CINCINNATI FINANCIAL CORP
Form 10-K
February 27, 2014

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, 2013.

¨ 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 ¨

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 ¨ 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 ¨

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 if 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). Yes þ No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) 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. ¨

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.

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

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

The aggregate market value of voting stock held by nonaffiliates of the Registrant was $6,820,642,248 as of June 30, 2013.

As of February 21, 2014, there were 163,506,115 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 April 26, 2014, are incorporated by reference into Part III of this Form 10-K.

2013 ANNUAL REPORT ON 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 property casualty insurance marketed through independent insurance agencies in 39 states. Our headquarters is in Fairfield, Ohio. At year-end 2013, we employed 4,163 associates, including 2,845 headquarters associates who provide support to 1,318 field associates.

Cincinnati Financial Corporation owns 100 percent of three subsidiaries: The Cincinnati Insurance Company, CSU Producer Resources Inc. and CFC Investment Company. In addition, the parent company has an investment portfolio, owns the headquarters property and is responsible for corporate borrowings and shareholder dividends.

The Cincinnati Insurance Company owns 100 percent of our four additional insurance subsidiaries. Our standard market property casualty insurance group includes two of those subsidiaries – The Cincinnati Casualty Company and The Cincinnati Indemnity Company. This group writes a broad range of business, homeowner and auto policies. Other subsidiaries of The Cincinnati Insurance Company include The Cincinnati Life Insurance Company, which provides life insurance, disability income policies and fixed annuities, and The Cincinnati Specialty Underwriters Insurance Company, which offers excess and surplus lines insurance products.

The two noninsurance subsidiaries of Cincinnati Financial Corporation are CSU Producer Resources, which offers insurance brokerage services to our independent agencies so their clients can access our excess and surplus lines insurance products; and CFC Investment Company, which offers commercial leasing and financing services to our agencies, their clients and other customers.

Our filings with the U.S. Securities and Exchange Commission (SEC) are available, free of charge, on our website, cinfin.com/investors, as soon as possible after they have been filed with the SEC. These filings include annual reports on Form 10-K, 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 websites. These websites, 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 accounting basis. When we provide our results on a comparable statutory accounting 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 over 60 years ago by four independent insurance agents. They established the mission that continues to guide all of the companies in the Cincinnati Financial Corporation 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 insurance market stability through financial strength
- producing competitive, up-to-date products and services
- developing associates committed to superior service

A select group of independent agencies in 39 states actively markets our property casualty insurance within their communities. At year-end 2013, standard market commercial lines and excess and surplus lines policies were marketed in all of those states, while personal lines policies were marketed in 30 of those states. Within our select group of agencies, 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 competitive advantages distinguish our company, positioning us to build shareholder value and to be successful overall:

- Commitment to our 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

The primary sources of our company's net income are summarized below. We discuss the contribution to net income from each source in Item 7, Corporate Financial Highlights of Management's Discussion and Analysis.

- Underwriting profit (loss) - Includes revenues from earned premiums from insurance policies sold, reduced by losses and loss expenses from insurance coverages provided by those policies. Those revenues are further reduced by underwriting expenses from marketing policies or related administration of our insurance operation. The net result represents an underwriting profit when revenues exceed losses and expenses.
- Investment income - Is generated primarily from investing premiums collected from insurance policies, until funds from cash or invested assets are needed to pay losses for insurance claims or other expenses. Interest income from bond investments or dividend income from stock investments are the main categories of our investment income.
- Realized investment gains (losses) - Occur from appreciation or depreciation of invested assets over time. Gains or losses are generally recognized when invested assets are sold or become impaired.

Independent Insurance Agency Marketplace

The U.S. property casualty insurance industry is a highly competitive marketplace with more than 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

- direct marketing to consumers

For the most part, we compete with standard market insurance companies that market through independent insurance agents. Agencies marketing our commercial lines products typically represent six to 12 standard market insurance carriers for commercial lines products, including both national and regional carriers, most of which are mutual companies. Our agencies typically represent four to six standard personal lines carriers. We also compete with carriers that market personal lines products through captive agents and direct writers. Distribution through independent insurance agents or brokers represents nearly 60 percent of overall U.S. property casualty insurance premiums and approximately 80 percent of commercial property casualty insurance premiums, according to studies by the Independent Insurance Agents and Brokers of America.

We are committed exclusively to the independent agency 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, targeting long-term success. 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 providing standard market property casualty insurance products, we operate our own excess and surplus lines insurance brokerage firm and insurance carrier so that we can offer our excess and surplus lines products exclusively to the independent agencies who market our other property casualty insurance products. We also market life insurance products through the agencies that market our property casualty products and through other independent agencies that represent The Cincinnati Life Insurance Company without also representing our other subsidiaries. We help our agencies meet the broader needs of their clients and increase and diversify their revenues and profitability by offering insurance solutions beyond our standard market property casualty insurance products.

The excess and surplus lines market exists due to a regulatory distinction. Generally, excess and surplus lines insurance carriers provide insurance that is unavailable in the standard market due to market conditions or characteristics of the insured persons or organizations that are caused by nature, their claim history or the characteristics of their business. Insurers operating in the excess and surplus lines marketplace generally market business through excess and surplus lines insurance brokers, whether they are small specialty insurers or specialized divisions of larger insurance organizations. We established an excess and surplus lines operation in response to requests to help meet the needs of agency clients when insurance is unavailable in the standard market. By providing superior service, we can help our agencies grow while also profitably growing our property casualty business.

At year-end 2013, our 1,450 property casualty agency relationships were marketing our standard market insurance products from 1,823 reporting locations. 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 39 active states. At year-end 2012, our 1,408 agency relationships had 1,758 reporting locations. At year-end 2011, our 1,312 agency relationships had 1,648 reporting locations.

We made 96, 140 and 133 new agency appointments in 2013, 2012 and 2011, respectively. Of these new appointments, 59, 109 and 93, respectively, were new relationships. The remainder included new branch offices opened by existing Cincinnati agencies and appointment of agencies that merged with a Cincinnati agency. These new appointments and other changes in agency structures or appointment status led to a net increase in agency relationships of 42, 96 and 67 and a net increase in reporting agency locations of 65, 110 and 104 in 2013, 2012 and 2011, respectively.

On average, we have a 12.0 percent share of the standard lines property casualty insurance purchased through our reporting agency locations, according to data from agency surveys. Our share is 16.1 percent in reporting agency locations that have represented us for more than 10 years; 8.0 percent in agencies that have represented us for six to 10 years; 5.4 percent in agencies that have represented us for two to five years; and 1.8 percent in agencies that have represented us for one year or less.

Our largest single agency relationship accounted for approximately 0.8 percent of our total property casualty earned premiums in 2013. No aggregate locations under a single ownership structure accounted for more than 2.1 percent of our earned premiums in 2013.

Financial Strength

We believe that our financial strength and strong capital and surplus position, reflected in our insurer financial strength ratings, are clear, competitive advantages in the segments 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, helping us withstand significant challenges.

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

We use various principles and practices such as diversification and enterprise risk management to maintain strong capital. For example, we maintain a diversified investment portfolio by reviewing and applying diversification parameters and tolerances.

- Our $9.121 billion fixed-maturity portfolio is diversified and exceeds total insurance reserves. The portfolio had an average rating of A2/A, and its fair value exceeded total insurance reserve liabilities by approximately 35 percent at December 31, 2013. No corporate bond exposure accounted for more than 0.7 percent of our fixed-maturity portfolio, and no municipal exposure accounted for more than 0.3 percent.
- The strength of our fixed-maturity portfolio provides an opportunity to invest for potential capital appreciation by purchasing equity securities. Our $4.375 billion equity portfolio minimizes concentrations in single stocks or industries. At December 31, 2013, no single security accounted for more than 3.2 percent of our portfolio of publicly traded common stocks, and no single sector accounted for more than 18.7 percent.

Strong liquidity increases our flexibility through all periods to maintain our cash dividend and to continue to invest in and expand our insurance operations. At December 31, 2013, we held $1.564 billion of our cash and invested assets at the parent company level, of which $1.363 billion, or 87.1 percent, was invested in common stocks, and $91 million, or 5.8 percent, was cash and cash equivalents.

We minimize reliance on debt as a source of capital, maintaining the ratio of debt-to-total-capital below 20 percent. At December 31, 2013, this ratio at 12.8 percent was well below the target limit as capital remained strong while debt levels did not change from year-end 2012. Long-term debt at year-end 2013 totaled $790 million and our short-term debt was $104 million. The long-term debt consists of three nonconvertible, noncallable debentures, two due in 2028 and one in 2034. Ratings for our long-term debt are discussed in Item 7, Liquidity and Capital Resources, Additional Sources of Liquidity.

At year-end 2013 and 2012, risk-based capital (RBC) for our standard market property casualty insurance, excess and surplus lines insurance and life insurance subsidiaries was strong, far exceeding regulatory requirements.

- We ended 2013 with a 0.9-to-1 ratio of property casualty premiums to surplus, a key measure of property casualty insurance company capacity and security. A lower ratio indicates more security for policyholders and greater capacity for growth by an insurer. We believe our ratio provides ample flexibility to diversify risk by expanding our operations into new geographies and product areas. The estimated industry average ratio was 0.7-to-1 at year-end 2013.
- We ended 2013 with a 9.5 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 11.8 percent at year-end 2013. A higher ratio indicates an insurer's stronger security for policyholders and capacity to support business growth.

(Dollars in millions) Statutory Information	At December 31,	
	2013	2012
Standard market property casualty insurance subsidiary		
Statutory capital and surplus	$4,326	$3,914
Risk-based capital (RBC)	4,343	3,928
Authorized control level risk-based capital	534	487
Ratio of risk-based capital to authorized control level risk-based capital	8.1	8.1
Written premium to surplus ratio	0.9	0.9
Life insurance subsidiary		
Statutory capital and surplus	$247	$276
Risk-based capital (RBC)	264	290
Authorized control level risk-based capital	31	29
Ratio of risk-based capital to authorized control level risk-based capital	8.1	10.1
Total liabilities excluding separate account business	2,807	2,626
Life statutory risk-based adjusted surplus to liabilities ratio	9.5	11.1
Excess and surplus lines insurance subsidiary		
Statutory capital and surplus	$228	$199
Risk-based capital (RBC)	228	199
Authorized control level risk-based capital	25	20
Ratio of risk-based capital to authorized control level risk-based capital	9.2	10.2
Written premium to surplus ratio	0.6	0.5

The consolidated property casualty insurance group’s ratio of investments in common stock to statutory capital and surplus was 65.7 percent at year-end 2013 compared with 58.1 percent at year-end 2012.

Cincinnati Financial Corporation’s senior debt is rated by four independent rating firms. In addition, the rating firms award our property casualty and life operations insurance 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 ratings agency, and each rating should be evaluated independently of any other rating.

All of our insurance subsidiaries continue to be highly rated. During 2013, each of the four ratings firms affirmed our insurance financial strength ratings. Three of the four continued their stable outlook on the ratings and one revised its outlook to stable from negative.

As of February 25, 2014, our insurance financial strength ratings were:

Rating agency	Insurer Financial Strength Ratings Standard market property casualty insurance subsidiary		Life insurance subsidiary			Excess and surplus lines insurance subsidiary			Date of most recent affirmation or action
		Rating Tier			Rating Tier			Rating Tier	
A. M. Best Co.	A+ Superior	2 of 16	A	Excellent	3 of 16	A	Excellent	3 of 16	Stable outlook (12/19/13)
Fitch Ratings	A+ Strong	5 of 21	A+	Strong	5 of 21	-	-	-	Stable outlook (11/12/13)
Moody's Investors Service	A1 Good	5 of 21	-	-	-	-	-	-	Stable outlook (4/30/13)

Standard & Poor's Ratings Services	A	Strong	6 of 21	A	Strong	6 of 21	-	-	-	Stable outlook (6/24/13)

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On December 19, 2013, A.M. Best affirmed our financial strength ratings that it had assigned in December 2008, continuing its stable outlook. A.M. Best cited our superior risk-adjusted capitalization, conservative loss reserving standards and increasing application of predictive analytic modeling tools along with our historically strong operating performance that improved in 2012 and 2013. Concerns noted included geographic concentration and weakened underwriting results for the five-year period 2008-2012, primarily due to significant catastrophe-related losses. A.M. Best acknowledged the strong franchise value of our insurance subsidiaries and the financial flexibility of the holding company.

On June 24, 2013, Standard & Poor's Ratings Services affirmed our ratings that it had assigned in July 2010, continuing its stable outlook. S&P said its rating reflected our strong competitive position and extremely strong capital and earnings, and also noted our geographic diversity and diversification benefits from our life insurance business. S&P stated that our risk position is moderate despite potential earnings volatility stemming from exposure to weather-related catastrophe losses, and that its rating could be unfavorably affected if capital adequacy deteriorated for a prolonged period of time or if earnings weakened substantially.

On May 1, 2013 and on November 12, 2013, Fitch Ratings affirmed our ratings that it had assigned in August 2009, continuing its stable outlook. Fitch noted that ratings strengths include conservative capitalization, our sizeable holding company cash and marketable securities position and a moderate financial leverage ratio. Fitch noted our reserve adequacy and benefits from our implementation of underwriting and pricing actions. Fitch said its rating could be unfavorably affected by a combined ratio exceeding 105 percent on a sustained basis or by deterioration in current balance sheet strengths.

On April 30, 2013, Moody's Investors Service affirmed our insurance financial strength ratings that it had assigned in September 2008, revising its outlook to stable from negative. Moody's reported that its rating is based on our entrenched regional franchise from our strong relationships with agents, our focus on small and middle-market commercial lines risks and our good risk-adjusted capital position. Moody' said other strengths include consistent reserve strength with strong financial flexibility and substantial holding company liquidity. Moody's added that our strengths are tempered by factors such as exposure to Midwest weather-related catastrophes, potential investment volatility due to a sizeable position in common equities relative to peers and competition from well-capitalized nationwide commercial lines carriers.

Our debt ratings are discussed in Item 7, Liquidity and Capital Resources, Additional Sources of Liquidity.

Operating Structure

We offer our broad array of insurance products through the independent agency distribution channel. We recognize that locally based independent agencies have relationships in their communities and local marketplace intelligence that can lead to policyholder satisfaction, loyalty and profitable business. Several of our strategic initiatives are intended not only to help us compete but also to enhance support of agencies that represent us, thereby contributing to agency success. We seek to be a consistent and predictable property casualty carrier that agencies can rely on to serve their clients.

In our 10 highest volume states for consolidated property casualty premiums, 1,067 reporting agency locations wrote 63.8 percent of our 2013 consolidated property casualty earned premium volume compared with 1,039 locations and 65.4 percent in 2012. We continue efforts to geographically diversify our property casualty risks.

Consolidated 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, 2013				
Ohio	$685	18.5 %	242	$2.8
Illinois	277	7.4	128	2.2
Indiana	248	6.7	112	2.2
Pennsylvania	209	5.6	94	2.2
Georgia	189	5.1	92	2.1
North Carolina	180	4.8	94	1.9
Michigan	179	4.8	139	1.3
Tennessee	138	3.7	58	2.4
Virginia	138	3.7	64	2.2
Kentucky	131	3.5	44	3.0

Field Focus

We rely on our force of 1,318 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 our agents serve, working from offices in their homes and providing 24/7 availability to our agents. Headquarters associates support agencies and field associates with underwriting, accounting, technology assistance, training and other services. Company executives and headquarters associates 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 underwriting new commercial lines business. They are joined by field representatives specializing in claims, loss control, personal lines, excess and surplus lines, machinery and equipment, bond, premium audit and life insurance. The field team provides many services for agencies and policyholders; for example, our loss control field representatives and others specializing in machinery and equipment risks 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 help 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 clients, who are also 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 and several payment options. 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 employ technology solutions and business process improvements that:

- allow our field and headquarters associates to collaborate with each other and with agencies more efficiently
- provide our agencies the ability to access our systems and data from their agency management systems to process business transactions from their offices

- allow policyholders to directly access, from their systems and mobile devices, pertinent policy information online in order to further improve efficiency for our agencies
- automate our internal processes so our associates can spend more time serving agents and policyholders
- reduce duplicated effort or friction points in technology processes, introducing more efficiency that reduces company and agency costs

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

Superior Claims Service

Our claims philosophy reflects our belief that we 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 778 locally based field claims associates 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 excess and surplus lines coverage in their communities. Handling of these claims includes guidance from headquarters-based excess and surplus lines claims managers.

Our property casualty claims operation uses CMS, our 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 a policyholder’s home or an agent’s office, and to print claim checks using portable printers. Agencies also can access selected CMS information such as activity notes on open claims.

Catastrophe response teams are comprised of volunteers from our experienced field claims staff who have the 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 with policyholders and easy sharing of information and data by rotating storm teams, headquarters staff and local field claims representatives. When hurricanes or other weather events are predicted, we can identify through mapping technologies the expected number of our policyholders that may be impacted by the event and choose to have catastrophe response team members travel to strategic locations near the expected impact area. They are then 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 policyholders and claimants. Our field claims representatives also are educated continuously on new techniques and repair trends for vehicles. 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 (SIU) with former law enforcement and claims professionals whose qualifications make them well suited to gathering facts to uncover potential fraud. While we believe our job is to pay what is due under each policy contract, we also want to prevent false claims from unfairly increasing overall premiums. Our SIU also operates a computer forensics lab, using sophisticated software to recover data and mitigate the cost of computer-related claims for business interruption and loss of records.

Insurance Products

We actively market property casualty insurance in 39 states through a select group of independent insurance agencies. For most agencies that represent us, we believe we offer insurance solutions for approximately 75 percent of the typical insurable risks of their clients. Our standard market commercial lines products and our excess and surplus lines are marketed in all 39 states while our standard market personal lines products are marketed in 30. We offer insurance coverage that includes business property and liability, automobile and homeowner as well as umbrella liability. We discuss our commercial lines, personal lines and excess and surplus lines insurance operations and products in Commercial Lines Property Casualty Insurance Segment, Personal Lines Property Casualty Insurance Segment, and Excess and Surplus Lines Property Casualty Insurance Segment.

The Cincinnati Specialty Underwriters Insurance Company began excess and surplus lines insurance operations 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 excess and surplus lines coverages, those agencies can write the whole account with Cincinnati, gaining benefits not often found in the broader excess and 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 Cincinnati Financial Corporation.

We also support the independent agencies affiliated with our property casualty operations in their programs to sell life insurance. The life insurance, disability and fixed annuity 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 insurance business from other independent life insurance agencies in geographic markets underserved through our property casualty agencies. We are careful to solicit business from these other agencies in a manner that does not compete with the life insurance marketing and sales efforts of our property casualty agencies. Our life insurance operation emphasizes up-to-date products, responsive underwriting, high-quality service and competitive pricing.

Other Services to Agencies

We complement our 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, online and in regional and agency locations.

Except for travel-related expenses to classes 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 available noninsurance financial services. CFC Investment Company offers equipment and vehicle leases and loans for independent insurance agencies, their commercial clients and other businesses. We also provide commercial real estate loans or other financial assistance to help agencies operate, expand and perpetuate their businesses. We believe that providing these services enhances agency relationships with the company and their clients, increasing loyalty while diversifying the agency's revenues.

We're studying opportunities to begin developing our consumer brand. Our goal is to support agents with tools and resources that help communicate the value of a Cincinnati policy to their clients and prospective clients. As part of that study, we began a small consumer advertising campaign in 2013 and will expand that effort to additional markets in 2014. During 2013, we initiated a social media presence, focusing on providing content that agents can share on their own sites.

Strategic Initiatives

Management has identified strategies that can position us for long-term success. The board of directors and management expect execution of our strategic plan to create significant value for shareholders over time. We broadly group these strategies into two areas of focus – improving insurance profitability and driving premium growth – correlating with important ways we measure progress toward our long-term financial objectives. A primary profitability long-term target is to produce a GAAP combined ratio over any five-year period that consistently averages within the range of 95 percent to 100 percent. A primary premium growth long-term target is to profitably grow to reach $5 billion of property casualty and life insurance annual direct written premiums by the end of 2015.

Effective capital management is an important part of creating shareholder value, serving as a foundation to support other strategies focused on profitable growth of our insurance business, with the overall objective of long-term benefit for shareholders. Our capital management philosophy is intended to preserve and build our capital while maintaining appropriate liquidity. A strong capital position provides the capacity to support premium growth, and liquidity provides for our investment in the people and infrastructure needed to implement our other strategic initiatives. Our strong capital and liquidity also provide financial flexibility for shareholder dividends or other capital management actions.

Our strategies seek to position us to compete successfully in the markets we have targeted while optimizing the balance of risk and returns. We believe successful implementation of key initiatives that support our strategies will help us better serve our agent customers, reduce volatility in our financial results and achieve our long-term objectives despite shorter-term effects of difficult economic, market or pricing cycles. We describe our expectations for the results of these initiatives in Item 7, Executive Summary of Management's Discussion and Analysis.

Improve Insurance Profitability

Implementation of the initiatives described below is intended to enhance underwriting expertise and knowledge for our property casualty business, improving our ability to manage our business while also providing greater efficiency. By improving our capabilities to determine individual insurance policy pricing with better alignment to risk attributes, we can increase our effectiveness in managing profit margins. By improving internal processes and further developing performance metrics, we can continue improving efficiency and effectiveness. These initiatives also support the ability of the agencies that represent us to grow profitably by allowing them to more efficiently serve clients and manage expenses. Important initiatives for 2014 to improve insurance profitability include:

- Enhance underwriting expertise and knowledge – We continue to increase our use of information and develop our skills for better underwriting performance, focusing on areas that will benefit most from additional effort. We also continue to expand our pricing capabilities by using predictive analytics, expecting cumulative benefits of these efforts to improve loss ratios over time. Expanded capabilities include streamlining and optimizing data to increase accuracy, timeliness and ease of use. Development of additional business data to support more accurate underwriting, more granular pricing and other business decision-making also continues through a multi-year, phased project. Project deliverables include enhancing our data management program in phases, including further developing the data warehouse used in our insurance operations.

Initiatives for 2014 include expanding pricing precision with ongoing enhancement of analytics and predictive modeling tools. These tools better align individual insurance policy pricing to risk attributes. We continue to further integrate such tools with policy administration systems to help our underwriting associates better target profitability and discuss pricing impacts with agency personnel. Use of enhanced pricing precision tools and techniques with our existing policies as they renew should strengthen loss ratios over time, allowing us to ensure we are competitive on the most desirable business and able to adapt more rapidly to changes in market conditions.

During 2014, we plan to introduce, in select states, predictive modeling for dwelling fire policies and a by-peril rating plan for homeowners. By-peril rating for homeowner policies is expected to improve pricing precision by separately pricing for the risk of losses from distinct perils, such as wind versus fire.

Work continues in 2014 on initiatives to more profitably underwrite property coverages, including more staff specialization, more inspections of insured property to provide enhanced underwriting knowledge and greater use of deductibles or other policy terms and conditions as policies renew. We will inspect or conduct loss control activities at a significant number of commercial properties and homes across several states, allowing us to emphasize roof conditions or other policy underwriting attributes in our pricing and risk selection processes. During the period 2013-2015, we plan to complete inspections for approximately 300,000 homes or business properties, including roughly 130,000 in 2014. We will also increase our use of higher minimum loss deductible amounts for homeowner policies and per-building deductibles for commercial risks, along with more use of wind and hail deductibles in areas subject to severe convective storm activity. We expect these actions, along with others such as more use of actual cash value coverage for older roofs, to improve underwriting profitability over time for our property-related lines of business.

Similar initiatives will continue to advance profitable underwriting of our commercial auto line of business. They include an ongoing focus on pricing precision, such as classification of insured commercial autos and improvements in the collection and use of commercial vehicle identification numbers.

- Improve internal processes - Improved processes support our strategic goals, reducing internal costs and allowing us to focus more resources on providing agency services. Important process upgrades include

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continuing to streamline processing between company and agency management systems for more policies. This allows for processing of qualified personal lines or small commercial lines business without intervention by an underwriter or for routing of complex work items to the most appropriate associate for optimal service. This form of streamlined processing is already used on small accounts for our major commercial lines of business. In 2014, we plan to expand it to additional states for personal lines policies that qualify. Audits of policies processed without an underwriter continue to indicate that the streamlined processing is underwriting and issuing policies as intended.
We also plan to enhance policy processing by migrating additional types of coverages to our e-CLAS® CPP commercial lines policy administration system. Those coverages include workers' compensation, management liability products and selected target market programs. We will offer enhanced policy billing or payment options in 2014 for both our standard market policies and our excess and surplus lines policies. Improved workflow tools should increase our efficiency, providing additional operational reporting metrics and making it easier for agencies to do business with us.
We measure the overall success of our strategy to improve insurance profitability primarily through our GAAP combined ratio for property casualty results, which we believe can consistently average within the range of 95 percent to 100 percent for any five-year period. We also compare our statutory combined ratio to the industry average to gauge our progress.

We expect these initiatives to contribute to our position as the No. 1 or No. 2 carrier based on premium volume in agencies that have represented us for at least five years. We again hit that mark in nearly 75 percent of such agencies based on 2012 premiums. We are working to increase the percentage of agencies where we achieve that rank.

Drive Premium Growth
Implementation of the operational initiatives below is intended to further penetrate each market we serve through our independent agencies. We expect strategies aimed at specific market opportunities, along with service enhancements, to encourage our agents to grow and to increase our share of their business. Our strategy includes evaluating demographics, historical profitability trends and historical catastrophe trends to estimate premium growth from existing agencies and to make careful projections about the number of additional agencies needed to achieve premium targets. Our focus remains on the key components of agent satisfaction based on factors that agents tell us are most important. Significant 2014 initiatives to drive premium growth include:

- Expansion of our marketing and service capabilities - We continue to enhance our generalist approach to allow our appointed agencies to better compete in the marketplace by providing services an agent's clients want and need. During 2014, we will continue to develop and coordinate targeted marketing, including cross-selling opportunities, through our Target Markets department. This area focuses on commercial product development, including identification of and promotional support for promising classes of business. We offered 18 target market programs to our agencies at the end of 2013. In 2014, we will work on developing two new programs, in addition to expanding product offerings within various programs. Our enhanced policy administration platforms will allow us to implement these new target market programs after 2014.

We plan to offer our customer care center for small commercial business policies, currently in pilot, to additional agencies in 2014. Our services include various policy administration functions routinely provided by agencies, allowing agency personnel to focus more on marketing efforts and on providing additional service to their clients as needed. We will also continue to add field marketing representatives where needed for additional agency support in targeted areas, including some specializing in personal lines or excess and surplus lines. Associates in our life insurance segment plan to increase opportunities for agencies to cross-sell to their clients by providing updated market sensitive products and services.

- New agency appointments - We continue to appoint new agencies to develop additional points of distribution, focusing on areas where our property casualty insurance market share is less than 1 percent while also considering economic and catastrophe risk factors. In 2014, we are planning approximately 100 appointments of independent agencies that write in aggregate $1 billion or more in property casualty business annually with various insurance carriers. We generally appoint those agencies in order to have them represent us to sell life insurance, as well as our property casualty insurance, to their clients. We plan to appoint approximately 50 additional independent life agencies to offer only our life insurance products and service. Our excess and surplus lines marketing will focus on selected areas and seek to increase penetration with recently appointed agencies.

We seek to build a close, long-term relationship with each agency we appoint. The contribution of new agencies to our property casualty premium growth should occur over several years, as time is required to fully realize the benefits of our agency relationships. We generally earn a 10 percent share of an agency's business within 10 years of its appointment. We also help our agents grow their business by attracting more clients in their communities through unique Cincinnati-style service. We carefully evaluate the marketing reach of each new appointment to ensure the territory can support both current and new agencies. In counting new agency appointments, we include appointment of new agency relationships with property casualty insurance group subsidiaries of The Cincinnati Insurance Companies. For those that we believe will produce a meaningful amount of new business premiums, we also count appointments of agencies that merge with an existing Cincinnati agency and new branch offices opened by current Cincinnati agencies. We made 96, 140 and 133 new appointments in 2013, 2012 and 2011, respectively, with 59, 109 and 93 representing new relationships.

We measure the overall success of our strategy to drive premium growth primarily through changes in net written premiums. Other important indicators that we are successfully executing initiatives to drive premium growth include tracking our progress toward our year-end 2015 direct written premiums target. We believe we can grow premiums faster than the industry average over any five-year period, while also achieving our long-term objective for underwriting profitability.

Our Segments

Consolidated financial results primarily reflect the results of our five 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
- Excess and surplus lines property casualty insurance
- Life insurance
- Investments

We evaluate results for our consolidated property casualty operations, which is the total of our commercial lines, personal lines and excess 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. Some of that information 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 Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

Commercial Lines Property Casualty Insurance Segment

In 2013, the commercial lines property casualty insurance segment contributed net earned premiums of $2.636 billion, representing 58.2 percent of consolidated total revenues. This segment reported profit before income taxes of $186 million. Commercial lines net earned premiums rose 11 percent in 2013, 8 percent in 2012 and 2 percent in 2011.

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 – 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 excess insurance and umbrella liability, including personal umbrella liability written as an endorsement to commercial umbrella coverages, and employment practices liability (EPLI), which protects businesses against claims by employees that their legal rights as employees of the company have been violated, and against other acts or failures to act under specified circumstances. The commercial casualty business line includes liability coverage written as part of commercial package policies.

- Commercial property – 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 builder's risk, cargo, electronic data processing equipment and a variety of mobile equipment, such as contractor's equipment. Various property coverages can be written as stand-alone policies or can be added to a commercial package policy.
- Commercial auto – Protects 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 – Covers employers for 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, Washington and Wyoming, where coverage is provided solely by the state instead of by private insurers.
- Specialty packages – Includes 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.
- Management liability and surety (formerly surety and executive risk) – This business line includes:

Director and officer (D&O) liability insurance, which covers liability for actual or alleged errors in judgment, breaches of duty or other wrongful acts related to activities of for-profit or nonprofit organizations. Approximately 80 percent of our D&O policies and 47 percent of the D&O premium volume in force for 2013 were for nonprofit entities. Our director and officer liability policy can optionally include EPLI coverage, trustee and fiduciary coverage and Internet liability services coverage.

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

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

- Machinery and equipment – Specialized coverage provides protection for loss or damage to boilers and machinery, including production and computer equipment and business interruption, due to sudden and accidental mechanical breakdown, steam explosion or artificially generated electrical current.

Our emphasis is on products that agents can market to small to midsized businesses in their communities. Of our 1,823 reporting agency locations, 17 market only our management liability and surety products and 30 market only our personal lines products. The remaining 1,776 locations, located in all states in which we actively market, offer some or all of our standard market commercial insurance products.

In 2013, our 10 highest volume commercial lines states generated 61.1 percent of our earned premiums compared with 62.3 percent in 2012 and 63.3 percent in 2011 as we continued efforts to geographically diversify our property casualty risks. Earned premiums in the 10 highest volume states increased 8 percent in 2013 and increased 14 percent in the remaining 29 states. The number of reporting agency locations in our 10 highest volume states increased to 1,064 in 2013 from 1,035 in 2012.

Commercial Lines Earned Premiums by State

(Dollars in millions)	Earned premiums	% of total earned	Agency locations	Average premium per location
Year ended December 31, 2013				
Ohio	$395	15.0 %	241	$1.6
Illinois	203	7.7	128	1.6
Pennsylvania	181	6.9	94	1.9
Indiana	163	6.2	110	1.5
North Carolina	129	4.9	92	1.4
Michigan	120	4.5	136	0.9
Virginia	111	4.2	64	1.7
Georgia	104	4.0	87	1.2
Wisconsin	103			