

Report of Examination of

**The Cincinnati Insurance Company**  
Fairfield, Ohio

As of December 31, 2009

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Columbus, Ohio  
August 3, 2010

Honorable Alfred W. Gross  
Chair, Financial Condition (E) Committee  
National Association of Insurance Commissioners (“NAIC”)  
Virginia State Corporation Commission  
Bureau of Insurance  
Post Office Box 1157  
Richmond, Virginia 23218

Honorable Joseph Torti III  
Chair, Northeastern Zone  
NAIC  
State of Rhode Island  
Department of Business Regulation  
Division of Insurance  
1511 Pontiac Avenue, Building 69-2  
Cranston, Rhode Island 02920

Honorable Mary Jo Hudson  
Director  
Ohio Department of Insurance (“Department”)  
50 West Town Street  
Third Floor – Suite 300  
Columbus, Ohio 43215

Dear Sirs and Madam:

In accordance with Section 3901.07 of the Ohio Revised Code (“ORC”), an examination was made of

**The Cincinnati Insurance Company**

an Ohio domiciled, stock, property and casualty insurance company, hereinafter referred to as the “Company.” The examination was conducted at the Company’s home office, located at 6200 South Gilmore Road, Fairfield, Ohio.

A report of this examination is hereby respectfully submitted.

The Company was last examined as of December 31, 2008, by the Department. Representatives of the Department conducted the current examination covering the intervening period to and including December 31, 2009.

## Management and Control

### Board of Directors

Management of the Company is vested in its Board of Directors, which was comprised of the following members as of the examination date.

<b>Name</b>	<b>Principal Occupation</b>
William F. Bahl	Bahl & Gaynor Investment Counsel, Inc. Chairman
James E. Benoski	The Cincinnati Insurance Companies Retired
Gregory T. Bier	Deloitte & Touche, LLP Retired
Donald J. Doyle, Jr.	The Cincinnati Insurance Companies Senior Vice President
Martin F. Hollenbeck	The Cincinnati Insurance Companies Senior Vice President and Chief Investment Officer
Steven J. Johnston	The Cincinnati Insurance Companies Chief Financial Officer, Secretary and Treasurer
Thomas A. Joseph	The Cincinnati Insurance Companies Senior Vice President
W. Rodney McMullen	The Kroger Company Vice Chairman, President and Chief Operating Officer
Martin J. Mullen	The Cincinnati Insurance Companies Senior Vice President
Jacob F. Scherer	The Cincinnati Insurance Companies Executive Vice President
John J. Schiff, Jr.	The Cincinnati Insurance Companies Chairman
Thomas R. Schiff	John J. & Thomas R. Schiff & Company, Inc. Chairman, Chief Executive Officer and Agent

Kenneth W. Stecher	The Cincinnati Insurance Companies President and Chief Executive Officer
John F. Steele, Jr.	Hilltop Basic Resources, Inc. Chairman and Chief Executive Officer
Charles P. Stoneburner, II	The Cincinnati Insurance Companies Senior Vice President
Timothy L. Timmel	The Cincinnati Insurance Companies Senior Vice President
Larry R. Webb	Webb Insurance Agency, Inc. President, Director and Agent
E. Anthony Woods	SupportSource, LLC Chairman and Chief Executive Officer

## **Officers**

As of the examination date, the following officers were elected and serving in accordance with the Company's Bylaws:

<b>Name</b>	<b>Title</b>
Kenneth W. Stecher	Chief Executive Officer, President
Steven J. Johnston	Chief Financial Officer, Secretary
Thesesa A. Hoffer	Vice President, Treasurer
Richard W. Cumming	Senior Vice President
Donald J. Doyle, Jr.	Senior Vice President
Craig W. Forrester	Senior Vice President
Martin F. Hollenbeck	Senior Vice President
Thomas A. Joseph	Senior Vice President
Eric N. Mathews	Senior Vice President
Martin J. Mullen	Senior Vice President
Jacob F. Scherer	Executive Vice President
John J. Schiff, Jr.	Chairman of the Executive Committee
Joan O. Shevchik	Senior Vice President
Charles P. Stoneburner, II	Senior Vice President
Timothy L. Timmel	Senior Vice President

## **Insurance Holding Company System**

The Company is a member of a holding company system as defined in Section 3901.32 of the ORC. The following displays the chain of ownership of the insurance companies as of December 31, 2009:

Cincinnati Financial Corporation  
CFC Investment Company  
The Cincinnati Insurance Company  
The Cincinnati Casualty Company  
The Cincinnati Indemnity Company  
The Cincinnati Life Insurance Company  
The Cincinnati Specialty Underwriters Insurance Company  
CSU Producer Resources, Inc.

## **Reinsurance**

### **Ceded**

The Company uses a property per risk treaty to provide capacity up to \$25 million. It also includes protection for extra-contractual liability coverage losses. The Company retains the first \$5 million of each loss. Losses between \$5 million and \$25 million are reinsured at 100 percent.

The Company uses a casualty per occurrence treaty to provide capacity up to \$25 million. It also includes protection for extra-contractual liability coverage losses. The Company retains the first \$6 million of each loss. Losses between \$6 million and \$25 million are reinsured at 100 percent.

The Company purchases a casualty reinsurance treaty that provides an additional \$25 million in protection for certain casualty losses. This treaty, along with the casualty per occurrence treaty, provides a total of \$50 million of protection for workers' compensation, extra-contractual liability coverage and clash coverage losses, which would apply when a single occurrence involved multiple policyholders of The Company and its affiliates or multiple coverages for one insured.

The Company purchases a second casualty excess treaty, which provides an additional \$20 million in casualty loss coverage. This treaty also provides catastrophic coverage for workers' compensation and extra-contractual liability coverage losses.

The Company uses a property catastrophe treaty with a limit up to \$500 million to protect against catastrophic events such as wind and hail, hurricanes or earthquakes. Retention on this program is \$45 million. The Company also retains 33 percent of losses between \$45 million and \$70 million, 19 percent of losses between \$70 million and \$105 million, 14 percent of losses between \$105 million and \$200 million, 20 percent of losses between \$200 million and \$300 million, 18 percent of losses between \$300 million and \$400 million and 7 percent of losses between \$400 million and \$500 million. Maximum exposure to a catastrophic event that caused \$500 million in covered losses is \$118 million.

Individual risks with insured property values in excess of \$25 million are handled through a different reinsurance mechanism. The Company typically reinsures property coverage for individual risks with insured values between \$25 million and \$65 million under an automatic facultative treaty. For risks with property values exceeding \$65 million, the Company typically negotiates the purchase of facultative coverage on an individual certificate basis. For casualty coverage on individual risks with limits exceeding \$25 million, facultative reinsurance coverage is typically placed on an individual certificate basis.

Terrorism coverage at various levels has been secured in all of the Company's reinsurance agreements. The broadest coverage for this peril is found in the property and casualty working treaties, which provide coverage for commercial and personal risks. The Company's property catastrophe treaty provides coverage for personal risks, and the majority of its reinsurers provide limited coverage for commercial risks with total insured values of \$10 million or less. For insured values between \$10 million and \$25 million, there also may be coverage in the property working treaty.

Reinsurance protection for the Company's surety business is covered under separate treaties with many of the same reinsurers that write the property casualty working treaties.

All contracts reviewed contained the necessary clauses that meet the guidelines prescribed by the NAIC.

### **Assumed**

The only material business assumed by the Company comes through an inter-company reinsurance agreement whereby the Company assumes 100% of all direct and assumed business of its affiliates, The Cincinnati Casualty Company and The Cincinnati Indemnity Company. The contract was noted to contain all necessary clauses that meet the guidelines prescribed by the NAIC.

### **Territory and Plan of Operations**

The Company was licensed to transact business in all states and the District of Columbia and Puerto Rico.

The percentage of net business written by line by the Company during 2009 is illustrated by the following:

<u>Description</u>	<u>%</u>
Fire	2.04
Allied lines	1.56
Homeowners multiple peril	9.63
Commercial multiple peril	28.12
Inland marine	2.07
Medical malpractice – occurrence	1.35
Workers’ compensation	11.23
Other liability – occurrence	13.16
Other liability - claims-made	2.18
Products liability – occurrence	1.61
Private passenger auto liability	6.34
Commercial auto liability	10.18
Auto physical damage	8.27
Surety	1.39
All other	0.87
Total	<u>100.00</u>

### **Scope of Examination**

One of the purposes of the examination was to make an assessment of the financial condition of the Company as of December 31, 2009. To substantiate the various items, tests were made either by complete audits of accounts or by sampling methods prescribed by the NAIC Examiner's Handbook. In selecting the examination procedures used, due consideration was given to the importance of each account to overall solvency. Transactions occurring subsequent to the date of the examination were reviewed to the extent deemed necessary.

For the period under examination, the Certified Public Accounting (“CPA”) firm of Deloitte & Touche, LLP has provided an unqualified opinion based on statutory accounting principles. Relevant work performed by the CPA firm during its annual audit of the Company was reviewed during the examination and incorporated into the examination workpapers.

The Department’s property and casualty actuary reviewed the relevant work performed by the opining actuary to report on the adequacy of the carried reserves and to comment on any other statutory matters relating to reserves.

In addition, the following items were reviewed during the course of this examination:

1. Company history;
2. fidelity bonds and other insurance;
3. officers', employees', and agents' welfare and pension plans;
4. growth of Company;
5. loss experience;
6. pending litigation; and
7. Articles of Incorporation and Bylaws.

### **Financial Statements**

The financial condition and the results of its operations for the one year period under examination as reported and filed by the Company with the Department and audited by the Company's external auditors, are reflected in the following:

Statement of Assets, Liabilities, Surplus and Other Funds  
Statement of Operations  
Statement of Changes in the Capital and Surplus Account

## Statement of Assets, Liabilities, Surplus and Other Funds

**December 31, 2009**

### **Admitted assets**

#### Cash and invested assets:

Bonds	\$4,853,585,955
Preferred stocks	102,816,355
Common Stocks	2,578,662,434
Real estate	10,263,952
Cash and short-term investments	303,138,969
Other invested assets	11,001,268
Receivables for securities	5,187,636
Total cash and invested assets	<u>7,864,656,569</u>
Accrued investment income	73,972,840
Uncollected premiums and agents' balances	241,722,481
Deferred premiums, agents' balances and installments	744,883,859
Amounts recoverable from reinsurers	28,686,436
Funds held by or deposited with reinsured companies	218,576
Net deferred tax asset	146,309,838
Electronic data processing equipment and software	4,229,153
Receivables from parent, subsidiaries and affiliates	3,487,239
Aggregate write-ins for other than invested assets	36,741,793
Total admitted assets	<u>\$9,144,908,784</u>

**December 31, 2009**

**Liabilities, capital and surplus**

Liabilities:

Losses	\$2,803,198,942
Reinsurance payable on paid losses	47,781,835
Loss adjustment expenses	835,787,925
Commissions payable	83,004,607
Other expenses	17,521,513
Taxes, licenses and fees	13,881,561
Current federal and foreign income taxes	67,136,441
Unearned premiums	1,469,843,253
Advance premium	12,033,638
Stockholder dividends	50,000,000
Policyholder dividends	17,079,642
Ceded reinsurance premiums payable	19,533,448
Amounts withheld or retained by company for account of others	3,930,706
Payable to parent, subsidiaries and affiliates	4,271,682
Payable for securities	27,270,000
Aggregate write-ins for liabilities	<u>24,842,086</u>
Total liabilities	<u>5,497,117,279</u>

Capital and surplus:

Common capital stock	3,586,355
Gross paid in and contributed surplus	363,410,416
Unassigned funds	<u>3,280,794,734</u>
Total capital and surplus	<u>3,647,791,505</u>
Total liabilities, capital and surplus	<u><u>\$9,144,908,784</u></u>

## Statement of Operations

**For the Year Ended  
December 31, 2009**

Premiums earned	\$2,886,770,071
Losses incurred	1,692,297,859
Loss expenses incurred	373,836,083
Other underwriting expenses incurred	916,969,915
Underwriting loss	<u>(96,333,786)</u>
Net investment income earned	337,483,785
Net realized capital gains	120,024,325
Net investment gain	<u>457,508,110</u>
Net loss from agents' or premium balances charged off	(143,428)
Finance and service charges not included in premiums	3,182,594
Aggregate write-ins for miscellaneous income	(8,097,124)
Total other income	<u>(5,057,958)</u>
Income before dividends to policyholders and before federal and foreign income taxes	356,116,366
Dividends to policyholders	<u>17,180,324</u>
Income after dividends to policyholders but before federal income taxes	338,936,042
Federal income taxes	(10,090)
Net income	<u><u>\$338,946,132</u></u>

## Statement of Changes in the Capital and Surplus Account

	<b>2009</b>
Capital and surplus, December 31 previous year	<u>\$3,360,297,707</u>
Net income	338,946,132
Net unrealized capital gains	18,607,765
Change in net deferred income tax	(27,255,552)
Change in nonadmitted assets	7,195,453
Dividends to stockholders	(50,000,000)
Net change in capital and surplus	<u>287,493,798</u>
Capital and surplus, December 31 current year	<u><u>\$3,647,791,505</u></u>

## Notes to Financial Statements

### Investments

The Company's investments were in compliance with Section 3925.08 of the ORC.

### Loss and Loss Adjustment Expense Reserves

The Company had an outside actuary, Susan R. Pino, ACAS, MAAA, ARM of Deloitte Consulting, LLP certify the total reserves for the years covered by the examination. The Department's actuary, Mary D. Miller, FCAS, MAAA, reviewed the detailed calculations for the reserves of the major lines of business as of December 31, 2009.

On the basis of the above-mentioned analysis, it was determined that the loss and loss adjustment expense reserves were reasonable as of December 31, 2009.

### Conclusion

The balance sheet contained in this Report of Examination reflects the financial condition of the Company as of December 31, 2008, and is summarized as follows:

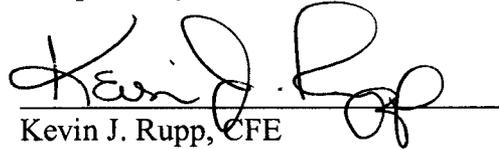
Total Admitted Assets	<u>\$9,144,908,784</u>
Liabilities	\$5,497,117,279
Surplus as Regards Policyholders	<u>3,647,791,505</u>
Total Liabilities and Surplus as Regards Policyholders	<u>\$9,144,908,784</u>

## Acknowledgement

Appreciation is expressed for the assistance extended by the officers and employees of the Company during the course of this examination.

In addition to the undersigned, the following representatives of the Department participated in this examination: Mohammad Arif, AES, CFE, CIDM, CISA, CISSP; Aaron Hibbs, CPA, FLMI, ChFC; Floyd Meeks, AES, CFE, CIDM, CISA, CPA, MBA; Roy Moster, CFE, CPA; and Larry Rice, CFE, CPA.

Respectfully,



Kevin J. Rupp, CFE  
Examiner-In-Charge  
Ohio Department of Insurance



David A. Cook, CFE  
Assistant Chief Examiner  
Ohio Department of Insurance

**Verification**

As required by Section 3901.07 of the Ohio Revised Code, the undersigned hereby attest to the best of their knowledge and belief that the attached is a true Report of Examination as of December 31, 2009.

Kevin J. Rupp      8/9/10      Sam Chase      8/9/10  
Examiner-In-Charge      Date      Assistant Chief Examiner      Date

State of Ohio  
County of Franklin

Personally appeared before me the above named Kevin J. Rupp, personally known to me, who executed the above instrument and that the statements and answers contained therein are true and correct to the best of his knowledge and belief.

Subscribed and sworn to before me this 9 day of August, 2010.

Elizabeth Chase  
(Notary Public)  
**ELIZABETH CHASE**  
NOTARY PUBLIC, STATE OF OHIO  
MY COMMISSION EXPIRES MAY 22, 2012  
My Commission Expires

State of Ohio  
County of Franklin

Personally appeared before me the above named David A. Cook, personally known to me, who executed the above instrument and that the statements and answers contained therein are true and correct to the best of his knowledge and belief.

Subscribed and sworn to before me this 9 day of August, 2010.

Elizabeth Chase  
(Notary Public)  
**ELIZABETH CHASE**  
NOTARY PUBLIC, STATE OF OHIO  
MY COMMISSION EXPIRES MAY 22, 2012  
My Commission Expires