

Life Insurers
U.S. and Canada
Full Rating Report

The Cincinnati Life Insurance
Company

Ratings

Security Class	Rating
Insurer Financial Strength	A+

Rating Outlook

Stable

Financial Data

The Cincinnati Life Insurance Company		
	Date YTD	S Mil.
Net Income	6/30/10	11
Total Adjusted Capital	6/30/10	321
RBC Ratio (%)	6/30/10	373

YTD – Year to date. Note: Statutory data.

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Related Research

Applicable Criteria

- *Insurance Rating Methodology, Aug. 16, 2010*
- *Life Insurance Rating Methodology, March 24, 2010*
- *Fitch's Approach to Rating Insurance Groups, March 24, 2010*

Other Research

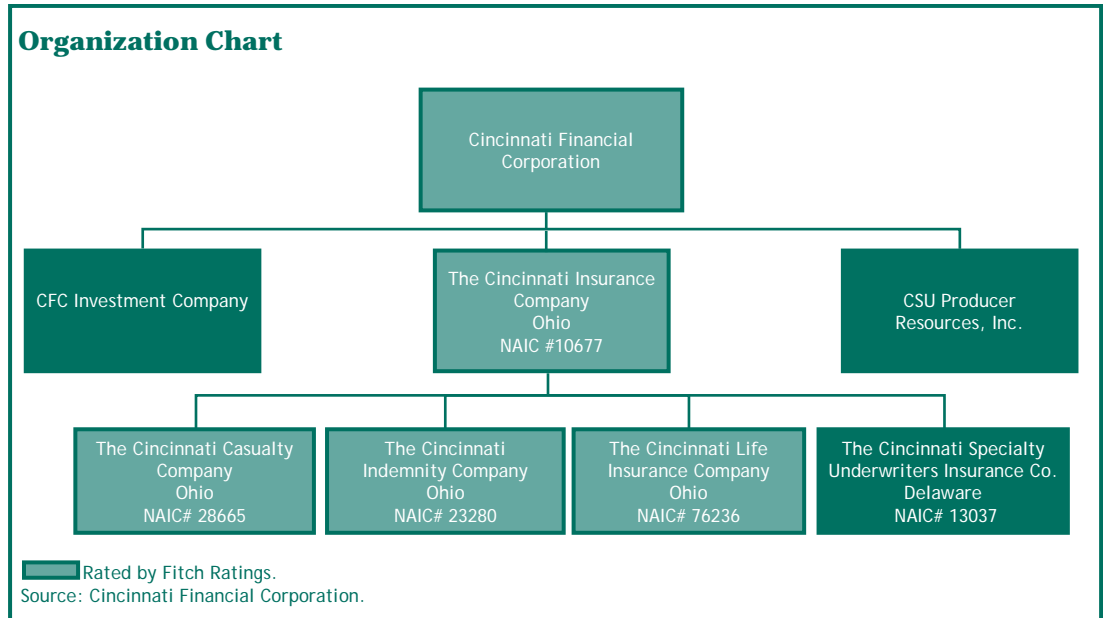
- *Cincinnati Financial Corp., Sept. 10, 2010.*
- *U.S. Life Insurance Sector: Outlook Revised to Stable, Sept. 7, 2010*
- *2010 Statutory Trends for U.S. Life Insurance Sector, May 13, 2010*
- *NAIC Risk-Based Capital: Key Challenges Interpreting Results, May 6, 2010*
- *Insurance Industry Rating Outlooks: Global Update, Sept. 2, 2009*

Rating Rationale

- The Cincinnati Life Insurance Company's (CLIC) rating is based on the company's much larger property/casualty parent, The Cincinnati Insurance Company (CIC). The group rating approach reflects Fitch Ratings' view that CLIC is an important subsidiary of Cincinnati Financial Corp. (CFC), and recognizes the high degree of operational integration between the company and the property/casualty parent. Without such parental support, CLIC's ratings would be two notches lower than the current rating.
- CLIC's diversified portfolio of life products helps to round out the product offerings of the group's independent property/casualty agents, who account for about 70% of life sales. The company has been successful in growing life premium through cross-selling both to individuals and small-business clients who purchase CIC's property/casualty products.
- Fitch believes that CFC maintains a strategic commitment to the life insurance business. The life and property/casualty businesses share common management, including investment and expense management, as well as marketing and distribution. The life operations provide modest diversification to the group's revenue and earnings stream, and the company has generally met management's earnings per share (EPS) targets.
- Fitch views favorably the number of steps CFC has taken to rebalance its investment portfolio and reduce equity concentration. At June 30, 2010 CLIC's risky asset ratio was 61%, down from 107% at year-end 2006.
- Fitch believes CLIC faces interest rate and disintermediation risk within in its fixed-annuity and bank-owned life insurance (BOLI) books of business.
- CLIC's capital is strong on both an absolute and a risk-adjusted basis. Total adjusted capital was \$321 million at June 30, 2010 compared with \$316 million for year-end 2009. The risk-based capital (RBC) ratio was 373% at June 30, 2010 compared with 393% at year-end 2009 due to an increase in liabilities. Operating leverage remains exceptionally low.

Key Rating Drivers

- While Fitch believes CLIC could not be easily divested due to its small scale and distribution dependence, any change in CFC's commitment to the life business would cause Fitch to reassess CLIC's rating.
- Fitch expects CLIC's statutory operating earnings to remain under pressure over the near term due primarily to higher reserve requirements for the company's level term life products (Regulation XXX) as well as new business strain. On a GAAP basis, Fitch expects CLIC to continue to meet CFC's earnings per shares expectations and remain strategically important to the enterprise.
- Fitch expects CLIC's capitalization on an absolute and risk-adjusted basis to remain unchanged in 2010 from year-end 2009. Fitch notes that CFC holds \$1 billion of cash and investments at the holding company, which could be downstreamed to the insurance subsidiaries should capitalization deteriorate.



Company Profile

Ownership Structure

CLIC is a wholly owned subsidiary of CIC, the lead property/casualty subsidiary of CFC. CFC is a publicly traded financial services holding company focusing on commercial and personal lines of property/casualty insurance as well as life insurance through independent agencies. The life operations are designed to complement the property/casualty business and to provide products and services that will help to attract and retain high-quality independent agencies. As of June 30, 2010, CLIC had total GAAP assets of about \$3.5 billion, or approximately 24% of CFC's total assets of \$14.6 billion.

Key Events

CFC's lead insurance subsidiary, The Cinnati Insurance Company, was founded in 1950. Property/casualty business is largely written out of The Cinnati Insurance Company as well as its three wholly owned subsidiaries: The Cinnati Casualty Company, The Cinnati Indemnity Company, and The Cinnati Specialty Underwriters Insurance Company.

CLIC was formed in 1987 to provide the property/casualty agents with a more complete portfolio of products. Additionally, the company provides a small degree of diversity to CFC's predominant property/casualty revenue and earnings.

Products, Target Markets, and Distribution Channels

CLIC's target market is predominantly middle-income individuals and small businesses. Term, universal life, whole life, and voluntary worksite life and disability products accounted for more than 96% of CLIC's GAAP revenues in 2009. The company also markets disability income insurance and fixed annuities. Universal and term life, both individual and payroll deduction, are the primary products. CLIC also has selectively written BOLI. The bulk of the BOLI liabilities on the company's balance sheet relates to a \$300 million single-pay policy sold in 1999.

Fitch believes that CIC's distribution is a competitive advantage for CLIC. CLIC has been successful in growing its life premiums by cross-selling through its independent property/casualty agencies. At year-end 2009, almost 85% of CIC's 1,463

CLIC offers simple, yet competitive products to help meet the needs of its agents.

property/casualty agency locations offered life products to their clients. Approximately 70% of CLIC's premiums were generated through these agency relationships. CLIC generates the remaining 30% of life premiums from approximately 650 independent life-only insurance agencies. Growth is expected to come from a combination of further penetration of the property/casualty channel and life-only distribution.

CIC is committed to the local agent. It builds strong relationships with select independent agents, valuing their local knowledge and expertise. Fitch believes that the strong relationships CIC maintains with its property/casualty agents contribute to generally better persistency and underwriting results in the life segment. Further penetration of this channel offers a natural avenue for growth. In addition, since field agents and claims professionals work from home/mobile/agency offices, CFC maintains an expense advantage over competitors.

In appointing life-only agents outside the property/casualty channel, CLIC has been careful to avoid conflicts with existing agents in their established territories. CLIC sees the appointment of life-only agents as a low-cost opportunity to diversify distribution.

Financial Analysis

Profitability

Fitch views CLIC's GAAP operating profitability as solid. While the company's contribution to the overall profitability of CFC is relatively modest, it has provided some diversification benefit in recent years when CFC's property/casualty operations were negatively affected by catastrophe losses and soft pricing. CLIC has generally been meeting the parent's expectations in terms of earnings per share, and Fitch believes that CFC remains strategically committed to the life operation over the near term.

Fitch's primary concern continues to be CLIC's statutory operating earnings, which are being pressured by increasing reserve requirements related to the company's popular level term life product. Through 2004, CLIC received considerable relief from reserve strain by reinsuring 80% of the risk of these policies to unaffiliated reinsurers on a coinsurance basis. However, starting in 2005, increasing reinsurance rates and the exit of certain key reinsurers from the market, resulted in the company switching to higher retention levels and yearly renewable term (YRT) reinsurance, which does not include reserve relief. This transition has depressed CLIC's statutory earnings, and that is expected to continue until an alternative solution is found or the NAIC adopts a principles-based reserving system rather than the current formulaic system.

While CLIC's absolute level of earnings has been stable, its contribution to CFC's overall operating income has grown from 6% in 2005 to 17% in 2009 and thus far in 2010.

GAAP Operating Performance — CLIC

(\$ Mil.)

	Six Months 6/30/10	2009	2008	2007	2006	2005
Earned Premium	79	143	126	125	115	106
After-Tax Operating Income	18	36	40	39	34	36
After-Tax Realized Investment Gains/(Losses)	(1)	(14)	(59)	26	29	11
Net Income	17	22	(19)	65	63	47
Earned Premium — As % of Total CFC (%)	5	5	4	4	3	3
Operating Income — As % of Total CFC (%)	17	17	12	6	7	6

CLIC – Cincinnati Life Insurance Co. CFC – Cincinnati Financial Corporation.
Source: CFC 10-K and 10-Q filings.

CLIC's statutory results have been negatively affected by new business strain and Regulation XXX reserve requirements.

Operating Performance
(\$ Mil.)

	Six Months Ended		2009	2008	2007	2006	2005
	6/30/10	6/30/09					
Total Premium Income	198	119	338	177	158	153	194
Investment Income	67	61	126	120	114	108	99
Total Revenue	268	180	466	305	285	273	312
Gain Before Federal Income Tax and Dividend	7	1	5	16	14	5	22
Policyholder Dividend	0	0	0	0	0	0	0
Pretax Gain from Operations	7	1	5	16	14	5	22
Federal Income Tax	(3)	(4)	(6)	34	7	6	12
Net Operating Gain	10	5	11	(18)	7	(0)	10
Realized Capital Gains	1	(6)	4	(53)	32	29	11
Net Income	11	(1)	15	(70)	39	28	21
Total Net Admitted Assets	3,010	2,556	2,831	2,478	2,550	2,521	2,352
Operating Return on TAC (%)	6.11	3.54	3.59	(4.41)	1.30	(0.09)	3.83
Pretax Return on Total Assets Predividend (%)	0.46	0.05	0.20	0.64	0.56	0.23	0.97
Pretax Return on Total Assets Post-Dividend (%)	0.46	0.05	0.20	0.64	0.56	0.23	0.97
Pretax Operating Margin (%)	2.52	0.35	1.11	5.24	5.02	2.01	7.02
Expense Ratio (%)	2.89	2.87	2.96	2.87	2.89	2.83	2.99
Net Investment Yield (%)	6.21	6.65	6.58	6.52	5.98	5.78	5.78
Mortality Ratio (%)	N.A.	N.A.	20.40	24.55	20.77	25.92	22.19
Ordinary Life Lapse Ratio (%)	N.A.	N.A.	6.50	6.50	6.10	5.90	6.10

TAC – Total adjusted capital. N.A. – Not available. Note: Statutory accounting principles.
Source: Cincinnati Life Insurance Company.

The individual life segment is the primary driver for CLIC's premium growth and earnings. Universal life and level term life are the most significant products. A new universal life secondary guarantee product was introduced in 2009 and a survivorship universal life secondary guarantee was introduced in 2010. The company has also expanded its worksite product portfolio in 2010 with the planned introduction of a 20-year level premium return of premium product.

The profitability of the individual life business has been supported by generally favorable mortality and persistency experience. CLIC has done a good job of managing expenses while growing the business as indicated by a declining ratio of expenses to premiums. Investment income has grown steadily but moderately over the past several years, and portfolio yields are in line with the industry.

Investments and Liquidity

CFC manages the life company's assets in accordance with the group's overall investment strategy. Historically, CFC employed a total return investment philosophy that resulted in a significant concentration in common stocks, particularly within the financial sector. The stock investment philosophy had been based on a "buy-and-hold" strategy of a relatively small number of companies that possessed the ability and commitment to grow earnings and dividends. Over the long term, this investment strategy proved successful for the company and resulted in a growth in book value and investment income.

During 2008, CFC adopted internal guidelines to place parameters around the investment portfolio designed to address issues such as the overall mix of the portfolio as well as security and sector concentrations. The company's primary investment strategy is to maintain liquidity to meet both immediate and long-range insurance obligations through the purchase of low-to-medium risk fixed maturities.

The life company currently has less than 5% of its portfolio invested in common and preferred stocks — or approximately 28% of total adjusted capital. At June 30, 2010, CLIC's equity portfolio was in a \$7 million pretax net unrealized loss position.

As a result of the steps CFC has taken to reduce its investment risk, CLIC's risky asset ratio has declined to 61%, which compares favorably with the life insurance industry average of 135%.

Investment Portfolio

(\$ Mil.)

	6/30/10	2009	2008	2007	2006	2005
Total Invested Assets	2,244	2,101	1,801	1,931	1,962	1,826
% Bonds	90.6	85.3	83.9	70.5	64.7	68.6
% Common and Preferred Stock	4.5	5.2	10.2	23.9	31.5	27.0
% Mortgage Loans	0.0	0.0	0.0	0.0	0.0	0.0
% Real Estate	0.0	0.0	0.0	0.0	0.1	0.2
% Policy Loans	1.7	1.9	2.0	1.6	1.6	1.6
% Cash and Equivalents	2.2	7.2	3.4	3.5	1.6	2.0
% Affiliated Investments	0.0	0.0	0.0	0.0	0.0	0.0
% Other Invested Assets	1.0	0.5	0.5	0.5	0.5	0.7
Below Investment Grade/Total Adj Capital (%)	26.6	28.8	24.5	24.0	16.4	18.1
Troubled Real Estate/Total Adjusted Capital (%)	0.0	0.0	0.0	0.0	0.0	0.0
Unaffiliated Common Stock/Total Adjusted Capital (%)	27.6	30.6	39.2	70.6	88.8	82.3
Schedule BA Other Invested Assets/Total Adjusted Capital (%)	7.1	3.3	3.3	1.9	1.7	2.3
Risky Assets Ratio (%)	61.3	62.7	67.0	96.4	106.9	102.7

Note: Statutory accounting principles.
Source: Cincinnati Life Insurance Company.

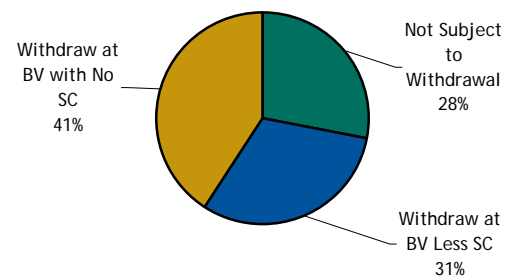
CLIC's bond portfolio is high quality with roughly 96% investment grade and 4% non-investment grade at June 30, 2010. Corporate and public utility securities represented 83% of the bond portfolio with U.S. government and agency securities representing 11% and state and municipal securities representing 6%. At June 30, 2010, the fixed-income portfolio was in a \$156 million pretax net unrealized gain position. CLIC has no exposure to real estate or mortgage loans and other invested assets consist entirely of surplus notes of other insurance companies.

Historically, asset liability management (ALM) has not been considered a strength of CLIC. However, in recent years, management has been focusing more attention on ALM as part of CFC's enterprise risk management. CLIC has begun segmenting investment portfolios for its various products and developing investment strategies for each. CLIC does perform annual cash flow testing, which indicates that reserves on the in-force block remain adequate on an aggregate basis.

Fitch believes CLIC is exposed to interest rate risk, particularly within its growing fixed-annuity book of business and universal life book. In 2009, statutory written fixed-annuity premiums increased to \$181.4 million, up from \$33.6 million written in 2008. The sharp increase was driven by CLIC's competitive interest crediting rate compared with bank certificate deposit rates. Fitch believes CLIC will face spread compression should the low interest rate environment persist for a long period of time.

Fitch believes CLIC is also exposed to disintermediation risk. About \$301 million, or 41% of the company's total fixed-annuity liabilities, were out of the surrender charge period at year-end 2009, which Fitch views as relatively high compared with peers. Additionally, the two separate account BOLI contracts — approximately \$570

CLIC Fixed-Annuity Withdrawal Characteristics
(As of Year-End 2009)



SC – Surrender charge. BV – Book value.
Source: CLIC statutory statement.

Liquidity

(\$ Mil.)

	2009	2008	2007	2006	2005
Public Bonds/Total Bonds (%)	94.8	96.1	99.5	99.8	99.8
Liquidity Ratio (%)	110.9	116.4	140.8	147.7	147.3
Operating Cash Flow Coverage (x)	2.4	1.8	1.4	1.3	2.0
Adjusted Liabilities and Separate Accounts	2,514	2,188	2,044	1,966	1,841
% Life Reserves	44.8	46.7	45.8	42.8	41.0
% Accident and Health	0.9	1.0	1.1	1.0	1.1
% Annuities and Pension Deposits	29.3	25.9	26.8	27.7	29.0
% Other	2.3	1.4	0.9	3.3	3.4
% Separate Accounts	22.7	25.0	25.5	25.2	25.5

Note: Statutory accounting principles.
Source: Cincinnati Life Insurance Company.

CLIC's operating cash flows increased in 2009 primarily due to premiums collected from its fixed annuity line of business.

million in account values — pose a slight liquidity risk since surrender charges expired at the end of 2009 and are now zero in 2010 and beyond.

The liquidity requirements of CLIC primarily relate to the liabilities associated with its products as well as operating costs and expenses. Historically, cash flows from operations, which primarily consist of premiums and investment income, have provided more than sufficient funds to meet these requirements without requiring a sale of investments or contributions from CFC. CLIC's operating cash flow coverage (as defined by consolidated statutory cash inflows from operations divided by net cash from operations) was strong at 2.4x at year-end 2009. At June 30, 2010, the company's cash position was \$48.7 million.

Capitalization

Fitch views CLIC's capital as very strong on both an absolute and a risk-adjusted basis. Total adjusted capital was \$321 million at June 30, 2010, compared with \$316 million at year-end 2009. Since year-end 2006, total adjusted capital (TAC) is down \$235 million primarily due to net realized and unrealized investment losses. However, RBC is down to

TAC is down from 2005–2007 levels as a result of realized and unrealized investment losses.

Capitalization

(\$ Mil.)

	6/30/10	2009	2008	2007	2006	2005
Beginning of Period Total Adjusted Capital	316	290	506	556	518	491
Net Operating Gain	10	11	(18)	7	(0)	10
Net Realized Gain/Loss	1	4	(53)	32	29	11
Change in Unrealized Gain/Loss	(5)	3	(112)	(92)	26	(5)
Change in Reserve Valuation	0	0	0	0	0	0
Paid in Capital/Surplus	0	0	0	0	0	0
Dividends to Stockholders	0	0	0	0	(14)	0
Other Changes	(1)	8	(33)	2	(3)	4
Total Changes	5	26	(216)	(50)	37	27
End of Period Total Adjusted Capital	321	316	290	506	556	518
Statutory Surplus	307	300	290	477	479	451
Asset Valuation Reserve	14	16	0	29	77	60
1/2 Policyholders' Dividends	0	0	0	0	0	0
Regulatory Capital	321	316	290	506	556	511
Required Capital (Company Action Level) ^a	86	80	73	131	135	105
Risk-Based Capital Ratio (%)	373	393	399	386	413	493
Assets/Statutory Surplus (x)	9.81	9.43	8.54	5.35	5.27	5.22
Adjusted Liabilities/Statutory Surplus (x)	6.84	6.48	5.65	3.19	3.07	3.04

^aRequired Capital at the company action level, for the quarter, is estimated based on year-to-date invested asset growth
Note: Statutory Accounting Principles.
Source: Cincinnati Life Insurance Company.

a lower extent to 373% at June 30, 2010 from 413% at year-end 2006 as the company has reduced its exposure to equities.

The company has no debt or surplus notes and has received no capital contributions from its parent over the past five years. It has paid one dividend of \$30 million in 2003 and another tax-related dividend of \$14 million in 2006. CLIC's dividend strategy has been to leave money in the life company as a cushion for future growth, periodically reviewing a potential dividend payment.

Fitch notes that at June 30, 2010 CFC held approximately \$1 billion in cash and investments at the holding company, which could be downstreamed to the insurance subsidiaries should capitalization deteriorate.

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