

**FORM 10-K**

**Commission File Number 000-19289**

**(Exact name of Registrant as specified in its charter)**

**31-1324304**  
(I.R.S. Employer Identification No.)

**43215-3976**

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(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code:

(614) 464-5000

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Shares, without par value

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☐

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

As of June 30, 2007, the last business day of the Registrant's most recently completed second fiscal quarter, the aggregate market value (based on the closing sales price on that date) of the voting stock held by non-affiliates of the Registrant was \$443,201,023.

On March 7, 2008, the Registrant had 40,167,853 Common Shares outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's Proxy Statement relating to the annual meeting of stockholders to be held May 7, 2008 (the 2008 Proxy Statement), which will be filed within 120 days of December 31, 2007, are incorporated by reference into Part III of this Form 10-K.

## **Table of Contents**

### **Index to Annual Report on Form 10-K for the year ended December 31, 2007**

Form 10-K	Item	Description	Page
Part I	1	<u>Business</u>	2
		<u>Executive Officers of the Registrant</u>	15
	1A	<u>Risk Factors</u>	16
	1B	<u>Unresolved Staff Comments</u>	25
	2	<u>Properties</u>	25
	3	<u>Legal Proceedings</u>	25
	4	<u>Submission of Matters to a Vote of Security Holders</u>	25
Part II	5	<u>Market for the Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities</u>	26
	6	<u>Selected Consolidated Financial Data</u>	28
	7	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	29
	7A	<u>Qualitative and Quantitative Disclosures about Market Risk</u>	76
	8	<u>Financial Statements and Supplementary Data</u>	77
		<u>Report of Independent Registered Public Accounting Firm</u>	77
	9	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosures</u>	121
	9A	<u>Controls and Procedures</u>	121
	9B	<u>Other Information</u>	121
Part III	10	<u>Directors, Executive Officers and Corporate Governance</u>	122
	11	<u>Executive Compensation</u>	122
	12	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	122
	13	<u>Certain Relationships and Related Transactions and Director Independence</u>	123
	14	<u>Principal Accountant Fees and Services</u>	123
Part IV	15	<u>Exhibits and Financial Statement Schedules</u>	123
		<u>Signatures</u>	134

## **Table of Contents**

### **IMPORTANT INFORMATION REGARDING FORWARD-LOOKING STATEMENTS**

All statements, other than statements of historical facts, included in this Annual Report on Form 10-K (this Form 10-K) of State Auto Financial Corporation (State Auto Financial or STFC) or incorporated herein by reference, including, without limitation, statements regarding State Auto Financial's future financial position, business strategy, budgets, projected costs, goals and plans and objectives of management for future operations, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements generally can be identified by the use of forward-looking terminology such as may, will, expect, intend, estimate, anticipate, believe or continue or the negative thereof or variations thereon or similar terminology. Forward-looking statements speak only as the date the statements were made. Although State Auto Financial believes that the expectations reflected in forward-looking statements have a reasonable basis, it can give no assurance that these expectations will prove to be correct. Forward-looking statements are subject to risks and uncertainties that could cause actual events or results to differ materially from those expressed in or implied by the statements. For a discussion of the most significant risks and uncertainties that could cause State Auto Financial's actual results to differ materially from those projected, see Risk Factors in Item 1A of this Form 10-K. Except to the limited extent required by applicable law, State Auto Financial undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

### **IMPORTANT DEFINED TERMS USED IN THIS FORM 10-K**

As used in this Form 10-K, the following terms have the meanings ascribed below:

State Auto Financial or STFC refers to State Auto Financial Corporation;

We, us, our or the Company refers to STFC and its consolidated subsidiaries, namely State Auto Property & Casualty Insurance Company (State Auto P&C), Milbank Insurance Company (Milbank), Farmers Casualty Insurance Company (Farmers), State Auto Insurance Company of Ohio (SA Ohio), State Auto National Insurance Company (SA National), Stateco Financial Services, Inc. (Stateco), Strategic Insurance Software, Inc. (S.I.S.) and 518 Property Management and Leasing, LLC (518 PML);

State Auto Mutual or our parent company refers to State Automobile Mutual Insurance Company, which owns approximately 64% of STFC's outstanding common shares;

The Pooled Companies or our Pooled Companies refer to State Auto P&C, Milbank, Farmers, SA Ohio (referred to as the STFC Pooled Companies), State Auto Mutual, and certain subsidiaries and affiliates of State Auto Mutual, namely State Auto Florida Insurance Company (SA Florida), State Auto Insurance Company of Wisconsin (SA Wisconsin), Meridian Security Insurance Company (Meridian Security), Meridian Citizens Mutual Insurance Company (Meridian Citizens Mutual), Beacon National Insurance Company (Beacon National), Patrons Mutual Insurance Company of Connecticut (Patrons Mutual), and Litchfield Fire Mutual Insurance Company (Litchfield); (State Auto Mutual, SA Florida, SA Wisconsin, Meridian Security, Meridian Citizens Mutual, Beacon National, Patrons Mutual and Litchfield are referred to as the Mutual Pooled Companies);

The MIGI Insurers refer to Meridian Security and Meridian Citizens Mutual, and the MIGI Companies refer to the MIGI Insurers and Meridian Insurance Group, Inc. (MIGI);

The Beacon Insurance Group or Beacon Group refers to Beacon National and Beacon Lloyds Insurance Company (Beacon Lloyds);

The Patrons Insurance Group or Patrons Group refers to Patrons Mutual, Litchfield, Patrons Fire Insurance Company of Rhode Island (Patrons Fire) and Provision State Insurance Company (Provision State); and

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The State Auto Group refers to the Pooled Companies and the non-pooled insurance companies including SA National, Beacon Lloyds, Provision State and Patrons Fire.

## **Table of Contents**

### **PART I**

#### **Item 1. Business**

##### **(a) General Development of Business**

State Auto Financial is an Ohio domiciled super-regional property and casualty insurance holding company incorporated in 1990. We are primarily engaged in writing both personal and business lines of insurance. State Auto Financial owns 100% of State Auto P&C, Milbank, Farmers, SA Ohio, and SA National, each of which is a property and casualty insurance company. Our operations are headquartered in Columbus, Ohio.

State Auto Financial owns 100% of Stateco, which provides investment management services to affiliated insurance companies. State Auto Financial also owns 100% of S.I.S., a developer and seller of insurance-related software. State Auto P&C and Stateco share ownership of 518 PML, which owns and leases property to affiliated companies. The results of the operations of S.I.S. and 518 PML are not material to our total operations.

Our parent company is State Auto Mutual, an Ohio domiciled super-regional mutual property and casualty insurance company organized in 1921. It owns approximately 64% of State Auto Financial's outstanding common shares. It also owns 100% of SA Florida and SA Wisconsin, each of which is a property and casualty insurance company. It also owns 100% of MIGI, an insurance holding company. MIGI owns 100% of Meridian Security, a property and casualty insurance company. MIGI is also a party to an affiliation agreement with Meridian Citizens Mutual, a mutual property and casualty insurance company. MIGI also owns 100% of State Auto Holdings, Inc., an insurance holding company, which owns 100% of the Beacon Insurance Group. In March 2007, State Auto Mutual completed its purchase of the Beacon Insurance Group of Wichita Falls, Texas. With this acquisition, Texas became the State Auto Group's 29<sup>th</sup> state of operation. The Beacon Insurance Group is comprised of Beacon National and Beacon Lloyds, which are affiliated through a trust agreement. Beacon National and Beacon Lloyds wrote premiums during 2007 in Texas and Arkansas. In December 2007, State Auto Mutual completed its affiliation with the Patrons Insurance Group. This affiliation expanded the State Auto Group's operations to 33 states by adding Connecticut, Massachusetts, Rhode Island and Vermont.

State Auto P&C has participated in a quota share reinsurance pooling arrangement with State Auto Mutual since 1987 (the "Pooling Arrangement"). Since January 1, 2005, the participants in the Pooling Arrangement have been State Auto P&C, State Auto Mutual, Milbank, SA Wisconsin, Farmers, SA Ohio, SA Florida, Meridian Security and Meridian Citizens Mutual. On January 1, 2008, Beacon National, Patrons Mutual and Litchfield became participants in the Pooling Arrangement. See "Narrative Description of Business - Pooling Arrangement" in this Item 1 for further information regarding the Pooling Arrangement.

The State Auto Group markets a broad line of property and casualty insurance, such as standard personal and commercial automobile, nonstandard personal automobile, homeowners and farmowners, commercial multi-peril, workers' compensation, general liability and property insurance, through independent insurance agencies in 33 states. Our Pooled Companies and SA National are rated A+ (Superior) by the A.M. Best Company.

##### **(b) Financial Information about Segments**

We have three significant reportable segments: personal insurance and business insurance (the "insurance segments"), and investment operations. The insurance segments are managed separately because of the differences in types of customers served, products provided or services offered. In 2007, the insurance segments distributed their products through the independent agency system in 29 states. The personal insurance segment provides primarily personal auto (standard and nonstandard) and homeowners to the personal insurance market. The business insurance segment provides primarily commercial auto, commercial multi-peril, fire and allied lines, other and product liability and workers' compensation insurance to small to medium sized businesses within the commercial insurance market, which in 2008 includes middle market business. The investment operations segment, managed by Stateco, provides investment services for our Company's invested assets.

## Table of Contents

Prior to 2007, we reported our financial information in two segments, a standard insurance segment and a nonstandard insurance segment. We believe that our new segments better reflect the manner in which we manage our business and report our results internally to our principal operating decision makers. We established integrated personal and business insurance teams with product and profit responsibilities for their respective areas. We evaluate the performance of our insurance segments using industry financial measurements based on Statutory Accounting Principles ( SAP ), which include loss and loss adjustment expense ratios, underwriting expense ratios, combined ratios, statutory underwriting gain (loss), net premiums earned and net written premiums. Prior reporting periods have been restated to conform to the new segment presentation.

### (c) Narrative Description of Business

#### Property and Casualty Insurance

##### Pooling Arrangement

Our Pooled Companies are parties to the Pooling Arrangement. In general, under the Pooling Arrangement, each of the Pooled Companies cedes premiums, losses and expenses on all of its business to State Auto Mutual, and State Auto Mutual in turn cedes to each of the Pooled Companies a specified portion of premiums, losses and expenses based on each of the Pooled Companies' respective pooling percentages. State Auto Mutual then retains the balance of the pooled business. The participation percentage for the STFC Pooled Companies has remained at 80% since 2001. Prior to 2008, the Pooling Arrangement covered all property and casualty insurance written by the Pooled Companies except State Auto Mutual's voluntary assumed reinsurance, middle market business insurance written by State Auto Mutual and Meridian Security and intercompany catastrophe reinsurance written by State Auto P&C.

In 2008, we made the following changes to the Pooling Arrangement:

Added Beacon National to the pool with a participation percentage of 0.0%;

Added Patrons Mutual and Litchfield to the pool with participation percentages of 0.4% and 0.1%, respectively;

Reduced State Auto Mutual's participation percentage from 19.5% to 19.0% to accommodate the participation percentages allocated to Patrons Mutual and Litchfield;

Included State Auto middle market business insurance written by State Auto Mutual and Meridian Security.

The following table sets forth a chronology of the participants and their participation percentage changes that have occurred in the Pooling Arrangement since January 1, 1997:

Year <sup>(1)</sup>	State			SA				Meridian	Citizens	Beacon	Patrons	Litchfield
	State Auto Mutual	Auto P&C	Milbank	Wisconsin	Farmers	SA Ohio	SA Florida					
1997	55.0	35.0	10.0	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
1998	52.0	37.0	10.0 <sup>(2)</sup>	1.0	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
1999	49.0	37.0	10.0	1.0	3.0	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2000 9/30/2001	46.0	39.0	10.0	1.0	3.0	1.0	N/A	N/A	N/A	N/A	N/A	N/A
10/1/2001 2002	19.0	59.0	17.0	1.0	3.0	1.0	N/A	N/A	N/A	N/A	N/A	N/A
2003 2004	18.3	59.0	17.0	1.0	3.0	1.0	0.7	N/A	N/A	N/A	N/A	N/A
1/1/2005 2007	19.5	59.0	17.0	0.0	3.0	1.0	0.0	0.0	0.5	N/A	N/A	N/A
1/1/2008 current	19.0	59.0	17.0	0.0	3.0	1.0	0.0	0.0	0.5	0.0	0.4	0.1

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- (1) Time period is for the year ended December 31, unless otherwise noted.
- (2) In July 1998, Milbank became a 100% owned subsidiary of STFC. Previously, Milbank was a 100% owned subsidiary of State Auto Mutual.



**Table of Contents**

The following table sets forth a summary of the Pooling Arrangement participation percentages of STFC and State Auto Mutual, aggregating their respective 100% owned subsidiaries:

Year <sup>(1)</sup>	STFC Pooled Companies	State Auto Mutual Pooled Companies
1997	35	65
1/1/1998 6/30/1998	37	63
7/1/1998 12/31/1998	47	53
1999	50	50
2000 9/30/2001	53	47
10/1/2001 current	80	20

(1) Time period is for the year ended December 31, unless otherwise noted.

It is not management's intention to recommend an adjustment to the STFC Pooled Companies' 80% participation level in the foreseeable future. Under applicable governance procedures, if the Pooling Arrangement were to be amended, management would make recommendations to the independent committees of the Board of Directors of both State Auto Mutual and STFC. The independent committees review and evaluate such factors as they deem relevant and recommend any appropriate pooling change to the Board of Directors of both State Auto Mutual and STFC. The Pooling Arrangement is terminable by any of our Pooled Companies at any time by any party by giving twelve months notice to the other parties and their respective domiciliary insurance departments. None of our Pooled Companies currently intends to terminate the Pooling Arrangement.

Under the terms of the Pooling Arrangement, all subject premiums, incurred losses, loss expenses and other underwriting expenses are prorated among our Pooled Companies on the basis of their participation in the pool. By spreading the underwriting risk among each of our Pooled Companies, the Pooling Arrangement is designed to produce more uniform and stable underwriting results for each of our Pooled Companies than any one company would experience individually. One effect of the Pooling Arrangement is to provide each of our Pooled Companies with an identical mix of pooled property and casualty insurance business on a net basis.

The Pooling Arrangement excludes catastrophic losses and loss adjustment expenses that are reinsured under our Catastrophe Assumption Agreement (defined below), as well as the premium for such exposures. State Auto P&C reinsures each insurer in the State Auto Group for this layer of reinsurance in the amount of \$100.0 million in excess of \$135.0 million. No losses were paid by State Auto P&C under the Catastrophe Assumption Agreement in 2007, 2006 or 2005. The State Auto Group does not currently intend to renew the Catastrophe Assumption Agreement upon its expiration on July 1, 2008. The State Auto Group is considering other alternatives, such as securing replacement coverage from a third party reinsurer or relying upon the \$100 million set aside under the Credit Agreement (defined below) to fund this layer of catastrophe reinsurance, but currently no decision has been reached. See "Narrative Description of Business Reinsurance" in this Item 1 for further information regarding the Catastrophe Assumption Agreement.

Our nonstandard automobile programs, written through SA National, provide insurance for private passenger automobile risks which do not qualify for the standard or preferred automobile insurance market. Typically, nonstandard risks have higher than average loss experience and an overall higher degree of risk than standard or preferred automobile business. We do not include the business of SA National in the Pooling Arrangement. See "Narrative Description of Business Marketing" for further information regarding our nonstandard auto insurance business.

**Management Agreement**

With the exception of the Patrons Group (discussed below), our subsidiary, State Auto P&C, provides the employees to perform all organizational, operational and management functions for the State Auto Group and



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## **Table of Contents**

State Auto Mutual provides certain operating facilities, including our corporate headquarters, for the State Auto Group through management and cost sharing agreements. Each of the affiliated management and cost sharing agreements has a ten-year term and renews for an additional ten-year period unless terminated sooner in accordance with their terms. If our primary management agreement, which we refer to as our 2005 Management Agreement, were terminated for any reason, we would have to relocate our facilities to continue our operations. However, we do not currently anticipate the termination of the 2005 Management Agreement. See also Item 2 (Property) of this Form 10-K.

On December 14, 2007, State Auto Mutual and State Auto P&C became parties to various management and/or cost sharing agreements in conjunction with State Auto Mutual's affiliation with the Patrons Insurance Group. Each of these management and/or cost sharing agreements apportions among the parties the actual costs of the services provided. Employees of the Patrons Group will remain employees of Patrons Mutual until January 1, 2009, at which time it is expected that they will become employees of State Auto P&C. The insurance operations of the Patrons Group will continue to be conducted at facilities owned by Patrons Mutual and Litchfield.

## **Marketing**

As of January 1, 2008, the State Auto Group marketed its products in 33 states through independent insurance agencies. None of the companies in the State Auto Group has any contracts with managing general agencies.

We view our independent insurance agents as our primary customers, because they are in a position to recommend either our insurance products or those of a competitor to their customers. We strongly support the independent agency system and believe its maintenance is essential to our present and future success. As such, we continually develop programs and procedures to enhance our agency relationships, including the following: regular travel by senior management and branch office staff to meet with agents, in person, in their home states; training opportunities; travel incentives related to profit and growth; contingent commissions; and an agent stock purchase plan.

We actively help our agencies develop professional sales skills within their staffs. Our training programs include both products and sales training conducted in our home office. Further, our training programs include disciplined follow-up and coaching for an extended time. Other targeted training sessions are held in our branch office locations from time to time, as well as in our agents' offices.

We have made continuing efforts to use technology to make it easier for our agents to do business with us. We offer internet-based (i) rating, (ii) policy application submission and (iii) execution of changes to policies for certain products. In addition, we provide our agents with the opportunity to maintain policyholder records electronically, avoiding the expense of preparing and storing paper records. Software developed by S.I.S. also enhances the ability of our agents and us to take advantage of electronic data submission. We believe that, since agents and their customers realize better service and efficiency through automation, they value their relationship with us. Automation can make it easier for an agent to do business with us, which attracts prospective agents and enhances existing agencies' relationships with us.

We share the cost of approved advertising with selected agencies. We provide our agents with defined travel and cash incentives if they achieve certain sales and underwriting profit levels. Further, we recognize our very top agencies—measured by consistent profitability, achievement of written premium thresholds and growth—as Inner Circle Agencies. Inner Circle Agencies are rewarded with additional trip and financial incentives, including additional contingent commissions and additional contributions to their Inner Circle Agent Stock Purchase Plan, a part of our Agent Stock Purchase Plan described below.

To strengthen agency commitment to producing profitable business and further develop our agency relationships, we make available to our agents a stock purchase plan which provides them with the opportunity to

## **Table of Contents**

use their commission income to purchase our stock. Our transfer agent administers this stock purchase plan using commission dollars assigned by the agents to purchase shares on the open market through a stockbroker. We also make available to our top performing agents a stock option plan which provides them with the opportunity to vest grants of options in our stock if they meet certain performance targets.

During 2007, the State Auto Group, which includes the Beacon and Patrons Groups, received premiums on products marketed in Alabama, Arizona, Arkansas, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, West Virginia and Wisconsin. During 2007, the eight states that contributed the greatest percentage of our direct premiums written were as follows: Ohio (17.1%), Kentucky (10.2%), Indiana (6.9%), Tennessee (6.3%), Pennsylvania (4.6%), Minnesota (4.6%), Maryland (4.4%) and Arkansas (4.1%).

## **Claims**

Our claims division emphasizes timely investigation of claims, settlement of meritorious claims for equitable amounts, maintenance of adequate case reserves for claims, and control of external claims adjustment expenses. Achievement of these goals supports our marketing efforts by providing agents and policyholders with prompt and effective service.

Claim settlement authority levels are established for each adjuster, supervisor and manager based on his or her level of expertise and experience. Our claims division is responsible for reviewing the claim, obtaining necessary documentation and establishing loss and expense reserves of certain claims. Generally, property or casualty claims estimated to reach \$150,000 or above are sent to our home office to be supervised by claims division specialists. Branches with low volumes of large claims are assigned a lower dollar threshold for referring claims to the home office. In territories in which there is not sufficient volume to justify having full-time adjusters, we use independent appraisers and adjusters to evaluate and settle claims under the supervision of claims division personnel.

We attempt to minimize claims adjusting costs by settling as many claims as possible through our internal claims staff and, if possible, by settling disputes regarding automobile physical damage and property insurance claims (first party claims) through arbitration. In addition, selected agents have authority to settle small first party claims, which improves claims service.

Our claim representatives use third party, proprietary bodily injury evaluation software to help them value bodily injury claims, except for the most severe injury cases. Our Claims Contact Centers allow us to improve claims efficiency and economy by concentrating the handling of smaller, less complex claims in a centralized environment. We provide claim service 24 hours a day, seven days a week, either through associates in our Claims Contact Centers, which are located in Des Moines, Iowa and Columbus, Ohio, or, for a few overnight hours, through a third party service provider.

## **Reserves**

Loss reserves are management's best estimates at a given point in time of what we expect to pay in claims, based on facts, circumstances and historical trends then known. During the loss settlement period, additional facts regarding individual claims may become known, and consequently it often becomes necessary to refine and adjust the estimates of liability. The results of our operations and financial condition could be impacted, perhaps significantly, in the future if the ultimate payments required to settle claims vary from the liability currently recorded.

We maintain reserves for the eventual payment of losses and loss expenses for both reported claims and incurred claims that have not yet been reported. Loss expense reserves are intended to cover the ultimate costs of settling all losses, including investigation, litigation and in-house claims processing costs from such losses.

**Table of Contents**

Reserves for reported losses are initially established on either a case-by-case or formula basis depending on the type and circumstances of the loss. The case-by-case reserve amounts are determined based on our reserving practices, which take into account the type of risk, the circumstances surrounding each claim and policy provisions relating to types of loss. The formula reserves are based on historical paid loss data for similar claims with provisions for trend changes caused by inflation. Loss and loss expense reserves for incurred claims that have not yet been reported are estimated based on many variables including historical and statistical information, changes in exposure units, inflation, legal developments, storm loss estimates and economic conditions. Case and formula basis loss reserves are reviewed on a regular basis. As new data becomes available, estimates are updated resulting in adjustments to loss reserves. Generally, reported losses initially reserved on a formula basis which have not settled after six months, are case reserved at that time. Although our management uses many resources to calculate reserves, there is no precise method for determining the ultimate liability. We do not discount loss reserves for financial statement purposes. For additional information regarding our reserves, see Item 7 of this Form 10-K, Management, Discussion and Analysis of Financial Condition and Results of Operations Loss and Loss Expense Reserves.

The following table presents our one-year development information on changes in the reserve for loss and loss expenses for each of the three years in the period ended December 31:

(\$ millions)	Year Ended December 31		
	2007	2006	2005
<b>Beginning of Year:</b>			
Loss and loss expenses payable	<b>\$ 674.5</b>	728.7	681.8
Less: Reinsurance recoverable on losses and loss expenses payable <sup>(1)</sup>	<b>13.5</b>	17.4	25.9
<i>Net losses and loss expenses payable<sup>(2)</sup></i>	<b>661.0</b>	711.3	655.9
<b>Provision for losses and loss expenses occurring:</b>			
Current year	<b>645.5</b>	659.3	657.7
Prior years <sup>(3)</sup>	<b>(54.7)</b>	(71.7)	(44.3)
<i>Total</i>	<b>590.8</b>	587.6	613.4
<b>Loss and loss expense payments for claims occurring during:</b>			
Current year	<b>368.7</b>	389.4	350.5
Prior years	<b>236.0</b>	248.5	242.8
<i>Total</i>	<b>604.7</b>	637.9	593.3
Impact of pooling change, January 1, 2005			35.3
<b>End of Year:</b>			
Net losses and loss expenses payable	<b>647.1</b>	661.0	711.3
Add: Reinsurance recoverable on losses and loss expenses payable <sup>(4)</sup>	<b>11.2</b>	13.5	17.4
<i>Losses and loss expenses payable<sup>(5)</sup></i>	<b>\$ 658.3</b>	674.5	728.7

(1) Includes amounts due from affiliates of \$2.7 million, \$5.5 million, and \$5.7 million at beginning of year 2007, 2006, and 2005, respectively.

(2) Includes net amounts assumed from affiliates of \$281.7 million, \$302.6 million, and \$296.9 million at beginning of year 2007, 2006, and 2005, respectively.

(3) This line item shows decreases in the current calendar year in the provision for losses and loss expenses attributable to claims occurring in prior years. See discussion regarding the calendar year developments at Item 7 of this Form 10-K Management's Discussion and Analysis section at 2007 Compared to 2006 Expenses and 2006 Compared to 2005 Expenses.

(4) Includes amounts due from affiliates of \$1.2 million, \$2.7 million, and \$5.5 million at end of year 2007, 2006, and 2005, respectively.

(5) Includes net amounts assumed from affiliates of \$257.2 million, \$281.7 million, and \$302.6 million at end of year 2007, 2006, and 2005, respectively.



## **Table of Contents**

The following table sets forth our development of reserves for losses and loss expenses from 1997 through 2007. Net liability for losses and loss expenses payable sets forth the estimated liability for unpaid losses and loss expenses recorded at the balance sheet date, net of reinsurance recoverables, for each of the indicated years. This liability represents the estimated amount of losses and loss expenses for claims arising in the current and all prior years that are unpaid at the balance sheet date, including losses incurred but not reported to us.

The upper section of the table shows the cumulative amounts paid with respect to the previously reported reserve as of the end of each succeeding year. For example, through December 31, 2007, we have paid 92.4% of the currently estimated losses and loss expenses that had been incurred, but not paid, as of December 31, 1997.

The lower portion of the table shows the re-estimated amounts of the previously reported reserve based on experience as of the end of each succeeding year. The estimate is increased or decreased as more information becomes known about the claims incurred.

The amounts on the cumulative redundancy (deficiency) line represent the aggregate change in the estimates over all prior years. For example, the 1997 calendar year reserve has developed a \$28.0 million or 14.4% deficiency through December 31, 2007. This \$28.0 million amount has been included in operating results over the ten years and did not have a significant effect on income in any one year.

In evaluating the information in the table, it should be noted that each amount includes the effects of all changes in amounts for prior periods. For example, the amount of the redundancy related to losses settled in 2000, but incurred in 1997, will be included in the cumulative redundancy or deficiency amounts for years 1997, 1998 and 1999. Conditions and trends that have affected the development of the liability in the past may not necessarily occur in the future. Accordingly, it may not be appropriate to extrapolate future redundancies or deficiencies based on this table.

In 1998, 1999, 2000 and 2001 the Pooling Arrangement was amended to increase our share of premiums, losses and expenses and in 2005 to add the business of two companies within the State Auto Group, the MIGI Insurers. An amount of assets equal to the increase in net liabilities was transferred to us from our parent company in 1998, 1999, 2000 and 2001 in conjunction with each year's respective pooling change and in 2005 from the MIGI Insurers. The amount of the assets transferred on the reserve liabilities assumed in 1998, 1999, 2000, 2001 and 2005 has been netted against and has reduced the cumulative amounts paid for years prior to 1998, 1999, 2000, 2001 and 2005, respectively.

**Table of Contents**

*(\$ millions)*

**Years Ended December 31**

<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
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