AMERICAN FINANCIAL GROUP INC
Form 10-Q
August 07, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

For the Quarterly Period Ended June 30, 2009	Commission File

No. 1-13653

AMERICAN FINANCIAL GROUP, INC.

Incorporated under the Laws of Ohio	IRS Employer I.D. No. 31-1544320

One East Fourth Street, Cincinnati, Ohio 45202
(513) 579-2121

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, and (2) has been subject to such filing requirements
for the past 90 days. Yes X No ___

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes ___ No ___

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company:

Large Accelerated Filer _X_ Accelerated Filer ___ Non-Accelerated Filer ___ Smaller Reporting Company ____

Indicate by check mark whether the Registrant is a shell company. Yes ___ No _X_

As of August 1, 2009, there were 116,058,037 shares of the Registrant's Common Stock outstanding, excluding 14.9 million shares owned by subsidiaries.

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PART I

ITEM I - FINANCIAL STATEMENTS

AMERICAN FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET (unaudited)

(Dollars In Millions)

	June 30, 2009	December 31, 2008
Assets:		
Cash and cash equivalents	$ 1,450.8	$ 1,264.0
Investments:		
Fixed maturities:		
Available for sale - at fair value		
(amortized cost - $16,009.9 and $15,948.1)	14,892.7	14,079.3
Trading - at fair value	325.4	280.5
Equity securities - at fair value:		
Common stocks (cost - $114.1 and $118.6)	253.1	216.5
Perpetual preferred stocks (cost - $120.2 and $178.4)	101.0	137.1
Mortgage loans	308.3	308.9
Policy loans	277.8	283.6
Real estate and other investments	339.8	300.6

Total cash and investments	17,948.9	16,870.5
Recoverables from reinsurers and prepaid reinsurance premiums	3,578.5	4,301.7
Agents' balances and premiums receivable	704.1	629.7
Deferred policy acquisition costs	2,068.2	2,343.1
Other receivables	386.3	414.8
Variable annuity assets (separate accounts)	457.8	415.9
Other assets	916.6	1,241.6
Goodwill	210.2	210.2
Total Assets	$26,270.6	$26,427.5
Liabilities and Equity:		
Unpaid losses and loss adjustment expenses	$ 6,243.3	$ 6,764.2
Unearned premiums	1,696.2	1,697.9
Annuity benefits accumulated	10,869.3	10,652.7
Life, accident and health reserves	1,571.0	1,539.8
Payable to reinsurers	274.4	504.1
Long-term debt	915.3	1,029.7
Variable annuity liabilities (separate accounts)	457.8	415.9
Accounts payable, accrued expenses and other liabilities	1,050.7	1,221.6
Total liabilities	23,078.0	23,825.9
Shareholders' Equity:		
Common Stock, no par value - 200,000,000 shares authorized - 115,834,660 and 115,599,169 shares outstanding	115.8	115.6
Capital surplus	1,245.0	1,235.8
Retained earnings	2,060.0	1,841.6
Accumulated other comprehensive income (loss), net of tax	(353.5)	(703.0)
Total shareholders' equity	3,067.3	2,490.0
Noncontrolling interests	125.3	111.6
Total equity	3,192.6	2,601.6
Total liabilities and equity	$26,270.6	$26,427.5

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AMERICAN FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EARNINGS (unaudited)

(In Millions, Except Per Share Data)

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Income:				
Property and casualty insurance premiums	$ 612.7	$ 618.8	$1,187.4	$1,253.8
Life, accident and health premiums	109.8	107.9	218.9	216.6
Investment income	299.0	270.9	599.2	537.2
Realized gains (losses) on securities (*)	15.6	(63.1)	(25.7)	(143.4)
Other income	59.1	82.7	122.0	154.8
	1,096.2	1,017.2	2,101.8	2,019.0
Costs and Expenses:				
Property and casualty insurance:				
Losses and loss adjustment expenses	277.9	343.1	549.6	634.0
Commissions and other underwriting expenses	226.6	211.0	425.3	433.0
Annuity benefits	103.7	81.8	211.3	186.7
Life, accident and health benefits	90.5	85.3	181.5	172.7
Annuity and supplemental insurance acquisition expenses	45.6	54.7	97.7	94.8
Interest charges on borrowed money	13.4	17.3	29.4	36.0
Other operating and general expenses	132.5	124.0	233.0	235.8

	890.2	917.2	1,727.8	1,793.0
Operating earnings before income taxes	206.0	100.0	374.0	226.0
Provision for income taxes	73.9	37.0	132.2	81.9
Net earnings, including noncontrolling interests	132.1	63.0	241.8	144.1
Less: Net earnings attributable to noncontrolling interests	(4.8)	(2.7)	(10.7)	(7.8)
Net Earnings Attributable to Shareholders	$ 127.3	$ 60.3	$ 231.1	$ 136.3
Earnings Attributable to Shareholders per Common Share:				
Basic	$1.10	$.53	$2.00	$1.20
Diluted	$1.09	$.52	$1.98	$1.16
Average number of Common Shares:				
Basic	115.8	113.3	115.7	113.4
Diluted	116.5	116.3	116.5	116.9
Cash dividends per Common Share	$.13	$.125	$.26	$.25

(*) Consists of the following:

Realized gains (losses) before impairments	$65.9	($ 7.5)	$100.6	$ 14.1
Losses on securities with impairment	(68.5)	(55.6)	(252.9)	(157.5)

Non-credit portion recognized in other comprehensive income (loss)	18.2	-	126.6	-
Impairment charges recognized in earnings	(50.3)	(55.6)	(126.3)	(157.5)
Total realized gains (losses) on securities	$15.6	($63.1)	($ 25.7)	($143.4)

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AMERICAN FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)

(Dollars in Millions)

	Shareholders' Equity					
	Common Shares	Common Stock and Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total	Noncon-trolling Interests
Balance at December 31, 2008	115,599,169	$1,351.4	$1,841.6	($703.0)	$2,490.0	$111.6
Cumulative effect of accounting change	-	-	17.5	(17.5)	-	-
Net earnings	-	-	231.1	-	231.1	10.7
Other comprehensive income (loss), net of tax:						
Change in unrealized gain (loss) on securities	-	-	-	356.3	356.3	2.3
Change in foreign currency translation	-	-	-	10.3	10.3	1.8

Change in unrealized pension and other postretirement benefits	-	-	-	.4	.4	-
Total comprehensive income					598.1	14.8
Dividends on Common Stock	-	-	(30.2)	-	(30.2)	-
Shares issued:						
Exercise of stock options	54,350	.9	-	-	.9	-
Benefit plans	169,076	1.7	-	-	1.7	-
Dividend reinvestment plan	12,065	.2	-	-	.2	-
Stock-based compensation expense	-	5.5	-	-	5.5	-
Other	-	1.1	-	-	1.1	(1.1)
Balance at June 30, 2009	115,834,660	$1,360.8	$2,060.0	($353.5)	$3,067.3	$125.3
Balance at December 31, 2007	113,499,080	$1,300.0	$1,733.5	$ 12.6	$3,046.1	$ 99.9
Net earnings	-	-	136.3	-	136.3	7.8
Other comprehensive income (loss), net of tax:						
Change in unrealized gain (loss) on securities	-	-	-	(281.9)	(281.9)	(4.3)
Change in foreign currency translation	-	-	-	(1.9)	(1.9)	.1
Change in unrealized pension and other postretirement benefits	-	-	-	.1	.1	-
Total comprehensive income (loss)					(147.4)	3.6
Dividends on Common Stock	-	-	(28.3)	-	(28.3)	-

Shares issued:						
Redemption of convertible notes	2,364,640	24.4	-	-	24.4	-
Exercise of stock options	943,514	19.1	-	-	19.1	-
Dividend reinvestment plan	142,759	3.7	-	-	3.7	-
Benefit plans	167,541	4.7	-	-	4.7	-
Other stock-based compensation expense	-	5.1	-	-	5.1	-
Shares acquired and retired	(1,803,000)	(20.7)	(26.7)	-	(47.4)	-
Shares tendered in option exercises	(247,632)	(2.8)	(3.6)	-	(6.4)	-
Noncontrolling interest of						
acquired subsidiary	-	-	-	-	-	18.7
Other	-	1.2	-	-	1.2	.4
Balance at June 30, 2008	115,066,902	$1,334.7	$1,811.2	($271.1)	$2,874.8	$122.6

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AMERICAN FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)

(In Millions)

	Six months ended June 30,	-
	2009	2008
Operating Activities:		
Net earnings, including noncontrolling interests	$ 241.8	$ 144.1
Adjustments:		
Depreciation and amortization	114.6	124.9
Annuity benefits	211.3	186.7
Realized losses on investing activities	29.8	137.6

Net (purchases) sales of trading securities	(38.1)	27.5
Deferred annuity and life policy acquisition costs	(82.2)	(95.6)
Decrease in reinsurance and other receivables	734.2	56.6
Decrease (increase) in other assets	40.5	(43.8)
Increase (decrease) in insurance claims and reserves	(491.4)	78.1
Decrease in payable to reinsurers	(229.7)	(11.1)
Decrease in other liabilities	(48.1)	(59.5)
Other, net	8.9	9.7
Net cash provided by operating activities	491.6	555.2
Investing Activities		
:		
Purchases of and additional investments in:		
Fixed maturity investments	(1,732.7)	(3,722.6)
Equity securities	(4.7)	(116.6)
Subsidiaries	(5.0)	(112.2)
Real estate, property and equipment	(21.3)	(25.0)
Maturities and redemptions of fixed maturity investments	901.0	1,253.9
Sales of:		
Fixed maturity investments	777.9	1,876.6
Equity securities	26.0	155.3
Real estate, property and equipment	.8	6.5
Decrease in securities lending collateral	49.1	26.0
Cash and cash equivalents of businesses acquired	-	44.3
Increase in other investments	(34.4	(14.3
	)	)
Net cash used in investing activities	(43.3	(628.1
	)	)
Financing Activities		
:		
Annuity receipts	669.6	789.6
Annuity surrenders, benefits and withdrawals	(681.7)	(693.9)
Net transfers from (to) variable annuity assets	(6.8)	27.7
Additional long-term borrowings	407.9	530.0
Reductions of long-term debt	(524.8)	(469.5)
Decrease in securities lending obligation	(95.6)	(26.0)
Issuances of Common Stock	1.2	14.3
Repurchases of Common Stock	-	(47.4)
Cash dividends paid on Common Stock	(30.0)	(24.6)
Other, net	(1.3	(.1
	)	)

Net cash provided by (used in) financing activities	(261.5)	100.1
Net Increase in Cash and Cash Equivalents	186.8	27.2
Cash and cash equivalents at beginning of period	1,264.0	815.9
Cash and cash equivalents at end of period	$1,450.8	$ 843.1

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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A. Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements for American Financial Group, Inc. ("AFG") and subsidiaries are unaudited; however, management believes that all adjustments (consisting only of normal recurring accruals unless otherwise disclosed herein) necessary for fair presentation have been made. The results of operations for interim periods are not necessarily indicative of results to be expected for the year. The financial statements have been prepared in accordance with the instructions to Form 10-Q and therefore do not include all information and footnotes necessary to be in conformity with U.S. generally accepted accounting principles.

AFG adopted Statement of Financial Accounting Standards ("SFAS") No. 160, "Noncontrolling Interests in Consolidated Financial Statements," on January 1, 2009. As a result, noncontrolling interests in subsidiaries (formerly referred to as minority interest) is reported in the Balance Sheet as a separate component of equity and in the Statement of Earnings as a deduction from net income (instead of as an expense) in deriving net earnings attributable to AFG's shareholders. SFAS No. 160 requires that purchases and sales of equity interests in less than 100%-owned subsidiaries that do not result in a change of control be accounted for as equity transactions and, upon loss of control, requires any interest retained to be recorded at fair value with a gain or loss recognized in earnings. SFAS No. 160 is required to be applied prospectively, except for the provisions related to financial statement presentation of noncontrolling interests, which have been applied retrospectively.

Certain reclassifications have been made to prior years to conform to the current year's presentation. All significant intercompany balances and transactions have been eliminated. The results of operations of companies since their formation or acquisition are included in the consolidated financial statements. Events or transactions occurring subsequent to June 30, 2009, and prior to August 7, 2009 (the filing date of this Form 10-Q), have been evaluated for potential recognition or disclosure herein.

The preparation of the financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Changes in circumstances could cause actual results to differ materially from those estimates.

Fair Value Measurements

Effective January 1, 2008, AFG adopted SFAS No. 157, "Fair Value Measurements," with the exception of the application of the statement to nonrecurring fair value measurements of nonfinancial assets and liabilities that was adopted as of January 1, 2009 in accordance with FSP FAS No. 157-2. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants on the measurement date. The standard establishes a hierarchy of valuation techniques based on whether the assumptions that market participants would use in pricing the asset or liability ("inputs") are observable or unobservable. Observable inputs reflect market

data obtained from independent sources, while unobservable inputs reflect AFG's assumptions about the assumptions market participants would use in pricing the asset or liability. In the first six months of 2009, AFG did not have any significant nonrecurring fair value measurements of nonfinancial assets and liabilities. AFG adopted FSP FAS No. 157-4 as of January 1, 2009. This standard provides guidance on estimating the fair value of an asset or liability when there is no active market and on identifying transactions that are not orderly. The standard did not change the objective of fair value measurements. Adoption of SFAS No. 157 and the FSPs did not have a significant impact on AFG's financial condition or results of operations.

In the second quarter of 2009, AFG adopted FSP FAS No. 107-1 and APB Opinion No. 28-1, "Interim Disclosures about Fair Value of Financial Instruments," which requires fair value disclosures in interim financial statements for financial instruments, including those that are not reflected in the balance sheet at fair value. Formerly, these disclosures were only required annually. Disclosures required by the FSP are contained in *Note C - "Fair Value Measurements."*

Investments

Fixed maturity and equity securities classified as "available for sale" are reported at fair value with unrealized gains and losses included in a separate component of shareholders' equity. Fixed maturity and equity securities classified as "trading" are reported at fair value with changes in unrealized holding gains or losses during the period included in investment income. Mortgage and policy loans are carried primarily at the aggregate unpaid balance.

Premiums and discounts on fixed maturity securities are amortized using the interest method; mortgage-backed securities ("MBS") are amortized over a period based on estimated future principal payments, including prepayments. Prepayment assumptions are reviewed periodically and adjusted to reflect actual prepayments and changes in expectations.

Gains or losses on securities are determined on the specific identification basis. When a decline in the value of a specific investment is considered to be other than temporary at the balance sheet date, a provision for impairment is charged to earnings (included in realized gains (losses)) and the cost basis of that investment is reduced.

In April 2009, the Financial Accounting Standards Board ("FASB") issued FSP FAS No. 115-2, "Recognition and Presentation of Other-Than-Temporary Impairments." Under the guidance, if management can assert that it does not intend to sell an impaired fixed maturity security and it is not more likely than not that it will have to sell the security before recovery of its amortized cost basis, then an entity may separate other than temporary impairments into two components: 1) the amount related to credit losses (recorded in earnings) and 2) the amount related to all other factors (recorded in other comprehensive income (loss)). The credit-related portion of an other than temporary impairment is measured by comparing a security's amortized cost to the present value of its current expected cash flows discounted at its effective yield prior to the impairment charge. Both components are required to be shown in the Statement of Earnings. If management intends to sell an impaired security, or it is more likely than not that it will be required to sell the security before recovery, an impairment charge is required to reduce the amortized cost of that security to fair value. AFG adopted this FSP effective January 1, 2009, and recorded a cumulative effect adjustment of $17.5 million to reclassify the non-credit component of previously recognized impairments from retained earnings to accumulated other comprehensive income (loss). Additional disclosures required by this FSP are contained in *Note D - "Investments."*

Certain AFG subsidiaries loan fixed maturity and equity securities to other institutions for short periods of time. The borrower is required to provide collateral on which AFG earns investment income, net of a fee to the lending agent. AFG records the collateral held (included in other assets) in its Balance Sheet at fair value. The obligation to return the collateral is included in other liabilities. The securities loaned remain a recorded asset on AFG's Balance Sheet.

Derivatives

Derivatives included in AFG's Balance Sheet are recorded at fair value and consist primarily of (i) components of certain fixed maturity securities (primarily interest-only MBS) and (ii) the equity-based component of certain annuity products (included in annuity benefits accumulated) and related call options (included in other investments) designed to be consistent with the characteristics of the liabilities and used to mitigate the risk embedded in those annuity products. Changes in the fair value of derivatives are included in earnings.

AFG adopted SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" on January 1, 2009. SFAS No. 161 requires enhanced disclosures about objectives and strategies for using derivatives, how they are accounted for and how the instruments affect the entity's financial statements. See Note E *"Derivatives"* for the related disclosures. Adoption of SFAS No. 161 had no impact on AFG's financial position or results of operations.

Goodwill

Goodwill represents the excess of cost of subsidiaries over AFG's equity in their underlying net assets. Goodwill is not amortized, but is subject to an impairment test at least annually.

Reinsurance

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policies. AFG's property and casualty insurance subsidiaries report as assets (a) the estimated reinsurance recoverable on paid and unpaid losses, including an estimate for losses incurred but not reported, and (b) amounts paid to reinsurers applicable to the unexpired terms of policies in force. Payable to reinsurers includes ceded premiums due to reinsurers as well as ceded premiums retained by AFG's property and casualty insurance subsidiaries under contracts to fund ceded losses as they become due. AFG's insurance subsidiaries also assume reinsurance from other companies. Earnings on reinsurance assumed is recognized based on information received from ceding companies.

Certain annuity and supplemental insurance subsidiaries cede life insurance policies to a third party on a funds withheld basis whereby the subsidiaries retain the assets (securities) associated with the reinsurance contracts. Interest is credited to the reinsurer based on the actual investment performance of the retained assets. These reinsurance contracts are considered to contain embedded derivatives (that must be adjusted to fair value) because the yield on the payables is based on specific blocks of the ceding companies' assets, rather than the overall creditworthiness of the ceding company. AFG determined that changes in the fair value of the underlying portfolios of fixed maturity securities is an appropriate measure of the value of the embedded derivative. The securities related to these transactions are classified as "trading." The adjustment to fair value on the embedded derivatives offsets the investment income recorded on the adjustment to fair value of the related trading portfolios.

Deferred Policy Acquisition Costs ("DPAC")

Policy acquisition costs (principally commissions, premium taxes and other marketing and underwriting expenses) related to the production of new business are deferred. For the property and

casualty companies, DPAC is limited based upon recoverability without any consideration for anticipated investment income and is charged against income ratably over the terms of the related policies. A premium deficiency