

State Auto Financial CORP  
Form 10-K  
March 12, 2007  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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**FORM 10-K**

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x Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the fiscal year ended December 31, 2006 or

.. 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 000-19289

STATE AUTO FINANCIAL CORPORATION  
(Exact name of Registrant as specified in its charter)

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Ohio  
(State or other jurisdiction of  
incorporation or organization)

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

518 East Broad Street, Columbus, Ohio  
(Address of principal executive offices)

43215-3976  
(Zip Code)

Registrant's telephone number, including area code:

(614) 464-5000

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

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

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## Common Shares, without par value

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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. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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, 2006, 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 \$465,863,913.

On March 2, 2007, the Registrant had 41,079,773 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 4, 2007 (the 2007 Proxy Statement), which will be filed within 120 days of December 31, 2006, are incorporated by reference into Part III of this Form 10-K.

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**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 65% 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) and Meridian Citizens Mutual Insurance Company (Meridian Citizens Mutual) (State Auto Mutual, SA Florida, SA Wisconsin, Meridian Security and Meridian Citizens Mutual are referred to as the Mutual Pooled Companies); and

The State Auto Group or our Group refers to the Pooled Companies and SA National.

**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.



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Our parent company, State Auto Mutual, is an Ohio domiciled super-regional mutual property and casualty insurance company organized in 1921. It owns approximately 65% 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 Meridian Insurance Group, Inc. ( MGI ), an insurance holding company. MGI owns 100% of Meridian Security, a property and casualty insurance company. MGI is also a party to an affiliation agreement with Meridian Citizens Mutual, a mutual property and casualty insurance company. Meridian Security and Meridian Citizens Mutual are hereafter referred to collectively as the MGI Insurers and together with MGI, the MGI Companies.

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.

State Auto P&C has participated in a quota share reinsurance pooling arrangement with our parent company 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. See Narrative Description of Business Pooling Arrangement in this Item 1 for further information regarding the Pooling Arrangement.

The State Auto Group writes 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 approximately 2,900 independent insurance agencies in 28 states. Our Pooled Companies and SA National are rated A+ (Superior) by the A.M. Best Company.

**(b) Financial Information about Segments**

During 2006, we continued to operate our business in two significant reportable segments: standard insurance and nonstandard insurance. Financial information about our segments for 2006 is set forth in Note 15 to our Company's Consolidated Financial Statements included in Item 8 of our Form 10-K. Additional information regarding our Company's insurance and noninsurance segments is provided in Narrative Description of Business. Under the leadership of Robert P. Restrepo, Jr., our new Chairman, President and Chief Executive Officer, 2006 became a transitional year for the State Auto Group as we undertook initiatives to realign our internal organization, specifically our people, processes, internal reporting systems and compensation reward programs to become more focused within the business and personal insurance markets. While 2007 will continue to be a transitional year in certain areas of our Company, we have already implemented integrated personal and business insurance teams with product, profit and production responsibilities for their respective areas. As a result of these transitional efforts, beginning in 2007, our significant reportable segments will change from standard and nonstandard insurance to personal insurance and business insurance along with a third segment for investment operations, and we will begin reporting on those bases to our chief operating decision makers.

**(c) Narrative Description of Business**

**Property and Casualty Insurance**

**Pooling Arrangement**

Our Pooled Companies are parties to the Pooling Arrangement. Prior to 2005, the Pooling Arrangement was governed by the reinsurance pooling agreement known as the 2000 Pooling Agreement. Since January 1, 2005, the Pooling Arrangement has been governed by the reinsurance pooling agreement known as the 2005 Pooling Agreement. The Pooling Arrangement covers all the property and casualty insurance written by our Pooled Companies except voluntary assumed reinsurance written by our parent company, State Auto Middle Market

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Insurance (as defined in the 2005 Pooling Agreement) and intercompany catastrophe reinsurance written by State Auto P&C. Under the Pooling Arrangement, each of our Pooled Companies cedes premiums, losses and expenses on all of their business to State Auto Mutual, which in turn cedes to each of our Pooled Companies a specified portion of premiums, losses and expenses based on each of their respective pooling percentages. State Auto Mutual then retains the balance of the pooled business.

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, 1996:

Year <sup>(1)</sup>	State			SA				Meridian Security	Meridian Citizens Mutual
	State Auto Mutual	Auto P&C	Milbank	Wisconsin	Farmers	SA Ohio	SA Florida		
1996 - 1997	55.0	35.0	10.0	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
1999	49.0	37.0	10.0	1.0	3.0	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
10/1/2001-2002	19.0	59.0	17.0	1.0	3.0	1.0	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
1/1/2005 - current	19.5	59.0	17.0	0.0	3.0	1.0	0.0	0.0	0.5

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

<sup>(2)</sup> In July 1998, Milbank became a 100% owned subsidiary of STFC. Previously, Milbank was a 100% owned subsidiary of State Auto Mutual.

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	Mutual Pooled
	Companies	Companies
1996 - 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 - 2006	80	20

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

In the aggregate, the pooling percentages for our Pooled Companies have remained at an 80% participation level since 2001. It is not management's current intention to recommend an adjustment to our Pooled Companies' aggregate participation percentage in the foreseeable future. Under applicable governance procedures, if the 2005 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 us. The Pooling Arrangement is terminable by any of our Pooled Companies at any time after a 90-day notice or by mutual agreement of our Pooled Companies. None of our Pooled Companies currently intends to terminate the Pooling Arrangement.

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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

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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 2005 Pooling Agreement contains (and the 2000 Pooling Agreement contained) a provision excluding catastrophic losses and loss adjustment expenses incurred by our Pooled Companies in the amount of \$100.0 million in excess of \$135.0 million after June 30, 2006 (\$120.0 million prior to July 1, 2006), 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 under a Catastrophe Assumption Agreement (defined below). No losses were paid by State Auto P&C under the Catastrophe Assumption Agreement in 2006, 2005 or 2004. See Narrative Description of Business Reinsurance in this Item 1 for further information regarding the Catastrophe Assumption Agreement.

### **Nonstandard Auto Insurance**

We write nonstandard auto insurance through SA National. Nonstandard automobile programs 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 our Pooling Agreement. See Narrative Description of Business Marketing and Reportable Segments in this Item 1 for further information regarding our nonstandard auto insurance business.

### **Management Agreement**

The employees of our subsidiary, State Auto P&C, provide all organizational, operational and management functions for all insurance affiliates within the State Auto Group through management and cost sharing agreements. State Auto Mutual provides facilities for all of our insurance affiliates under the same management and cost sharing agreements. A management and operations agreement, referred to as the 2005 Management Agreement, is in place among State Auto Mutual, State Auto P&C, State Auto Financial, Milbank, Farmers, SA Ohio, SA National, the MIGI Companies, Stateco, S.I.S. and 518 PML. The 2005 Management Agreement is a cost sharing agreement. A management agreement, referred to as the 2000 Midwest Management Agreement is in place among State Auto Mutual, State Auto P&C and SA Wisconsin. For the performance of SA Wisconsin's services under the 2000 Midwest Management Agreement, SA Wisconsin pays State Auto P&C a quarterly management and operations services fee of 0.75% of direct written premium. A separate cost sharing agreement is in place among State Auto Mutual, State Auto P&C and SA Florida.

Each of the affiliated management and cost sharing agreements has a ten-year term, except for the SA Florida cost sharing agreement, which has a five-year term. The SA Florida cost sharing agreement expires in 2007 and is renewed by mutual consent of the parties. The other cost sharing agreements automatically renew for an additional ten-year period unless terminated sooner in accordance with their terms. If the 2005 Management Agreement would be 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.

### **Reportable Segments**

See Note 15, Reportable Segments, of the Notes to our Consolidated Financial Statements included in Item 8 of our Form 10-K and Item 7 of our Form 10-K.

### **Marketing**

As of January 31, 2007, the State Auto Group marketed its standard products in 28 states (Colorado being our 28th state of operation beginning January 2007) through approximately 2,900 independent insurance agencies. None of the companies in the State Auto Group has any contracts with managing general agencies. As of January 31, 2007, SA National marketed its nonstandard auto products in 22 states exclusively through our network of independent agents. We anticipate continued state expansion for our products during 2007.

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Because independent insurance agents generally choose which products they recommend and provide their customers, we view our independent insurance agents as our primary customers. We strongly support the independent agency system and believe that maintenance of a strong agency system 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; sharing a portion of the underwriting profit generated by the agent's book of business; 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.

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 profit sharing bonus 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, our Agent Stock Purchase Plan offers the opportunity to use commission income to purchase our stock. Our transfer agent administers the plan using commission dollars assigned by the agents to purchase shares on the open market through a stockbroker. We also make available to certain top performing agents the opportunity to vest grants of options in our common shares provided the participants meet performance targets described in our Agent Stock Option Plan.

We receive premiums on products marketed in Alabama, Arizona, Arkansas, Colorado, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maryland, Michigan, Minnesota, Mississippi, Missouri, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Utah, Virginia, West Virginia and Wisconsin. During 2006, the seven states that contributed the greatest percentage of our direct premiums written were as follows: Ohio (17.6%), Kentucky (11.2%), Indiana (7.6%), Tennessee (6.7%), Minnesota (5.5%), Pennsylvania (5.0%) and Maryland (5.0%).

## **Claims**

Insurance claims on policies written by us are usually investigated and settled by staff claims adjusters. 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.

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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 24 hour, seven days a week claim service, 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.

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.

State Auto P&C's December 31, 1990 liability for losses and loss expenses of \$65.5 million has been guaranteed by State Auto Mutual. Pursuant to the guaranty agreement, all ultimate adverse development of the December 31, 1990 liability, if any, is to be reimbursed by State Auto Mutual to State Auto P&C in conformance with pooling percentages in place at that time. Through December 31, 2006, there has been no adverse development of the guaranteed liability. As of December 31, 2006, the remaining loss and loss expense liability is estimated to be \$0.9 million.

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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, 2006:

(\$ millions)	Year Ended December 31		
	2006	2005	2004
<b>Beginning of Year:</b>			
Loss and loss expenses payable	\$ 728.7	681.8	643.0
Less: Reinsurance recoverable on losses and loss expenses payable <sup>(1)</sup>	17.4	25.9	14.2
Net losses and loss expenses payable <sup>(2)</sup>	711.3	655.9	628.8
<b>Provision for losses and loss expenses occurring:</b>			
Current year	659.3	657.7	641.4
Prior years <sup>(3)</sup>	(71.7)	(44.3)	(22.2)
Total	587.6	613.4	619.2
<b>Loss and loss expense payments for claims occurring during:</b>			
Current year	389.4	350.5	361.5
Prior years	248.5	242.8	230.6
Total	637.9	593.3	592.1
Impact of pooling change, January 1, 2005		35.3	
<b>End of Year:</b>			
Net losses and loss expenses payable	661.0	711.3	655.9
Add: Reinsurance recoverable on losses and loss expenses payable <sup>(4)</sup>	13.5	17.4	25.9
<b>Losses and loss expenses payable<sup>(5)</sup></b>	<b>\$ 674.5</b>	<b>728.7</b>	<b>681.8</b>

(1) Includes amounts due from affiliates of \$5.5 million, \$5.7 million, and \$5.7 million at beginning of year 2006, 2005, and 2004, respectively.

(2) Includes net amounts assumed from affiliates of \$302.6 million, \$296.9 million, and \$303.9 million at beginning of year 2006, 2005, and 2004, 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 our Form 10-K Management's Discussion and Analysis section at 2006 Compared to 2005 Expenses and 2005 Compared to 2004 Expenses.

(4) Includes amounts due from affiliates of \$2.7 million, \$5.5 million, and \$5.7 million at end of year 2006, 2005, and 2004, respectively.

(5) Includes net amounts assumed from affiliates of \$281.7 million, \$302.6 million, and \$296.9 million at end of year 2006, 2005, and 2004, respectively.

The following table sets forth our development of reserves for losses and loss expenses from 1996 through 2006. 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 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 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, 2006, we have paid 90.0% of the currently estimated losses and loss expenses that had been incurred, but not paid, as of December 31, 1997.



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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 \$23.2 million or 11.9% deficiency through December 31, 2006. That amount has been included in operations over the ten years and did not have a significant effect on income in any one year. The effects on income caused by changes in estimates of the reserves for losses and loss expenses for the most recent three years are shown in the foregoing three-year loss development table.

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 1999, but incurred in 1996, 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 our subsidiaries, the MIGI Insurers. The amount of the assets transferred 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.

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(\$ millions)	Years Ended December 31										
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Net liability for losses and loss expenses payable	\$ 199.5	\$ 194.2	\$ 205.0	\$ 221.7	\$ 236.7	\$ 509.9	\$ 592.1	\$ 628.8	\$ 655.9	\$ 711.3	\$ 661.0
Paid (cumulative) as of:											
One year later	39.4%	32.7%	35.4%	41.8%	5.9%	43.4%	41.2%	36.7			