CINCINNATI FINANCIAL CORP
Form 10-Q
October 28, 2014

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 September 30, 2014.

¨ 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 or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

¨Yes þ No

As of October 23, 2014, there were 163,490,441 shares of common stock outstanding.

CINCINNATI FINANCIAL CORPORATION
FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2014

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Item 1. Financial Statements (unaudited)

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions except per share data)	September 30, 2014	December 31, 2013
Assets		
Investments		
Fixed maturities, at fair value (amortized cost: 2014—$8,924; 2013—$8,638)	$9,522	$9,121
Equity securities, at fair value (cost: 2014—$2,697; 2013—$2,523)	4,666	4,375
Other invested assets	67	68
Total investments	14,255	13,564
Cash and cash equivalents	412	433
Investment income receivable	119	121
Finance receivable	77	85
Premiums receivable	1,447	1,346
Reinsurance recoverable	549	547
Prepaid reinsurance premiums	28	26
Deferred policy acquisition costs	590	565
Land, building and equipment, net, for company use (accumulated depreciation: 2014—$439; 2013—$420)	198	210
Other assets	69	73
Separate accounts	730	692
Total assets	$18,474	$17,662
Liabilities		
Insurance reserves		
Loss and loss expense reserves	$4,435	$4,311
Life policy and investment contract reserves	2,484	2,390
Unearned premiums	2,128	1,976
Other liabilities	666	611
Deferred income tax	777	673
Note payable	49	104
Long-term debt and capital lease obligations	829	835
Separate accounts	730	692
Total liabilities	12,098	11,592
Commitments and contingent liabilities (Note 12)	—	—
Shareholders' Equity		
Common stock, par value—$2 per share; (authorized: 2014 and 2013—500 million shares; issued: 2014 and 2013—198 million shares)	397	397
Paid-in capital	1,205	1,191
Retained earnings	4,409	4,268
Accumulated other comprehensive income	1,658	1,504
Treasury stock at cost (2014 and 2013—35 million shares)	(1,293)	(1,290)
Total shareholders' equity	6,376	6,070
Total liabilities and shareholders' equity	$18,474	$17,662

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

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In millions except per share data)	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Revenues				
Earned premiums	$1,071	$992	$3,157	$2,877
Investment income, net of expenses	138	133	409	392
Realized investment gains, net	65	22	101	77
Fee revenues	3	2	9	6
Other revenues	3	3	7	7
Total revenues	1,280	1,152	3,683	3,359
Benefits and Expenses				
Insurance losses and policyholder benefits	686	642	2,181	1,841
Underwriting, acquisition and insurance expenses	319	312	967	919
Interest expense	13	13	40	40
Other operating expenses	3	3	10	12
Total benefits and expenses	1,021	970	3,198	2,812
Income Before Income Taxes	259	182	485	547
Provision for Income Taxes				
Current	68	46	106	137
Deferred	8	5	21	15
Total provision for income taxes	76	51	127	152
Net Income	$183	$131	$358	$395
Per Common Share				
Net income—basic	$1.12	$0.80	$2.19	$2.42
Net income—diluted	1.11	0.79	2.17	2.39

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

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Net Income	$183	$131	$358	$395
Other Comprehensive Income				
Change in unrealized gains (losses) on investments available-for-sale, net of tax of $(42), $22, $81 and $61, respectively	(78)	40	151	113
Net change in pension actuarial loss and prior service cost, net of tax of $0, $1, $0 and $3, respectively	1	1	—	4
Change in life deferred acquisition costs, life policy reserves and other, net of tax of $2, $2, $2 and $10, respectively	3	5	3	21
Other comprehensive income (loss), net of tax	(74)	46	154	138
Comprehensive Income	$109	$177	$512	$533

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In millions)	Common Stock						
	Outstanding Shares	Amount	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Share-holders' Equity
Balance December 31, 2012	163	$394	$1,134	$4,021	$1,129	$(1,225)	$5,453
Net income	—	—	—	395	—	—	395
Other comprehensive income, net	—	—	—	—	138	—	138
Dividends declared	—	—	—	(202)	—	—	(202)
Treasury stock acquired—share repurchase authorization	—	—	—	—	—	—	—
Other	1	2	43	—	—	(13)	32
Balance September 30, 2013	164	$396	$1,177	$4,214	$1,267	$(1,238)	$5,816
Balance December 31, 2013	163	$397	$1,191	$4,268	$1,504	$(1,290)	$6,070
Net income	—	—	—	358	—	—	358
Other comprehensive income, net	—	—	—	—	154	—	154
Dividends declared	—	—	—	(217)	—	—	(217)
Treasury stock acquired—share repurchase authorization	—	—	—	—	—	(21)	(21)
Other	—	—	14	—	—	18	32
Balance September 30, 2014	163	$397	$1,205	$4,409	$1,658	$(1,293)	$6,376

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

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)	Nine months ended September 30, 2014	2013
Cash Flows From Operating Activities		
Net income	$358	$395
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	38	30
Realized gains on investments, net	(101)	(77)
Stock-based compensation	15	14
Interest credited to contract holders	35	31
Deferred income tax expense	21	15
Changes in:		
Investment income receivable	2	—
Premiums and reinsurance receivable	(105)	(148)
Deferred policy acquisition costs	(32)	(60)
Other assets	—	(5)
Loss and loss expense reserves	124	77
Life policy reserves	104	53
Unearned premiums	152	234
Other liabilities	(30)	15
Current income tax receivable/payable	52	(36)
Net cash provided by operating activities	633	538
Cash Flows From Investing Activities		
Sale of fixed maturities	26	28
Call or maturity of fixed maturities	675	711
Sale of equity securities	225	178
Purchase of fixed maturities	(974)	(1,016)
Purchase of equity securities	(294)	(216)
Investment in finance receivables	(13)	(26)
Collection of finance receivables	23	22
Investment in buildings and equipment, net	(6)	(5)
Change in other invested assets, net	7	4
Net cash used in investing activities	(331)	(320)
Cash Flows From Financing Activities		
Payment of cash dividends to shareholders	(208)	(195)
Purchase of treasury shares	(21)	—
Decrease in notes payable	(55)	—
Proceeds from stock options exercised	14	17
Contract holders' funds deposited	66	64
Contract holders' funds withdrawn	(108)	(78)
Excess tax benefits on stock-based compensation	2	10
Other	(13)	(12)
Net cash used in financing activities	(323)	(194)
Net change in cash and cash equivalents	(21)	24
Cash and cash equivalents at beginning of year	433	487
Cash and cash equivalents at end of period	$412	$511
Supplemental disclosures of cash flow information:		
Interest paid	$27	$27

Income taxes paid	52	169
Non-cash activities:		
Conversion of securities	$7	$59
Equipment acquired under capital lease obligations	10	21
Cashless exercise of stock options	11	22

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. Our December 31, 2013, condensed consolidated balance sheet amounts are derived from the audited financial statements but do not include all disclosures required by GAAP.

Our September 30, 2014, condensed consolidated financial statements are unaudited. Certain financial information that is included in annual financial statements prepared in accordance with GAAP is not required for interim reporting and has been condensed or omitted. We believe that we have made all adjustments, consisting only of normal recurring accruals, that are necessary for fair presentation. These condensed consolidated financial statements should be read in conjunction with our consolidated financial statements included in our 2013 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.

Pending 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 is for annual reporting periods beginning after December 15, 2016. The ASU has not yet been adopted and will not have a material impact on our company’s financial position, cash flows or results of operations.

ASU 2014-12, Compensation-Stock Compensation: Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period

In June 2014, the FASB Issued ASU 2014-12, Compensation-Stock Compensation: Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. ASU 2014-12 requires that performance targets that affect vesting and that could be achieved after the requisite service period be treated as performance conditions. The effective date of ASU 2014-12 is for interim and annual reporting periods beginning after December 15, 2015. The ASU has not yet been adopted and will not have a material impact on our company’s financial position, cash flows or results of operations.

NOTE 2 – INVESTMENTS

The following table provides cost or amortized cost, gross unrealized gains, gross unrealized losses and fair value for our invested assets:

(In millions)	Cost or amortized	Gross unrealized		Fair
At September 30, 2014	cost	gains	losses	value
Fixed maturity securities:				
Corporate	$5,134	$449	$13	$5,570
States, municipalities and political subdivisions	3,294	173	3	3,464
Commercial mortgage-backed	250	5	1	254
Government-sponsored enterprises	222	—	12	210
Foreign government	10	—	—	10
Convertibles and bonds with warrants attached	7	—	—	7
United States government	7	—	—	7
Subtotal	8,924	627	29	9,522
Equity securities:				
Common equities	2,552	1,942	6	4,488
Nonredeemable preferred equities	145	34	1	178
Subtotal	2,697	1,976	7	4,666
Total	$11,621	$2,603	$36	$14,188
At December 31, 2013				
Fixed maturity securities:				
Corporate	$5,122	$433	$22	$5,533
States, municipalities and political subdivisions	3,107	125	21	3,211
Government-sponsored enterprises	227	—	27	200
Commercial mortgage-backed	148	—	5	143
Convertibles and bonds with warrants attached	17	—	—	17
Foreign government	10	—	—	10
United States government	7	—	—	7
Subtotal	8,638	558	75	9,121
Equity securities:				
Common equities	2,396	1,818	1	4,213
Nonredeemable preferred equities	127	38	3	162
Subtotal	2,523	1,856	4	4,375
Total	$11,161	$2,414	$79	$13,496

The net unrealized investment gains in our fixed-maturity portfolio are primarily the result of the continued low interest rate environment that increased the fair value of our fixed-maturity portfolio. The seven largest unrealized investment gains in our common stock portfolio are from Exxon Mobil Corporation (NYSE:XOM), The Procter & Gamble Company (NYSE:PG), Honeywell International Incorporated (NYSE:HON), Chevron Corporation (NYSE:CVX), Johnson & Johnson (NYSE:JNJ), BlackRock Inc. (NYSE:BLK), and RPM International (NYSE:RPM), which had a combined gross unrealized gain of $579 million. At September 30, 2014, BlackRock Inc. was our largest single common stock holding with a fair value of 3.1 percent of our publicly traded common stock portfolio and 1.0 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:

(In millions)	Less than 12 months		12 months or more		Total	Total
	Fair	Unrealized	Fair	Unrealized	fair	unrealized
At September 30, 2014	value	losses	value	losses	value	losses
Fixed maturity securities:						
Corporate	$224	$9	$114	$4	$338	$13
States, municipalities and political subdivisions	28	—	218	3	246	3
Commercial mortgage-backed	37	—	32	1	69	1
Government-sponsored enterprises	11	—	176	12	187	12
Foreign government	—	—	10	—	10	—
United States government	1	—	1	—	2	—
Subtotal	301	9	551	20	852	29
Equity securities:						
Common equities	105	2	80	4	185	6
Nonredeemable preferred equities	25	—	17	1	42	1
Subtotal	130	2	97	5	227	7
Total	$431	$11	$648	$25	$1,079	$36
At December 31, 2013						
Fixed maturity securities:						
Corporate	$572	$20	$43	$2	$615	$22
States, municipalities and political subdivisions	490	18	42	3	532	21
Government-sponsored enterprises	199	27	1	—	200	27
Commercial mortgage-backed	125	5	—	—	125	5
Foreign government	10	—	—	—	10	—
United States government	1	—	—	—	1	—
Subtotal	1,397	70	86	5	1,483	75
Equity securities:						
Common equities	77	1	—	—	77	1
Nonredeemable preferred equities	42	3	—	—	42	3
Subtotal	119	4	—	—	119	4
Total	$1,516	$74	$86	$5	$1,602	$79

The following table provides investment income, realized investment gains and losses, the change in unrealized investment gains and losses, and other items:

(In millions)	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Investment income summary:				
Interest on fixed maturities	$105	$104	$312	$309
Dividends on equity securities	35	30	101	87
Other investment income	—	1	2	2
Total	140	135	415	398
Less investment expenses	2	2	6	6
Total	$138	$133	$409	$392
Realized investment gains and losses summary:				
Fixed maturities:				
Gross realized gains	$6	$5	$12	$10
Gross realized losses	—	—	(4)	—
Other-than-temporary impairments	—	—	—	(2)
Equity securities:				
Gross realized gains	59	15	93	64
Gross realized losses	—	—	—	—
Other-than-temporary impairments	—	—	(1)	—
Other	—	2	1	5
Total	$65	$22	$101	$77
Change in unrealized gains and losses summary:				
Fixed maturities	$(66)	$(28)	$115	$(335)
Equity securities	(54)	90	117	509
Net change in pension actuarial loss and prior service cost	1	2	—	7
Adjustment to deferred acquisition costs and life policy reserves	4	9	(4)	38
Other	1	(2)	9	(7)
Income taxes on above	40	(25)	(83)	(74)
Total	$(74)	$46	$154	$138

During the three months ended September 30, 2014, there were no equity securities and no fixed-maturity securities other-than-temporarily impaired. During the nine months ended September 30, 2014, there were three equity securities and one fixed-maturity security 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 for the three and nine months ended September 30, 2014 and 2013. At September 30, 2014, 212 fixed-maturity investments with a total unrealized loss of $20 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. Four equity investments with a total unrealized loss of $5 million had been in an unrealized loss position for 12 months or more as of September 30, 2014. Of that total, no equity investments were trading below 70 percent of cost.

During 2013, we other-than-temporarily impaired seven fixed-maturity securities. At December 31, 2013, 40 fixed-maturity investments with a total unrealized loss of $5 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 investments in an unrealized loss position for 12 months or more as of December 31, 2013.

NOTE 3 – FAIR VALUE MEASUREMENTS

Fair Value Hierarchy

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, 2013, and ultimately management determines fair value. See our 2013 Annual Report on Form 10-K, Item 8, Note 3, Fair Value Measurements, Page 121, 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 September 30, 2014, and December 31, 2013. We do not have any material liabilities carried at fair value. There were no transfers between Level 1 and Level 2.

(In millions) At September 30, 2014	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	$—	$5,542	$28	$5,570
States, municipalities and political subdivisions	—	3,464	—	3,464
Commercial mortgage-backed	—	254	—	254
Government-sponsored enterprises	—	210	—	210
Foreign government	—	10	—	10
Convertibles and bonds with warrants attached	—	7	—	7
United States government	7	—	—	7
Subtotal	7	9,487	28	9,522
Common equities, available for sale	4,488	—	—	4,488
Nonredeemable preferred equities, available for sale	—	176	2	178
Separate accounts taxable fixed maturities	—	694	—	694
Top Hat Savings Plan mutual funds and common equity (included in Other assets)	17	—	—	17
Total	$4,512	$10,357	$30	$14,899
At December 31, 2013				
Fixed maturities, available for sale:				
Corporate	$—	$5,531	$2	$5,533
States, municipalities and political subdivisions	—	3,211	—	3,211
Government-sponsored enterprises	—	200	—	200
Commercial mortgage-backed	—	143	—	143
Convertibles and bonds with warrants attached	—	17	—	17
Foreign government	—	10	—	10
United States government	7	—	—	7
Subtotal	7	9,112	2	9,121
Common equities, available for sale	4,213	—	—	4,213

Nonredeemable preferred equities, available for sale	—	160	2	162
Separate accounts taxable fixed-maturities	—	682	—	682
Top Hat Savings Plan mutual funds and common equity (included in Other assets)	14	—	—	14
Total	$4,234	$9,954	$4	$14,192

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 September 30, 2014. 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. The quantitative detail of these unobservable inputs is neither provided nor reasonably available to us.

The following tables provide the change in Level 3 assets for the three months ended September 30:

(In millions)	Asset fair value measurements using significant unobservable inputs (Level 3)				
	Corporate fixed maturities	Commercial mortgage-backed fixed maturities	States, municipalities and political subdivisions fixed maturities	Nonredeemable preferred equities	Total
Beginning balance, June 30, 2014	$9	$—	$—	$2	$11
Total gains or losses (realized/unrealized):					
Included in net income	—	—	—	—	—
Included in other comprehensive income	—	—	—	—	—
Purchases	—	—	—	—	—
Sales	—	—	—	—	—
Transfers into Level 3	19	—	—	—	19
Transfers out of Level 3	—	—	—	—	—
Ending balance, September 30, 2014	$28	$—	$—	$2	$30
Beginning balance, June 30, 2013	$3	$—	$1	$2	$6
Total gains or losses (realized/unrealized):					
Included in net income	—	—	—	—	—
Included in other comprehensive income	—	—	—	—	—
Purchases	—	—	—	—	—
Sales	—	—	(1)	—	(1)
Transfers into Level 3	—	—	—	—	—
Transfers out of Level 3	—	—	—	—	—
Ending balance, September 30, 2013	$3	$—	$—	$2	$5

The following tables provide the change in Level 3 assets for the nine months ended September 30:

(In millions)	Asset fair value measurements using significant unobservable inputs (Level 3)				
	Corporate fixed maturities	Commercial mortgage-backed fixed maturities	States, municipalities and political subdivisions fixed maturities	Nonredeemable preferred equities	Total
Beginning balance, January 1, 2014	$2	$—	$—	$2	$4
Total gains or losses (realized/unrealized):					
Included in net income	—	—	—	—	—
Included in other comprehensive income	—	—	—	—	—
Purchases	—	—	—	—	—
Sales	—	—	—	—	—
Transfers into Level 3	26	5	—	—	31
Transfers out of Level 3	—	(5)	—	—	(5)
Ending balance, September 30, 2014	$28	$—	$—	$2	$30
Beginning balance, January 1, 2013	$3	$—	$1	$1	$5
Total gains or losses (realized/unrealized):					
Included in net income	—	—	—	—	—
Included in other comprehensive income	—	—	—	—	—
Purchases	—	—	—	1	1
Sales	—	—	(1)	—	(1)
Transfers into Level 3	—	—	—	—	—
Transfers out of Level 3	—	—	—	—	—
Ending balance, September 30, 2013	$3	$—	$—	$2	$5

Additional disclosures for the Level 3 category are not material.

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

The disclosures below are presented to provide timely 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:

(In millions)				Book value		Principal amount	
Interest rate		Year of issue		September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013
6.900	%	1998	Senior debentures, due 2028	$28	$28	$28	$28
6.920	%	2005	Senior debentures, due 2028	391	391	391	391
6.125	%	2004	Senior notes, due 2034	371	371	374	374
			Total	$790	$790	$793	$793

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

(In millions) At September 30, 2014	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Note payable	$—	$49	$—	$49
6.900% senior debentures, due 2028	—	33	—	33
6.920% senior debentures, due 2028	—	482	—	482
6.125% senior notes, due 2034	—	438	—	438
Total	$—	$1,002	$—	$1,002
At December 31, 2013				
Note payable	$—	$104	$—	$104
6.900% senior debentures, due 2028	—	30	—	30
6.920% senior debentures, due 2028	—	458	—	458
6.125% senior notes, due 2034	—	399	—	399
Total	$—	$991	$—	$991

During the second quarter of 2014, we repaid $55 million on our revolving short-term line of credit as part of routine cash management.

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

(In millions) At September 30, 2014	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	$—	$—	$39	$39
At December 31, 2013				
Life policy loans	$—	$—	$45	$45

Outstanding principal and interest for these life policy loans was $30 million and $36 million at September 30, 2014, and December 31, 2013, respectively.

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

(In millions) At September 30, 2014	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Deferred annuities	$—	$—	$904	$904
Structured settlements	—	220	—	220
Total	$—	$220	$904	$1,124
At December 31, 2013				
Deferred annuities	$—	$—	$911	$911
Structured settlements	—	219	—	219

Total	$—	$219	$911	$1,130

Recorded reserves for the deferred annuities were $864 million and $862 million at September 30, 2014, and December 31, 2013, respectively. Recorded reserves for the structured settlements were $184 million and $189 million at September 30, 2014, and December 31, 2013, respectively.

NOTE 4 – PROPERTY CASUALTY LOSS AND LOSS EXPENSES

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

(In millions)	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Gross loss and loss expense reserves, beginning of period	$4,408	$4,219	$4,241	$4,169
Less reinsurance receivable	282	333	299	356
Net loss and loss expense reserves, beginning of period	4,126	3,886	3,942	3,813
Net incurred loss and loss expenses related to:				
Current accident year	647	631	2,125	1,840
Prior accident years	(25)	(38)	(120)	(140)
Total incurred	622	593	2,005	1,700
Net paid loss and loss expenses related to:				
Current accident year	353	329	859	699
Prior accident years	286	233	979	897
Total paid	639	562	1,838	1,596
Net loss and loss expense reserves, end of period	4,109	3,917	4,109	3,917
Plus reinsurance receivable	284	321	284	321
Gross loss and loss expense reserves, end of period	$4,393	$4,238	$4,393	$4,238

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 management that 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 $42 million at September 30, 2014, and $69 million at September 30, 2013, for certain life and health loss and loss expense reserves.

For the three months ended September 30, 2014, we experienced $25 million of favorable development on prior accident years, including $24 million of favorable development in commercial lines, $5 million of adverse development in personal lines and $6 million favorable development in excess and surplus lines. This included $5 million from favorable development of catastrophe losses for the three months ended September 30, 2014, compared with $9 million of favorable development of catastrophe losses for the three months ended September 30, 2013. We recognized favorable reserve development during the three months ended September 30, 2014, of $15 million for the workers' compensation line, $8 million for each the commercial property line and the commercial casualty line and $12 million of adverse development for the commercial auto line, due to reduced uncertainty of prior accident year loss and loss adjustment expense for these lines.

For the nine months ended September 30, 2014, we experienced $120 million of favorable development on prior accident years, including $84 million of favorable development in commercial lines, $13 million of favorable development in personal lines and $23 million favorable development in excess and surplus lines. This included $19 million from favorable development of catastrophe losses for the nine months ended September 30, 2014, compared with $24 million of favorable development of catastrophe losses for the nine months ended September 30, 2013. We recognized favorable reserve development during the nine months ended September 30, 2014, of $45 million for the workers' compensation line, $33 million for the commercial property line, $25 million for the commercial casualty line and $24 million of adverse development in the commercial auto line, due to reduced uncertainty of prior accident year loss and loss adjustment expense for these lines.

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 universal life, deferred annuity 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:

(In millions)	September 30, 2014	December 31, 2013
Ordinary/traditional life	$863	$815
Universal life	527	508
Deferred annuities	864	862
Structured settlements	184	189
Other	46	16
Total life policy and investment contract reserves	$2,484	$2,390

NOTE 6 – DEFERRED 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.

(In millions)	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Deferred policy acquisition costs asset, beginning of period	$571	$546	$565	$470
Capitalized deferred policy acquisition costs	208	211	630	612
Amortized deferred policy acquisition costs	(195)	(190)	(598)	(552)
Amortized shadow deferred policy acquisition costs	6	9	(7)	46
Deferred policy acquisition costs asset, end of period	$590	$576	$590	$576

No premium deficiencies were recorded in the condensed consolidated statements of income, as the sum of the anticipated loss and loss adjustment 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 includes changes in unrealized gains and losses on investments available for sale and other invested assets, changes in pension obligations and changes in life deferred acquisition costs, life policy reserves and other as follows:

(In millions)	Three months ended September 30,					
	2014			2013		
	Before tax	Income tax	Net	Before tax	Income tax	Net
Accumulated unrealized gains, net, on investments available for sale, beginning of period	$2,687	$931	$1,756	$1,987	$686	$1,301
Other comprehensive income before reclassification	(55)	(20)	(35)	82	29	53
Reclassification adjustment for realized investment gains, net, included in net income	(65)	(22)	(43)	(20)	(7)	(13)
Effect on other comprehensive income	(120)	(42)	(78)	62	22	40
Accumulated unrealized gains, net, on investments available for sale, end of period	$2,567	$889	$1,678	$2,049	$708	$1,341
Accumulated unrealized losses, net, for pension obligations, beginning of period	$(19)	$(6)	$(13)	$(96)	$(33)	$(63)
Other comprehensive income before reclassification	—	—	—	—	—	—
Reclassification adjustment for amortization of actuarial loss and prior service cost, net, included in net income	1	—	1	2	1	1
Effect on other comprehensive income	1	—	1	2	1	1
Accumulated unrealized losses, net, for pension obligations, end of period	$(18)	$(6)	$(12)	$(94)	$(32)	$(62)
Accumulated unrealized losses, net, on life deferred acquisition costs, life policy reserves and other, beginning of period	$(16)	$(5)	$(11)	$(26)	$(9)	$(17)
Other comprehensive income before reclassification	5	2	3	9	2	7