CINCINNATI FINANCIAL CORP
Form 10-Q
October 26, 2017

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, 2017.

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

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

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

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

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

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

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

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

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

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

As of October 20, 2017, there were 164,071,775 shares of common stock outstanding.

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2017

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Item 1. Financial Statements (unaudited)

Cincinnati Financial Corporation and Subsidiaries
Condensed Consolidated Balance Sheets

(Dollars in millions except per share data)	September 30, 2017	December 31, 2016
Assets		
Investments		
Fixed maturities, at fair value (amortized cost: 2017—$10,135; 2016—$9,799)	$ 10,540	$ 10,085
Equity securities, at fair value (cost: 2017—$3,264; 2016—$2,995)	6,025	5,334
Other invested assets	99	81
Total investments	16,664	15,500
Cash and cash equivalents	674	777
Investment income receivable	128	134
Finance receivable	56	51
Premiums receivable	1,640	1,533
Reinsurance recoverable	522	545
Prepaid reinsurance premiums	44	62
Deferred policy acquisition costs	676	637
Land, building and equipment, net, for company use (accumulated depreciation: 2017—$251; 2016—$237)	186	183
Other assets	204	198
Separate accounts	798	766
Total assets	$ 21,592	$ 20,386
Liabilities		
Insurance reserves		
Loss and loss expense reserves	$ 5,350	$ 5,085
Life policy and investment contract reserves	2,716	2,671
Unearned premiums	2,475	2,307
Other liabilities	800	786
Deferred income tax	1,087	865
Note payable	17	20
Long-term debt and capital lease obligations	826	826
Separate accounts	798	766
Total liabilities	14,069	13,326
Commitments and contingent liabilities (Note 12)		
Shareholders' Equity		
Common stock, par value—$2 per share; (authorized: 2017 and 2016—198.3 million shares; issued: 2017 and 2016—198.3 million shares)	397	397
Paid-in capital	1,256	1,252
Retained earnings	5,193	5,037
Accumulated other comprehensive income	2,047	1,693
Treasury stock at cost (2017—34.3 million shares and 2016—33.9 million shares)	(1,370)	(1,319)
Total shareholders' equity	7,523	7,060

Total liabilities and shareholders' equity	$ 21,592	$ 20,386

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

Cincinnati Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Income

(Dollars in millions except per share data)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Revenues				
Earned premiums	$1,247	$1,191	$3,696	$3,518
Investment income, net of expenses	153	148	453	442
Realized investment gains and losses, net	7	56	156	161
Fee revenues	3	5	12	11
Other revenues	2	2	4	5
Total revenues	1,412	1,402	4,321	4,137
Benefits and Expenses				
Insurance losses and contract holders' benefits	874	753	2,581	2,298
Underwriting, acquisition and insurance expenses	393	380	1,157	1,106
Interest expense	13	13	39	39
Other operating expenses	3	3	11	10
Total benefits and expenses	1,283	1,149	3,788	3,453
Income Before Income Taxes	129	253	533	684
Provision for Income Taxes				
Current	27	60	98	173
Deferred	—	13	32	20
Total provision for income taxes	27	73	130	193
Net Income	$102	$180	$403	$491
Per Common Share				
Net income—basic	$0.62	$1.09	$2.45	$2.98
Net income—diluted	0.61	1.08	2.42	2.95

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

Cincinnati Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Comprehensive Income

(Dollars in millions)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Net Income	$102	$180	$403	$491
Other Comprehensive Income				
Change in unrealized gains on investments, net of tax of $66, $21, $189 and $224, respectively	123	41	352	417
Amortization of pension actuarial loss and prior service cost, net of tax of $1, $0, $1 and $1, respectively	—	—	1	1
Change in life deferred acquisition costs, life policy reserves and other, net of tax (benefit) of $(1), $0, $0 and $(4), respectively	(1)	(3)	1	(10)
Other comprehensive income	122	38	354	408
Comprehensive Income	$224	$218	$757	$899

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

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

(Dollars in millions)	Nine months ended September 30,	
	2017	2016
Common Stock		
Beginning of year	$397	$397
Share-based awards	—	—
End of period	397	397
Paid-In Capital		
Beginning of year	1,252	1,232
Share-based awards	(18)	(9)
Share-based compensation	19	18
Other	3	3
End of period	1,256	1,244
Retained Earnings		
Beginning of year	5,037	4,762
Net income	403	491
Dividends declared	(247)	(237)
End of period	5,193	5,016
Accumulated Other Comprehensive Income		
Beginning of year	1,693	1,344
Other comprehensive income	354	408
End of period	2,047	1,752
Treasury Stock		
Beginning of year	(1,319)	(1,308)
Share-based awards	22	29
Shares acquired - share repurchase authorization	(70)	(2)
Shares acquired - share-based compensation plans	(6)	(10)
Other	3	3
End of period	(1,370)	(1,288)
Total Shareholders' Equity	$7,523	$7,121
(In millions)		
Common Stock - Shares Outstanding		
Beginning of year	164.4	163.9
Share-based awards	0.7	0.8
Shares acquired - share repurchase authorization	(1.0)	—
Shares acquired - share-based compensation plans	(0.1)	(0.1)
Other	—	0.1
End of period	164.0	164.7

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

Cincinnati Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows

(Dollars in millions)	Nine months ended September 30,	
	2017	2016
Cash Flows From Operating Activities		
Net income	$403	$491
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	40	34
Realized investment gains, net	(156)	(161)
Share-based compensation	19	18
Interest credited to contract holders'	36	36
Deferred income tax expense	32	20
Changes in:		
Investment income receivable	6	8
Premiums and reinsurance receivable	(66)	(111)
Deferred policy acquisition costs	(44)	(31)
Other assets	(34)	(32)
Loss and loss expense reserves	265	273
Life policy reserves	71	75
Unearned premiums	168	187
Other liabilities	(46)	11
Current income tax receivable/payable	52	17
Net cash provided by operating activities	746	835
Cash Flows From Investing Activities		
Sale of fixed maturities	20	15
Call or maturity of fixed maturities	815	1,160
Sale of equity securities	290	311
Purchase of fixed maturities	(1,155)	(1,465)
Purchase of equity securities	(399)	(396)
Investment in finance receivables	(21)	(13)
Collection of finance receivables	17	24
Investment in buildings and equipment, net	(14)	(9)
Change in other invested assets, net	(12)	(13)
Net cash used in investing activities	(459)	(386)
Cash Flows From Financing Activities		
Payment of cash dividends to shareholders	(239)	(229)
Shares acquired - share repurchase authorization	(70)	(2)
Payments of note payable	(3)	(15)
Proceeds from stock options exercised	10	17
Contract holders' funds deposited	60	71
Contract holders' funds withdrawn	(119)	(118)
Excess tax benefits on share-based compensation	—	4
Other	(29)	(21)
Net cash used in financing activities	(390)	(293)
Net change in cash and cash equivalents	(103)	156
Cash and cash equivalents at beginning of year	777	544

Cash and cash equivalents at end of period	$674	$700
Supplemental Disclosures of Cash Flow Information:		
Interest paid	$26	$26
Income taxes paid	44	152
Noncash Activities		
Conversion of securities	$5	$4
Equipment acquired under capital lease obligations	10	18
Cashless exercise of stock options	6	10
Other assets and other liabilities	74	29

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

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

Our September 30, 2017, condensed consolidated financial statements are unaudited. We believe that we have made all adjustments, consisting only of normal recurring accruals, that are necessary for fair presentation. These condensed consolidated financial statements should be read in conjunction with our consolidated financial statements included in our 2016 Annual Report on Form 10-K. The results of operations for interim periods do not necessarily indicate results to be expected for the full year.

Adopted Accounting Updates

ASU 2016-07, Investments - Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting
In March 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-07, Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting. ASU 2016-07 eliminates the requirement to retroactively adjust an investment, results of operations, and retained earnings once an investment qualifies for use of the equity method. It requires the equity method investor to add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting without retroactive adjustment. The effective date of ASU 2016-07 was for interim and annual reporting periods beginning after December 15, 2016, and was applied prospectively. The company adopted this ASU effective January 1, 2017, and it did not have a material impact on our company's consolidated financial position, cash flows or results of operations.

ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting
In March 2016, the FASB issued ASU 2016-09, Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The effective date of ASU 2016-09 was for interim and annual reporting periods beginning after December 15, 2016. The recognition and classification of the excess tax benefit provisions were applied prospectively in the results of operations and statement of cash flows. This adoption resulted in excess tax benefits of an immaterial amount for the three months ended September 30, 2017, and
$7 million for the nine months ended September 30, 2017, which reduced our current provision for income taxes in our results of operations. The statutory tax withholding classification, which are cash payments made to taxing authorities for shares withheld, were applied retrospectively and reclassified the statutory tax withholding requirements in the statement of cash flows from Other liabilities in operating activities to Other in financing activities. This statutory tax withholding reclassification resulted in $13 million and $11 million being included in financing activities for the nine months ended September 30, 2017 and 2016, respectively. There were no cumulative

effect adjustments upon adoption of this ASU.

Pending Accounting Updates

ASU 2014-09 Revenue from Contracts with Customers
In May 2014, the FASB issued 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 interim and annual reporting periods beginning after December 15, 2017. 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 2016-01, Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities
In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 revises the accounting related to the classification and measurement of investments in equity securities and the presentation of certain fair value changes for financial liabilities measured at fair value. Our results of operations will be impacted as changes in fair value of equity securities will be reported in net income instead of reported in other comprehensive income. The effective date of ASU 2016-01 is for interim and annual reporting periods beginning after December 15, 2017, and will be applied prospectively. The ASU has not yet been adopted. Had we adopted this ASU on September 30, 2017, $1.795 billion of after-tax unrealized gains on equity securities would have been reclassified from accumulated other comprehensive income to retained earnings. The actual amount reclassified upon adoption will vary depending on the future changes in fair value of our equity portfolio.

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

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

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

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

In March 2017, the FASB issued ASU 2017-07, Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Postretirement Benefit Costs. ASU 2017-07 provides guidance on how to present the components of net periodic benefit costs in the income statement for pension plans and other post-retirement benefit plans. The effective date of ASU 2017-07 is for interim and annual reporting periods beginning after December 15, 2017. The ASU has not yet been adopted; however, it will not have a material impact on our company's consolidated financial position, cash flows or results of operations.

ASU 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities

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

ASU 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting

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

NOTE 2 – Investments

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

(Dollars in millions)	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
At September 30, 2017				
Fixed maturity securities:				
Corporate	$ 5,514	$ 280	$ 11	$5,783
States, municipalities and political subdivisions	4,103	144	13	4,234
Commercial mortgage-backed	280	8	—	288
Government-sponsored enterprises	207	—	3	204
United States government	16	—	—	16
Foreign government	10	—	—	10
Convertibles and bonds with warrants attached	5	—	—	5
Subtotal	10,135	432	27	10,540
Equity securities:				
Common equities	3,084	2,762	38	5,808
Nonredeemable preferred equities	180	37	—	217
Subtotal	3,264	2,799	38	6,025
Total	$ 13,399	$ 3,231	$ 65	$16,565
At December 31, 2016				
Fixed maturity securities:				
Corporate	$ 5,555	$ 252	$ 26	$5,781
States, municipalities and political subdivisions	3,770	100	42	3,828
Commercial mortgage-backed	282	7	2	287
Government-sponsored enterprises	167	—	3	164
United States government	10	—	—	10
Foreign government	10	—	—	10
Convertibles and bonds with warrants attached	5	—	—	5
Subtotal	9,799	359	73	10,085
Equity securities:				
Common equities	2,812	2,320	9	5,123
Nonredeemable preferred equities	183	28	—	211
Subtotal	2,995	2,348	9	5,334
Total	$ 12,794	$ 2,707	$ 82	$15,419

The net unrealized investment gains in our fixed-maturity portfolio at September 30, 2017, are primarily the result of the continued low interest rate environment that increased the fair value of our fixed-maturity portfolio. Our commercial mortgage-backed securities had an average rating of Aa1/AA at September 30, 2017, and December 31, 2016. At September 30, 2017, the seven largest unrealized investment gains in our common stock portfolio are from Honeywell International Incorporated (NYSE:HON), JP Morgan Chase & Co. (NYSE:JPM), Apple Inc. (Nasdaq:AAPL), Blackrock Inc. (Nasdaq:BLK), Microsoft Corporation (Nasdaq:MSFT), Johnson & Johnson (NYSE:JNJ) and 3M Company (NYSE:MMM), which had a combined gross unrealized gain of $864 million. At September 30, 2017, Apple Inc. was our largest single equity holding with a fair value of $216 million, which was 3.7 percent of our publicly traded common equities portfolio and 1.3 percent of the total investment portfolio.

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

(Dollars in millions)	Less than 12 months		12 months or more		Total	
At September 30, 2017	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Fixed maturity securities:						
Corporate	$ 231	$ 4	$ 193	$ 7	$424	$ 11
States, municipalities and political subdivisions	508	8	122	5	630	13
Commercial mortgage-backed securities	43	—	3	—	46	—
Government-sponsored enterprises	152	3	43	—	195	3
United States government	7	—	—	—	7	—
Subtotal	941	15	361	12	1,302	27
Equity securities:						
Common equities	276	38	—	—	276	38
Subtotal	276	38	—	—	276	38
Total	$ 1,217	$ 53	$ 361	$ 12	$1,578	$ 65
At December 31, 2016						
Fixed maturity securities:						
Corporate	$ 733	$ 15	$ 189	$ 11	$922	$ 26
States, municipalities and political subdivisions	989	42	—	—	989	42
Commercial mortgage-backed	89	2	2	—	91	2
Government-sponsored enterprises	155	3	—	—	155	3
United States government	6	—	—	—	6	—
Subtotal	1,972	62	191	11	2,163	73
Equity securities:						
Common equities	103	9	—	—	103	9
Nonredeemable preferred equities	4	—	—	—	4	—
Subtotal	107	9	—	—	107	9
Total	$ 2,079	$ 71	$ 191	$ 11	$2,270	$ 82

Contractual maturity dates for fixed-maturity investments were:

(Dollars in millions) At September 30, 2017	Amortized cost	Fair value	% of fair value
Maturity dates:			
Due in one year or less	$ 674	$686	6.5 %
Due after one year through five years	2,668	2,803	26.6
Due after five years through ten years	3,853	4,009	38.0
Due after ten years	2,940	3,042	28.9
Total	$ 10,135	$10,540	100.0%

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

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

(Dollars in millions)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Investment income:				
Interest	$112	$111	$334	$330
Dividends	43	39	124	117
Other	1	1	3	2
Total	156	151	461	449
Less investment expenses	3	3	8	7
Total	$153	$148	$453	$442
Realized investment gains and losses:				
Fixed maturities:				
Gross realized gains	$3	$10	$16	$17
Gross realized losses	—	—	—	(1)
Other-than-temporary impairments	—	—	(6)	(2)
Equity securities:				
Gross realized gains	1	47	160	147
Gross realized losses	—	—	(14)	(1)
Other-than-temporary impairments	—	—	(3)	—
Other	3	(1)	3	1
Total	$7	$56	$156	$161
Change in unrealized investment gains and losses:				
Fixed maturities	$9	$(20)	$119	$274
Equity securities	180	82	422	367
Income tax provision	(66)	(21)	(189)	(224)
Total	$123	$41	$352	$417

During the three months ended September 30, 2017, there were no equity securities and no fixed-maturity securities other-than-temporarily impaired. During the nine months ended September 30, 2017, there were five 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, 2017 and 2016.

At September 30, 2017, 94 fixed-maturity investments with a total unrealized loss of $12 million had been in an unrealized loss position for 12 months or more. Of that total, no fixed-maturity investment had a fair value below 70 percent of amortized cost. At September 30, 2017, no equity investment had been in an unrealized loss position for 12 months or more. There were no equity investments with a fair value below 70 percent of amortized cost. At December 31, 2016, 32 fixed-maturity investments with a total unrealized loss of $11 million had been in an unrealized loss position for 12 months or more. Of that total, no fixed-maturity investments had fair values below 70 percent of amortized cost. There were no equity security investments in an unrealized loss position for 12 months or more as of December 31, 2016. There were no equity investments with a fair value below 70 percent of amortized cost at December 31, 2016.

NOTE 3 – Fair Value Measurements

In accordance with accounting guidance for fair value measurements and disclosures, we categorized our financial instruments, based on the priority of the observable and market-based data for the valuation technique used, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices with readily available independent data in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable market inputs (Level 3). When various inputs for measurement fall within different levels of the fair value hierarchy, the lowest observable input that has a significant impact on fair value measurement is used.
Our valuation techniques have not changed from those used at December 31, 2016, and ultimately management determines fair value. See our 2016 Annual Report on Form 10-K, Item 8, Note 3, Fair Value Measurements, Page 132, for information on characteristics and valuation techniques used in determining fair value.

Fair Value Disclosures for Assets

The following tables illustrate the fair value hierarchy for those assets measured at fair value on a recurring basis at September 30, 2017, and December 31, 2016. We do not have any material liabilities carried at fair value. There were no transfers between Level 1 and Level 2.

(Dollars in millions) At September 30, 2017	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	$ —	$ 5,782	$ 1	$5,783
States, municipalities and political subdivisions	—	4,229	5	4,234
Commercial mortgage-backed	—	288	—	288
Government-sponsored enterprises	—	204	—	204
United States government	16	—	—	16
Foreign government	—	10	—	10
Convertibles and bonds with warrants attached	—	5	—	5
Subtotal	16	10,518	6	10,540
Common equities, available for sale	5,808	—	—	5,808
Nonredeemable preferred equities, available for sale	—	217	—	217
Separate accounts taxable fixed maturities	—	783	—	783
Top Hat savings plan mutual funds and common equity (included in Other assets)	30	—	—	30
Total	$ 5,854	$ 11,518	$ 6	$17,378
At December 31, 2016				
Fixed maturities, available for sale:				
Corporate	$ —	$ 5,703	$ 78	$5,781
States, municipalities and political subdivisions	—	3,828	—	3,828
Commercial mortgage-backed	—	287	—	287
Government-sponsored enterprises	—	164	—	164
United States government	10	—	—	10
Foreign government	—	10	—	10
Convertibles and bonds with warrants attached	—	5	—	5
Subtotal	10	9,997	78	10,085
Common equities, available for sale	5,123	—	—	5,123
Nonredeemable preferred equities, available for sale	—	211	—	211
Separate accounts taxable fixed maturities	—	750	—	750
Top Hat savings plan mutual funds and common equity (included in Other assets)	24	—	—	24
Total	$ 5,157	$ 10,958	$ 78	$16,193

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, 2017. Total Level 3 assets continue to be less than 1 percent of financial assets measured at fair value in the condensed consolidated balance sheets. Assets presented in the table below were valued based primarily on broker/dealer quotes for which there is a lack of transparency as to inputs used to develop the valuations. Transfers out of Level 3 included situations where a broker quote was used without observable inputs or data that could be corroborated by our pricing vendors in the prior period and significant other observable inputs were identified in the current period. The quantitative detail of these unobservable inputs is neither provided nor reasonably available to us.

The following table provides the change in Level 3 assets for the three months ended September 30:

(Dollars in millions)	Asset fair value measurements using significant unobservable inputs (Level 3)				
	Corporate fixed maturities	Taxable fixed maturities - separate accounts	States, municipalities and political subdivisions fixed maturities	Nonredeemable preferred equities	Total
Beginning balance, July 1, 2017	$1	$ —	$ 5	$ —	$6
Total gains or losses (realized/unrealized):					
Included in net income	—	—	—	—	—
Included in other comprehensive income	—	—	—	—	—
Purchases	—	—	—	—	—
Sales	—	—	—	—	—
Transfers into Level 3	—	—	—	—	—
Transfers out of Level 3	—	—	—	—	—
Ending balance, September 30, 2017	$1	$ —	$ 5	$ —	$6
Beginning balance, July 1, 2016	$52	$ 1	$ —	$ —	$53
Total gains or losses (realized/unrealized):					
Included in net income	—	—	—	—	—
Included in other comprehensive income	1	—	—	—	1
Purchases	—	—	—	—	—
Sales	(1)	—	—	—	(1)
Transfers into Level 3	—	—	—	—	—
Transfers out of Level 3	(10)	(1)	—	—	(11)
Ending balance, September 30, 2016	$42	$ —	$ —	$ —	$42

The following table provides the change in Level 3 assets for the nine months ended September 30:

(Dollars in millions)	Asset fair value measurements using significant unobservable inputs				
	Corporate fixed maturities	Taxable fixed maturities - separate accounts	States, municipalities and political subdivisions fixed maturities	Nonredeemable preferred equities	Total
Beginning balance, January 1, 2017	$ 78	$ —	$ —	$ —	$ 78
Total gains or losses (realized/unrealized):					
Included in net income	—	—	—	—	—
Included in other comprehensive income	—	—	—	—	—
Purchases	—	—	5	—	5
Sales	—	—	—	—	—
Transfers into Level 3	—	—	—	—	—
Transfers out of Level 3	(77)	—	—	—	(77)
Ending balance, September 30, 2017	$ 1	$ —	$ 5	$ —	$ 6
Beginning balance, January 1, 2016	$ 51	$ 1	$ —	$ 3	$ 55
Total gains or losses (realized/unrealized):					
Included in net income	—	—	—	—	—
Included in other comprehensive income	1	—	—	(1)	—
Purchases	22	—	—	—	22
Sales	(1)	—	—	(2)	(3)
Transfers into Level 3	—	—	—	—	—
Transfers out of Level 3	(31)	(1)	—	—	(32)
Ending balance, September 30, 2016	$ 42	$ —	$ —	$ —	$ 42

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

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

(Dollars in millions)			Book value		Principal amount	
Interest rate	Year of issue		September 30, 2017	December 31, 2016	September 30, 2017	December 31, 2016
6.900%	1998	Senior debentures, due 2028	$ 26	$ 26	$ 28	$ 28
6.920%	2005	Senior debentures, due 2028	391	391	391	391
6.125%	2004	Senior notes, due 2034	370	370	374	374
		Total	$ 787	$ 787	$ 793	$ 793

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

(Dollars in millions) At September 30, 2017	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Note payable	$ —	$ 17	$ —	$ 17
6.900% senior debentures, due 2028	—	34	—	34
6.920% senior debentures, due 2028	—	503	—	503
6.125% senior notes, due 2034	—	459	—	459
Total	$ —	$ 1,013	$ —	$ 1,013
At December 31, 2016				
Note payable	$ —	$ 20	$ —	$ 20
6.900% senior debentures, due 2028	—	33	—	33
6.920% senior debentures, due 2028	—	488	—	488
6.125% senior notes, due 2034	—	435	—	435
Total	$ —	$ 976	$ —	$ 976

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

(Dollars in millions) At September 30, 2017	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	$ —	$ —	$ 41	$ 41
At December 31, 2016				
Life policy loans	$ —	$ —	$ 40	$ 40

Outstanding principal and interest for these life policy loans totaled $31 million at September 30, 2017, and December 31, 2016.

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

(Dollars in millions) At September 30, 2017	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Deferred annuities	$ —	$ —	$ 846	$ 846
Structured settlements	—	209	—	209
Total	$ —	$ 209	$ 846	$ 1,055
At December 31, 2016				
Deferred annuities	$ —	$ —	$ 839	$ 839
Structured settlements	—	206	—	206
Total	$ —	$ 206	$ 839	$ 1,045

Recorded reserves for the deferred annuities were $844 million and $861 million at September 30, 2017, and December 31, 2016, respectively. Recorded reserves for the structured settlements were $163 million and $170 million at September 30, 2017, and December 31, 2016, respectively.

NOTE 4 – Property Casualty Loss and Loss Expenses

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

(Dollars in millions)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Gross loss and loss expense reserves, beginning of period	$5,213	$4,918	$5,035	$4,660
Less reinsurance recoverable	283	310	298	281
Net loss and loss expense reserves, beginning of period	4,930	4,608	4,737	4,379
Net incurred loss and loss expenses related to:				
Current accident year	835	730	2,493	2,261
Prior accident years	(20)	(40)	(96)	(151)
Total incurred	815	690	2,397	2,110
Net paid loss and loss expenses related to:				
Current accident year	411	374	969	848
Prior accident years	314	288	1,145	1,005
Total paid	725	662	2,114	1,853
Net loss and loss expense reserves, end of period	5,020	4,636	5,020	4,636
Plus reinsurance recoverable	280	301	280	301
Gross loss and loss expense reserves, end of period	$5,300	$4,937	$5,300	$4,937

We use actuarial methods, models and judgment to estimate, as of a financial statement date, the property casualty loss and loss expense reserves required to pay for and settle all outstanding insured claims, including incurred but not reported (IBNR) claims, as of that date. The actuarial estimate is subject to review and adjustment by an inter-departmental committee that includes actuarial, claims, underwriting, loss prevention and accounting management. This committee is familiar with relevant company and industry business, claims and underwriting trends, as well as general economic and legal trends that could affect future loss and loss expense payments. The amount we will actually have to pay for claims can be highly uncertain. This uncertainty, together with the size of our reserves, makes the loss and loss expense reserves our most significant estimate. The reserve for loss and loss expenses in the condensed consolidated balance sheets also included $50 million at September 30, 2017, and $54 million at September 30, 2016, for certain life and health loss and loss expense reserves.

For the three months ended September 30, 2017, we experienced $20 million of favorable development on prior accident years, including $18 million of favorable development in commercial lines, $3 million of favorable development in excess and surplus lines and $1 million of adverse development in our reinsurance assumed operations. This included $6 million from favorable development of catastrophe losses for the three months ended September 30, 2017. For the three months ended September 30, 2017, we recognized favorable reserve development of $14 million for the workers' compensation line, $7 million for the commercial property line and $5 million for the other commercial lines due to reduced uncertainty of prior accident year loss and loss adjustment expense for these lines. For the three months ended September 30, 2017, we recognized unfavorable reserve development of $8 million for the commercial auto line.

For the nine months ended September 30, 2017, we experienced $96 million of favorable development on prior accident years, including $55 million of favorable development in commercial lines, $13 million of favorable development in personal lines, $25 million of favorable development in excess and surplus lines and $3 million of favorable development in our reinsurance assumed operations. This included $20 million from favorable development of catastrophe losses for the nine months ended September 30, 2017. For the nine months ended September 30, 2017, we recognized favorable reserve development of $44 million for the workers' compensation line, $21 million for the commercial property line and $25 million for the other commercial lines due to reduced uncertainty of prior accident year loss and loss adjustment expense for these lines. For the nine months ended September 30, 2017, we recognized unfavorable reserve development of $27 million for the commercial auto line and $8 million for the commercial casualty line. The unfavorable reserve development for commercial casualty reflected higher large loss activity than prior year.

For the three months ended September 30, 2016, we experienced $40 million of favorable development on prior accident years, including $31 million of favorable development in commercial lines, $4 million of adverse development in personal lines, $12 million of favorable development in excess and surplus lines and $1 million of favorable development in our reinsurance assumed operations. We recognized favorable reserve development during the three months ended September 30, 2016, of $16 million for the workers' compensation line, $7 million for commercial casualty line and $11 million for the other commercial lines due to reduced uncertainty of prior accident year loss and loss adjustment expenses for these lines. We recognized unfavorable reserve development during the three months ended September 30, 2016, of $9 million for the personal auto line and $4 million for the commercial auto line. Both lines developed unfavorably due to higher loss cost effects in recent accident years, resulting in an increase of our reserve estimate for claims that have not yet been settled.

For the nine months ended September 30, 2016, we experienced $151 million of favorable development on prior accident years, including $118 million of favorable development in commercial lines, $4 million of favorable development in personal lines, $27 million of favorable development in excess and surplus lines and $2 million of favorable development in our reinsurance assumed operations. This included $5 million from favorable development of catastrophe losses for the nine months ended September 30, 2016. We recognized favorable reserve development during the nine months ended September 30, 2016, of $52 million for the workers' compensation line, $30 million for the commercial casualty line, $25 million for the commercial property line and $37 million for the other commercial lines due to reduced uncertainty of prior accident year loss and loss adjustment expenses for these lines. We recognized unfavorable reserve development during the nine months ended September 30, 2016, of $26 million for the commercial auto line and $15 million for the personal auto line. Both lines developed unfavorably due to higher loss cost effects in recent accident years, resulting in an increase of our reserve estimate for claims that have not yet settled.

NOTE 5 – Life Policy and Investment Contract Reserves

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

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

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

This table summarizes our life policy and investment contract reserves:

(Dollars in millions)	September 30, 2017	December 31, 2016
Life policy reserves:		
Ordinary/traditional life	$ 1,063	$ 1,011
Other	46	45
Subtotal	1,109	1,056
Investment contract reserves:		
Deferred annuities	844	861
Universal life	594	578
Structured settlements	163	170
Other	6	6
Subtotal	1,607	1,615
Total life policy and investment contract reserves	$ 2,716	$ 2,671

NOTE 6 – Deferred Policy Acquisition Costs

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

(Dollars in millions)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Property casualty:				
Deferred policy acquisition costs asset, beginning of period	$448	$412	$408	$388
Capitalized deferred policy acquisition costs	223	216	686	644
Amortized deferred policy acquisition costs	(220)	(207)	(643)	(611)
Deferred policy acquisition costs asset, end of period	$451	$421	$451	$421
Life:				
Deferred policy acquisition costs asset, beginning of period	$230	$212	$229	$228
Capitalized deferred policy acquisition costs	13	11	38	35
Amortized deferred policy acquisition costs	(17)	(15)	(37)	(37)
Amortized shadow deferred policy acquisition costs	(1)	(2)	(5)	(20)
Deferred policy acquisition costs asset, end of period	$225	$206	$225	$206
Consolidated:				
Deferred policy acquisition costs asset, beginning of period	$678	$624	$637	$616
Capitalized deferred policy acquisition costs	236	227	724	679
Amortized deferred policy acquisition costs	(237)	(222)	(680)	(648)
Amortized shadow deferred policy acquisition costs	(1)	(2)	(5)	(20)
Deferred policy acquisition costs asset, end of period	$676	$627	$676	$627

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

NOTE 7 – Accumulated Other Comprehensive Income

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

(Dollars in millions)	Three months ended September 30,					
	2017			2016		
	Before tax	Income tax	Net	Before tax	Income tax	Net
Investments:						
AOCI, beginning of period	$2,977	$1,031	$1,946	$2,673	$925	$1,748
OCI before realized gains recognized in net income	193	67	126	119	41	78
Realized gains recognized in net income	(4)	(1)	(3)	(57)	(20)	(37)
OCI	189	66	123			