premiums) and we estimate it will be $383 million (20 percent of 2008 subject premiums) in 2009.

Office of Foreign Asset Control (OFAC) Subject to an Executive Order signed on September 24, 2001, intended to thwart financing of terrorists and sponsors of terrorism, financial institutions were required to block and report transactions and attempted transactions between their organizations and persons and organizations named in a list published by OFAC. We currently use a combination of software, third-party vendor and manual searches to accomplish our transaction blocking and reporting activities.

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Investment Advisers Act of 1940   Our subsidiary, CinFin Capital Management Company, operates an investment advisory business and is therefore subject to regulation by the SEC as a registered investment adviser under the Investment Advisers Act of 1940. This law imposes certain annual reporting, recordkeeping, client disclosure and compliance obligations on CinFin Capital Management. CinFin Capital Management is terminating operations effective February 28, 2009.

Troubled Asset Relief Program (TARP), the economic stimulus bill, and related executive, legislative and regulatory actions   The President, Congress and various regulatory agencies have worked, and continue to work, to enact measures designed to improve the economy by recapitalizing banks, stimulating the economy, providing relief to homeowners at risk of foreclosure and enhancing oversight of the financial system. To date, none of these measures directly affect us. We are not a bank or a bank holding company and do not intend to obtain TARP funds. Effects of other statutes and regulations on our business are uncertain, as details of existing and proposed laws continue to emerge.

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Item 1A. Risk Factors

Our business involves various risks and uncertainties that may affect achievement of our business objectives. Many of the risks could have ramifications across our organization. For example, while risks related to setting insurance rates and establishing and adjusting loss reserves are insurance activities, errors in these areas could have an impact on our investment activities, growth and overall results. The following discussion should be viewed as a starting point for understanding the significant risks we face. It is not a definitive summary of their potential impacts or of our strategies to manage and control the risks. Please see Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, Page 37, for a discussion of those strategies.

The risks and uncertainties discussed below are not the only ones we face. There are additional risks and uncertainties that we currently do not believe are material at this time. There also may be risks and uncertainties of which we are not aware. If any risks or uncertainties discussed here develop into actual events, they could have a material adverse effect on our business, financial condition or results of operations. In that case, the market price of our common stock could decline materially.

Readers should carefully consider this information together with the other information we have provided in this report and in other reports and materials we file periodically with the Securities and Exchange Commission as well as news releases and other information we disseminate publicly.

We rely exclusively on independent insurance agents to distribute our products.

We market our products through independent, non-exclusive insurance agents. These agents are not obligated to promote our products and can and do sell our competitors products. We must offer insurance products that meet the needs of these agencies and their clients. We need to maintain good relationships with the agencies that market our products. If we do not, these agencies may market our competitors products instead of ours, which may lead to us having a less desirable mix of business and could affect our results of operations.

Events or conditions that could diminish our agents desire to produce business for us and the competitive advantage that our independent agencies enjoy:

- Downgrade of the financial strength ratings of our insurance subsidiaries. We believe our strong insurer financial strength ratings, in particular the A+ (Superior) rating from A.M. Best for our standard market property casualty insurance subsidiaries, are an important competitive advantage. Ratings agencies could change or expand their requirements. If our property casualty ratings were to be further downgraded, our agents might find it more difficult to market our products or might choose to emphasize the products of other carriers. See Item 1, Our Business and Our Strategy, Page 1, for additional discussion of our financial strength ratings.

- Concerns that doing business with us is difficult or not profitable, perceptions that our level of service is no longer a distinguishing characteristic in the marketplace, or perceptions that our business practices are not compatible with agents business models. These issues could occur if agents or policyholders believe that we are no longer providing the prompt, reliable personal service that has long been a distinguishing characteristic of our insurance operations.

- Delays in the development, implementation, performance and benefits of technology projects and enhancements or independent agent perceptions that our technology solutions are inadequate to match their needs.

A reduction in the number of independent agencies marketing our products, the failure of agencies to successfully market our products or the choice of agencies to reduce their writings of our products could affect our results of operations if we are unable to replace them with agencies that produce adequate and profitable premiums. We could lose premium if a bank that owns appointed agencies changes its strategies.

Further, policyholders may choose a competitor s product rather than our own because of real or perceived differences in price, terms and conditions, coverage or service. If the quality of the independent agencies with which we do business were to decline, that also might cause policyholders to purchase their insurance through different agencies or channels. Consumers, especially in the personal insurance segments, may increasingly choose to purchase insurance from distribution channels other than independent insurance agents, such as direct marketers.

We could experience an unusually high level of losses due to catastrophic, pandemic or terrorism events or risk concentrations.

In the normal course of our business, we provide coverage against perils for which estimates of losses are highly uncertain, in particular catastrophic and terrorism events. Catastrophes can be caused by a number of events, including hurricanes, tornadoes, windstorms, earthquakes, hailstorms, explosions, severe winter weather and fires. Due to the nature of these events, we are unable to predict precisely the frequency or potential cost of catastrophe occurrences. The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Our ability to appropriately manage catastrophe risk depends partially on catastrophe models, the accuracy of which may be impacted by inaccurate or incomplete data, the uncertainty of the frequency and severity of future events and the uncertain impact of climate change.

The geographic regions in which we market insurance are exposed to numerous natural catastrophes, such as:

- Hurricanes in the gulf, eastern and southeastern coastal regions.

- Earthquakes in the New Madrid fault zone, which lies within the central Mississippi valley, extending from northeast Arkansas through southeast Missouri, western Tennessee and western Kentucky to southern Illinois, southern Indiana and parts of Ohio.

- Tornado, wind and hail in the Midwest, South and Southeast and, to a certain extent, the mid-Atlantic.

The occurrence of terrorist attacks in the geographic areas we serve could result in substantially higher claims under our insurance policies than we have anticipated. While we do insure terrorism risk in all areas we serve, we have identified our major terrorism exposure as general commercial risks in the metropolitan Chicago area as well as small co-op utilities, small shopping malls and small colleges throughout our 35 active states. Additionally, our life insurance subsidiary could be adversely affected in the event of a terrorist event or an epidemic such as the avian flu, particularly if the epidemic were to affect a broad range of the population beyond just the very young or the very old. Our associate health plan is self-funded and could similarly be affected.

Our results of operations would be adversely affected if the level of losses we experience over a period of time exceeds our actuarially determined expectations. In addition, our financial condition would be adversely affected if we were required to sell securities prior to maturity or at unfavorable prices to pay an unusually high level of loss and loss expenses. Securities pricing might be even less favorable if a number of insurance companies needed to sell securities during a short period of time because of unusually high losses from catastrophic events.

Our geographic concentration ties our performance to business, economic, environmental and regulatory conditions in certain states. We market our property casualty insurance products in 35 states, but our business is concentrated in the Midwest and Southeast. We also have exposure in states where we do not actively market insurance when clients of our independent agencies have businesses or properties in multiple states.

The Cincinnati Insurance Company also participates in three assumed reinsurance treaties with two reinsurers that spread the risk of very high catastrophe losses among many insurers. In 2009, we have exposure of up to $7 million of assumed losses in three layers, from $1.0 billion to $1.7 billion, from a single event under an assumed reinsurance treaty for Munich Re Group. The other two assumed reinsurance treaties are immaterial.

In the event of a severe catastrophic event or terrorist attack elsewhere in the world, our insurance losses may be immaterial. However, the companies in which we invest might be severely affected, which could affect our financial condition and results of operations. Our reinsurers might experience significant losses, potentially jeopardizing their ability to pay losses we cede to them. We also may be exposed to state guaranty fund assessments if other carriers in a state cannot meet their obligations to policyholders. A catastrophe or epidemic event also could affect our operations by damaging our headquarters facility, injuring associates and visitors at our Fairfield, Ohio, headquarters or disrupting our associates ability to perform their assigned tasks.

Our ability to achieve our performance objectives could be affected by changes in the financial, credit and capital markets or the general economy.

We invest premiums received from policyholders and other available cash to generate investment income and capital appreciation, maintaining sufficient liquidity to pay covered claims and operating expenses, service our debt obligations and pay dividends.

Investment income is an important component of our revenues and net income. The ability to increase investment income and generate longer-term growth in book value is affected by factors that are beyond our control, such as inflation, economic growth, interest rates, world political conditions, terrorism attacks or threats, adverse events affecting other companies in our industry or the industries in which we invest, market events leading to credit constriction and other widespread unpredictable events. These events may adversely affect the economy generally and could cause our investment income or the value of securities we own to decrease. A significant decline in our investment income could have an adverse effect on our net income, and thereby on our shareholders equity and our policyholders surplus. For more detailed discussion of risks associated with our investments, please refer to Item 7A, Qualitative and Quantitative Disclosures About Market Risk, Page 85.

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We issue life contracts with guaranteed minimum returns, referred to as bank-owned life insurance contracts (BOLIs). BOLI investment assets must meet certain criteria established by the regulatory authorities in which jurisdiction the group contract holder is subject. Therefore, sales of investments may be mandated to maintain compliance with these regulations, possibly requiring gains or losses to be recorded. We could experience losses if the assets in the accounts are less than liabilities at the time of maturity or termination. We discuss other risks associated with our separate account BOLIs in Item 7, Critical Accounting Estimates, Separate Accounts, Page 47.

Further deterioration in the banking sector or in banks with which we have relationships could affect our results of operations. Our ability to maintain or obtain short-term lines of credit could be affected if the banks from which we obtain these lines are purchased, fail or are otherwise negatively affected. The value of corporate bonds and common equities we hold in the banking sector could further deteriorate. We may lose premium if a bank that owns appointed agencies changes its strategies. We could experience increased losses in our directors and officers liability line of business if claims are made against insured financial institutions.

Our investment performance also could suffer because of the types or concentrations of investments, industry groups and/or individual securities in which we choose to invest. Market value changes related to these choices could cause a material change in our financial condition or results of operations.

At year-end 2008, common stock holdings made up 30.6 percent of our invested assets. Adverse news or events affecting the global or U.S. economy or the equity markets could affect our net income, book value and overall results as well as our ability to pay our common stock dividend. See Item 7, Investments Results of Operations, Page 66, and Item 7A, Qualitative and Quantitative Disclosures About Market Risk, Page 85, for discussion of our investment activities.

Deteriorating credit and market conditions could also impair our ability to access credit markets and could affect existing or future lending arrangements.

Our overall results could be affected if a significant portion of our commercial lines policyholders, including those purchasing surety bonds, are adversely affected by marked or prolonged economic downturns and events such as a downturn in construction and related sectors, tightening credit markets and higher fuel costs. Such events could make it more difficult for policyholders to finance new projects, complete projects or expand their businesses, leading to lower premiums from reduced payrolls and sales and lower purchases of equipment and vehicles. These events could also cause claims, including surety claims, to increase due to a policyholder s inability to secure necessary financing to complete projects or to collect on underlying lines of credit in the claims process. Such economic downturns and events could have a greater impact in the construction sector where we have a concentration of risks and in geographic areas that are hardest hit by economic downturns.

Deteriorating economic conditions could also increase the degree of credit risk associated with amounts due from independent agents who collect premiums for payment to us and could hamper our ability to recover amounts due from reinsurers.

Our ability to properly underwrite and price risks and increased competition could adversely affect our results.

Our financial condition, cash flow and results of operations depend on our ability to underwrite and set rates accurately for a full spectrum of risks. We establish our pricing based on assumptions about the level of losses that may occur within classes of business, geographic regions and other criteria.

To properly price our products, we must collect and properly analyze data; the data must be sufficient, reliable and accessible; we need to develop appropriate rating methodologies and formulae; and we may need to identify and respond to trends quickly. If rates are not accurate, we may not generate enough premiums to offset losses and expenses or we may not be competitive in the marketplace.

Setting appropriate rates could be hampered if a state or states where we write business refuses to allow rate increases that we believe are necessary to cover the risks insured. At least one state requires us to purchase reinsurance from a mandatory reinsurance fund. Such reinsurance funds can create a credit risk for insurers if not adequately funded by the state and, in some cases, the existence of a reinsurance fund could affect the prices charged for our policies. The effect of these and similar arrangements could reduce our profitability in any given period or limit our ability to grow our business.

The insurance industry is cyclical and intensely competitive. From time to time, the insurance industry goes through prolonged periods of intense competition during which it is more difficult to attract new business, retain existing business and maintain profitability. Competition in our insurance business is based on many factors, including:

- Competitiveness of premiums charged

- Relationships among carriers, agents, brokers and policyholders

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- Underwriting and pricing methodologies that allow insurers to identify and flexibly price risks
- Compensation provided to agents
- Underwriting discipline
- Terms and conditions of insurance coverage
- Speed at which products are brought to market
- Product and marketing innovations, including advertising
- Technological competence and innovation
- Ability to control expenses
- Adequacy of financial strength ratings by independent ratings agencies such as A.M. Best
- Quality of services provided to agents and policyholders
- Claims satisfaction and reputation

If our pricing is incorrect or we are unable to compete effectively because of one or more of these factors, our premium writings could decline and our results of operations and financial condition could be materially adversely affected.

Please see the discussion of our Commercial Lines, Personal Lines and Life Insurance Segments in Item 1, Page 11, Page 14 and Page 16, for a discussion of our competitive position in the insurance marketplace.

Our loss reserves, our largest liability, are based on estimates and could be inadequate to cover our actual losses.

Our consolidated financial statements are prepared using GAAP. These principles require us to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and accompanying Notes. Actual results could differ materially from those estimates. For a discussion of the significant accounting policies we use to prepare our financial statements and the material implications of uncertainties associated with the methods, assumptions and estimates underlying our critical accounting policies, please refer to Item 8, Note 1 of the Consolidated Financial Statements, Page 98, and Item 7, Critical Accounting Estimates, Property Casualty Insurance Loss and Loss Expense Reserves and Life Insurance Policy Reserves, Page 41 and Page 44.

Our most critical accounting estimate is loss reserves. Loss reserves are the amounts we expect to pay for covered claims and expenses we incur to settle those claims. The loss reserves we establish in our financial statements represent an estimate of amounts needed to pay and administer claims arising from insured events that have already occurred, including events that have not yet been reported to us. Loss reserves are estimates and are inherently uncertain; they do not and cannot represent an exact measure of liability. Accordingly, our loss reserves for past periods could prove to be inadequate to cover our actual losses and related expenses. Any changes in these estimates are reflected in our results of operations during the period in which the changes are made. An increase in our loss reserves would decrease earnings, while a decrease in our loss reserves would increase earnings.

The estimation process for unpaid loss and loss expense obligations involves uncertainty by its very nature. We continually review the estimates and adjust the reserves as facts about individual claims develop, additional losses are reported and new information becomes known. Adjustments due to loss development on prior periods are reflected in the calendar year in which they are identified. The process used to determine our loss reserves is discussed in Item 7, Critical Accounting Estimates, Property Casualty Insurance Loss and Loss Expense Reserves and Life Insurance Policy Reserves, Page 41 and Page 44.

Unforeseen losses, the type and magnitude of which we cannot predict, may emerge in the future. These additional losses could arise from changes in the legal environment, laws and regulations, climate change, catastrophic events, increases in loss severity or frequency, or other causes. Such future losses could be substantial.

Our ability to obtain or collect on our reinsurance protection could affect our business, financial condition, results of operations and cash flows.

We buy property casualty and life reinsurance coverage to mitigate the liquidity risk of an unexpected rise in claims severity or frequency from catastrophic events or a single large loss. The availability, amount and cost of reinsurance depend on market conditions and may vary significantly. If we are unable to obtain reinsurance on acceptable terms and in appropriate amounts, our business and financial condition may be adversely affected.

In addition, we are subject to credit risk with respect to our reinsurers. Although we purchase reinsurance to manage our risks and exposures to losses, this reinsurance does not discharge our direct obligations under the policies we write. We would remain liable to our policyholders even if we were unable to recover what we believe we are entitled to receive under our reinsurance contracts. Reinsurers might refuse or fail to pay losses that we cede to them, or they might delay payment. For long-tail claims, the creditworthiness of our reinsurers may change before we can recover amounts to which we are entitled. A reinsurer s insolvency, inability or unwillingness to make payments under the terms of its reinsurance agreement with our insurance subsidiaries could have a material adverse effect on our financial position, results of operations and cash flows.

Prior to 2003, we participated in USAIG, a joint underwriting association of individual insurance companies that collectively functions as a worldwide insurance market for all types of aviation and aerospace accounts. At year-end 2008, 28.6 percent, or $217 million, of our total reinsurance receivables were related to USAIG, primarily for September 11, 2001, events, offset by $226 million of amounts ceded to other pool participants and reinsurers. If the pool participants and reinsurers are unable to fulfill their financial obligations and all security collateral that supports the participants obligations becomes worthless, we could be liable for an additional pool liability of $283 million and our financial position and results of operations could be materially affected. Currently all pool participants and reinsurers are financially solvent.

We no longer participate in new business generated by USAIG and its members. Please see Item 7, 2009 Reinsurance Programs, Page 81, for a discussion of our reinsurance treaties.

Our business depends on the uninterrupted operation of our facilities, systems and business functions.

Our business depends on our associate s ability to perform necessary business functions, such as processing new and renewal policies and claims. We increasingly rely on technology and systems to accomplish these business functions in an efficient and uninterrupted fashion. Our inability to access our headquarters facilities or a failure of technology, telecommunications or other systems could significantly impair our ability to perform such functions on a timely basis or affect the accuracy of transactions. If sustained or repeated, such a business interruption or system failure could result in a deterioration of our ability to write and process new and renewal business, serve our agents and policyholders, pay claims in a timely manner, collect receivables or perform other necessary business functions. If our disaster recovery and business continuity plans did not sufficiently consider, address or reverse the circumstances of an interruption or failure, this could result in a materially adverse effect on our operating results and financial condition. This risk is exacerbated because approximately 70 percent of our associates work at our Fairfield, Ohio, headquarters.

The effects of changes in industry practices and regulations on our business are uncertain.

As industry practices and legal, judicial, legislative, regulatory, political, social and other environmental conditions change, unexpected and unintended issues related to insurance pricing, claims, and coverage, may emerge. These issues may adversely affect our business by impeding our ability to obtain adequate rates for covered risks, extending coverage beyond our underwriting intent or by increasing the number or size of claims. In some instances, unforeseeable emerging and latent claim and coverage issues may not become apparent until some time after we have issued the insurance policies that could be affected by the changes. As a result, the full extent of liability under our insurance contracts may not be known for many years after a policy is issued.

Further, the National Association of Insurance Commissioners (NAIC), state insurance regulators and state legislators are continually reexamining existing laws and regulations governing insurance companies and insurance holding companies, specifically focusing on modifications to statutory accounting principles, interpretations of existing laws and the development of new laws and regulations that affect a variety of financial and nonfinancial components of our business. Any proposed or future legislation, regulation or NAIC initiatives, if adopted, may be more restrictive on our ability to conduct business than current regulatory requirements or may result in higher costs.

Additionally, laws and regulations may be enacted in the wake of the current financial and credit crises that have adverse affects on our business, potentially including a change from a state-based system of regulation to a system of federal regulation. While we do not participate or intend to seek to participate in the Troubled Asset Relief Program, the effect of it or any similar legislation on our industry and the economy in general is uncertain.

The effects of such changes could adversely affect our results of operations. Please see Item 7, Critical Accounting Estimates, Property Casualty Insurance Loss and Loss Expense Reserves and Life Insurance Policy Reserves, Page 41 and Page 44, for a discussion of our reserving practices.

Managing technology initiatives and meeting new data security requirements are significant challenges.

While technology can streamline many business processes and ultimately reduce the cost of operations, technology initiatives present short-term cost, implementation and operational risks. In addition, we may have inaccurate expense projections, implementation schedules or expectations regarding the efficacy of the

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end product. These issues could escalate over time. If we are unable to find and retain employees with key technical knowledge, our ability to develop and deploy key technology solutions could be hampered.

We necessarily collect, use and hold data concerning individuals and businesses with whom we have a relationship. Threats to data security rapidly emerge and change, exposing us to rising costs and competing time constraints to secure our data in accordance with customer expectations and statutory and regulatory requirements. A breach of our security that results in unauthorized access to our data could expose us to data loss, litigation, damages, fines and penalties, significant increases in compliance costs and reputational damage.

Please see Item 1, Strategic Initiatives, Page 7 for a discussion of our technology initiatives.

Our status as an insurance holding company with no direct operations could affect our ability to pay dividends in the future.

Cincinnati Financial Corporation is a holding company that transacts substantially all of its business through its subsidiaries. Our primary assets are the stock in our operating subsidiaries and our investments. Consequently, our cash flow to pay cash dividends and interest on our long-term debt depends on dividends we receive from our operating subsidiaries and income earned on investments held at the parent-company level.

Dividends paid to our parent company by our insurance subsidiary are restricted by the insurance laws of Ohio, its domiciliary state. These laws establish minimum solvency and liquidity thresholds and limits. Currently, the maximum dividend that may be paid without prior regulatory approval is limited to the greater of 10 percent of statutory surplus or 100 percent of statutory net income for the prior calendar year, up to the amount of statutory unassigned surplus as of the end of the prior calendar year. Dividends exceeding these limitations may be paid only with prior approval of the Ohio Department of Insurance. Consequently, at times, we might not be able to receive dividends from our insurance subsidiary, or we might not receive dividends in the amounts necessary to meet our debt obligations or to pay dividends on our common stock. This could affect our financial position.

Please see Item 1, Regulation, Page 22, and Item 8, Note 9 of the Consolidated Financial Statements, Page 110, for discussion of insurance holding company dividend regulations.

Item 1B. Unresolved Staff Comments

None

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Item 2. Properties

Cincinnati Financial Corporation owns our headquarters building located on 100 acres of land in Fairfield, Ohio. This building has approximately 1,508,200 total square feet of available space. In 2008, we completed construction of a 425,400 square foot third office tower and 276,800 square foot underground garage. We expect this expansion to accommodate our business needs for the foreseeable future. The property, including land, is carried in our financial statements at $159 million as of December 31, 2008, and is classified as land, building and equipment, net, for company use. John J. & Thomas R. Schiff & Co. Inc., a related party, occupies approximately 6,750 square feet (less than 1 percent).

Cincinnati Financial Corporation also owns the Fairfield Executive Center, which is located on the northwest corner of our headquarters property. This four-story office building has approximately 124,000 square feet of available space. The property is carried in the financial statements at $6 million as of December 31, 2008, and is classified as an other invested asset. Unaffiliated tenants occupy approximately 8 percent. All unoccupied space is currently available for lease.

The Cincinnati Insurance Company owns an unoccupied building on 16 acres of land in Springfield Township, Ohio, approximately six miles from our headquarters. We plan to renovate the 48,000 square foot building to serve as a business continuity center. The property, including land, is carried on our financial statements at $6 million as of December 31, 2008, and is classified as land, building and equipment, net, for company use.

Item 3. Legal Proceedings

Neither the company nor any of our subsidiaries is involved in any material litigation other than ordinary, routine litigation incidental to the nature of its business.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders of Cincinnati Financial during the fourth quarter of 2008.

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Part II

Item 5. Market for the Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Cincinnati Financial Corporation had approximately 12,000 shareholders of record and approximately 37,000 beneficial shareholders as of December 31, 2008. Many of our independent agent representatives and most of the 4,179 associates of our subsidiaries own the company s common stock. We are unable to quantify those holdings because many are beneficially held.

Our common shares are traded under the symbol CINF on the Nasdaq Global Select Market.

(Source: Nasdaq Global Select Market)	**2008**				2007			
Quarter:	**1st**	**2nd**	**3rd**	**4th**	1st	2nd	3rd	4th
High close	**$39.71**	**$39.97**	**$33.60**	**$31.71**	$45.92	$47.62	$44.79	$44.84
Low close	**35.10**	**25.40**	**21.83**	**18.80**	42.24	42.57	36.91	38.37
Period-end close	**38.04**	**25.40**	**28.44**	**29.07**	42.40	43.40	43.31	39.54
Cash dividends declared	**0.39**	**0.39**	**0.39**	**0.39**	0.355	0.355	0.355	0.355

We discuss the factors that affect our ability to pay cash dividends and repurchase shares in Item 7, Liquidity and Capital Resources, Page 70. One factor we address is regulatory restrictions on the dividends our insurance subsidiary can pay to the parent company, which also is discussed in Item 8, Note 9 of the Consolidated Financial Statements, Page 110.

The following summarizes securities authorized for issuance under our equity compensation plans as of December 31, 2008:

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights at December 31, 2008 (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plan (excluding securities reflected in column (a)) at December 31, 2008 (c)
Equity compensation plans approved by security holders	10,789,082	$ 36.31	7,333,645
Equity compensation plans not approved by security holders			
Total	10,789,082	$ 36.31	7,333,645

The number of securities remaining available for future issuance includes: 7,304,065 shares available for issuance under the Cincinnati Financial Corporation 2006 Stock Compensation Plan, which can be issued as stock options, service-based, or performance-based restricted stock units, stock appreciation rights or other equity-based grants; 25,394 shares available for issuance of full share grants under the Cincinnati Financial Corporation 2003 Non-Employee Directors Stock Plan; and 4,186 shares of stock options available for issuance under the Cincinnati Financial Corporation Stock Option Plan VII. Additional information about stock-based associate compensation granted under our equity compensation plans is available in Item 8, Note 17 of the Consolidated Financial Statements, Page 117.

Month	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
January 1-31, 2008	71,003	$ 0.00	71,003	12,293,608
February 1-29, 2008	1,192,197	37.51	1,192,197	11,101,411
March 1-31, 2008	1,736,800	37.15	1,736,800	9,364,611
April 1-30, 2008	0	0.00	0	9,364,611
May 1-31, 2008	750,957	35.88	750,000	8,614,611
June 1-30, 2008	71,003	34.59	71,003	8,543,608
July 1-31, 2008	0	0.00	0	8,543,608
August 1-31, 2008	0	0.00	0	8,543,608
September 1-30, 2008	0	0.00	0	8,543,608
October 1-31, 2008	0	0.00	0	8,543,608
November 1-30, 2008	0	0.00	0	8,543,608
December 1-31, 2008	0	0.00	0	8,543,608
Totals	3,821,960	36.28	3,821,003	

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We did not sell any shares that were not registered under the Securities Act during 2008. The board of directors has authorized share repurchases since 1996. In 2008, we repurchased a total of 3.8 million shares. In January 2008, we acquired 71,003 shares to settle the accelerated share repurchase program authorized in October 2007, when the board of directors expanded an existing repurchase authorization to approximately 13 million shares. Purchases are expected to be made generally through open market transactions. The board gives management discretion to purchase shares at reasonable prices in light of circumstances at the time of purchase, pursuant to SEC regulations.

The prior repurchase program for 10 million shares was announced in 2005, replacing a program that had been in effect since 1999. No repurchase program has expired during the period covered by the above table. All of the publicly announced plan repurchases in the table above were made under the expansion announced in October 2007 of our 2005 program. Neither the 2005 nor 1999 program had an expiration date, but no further repurchases will occur under the 1999 program.

Cumulative Total Return

As depicted in the graph below, the five year total return on a $100 investment made December 31, 2003, assuming the reinvestment of all dividends, was a negative 9.0 percent for Cincinnati Financial Corporation s common stock compared with a negative 2.1 percent for the Standard & Poor s Composite 1500 Property & Casualty Insurance Index and a negative 10.5 percent for the Standard & Poor s 500 Index.

The Standard & Poor s Composite 1500 Property & Casualty Insurance Index includes 23 companies: Allstate Corporation, Berkley (W R) Corporation, Chubb Corporation, Cincinnati Financial Corporation, Fidelity National Financial Inc., First American Corporation, Hanover Insurance Group Inc., Infinity Property & Casualty Corporation, MBIA Inc., Mercury General Corporation, Navigators Group Inc., Old Republic International Corporation, Proassurance Corporation, Progressive Corporation, RLI Corporation, Safety Insurance Group Inc., Selective Insurance Group Inc., Stewart Information Services, Tower Group Inc., Travelers Companies Inc., United Fire & Casualty Company, XL Capital Ltd. and Zenith National Insurance Corporation.

The Standard & Poor s 500 Index includes a representative sample of 500 leading companies in a cross section of industries of the U.S. economy. Although this index focuses on the large capitalization segment of the market, it is widely viewed as a proxy for the total market.

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Item 6. Selected Financial Data

(In millions except per share data)	Years ended December 31,			
	2008	2007	2006	2005
Consolidated Income Statement Data				
Earned premiums	**$ 3,136**	$ 3,250	$ 3,278	$ 3,164
Investment income, net of expenses	**537**	608	570	526
Realized investment gains and losses*	**138**	382	684	61
Total revenues	**3,824**	4,259	4,550	3,767
Net income	**429**	855	930	602
Net income per common share:				
Basic	**$ 2.63**	$ 5.01	$ 5.36	$ 3.44
Diluted	**2.62**	4.97	5.30	3.40
Cash dividends per common share:				
Declared	**1.56**	1.42	1.34	1.205
Paid	**1.525**	1.40	1.31	1.162
Shares Outstanding				
Weighted average, diluted	**163**	172	175	177
Consolidated Balance Sheet Data				
Invested assets	**$ 8,890**	$12,261	$13,759	$12,702
Deferred policy acquisition costs	**509**	461	453	429
Total assets	**13,369**	16,637	17,222	16,003
Loss and loss expense reserves	**4,086**	3,967	3,896	3,661
Life policy reserves	**1,551**	1,478	1,409	1,343
Long-term debt	**791**	791	791	791
Shareholders equity	**4,182**	5,929	6,808	6,086
Book value per share	**25.75**	35.70	39.38	34.88
Consolidated Property Casualty Operations				
Earned premiums	**$ 3,010**	$ 3,125	$ 3,164	$ 3,058
Unearned premiums	**1,542**	1,562	1,576	1,557
Loss and loss expense reserves	**4,040**	3,925	3,860	3,629
Investment income, net of expenses	**350**	393	367	338
Loss ratio	**57.7%**	46.6%	51.9%	49.2%
Loss expense ratio	**10.6**	12.0	11.6	10.0
Underwriting expense ratio	**32.3**	31.7	30.8	30.0
Combined ratio	**100.6%**	90.3%	94.3%	89.2%

Per share data adjusted to reflect all stock splits and dividends prior to December 31, 2008.

* Realized investment gains and losses are integral to our financial

results over the long term, but our substantial discretion in the timing of investment sales may cause this value to fluctuate substantially. Also, applicable accounting standards require us to recognize gains and losses from certain changes in fair values of securities and embedded derivatives without actual realization of those gains and losses. We discuss realized investment gains for the past three years in Item 7, Investments Results of Operations, Page 66.

One-time Charges or Adjustments:

2008 We changed the form of retirement benefit we offer certain associates to a 401(k) plan with company match from a qualified defined benefit pension plan. We incurred a pretax expense of $27 million to recognize a settlement loss associated with the partial termination of the qualified pension plan. The expense reduced net income by $17 million, or 11 cents per share, and raised the combined ratio by 0.8 percentage points.

2003 As the result of a settlement negotiated with a vendor, pretax results included the recovery of $23 million of the $39 million one-time, pretax charge incurred in 2000.

2000 We recorded a one-time charge of $39 million, pretax, to write down previously capitalized costs related to the development of software to process property casualty policies. We earned $5 million in interest in the first quarter from a $303 million single-premium bank-owned life insurance (BOLI) policy booked at the end of 1999 that was segregated as a separate account effective April 1, 2000. Investment income and realized investment gains and losses from separate accounts generally accrue directly to the contract holder and, therefore, are not included in the company s consolidated financials.

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2004	2003	2002	2001	2000	1999	1998
$ 3,020	$ 2,748	$ 2,478	$ 2,152	$ 1,907	$ 1,732	$ 1,613
492	465	445	421	415	387	368
91	(41)	(94)	(25)	(2)	0	65
3,614	3,181	2,843	2,561	2,331	2,128	2,054
584	374	238	193	118	255	242
$ 3.30	$ 2.11	$ 1.33	$ 1.10	$ 0.67	$ 1.40	$ 1.31
3.28	2.10	1.32	1.07	0.67	1.37	1.28
1.04	0.90	0.81	0.76	0.69	0.62	0.55
1.02	0.89	0.80	0.74	0.67	0.60	0.54
178	178	180	179	181	186	190
$12,677	$12,485	$11,226	$11,534	$11,276	$10,156	$10,296
400	372	343	286	259	226	143
16,107	15,509	14,122	13,964	13,274	11,795	11,484
3,549	3,415	3,176	2,887	2,473	2,154	2,055
1,194	1,025	917	724	641	885	536
791	420	420	426	449	456	472
6,249	6,204	5,598	5,998	5,995	5,421	5,621
35.60	35.10	31.43	33.62	33.80	30.35	30.58
$ 2,919	$ 2,653	$ 2,391	$ 2,073	$ 1,828	$ 1,658	$ 1,543
1,537	1,444	1,317	1,060	920	835	458
3,514	3,386	3,150	2,894	2,416	2,093	1,979
289	245	234	223	223	208	204
49.8%	56.1%	61.5%	66.6%	71.1%	61.6%	65.4%
10.3	11.6	11.4	10.1	11.3	10.0	9.3
29.7	27.0	26.8	28.2	30.4	28.6	29.6
89.8%	94.7%	99.7%	104.9%	112.8%	100.2%	104.3%

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

Introduction

The purpose of Management s Discussion and Analysis is to provide an understanding of Cincinnati Financial Corporation s consolidated results of operations and financial condition. Our Management s Discussion and Analysis should be read in conjunction with Item 6, Selected Financial Data, Pages 34 and 35, and Item 8, Consolidated Financial Statements and related Notes, beginning on Page 91. We present per share data on a diluted basis unless otherwise noted, adjusting those amounts for all stock splits and stock dividends.

We begin with an executive summary of our results of operations and outlook, as well as details on critical accounting policies and estimates. Periodically, we refer to estimated industry data so that we can give information on our performance within the context of the overall insurance industry. Unless otherwise noted, the industry data is prepared by A.M. Best, a leading insurance industry statistical, analytical and financial strength rating organization. Information from A.M. Best is presented on a statutory basis. When we provide our results on a comparable statutory basis, we label it as such; all other company data is presented in accordance with accounting principles generally accepted in the United States of America (GAAP).

Executive Summary

Through The Cincinnati Insurance Company, Cincinnati Financial Corporation is one of the 25 largest property casualty insurers in the nation, based on written premium volume for approximately 2,000 U.S. stock and mutual insurer groups. We market our insurance products through a select group of independent insurance agencies in 35 states as discussed in Item 1, Our Business and Our Strategy, Page 1.

Although 2008 was a difficult year for our economy, our industry and our company, our long-term perspective lets us address the immediate challenges while focusing on the major decisions that best position the company for success through all market cycles. We believe that this forward-looking view has consistently benefited our policyholders, agents, shareholders and associates.

To measure our progress, we have defined a measure of value creation that we believe captures the contribution of our insurance operations, the success of our investment strategy and the importance we place on paying cash dividends to shareholders. Between 2010 and 2014, we expect the total of 1) our rate of growth in book value per share plus 2) the ratio of dividends declared per share to beginning book value per share to average 12 percent to 15 percent. With the current economic and market uncertainty, we believe this ratio is an appropriate way to measure our long-term progress in creating value.

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

- Premium growth We believe over any five-year period our agency relationships and initiatives can lead to a property casualty written premium growth rate that exceeds the industry average. The compound annual growth rate of our net written premiums was 1.3 percent over the past five years, equal to the estimated growth rate for a broad group of standard market property casualty insurance companies.
- Combined ratio We believe our underwriting philosophy and initiatives can generate a GAAP combined ratio over any five-year period that is consistently below 100 percent. Our GAAP combined ratio has averaged 92.8 percent over the past five years. Our combined ratio was below 100 percent in each year during the period, except 2008 when we experienced a record level of catastrophe losses as discussed in Consolidated Property Casualty Insurance Results of Operations, Page 49. Our statutory combined ratio averaged 92.6 percent over the same period compared with an estimated 98.5 percent for the same industry group.
- Investment contribution We believe our investment philosophy and initiatives can drive investment income growth and lead to a total return on our equity investment portfolio over a five-year period that exceeds the five-year return of the Standard & Poor s 500 Index.
  - o Investment income growth has averaged 2.9 percent over the past five years. It grew in each year except 2008 when we experienced a dramatic reduction in dividend payouts by financial services companies held in our equity portfolio, a risk we addressed aggressively during 2008.
  - o Over the five years ended December 31, 2008, our compound annual equity portfolio return was a negative 9.0 percent compared with a compound annual total return of a negative 2.1 percent for the Index. Our equity portfolio underperformed the market for the five-year period primarily because of the decline in the market

value of our previously large holdings in the financial services sector. In 2008, our compound annual equity portfolio return was a negative 31.5 percent, compared with a negative 36.9 percent for the Index.

The board of directors is committed to rewarding shareholders directly through cash dividends and through share repurchase authorization. The board also has periodically declared stock dividends and splits. Through

2008, the company has increased the indicated annual cash dividend rate for 48 consecutive years, a record we believe is matched by only 11 other publicly traded companies. While seeing merit in continuing that record, in February 2009, our board indicated its first priority was assuring continued financial strength for the company and that its intention was to consider the potential for a 49th year of increase over the course of 2009. We discuss our financial position in more detail in Liquidity and Capital Resources, Page 70.

Strategic Initiatives Highlights

Management has worked with the board of directors to identify the strategies that can lead to long-term success. Our strategies are intended to position us to compete successfully in the markets we have targeted while minimizing risk. We believe successful implementation of the initiatives that support our strategies will help us better serve our agent customers, reduce volatility in our financial results and weather difficult economic, market or pricing cycles.

- Preserve capital Implementation of these initiatives is intended to preserve our capital and liquidity so that we can successfully grow our insurance business. A strong capital position provides the capacity to support premium growth and provides the liquidity to sustain our investment in the people and infrastructure needed to implement our other strategic initiatives.
- Improve insurance profitability Implementation of these operational initiatives is intended to support improved cash flow and profitable growth for the agencies that represent us and for our company. These initiatives primarily seek to strengthen our relationships with agents, allowing them to serve clients faster and manage expenses better. Others may streamline our internal processes so we can devote more resources to agent service.
- Drive premium growth Implementation of these operational initiatives is intended to expand our geographic footprint and diversify our premium sources to obtain profitable growth without significant infrastructure expense. Diversified growth also may reduce our catastrophe exposure risk.

We discuss each of these strategies, along with the metrics we use to assess their progress, in Item 1, Strategic Initiatives, Page 7,

Factors Influencing Our Future Performance

In January and February of 2009, storms affecting our policyholders largely in the Midwest currently are estimated to have resulted in about $30 million of reported claims, which will be included in first-quarter pretax catastrophe losses. This estimate does not take into account development of these catastrophes, any further catastrophe activity that may occur in the remainder of the first quarter of 2009 or potential development from events in prior periods.

In 2008, the rate of growth in book value plus the rate of dividend contribution was below our target, as discussed in the review of our financial highlights below. In 2009, we believe our value creation ratio may also be below our long-term target for several reasons.

- The weak economy is expected to continue to affect policyholders by deflating their business and personal insurable assets. Until the economy begins to recover, we also do not expect to see significant appreciation of our investments.
- Lingering effects of soft insurance market pricing are expected to affect growth rates and earned premium levels into 2010, continuing to weaken loss ratios and hamper near-term profitability. Economic factors, including inflation, may increase our claims and settlement expenses related to medical care, litigation and construction.
- Property casualty written premium growth may lag as our growth initiatives need more time to reach their full contribution.
- We will incur the cost of continued investment in our business, including technology, new states and process initiatives to create long-term value. In addition, we will not see the full advantage of many of our investments in technology until 2010 and beyond.
- Diversification of the investment portfolio over the past year included sales of selected positions to lock in gains, reduce concentrations and increase liquidity. Proceeds of sales are being reinvested in both fixed income and in equity securities with yields that we believe are likely to be more secure. This may slow the return to growth in investment income although we believe year-over-year comparisons may turn positive in the second half of the year. We expect to continue to make changes to the portfolio, as appropriate.

Our view of the value we can create over the next five years relies on two assumptions about the external environment. First, we re anticipating some firming of commercial insurance pricing during 2009. Second, we believe that the economy and financial markets can resume a growth track by the end of 2010. If those assumptions prove to be inaccurate, we may not be able to achieve our performance targets even if we accomplish our strategic objectives.

Other factors that could influence our ability to achieve our targets include:

- We expect the insurance marketplace to remain competitive, which is likely to cause carriers to pursue strategies that they believe could lead to economies of scale, market share gains or the potential for an improved competitive posture. Direct writers will continue to be a factor in the personal insurance market.
- We expect the independent insurance agency system to remain strong and viable, with continued agency consolidation, especially as agency margins come under more pressure due to soft pricing and the difficult economic environment. The soft commercial market that has extended into 2009 creates additional risk for agencies. We expect the soft market to continue, particularly in non-catastrophe event prone states and lines of business, absent a significant event or events.
- We expect initiatives that make it easier for agents to do business with us will continue to be a significant factor in agency relationships, with technology being a major driver. Policyholders will increasingly demand online services and access from agents or carriers.

We discuss in our Item 1A, Risk Factors, Page 25, many potential risks to our business and our ability to achieve our qualitative and quantitative objectives. These are real risks, but their probability of occurring may not be high. We also believe that our risk management programs generally can mitigate their potential effects, in the event they do occur.

We have formal risk management programs overseen by a senior officer and supported by a team of representatives from business areas. The team reports to our chairman, our president and chief executive officer and our board of directors, as appropriate, on detailed and summary risk assessments, risk metrics and risk plans. Our use of operational audits, strategic plans and departmental business plans, as well as our culture of open communications and our fundamental respect for our code of conduct, continue to help us manage risks on an ongoing basis.

Below we review highlights of our financial results for the past three years. Detailed discussion of these topics appears in Results of Operations, Page 48, and Liquidity and Capital Resources, Page 70.

Corporate Financial Highlights

The value creation ratio discussed in the Executive Summary, Page 37, was a negative 23.5 percent in 2008, a negative 5.7 percent in 2007 and a positive 16.7 percent in 2006. In both 2008 and 2007, a decline in unrealized gains on our investment portfolio was the most significant factor in the decline in book value as discussed below. In 2008, net income also was significantly below the level of the prior two years.

Cash dividends declared per share rose 9.9 percent in 2008, 6.0 percent in 2007 and 11.2 percent in 2006.

Balance Sheet Data and Performance Measures

(Dollars in millions except share data)	**At December 31, 2008**	At December 31, 2007	At December 31, 2006
Balance sheet data			
Invested assets	**$ 8,890**	$ 12,261	$ 13,759
Total assets	**13,369**	16,637	17,222
Short-term debt	**49**	69	49
Long-term debt	**791**	791	791
Shareholders equity	**4,182**	5,929	6,808
Book value per share	**25.75**	35.70	39.38
Debt-to-capital ratio	**16.7%**	12.7%	11.0%

	Years ended December 31,		
	2008	2007	2006
Performance measures			

Value creation ratio	**(23.5)%**	(5.7)%	16.7%

Invested assets declined because of lower fair values for portfolio investments, largely due to economic factors. The downturn in the economy had a particularly adverse effect on our financial sector equity holdings, which made up a significant portion of the portfolio prior to mid-2008. By year-end 2008, the portfolio was substantially more diversified and generally better positioned to withstand short-term fluctuations. We discuss our investment strategy in Item 1, Investments Segment, Page 17, and results for the segment in Investments Results of Operations, Page 66.

Our ratio of debt to total capital (debt plus shareholders equity) rose over the three years due to the effect on shareholders equity of the declining value of our invested assets. Long-term debt was unchanged over the period.

Income Statement and Per Share Data

(Dollars in millions except share data)	Twelve months ended December 31,			**2008-2007** Change %	2007-2006 Change %
	2008	2007	2006		
Income statement data					
Earned premiums	**$ 3,136**	$ 3,250	$ 3,278	**(3.5)**	(0.9)
Investment income, net of expenses	**537**	608	570	**(11.6)**	6.6
Realized investment gains and losses (pretax)	**138**	382	684	**(64.0)**	(44.1)
Total revenues	**3,824**	4,259	4,550	**(10.2)**	(6.4)
Net income	**429**	855	930	**(49.9)**	(8.0)
Per share data (diluted)					
Net income	**$ 2.62**	$ 4.97	$ 5.30	**(47.3)**	(6.2)
Cash dividends declared	**1.56**	1.42	1.34	**9.9**	6.0
Diluted weighted average shares outstanding	**163,362,409**	172,167,452	175,451,341	**(5.1)**	(1.9)

Net income declined in 2008 from the higher levels of the prior two years because of a three-year decline in realized investment gains, a first-ever decline in investment income and a lower aggregate contribution from our insurance segments. The pension plan settlement reduced 2008 net income by $17 million, or 11 cents per share. The transition from a defined benefit pension plan reduces company risk while providing flexible, company-sponsored 401(k) benefit to associates.

Weighted average shares outstanding may fluctuate from period to period because we repurchase shares under board authorizations and we issue shares when associates exercise stock options. Weighted average shares outstanding on a diluted basis declined 9 million in 2008, 3 million in 2007 and 2 million in 2006.

As discussed in Investments Results of Operation, Page 66, security sales led to realized investment gains in all three years, although 2008 gains were tempered by $510 million in other-than-temporary impairment charges. Realized investment gains and losses are integral to our financial results over the long term. We have substantial discretion in the timing of investment sales and, therefore, the gains or losses that are recognized in any period. That discretion generally is independent of the insurance underwriting process. Also, applicable accounting standards require us to recognize gains and losses from certain changes in fair values of securities and for securities with embedded derivatives without actual realization of those gains and losses.

Lower income from dividends led to an 11.6 percent decline in net investment income in 2008, the first decline in this measure in company history. The primary reason for the decline was dividend reductions by common and preferred holdings, including reductions during the year on positions subsequently sold or reduced.

Contribution from Insurance Segments

(Dollars in millions)	Years ended December 31,			**2008-2007**	2007-2006 Change %
	2008	2007	2006	**Change %**	
Consolidated property casualty highlights					
Written premiums	**$3,010**	$3,117	$3,178	**(3.4)**	(1.9)
Earned premiums	**3,010**	3,125	3,164	**(3.7)**	(1.2)
Underwriting profit (loss)	**(17)**	304	181	**(105.6)**	68.3

				Pt. Change	Pt. Change
GAAP combined ratio	**100.6%**	90.3%	94.3%	**10.3**	(4.0)
Statutory combined ratio	**100.4**	90.3	93.9	**10.1**	(3.6)
Written premium to statutory surplus	**0.9**	0.7	0.7	**0.2**	0.0

The trend in overall written premium growth reflected the competitive and market factors discussed in Item 1, Commercial Lines and Personal Lines Property Casualty Insurance Segment, Page 11 and Page 14.

In 2008, our property casualty insurance operations reported an underwriting loss after achieving record profitability in 2007. Underwriting profitability can be measured by the combined ratio. (The combined ratio is the percentage of each earned premium dollar spent on claims plus all expenses the lower the ratio, the better the performance.) In 2008 and 2007, higher savings from favorable development on prior period reserves helped offset other loss and loss expenses. Catastrophe losses fluctuated dramatically over the three-year period, making an unusually high contribution of 6.8 percentage points to the combined ratio in 2008 after an unusually low 0.8 points in 2007. The pension plan settlement increased the 2008 combined ratio by 0.8 percentage points.

Our new surplus lines operation contributed $14 million to net written premiums and $5 million to earned premiums, but had an immaterial effect on net income. The business achieved its first-year strategic plan objectives.

Our life insurance segment continued to provide a consistent source of profit. We discuss results for the segment in Life Insurance Results of Operations, Page 64. Income and gains from the life insurance investment portfolio are included in Investment segment results.

Critical Accounting Estimates

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

The significant accounting policies used in the preparation of the financial statements are discussed in Item 8, Note 1 of the Consolidated Financial Statements, Page 98. In conjunction with that discussion, material implications of uncertainties associated with the methods, assumptions and estimates underlying the company s critical accounting policies are discussed below. The audit committee of the board of directors reviews the annual financial statements with management and the independent registered public accounting firm. These discussions cover the quality of earnings, review of reserves and accruals, reconsideration of the suitability of accounting principles, review of highly judgmental areas including critical accounting policies, audit adjustments and such other inquiries as may be appropriate.

Property Casualty Insurance Loss And Loss Expense Reserves

Overview

We establish loss and loss expense reserves for our property casualty insurance business as balance sheet liabilities. These reserves account for unpaid loss and loss expenses as of a financial statement date. Unpaid loss and loss expenses are the estimated amounts necessary to pay for and settle all outstanding insured claims, including incurred but not reported (IBNR) claims, as of that date.

For some lines of business that we write, a considerable and uncertain amount of time can elapse between the occurrence, reporting and payment of insured claims. The amount we will actually have to pay for such claims also can be highly uncertain. This uncertainty, together with the size of our reserves, makes the loss and loss expense reserves our most significant estimate. Gross loss and loss expense reserves were $4.040 billion at year-end 2008 compared with $3.925 billion at year-end 2007.

How Reserves Are Established

Our field claims representatives establish case reserves when claims are reported to the company to provide for our unpaid loss and loss expense obligation associated with these claims. Experienced headquarters claims supervisors review individual case reserves greater than $35,000 that were established by field claims representatives. Headquarters claims managers also review case reserves greater than $100,000.

Our claims representatives base their case reserve estimates primarily upon case-by-case evaluations that consider:

- type of claim involved
- circumstances surrounding each claim
- policy provisions pertaining to each claim
- potential for subrogation or salvage recoverable
- general insurance reserving practices

Case reserves of all sizes are subject to review on a 90-day cycle, or more frequently if new information about a loss becomes available. As part of the review process, we monitor industry trends, cost trends, relevant court cases, legislative activity and other current events in an effort to ascertain new or additional loss exposures.

We also establish incurred but not reported (IBNR) reserves to provide for all unpaid loss and loss expenses not accounted for by case reserves:

- For weather events designated as catastrophes, we calculate IBNR reserves directly as a result of an estimated IBNR claim count and an estimated average claim amount for each event. Our claims department management coordinates the assessment of these events and prepares the related IBNR reserve estimates. Such an assessment involves a comprehensive analysis of the nature of the storm, of policyholder exposures within the affected geographic area and of available claims intelligence. Depending on the nature of the event, available claims intelligence could include surveys of field claims associates within the affected geographic area, feedback from a catastrophe claims team sent into the area, as well as data on claims reported as of the financial statement date. We generally use the catastrophe definition provided by Property Claims Service, a division of Insurance Services Office. PCS defines a catastrophe as an event that causes countrywide damage of $25 million or more in insured property losses and affects a significant number of policyholders and insureds.

- For asbestos and environmental claims, we calculate IBNR reserves by deriving an actuarially based estimate of total unpaid loss and loss expenses. We then reduce the estimate by total case reserves. We discuss the reserve analysis that applies to asbestos and environmental reserves in Asbestos and Environmental Reserves, Page 76.
- For all other claims and events, we calculate IBNR reserves quarterly by first deriving an actuarially based estimate of the ultimate cost of total loss and loss expenses incurred. We then reduce the estimate by total loss and loss expense payments and total case reserves carried. We discuss below the development of actuarial-based estimates of the ultimate cost of total loss and loss expenses incurred.

Our actuarial staff applies significant judgment in selecting models and estimating model parameters when preparing reserve analyses. In addition, unpaid loss and loss expenses are inherently uncertain as to timing and amount. Uncertainties relating to model appropriateness, parameter estimates and actual loss and loss expense amounts are referred to as model, parameter and process uncertainty, respectively. Our management and actuarial staff control for these uncertainties in the reserving process in a variety of ways.

Our actuarial staff bases its IBNR reserve estimates for these losses primarily on the indications of methods and models that analyze accident year data. Accident year is the year in which an insured claim, loss, or loss expense occurred. The specific methods and models that our actuaries have used for the past several years are:

- paid and reported loss development methods
- paid and reported loss Bornhuetter-Ferguson methods
- individual and multiple probabilistic trend family models

Our actuarial staff uses diagnostics provided by stochastic reserving software to evaluate the appropriateness of the models and methods listed above. The software s diagnostics have indicated that the appropriateness of these models and methods for estimating IBNR reserves for our lines of business tends to depend on a line s tail. Tail refers to the time interval between a typical claim s occurrence and its settlement. For our long-tail lines such as workers compensation and commercial casualty, models from the probabilistic trend family tend to provide superior fits and to validate well compared with models underlying the loss development and Bornhuetter-Ferguson methods. The loss development and Bornhuetter-Ferguson methods, particularly the reported loss variations, tend to produce the more appropriate IBNR reserve estimates for our short-tail lines such as homeowner and commercial property. For our mid-tail lines such as personal and commercial auto liability, all models and methods provide useful insights.

Our actuarial staff also devotes significant time and effort to the estimation of model and method parameters. The loss development and Bornhuetter-Ferguson methods require the estimation of numerous loss development factors. The Bornhuetter-Ferguson methods also involve the estimation of numerous ultimate loss ratios by accident year. Models from the probabilistic trend family require the estimation of development trends, calendar year inflation trends and exposure levels. Consequently, our actuarial staff monitors a number of trends and measures to gain key business insights necessary for exercising appropriate judgment when estimating the parameters mentioned.

These trends and measures include:

- company and industry pricing
- company and industry exposure
- company and industry loss frequency and severity
- past large loss events such as hurricanes
- company and industry premium
- company in-force policy count
- average premium per policy

These trends and measures also support the estimation of ultimate accident year loss ratios needed for applying the Bornhuetter-Ferguson methods and for assessing the reasonability of all IBNR reserve estimates computed. Our actuarial staff reviews these trends and measures quarterly and updates them as necessary.

Quarterly, our actuarial staff summarizes its reserve analysis by preparing an actuarial best estimate and a range of reasonable IBNR reserves intended to reflect the uncertainty of the estimate. An inter-departmental committee that includes our actuarial management team reviews the results of each quarterly reserve analysis. The committee establishes management s best estimate of IBNR reserves, which is the amount that is included in each period s financial statements. In addition to the information provided by actuarial staff, the committee also considers factors such as the following:

- large loss activity and trends in large losses
- new business activity

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- judicial decisions
- general economic trends such as inflation
- trends in litigiousness and legal expenses
- product and underwriting changes
- changes in claims practices

The determination of management s best estimate, like the preparation of the reserve analysis that supports it, involves considerable judgment. Changes in reserving data or the trends and factors that influence reserving data may signal fundamental shifts or may simply reflect single-period anomalies. Even if a change reflects a fundamental shift, the full extent of the change may not become evident until years later. Moreover, since our methods and models do not explicitly relate many of the factors we consider directly to reserve levels, we typically cannot quantify the precise impact of such factors on the adequacy of reserves prospectively or retrospectively.

Due to the uncertainties described above, our 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.

Key Assumptions Loss Reserving

Our actuarial staff makes a number of key assumptions when using their methods and models to derive IBNR reserve estimates. Appropriate reliance on these key assumptions essentially entails determinations of the likelihood that statistically significant patterns in historical data may extend into the future. The four most significant of the key assumptions used by our actuarial staff and approved by management are:

- Emergence of loss and allocated loss expenses on an accident year basis. Historical paid loss, reported loss and paid allocated loss expense data for the business lines we analyze contain patterns that reflect how unpaid losses, unreported losses and unpaid allocated loss expenses as of a financial statement date will emerge in the future on an accident year basis. Unless our actuarial staff or management identifies reasons or factors that invalidate the extension of historical patterns into the future, these patterns can be used to make projections necessary for estimating IBNR reserves. Our actuaries significantly rely on this assumption in the application of all methods and models mentioned above.
- Calendar year inflation. For long-tail and mid-tail business lines, calendar year inflation trends for future paid losses and paid allocated loss expenses will not vary significantly from a stable, long-term average. Our actuaries base reserve estimates derived from probabilistic trend family models on this assumption.
- Exposure levels. Historical earned premiums, when adjusted to reflect common levels of product pricing and loss cost inflation, can serve as a proxy for historical exposures. Our actuaries require this assumption to estimate expected loss ratios and expected allocated loss expense ratios used by the Bornhuetter-Ferguson reserving methods. They also use this assumption to establish exposure levels for recent accident years, characterized by green or immature data, when working with probabilistic trend family models.
- Claims having atypical emergence patterns. Characteristics of certain subsets of claims, such as high frequency, high severity, or mass tort claims, have the potential to distort patterns contained in historical paid loss, reported loss and paid allocated loss expense data. When testing indicates this to be the case for a particular subset of claims, our actuaries segregate these claims from the data and analyze them separately. Subsets of claims that could fall into this category include hurricane claims, individual large claims and asbestos and environmental claims.

These key assumptions have not changed since 2005, when our actuarial staff began using probabilistic trend family models to estimate IBNR reserves.

Paid losses, reported losses and paid allocated loss expenses are subject to random as well as systematic influences. As a result, actual paid losses, reported losses and paid allocated loss expenses are virtually certain to differ from projections. Such differences are consistent with what specific models for our business lines predict and with the related patterns in the historical data used to develop these models. As a result, management does not closely monitor statistically insignificant differences between actual and projected data.

Reserve Estimate Variability

Management believes that the standard error of a reserve estimate, a measure of the estimate s variability, provides the most appropriate measure of the estimate s sensitivity. The reserves we establish depend on the models we use and the related parameters we estimate in the course of conducting reserve analyses.

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However, the actual amount required to settle all outstanding insured claims, including IBNR claims, as of a financial statement date depends on stochastic, or random, elements as well as the systematic elements captured by our models and estimated model parameters. For the lines of business we write, process uncertainty the inherent variability of loss and loss expense payments typically contributes more to the imprecision of a reserve estimate than parameter uncertainty.

Consequently, a sensitivity measure that ignores process uncertainty would provide an incomplete picture of the reserve estimate s sensitivity. Since a reserve estimate s standard error accounts for both process and parameter uncertainty, it reflects the estimate s full sensitivity to a range of reasonably likely scenarios.

The table below provides standard errors and reserve ranges for lines of business that account for 90.6 percent of our 2008 loss and loss expense reserves as well as the potential effects on our net income, assuming a 35 percent federal tax rate. Standard errors and reserve ranges for assorted groupings of these lines of business cannot be computed by simply adding the standard errors and reserve ranges of the component lines of business, since such an approach would ignore the effects of product diversification. See Range of Reasonable Reserves, Page 74, for a total reserve range. While the table reflects our assessment of the most likely range within which each line s actual unpaid loss and loss expenses may fall, one or more lines actual unpaid loss and loss expenses could nonetheless fall outside of the indicated ranges.

(In millions)	Net loss and loss expense range of reserves				
	Carried reserves	Low point	High point	Standard error	Net income effect
At December 31, 2008					
Total	**$ 3,498**	**$ 3,256**	**$ 3,592**		
Commercial casualty	**$ 1,559**	**$ 1,280**	**$ 1,595**	**$ 158**	**$ 103**
Commercial property	**137**	**123**	**160**	**19**	**12**
Commercial auto	**385**	**367**	**401**	**17**	**11**
Workers compensation	**842**	**854**	**943**	**45**	**29**
Personal auto	**165**	**153**	**170**	**8**	**5**
Homeowners	**82**	**74**	**90**	**8**	**5**
At December 31, 2007					
Total	$ 3,397	$ 3,132	$ 3,427		
Commercial casualty	$ 1,565	$ 1,352	$ 1,634	$ 141	$ 92
Commercial property	121	104	136	16	10
Commercial auto	383	362	395	17	11
Workers compensation	777	726	786	30	20
Personal auto	189	173	191	9	6
Homeowners	77	75	88	7	5

If actual unpaid loss and loss expenses fall within these ranges, our cash flow and fixed maturity investments should provide sufficient liquidity to make the subsequent payments. To date, our cash flow has covered our loss and loss expense payments, and we have never had to sell investments to make these payments. If this were to become necessary, however, our fixed maturity investments should provide us with ample liquidity. At year-end 2008, consolidated fixed maturity investments exceeded total insurance reserves (including life policy reserves) by more than $190 million.

Life Insurance Policy Reserves

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

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

Asset Impairment

Our fixed-maturity and equity investment portfolios are our largest assets. The company s asset impairment committee continually monitors the holdings in these portfolios and all other assets for signs of other-than-temporary or permanent impairment. The committee monitors significant decreases in the fair value of invested assets, changes in legal factors or in the business climate, an accumulation of costs in excess of the amount originally expected to acquire or construct an asset, uncollectability of all receivable assets, or other factors such as bankruptcy, deterioration of creditworthiness, failure to pay interest or dividends or signs indicating that the carrying amount may not be recoverable.

The application of our impairment policy resulted in other-than-temporary impairment charges that reduced our income before income taxes by $510 million in 2008, $16 million in 2007 and $1 million in 2006. Impairment charges are recorded for other-than-temporary declines in value, if, in the asset impairment committee s judgment, there is little expectation that the value may be recouped within a designated recovery period. Other than-temporary impairment losses represent non-cash charges to income.

Our portfolio managers monitor their assigned portfolios. If a security is trading below book value, the portfolio managers undertake additional reviews. Such declines often occur in conjunction with events taking place in the overall economy and market, combined with events specific to the industry or operations of the issuing organization. Management reviews quantitative measurements such as a declining trend in fair value, the extent of the fair value decline and the length of time the value of the security has been depressed, as well as qualitative measures such as pending events, credit ratings and issuer liquidity. We are even more proactive when these declines in valuation are greater than might be anticipated when viewed in the context of overall economic and market conditions. We provide information about valuation of our invested assets in Item 8, Note 2 of the Consolidated Financial Statements, Page 104.

All securities valued below 100 percent of book value are reported to the asset impairment committee for evaluation. A security valued between 95 percent and 100 percent of book value is not monitored separately by the committee. These assets generally are at this value because of interest rate-driven factors.

When evaluating for other-than-temporary impairments, the committee considers the company s intent and ability to retain a security for a period adequate to recover its cost. Because of the company s financial strength, management may not impair certain securities even when they are trading below cost.

For fixed-maturity investments, we can make that determination based on our ability to hold until their scheduled redemption securities that are meeting their debt obligations and have the potential to recover value. For equity investments, we can make that determination based on a thorough assessment of the potential for recovery over a longer-term horizon. In addition to evaluating the security s current valuation, the impairment committee reviews objective evidence that indicates the potential for a recovery in value. Information is evaluated regarding the security, such as financial performance, near-term prospects and the financial condition of the region and industry in which the issuer operates.

Securities that have previously been impaired are evaluated based on their adjusted book value and written down further, if deemed appropriate. We provide detailed information about securities trading in a continuous loss position at year-end 2008 in Item 7A, Application of Asset Impairment Policy, Page 87. An other-than-temporary decline in the fair value of a security is recognized in net income as realized investment losses.

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

Fair Value Measurements

Valuation of Financial Instruments

Valuation of financial instruments, primarily securities held in our investment portfolio, is a critical component of our interim financial statement preparation. We account for our investment portfolio at fair value and apply fair value measurements as defined by SFAS No. 157, Fair Value Measurements, to financial instruments. Fair value is applicable to SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, SFAS No. 155, Accounting for Certain Hybrid Financial Instruments, and SFAS No. 107, Disclosures about Fair Value of Financial Instruments.

We adopted the provisions of SFAS No. 157 on January 1, 2008. SFAS No. 157 defines fair value as the exit price or the amount that would be 1) received to sell an asset or 2) paid to transfer a liability in an orderly transaction between marketplace participants at the measurement date. When determining an exit price, we

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must, whenever possible, rely upon observable market data. Prior to the adoption of SFAS No. 157, we considered various factors such as liquidity and volatility but primarily obtained pricing from various external services, including broker quotes.

The SFAS No. 157 exit price notion requires our valuation also to consider what a marketplace participant would pay to buy an asset or receive to assume a liability. Therefore, while we can consider pricing data from outside services, we ultimately determine whether the data or inputs used by these outside services are observable or unobservable.

In accordance with SFAS No. 157, we have categorized our financial instruments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level that is significant to the fair value measurement of the instrument.

Financial assets and liabilities recorded on the Consolidated Balance Sheets are categorized based on the inputs to the valuation techniques as described in Item 8, Note 3 of the Consolidated Financial Statements, Page 106.

Level 1 and Level 2 Valuation Techniques

Over 98 percent of our $8.8 billion invested assets measured at fair value are classified as Level 1 or Level 2.

Financial assets that fall within Level 1 and Level 2 are priced according to observable data from identical or similar securities that have traded in the marketplace. Also within Level 2 are securities that are valued by outside services or brokers where we have evaluated the pricing methodology and determined that the inputs are observable.

Included in the Level 2 hierarchy are a small portfolio of collateralized mortgage obligations that represented less than 1 percent of the fair value of our investment portfolio at December 31, 2008. We obtained the CMOs as part of the termination of our securities lending program during 2008. The CMOs were an investment made by one of the short-duration funds, which subsequently dissolved and distributed the assets to its investors. When we terminated the securities lending program, we chose to retain the CMOs rather than sell them at what we felt were distressed prices in an illiquid market.

All $30 million of the CMOs in our portfolio are collateralized by Alt-A mortgages that originated between 2004 and 2006. We owned investment grade CMOs with a fair value and book value of $27 million and $39 million, respectively, at December 31, 2008. Of the $27 million investment-grade CMOs, $21 million were rated AAA by Standard & Poor s. We also owned non-investment grade CMOs that had a fair value and book value of $3 million and $4 million, respectively. We do not intend to make additional investments in this asset category.

Level 3 Valuation Techniques

Financial assets that fall within the Level 3 hierarchy are valued based upon unobservable market inputs, normally because they are not actively traded on a public market. Level 3 taxable fixed maturities securities include certain private placements, small issues, general corporate bonds and medium-term notes. Level 3 tax-exempt fixed maturities securities include various thinly traded municipal bonds. Level 3 common equities include private equity securities. Level 3 preferred equities include private and thinly traded preferred securities.

Pricing for each Level 3 security is based upon inputs that are market driven, including third-party reviews provided to the issuer or broker quotes. However, we placed in the Level 3 hierarchy securities for which we were unable to obtain the pricing methodology or we could not consider the price provided as binding. Management ultimately determined the pricing for each Level 3 security that we considered to be the best exit price valuation. As of December 31, 2008, total Level 3 assets were 1.6 percent of our investment portfolio measured at fair value, which was relatively stable throughout 2008. Broker quotes are obtained for thinly traded securities that subsequently fall within the Level 3 hierarchy. We obtained two non-binding quotes from brokers and used the more conservative price for fair value. At December 31, 2008, total fair value of assets priced by broker quotes for the SFAS No. 157 disclosure was $83 million and consisted mostly of taxable fixed maturities.

Employee Benefit Pension Plan

As discussed in Item 8, Note 13 of the Consolidated Financial Statements, Page 113, we modified our qualified defined benefit pension during 2008, terminating participation in the plan for certain participants in a transition to a sponsored 401(k) with company matching of associate contributions. Contributions and pension costs are developed from annual actuarial valuations. These valuations involve key assumptions including discount rates and expected return on plan assets, which are updated each year. Any adjustments to these assumptions are based on considerations of current market conditions. Therefore, changes in the related pension costs or credits may occur in the future due to changes in assumptions.

Key assumptions used in developing the 2008 net pension obligation were a 6.00 percent discount rate and rates of compensation increases ranging from 4 percent to 6 percent. Key assumptions used in developing the 2008 net pension expense were a 6.25 percent discount rate, an 8 percent expected return on plan assets and rates of compensation increases ranging from 4 percent to 6 percent. See Note 13 for additional information on assumptions.

In 2008, the net pension expense was $47 million, including one-time charges of $27 million for settlement and $3 million for curtailment related to the modifications to the qualified pension plan. In 2009, we expect a net pension expense of $11 million.

Holding all other assumptions constant, a 0.5 percentage point decline in the discount rate would lower our 2009 net income before income taxes by $1 million. Likewise, a 0.5 percentage point decline in the expected return on plan assets would lower our 2009 income before income taxes by $1 million.

The fair value of the plan assets was $52 million less than the accumulated benefit obligation at year end 2008 and $4 million greater than the accumulated benefit obligation at year-end 2007. The fair value of the plan assets was $88 million less than the projected plan benefit obligation at year-end 2008 and $60 million less at year-end 2007. Market conditions and interest rates significantly affect future assets and liabilities of the pension plan. In 2009, we expect to contribute approximately $33 million to our qualified plan.

Deferred Acquisition Costs

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

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

Contingent Commission Accrual

Another significant estimate relates to our accrual for property casualty contingent (profit-sharing) commissions. We base the contingent commission accrual estimates on property casualty underwriting results and on supplemental information. Contingent commissions are paid to agencies using a formula that takes into account agency profitability, premium volume and other factors, such as prompt monthly payment of amounts due to the company. Due to the complexity of the calculation and the variety of factors that can affect contingent commissions for an individual agency, the amount accrued can differ from the actual contingent commissions paid. The contingent commission accrual of $75 million in 2008 contributed 2.5 percentage points to the property casualty combined ratio. If contingent commissions paid were to vary from that amount by 5 percent, it would affect 2009 net income by $2 million (after tax), or 1 cent per share, and the combined ratio by approximately 0.1 percentage points.

Separate Accounts

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

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

For our most significant separate account, written in 1999, realized gains and losses are retained in the separate account and are deferred and amortized to the contract holder over a five-year period, subject to certain limitations. Upon termination or maturity of this separate account contract, any unamortized deferred gains and/or losses will revert to the general account. In the event this separate account holder were to exchange the contract for the policy of another carrier in 2009, the account holder would pay a surrender charge equal to 1 percent of the contract s account value. The surrender charge falls to zero in 2010 and beyond.

At year-end 2008, net unamortized realized losses amounted to $12 million. In accordance with this separate account agreement, the investment assets must meet certain criteria established by the regulatory authorities to whose jurisdiction the group contract holder is subject. Therefore, sales of investments may be mandated to maintain compliance with these regulations, possibly requiring gains or losses to be recorded, and charged to the general account. Potentially, losses could be material; however, unrealized losses are approximately $36 million before tax in the separate account portfolio, which had a book value of $521 million at year-end 2008.

Recent Accounting Pronouncements

Information about recent accounting pronouncements is provided in Item 8, Note 1 of the Consolidated Financial Statements, Page 98. We have determined that recent accounting pronouncements have not had nor are they expected to have any material impact on our consolidated financial statements.

Results Of Operations

Consolidated financial results primarily reflect the results of our four reporting segments. These segments are defined based on financial information we use to evaluate performance and to determine the allocation of assets.

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

We report as Other the non-investment operations of the parent company and its subsidiaries CFC Investment Company and CinFin Capital Management Company (excluding client investment activities), as well as other income of our standard market property casualty insurance operations. CinFin Capital Management will terminate all operations effective February 28, 2009. Beginning in 2008, we also include in Other the results of The Cincinnati Specialty Underwriters Insurance Company and CSU Producer Resources.

We measure profit or loss for our commercial lines and personal lines property casualty and life insurance segments based upon underwriting results (profit or loss), which represent net earned premium less loss and loss expenses and underwriting expenses on a pretax basis. We also frequently evaluate results for our consolidated property casualty insurance operations, which is the total of our commercial, personal and surplus insurance results. Underwriting results and segment pretax operating income are not substitutes for net income determined in accordance with GAAP. For our consolidated property casualty insurance operations as well as the insurance segments, statutory accounting data and ratios are key performance indicators that we use to assess business trends and to make comparisons to industry results, since GAAP-based industry data generally is not as readily available.

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

The calculations of segment data are described in more detail in Item 8, Note 18 of the Consolidated Financial Statements, Page 119. The following sections review results of operations for each of the four segments. Commercial Lines Insurance Results of Operations begins on Page 51, Personal Lines Insurance Results of Operations begins on Page 59, Life Insurance Results of Operations begins on Page 64, and Investments Results of Operations begins on Page 66. We begin with an overview of our consolidated property casualty operations, which is the total of our commercial lines, personal lines and surplus lines results.

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Consolidated Property Casualty Insurance Results Of Operations

In addition to the factors discussed in Commercial Lines and Personal Lines Insurance Results of Operations, Page 51 and Page 59, growth and profitability for our consolidated property casualty insurance operations were affected by a number of common factors.

Changes in written and earned premiums over the past three years reflected growing price competition partially offset by consistently high retention rates of renewal business. New business written directly by agencies rose in 2008 after declining in 2007. The resurgence in new business was largely due to the contribution of agencies appointed the past five years, the contribution of our surplus lines business and more competitive personal lines pricing. Other written premium is largely ceded reinsurance premiums.

(Dollars in millions)	Years ended December 31,			**2008-2007 Change**	2007-2006 Change
	2008	2007	2006	**%**	%
Agency renewal written premiums	**$ 2,828**	$ 2,960	$ 2,931	**(4.5)**	1.0
Agency new business written premiums	**368**	325	357	**13.1**	(8.9)
Other written premiums	**(186)**	(168)	(110)		