CINCINNATI FINANCIAL CORP
Form 10-Q
April 25, 2018

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

(Mark one)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the quarterly period ended March 31, 2018.

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the transition period from ______________________ to ______________________.
Commission file number 0-4604

CINCINNATI FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
þYes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
þYes ¨ No

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

þ Large accelerated filer ¨ Accelerated filer ¨ Nonaccelerated filer ¨ Smaller reporting company
¨ Emerging growth company
(Do not check if a smaller reporting company)

¨ If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):
¨Yes þ No

As of April 20, 2018, there were 164,145,978 shares of common stock outstanding.

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
FORM 10-Q FOR THE QUARTER ENDED March 31, 2018

TABLE OF CONTENTS

Part I – Financial Information
Item 1. Financial Statements (unaudited)

Cincinnati Financial Corporation and Subsidiaries
Condensed Consolidated Balance Sheets

(Dollars in millions, except per share data)	March 31, 2018	December 31, 2017
Assets		
Investments		
Fixed maturities, at fair value (amortized cost: 2018—$10,364; 2017—$10,314)	$10,528	$ 10,699
Equity securities, at fair value (cost: 2017—$3,094)	6,086	6,249
Other invested assets	107	103
Total investments	16,721	17,051
Cash and cash equivalents	604	657
Investment income receivable	124	134
Finance receivable	61	61
Premiums receivable	1,626	1,589
Reinsurance recoverable	423	432
Prepaid reinsurance premiums	39	42
Deferred policy acquisition costs	691	670
Land, building and equipment, net, for company use (accumulated depreciation: 2018—$259; 2017—$253)	186	185
Other assets	192	216
Separate accounts	803	806
Total assets	$21,470	$ 21,843
Liabilities		
Insurance reserves		
Loss and loss expense reserves	$5,345	$ 5,273
Life policy and investment contract reserves	2,740	2,729
Unearned premiums	2,459	2,404
Other liabilities	672	792
Deferred income tax	652	745
Note payable	24	24
Long-term debt and capital lease obligations	829	827
Separate accounts	803	806
Total liabilities	13,524	13,600
Commitments and contingent liabilities (Note 12)		
Shareholders' Equity		
Common stock, par value—$2 per share; (authorized: 2018 and 2017—500 million shares; issued: 2018 and 2017—198.3 million shares)	397	397
Paid-in capital	1,258	1,265
Retained earnings	7,565	5,180
Accumulated other comprehensive income	115	2,788
Treasury stock at cost (2018—34.2 million shares and 2017—34.4 million shares)	(1,389)	(1,387)
Total shareholders' equity	7,946	8,243

Total liabilities and shareholders' equity	$21,470	$ 21,843

Accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

Cincinnati Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Income

(Dollars in millions, except per share data)	Three months ended March 31, 2018	2017
Revenues		
Earned premiums	$1,260	$1,208
Investment income, net of expenses	150	149
Investment gains and losses, net	(191)	160
Fee revenues	4	5
Other revenues	1	1
Total revenues	1,224	1,523
Benefits and Expenses		
Insurance losses and contract holders' benefits	854	853
Underwriting, acquisition and insurance expenses	403	377
Interest expense	13	13
Other operating expenses	4	4
Total benefits and expenses	1,274	1,247
Income (Loss) Before Income Taxes	(50)	276
Provision (Benefit) for Income Taxes		
Current	28	40
Deferred	(47)	35
Total provision (benefit) for income taxes	(19)	75
Net Income (Loss)	$(31)	$201
Per Common Share		
Net income (loss)—basic	$(0.19)	$1.22
Net income (loss)—diluted	(0.19)	1.21

Accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

Cincinnati Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Comprehensive Income

(Dollars in millions)	Three months ended March 31,	
	2018	2017
Net Income (Loss)	$(31)	$201
Other Comprehensive Income (Loss)		
Change in unrealized gains on investments, net of tax (benefit) of ($46) and $46, respectively	(175)	85
Amortization of pension actuarial loss and prior service cost, net of tax of $0 and $0, respectively	—	1
Change in life deferred acquisition costs, life policy reserves and other, net of tax of $1 and $1, respectively	5	1
Other comprehensive income (loss)	(170)	87
Comprehensive Income (Loss)	$(201)	$288

Accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

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

(Dollars in millions)	Three months ended March 31,	
	2018	2017
Common Stock		
Beginning of year	$397	$397
Share-based awards	—	—
End of period	397	397
Paid-In Capital		
Beginning of year	1,265	1,252
Share-based awards	(17)	(18)
Share-based compensation	9	8
Other	1	1
End of period	1,258	1,243
Retained Earnings		
Beginning of year	5,180	5,037
Cumulative effect of change in accounting for equity securities as of January 1, 2018	2,503	—
Adjusted beginning of year	7,683	5,037
Net income (loss)	(31)	201
Dividends declared	(87)	(82)
End of period	7,565	5,156
Accumulated Other Comprehensive Income		
Beginning of year	2,788	1,693
Cumulative effect of change in accounting for equity securities as of January 1, 2018	(2,503)	—
Adjusted beginning of year	285	1,693
Other comprehensive income (loss)	(170)	87
End of period	115	1,780
Treasury Stock		
Beginning of year	(1,387)	(1,319)
Share-based awards	14	17
Shares acquired - share repurchase authorization	(15)	(15)
Shares acquired - share-based compensation plans	(2)	(4)
Other	1	1
End of period	(1,389)	(1,320)
Total Shareholders' Equity	$7,946	$7,256
(In millions)		
Common Stock - Shares Outstanding		
Beginning of year	163.9	164.4
Share-based awards	0.4	0.5
Shares acquired - share repurchase authorization	(0.2)	(0.2)
Shares acquired - share-based compensation plans	—	(0.1)
Other	—	—

End of period	164.1	164.6

Accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

Cincinnati Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows

(Dollars in millions)	Three months ended March 31,	
	2018	2017
Cash Flows From Operating Activities		
Net income (loss)	$(31)	$201
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	18	14
Investment gains and losses, net	191	(160)
Share-based compensation	9	8
Interest credited to contract holders'	11	13
Deferred income tax expense	(47)	35
Changes in:		
Investment income receivable	10	11
Premiums and reinsurance receivable	(26)	(44)
Deferred policy acquisition costs	(10)	(25)
Other assets	(8)	(5)
Loss and loss expense reserves	72	92
Life policy and investment contract reserves	21	25
Unearned premiums	55	70
Other liabilities	(137)	(139)
Current income tax receivable/payable	26	40
Net cash provided by operating activities	154	136
Cash Flows From Investing Activities		
Sale of fixed maturities	5	12
Call or maturity of fixed maturities	393	249
Sale of equity securities	104	216
Purchase of fixed maturities	(438)	(403)
Purchase of equity securities	(110)	(313)
Investment in finance receivables	(6)	(5)
Collection of finance receivables	6	6
Investment in buildings and equipment	(3)	(2)
Change in other invested assets, net	(5)	(6)
Net cash used in investing activities	(54)	(246)
Cash Flows From Financing Activities		
Payment of cash dividends to shareholders	(80)	(77)
Shares acquired - share repurchase authorization	(15)	(15)
Payments of note payable	—	(3)
Proceeds from stock options exercised	4	6
Contract holders' funds deposited	21	23
Contract holders' funds withdrawn	(46)	(43)
Other	(37)	(15)
Net cash used in financing activities	(153)	(124)
Net change in cash and cash equivalents	(53)	(234)
Cash and cash equivalents at beginning of year	657	777
Cash and cash equivalents at end of period	$604	$543
Supplemental Disclosures of Cash Flow Information:		

Interest paid	$—	$—
Income taxes paid	—	—
Noncash Activities		
Conversion of securities	$3	$4
Equipment acquired under capital lease obligations	5	3
Cashless exercise of stock options	2	4
Other assets and other liabilities	30	73

Accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 — Accounting Policies
The condensed consolidated financial statements include the accounts of Cincinnati Financial Corporation and its consolidated subsidiaries, each of which is wholly owned. These statements are presented in conformity with accounting principles generally accepted in the United States of America (GAAP). All intercompany balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Our actual results could differ from those estimates. Certain financial information that is normally included in annual financial statements prepared in accordance with GAAP, but that is not required for interim reporting purposes, has been condensed or omitted.

Our March 31, 2018, condensed consolidated financial statements are unaudited. We believe that we have made all adjustments, consisting only of normal recurring accruals, that are necessary for fair presentation. These condensed consolidated financial statements should be read in conjunction with our consolidated financial statements included in our 2017 Annual Report on Form 10-K. The results of operations for interim periods do not necessarily indicate results to be expected for the full year.

Adopted Accounting Updates

ASU 2014-09 Revenue from Contracts with Customers
In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers. ASU 2014-09 requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. Insurance contracts do not fall within the scope of this ASU. The effective date of ASU 2014-09 was for interim and annual reporting periods beginning after December 15, 2017. The company adopted this ASU effective January 1, 2018 and it did not have a material impact on the company's consolidated financial position, cash flows or results of operations.

ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities
In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 revised the accounting related to the classification and measurement of investments in equity securities and the presentation of certain fair value changes for financial liabilities measured at fair value. The effective date of ASU 2016-01 was for interim and annual reporting periods beginning after December 15, 2017. The company adopted this ASU on January 1, 2018, and applied it prospectively without prior period amounts restated. As a result of the adoption, $2.503 billion of after-tax unrealized gains on equity securities was reclassified on January 1, 2018, from accumulated other comprehensive income to retained earnings. Results of operations were impacted as changes in fair value of equity securities are now reported in net income (loss) instead of reported in other comprehensive income (loss). As a result of the adoption of this ASU, the first quarter 2018 net investment loss of $191 million in the condensed consolidated statements of income included $198 million from the fair value change of equity securities.

ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. ASU 2016-15 addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The effective date of ASU 2016-15 is for interim and annual reporting periods beginning after December 15, 2017. The company adopted this ASU effective January 1, 2018, and it did not have a material impact on our company's consolidated financial position, cash flows or results of operations.

ASU 2017-07, Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

In March 2017, the FASB issued ASU 2017-07, Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Postretirement Benefit Costs. ASU 2017-07 provides guidance on how to present the components of net periodic benefit costs in the income statement for pension plans and other post-retirement benefit plans and allows only the service cost component of net benefit cost to be eligible for capitalization when applicable. The effective date of ASU 2017-07 is for interim and annual reporting periods beginning after December 15, 2017. The company adopted this ASU effective January 1, 2018 and disclosed the line items used in the statements of income to present the service and non-service components of net periodic benefit costs in Note 11, Employee Retirement Benefits, to these consolidated financial statements. The adoption did not have a material impact on our company's consolidated financial position, cash flows or results of operations.

ASU 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting
In May 2017, the FASB issued ASU 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. ASU 2017-09 clarifies when to account for a change to the terms or conditions of a share based payment award as a modification. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. The effective date of ASU 2017-09 was for interim and annual reporting periods, beginning after December 15, 2017, and was applied prospectively. The company adopted this ASU effective January 1, 2018, and it did not have a material impact on our company's consolidated financial position, cash flows or results of operations.

Pending Accounting Updates

ASU 2016-02, Leases (Topic 842)
In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The main provision of ASU 2016-02 requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The effective date of ASU 2016-02 is for interim and annual reporting periods beginning after December 15, 2018. The ASU has not yet been adopted; however, it is not expected to have a material impact on our company’s consolidated financial position, cash flows or results of operations.

ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments
In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13 amends previous guidance on the impairment of financial instruments by adding an impairment model that allows an entity to recognize expected credit losses as an allowance rather than impairing as they are incurred. The new guidance is intended to reduce complexity of credit impairment models and result in a more timely recognition of expected credit losses. The effective date of ASU 2016-13 is for interim and annual reporting periods beginning after December 15, 2019. The ASU has not yet been adopted. Management is currently evaluating the impact on our company's consolidated financial position, cash flows or results of operations.

ASU 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities
In March 2017, the FASB issued ASU 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. ASU 2017-08 amends guidance on the amortization period of premiums on certain purchased callable debt securities. The amendments shorten the amortization period of premiums on certain purchased callable debt securities to the earliest call date. The amendments should be applied on a modified retrospective basis through a cumulative-effect adjustment to beginning retained earnings. The effective date of ASU 2017-08 is for interim and annual reporting periods beginning after December 15, 2018. The ASU has not yet been adopted; however, it is not expected to have a material impact on our

company's consolidated financial position, cash flows or results of operations.

NOTE 2 – Investments

In the first quarter of 2018, we adopted ASU 2016-01, which resulted in changes in the fair value of equity securities still held at March 31, 2018, being reported in net income (loss) instead of being reported in other comprehensive income (loss). See Note 1, Accounting Policies, for additional discussion.

The following table provides cost or amortized cost, gross unrealized gains, gross unrealized losses and fair value for our fixed-maturity and equity securities:

(Dollars in millions)	Cost or amortized cost	Gross unrealized		Fair value
At March 31, 2018		gains	losses	
Fixed maturity securities:				
Corporate	$ 5,452	$ 155	$ 35	$5,572
States, municipalities and political subdivisions	4,304	85	35	4,354
Commercial mortgage-backed	285	3	2	286
Government-sponsored enterprises	277	—	6	271
United States government	36	—	1	35
Foreign government	10	—	—	10
Total	10,364	243	79	10,528
At December 31, 2017				
Fixed maturity securities:				
Corporate	$ 5,420	$ 246	$ 13	$5,653
States, municipalities and political subdivisions	4,316	155	6	4,465
Commercial mortgage-backed	280	7	1	286
Government-sponsored enterprises	257	1	4	254
United States government	31	—	—	31
Foreign government	10	—	—	10
Subtotal	10,314	409	24	10,699
Equity securities:				
Common equities	2,918	3,135	14	6,039
Nonredeemable preferred equities	176	34	—	210
Subtotal	3,094	3,169	14	6,249
Total	$ 13,408	$ 3,578	$ 38	$16,948

The net unrealized investment gains in our fixed-maturity portfolio at March 31, 2018, are primarily the result of the continued low interest rate environment that increased the fair value of our fixed-maturity portfolio. Our commercial mortgage-backed securities had an average rating of Aa1/AA at March 31, 2018, and December 31, 2017.

At March 31, 2018, JP Morgan Chase & Co. (NYSE:JPM) was our largest single equity holding with a fair value of $248 million, which was 4.2 percent of our publicly traded common equities portfolio and 1.5 percent of the total investment portfolio.

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

(Dollars in millions)	Less than 12 months		12 months or more		Total	
At March 31, 2018	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Fixed maturity securities:						
Corporate	$ 1,002	$ 20	$ 253	$ 15	$1,255	$ 35
States, municipalities and political subdivisions	1,052	21	256	14	1,308	35
Commercial mortgage-backed securities	81	1	35	1	116	2
Government-sponsored enterprises	131	2	123	4	254	6
Foreign government	10	—	—	—	10	—
United States government	24	1	11	—	35	1
Total	$ 2,300	$ 45	$ 678	$ 34	$2,978	$ 79
At December 31, 2017						
Fixed maturity securities:						
Corporate	$ 330	$ 4	$ 252	$ 9	$582	$ 13
States, municipalities and political subdivisions	88	1	264	5	352	6
Commercial mortgage-backed	33	—	36	1	69	1
Government-sponsored enterprises	96	1	124	3	220	4
Foreign government	10	—	—	—	10	—
United States government	23	—	6	—	29	—
Subtotal	580	6	682	18	1,262	24
Equity securities:						
Common equities	229	14	—	—	229	14
Subtotal	229	14	—	—	229	14
Total	$ 809	$ 20	$ 682	$ 18	$1,491	$ 38

Contractual maturity dates for fixed-maturity investments were:

(Dollars in millions) At March 31, 2018	Amortized cost	Fair value	% of fair value
Maturity dates:			
Due in one year or less	$ 449	$457	4.4 %
Due after one year through five years	2,714	2,768	26.3
Due after five years through ten years	3,986	4,046	38.4
Due after ten years	3,215	3,257	30.9
Total	$ 10,364	$10,528	100.0%

Actual maturities may differ from contractual maturities when there is a right to call or prepay obligations with or without call or prepayment penalties.

The following table provides investment income and investment gains and losses, net:

(Dollars in millions)	Three months ended March 31, 2018	2017
Investment income:		
Interest	$110	$111
Dividends	42	39
Other	1	1
Total	153	151
Less investment expenses	3	2
Total	$150	$149
Investment gains and losses, net:		
Equity securities:		
Investment gains and losses on securities sold, net	$3	$—
Unrealized gains and losses on securities still held, net	(198)	—
Gross realized gains	—	153
Gross realized losses	—	(4)
Subtotal	(195)	149
Fixed maturities:		
Gross realized gains	4	10
Gross realized losses	—	—
Subtotal	4	10
Other	—	1
Total	$(191)	$160

During the three months ended March 31, 2018, there were no fixed-maturity securities other-than-temporarily impaired. During the three months ended March 31, 2017, there were no equity securities and no fixed-maturity securities other-than-temporarily impaired. There were no credit losses on fixed-maturity securities for which a portion of other-than-temporary impairment (OTTI) has been recognized in other comprehensive income (loss) for the three months ended March 31, 2018 and 2017.

At March 31, 2018, 250 fixed-maturity investments with a total unrealized loss of $34 million had been in an unrealized loss position for 12 months or more. Of that total, one fixed-maturity investment had a fair value below 70 percent of amortized cost. At December 31, 2017, 249 fixed-maturity investments with a total unrealized loss of $18 million had been in an unrealized loss position for 12 months or more. Of that total, no fixed-maturity investments had fair values below 70 percent of amortized cost. There were no equity security investments in an unrealized loss position for 12 months or more as of December 31, 2017.

NOTE 3 – Fair Value Measurements

In accordance with accounting guidance for fair value measurements and disclosures, we categorized our financial instruments, based on the priority of the observable and market-based data for the valuation technique used, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices with readily available independent data in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable market inputs (Level 3). When various inputs for measurement fall within different levels of the fair value hierarchy, the lowest observable input that has a significant impact on fair value measurement is used.
Our valuation techniques have not changed from those used at December 31, 2017, and ultimately management determines fair value. See our 2017 Annual Report on Form 10-K, Item 8, Note 3, Fair Value Measurements, Page 132, for information on characteristics and valuation techniques used in determining fair value.

Fair Value Disclosures for Assets
The following tables illustrate the fair value hierarchy for those assets measured at fair value on a recurring basis at March 31, 2018, and December 31, 2017. We do not have any liabilities carried at fair value. There were no transfers between Level 1 and Level 2.

(Dollars in millions) At March 31, 2018	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Fixed maturities, available for sale:				
Corporate	$ —	$ 5,571	$ 1	$5,572
States, municipalities and political subdivisions	—	4,350	4	4,354
Commercial mortgage-backed	—	286	—	286
Government-sponsored enterprises	—	271	—	271
United States government	35	—	—	35
Foreign government	—	10	—	10
Subtotal	35	10,488	5	10,528
Common equities	5,893	—	—	5,893
Nonredeemable preferred equities	—	193	—	193
Separate accounts taxable fixed maturities	—	793	—	793
Top Hat savings plan mutual funds and common equity (included in Other assets)	34	—	—	34
Total	$ 5,962	$ 11,474	$ 5	$17,441
At December 31, 2017				
Fixed maturities, available for sale:				
Corporate	$ —	$ 5,652	$ 1	$5,653
States, municipalities and political subdivisions	—	4,460	5	4,465
Commercial mortgage-backed	—	286	—	286
Government-sponsored enterprises	—	254	—	254
United States government	31	—	—	31
Foreign government	—	10	—	10
Subtotal	31	10,662	6	10,699
Common equities, available for sale	6,039	—	—	6,039
Nonredeemable preferred equities, available for sale	—	210	—	210
Separate accounts taxable fixed maturities	—	795	—	795
Top Hat savings plan mutual funds and common equity (included in Other assets)	31	—	—	31

Total	$ 6,101	$ 11,667	$ 6	$17,774

Each financial instrument that was deemed to have significant unobservable inputs when determining valuation is identified in the following tables by security type with a summary of changes in fair value as of March 31, 2018. Total Level 3 assets continue to be less than 1 percent of financial assets measured at fair value in the condensed consolidated balance sheets. Assets presented in the table below were valued based primarily on broker/dealer quotes for which there is a lack of transparency as to inputs used to develop the valuations. Transfers out of Level 3 included situations where a broker quote was used without observable inputs or data that could be corroborated by our pricing vendors in the prior period and significant other observable inputs were identified in the current period. The quantitative detail of these unobservable inputs is neither provided nor reasonably available to us.

The following table provides the change in Level 3 assets for the three months ended March 31:

(Dollars in millions)	Asset fair value measurements using significant unobservable inputs		
	Corporate fixed maturities	States, municipalities and political subdivisions fixed maturities	Total
Beginning balance, January 1, 2018	$ 1	$ 5	$ 6
Total gains or losses (realized/unrealized):			
Included in net income (loss)	—	—	—
Included in other comprehensive income (loss)	—	(1)	(1)
Purchases	—	—	—
Sales	—	—	—
Transfers into Level 3	—	—	—
Transfers out of Level 3	—	—	—
Ending balance, March 31, 2018	$ 1	$ 4	$ 5
Beginning balance, January 1, 2017	$ 78	$ —	$ 78
Total gains or losses (realized/unrealized):			
Included in net income	—	—	—
Included in other comprehensive income	—	—	—
Purchases	—	—	—
Sales	—	—	—
Transfers into Level 3	—	—	—
Transfers out of Level 3	(77)	—	(77)
Ending balance, March 31, 2017	$ 1	$ —	$ 1

With the exception of the above table, additional disclosures for the Level 3 category are not material and therefore not provided.

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

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

This table summarizes the book value and principal amounts of our long-term debt:

(Dollars in millions)			Book value		Principal amount	
Interest rate	Year of issue		March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017
6.900%	1998	Senior debentures, due 2028	$26	$ 26	$ 28	$ 28
6.920%	2005	Senior debentures, due 2028	391	391	391	391
6.125%	2004	Senior notes, due 2034	370	370	374	374
		Total	$787	$ 787	$ 793	$ 793

The following table shows fair values of our note payable and long-term debt:

(Dollars in millions) At March 31, 2018	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Note payable	$ —	$ 24	$ —	$24
6.900% senior debentures, due 2028	—	33	—	33
6.920% senior debentures, due 2028	—	490	—	490
6.125% senior notes, due 2034	—	464	—	464
Total	$ —	$ 1,011	$ —	$1,011
At December 31, 2017				
Note payable	$ —	$ 24	$ —	$24
6.900% senior debentures, due 2028	—	34	—	34
6.920% senior debentures, due 2028	—	505	—	505
6.125% senior notes, due 2034	—	477	—	477
Total	$ —	$ 1,040	$ —	$1,040

The following table shows the fair value of our life policy loans included in other invested assets:

(Dollars in millions) At March 31, 2018	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Life policy loans	$ —	$ —	$ 40	$ 40
At December 31, 2017				
Life policy loans	$ —	$ —	$ 41	$ 41

Outstanding principal and interest for these life policy loans totaled $31 million at March 31, 2018, and December 31, 2017.

The following table shows fair values of our deferred annuities and structured settlements included in life policy and investment contract reserves:

(Dollars in millions) At March 31, 2018	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Deferred annuities	$ —	$ —	$ 788	$788
Structured settlements	—	200	—	200
Total	$ —	$ 200	$ 788	$988
At December 31, 2017				
Deferred annuities	$ —	$ —	$ 834	$834
Structured settlements	—	210	—	210
Total	$ —	$ 210	$ 834	$1,044

Recorded reserves for the deferred annuities were $821 million and $835 million at March 31, 2018, and December 31, 2017, respectively. Recorded reserves for the structured settlements were $161 million at March 31, 2018, and December 31, 2017.

NOTE 4 – Property Casualty Loss and Loss Expenses

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

(Dollars in millions)	Three months ended March 31,	
	2018	2017
Gross loss and loss expense reserves, beginning of period	$5,219	$5,035
Less reinsurance recoverable	187	298
Net loss and loss expense reserves, beginning of period	5,032	4,737
Net incurred loss and loss expenses related to:		
Current accident year	839	826
Prior accident years	(48)	(38)
Total incurred	791	788
Net paid loss and loss expenses related to:		
Current accident year	195	185
Prior accident years	519	509
Total paid	714	694
Net loss and loss expense reserves, end of period	5,109	4,831
Plus reinsurance recoverable	184	297
Gross loss and loss expense reserves, end of period	$5,293	$5,128

We use actuarial methods, models and judgment to estimate, as of a financial statement date, the property casualty loss and loss expense reserves required to pay for and settle all outstanding insured claims, including incurred but not reported (IBNR) claims, as of that date. The actuarial estimate is subject to review and adjustment by an inter-departmental committee that includes actuarial, claims, underwriting, loss prevention and accounting management. This committee is familiar with relevant company and industry business, claims and underwriting trends, as well as general economic and legal trends that could affect future loss and loss expense payments. The amount we will actually have to pay for claims can be highly uncertain. This uncertainty, together with the size of our reserves, makes the loss and loss expense reserves our most significant estimate. The reserve for loss and loss expenses in the condensed consolidated balance sheets also included $52 million at March 31, 2018, and $49 million at March 31, 2017, for certain life and health loss and loss expense reserves.

For the three months ended March 31, 2018, we experienced $48 million of favorable development on prior accident years, including $35 million of favorable development in commercial lines, $1 million of favorable development in personal lines, $10 million of favorable development in excess and surplus lines and $2 million of favorable development in our reinsurance assumed operations. This included $7 million from favorable development of catastrophe losses for the three months ended March 31, 2018. For the three months ended March 31, 2018, we recognized favorable reserve development of $21 million for the commercial property line, $13 million for the workers' compensation line, $2 million for the commercial auto line and $4 million for the other commercial lines due to reduced uncertainty of prior accident year loss and loss adjustment expense for these lines. For the three months ended March 31, 2018, we recognized unfavorable reserve development of $5 million for the commercial casualty line. The unfavorable reserve development for commercial casualty was primarily due to an increase in case reserves for accident year 2017.

For the three months ended March 31, 2017, we experienced $38 million of favorable development on prior accident years, including $11 million of favorable development in commercial lines, $10 million of favorable development in personal lines, $13 million of favorable development in excess and surplus lines and $4 million of favorable development in our reinsurance assumed operations. This included $11 million from favorable development of catastrophe losses for the three months ended March 31, 2017. For the three months ended March 31, 2017, we recognized favorable reserve development of $18 million for the workers' compensation line, $10 million for the commercial property line and $8 million for the other commercial lines due to reduced uncertainty of prior accident year loss and loss adjustment expenses for these lines. For the three months ended March 31, 2017, we recognized unfavorable reserve development of $15 million for the commercial casualty line and $10 million for the commercial auto line. The unfavorable reserve development for commercial casualty reflected higher than usual large loss activity. Commercial auto developed unfavorably due to higher loss cost effects in recent accident years, resulting in an increase of our reserve estimate for claims that have not yet been settled.

NOTE 5 – Life Policy and Investment Contract Reserves

We establish the reserves for traditional life insurance policies based on expected expenses, mortality, morbidity, withdrawal rates, timing of claim presentation and investment yields, including a provision for uncertainty. Once these assumptions are established, they generally are maintained throughout the lives of the contracts.

We use both our own experience and industry experience, adjusted for historical trends, in arriving at our assumptions for expected mortality, morbidity and withdrawal rates as well as for expected expenses. We base our assumptions for expected investment income on our own experience adjusted for current economic conditions.

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

This table summarizes our life policy and investment contract reserves:

(Dollars in millions)	March 31, 2018	December 31, 2017
Life policy reserves:		
Ordinary/traditional life	$ 1,098	$ 1,080
Other	47	47
Subtotal	1,145	1,127
Investment contract reserves:		
Deferred annuities	821	835
Universal life	607	601
Structured settlements	161	160
Other	6	6
Subtotal	1,595	1,602
Total life policy and investment contract reserves	$ 2,740	$ 2,729

NOTE 6 – Deferred Policy Acquisition Costs

Expenses directly related to successfully acquired insurance policies – primarily commissions, premium taxes and underwriting costs – are deferred and amortized over the terms of the policies. We update our acquisition cost assumptions periodically to reflect actual experience, and we evaluate the costs for recoverability. The table below shows the deferred policy acquisition costs and asset reconciliation.

(Dollars in millions)	Three months ended March 31,	
	2018	2017
Property casualty:		
Deferred policy acquisition costs asset, beginning of period	$438	$408
Capitalized deferred policy acquisition costs	232	226
Amortized deferred policy acquisition costs	(224)	(206)
Deferred policy acquisition costs asset, end of period	$446	$428
Life:		
Deferred policy acquisition costs asset, beginning of period	$232	$229
Capitalized deferred policy acquisition costs	13	13
Amortized deferred policy acquisition costs	(10)	(8)
Amortized shadow deferred policy acquisition costs	10	(2)
Deferred policy acquisition costs asset, end of period	$245	$232
Consolidated:		
Deferred policy acquisition costs asset, beginning of period	$670	$637
Capitalized deferred policy acquisition costs	245	239
Amortized deferred policy acquisition costs	(234)	(214)
Amortized shadow deferred policy acquisition costs	10	(2)
Deferred policy acquisition costs asset, end of period	$691	$660

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

NOTE 7 – Accumulated Other Comprehensive Income

Accumulated other comprehensive income (AOCI) includes changes in unrealized gains and losses on investments, changes in pension obligations and changes in life deferred acquisition costs, life policy reserves and other as follows:

(Dollars in millions)	Three months ended March 31,					
	2018			2017		
	Before tax	Income tax	Net	Before tax	Income tax	Net
Investments:						
AOCI, beginning of period	$3,540	$733	$2,807	$2,625	$908	$1,717
Cumulative effect of change in accounting for equity securities as of January 1, 2018	(3,155)	(652)	(2,503)	—	—	—
Adjusted AOCI, beginning of period	385	81	304	2,625	908	1,717
OCI before investment gains recognized in net income	(217)	(45)	(172)	290	102	188
Investment gains recognized in net income	(4)	(1)	(3)	(159)	(56)	(103)
OCI	(221)	(46)	(175)	131	46	85
AOCI, end of period	$164	$35	$129	$2,756	$954	$1,802
Pension obligations:						
AOCI, beginning of period	$(12)	$(1)	$(11)	$(26)	$(8)	$(18)
OCI excluding amortization recognized in net income	—	—	—	—	—	—
Amortization recognized in net income	—	—	—	1	—	1
OCI	—	—	—	1	—	1
AOCI, end of period	$(12)	$(1)	$(11)	$(25)	$(8)	$(17)
Life deferred acquisition costs, life policy reserves and other:						
AOCI, beginning of period	$(10)	$(2)	$(8)	$(9)	$(3)	$(6)
OCI before realized gains and losses recognized in net income	6	1	5	3	2	1
Realized gains recognized in net income	—	—	—	(1)	(1)	—
OCI	6	1	5	2	1	1
AOCI, end of period	$(4)	$(1)	$(3)	$(7)	$(2)	$(5)
Summary of AOCI:						
AOCI, beginning of period	$3,518	$730	$2,788	$2,590	$897	$1,693
Cumulative effect of change in accounting for equity securities as of January 1, 2018	(3,155)	(652)	(2,503)	—	—	—
Adjusted AOCI, beginning of period	363	78	285	2,590	897	1,693
Investments OCI	(221)	(46)	(175)	131	46	85
Pension obligations OCI	—	—	—	1	—	1
Life deferred acquisition costs, life policy reserves and other OCI	6	1	5	2	1	1
Total OCI	(215)	(45)	(170)	134	47	87
AOCI, end of period	$148	$33	$115	$2,724	$944	$1,780

Investment gains and losses, net and life deferred acquisition costs, life policy reserves and other investment gains and losses, net, are recorded in the investment gains and losses, net, line item in the condensed consolidated statements of income. Amortization on pension obligations is recorded in the insurance losses and contract holders'

benefits and underwriting, acquisition and insurance expenses in the condensed consolidated statements of income.

NOTE 8 – Reinsurance

Primary components of our property casualty reinsurance assumed operations include involuntary and voluntary assumed risks as well as contracts from our reinsurance assumed operations, known as Cincinnati Re. Primary components of our ceded reinsurance include a property per risk treaty, property excess treaty, casualty per occurrence treaty, casualty excess treaty, property catastrophe treaty and catastrophe bonds and retrocessions on our reinsurance assumed operations. Management's decisions about the appropriate level of risk retention are affected by various factors, including changes in our underwriting practices, capacity to retain risks and reinsurance market conditions.

The tables below summarize our consolidated property casualty insurance net written premiums, earned premiums and incurred loss and loss expenses:

(Dollars in millions)	Three months ended March 31,	
	2018	2017
Direct written premiums	$1,247	$1,226
Assumed written premiums	49	33
Ceded written premiums	(38)	(28)
Net written premiums	$1,258	$1,231

(Dollars in millions)	Three months ended March 31,	
	2018	2017
Direct earned premiums	$1,207	$1,163
Assumed earned premiums	33	27
Ceded earned premiums	(40)	(39)
Earned premiums	$1,200	$1,151

(Dollars in millions)	Three months ended March 31,	
	2018	2017
Direct incurred loss and loss expenses	$781	$788
Assumed incurred loss and loss expenses	16	15
Ceded incurred loss and loss expenses	(6)	(15)
Incurred loss and loss expenses	$791	$788

Our life insurance company purchases reinsurance for protection of a portion of the risks that are written. Primary components of our life reinsurance program include individual mortality coverage, aggregate catastrophe and accidental death coverage in excess of certain deductibles.

The tables below summarize our consolidated life insurance earned premiums and contract holders' benefits incurred:

(Dollars in millions)	Three months ended March 31,	
	2018	2017
Direct earned premiums	$77	$74

Ceded earned premiums	(17)	(17)
Earned premiums	$60	$57

(Dollars in millions)	Three months ended March 31,	
	2018	2017
Direct contract holders' benefits incurred	$76	$76
Ceded contract holders' benefits incurred	(13)	(11)
Contract holders' benefits incurred	$63	$65

The ceded benefits incurred can vary depending on the type of life insurance policy held and the year the policy was issued.

NOTE 9 – Income Taxes
As of March 31, 2018, and December 31, 2017, we had no liability for unrecognized tax benefits.

The differences between the 21 percent and 35 percent statutory federal income tax rates and our effective income tax rate were as follows:

(Dollars in millions)	Three months ended March 31,			
	2018		2017	
Tax at statutory rate:	$(11)	21.0%	$97	35.0 %
Increase (decrease) resulting from:				
Tax-exempt income from municipal bonds	(5)	10.0	(9)	(3.3)
Dividend received exclusion	(3)	6.0	(8)	(2.9)
Other	—	1.0	(5)	(1.6)
Provision for income taxes	$(19)	38.0%	$75	27.2 %

The provision for federal income taxes is based upon filing a consolidated income tax return for the company and its subsidiaries.

Our 2017 10-K discusses enactment of the Tax Cuts and Jobs Act (the “Tax Act”) on December 22, 2017, and its impact on our financial results for that period. Interpretive guidance of the Tax Act will be received throughout 2018, and we expect to update our estimates and our disclosure on a quarterly basis as interpretative guidance is received within each quarter that it is received. During the period ended March 31, 2018, the U.S. Treasury Department (the “Treasury”) and the Internal Revenue Service (the ”IRS”) have not issued further clarification or guidance for the items for which our accounting for the Tax Act is incomplete. We expect to complete determination of the effects of the Tax Act on our deferred tax assets and liabilities as part of the annual income tax return filing process.

As of March 31, 2018, we had no operating or capital loss carryforwards.

NOTE 10 – Net Income (Loss) Per Common Share

Basic earnings per share are computed based on the weighted average number of common shares outstanding. Diluted earnings per share are computed based on the weighted average number of common and dilutive potential common shares outstanding using the treasury stock method. The table shows calculations for basic and diluted earnings per share:

(In millions, except per share data)	Three months ended March 31, 2018	2017
Numerator:		
Net income (loss)—basic and diluted	$(31)	$201
Denominator:		
Basic weighted-average common shares outstanding	164.0	164.6
Effect of share-based awards:		
Stock options	—	1.1
Nonvested shares	—	0.8
Diluted weighted-average shares	164.0	166.5
Earnings per share:		
Basic	$(0.19)	$1.22
Diluted	(0.19)	1.21
Number of anti-dilutive share-based awards	2.8	0.7

In accordance with ASC 260, Earnings per Share, the assumed exercise of share-based awards in 2018 were excluded from the computation of diluted loss per share. See our 2017 Annual Report on Form 10-K, Item 8, Note 17, Share-Based Associate Compensation Plans, Page 161, for information about share-based awards. The above table shows the number of anti-dilutive share-based awards for the three months ended March 31, 2018 and 2017. These share-based awards were not included in the computation of net income (loss) per common share (diluted) because their exercise would have anti-dilutive effects.

NOTE 11 – Employee Retirement Benefits

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

(Dollars in millions)	Three months ended March 31, 2018	2017
Service cost	$3	$ 3
Non-service costs (benefit):		
Interest cost	3	3
Expected return on plan assets	(5)	(5)
Amortization of actuarial loss and prior service cost	—	1
Total non-service benefit	(2)	(1)
Net periodic benefit cost	$1	$ 2

See our 2017 Annual Report on Form 10-K, Item 8, Note 13, Employee Retirement Benefits, Page 156, for information on our retirement benefits. Service costs and non-service costs (benefit) are allocated in the same proportion primarily to underwriting, acquisition and insurance expenses line item with the remainder allocated to insurance losses and contract holders' benefits line item on the consolidated statements of income for both 2018 and 2017.

We made matching contributions totaling $6 million to our 401(k) and Top Hat savings plans during the first quarter of 2018 and 2017.

We contributed $5 million to our qualified pension plan during the first three months of 2018.

NOTE 12 – Commitments and Contingent Liabilities
In the ordinary course of conducting business, the company and its subsidiaries are named as defendants in various legal proceedings. Most of these proceedings are claims litigation involving the company's insurance subsidiaries in which the company is either defending or providing indemnity for third-party claims brought against insureds or litigating first-party coverage claims. The company accounts for such activity through the establishment of unpaid loss and loss expense reserves. We believe that the ultimate liability, if any, with respect to such ordinary-course claims litigation, after consideration of provisions made for potential losses and costs of defense, is immaterial to our consolidated financial condition, results of operations and cash flows.

The company and its subsidiaries also are occasionally involved in other legal and regulatory proceedings, some of which assert claims for substantial amounts. These actions include, among others, putative class actions seeking certification of a state or national class. Such proceedings have alleged, for example, breach of an alleged duty to search national databases to ascertain unreported deaths of insureds under life insurance policies. The company's insurance subsidiaries also are occasionally parties to individual actions in which extra-contractual damages, punitive damages or penalties are sought, such as claims alleging bad faith handling of insurance claims or writing unauthorized coverage or claims alleging discrimination by former or current associates.

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

NOTE 13 – Segment Information

We operate primarily in two industries, property casualty insurance and life insurance. Our chief operating decision maker regularly reviews our reporting segments to make decisions about allocating resources and assessing performance. Our reporting segments are:

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

We report as Other the noninvestment operations of the parent company and its noninsurer subsidiary, CFC Investment Company and Cincinnati Re, our reinsurance assumed operations. See our 2017 Annual Report on Form 10-K, Item 8, Note 18, Segment Information, Page 164, for a description of revenue, income or loss before income taxes and identifiable assets for each of the five segments.

Segment information is summarized in the following table:

(Dollars in millions)	Three months ended March 31, 2018	2017
Revenues:		
Commercial lines insurance		
Commercial casualty	$265	$265
Commercial property	228	223
Commercial auto	161	155
Workers' compensation	80	84
Other commercial	56	54
Commercial lines insurance premiums	790	781
Fee revenues	2	1
Total commercial lines insurance	792	782
Personal lines insurance		
Personal auto	151	141
Homeowner	136	125
Other personal	38	34
Personal lines insurance premiums	325	300
Fee revenues	1	2
Total personal lines insurance	326	302
Excess and surplus lines insurance	56	48
Life insurance premiums	60	57
Fee revenues	1	2
Total life insurance	61	59
Investments		
Investment income, net of expenses	150	149
Investment gains and losses, net	(191)	160
Total investment revenue	(41)	309
Other		
Cincinnati Re insurance premiums	29	22
Other	1	1
Total other revenues	30	23
Total revenues	$1,224	$1,523
Income (loss) before income taxes:		
Insurance underwriting results		
Commercial lines insurance	$15	$(2)
Personal lines insurance	(9)	(15)
Excess and surplus lines insurance	18	18
Life insurance	2	—
Investments	(65)	286
Other	(11)	(11)
Total income (loss) before income taxes	$(50)	$276

Identifiable assets:	March 31, 2018	December 31, 2017
Property casualty insurance	$ 2,888	$ 2,863
Life insurance	1,418	1,409
Investments	16,748	17,112
Other	416	459
Total	$ 21,470	$ 21,843

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

The following discussion highlights significant factors influencing the condensed consolidated results of operations and financial position of Cincinnati Financial Corporation. It should be read in conjunction with the consolidated financial statements and related notes included in our 2017 Annual Report on Form 10-K. Unless otherwise noted, the industry data is prepared by A.M. Best Co., a leading insurance industry statistical, analytical and financial strength rating organization. Information from A.M. Best is presented on a statutory basis. When we provide our results on a comparable statutory basis, we label it as such; all other company data is presented in accordance with accounting principles generally accepted in the United States of America (GAAP).

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

SAFE HARBOR STATEMENT

This is our "Safe Harbor" statement under the Private Securities Litigation Reform Act of 1995. Our business is subject to certain risks and uncertainties that may cause actual results to differ materially from those suggested by the forward-looking statements in this report. Some of those risks and uncertainties are discussed in our 2017 Annual Report on Form 10-K, Item 1A, Risk Factors, Page 30.

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

- Unusually high levels of catastrophe losses due to risk concentrations, changes in weather patterns, environmental events, terrorism incidents or other causes
- Increased frequency and/or severity of claims or development of claims that are unforeseen at the time of policy issuance
- Inadequate estimates, assumptions or reliance on third-party data used for critical accounting estimates
- Declines in overall stock market values negatively affecting the company's equity portfolio and book value
- Prolonged low interest rate environment or other factors that limit the company's ability to generate growth in investment income or interest rate fluctuations that result in declining values of fixed-maturity investments, including declines in accounts in which we hold bank-owned life insurance contract assets
- Domestic and global events resulting in capital market or credit market uncertainty, followed by prolonged periods of economic instability or recession, that lead to:
  - Significant or prolonged decline in the fair value of a particular security or group of securities and impairment of the asset(s)
  - Significant decline in investment income due to reduced or eliminated dividend payouts from a particular security or group of securities
  - Significant rise in losses from surety and director and officer policies written for financial institutions or other insured entities
- Recession or other economic conditions resulting in lower demand for insurance products or increased payment delinquencies
- Difficulties with technology or data security breaches, including cyberattacks, that could negatively affect our ability to conduct business and our relationships with agents, policyholders and others
- Disruption of the insurance market caused by technology innovations such as driverless cars that could decrease consumer demand for insurance products
- Delays, inadequate data developed internally or from third parties, or performance inadequacies from ongoing development and implementation of underwriting and pricing methods, including telematics and other usage-based insurance methods, or technology projects and enhancements expected to increase our pricing accuracy, underwriting profit and competitiveness
- Increased competition that could result in a significant reduction in the company's premium volume

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

- Inability to obtain adequate ceded reinsurance on acceptable terms, amount of reinsurance coverage purchased, financial strength of reinsurers and the potential for nonpayment or delay in payment by reinsurers
- Inability to defer policy acquisition costs for any business segment if pricing and loss trends would lead management to conclude that segment could not achieve sustainable profitability

- Inability of our subsidiaries to pay dividends consistent with current or past levels
- Events or conditions that could weaken or harm the company's relationships with its independent agencies and hamper opportunities to add new agencies, resulting in limitations on the company's opportunities for growth, such as:
  - Downgrades of the company's financial strength ratings
  - Concerns that doing business with the company is too difficult
  - Perceptions that the company's level of service, particularly claims service, is no longer a distinguishing characteristic in the marketplace
  - Inability or unwillingness to nimbly develop and introduce coverage product updates and innovations that our competitors offer and consumers expect to find in the marketplace
- Actions of insurance departments, state attorneys general or other regulatory agencies, including a change to a federal system of regulation from a state-based system, that:
  - Impose new obligations on us that increase our expenses or change the assumptions underlying our critical accounting estimates
  - Place the insurance industry under greater regulatory scrutiny or result in new statutes, rules and regulations
  - Restrict our ability to exit or reduce writings of unprofitable coverages or lines of business
  - Add assessments for guaranty funds, other insurance related assessments or mandatory reinsurance arrangements; or that impair our ability to recover such assessments through future surcharges or other rate changes
  - Increase our provision for federal income taxes due to changes in tax law
  - Increase our other expenses
  - Limit our ability to set fair, adequate and reasonable rates
  - Place us at a disadvantage in the marketplace
  - Restrict our ability to execute our business model, including the way we compensate agents
- Adverse outcomes from litigation or administrative proceedings
- Events or actions, including unauthorized intentional circumvention of controls, that reduce the company's future ability to maintain effective internal control over financial reporting under the Sarbanes-Oxley Act of 2002
- Unforeseen departure of certain executive officers or other key employees due to retirement, health or other causes that could interrupt progress toward important strategic goals or diminish the effectiveness of certain longstanding relationships with insurance agents and others
- Events, such as an epidemic, natural catastrophe or terrorism, that could hamper our ability to assemble our workforce at our headquarters location

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

CORPORATE FINANCIAL HIGHLIGHTS

Net Income (Loss) and Comprehensive Income (Loss) Data

(Dollars in millions, except per share data)	Three months ended March 31,		
	2018	2017	% Change
Earned premiums	$1,260	$1,208	4
Investment income, net of expenses (pretax)	150	149	1
Investment gains and losses, net (pretax)	(191)	160	nm
Total revenues	1,224	1,523	(20)
Net income (loss)	(31)	201	nm
Comprehensive income (loss)	(201)	288	nm
Net income (loss) per share—diluted	(0.19)	1.21	nm
Cash dividends declared per share	0.53	0.50	6
Diluted weighted average shares outstanding	164.0	166.5	(2)

Total revenues decreased for the first quarter of 2018, compared with the same period of 2017, as higher earned premiums were offset by a reduction in net investment gains. Premium and investment revenue trends are discussed further in the respective sections of Financial Results.

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

The net loss for first-quarter of 2018, compared with first-quarter 2017 net income, was a change of $232 million, primarily due to a $254 million decrease in after-tax net investment gains and losses that offset a $19 million increase in after-tax property casualty underwriting income. New accounting requirements adopted during the first quarter of 2018 resulted in reporting, through net income, the change in fair value for equity securities still held, as disclosed in this quarterly report Item 1, Note 1, Accounting Policies, and Note 2, Investments. Included in the $254 million decrease in net investment gains was $156 million from the recognition of fair value changes of equity securities still held that prior to 2018 would have been reported in other comprehensive income instead of net income. Catastrophe losses, mostly weather related, were $27 million less after taxes and favorably affected both net income and property casualty underwriting income. First-quarter 2018 after-tax investment income in our investments segment results rose $13 million. Life insurance segment results on a pretax basis for the first quarter of 2018 rose $2 million compared with the first quarter of 2017.

Performance by segment is discussed below in Financial Results. As discussed in our 2017 Annual Report on Form 10-K, Item 7, Factors Influencing Our Future Performance, Page 48, there are several reasons that our performance during 2018 may be below our long-term targets. In that annual report, as part of Financial Results, we also discussed the full-year 2018 outlook for each reporting segment.

The board of directors is committed to rewarding shareholders directly through cash dividends and through share repurchase authorizations. Through 2017, the company had increased the annual cash dividend rate for 57 consecutive years, a record we believe is matched by only seven other publicly traded companies. In January 2018, the board of directors increased the regular quarterly dividend to 53 cents per share, setting the stage for our 58th consecutive year of increasing cash dividends. During the first three months of 2018, cash dividends declared by the company increased 6 percent compared with the same period of 2017. Our board regularly evaluates relevant factors in decisions related to dividends and share repurchases. The 2018 dividend increase reflected our strong earnings performance and signaled management’s and the board’s positive outlook and confidence in our outstanding capital, liquidity and financial flexibility.

Balance Sheet Data and Performance Measures

(Dollars in millions, except share data)	At March 31, 2018	At December 31, 2017